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Recent developments in international taxation: Paraguay

Executive summary

Paraguay has undertaken a major modernisation of its tax system through Law No 6380/2019, which entered into force progressively from 2020. The law replaces the former income tax on commercial and industrial activities and services (IRACIS) with an enhanced corporate income tax, which substantially reforms the personal income tax, and introduces a new non-resident income tax. It also creates a specific dividends and profits tax, applied upon distribution, with differentiated rates for residents and non-residents. The new framework strengthens legal certainty, aligns cross-border taxation with international standards (including transfer pricing), broadens the corporate tax base, preserves the territoriality principle for individuals, and modernises the overall system.

The 10 per cent flat corporate tax and streamlined administrative rules position Paraguay as one of the most competitive jurisdictions in the region, increasingly chosen by internationally mobile individuals for tax residency. However, this low-tax positioning may face pressure if the country moves to adopt the OECD's Pillar Two global minimum tax rules.

A key milestone in Paraguay's international tax evolution is the entry into force of the Spain–Paraguay Double Taxation Agreement as of 1 January 2025. The treaty introduces significantly reduced withholding tax rates and follows the OECD principle that business income from services is generally taxable in the source state only if a permanent establishment (PE) is involved or if the payment qualifies as a royalty, marking a clear shift from prior gross-basis taxation. However, the absence of tax rulings or case law on such treaty provisions creates uncertainty as to how the tax authorities will apply them in practice, particularly regarding the treatment of permanent establishments, the use of the reduced withholding rates, and the implementation of anti-abuse measures.

Institutionally, the creation of the Dirección Nacional de Ingresos Tributarios in 2023 – merging the tax and customs authorities – reflects a strategic effort to modernise enforcement, coordinate oversight and enhance Paraguay's capacity to engage in international tax cooperation. These reforms collectively position the country for deeper integration into global fiscal standards, although sustained regulatory development will be key to their success.

Modernisation of the Paraguayan tax system

Paraguay's tax system has undergone substantial modernisation since the enactment of Law No 6380/2019 (the 'Tax Law'). Since 2020, the legislation has restructured the country's tax framework by introducing a modern income tax regime, new rules on dividend and non-resident taxation, and, from 2021 onward, a comprehensive set of

transfer pricing standards. These reforms represent a significant step toward aligning Paraguay's tax system with international standards.

Overview of the general tax regime

Income taxes under the new Tax Law

The reformed system includes four principal income taxes.

- **Corporate income tax (IRE):** A 10 per cent flat corporate income tax that applies to both individuals and legal entities engaging in business activities, with partial worldwide income reach subject to foreign tax credit rules.
- **Dividends and profits tax (IDU):** Levied at 8 per cent for residents and 15 per cent for non-residents, collected through withholding upon distribution. A credit mechanism applies to intercompany distributions within Paraguay to avoid domestic cascading.
- **Personal income tax (IRP):** A progressive tax (8 per cent, 9 per cent or 10 per cent) on employment and personal income applicable to residents exceeding statutory thresholds, also levied on capital gains at 8 per cent.
- **Non-resident income tax (INR):** Applies on a final withholding basis with deemed income ratios between 30 per cent and 100 per cent, resulting in effective tax rates between 4.5 per cent and 15 per cent.

The IRE allows the deduction of expenses that are real, duly documented, and causally linked to the generation or maintenance of taxable income. The tax base includes domestic and, in certain cases, foreign-source income. Paraguay applies a mixed system for eliminating international double taxation – based on credit or exemption mechanisms – but this relief is not available for all types of foreign-source income, which paradoxically may result in both favourable and unfavourable outcomes for taxpayers. Additionally, the regime permits tax losses to be carried forward for up to five fiscal years and establishes a minimum taxation rule, requiring that at least 80 per cent of the taxpayer's fiscal gain be subject to tax annually.

VAT and selective consumption tax (excise tax)

The VAT (IVA) is a monthly declared tax on goods and services, including those imported or consumed digitally. The general rate is 10 per cent, with a 5 per cent reduced rate applicable to food staples, certain agricultural products and housing rentals. Exporters benefit from a zero-rated VAT regime and may be entitled to input VAT refunds; however, eligibility is subject to specific conditions. Certain activities – such as the export of unprocessed agricultural products – are excluded from refund rights. While the refund process is generally manageable, it still involves formalities that can affect timing and predictability.

The selective consumption tax (ISC) applies at low to moderate rates (0.5 per cent to 50 per cent) to a defined list of goods, including electronics, fuel and luxury items. It is collected at the time of importation or, for domestically produced goods, upon their first sale in Paraguay.

Transfer pricing and thin capitalisation

Since 2021, corporate taxpayers engaged in cross-border transactions are required to comply with the arm's-length principle. Those with annual gross revenue exceeding PYG 10bn (~US\$1.4m) must submit a transfer pricing technical report (ETPT) each year. This requirement applies not only to related-party transactions, but also to dealings with residents of low or no-tax jurisdictions, as well as users of foreign free trade zones and offshore *maquiladora* regimes – unless the presumption of relatedness is rebutted.

Interest, royalties and service payments to foreign related parties are subject to a deductibility cap of 30 per cent of net income before such expenses. In addition, these amounts must comply with the arm's-length principle, as required under Paraguay's transfer pricing rules.

Digital and cross-border services

Cross-border services, especially digital ones, are taxed under the INR and VAT systems. Inbound services trigger a 10 per cent VAT via reverse charge, with banks acting as collection agents for digital transactions. For INR purposes, local payers must withhold in B2B operations, while in B2C cases, non-resident providers may pay directly via international transfer and appoint a local representative. These measures reflect OECD-aligned efforts, though their interaction with a future reactivation of Pillar One remains uncertain.

The most significant development of the last 12 months: the CDI with Spain

The entry into force of the double taxation agreement between Paraguay and Spain (CDI ES–PY) as of 1 January 2025, stands out as a transformative development in Paraguay's tax landscape over the past year. While no substantial changes have occurred in domestic tax legislation during this period, the CDI ES–PY introduces a framework that improves competitiveness for inbound investment and deepens Paraguay's integration into the global tax treaty network.

While primarily based on the OECD Model Tax Convention, the CDI ES–PY also draws from other international instruments, such as the ONU Model Convention, creating a hybrid framework. Importantly, it marks a departure from Paraguay's traditional commitment to territorial taxation. The treaty limits source taxation in key areas such as business profits, interest, and technical services – an approach that contrasts with the Paraguay–Uruguay treaty, which follows the UN model and applies source taxation even to services under Article 12A.

Although favourable to investors, it potentially reduces Paraguay's ability to tax outbound payments, departing from a long-standing administrative practice centred on source-based taxation.

It is also worth noting that Paraguay has not signed the multilateral instrument (MLI), meaning that updates to existing treaties, such as the inclusion of anti-abuse provisions or arbitration clauses, must be negotiated bilaterally.

This section analyses the key provisions and implications of the CDI ES–PY, positioning it as a benchmark for Paraguay’s evolving treaty policy.

Withholding tax relief

DIVIDENDS

- 0 per cent for pension funds;
- 5 per cent for companies holding ≥ 50 per cent of the capital; and
- 10 per cent general cap.

INTEREST

- 0 per cent for public institutions and financial entities; and
- 5 per cent general cap.

ROYALTIES

- 5 per cent maximum withholding.

These rates represent a significant reduction from Paraguay’s statutory 15 per cent INR rate and create strategic planning opportunities for Spanish investors.

Business profits and permanent establishment

As regards business income, the CDI ES–PY limits source taxation to situations where a permanent establishment (PE) is constituted under Article 5. In the absence of a specific provision on services income, payments for cross-border services are generally covered by Article 7 and thus not subject to withholding tax unless a PE arises. This framework facilitates technical cooperation and cross-border service provision.

When a PE is deemed to exist, Paraguay’s tax administration has consistently taken the view that registration as an IRE taxpayer is mandatory for subsidiaries or formal branches. In all other cases, it considers that the application of withholding tax on gross payments suffices to discharge tax obligations, even where a PE is triggered under the treaty.

This administrative practice prioritises simplicity but raises concerns regarding its consistency with both the treaty and domestic law, which require that a PE, once triggered, be registered and taxed on net income. Moreover, the CDI ES–PY, like the Uruguay treaty but unlike the one with Chile, incorporates anti-fragmentation provisions in line with OECD base erosion profit shifting (BEPS) Action 7, aiming to prevent the artificial avoidance of PE status through the splitting of activities. The absence of domestic case law or interpretive guidance further complicates the effective implementation of these provisions.

Anti-abuse and substance rules

The CDI includes:

- a principal purpose test (PPT) to prevent treaty abuse;

- beneficial ownership clauses for dividends, interest and royalties; and
- retention of domestic anti-avoidance rules, such as Paraguay's thin capitalisation limits and transfer pricing rules.

While the treaty does not include a traditional, objective limitation on benefits (LOB) clause, its anti-abuse framework operates as a hybrid approach, combining elements of both PPT and beneficial ownership concepts. It is not a standardised model, but rather a flexible structure aimed at capturing abusive arrangements through substance-based interpretation.

To date, Paraguay has no precedent or litigation experience applying these standards, and the tax administration has not raised specific challenges based on them. In our view, the application of these clauses will ultimately depend on the facts and circumstances of each case, and it will be essential for taxpayers to meet the relevant substantive requirements, particularly those related to economic substance and effective control over the income, to benefit from treaty protections.

Legal and administrative challenges

Paraguay's electronic tax systems require updates to manage multiple treaty rates. Furthermore, the tax residence certificate format may need to be redesigned to align with foreign tax authority expectations. Taxpayers should ensure detailed documentation to access treaty benefits and avoid denial under PPT.

Institutional developments and international cooperation

The Dirección Nacional de Ingresos Tributarios (DNIT)

The creation of the DNIT, which integrates internal taxation and customs, marks a historic restructuring of Paraguay's fiscal apparatus. The aim is to improve oversight, harmonise procedures, and enhance enforcement against smuggling and tax evasion.

International engagement and BEPS

Paraguay is an active participant in the OECD Inclusive Framework on BEPS and has committed to improving its transparency and implementing standards on harmful tax practices, transfer pricing documentation, and country-by-country reporting (CbCR). Implementation is ongoing.

In parallel, Paraguay is a signatory to the Punta del Este Declaration on Tax Transparency, and plays a leading role in its development – the current director of DNIT serves as President of the Declaration's Steering Group. The country has already begun to engage in exchange of information upon request and is developing the institutional and technological capacity to implement automatic exchange of information (AEOI) in the coming years.

A key step in this direction has been the recent creation of a Directorate of International Taxation within DNIT, aimed at consolidating Paraguay's technical capacity in cross-border cooperation. These developments position Paraguay as an increasingly credible actor in regional and global tax transparency efforts.

Strategic outlook and remaining challenges

The CDI ES–PY is a milestone, but its success will depend on:

- the accumulation of institutional experience in applying treaty benefits;
- clarification of PE thresholds and attribution methods;
- strengthening of audit and dispute resolution mechanisms; and
- the development of a mutual agreement procedure (MAP) and eventually advance pricing agreements (APA).

While MAPs and APAs are increasingly standard in international tax treaty practice, Paraguay currently lacks any real experience or administrative precedent in either. As of this writing, no formal MAPs have been initiated, nor has the tax administration issued guidance or developed a framework for APAs. This absence of institutional history and regulatory practice generates significant uncertainty for taxpayers seeking to resolve double taxation disputes or secure prospective clarity in transfer pricing arrangements.

Rather than being viewed solely as an isolated milestone, the CDI ES–PY should be understood as a strategic lever to reopen and modernise Paraguay’s broader treaty network. Additionally, the ES–PY model could serve as a reference for new negotiations with third countries, encouraging convergence toward OECD-aligned standards and broader investment protections. Importantly, the agreement also marks Paraguay’s first bilateral negotiation with an OECD member country that possesses a vast network of double taxation treaties – thereby expanding not only the fiscal reach of Paraguay but also its reputational footprint in the international tax arena.

This dynamic creates an opportunity, but also a challenge, for Paraguayan tax policy: to deploy the ES–PY not only as a technical instrument, but as a diplomatic and institutional benchmark capable of catalysing a new generation of agreements that reflect the country’s evolving fiscal agenda and integration into global tax governance. However, by setting a new and more favourable standard for withholding limits, the ES–PY may also create pressure to revisit existing treaties that currently contain higher thresholds. In that sense, it could backfire by triggering demands from treaty partners to renegotiate terms on less competitive grounds, potentially narrowing the fiscal advantages Paraguay has enjoyed to date in some bilateral relationships.

Conclusion

Paraguay has made substantial progress in modernising its tax system and aligning with international standards. The structural reforms introduced by the Tax Law, the adoption of transfer pricing rules, and the entry into force of the CDI ES–PY reflect a coherent strategy to position the country as a credible and competitive jurisdiction in the evolving landscape of global tax governance.

The CDI ES–PY, in particular, marks a shift from a predominantly source-based taxation model toward greater alignment with residence-based principles and treaty-centred cooperation. Its reduced withholding rates, anti-fragmentation provisions and

hybrid anti-abuse clauses position it as Paraguay's most advanced treaty to date. Realising its full potential, however, will require further development of interpretative guidance, improvements in treaty administration, and institutional mechanisms for dispute resolution, such as MAPs and APAs.

Looking ahead, the CDI ES–PY should not be viewed in isolation. Rather, it serves as a strategic benchmark for rethinking Paraguay's broader treaty policy and fiscal diplomacy. Its favourable terms raise the bar for future negotiations and call for a more coherent and technically robust international tax agenda.

In this context, the recent creation of the DNIT, which unifies the tax and customs administrations, offers a promising platform for institutional consolidation. It reinforces the administrative infrastructure needed to support international commitments and to strengthen Paraguay's voice in global tax coordination efforts.

With the right mix of legal clarity, institutional capacity and strategic vision, Paraguay is well placed to translate technical progress into durable credibility, both as a tax jurisdiction and as an emerging actor in international fiscal dialogue.