



LEGAL GUIDE TO INVESTING IN COSTA RICA



TEL.: (506) 201-8700

FAX: (506) 201-8707

www.faciolaw.com

info@faciolaw.com



INDEX

Introduction	3
Corporations	4
Incorporation Requisites	5
Powers of Attorney	5
Investing in Real Estate	7
Fee Simple	7
Concessions in the Shoreline Zone	7
Condominiums	8
Zoning	9
Protection of Real Estate	9
Public Registry	10
Buying Real Estate in Costa Rica	10
Sale of Real Estate and Tax Planning	11
Taxes	13
Inscription as a Taxpayer	13
General Requirements	13
Corporate Income Tax	13
Professional Services Income Tax	14
Costa Rican Tax System and its Relevance in Real Estate Transactions	15
Contact Information	19



Facio Abogados was established in 2000 by a select group of experienced professionals seeking to provide a high-standard personalized service to a mostly foreign client base. Even though our law firm is prepared to provide assistance in a full range of legal services, our emphasis through many years of consolidated practice has focused on Corporate and Business Law and Foreign Investment Counseling in the areas of Tourism, Real Estate Development and Transactions and Tax Planning. The firm consists of six partners and eight associates, along with an international group of counsel assistance, paralegals, certified translation and bookkeeping services personnel.

In our continuous effort to contribute to our region and client base, we have developed the following document to better serve your interests in our country as well as in our neighboring countries and help you attain the minimum legal guidelines required to invest and do business in the area. We hope this document serves you well and remain at your disposition for anything you may deem pertinent.

CORPORATIONS

The following is a brief outline of the requirements involved in the incorporation of a Costa Rican Corporation (S.A.) or Limited Liability Company (LLC):

Sociedad de Responsabilidad Limitada

The Sociedad de Responsabilidad Limitada (LTDA or LLC) was created as an alternative to the Socieadad Anonima (SA) (described below). It is simpler to operate than a SA since it does not require many formal acts to function. This makes it suitable for small business enterprises. The main characteristics of the limited liability company are, that the liability of the shareholders is limited to the amount of their capital contribution, the capital is divided into individual registered quotes which cannot be sold to the public unless priviously offered to other partners (first right of refusal), the company is made up of a minimum of two quoteholders with no limit as to the maximum number of shareholders allowed.

The company is managed by one or several MANAGERS who may or may not be shareholders. While the simplicity of the operation is a benefit of this form of incorporation the draw back is the limitation on the ability to transfer ownership of the LTDA to third parties.

The LTDA can be handled by a manager with broad powers of attorney. There can also be more managers or vice-managers, as deemed appropriate by the owners.

Sociedad Anonima

In Costa Rica Socieadad Anonima is the most common used corporation form of business organization. The main features are that the liability of the shareholders is limited to their capital contribution and stock ownership in the corporation is easily transferred to a third parties (endorsement of shares).

The Board of Directors is the supreme organ of the corporation and it expresses the collective disposition of the partners. The following positions should be assigned in the Board of Directors of the company:

1. President
2. Secretary
3. Treasurer

Additionally, a Controller (cannot be family related with any other Board Member) and a Resident Attorney or Agent has to be appointed. The Resident Attorney or Agent must be

an Attorney at Law in Costa Rica. In general, the positions outlined above are the minimum necessary for incorporation purposes and do not exclude the possibility of appointing vice-presidents, managers and others. Moreover, your disposition concerning which member(s) of the Board of Directors will have Powers of Attorney in the company and if those powers will be exercised jointly or separately (at least the President has to have powers to represent the company, both in court and out of court) is necessary.

Incorporation Requisites

In order to incorporate either of these types of companies, we will require the following information of at least two founding partners:

1. Full name
2. Marital Status
3. Occupation
4. Street address
5. Passport number

Powers of Attorney:

In Costa Rica, there are various types of Powers of Attorney, among them and the most commonly used are Full, General and Special, all of which can be limited in kind, in time and in amount; and are summarized as follows:

1. Full Power of Attorney: allows purchase, sale, mortgage, etc. of any goods that the corporation may have. It also empowers to sign checks, pay invoices, contract with suppliers, etc. It can be limited, both in the type of acts that are permitted and prohibited, as well as in total amount of each of the acts or contracts.
2. General Power of Attorney: is solely intended to be used for administrative purposes, such as contracting of personnel for business purposes, signing invoices and, in general, any other document which is strictly related to the company's scope of activity. Can also be limited in the amount of the acts.
3. Special Power of Attorney: entitles the representative to execute one or more specific acts, whether of administration or disposition. One special characteristic of this power of attorney is that, as opposed to the two previously explained powers of attorney, it does not need to be recorded in the Mercantile Section of the Public Registry.

Using the above mentioned guidelines, powers of attorney may be drafted to fit special corporate needs. For instance, you may have the following scenarios:

- a. President holds full powers of attorney.
- b. President and Secretary hold full powers of attorney so long as they act jointly.
- c. President and Secretary hold full powers of attorney acting individually for transactions up to \$ 50,000.00 and jointly thereafter.
- d. All Board Members hold full powers of attorney.
- e. Any other combination established by the Shareholders.

INVESTING IN REAL ESTATE

Just like in the United States, Canada, and Europe, there are different types of property available to buyers that can be owned on a personal capacity or through a corporation; regardless of the owner's nationality (With the exception of concessions in shoreline zone, detailed later in this document). Understanding the various types that are available for purchase is critical in the evaluation process. This section highlights the property types that can be purchased in Costa Rica and the implications of each type of ownership for the buyer.

1. Fee Simple

The most comprehensive form of property ownership in Costa Rica is fee simple ownership. In this respect, the conditions for this type of ownership are the same for Costa Rican nationals as they are for foreigners. The concept of fee simple ownership is the same in Costa Rica as in the United States, Canada and Europe; namely, fee simple ownership gives the owner of the property the absolute right to materially own the property, use it, enjoy it, sell it, lease it, improve it, among other things, subject only to conditions outlined in the Costa Rican Laws.

2. Concessions in the Shoreline Zone

Beachfront property is more commonly known as "concession property." In Costa Rica, 95% of beachfront property is concession property and is governed by the Shoreline Zone Law (Law No. 6043) and other specific regulations including but not limited to special dispositions ensuing from local governments (i.e. municipalities) and Costa Rican Board of Tourism (ICT). These legal dispositions set forth the conditions under which foreigners and local residents can lease concession property.

In Costa Rica, a concession is defined as the right to use and enjoy a specific portion of land located on the shoreline zone for a pre-determined period of time and based on a predetermined use of the soil (zoning or master plan, known as "Plan Regulador"). The Government, through its corresponding municipality, grants this right by means of a private agreement between concessionaire and municipality that is further recorded in a Public Registry. This agreement also establishes a yearly concession fee that is paid based on an appraisal performed by government financial authorities.

Costa Rica's shoreline zone is comprised of 200 meters (approximately 600 feet) starting at the mean hightide mark and heading inland. The 200 meter zone is government owned. No individual or company can own the 200 meter zone. The shoreline zone is divided into two strips of land:

- a. The first strip is 50 meters (approximately 150 feet) wide is known as the "public zone" and is absolutely public. This zone is not available for ownership of any kind. No development is allowed, except for

constructions approved by government entities (i.e. marinas). Furthermore, this area is deemed public, therefore, it is available for use and transit of any individual.

- b. The following 150 meters (approximately 450 feet) can be subject to occupation or lease by individuals or companies, either through a concession with the respective municipality (in case of residential and commercially exploitable portions of land) or a management plan with the Ministry of Environment and Energy (MINAE), in the case of environmentally sensitive, low density, portions of land. In both cases, the property can be used, although not owned (same as with a lease).

Both concession agreements and management plans are entered between private parties and the Government for a limited period of time (5 to 20 years at Government's discretion); however, most concessions and management plans are granted for 20 years. During this period, the concessionaire pays a fee for the use and occupation of such government land. Renewal for equal and consecutive periods is negotiated between private parties and the corresponding government authority; such renewal is usually based on the concessionaire's ability to comply with its commitments and obligations during the previous agreement. Such obligations may include having assumed the compromise to build on that concession land, subdivide it or perform other acts of development or improvement on the land, in which case, the concessionaire will be required to obtain all appropriate permits from the local municipality.

Unlike fee simple property, foreigners do not have the same rights as citizens when it comes to leasing shoreline zone concession land. The law establishes that foreigners cannot be majority holders of concession land. A foreigner can, however, enter into a partnership with a Costa Rican citizen where the Costa Rican national appears as the majority holder of the concession land. An exception to this prohibition applies to foreigners who have resided in Costa Rica for at least five years, who can also appear as majority holders of a concession. Nevertheless, alternative mechanisms can be analyzed on a case by case basis.

3. Condominiums

Traditionally, the concept of "Condominium" is associated with apartment buildings and townhouses. In Costa Rica, however, there is a specific law called "Condominium Property Law" that provides a framework for development of different types of properties, including single family residence projects, finished lot projects, vertical and horizontal property condos, among other.

This law allows a developer to restrict and regulate certain aspects of the development. Each Condominium development has its own by-laws containing all applicable conditions, restrictions and regulations applicable to owners in such development.

Condominium property ownership is fee simple ownership, but usually carries with it a few additional restrictions set forth by the developer, such as architectural guidelines, land use restrictions, and other limitations that may be placed on each branch property. For the most part, condominium laws are designed to protect the integrity of a development and maintain the “look and feel” of the project.

Zoning

The criteria for entering into either a concession or a management plan is based on the use of soil or zoning, which is determined by the corresponding government authority. Such authorities will divide real estate into several segments based on the optimum use that each portion of the land is best suited for. Notwithstanding this, individuals and companies can request a change of use of a determined portion of land, which must be approved by the corresponding entity.

Some of the steps that need to be taken in complying with zoning regulations and engaging in future development of such property include the following:

1. Preparation of Master Plan. If land is located in the shoreline zone, the master plan must be in accordance with the use of soil standards set forth by the Municipality, and its approval will require the existence of a concession agreement on the shoreline zone land.
2. Preparation and recording of surveys for subdivision of land, both from the mother farm and into branch properties.
3. Approval of Master Plan before Board of Architects and Engineers, Health Ministry and National Urban Development Institute. This approval may require the preparation of an Environmental Impact Study.
4. Enter into Construction Agreement with a contractor. This will include negotiation of agreement and guarantees, inspection of works and other related matters.
5. Preparation and recording of Condominium Declaration and CC & R's. Management, Homeowners' Association, Rental Pool, Fractional Ownership and other related agreements may be applicable during this stage.
6. Sale of branch properties to end buyers. Based on the desired ownership and tax structures, incorporation of holding companies and other forms of ownership agreements for transfer of title to buyers is permitted.

Protection of Real Estate

One of the greatest concerns of foreigners when purchasing real estate in a foreign country is to ensure that the transaction will be executed legally and that the system can ensure a lifetime use and protection of the property. In this respect, the Costa Rican legal

system does provide ample protection to investors; however, some investors prefer to secure their property with a title guaranty or title insurance.

Similar to how it functions in the United States, the title guaranty serves as a contract by which a third party (Guaranty Company) commits to indemnify losses due to legal situations that could affect the property, less any exceptions or exclusions from the coverage. This legal document grants the buyer the security and peace of mind that the property has free and clear title to it and is protected in the event of defect, including fraudulent conveyance of title.

The process of issuing a Title Guaranty includes the issuance of a Title Commitment prior to closing, which allows the buyer time to examine the legal status of the property and determine if the property is in proper condition for purchase. The final title guaranty is issued after closing and is based on the title commitment. The Title Guaranty is a new concept in Costa Rica and Latin America in general, but it has already proven to add value to initial real estate purchases, re-sales and has encouraged transparency and increased liquidity in the real estate process.

Public Registry

All Real Estate properties are recorded in a Public Registry (Registro Nacional de la Propiedad), which is controlled and administered by the government. There is only one Public Registry for the entire country, that is, regardless of the location of the property, all of them need to be recorded in this unified Registry. As the name indicates, this Registry is absolutely Public and therefore any citizen or non citizen of Costa Rica can search any inquiries they might have. In the Registry you can find all the public information on a property, such as the name of the owner, area, liens, embargos, rights of way, and all other possible affections the property might have.

Whenever, somebody wants to transfer a property, they need the professional services of a Notary Public, who will grant a private deed between the interested parties (Seller/Buyer). Even though such private sale or contract is sufficient to validly transfer the property, the contract does not have effects on third parties unless it is recorded in the Public Registry. Once the document is recorded in the Public Registry the document acquires publicity and nobody can allege lack of knowledge.

When buying Real Estate in Costa Rica you need to be concerned about the following issues:

1. Status of the Property: The first thing that one needs to do is check the actual condition of the property. Is the property really owned by the person who claims to own it? Is the property free of any liens, embargoes, affectations, and squatters? Most of these questions might be answered by performing a title search at the Public Registry.

2. Recorded Survey: The second step is to check the status of the survey of the property. Many properties have surveys recorded years if not decades ago and thus are not as accurate as one may want. Make sure the area stated on the survey matches the area recorded on the Public Registry. If it doesn't, as it often happens, make sure you find out why those areas don't match.

3. Sale and Purchase Agreement: If you are not ready to close on the property immediately, you might want to consider signing a Sale and Purchase Agreement (SPA) to tie down the property. SPA will be signed by both SELLERS and BUYERS and terms and conditions will be included in detail. Usually 10% of the sale price is given as a deposit held in escrow until closing.

4. Deed of Transfer: At closing, both SELLER and BUYER will grant the deed of transfer before a Notary Public. The Notary Public will in turn submit a copy of the deed to the Public Registry for recording. (usually about 2 weeks)

Sale of Real Estate and Tax Planning

In general terms, the sale of real estate to residents and non-residents will require sophisticated forms of ownership and tax planning to mitigate the tax impact on both developer and end buyers and make sale of units as attractive as possible to buyers and as profitable as possible to developers.

Purchase of real estate in Costa Rica can take place either through a direct purchase by an individual, where the person acquires the property in his or her personal name, or by using a company (corporation or other) to hold title to such real estate. The latter is a common practice in Costa Rica, whereby individuals will acquire properties through a new company or through an existing one that appears as the recorded owner of such property.

In this respect, setting up a corporation is not complicated, but does require a knowledgeable attorney who understands the exact protocols and procedures necessary to properly set up the same. One of the advantage of this system is that it allows a buyer to protect his asset anonymously.

Furthermore, if a purchaser acquires a property through an existing corporation that already owns the property, there are no government transfer taxes or tax stamps involved in the transfer of title of the stock in the holding company owning the real estate. This, because transfer taxes and tax stamps are only due when title to the property is transferred at the Public Registry, but not when title to the property is transferred as a consequence of the transfer of title to the stock in a holding company. In other words, if a buyer acquires the shares of an existing corporation, technically there is no change in the recorded owner of the property (i.e. the corporation still owns the property).

However, if a property is acquired through forming a new company that takes title to the property directly from the previous owner, all transfer taxes and taxes stamps must be

paid due to a change ownership at the Public Registry. In this respect, Costa Rican law establishes that all costs (Notary Public fees, tax stamps and transfer taxes) shall be borne by buyer and seller equally. The main reason for buying the property directly vis a vis buying the stock in a company is that the latter involves a risk for the buyer of acquiring an existing corporation that may have other liabilities; thus, there is no way to verify 100% that the corporation is clean from any such contingencies and/or liabilities.

TAXES

The fiscal year in Costa Rica begins on October 1 and ends September 30 of each year. The tax returns are due by December 17 of each year.

Costa Rica abides by a limited territoriality concept in taxation. This means that Costa Rica only taxes income that is derived from a Costa Rican source. The Costa Rican tax law provides that all individuals or legal entities that carry business or trade activity for profit within Costa Rica is subject to a tax on their income.

Taxable income in Costa Rica is based upon net income. In order to arrive at net income it is necessary to establish the gross income derived by the taxpayer and deduct from that the necessary business expenses and deduction specifically authorized by the tax law.

Inscription as a taxpayer

This inscription is required to all those who perform one or more commercial activities.

General requirements:

Foreigners:

- 1) A form given by the Tributary Administration Offices, duly completed,
- 2) Passport (original and a copy).

Corporation or a limited liability company:

- 1) A form given by the Tributary Administration Offices, duly completed;
- 2) Identification document (original and a copy), and;
- 3) Bylaws of the Corporation and legal capacity certificate.

Corporate Income Tax

A corporation's net profits are taxed according to their annual gross income as follows:

Income Tax Rates applicable to companies

2004 Gross income amount	2005	2006	Tax Rate
Up to 21.468.000	Up to 24.381.000	Up to 27.811.000	10%
Up to 43.183.000	Up to 49.043.000	Up to 55.943.000	20%
Excess of 43.183.000	Excess of 49.043.000	Excess of 55.943.000	30%

Amounts expressed in Colones (local currency). Consult current exchange rate @ www.bccr.fi.cr

Gross income includes earnings, benefits and rents, whether in cash or in kind. Companies may deduct from gross income all the costs and expenses necessary to produce taxable income or to protect their investments. Partnerships are treated as corporations independent of their partners and are liable for corporate taxes on net profits.

Capital gains or and losses on non-depreciable assets or shares of other companies, are excluded for income tax purposes. Foreign source income is not taxed.

Deductions corporations can take against gross income:

- 1) Expenses necessary to produce taxable income are deductible provided they are duly recorded;
- 2) Bad debts provided that evidence of legal action to collect exists;
- 3) Payments to residents or nonresidents for rent, royalties, technical or financial assistance, trademarks, franchises and similar items;
- 4) Taxes paid, except income, sales and consumption taxes or related penalties;
- 5) Interests payments on business loans, as well as the costs of obtaining said loans;
- 6) Loss of assets and casualty losses not covered by insurance;
- 7) Contributions to a recognized cultural or charitable institution;
- 8) Local insurance premiums, and;
- 9) Foreign exchange losses, except when related to the acquisition of fixed assets.

Municipal, Permit and Stamp Taxes

Costa Rica has no state nor city income taxes. There are, however, minor municipal taxes, operation permit fees and stamp taxes. Stamp taxes are levied on most legal documents.

Municipal tax: this tax includes:

- | | |
|---------------------|--|
| Territorial tax: | 0.25% of the value of the property |
| Municipal services: | from \$0.50 to \$2.45 for every meter of garbage recollection.
from \$0.75 to \$1.87 for cleaning |

Operation permit or warrant tax: 0.035% (every trimester) from the gross income of the company

Education and Culture Stamp Tax

An education and culture statutory stamp tax is imposed annually, with fees ranging from \$2 to \$24, based on the capital stock of the company.

Sales Tax

The general sales tax is a value added tax which is levied on the sale and import of goods and the rendering of specified services. The tax is applied in such a way that, through a

system of shifts and credits, the tax is charged only once on the various transactions in chargeable goods. The normal sales tax rate is 13%.

Municipal Warrant

Any lucrative activity requires a warrant from the municipality where the activity develops. This type of warrant implies an extra tax payment during the operational time of the company.

Costa Rican Tax System and its Relevance in Real Estate Transactions

Costa Rican income tax system is based on the "territoriality principle" whereby only income generated within the physical territory of Costa Rica and from Costa Rican based sources is subject to income tax. Article 1 of the Costa Rica Income Tax Law (ITL) states that the tax is imposed on occasional or continued revenues received by individuals or entities, perceived within the national territory, irrespective of the nationality or domicile of the recipient.

According to the said article 1 ITL, revenues, income, or benefits from a Costa Rican source are those derived from services rendered, goods located or capital invested within Costa Rica during a specific tax period. Therefore, income ensuing from services rendered abroad is not considered a Costa Rican source of income and is not considered taxable under Costa Rican law. Hence, since Costa Rican tax legislation is based on a source-based taxation system, all income generated within Costa Rica is taxable irrespective of the fact that the individual is a Costa Rican national or an expatriate. Consequently, income tax is applied on all income earned within Costa Rica or from Costa Rican sources, regardless of the taxpayer's citizenship, domicile or residence.

Notwithstanding the preceding, if the individual is considered to be domiciled in Costa Rica for tax purposes, a net Income Tax will be applied on any profits generated by such individual or entity. If the individual or entity is considered to be a non-resident or non-domiciled taxpayer, Withholding Tax on Remittances Abroad applies to the gross income remitted abroad.

Profits from Operating a Real Estate Business Whose Inventory is Land

The Costa Rican tax system does not tax capital gains unless these ensue from the sale of depreciable assets or from the sale of non-depreciable assets sold in the ordinary course of a trade or business (i.e. the activity to which a business or individual is primarily dedicated to, performed in a public and periodic manner).

In this respect, the current criteria of not taxing capital gains is currently being discussed in Congress and there is a chance that, in the near future, such tax exemption may disappear. This project also contemplates the possibility of extending taxable events to activities performed outside the territory of Costa Rica. None of these amendments to the tax system have been implemented, nor are they a concrete reality; however, the fact that

such changes are being entertained is worth considering when planning the tax exposure of future real estate developments in Costa Rica.

Going back to the current scenario and, based on the aforementioned elements, profits obtained from operating a real estate business whose inventory is land may be considered as taxable income when referred to an on-going business. In other words, if an individual or entity sells one or two pieces of property within a tax period, such activity will not be considered as habitual practice for capital gains purpose.

The concept of “habitual practice” is defined in the Income Tax Law, as well as in reiterated tax judgments. According to this concept, “habitual practice” must be understood “as the activity to which a business or individual is primarily dedicated, which is performed in a public and periodic way, and to which most of the taxpayer’s time is dedicated.” However, there is no fixed parameter of time in order to define habitual practice, thus, the existence of habitual practice can only be determined on a case-by-case basis.

It is important to emphasize the fact that it is not relevant whether the income is generated by a domiciled or non-domiciled individual or entity, for our system is based on the territoriality principle.

Dividend Distributions from a Real Estate Company to Foreign Shareholders

Dividends paid from a Costa Rican entity to a non-domiciled entity are taxed with a 15% withholding tax on remittances abroad.

Tax Rates applicable to Foreign Remittances

ACTIVITY	RATE
Transport and communications	8.5%
Retirement and pension, salaries and likewise	10%
Fees, commissions, diets and other similar personal income.	15%
Reassurance, refinancing and insurance premiums.	5.5%
Use of movie films for television, recordings, records and any other means of public broadcasting, as well as use of international news footage.	20%
Radio and TV soap operas	50%
Dividends and income ensuing from entities recorded in stock markets and other official Institutions.	5%
Dividends and income ensuing from entities not recorded in stock markets and other official Institutions.	15%
Commercial leases.	15%
Interests, commissions and other financial expenses.	15%
Technical or Financial Support, or other support related to patents supply of formulas, trademarks, privileges, franchises and royalties.	25%
Other remittances not contemplated in previous sections.	30%

Fee Structure

For details of our fee structure please contact our offices directly.

CONTACT US:



TEL.: (506) 201-8700

FAX: (506) 201-8707

www.faciolaw.com

info@faciolaw.com