KPMG

GMS Flash Alert

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Costa Rica – Update on Tax Reform and Changes to Tax Residency

The Costa Rican legislature recently approved a tax reform law, with many important changes affecting the country's systems of direct and indirect taxation.

The *Law for the Strengthening of Public Finances*, Law number 9635[1] ("the Law"), represents the most important reform of the Costa Rican Tax system in recent decades. These reforms will take effect on July 1, 2019.

Also, new rules on tax residency recently got attention. On February 4, 2019, Resolution DGT-R-065-2018 was published in the *Gaceta Oficial*, the country's official gazette. The Resolution stipulates how tax residency is defined and determined and the requirements and procedures for obtaining a certificate of tax residence for individuals, entities, and trusts. The Resolution is effective as from February 4, 2019.

We will highlight in this GMS *Flash Alert* a few of the important changes under the Law impacting individuals and their multinational employers and the new developments in respect of residency.

WHY THIS MATTERS

Assignees, their global mobility managers, and their tax service providers should be cognizant of the changes affecting Costa Rica's personal income tax system and tax residency. Assignees' tax status, liabilities, and proper compliance are all affected by the changes. Failure to adhere to the new rules and follow proper procedures could put the assignee and his/her employer at risk. Moreover, the changes to indirect taxation -- the transformation of the existing sales tax to a value added tax -- could end up raising day-to-day costs for consumers (e.g., assignees working and living in the country). When developing compensation packages for assignees to Costa Rica, HR managers and compensation advisers should take this on board.

Tax Residency

According to Decree 41274-H (which was published in the 22 October 2018 *Gaceta Oficial*), individuals are considered domiciled in Costa Rica when they stay in the country for more than 183 days during the fiscal period (this includes short-term absences), unless tax residency in another country is proven.

As noted above in the introduction to this newsletter, a recently published Resolution amends the country's tax residency rules[3] thereby further developing the rules around tax residency. The Resolution deals with:

- definitions of residency,
- issuance of the tax residency certificate,
- requirements for applying for a tax residency certificate,
- terms for withdrawal of the certificate of tax residency, and
- charges to the applicant for issuance of a tax residency certificate.[2]

For a more detailed report, see the recently-issued "News Flash" (in English and Spanish) from Tax & Legal KPMG Costa Rica, published by the KPMG International member firm in Costa Rica.

Non-Domiciled Individuals Owning and Selling Real Estate

Under new rules, when a non-domiciled individual who owns a real estate asset in Costa Rica sells that asset, he or she will be subject to a 2.5-percent withholding tax.

Permanent Establishment

Costa Rica's territorial income tax regime will remain unchanged, but a revised definition of permanent establishment ("PE") brings Costa Rica's PE rules more in accordance with international standards. PE is now defined as a fixed place of business, and the 183 days rule is established for services and construction works, considering the case of associated companies. A dependent agent may also create a permanent establishment.

Global Income

Taxpayers must include in their income tax returns all income subject to withholding tax, and the withheld amount is considered an advance payment of tax. This applies only to the revenue derived from assets used in the taxpayer's habitual trade or business. However, the tax on dependent personal work (salaries and allowances of directors) as well as income derived from assets that are not used in the taxpayer's habitual business activities are excluded from this rule.

Withholding on Interest and Remittances

Withholdings on interest will generally be 15 percent and tax withholdings on remittances abroad on professional services will increase from 15 percent to 25 percent.

Salary Tax Rate / Bands

Third and fourth tranches are added to the tax rates scale, with any income between CRC 2,103,000 monthly to CRC 4,205,000 monthly subject to a tax rate of 20 percent; and income in excess of CRC 4,205,000 monthly will be subject to a rate of 25 percent.

The new income tax rates for individuals are as follows:

Up to CRC 817,000	0%
More than CRC 817,000 and up to CRC 1,226,000*	10%
More than CRC 1,226,000* and up to CRC 2,103,000	15%
More than CRC 2,103,000 and up to CRC 4,205,000	20%
More than CRC 4,205,000	25%

Source: KPMG, Costa Rica

*The CRC 1,226,000 amount might be changed to CRC 1,199,000. As there is an error in the newly-enacted Law.

[CRC 1 = USD 0.00164 | CRC 1 = EUR 0.00144 | CRC 1 = GBP 0.00124 | CRC 1 = PAB 0.00164]

Fiscal Period

The tax period will be from January 1 to December 31. The Tax Administration may establish different periods for certain activities.

The period comprising the months of October through December 2019 might be considered as a transition period, or either as the first calendar-year period.

Further regulations are expected.

Tax Amnesty

This law includes a tax amnesty that expires on March 5, 2019. During this period, taxpayers may pay certain taxes without paying interest and with important reductions in fines and penalties.

For a more detailed report, see the recently-issued "News Flash" (in English and Spanish) from Tax & Legal KPMG Costa Rica, published by the KPMG International member firm in Costa Rica.

Sales Tax Reformed to Value Added Tax (VAT)/Impuesto al Valor Agregado

The Law converts Costa Rica's indirect system of taxation from a sales tax-based system – which had been applied to the sale of goods -- to a VAT-based system. The new system includes the (previously-excluded) provision of services.

Tax

- Sales of goods are taxed, and virtually all exemptions are eliminated.

- The provision of services is taxed according to the ordinary tax rate, but several exemptions are created.
- A service import regime is created where taxpayers must pay VAT on services acquired from abroad.
- Purchases of services through the Internet are taxed and credit card processors must act as tax collectors.
- A special regime is established for resellers of used goods.

Rate

- The tax rate is maintained at 13 percent. However, there are reduced rates for certain goods and services – e.g., 4 percent, 2 percent, and 1 percent. For example, private health services will be subject to a reduced 4-percent tax rate, and private education services to a reduced 2-percent rate.

Solidarity Tax

Executive Decree No. 41478-H ("the Decree") was published in the *Gaceta Oficial* on 10 January 2019. The Decree provides an increase in the exempt threshold for the solidarity tax[4] so that dwellings under CRC 131,000,000 are exempt from tax.

The Decree entered into force on 1 January 2019.

For more details on the tax reform, see the recently-published "News Flash" (in English and Spanish) from Tax & Legal KPMG Costa Rica, published by the KPMG International member firm in Costa Rica.

Also see "Costa Rica: Overview of Tax Reform Law Measures," (December 17, 2018), a publication of the KPMG International member firm in Costa Rica.

FOOTNOTES:

1 *Ley para el Fortalecimiento de las Finanzas Públicas*, as published in *La Gaceta Oficial* (online). You can also find the law by accessing it (in Spanish) at the National Printing Office (*Imprenta Nacional*).

2 *Resolución 065-2018 del 17 de diciembre de 2018* published (in Spanish) in *La Gaceta Oficial* N° 24 del 4 de febrero de 2019. For more information (in Spanish), see the "Certificado de residencia fiscal" web page on the Ministry of Finance's (*Ministerio de Hacienda*) website.

3 Ibid.

4 *Note*: The solidarity tax is a tax on dwellings (real estate properties), including those used habitually, occasionally, or for recreational use, established under Law 8683, to support Costa Rica's social housing program (*impuesto solidario para el fortalecimiento de programas de vivienda*). The tax is calculated on the estimated value of the real estate asset, taking into account the land and what is built on the land. The exemption threshold is updated every year in December, taking into account the inflation rate for that year.

Contact us

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