



## Costa Rica

### Introduction

A person's liability to Costa Rican income tax is determined by the territoriality principle, in opposition to the method of taxation based on residence status. However, residents and nonresidents receive different tax treatment. Furthermore, the Costa Rican income tax legislation also differentiates in the tax treatment given to individuals working independently, conversely, to those working under a labor relationship. Whereas residents working independently are subject to a progressive tax schedule with the highest bracket being 25 percent of net income, which is computed by deducting deductible expenses from total taxable income, resident individuals working under a labor relationship are subject to a progressive tax schedule for which the highest tax rate is 15 percent.

In both situations, deductibility of personal expenses is limited to immaterial fixed amounts for the spouse and for each dependent child. On the other hand, nonresidents providing independent professional services within the country are subject to a 15 percent withholding tax on gross income and nonresidents providing dependent services within the country are subject to a 10 percent withholding tax on gross income.

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### Key messages

Extended business travelers are likely to be taxed on employment income relating to their Costa Rican work days.

Also, formal tax obligations differ between these categories. Resident individuals working independently should file income tax returns annually. Resident individuals working under a labor relationship and nonresidents providing services in the country, whether it is independently or not, are subject to a monthly withholding tax system, where the payor acts as withholding agent and consequently, is responsible before the tax authorities for the correct compliance of the tax obligations of the individual or entity beneficiary of the income. The withholding tax agent is joint and severally responsible together with the corresponding taxpayer for taxes due before the tax authorities.

## Income tax

### Liability for income tax

The Costa Rican tax system is based on the territoriality principle whereby all income derived within Costa Rican territory and from Costa Rican sources is subject to income tax. Certain exceptions apply. The amount taxable in Costa Rica does not change based on residency status. The method of taxation does however change for expatriates residing in Costa Rica for six months or longer.

Residence for tax purposes is triggered by a continuous physical presence in the country for six months during the tax period. Pursuant to article 5 of the Regulations to the Income Tax Law, the tax authorities are empowered to treat as residents for tax purposes, individuals who have not yet satisfied the six-month period of permanence in the country, provided certain conditions are met. These refer to the following: (a) the tax authorities may consider as residents for tax purposes those individuals who even though they have resided in the country for less than six months have been in a labor relationship with Costa Rican employers and (b) the tax authorities have granted the residence condition to individuals who just arrived to the country but are transferred on assignments that would exceed the six-month period; therefore, these individuals are considered as residents for tax purposes as of day one of permanence in the country.

Then, according to the above-mentioned, the tax rules that would apply to an expatriate on assignment in Costa Rica would differ depending on the length of the assignment. If the assignment would not exceed the six-month period of permanence and the expatriate would not be working under a labor relationship with a Costa Rican employer, then the expatriate would be subject to a 10 percent withholding tax rate on gross income received for services provided within

the country. This tax should be withheld by the payor at the moment of paying the income to the expatriate. When the employer is a foreign entity, then it is the expatriate's responsibility to pay taxes due before the Costa Rican government. For such purposes, the expatriate should file the form named "Recibo Oficial de Pago" and make the corresponding filing and payment of taxes due, before any authorized bank agency of the National Banking System.

Expatriates residing in Costa Rica for more than six months on a continuous basis will be considered residents for tax purposes. Similar treatment would apply to those expatriates who are transferred on assignment for a period exceeding such term, but in this situation, the resident status would apply as of day one of assignment. In these cases, the expatriates will be subject to salary tax which is the income tax applicable to domiciled individuals obtaining income from the provision of personal services rendered under a labor relationship. This tax applies a progressive tax rate schedule.

### Definition of source

Employment income is generally treated as Costa Rican-sourced income when it derives from the provision of services rendered while the individual is physically located in Costa Rica, irrespective of the location where the salary is being paid.

Compensation related to services provided outside Costa Rica will receive a different tax treatment depending on the tasks being performed abroad. Herein we include the different possible situations and their corresponding tax treatment.

- a. Income received by residents working temporarily abroad for the benefit of the Costa Rican entity. The income is considered connected to the economic structure of the country, and consequently, is treated as Costa Rican source income subject to tax in the country.
- b. Income received by residents working temporarily abroad for the benefit of foreign entities. In this situation, the income obtained by the individual is considered foreign source income not subject to tax in the country.
- c. Nonresidents working abroad are not subject to tax in Costa Rica.

The above-mentioned criteria are not applied for social security purposes, where the rules differ. Within this scope, individuals are liable to pay social security contributions when working within Costa Rica to the benefit of a local or foreign employer or when working abroad to the benefit of a local employer. It is important to call attention to this latter situation, to the extent that the employee is on a local payroll, the social security authorities will charge social security contributions regardless of the fact that the employee works in Costa Rica or abroad, or regardless of the fact that his/her work is performed abroad for the benefit of the local entity or for the benefit of a foreign entity.

## Tax trigger points

Technically, there is no threshold/minimum number of days that exempts the employee from the requirements to file and pay taxes in Costa Rica, including both income tax and social security contributions.

## Types of taxable income

For extended business travelers, the types of income that are generally taxed are employment income and other Costa Rican-sourced income. However, Costa Rica has a statutory 13th month benefit that is not subject to salary tax or social security contributions.

## Tax rates

Residents' employment taxable income is taxed at progressive tax rates ranging from 0 percent to 15 percent. For 2011, the tax schedule in force is:

Income	Tax rates
Up to ₡ 651,000 (US \$ 1,287) <sup>1</sup>	0% (exempt)
From ₡ 651,000 to ₡ 977,000 (US \$ 1,932)	10%
Over ₡ 977,000	15%

(1) 1 US \$ = ₡ 505.65 (Source: Costa Rican Central Bank, April 12, 2011. [http://www.bccr.fi.cr/flat/bccr\\_flat.htm](http://www.bccr.fi.cr/flat/bccr_flat.htm))

Deductibility of personal expenses is limited to annual expense per child ₡ 14,760 and for the spouse ₡ 21,840. This tax is reported on an annual basis. Even though the tax liability is determined at the end of the tax year, the law establishes that taxpayers must perform three advance income tax payments prior to the final due date. These are carried out on a quarterly basis and the amount is determined based on either the amount of income tax liability paid in the previous year or the average of the previous three years – whichever is higher.

Nonresidents working under a labor relationship are subject to a flat tax rate of 10 percent on gross Costa Rican-sourced income.

Self-employed nonresidents working in Costa Rica are subject to a 15 percent tax rate on gross Costa Rican-sourced income received.

Income	Tax rates
Up to ₡ 2,890,000 (US \$ 5,715) <sup>2</sup>	0% (exempt)
From ₡ 2,890,000 to ₡ 4,316,000 (US \$ 8,536)	10%
From ₡ 4,316,000 to ₡ 7,199,000 (US \$ 14,237)	15%
From ₡ 7,199,000 to ₡ 14,427,000 (US \$ 28,531)	20%
Over ₡ 14,427,000	25%

(2) 1 US \$ = ₡ 505.65 (Source: Costa Rican Central Bank, April 12, 2011. [http://www.bccr.fi.cr/flat/bccr\\_flat.htm](http://www.bccr.fi.cr/flat/bccr_flat.htm))

## Social security

### Liability for social security

There is a comprehensive social security system in Costa Rica. Employees must contribute to all segments of social security. The segments include a workers' bank, social security, a national training institute, a social welfare institute, and welfare for the poor. The social security rates are uncapped and are applied to gross compensation. The employee's contribution rate is 9.17 percent and the employer's contribution rate is 26.17 percent.

In addition, the employer must make contributions to a professional risk insurance scheme. The risk insurance rates can vary widely depending upon the nature of the risk.

Costa Rica has entered into formal social security totalization agreements with 20 other countries of the Iberoamerican Organization to prevent double taxation and allow cooperation between Costa Rica and overseas social security authorities in enforcing their respective laws. Ratifications by treaty partners are still pending, and a minimum number of countries must ratify for the multilateral agreement to come into force.

## Compliance obligations

### Employee compliance obligations

Individuals whose entire income is subject to salary withholding tax are not required to file an income tax return. Otherwise, income tax returns are due by December 15 following the tax year-end, which is September 30.

### Employer reporting and withholding requirements

Residents receiving employment income are subject to withholding tax. The employer should do the corresponding withholdings at the moment it pays the corresponding salary to the employee.

Nonresidents receiving Costa Rican source income are also subject to withholding tax. The withholding tax agent is the payor of such income and it should withhold the corresponding remittances abroad tax at the moment of paying or crediting Costa Rican source income to the benefit of the nonresident beneficiary.

The tax liability should be paid to the Tax Administration within the first 15 days of the following month to that of the date of payment and should be paid together with the filing of Form D-103 (withholding tax return) for both residents and nonresidents.

## Other

### Work permit/visa requirements

A visa must be applied for before the individual enters Costa Rica. The type of visa required will depend on the purpose of the individual's entry into Costa Rica. For example, an individual may be considered a business visitor provided his or her activities are limited to attending business meetings, making sales calls to potential clients on behalf of a non-Costa Rican entity, and attending seminars.

A consular visa used by a tourist visitor is generally valid for 90 days and may be extended for up to an additional 90 days. Certain nationalities may be granted shorter visas. The length of time may vary depending on the nationality of the foreigner. The different treatments can be reviewed at the official web site: [http://www.migracion.go.cr/visas/Directrices\\_ingreso/Directrices%visas-Noviember2009.pdf](http://www.migracion.go.cr/visas/Directrices_ingreso/Directrices%visas-Noviember2009.pdf).

A business visitor, someone who is visiting Costa Rica for a period equal to twice the consular visa used as a tourist, may obtain a business visa. All business visitors have to comply with the Costa Rican laws and the payment of the corresponding taxes.

### Double taxation treaties

Costa Rica has signed income tax treaties with Romania (1991), Germany (1993), and Spain (2004). The treaty with Spain came in force last January 1, 2011. The income tax treaty with Germany is being negotiated for the third time, and the treaty signed with Romania is not expected to come in force. There has been an exchange-of-information agreement in force with the United States since 1990. Costa Rica signed an exchange-of-information agreement with Argentina in 2009, and currently, it is in the process of being approved by the Congress, to become enforceable. Also, Costa Rica is negotiating 16 exchange-of-information agreements with other countries and expects to have them duly sign by mid-2011, in order to comply with the term granted by the OECD to eliminate Costa Rica from its gray list.

### Permanent establishment implications

There is the potential that a permanent establishment could be created as a result of extended business travel, but this would depend on the type of services performed and the level of authority the employee has.

### Indirect taxes

The standard VAT rate is 13 percent.

In accordance with the Sales Tax Law (the VAT Law), VAT is levied on the sale of all merchandise within the country and/or the import of merchandise into the country.

According to Article 1 of the Executive Regulation to the VAT Law, the term "merchandise" must be understood as any material, product, article, manufacture, and, in general, all movable goods produced or acquired for their processing or trade. According to this article, the term "merchandise" does not include intangible property such as stock or securities. Immovable property is also excluded from the term "merchandise."

Only those goods specifically listed in the VAT Law as exempt are exempted from VAT.

Unlike goods, services are not subject to VAT except when expressly taxed by law. Article 1 of the VAT Law includes a list of services that are subject to the general sales tax.

Taxable services include:

- Services provided by restaurants
- Bars
- Night, social, or recreational centers
- Hotels, motels, pensions, and similar establishments
- Repair shops of any kind of merchandise including motor vehicles
- Parking facilities
- Telephone, cable, or telex services

Article 1 of the VAT Law also includes:

- Photocopying and photographic developing services
- Certain storage services
- Laundry and ironing services
- Public shows except sports, theater, and children's movies
- Advertising services
- Cable and satellite television services
- Services rendered by customs brokers
- International moving services
- Services rendered by real estate brokers
- Pagers and similar services
- Washing, cleaning, and maintenance services for vehicles
- Services rendered by printing houses and lithographers
- Insurance premiums (except for those insurances referred to work risks, crops, houses of social interest, and personal insurances)

All other services are not subject to VAT since the law does not expressly mention them.

The export of goods and the sale of exempt goods allow the taxpayer a credit for the input VAT paid. The legislation in force establishes restrictions to the input VAT that can be credited.

### Costa Rican entities

Under the "value-added taxation" system established by the VAT Law, taxpayers are those:

- Individuals or entities engaged in exporting goods. These are considered declarants for purposes of the VAT Law. They must register as such in order to obtain a credit on taxes paid on inputs.
- Individuals or entities that produce or sell goods or services subject to VAT.

In such cases, the final tax liability is calculated by subtracting total VAT paid on imports or local purchases that are incorporated to the taxable good or service provided, from total VAT collected from taxable sales during a given period. Pursuant to article 5 of the VAT Law, these individuals or entities are known as “VAT taxpayers” and have an obligation to register as such before the tax authorities. Registration is a simple process and is accomplished by filing a registration form before the Unique Taxpayers Registry of the Tax Authorities. It can usually be accomplished in a single day, if filed together with the requirements requested for such purposes.

### **Non-Costa Rican entities**

The Costa Rican VAT Law does not distinguish between Costa Rican and non-Costa Rican entities. Non-Costa Rican entities that fall under the description indicated above are required to register as VAT taxpayers.

### **Transfer pricing**

Costa Rica does not have legal rules governing transfer pricing issues. However, the tax authorities are applying transfer pricing rules based on the general principle of substance over form. During the last five years, the Tax Administration has become more aggressive in applying transfer pricing rules to intercompany transactions of taxpayers and in requesting due compliance of market price conditions in intercompany transactions.

A transfer pricing implication could arise to the extent that the employee is being paid by an entity in one jurisdiction but performing services for the benefit of another entity in another jurisdiction, in other words, when a cross-border benefit is being provided. This may apply depending on the nature and complexity of the services performed.

### **Local data privacy requirements**

Costa Rica does not provide for the statutory protection of privacy. Some protections are available under Article 24 of the Constitutional Act.

### **Exchange control**

Costa Rica does not restrict the flow of Costa Rican or foreign currency into or out of the country. Only some anti-money laundering rules are in place to keep track of capitals and prove their legal source.

### **Nondeductible costs for assignees**

Nondeductible costs for assignees may include a portion or all of contributions by an employer to non-Costa Rican pension funds.

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