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FOREIGN INVESTMENT IN COSTA RICA: THE LEGAL FRAMEWORK

HUMBERTO PACHECO A.*

Before discussing the legalities of foreign investment in any country, it is advisable to describe — in general terms — the country and its people. In this age of social unrest, racial turmoil and revolution, this information is essential for the prospective investor.

Costa Rica is a law abiding country ruled by a popularly elected government. It prides itself in being among the first democracies in the world. Its political structure is based on Montesquieu's division of powers — legislative, executive and judicial. In Costa Rica the latter is in fact the strongest of the three. There is a fourth power not officially established at the level of these other three by the Constitution, but which is of comparable importance to the others — the Electoral Tribunal. This Tribunal, composed of five magistrates having no nexus with the Government, rules over the popular elections held every four years to elect the President, Congress and the Municipalities. The political system is similar to that of the United States of America, but the President is not eligible for a second term of office. The philosophy of this constitutional precept rests in the concern for the continuation of power, i.e. that the exercise of Presidential powers tends to make a man excessively strong, thus endangering democracy. This is conducive to an evil which affects many Latin American nations today — dictatorship. Furthermore, the President of the Republic cannot participate actively in politics during his term in office, nor can he promote any candidate whatsoever.

It is of interest to note that during the past twenty-five years, with no previous political agreement, the opposition party has consistently won the elections.

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Another factor worth mentioning is that Costa Rica does not have an army. The Army was abolished, and its reinstatement prohibited by the Constitution of 1949. Security is entrusted (with highly satisfactory results) to a body of two thousand five hundred policemen who normally do not carry guns. This is clear evidence of the civic spirit of the Costa Ricans who number 1.8 million. At a meeting of the Inter-American Association for Democracy and Liberty held in New York on October 17, 1970, Arthur Schlesinger referred to Costa Rica as being "the most civilized country in the world" for having abolished the Army.

The population is composed largely of people of Spanish origin, partly of other Europeans, and of Asians and Africans. There are no racial or religious problems; the literacy rate is among the highest in the world.

As previously stated, the Judicial Power is in fact the strongest although the Constitution dictates the equality of the three branches of government. In a conflict of interests between the Government and private enterprise — national or foreign — rulings against the Government are not a rarity.

Insofar as the economy is concerned, the country is in the process of tremendous growth, its gross national product per capita being among the highest in Latin America. There are no exchange controls or currency limitations. The national currency is called the *colón* which is broken down into one hundred *céntimos*. One dollar is worth six *colones* and sixty-five *céntimos*; there has been no change in the exchange rate for the last twenty years. Even during the period of 1966-69, in which there were exchange restrictions for nationals, foreigners could register their investments at the *Banco Central* (Federal Reserve Bank) and thereby insure repatriation of their investment and earnings at the rate of 6:65.

Industry is flourishing due mainly to the moral integrity of the Government and the existing legal structure which has encouraged investment both by nationals and foreigners. A large number of American and European companies have established factories in Costa Rica.

The climate of the Central Plateau — where San José is located — is very temperate. It has been said often that San José is air conditioned by nature. The country is bordered east and west by the Atlantic and the Pacific Oceans respectively; north and south by Nicaragua and Panama. The main products are coffee, bananas and cattle, both dairy and beef.

Costa Rica has excellent air connections with the United States and other countries. Telephone, cable and telex services with the rest of the world and internally are likewise excellent.

DOING BUSINESS IN COSTA RICA

The right to engage in any legitimate business is granted to nationals and foreigners alike, whether they be natural or juristic persons. The Constitution, in Article 19, grants aliens the same rights as nationals, except for political rights which are reserved to Costa Ricans. The Commercial Code establishes the requisites to be a "merchant", and also contains a detailed account of the types of companies which can be formed in the country. The Code also covers the requirements that a foreign corporation has to fulfill to open an agency or branch, or to appoint a representative in the national territory.

A natural person can engage in business *per se*, but business prudence dictates limiting personal liability and this can only be achieved through the concept of the juristic personality. The following is a description of the types of juristic persons which can be organized in Costa Rica.

INDIVIDUAL ENTERPRISE OF LIMITED LIABILITY

The individual enterprise of limited liability (*empresa individual de responsabilidad limitada*), henceforth called enterprise, is a very particular form of juristic person which originated in Liechtenstein. Different from all other forms of juristic personality in Costa Rican legislation, the enterprise can be formed by a single person in lieu of the two necessary in other cases. Furthermore, it can only be formed by a natural person, as opposed to the other types of juristic entities which can be constituted by natural persons, juristic persons or a combination of both.

The enterprise is formed before a Notary Public in the manner described subsequently in the section dealing with the formation of juristic persons. Its most important features are: (1) that it is created to handle specific aspects of a person's business with liability limited to the amount of capital assigned to it, and (2) its administrative simplicity. It only requires a manager—who can be the owner or a third person—with broadest powers of attorney.

COLLECTIVE COMPANY

The collective company (*sociedad en nombre colectivo*) is a "family" type of business association no longer being used in Costa Rica, mainly

because it does not limit the liability of the owners. It is comparable to the general partnership of common law countries.

COMMANDITE COMPANY

The commandite company (*sociedad en comandita*) is a juristic person which requires at least one financial associate and one working associate. The former are called commanditaire or limited partners and their liability is limited to the extent of the capital furnished by them. The latter are known as general partners and are jointly and severally responsible. It should be noted, however, that if the commanditaire partners participate in the administration of the company their liability will be equal to that of the general partners. This type of company is not used very frequently in Costa Rica. It is similar to the limited partnership of common law countries.

LIMITED-LIABILITY COMPANY

The limited-liability company (*sociedad de responsabilidad limitada*), henceforth referred to as the company, is one in which the partners' liability is limited to the extent of their capital contribution. At least two persons — natural or juristic — are required to form it, but its status is not altered by the fact that a single person may become sole owner of the totality of the interests or the *cuotas* which represent the social capital. These *cuotas* are nominative and can only be transferred by cession or assignment.

The company resembles a combination of a partnership and a close corporation in common law countries, and for taxation purposes it can be structured as a partnership. Its administration is very simple as it only requires a manager with broadest powers of attorney. Thus, it meets the tests of limitation of liability and administrative simplicity.

STOCK CORPORATION OR CHARTERED COMPANY

The stock corporation or chartered company (*sociedad unónima*), henceforth called corporation, is the most widely used juristic person in Costa Rica. As in the limited liability company at least two incorporators — natural or juristic — are needed at its inception, but eventually a single person may become sole owner of all the shares without altering the legal status of the corporation. The liability of the shareholders is limited to the extent of their capital investments in accordance with modern corporate principles. The corporation can be formed with either nominative

or bearer shares. The former are transmitted by endorsement; the latter by simple exchange or delivery.

In the bearer share corporation — the authentic anonymous society — the incorporators do not necessarily have to be the owners because once the corporation is registered the shares can be transmitted to the real owners without the necessity of any special procedure. In this manner an investor wishing to keep his identity unknown from third persons insures privacy regarding his investments and business activities. Nevertheless, bearer shares can only be issued when their entire value has been paid. If not, the shares issued will be nominative until fully paid. Furthermore, no non-par value shares may be issued in Costa Rica.

A corporation is administered by a Board of Directors or Administrative Council composed of a minimum of three persons. The Board or Council is supervised by an inspector or overseer (*fiscal*), appointed by the Stockholders' Assembly, and he reports to the latter on the activities of the Board or Council. The *fiscal* is not a member of the Board of Directors and has no authority to represent the corporation in any manner whatsoever.

Both nominative and bearer share corporations may be established either privately (close corporation) or by public subscription. The organizational procedure is set forth in a subsequent section. It should be noted that there is no such entity in Costa Rican legislation as the Securities and Exchange Commission, although efforts being made by the National Chamber of Finance, Investment and Credit to create a stock exchange could eventually lead to the creation of some sort of surveillance agency.

A corporation can hold its board and stockholders meetings in or outside of Costa Rica. Provision for the latter may be made when drawing the constitutive charter.

The stock corporation, as in other jurisdictions, has proven a very valuable type of business association in Costa Rica. Nevertheless, due care should be taken when establishing such an association to ascertain that all the elements necessary to make it functional are dealt with, including the tax considerations. Costa Rican legal counsel should be retained for this purpose to insure harmonization of the provisions of the diverse laws bearing on the subject.

ESTABLISHMENT OF A BRANCH OR APPOINTMENT OF A REPRESENTATIVE OF A FOREIGN CORPORATION

In some cases, foreign investors may prefer to use their existing corporate structures to operate in Costa Rica rather than to create a juristic person under local legislation. Taxation, accounting problems or

business policy may inspire such a decision. This may be done in one of two ways: (1) establish a branch or agency under the management of an attorney with broadest powers (attorney here is not intended to mean a lawyer, only a representative), or (2) appoint a representative with broadest powers. In either case all the documents required by the Commercial Code (Articles 226 to 233) should be duly authenticated by the Costa Rican consul prior to registration in the Public Registry.

CREATION OF A JURISTIC PERSON AND ITS REGISTRATION IN THE MERCANTILE SECTION OF THE PUBLIC REGISTRY

Three elements are essential for the formation and existence of a juristic person: (1) execution of a public document containing the constitutive charter before a Notary Public; (2) publication in the official newspaper, *La Gaceta*; and (3) registration of the constitutive charter in the Mercantile Section of the Public Registry.

The Notary Public in Costa Rican law is invested with public faith and all civil legal acts of importance should be executed before him in order to create a valid public instrument. (Contracts and other civil acts may also be executed privately by the parties involved, but the resulting documents are not as legally effective as those executed with the assistance of a Notary Public.)

To be a Notary Public a person must be Costa Rican by birth or, if naturalized, of Central American origin as long as the nation of origin grants reciprocity. Furthermore, such person must be a member of the Costa Rican Bar Association.

The Notary Public keeps a book known as the Protocol in his custody where he inserts all the legal acts executed before him: the resulting document is called a public writing (*Escritura Pública*). The Protocol contains one hundred pages with two sides to each page, and once it is filled the Notary Public has to turn it in to the National Files of the Government. Moreover, he must render written reports to said office every fortnight detailing all the negotiations brought before him during the preceding two weeks.

When two or more incorporators come before a Notary Public with the intention of organizing a company (one individual in case of the individual enterprise of limited liability) the Notary inserts the constitutive charter of the company in his protocol. A copy called a "testimony" is then issued and sent to the Internal Revenue Department where note is

taken of the legal act which has been consummated. The document is then returned to the Notary. Simultaneously the Notary Public sends a summary of the charter for publication to *La Gaceta*. Finally the testimony is sent to the Public Registry where it is recorded in the books of the Mercantile Section. There the public has free access in order to obtain information about the corporation.

Once the testimony is registered in the Public Registry, it is returned to the Notary Public who orders the shares or *cuotas* printed. All the documentation is then turned over to the President or Manager. The whole process takes approximately two weeks. Any changes in the articles of incorporation have to follow the same procedure.

A registry fee is paid for incorporation and for subsequent changes in the articles of incorporation, but there are no annual charges for operating a corporation. The incorporation fees, listed in Appendix A, are in accordance with the amount of the social capital of the company.

POWERS OF ATTORNEY

In Costa Rica the mandate contract (*mandato*) is subject to the regulations contained in the Civil Code. Articles 1251 to 1300 spell out the extent of the powers which can be delegated to the attorney by the principal, as well as the resulting rights and obligations of the contracting parties. Articles 1253, 1255 and 1256 describe the more commonly employed powers of attorney: broadest power of attorney (*poder generalísimo*), general power of attorney (*poder general*), and special power of attorney (*poder especial*); Article 1289 outlines the judicial power of attorney (*mandato judicial*).

The contract by which a *mandato* is granted can be drawn up in a public document before a Notary Public or in a private document. It can also be agreed upon orally. However, the broadest power of attorney and the general power must be granted before a Notary Public and recorded in the Public Registry. The resulting instrument is called a *poder*. These will only affect third parties as of the date of their inscription in the Public Registry.

The contract of *mandato* is considered in effect when accepted by the representative; acceptance may be either expressed or implied. Implied acceptance will be presumed by any act on the part of the representative in furtherance of the power of attorney granted, except in cases necessary to prevent the principal from incurring any losses whilst another attorney is appointed.

An attorney granted broadest powers to represent his principal can handle the business as if the principal himself were acting in his own behalf. He can sell, mortgage or in any other way alienate the principal's assets; he may accept or repudiate inheritances; act in court; execute all types of contracts and juridical acts except those which by their personal nature must be executed by the principal; or those acts for which the law expressly requires a very special power of attorney (*poder especialísimo*).

The broadest power of attorney can also be granted to carry out single or a few undertakings. The authority granted may be for limited or unlimited sums of money.

The general power is a power of administration by which the principal invests the representative with sufficient capacity to manage his affairs. As in the case of the broadest power, it can be granted for all the dealings of the principal, or for just single or special ventures. The monetary amounts may be limited or unlimited.

The special power of attorney is limited to those acts expressly described therein and excludes even those which may be implied from it. The fulfillment of its purpose brings about the termination of this power.

Another form of *mandato* is the judicial mandate. It can only be granted to an attorney at law and is designed to be used for proceedings in court. The attorney may appear in court as plaintiff or defendant in the name of his principal in connection with any business which concerns such principal; he may follow the action to its conclusion; use all the ordinary and extraordinary remedies and appeals available; transact; submit to arbitration; request depositions and give testimony; attest documents; receive money and extend the corresponding receipts; grant and cancel deeds; renounce any procedure; challenge judges and do anything else that the principal himself would do to achieve his objectives. In general, regulations governing powers of attorney apply to the judicial mandate.

TAXATION

Income Tax

Current tax systems of most countries provide for double taxation although subject to certain deductions and credits conferred to tax payers for income earned and taxed abroad. Dividends declared by a company

which has paid taxes on its earned income are usually subject to a second tax when they reach the shareholder. This, plus a high rate of taxation tend to diminish the individual's incentive to increase his income once he reaches a certain earning bracket.

Concerning the above, Costa Rica offers the foreign or national investor a very attractive system. Article 2 of the Income Tax Law reads: "Natural and juristic persons whose domicile is in Costa Rica will pay a tax on income from sources within the country, and non-resident aliens or foreign corporations will pay a tax on income derived from assets, enterprises or businesses located or having effect in Costa Rica. . . ." Thus in contrast to other countries, nationals and resident aliens *do not* pay taxes on income derived from sources without the country.

Branches or agencies of foreign corporations are subject to a special tax equivalent to $\frac{1}{2}\%$ of their net income per annum in addition to the regular income tax levied on nationals, but even then the effective total tax rate is very reasonable.

Capital gains are not taxed except when they result from the usual business of the taxpayer. Such is the case of capital gains of land development companies. In the case of installment sales, however, the tax paid is proportionate to the cash flow.

Article 8, Section 7 of the Income Tax Law taxes non-resident aliens with a flat 20% rate which must be withheld at the source. Said article refers expressly to "salaries or remunerations paid (in Costa Rica) to persons, members of the Board of Directors or management of companies operating outside the country; honorariums and other remunerations paid for technical, financial or other types of counsel rendered from a foreign country; as well as for amounts paid for use of patents, formulas, trademarks, privileges, franchises, royalties or other similar payments to persons with a foreign domicile. . . ." This tax makes no allowance for business deductions or personal items.

Both natural and juristic persons are taxed in accordance with the tax-rate table set forth in Appendix B. This table establishes a maximum tax-rate of 30% on earnings of five hundred thousand *colones* or more per year (approximately seventy-five thousand dollars).

Dividends paid out by *de jure* or *de facto* companies which have paid income tax on their earnings are tax free for the recipient; the taxpayer's only obligation being to report the dividends in his income tax return for information purposes. Thus, taxation of earnings of companies takes place only at the corporate level.

The social capital of companies is not subject to tax, and neither are the profits earned by a corporation through the sale of treasury stock at higher than face value.

Care should be taken when establishing a company to avoid placing 51% or more of its social capital in the hands of one single person. Such a person will be considered the owner of the company and his tax return will be consolidated with that of the company for income tax purposes. In accordance with Article 9 of the Commercial Code regarding individual enterprises of limited liability such consolidation is automatic in all cases.

Land or Territorial Tax

Law No. 27 of 2 March 1939, as amended, establishes a tax on real estate called a land or territorial tax. This tax is levied in favor of the Federal Government and, as in the case of the income tax, is very reasonable. It taxes land and all permanent buildings, installations, and plantations contained therein.

A number of assets are exempted from this tax, all of them of a public or semi-public nature. For example, State, Provincial, Municipal and Board of Education properties provided these are not in the possession of private parties as a result of concessions. In such cases the private party must pay the tax.

Also exempted from this tax are lands owned by private education centers which have been officially recognized; charitable and religious organizations of any denomination as long as these are permitted by law; and buildings of foreign missions. Lands of those persons whose real estate holdings do not exceed ten thousand *colones* and lands occupied by houses built by employers for the free use of their farm labor are also exempt.

The land tax rate table follows:

From ₡ 10.000,00 to ₡ 250.000,00	0.30% per annum
From 250.001,00 to 500.000,00	0.55% per annum
From 500.001,00 to 3.000.000,00	0.80% per annum
From 3,000.001,00 on	1.05% per annum

ESTATE TAXES

Succession Tax

A third great area of tax concern relates to estate taxes. A larger number of businessmen are planning their estates in order to avoid the

full impact of taxation on their estates. As in the previous two areas, Costa Rican taxation laws are very favorable to the taxpayer.

All inheritances, whether testate or intestate, of nationals or foreigners, are subject to a succession tax based on their net value. The law states that net value means the value of the estate after funeral expenses and other valid debts have been paid. It excludes from the taxable portion of the estate that part which goes *per lege* to the surviving husband or wife, as well as the contributions of the surviving spouse in the cases where a conjugal society had been established.

The estate of a foreigner will be taxed in accordance with his holdings in Costa Rica, but Law No. 10 of 3 December, 1937, makes an exception regarding certain assets of a non-resident alien. Under Article 3, the following will be exempted from this tax—mortgages, chattel mortgages, mortgage bonds and chattel mortgage bonds belonging to the estate of a non-resident alien.

The tax-rate table found in Article 5 of said law is structured on a gradually ascending scale and has a maximum tariff of 9% for amounts in excess of ₡1,000,000.00 (approximately \$150,000.00) when applied to ascendants or descendants or the spouse. In cases in which the estate passes to the brothers or sisters, nephews or nieces or uncles or aunts of the deceased, a surcharge of 50% is added to the liquidated tax. If the estate passes to other relatives of the deceased or to strangers, the tax applicable will be twice the amount established by the table. The applicable table is found in Appendix C.

The succession tax must be paid by the Administrator, with estate funds, within a period of six months from the date on which the death occurred.

It should be noted that Article 24 of the above-mentioned law presumes that all collective or stock companies formed between spouses themselves or with their ascendants, descendants, immediate relatives or dependent employees are established for the purpose of evading inheritance taxes. This will lead to the imposition of the succession tax, upon the death of the incorporator, on all the company's capital as if it were a personal asset.

It should also be noted that the law makes an exception regarding such companies when these are founded by non-resident aliens for the purpose of making investments in Costa Rica provided such investments are guaranteed with mortgages, mortgage bonds, chattel mortgages or chattel mortgage bonds.

In the case of a stock corporation the bearer shares subscribed by the incorporators will pay inheritance taxes on their appraised value if the incorporator dies within a period of five years from the date of the establishment of the company.

Chartered companies incorporated by relatives or with dependent employees cannot issue bearer shares. Article 25 of the law establishes that these must issue nominative shares which should be registered with the *Tributación Directa* (Internal Revenue Department). The law, however, makes an exception in the case of non-resident aliens referred to in Article 24.

University Stamp Tax

The other important tax levied on estates is the University Stamp Tax instituted by Law No. 2837 of October 17, 1961. The University of Costa Rica is a state-owned, decentralized, self-governing institution. This tax was created to help support and enlarge this institution which currently enrolls approximately 15,000 students.

The University Stamp Tax is assessed in the same manner as the succession tax and must be paid to the Treasury of the University within twelve months from the date of death. The tax-rate table for this tax and its related rules is identical to that of the succession tax. Thus, the table contained in Appendix C is applicable. Because the principles of the succession tax law are in line with those of the University Stamp Tax law, the same general comments made with respect to the former apply to the latter law.

TAX EXEMPTIONS ON LOANS FROM FOREIGN OFFICIAL BANKS

Law No. 1814 of October 21, 1954 expressly exempts principal and interest of loans from foreign official banks to Costa Rican enterprises (public or private) from any national or municipal taxes, present or future. This same law exempts securities of Autonomous Institutions of the State and banks of the National Banking System (public or private) and their interest from any such taxes.

BANKING

Costa Rica's rather unique banking structure provides for a State monopoly under which the acceptance of deposits from the public is re-

stricted to national banks owned by the State. This has caused many controversies and it is sometimes erroneously said that Costa Rica's banking system is completely nationalized.

BACKGROUND

Prior to the Revolution of 1948 the banks of Costa Rica were privately owned. At the beginning they were mainly in the hands of foreigners; gradually local capital appeared on the scene. Private ownership, plus scant governmental control in the matter of the credit policies to be followed by the banks in the administration of deposits received from the public originated a series of injustices and deficiencies. The main problems resulted from the way in which loans were granted, since it was essential to have very good leverage in order to be favored with a low interest bank loan. The alternative to the borrower was to recur to a loan shark who ended up by taking over whatever equity the debtor had put up as guarantee. Often the loan shark happened to be an important shareholder of the bank which had denied the credit.

Law No. 1644 of September 26, 1953 attempted to correct these and other deficiencies by establishing a system in which the deposits of the public would be administered through State-owned banks.

BANKING OPERATIONS

The system distinguishes between State banks, commonly known as national or public banks, and private banks. Public and private designations shall be used hereafter to differentiate between State-owned and privately owned banks.

Except for the deposit restrictions mentioned above, both public and private banks can perform all other commercial banking operations. That is, private banks may issue stock and debentures; lend money; discount paper; open credit lines; make advances on goods; grant special, commercial, or firm credits; sell money orders and drafts; effect transfers; issue letters of credit; act as brokers, commissioners or trustees; lease safety deposit boxes; own and operate bond warehouses; and, in general, exercise all banking activities except the acceptance of deposits from the public.

THE BANKING SYSTEM

The national banking system of Costa Rica consists of the following entities:

1. Central Bank of Costa Rica (Federal Reserve Bank in some countries).
2. State-owned or Public Banks (Currently the existing public banks are Banco Nacional de Costa Rica, Banco de Costa Rica, Banco Anglo Costarricense, Banco Crédito Agrícola de Cartago and Banco Popular y de Desarrollo Comunal).
3. Commercial Private Banks formed in accordance with Section VI of the Organic Law of the National Banking System (At present said banks are Banco Lyon and Bank of America).

All these banks are commercial banks with the exception of the Central Bank of Costa Rica, which is the comptroller bank. They are regulated by the Organic Law of the National Banking System; the Central Bank has its own organic law.

Public banks are autonomous, decentralized institutions governed by a Board of Directors. They are juristic persons and the law expressly indicates that the Executive Power cannot interfere with their management nor oppose their decisions on matters relating to their own activities. Their operations must adhere strictly to the mandates of the Constitution, the law and the corresponding by-laws.

Commercial banks may act as correspondents or agents to first-rate foreign banks and appoint these as their agents or correspondents in foreign countries.

A very interesting characteristic, and certainly a safeguard for depositors, is that the public banks of Costa Rica cannot become insolvent. The State guarantees the operations of all public banks and thus bankruptcy is ruled out. Moreover, the law establishes that all State departments and public institutions must give public banks any cooperation required.

In accordance with the provisos of the Organic law of the Central Bank, public as well as private banks are under the surveillance of the General Auditor of Banks, who can inspect books and financial statements at any time. During the first fifteen days of each month the General

Auditor will order publication in *La Gaceta* of the financial statements of all commercial banks during the previous month.

Public banks are required to have a Board of Directors appointed by the Council of Government, a body composed of the President of the Republic and the Cabinet Ministers. To be a member of the Board of Directors of a public bank it is necessary to be a Costa Rican either by birth or, if naturalized, with no less than ten years residence in the country. Other requirements are set forth in Articles 21, 22 and 23 of the above-mentioned law. Among these: minimum age of twenty-five years, banking or commercial experience, and a fidelity policy or other form of guarantee. Members of the boards and employees of other banks, members of the three powers of government, and managers and employees of the same banks, as well as delinquent debtors or insolvents and relatives of other directors may not be directors.

Members of the Board are elected for periods of four years and may be re-elected indefinitely, but they cannot be removed before their terms expire unless they cease to comply with the above-mentioned prerequisites or they incur in any of the faults detailed in Article 25 of the law.

Members of the Board of Directors of public banks may not participate actively in politics though they may exercise the right to vote. This restriction extends to Managers, Chiefs and Assistant Chiefs of Departments and Sections.

Each public bank is required to have a Manager and two Assistant Managers appointed by the corresponding Board of Directors. They are in charge of the management of the bank and are directly responsible to the Board of Directors.

BANK DEPOSITS

Article 59 of the banking law of 1953 establishes that only public banks can accept deposits in cash from the public and invest them in commercial or credit operations. This is in accordance with the policy of nationalized bank deposits, which prohibits this activity to private banks.

This limitation has been the cause of vehement protests from certain sectors of the public which feel that private banks should also be given the right to accept deposits. These groups have advocated solutions ranging from total freedom for private banks to receive deposits to the establishment of a combined entity owned partly by the State and partly by private parties.

The rationale for reserving the right to public banks is sound. Engaging in business and risking one's own capital is one thing; making a profit with very little investment and with the use of the public's money is another. Also, it must be remembered that most of the groups able and willing to engage in the banking business are foreign. This means that the profits generated by the public's deposits will generally leave the country in the form of dividends. This escape of the nation's riches is not compensated by services of a very special or beneficial nature such as banking. There is basically no reason why the administration and distribution of public funds obtained through deposits should be placed in the hands of private banks, local or foreign, when this can be better achieved through the State-owned banks. It is easier to understand this position knowing that the larger foreign banks have consistently said that they will not bring into the country large amounts of capital but would — if given the chance — operate mainly on the public's deposits. Hence, not even a foreign investment benefit would be attained by modifying the law.

Another reason worth considering is that private banks — rightly so — will direct the investment of their portfolios towards the more productive fields. Public banks assume a more civic attitude and try to provide assistance where it is most needed for development. They balance their profitable commercial portfolios with others less profitable and even with those which are losers, but which are necessary for the socio-economic development of the nation.

The foreign banks which have come into Costa Rica in recent years seem to understand this point of view. Jointly with local private banks they will benefit from other investment opportunities currently under study by the Government, the National Chamber of Finance, Investment and Credit and by other public and private entities. Their objective is to make Costa Rica a financial haven where both nationals and foreigners — in accordance with the equality granted by the Constitution — may work in peace and for profit.

Public banks may accept deposits either in *colones* or in foreign currency. Furthermore, a checking account in U. S. dollars may be opened at any of these banks without restrictions as to the use of these funds.

PRIVATE BANKS

The operation of private banks is regulated by special rules contained in Articles 141 to 177 of Law No. 1644. These articles establish that

private banks shall operate by means of corporations which, in contrast to commercial chartered companies, can only issue nominative shares and which require at least ten incorporators. The maximum term for which these corporations may be organized is thirty years, but they may be renewed with the authorization of the Central Bank.

No bank may operate until the Central Bank has granted the corresponding authorization. This must be preceded by a favorable opinion from the General Auditor of Banks.

Private banks are required to have a Board of Directors whose members may not be managers or employees of the same or other banks.

Private banks may engage in all spheres of banking except those reserved exclusively to public banks, namely the acceptance of deposits from the public. Their capital may not be less than five million *colones*, and it must be entirely subscribed and paid in. Prior to commencing activities the entire capital must be deposited in the Central Bank.

The total organization and installation expenses may not exceed 20% of the initial capital and must be totally amortized within five years.

The social capital of the bank may be increased at any time by means of a modification of the articles of incorporation. It may also be decreased — with the authorization of the Central Bank — to the minimum amount required for incorporation.

Net gains per semester of private banks will be distributed as follows:

- 1) 10% to the Legal Reserve.
- 2) 10% to a retirement fund for employees of the bank.
- 3) The balance for dividends to shareholders, or any other purpose determined by the Board of Directors with the consent of the General Stockholders Meeting.

Dividends may not be paid in shares and therefore, if shareholders agree to reinvest them in the corporation, a regular capital increase will be necessary. This will take place in the form of a modification to the articles of incorporation.

Concerning taxation, dividends of bank corporations, as those of all other corporations in Costa Rica, are tax free.

Regulations for corporations contained in the Commercial Code apply to private banks in the absence of specific provisions in the law.

INDUSTRIAL INCENTIVES

Industry and commerce have probably received the most governmental backing in the last twenty years, both in Central America in general and, specifically in Costa Rica. Government aid has been in the nature of fiscal incentives such as exemptions from custom and consular duties, income taxes and similar burdens. Law No. 2426 of September 3, 1959, also known as Law of Industrial Protection and Development, was the original statutory enactment.

The promulgation of this law represented a tremendous fiscal sacrifice on the part of the Government which stopped receiving large sums lost through extensive exemptions of customs duties and taxes. However, a ten year period of great industrial development resulted for the nation.

This local effort was enhanced by the decision of the five Central American nations — Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica — to lift their tariff barriers on products manufactured in the area and raise those on foreign competitive products, i.e., to establish the Central American Common Market (CACM). The Treaty of Central American Economic Integration, signed in Managua, Nicaragua on 13 December, 1960, culminated efforts begun one hundred and fifty years previously to unify the area. It also represented the efforts of the previous decade to structure an effective common market.

The Uniform Fiscal Incentives Convention of Central America, subscribed in San José, Costa Rica on 31 July, 1962 and designed to come into effect no later than seven years from the above date, has replaced Law No. 2426. The convention specifies what types of industries are entitled to protection and classifies them into three groups as will be seen *infra*.

In addition to its participation in the CACM, Costa Rica concluded treaties with Panama, which is not a member of the common market. These treaties provide that a large number of products manufactured in each country may enter the other country under low duties, or under no import duties whatsoever.

At present the Central American Common Market is suffering from the blow of Honduras' withdrawal. To analyze the causes of this separation would require a lengthy paper and is not the object of this study. It is sufficient to state here that the other member nations are making a tremendous effort to keep the market going, and to bring Honduras back into the organization.

The Convention

The Convention establishes a uniform fiscal incentives regime throughout Central America. It is applicable to the organization or enlargement of manufacturing industries which will contribute to the economic development of the area, and it prohibits the Contracting States from granting any privileges or concessions different from those set forth in the Convention.

An exception is made with respect to the following industries, which will be ruled by national laws:

- a) mining
- b) oil and gas drilling
- c) lumbering
- d) fishing and (maritime hunting)
- e) service industries
- f) agricultural activities
- g) construction of popular housing

The above mentioned exceptions do not include the industrial processing of the products obtained from these activities.

The incentive program is only available to enterprises whose manufacturing plants in Central America produce articles necessary to the development of other productive activities, satisfy basic needs of the population, replace articles imported in considerable amounts, or increase the volume of export products.

The following factors will be taken into consideration when evaluating the service of such plants to the economic development of the area: the importance of the aggregate value in their industrial process; the contribution to a larger use of regional raw materials and semi-elaborated products; and, in general, the use they make of Central American human, natural and capital resources.

The Convention distinguishes between new and existing industries in three groups known as A, B and C. The first group includes enterprises which produce raw materials and capital assets. Also, consumer articles, containers or semi-elaborated products, as long as at least 50% of the products used in their manufacture are of Central American origin.

Group B encompasses all enterprises which produce consumer articles, containers or semi-elaborated products (in which less than 50% of the materials used are of Central American origin). Also those whose products will have a substantial positive impact on the balance of payments, or

whose industrial process has a high aggregate value. Also included in this group are those enterprises which use raw materials, containers and semi-elaborated products which come entirely or to a large extent from outside of Central America.

Group C comprises all those industries which do not meet the requirements of the previous groups, i.e., those which simply assemble goods, as well as those enumerated in Annex 1 of the Convention.

The benefits granted by the Convention include exemption from customs and consular duties for the importation of machinery, equipment, raw materials, containers, semi-elaborated products and industrial combustibles except petrol; exemption, to the enterprise and to its stockholders, from income taxes, except when such beneficiaries are affected by taxes from other nations which make such exemption ineffective; and, exemption from taxes on paid-in capital and on the assets of the enterprises.

The Convention was subscribed by the five Central American nations although, as stated before, Honduras has now withdrawn from the organization. In the interest of the whole community it is hoped that it will reconsider its attitude. Extensive efforts and intensive planning have gone into this project; it must be saved in the interest of all of Central America.

GENERAL COMMENTS

The legal and economic frameworks set forth in this study give the reader a picture of the present investment climate in Costa Rica. In the midst of an increasingly turbulent world, Costa Rica has managed to create a sound legal system with a deep respect for human rights. This augurs well for the foreign investor particularly at a time when most of Latin America is suffering from dictatorships of the right and of the left. Perhaps, the fact that the country was not attractive to the Conquistadores in search of gold and gems; that at the very beginning there was complete religious and racial homogeneity, and that the inhabitants had to live closely united to survive the vicissitudes of the discovery period possibly led to the emergence of a special class of people whose primary objective was to toil the land in peace. This love for peace persists to our day and has resulted in a nation governed by lawyers and legislators rather than soldiers.

In no uncertain way has this civilian spirit influenced the abolishment of the military and the creation of legal entities for the protection of human rights. The emergent peace loving society is proud of its heritage and its respect for the rights of others.

APPENDIX A

PUBLIC REGISTRY TARIFFS
INCORPORATION FEE

		FEE	
For		¢ 1.000	¢ 5.00
From	¢ 1.001 to	2.000	10.00
From	2.001 to	3.000	15.00
From	3.001 to	4.000	20.00
From	4.001 to	5.000	25.00
From	5.001 to	6.000	30.00
From	6.001 to	7.000	35.00
From	7.001 to	8.000	40.00
From	8.001 to	9.000	45.00
From	9.001 to	10.000	50.00
From	10.001 to	12.000	75.00
From	12.001 to	14.000	95.00
From	14.001 to	16.000	110.00
From	16.001 to	18.000	125.00
From	18.001 to	20.000	140.00
From	20.001 to	24.000	150.00
From	24.001 to	28.000	165.00
From	28.001 to	32.000	180.00
From	32.001 to	36.000	195.00
From	36.001 to	40.000	210.00
From	40.001 to	45.000	225.00
From	45.001 to	50.000	250.00
From	50.001 to	55.000	275.00
From	55.001 to	60.000	300.00
From	60.001 to	65.000	325.00
From	65.001 to	70.000	350.00
From	70.001 to	75.000	375.00
From	75.001 to	80.000	400.00
From	80.001 to	85.000	425.00
From	85.001 to	90.000	450.00
From	90.001 to	95.000	475.00
From	95.001 to	100.000	500.00
From	100.000 on, per thousand or fraction thereof, additionally		5.00

APPENDIX B
INCOME TAX TABLE

	ANNUAL		EXCESS	TOTALS
From ₡ .000 to ₡ 3.000	1%	₡ —	₡ 30	
In excess of 3.000 to 5.000	2	40	70	
In excess of 5.000 to 7.000	3	60	130	
In excess of 7.000 to 9.000	4	80	210	
In excess of 9.000 to 11.000	5	100	310	
In excess of 11.000 to 14.000	6	180	499	
In excess of 14.000 to 17.000	7	210	700	
In excess of 17.000 to 20.000	8	240	940	
In excess of 20.000 to 23.000	9	270	1.210	
In excess of 23.000 to 26.000	10	300	1.510	
In excess of 26.000 to 30.000	11	440	1.950	
In excess of 30.000 to 35.000	12	600	2.550	
In excess of 35.000 to 40.000	13	650	3.200	
In excess of 40.000 to 45.000	14	700	3.900	
In excess of 45.000 to 50.000	15	750	4.650	
In excess of 50.000 to 57.000	16	1.120	5.770	
In excess of 57.000 to 65.000	17	1.360	7.130	
In excess of 65.000 to 75.000	18	1.800	8.930	
In excess of 75.000 to 85.000	19	1.900	10.830	
In excess of 85.000 to 95.000	20	2.000	12.830	
In excess of 95.000 to 105.000	21	2.100	14.930	
In excess of 105.000 to 120.000	22	3.300	18.230	
In excess of 120.000 to 135.000	23	3.450	21.680	
In excess of 135.000 to 155.000	24	4.800	26.480	
In excess of 155.000 to 175.000	25	5.000	31.480	
In excess of 175.000 to 200.000	26	6.500	37.980	
In excess of 200.000 to 250.000	27	13.500	51.480	
In excess of 250.000 to 350.000	28	28.000	79.480	
In excess of 350.000 to 500.000	29	43.500	122.980	
ABOVE	30			

APPENDIX C

SUCCESSION DUTY TABLE

1	% on the first ₡5.000,00, as long as the total liquid capital exceeds	₡ 1.000,00
1½	% for the excess over ₡ 5.000,00 and up to	10.000,00
2	% for the excess over 10.000,00 and up to	20.000,00
2½	% for the excess over 20.000,00 and up to	40.000,00
3	% for the excess over 40.000,00 and up to	60.000,00
3½	% for the excess over 60.000,00 and up to	80.000,00
4	% for the excess over 80.000,00 and up to	100.000,00
5	% for the excess over 100.000,00 and up to	250.000,00
6	% for the excess over 250.000,00 and up to	500.000,00
7	% for the excess over 500.000,00 and up to	750.000,00
8	% for the excess over 750.000,00 and up to	1.000.000,00
	and	
9	% for the excess over 1.000.000,00	