



Costa Rica transition period for imposition of withholding tax on payments abroad expires

A six-month transition period that delayed the application of new withholding tax rules in Costa Rica expired on 28 May 2015. Law No. 8634, which became effective on 27 November 2014, amended the withholding tax rules for certain payments made to nonresidents, including interest payments made to foreign banks.

Law No. 8634 made significant changes to section 59 of the Income Tax Law, under which a 15% withholding tax generally applied to interest payments made to nonresidents, with an exemption for payments to an entity recognized by the Costa Rican central bank as a “first order financial institution” or an entity normally engaged in international operations as included on special lists issued by the Costa Rican central bank. Law No. 8634 retains the 15% withholding tax, but abolishes the exemption for interest paid to a first-order bank or an entity normally engaged in international operations so that such payments now are subject to the 15% withholding tax. The law does not affect the treatment of interest paid on loans to domestic banks, which remains exempt from withholding tax.

As noted above, transition rules allowed taxpayers to continue to apply the tax treatment applicable under the prior law (e.g. to apply a withholding tax exemption, where applicable) for payments of interest, fees and financial costs on loans outstanding, for a period of six months after the new law became effective, i.e. until 28 May 2015; that period now is expired. The 15% rate under Law 8634 applied immediately for any new loans signed after 27 November 2014.

The following table summarizes the withholding tax treatment of various payments:

Payment	Withholding tax
Interest, fees and other financial expenses, as well as lease payments for capital assets paid to nonresident individuals or legal persons	15%
Interest, fees and other financial expenses paid by domestic entities to domestic banks	Exempt
Interest, fees and other financial expenses, as well as lease payments for capital assets paid to foreign banks that are part of a Costa Rican group or financial conglomerate regulated by the Costa Rican Financial System (CONASIFF)	5.5% for the first year Law 8634 is in effect, 9% in the second year, 13% in the third year and 15% as from the fourth year
Interest, fees and other financial expenses, as well as lease payments for capital assets paid to foreign entities that are not part of a Costa Rican financial group or conglomerate and that are regulated (i.e. subject to supervision and inspection) in their home country	15%/5% (the 5% rate applies if the interest is paid by a Costa Rican bank)
Interest, fees and other financial expenses paid by domestic entities regulated by the Superintendent of Financial Entities (SUGEF) to foreign entities that are regulated in their home jurisdiction	5.5%
Interest, fees and other financial expenses paid on a loan from a foreign bank that then distributes the payments to other banks that participated in the granting of the loan if the portion of interest, fees and other financial expenses relating to each bank is not separately stated in the contract	15%

If the contract separately states these portions and participating banks have connections with Costa Rican financial groups and the foreign entities are part of a Costa Rican financial group or conglomerate	5.5% for the first year Law 8634 is in effect, 9% in the second year, 13% in the third year and 15% as from the fourth year
Interest paid to a “first-order” bank or an entity normally engaged in international operations	15%
Interest, fees and other financial expenses arising from loans from multilateral development banks and other multilateral or bilateral development agencies and from nonprofit organizations that are not subject to tax	Exempt

In addition to the withholding tax changes, the law repeals the special annual tax of USD 125,000 that applied to offshore entities and certain other entities linked to domestic banks.

Comments

Costa Rican taxpayers should pay close attention to all payments made abroad, to determine if it is necessary to withhold tax on these payments. The exemptions for payments to first-order banks or entities normally engaged in international operations or operations related to financial services generally have been abolished, although the exemptions for multilateral development banks and multilateral or bilateral development agencies have been retained, so it is necessary to identify which entities fall into these categories and the provisions that must be included in relevant documents to support their status as authorized banks.

It also may be necessary to amend the terms of certain loans in which a domestic bank does not act as a direct debtor, primarily in cases where it is involved with other entities in the granting of credit, to separately state each entity’s level of participation in the loan transaction to allow for the application of the 5.5% rate, rather than the 15% rate.

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