



A B O G A D O S
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A T T O R N E Y S

**SELECTED LEGAL ASPECTS OF DOING
BUSINESS IN COSTA RICA**



SELECTED LEGAL ASPECTS OF DOING BUSINESS IN COSTA RICA

This memorandum provides basic guidance to persons or companies that are contemplating establishing business operations in or exporting to Costa Rica. It covers briefly the most important legal aspects of doing business in Costa Rica, whether the operations will (i) serve the national market, (ii) serve the region from Costa Rica as a base or (iii) use Costa Rica as a manufacturing base.

I. FOREIGN INVESTMENT AND EXCHANGE CONTROLS

Costa Rica has no general foreign investment law, and its exchange controls were lifted in 1992. Costa Rican law permits national and foreign companies to operate bank accounts in colones or in dollars, both in Costa Rican banks and abroad. There are no technology transfer requirements. Foreign remittances are taxed (see section on taxation) and some tax incentives include export performance requirements. Costa Rican law currently establishes some industries such as telecommunications, electricity generation and distribution, and insurance services as state monopolies, and prohibits private investment there. Under the Central American Free Trade Agreement with the US (CAFTA), these monopolies would be phased out in the near future.

II. REAL PROPERTY: OWNERSHIP AND LEASING

The general rule in Costa Rica is that foreign persons have the same property rights as Costa Rican nationals. Thus, there are no legal restrictions that would specifically affect a foreign entity or a Costa Rican entity owned by foreign capital that desires to rent or purchase real estate. Costa Rica's Civil Code generally regulates all types of leases in the national territory. In addition to the basic provisions of the Civil Code, urban leases are also subject to a separate Law for Urban Leases.

III. IMMIGRATION LAW

Although ninety-day tourist visas are readily available, work permits may be difficult to obtain. Companies that obtain the status of "recognized company" from the Immigration Authority can benefit from simplified procedures. To obtain "recognized company" status, a Costa Rican employer (including a branch or subsidiary of a foreign company) must have significant capital in Costa Rica (50 million colones — around US\$120,000 at an exchange rate of CRC¢420/US\$) and provide



jobs for fifteen to thirty persons. Employees could be Costa Ricans or from any other country. Administrative proceedings to obtain the labor permit take three to six months on average. In some cases, persons who will be employed in "positions of confidence" (puestos de confianza, e.g., as managers with powers of attorney) may obtain business residence permits without meeting these work permit requirements, but availability of the exception is not assured. If granted, the business residence permit for an "employee of confidence" may be available in as little as one month from the time the corresponding power of attorney is filed with the immigration officials.

IV. COMPANIES LAW

Costa Rican law recognizes a wide variety of organizations, including corporations (sociedad anónima, or SA), limited liability companies (sociedad de responsabilidad limitada, SRL or LLC), general (sociedad en nombre colectivo) and limited partnerships (sociedad en comandita), limited liability individual enterprises, trusts, foundations, civil associations and cooperatives. Foreign companies may operate legally in Costa Rica through local branches, joint-ventures, wholly-owned subsidiaries and other variations of the standard organizations.

Regardless of the method of operation, an enterprise doing business requiring a legal representative in Costa Rica must register with the Commercial Section of the National Registry (Registro Nacional), thus becoming a national enterprise and taxpayer for Costa Rican purposes, regardless of the nationality of its owners or officers. Foreigners may (i) act as officers, directors, partners or trustees in local companies, (ii) make use of negotiable commercial documents and (iii) execute any kind of legal contract.

The corporation is by far the most common form of business entity in Costa Rica. In recent years, however, US and European tax advantages have made the limited liability company more desirable for some businesses. Corporations and LLC's are relatively easy to manage, especially with respect to powers of representation, decision-making issues and other day-to-day business administration activities. They both limit the financial exposure and liabilities of shareholders vis-à-vis third parties.

Foreign companies may register branch offices, which are only liable for income tax on Costa Rican source income (see section on Taxes below). Although branch offices are not separate legal entities and therefore do not limit the potential liabilities of the foreign company in Costa Rica, foreign companies may in effect achieve limitation of liability by forming a special purpose subsidiary in their own or a third jurisdiction and registering a branch office of the special purpose company in Costa Rica, thus limiting liability in Costa Rica to the capital of the special purpose company.



A. CORPORATIONS

1. Formation

A Costa Rican corporation may be established either by private capital (closely held) or by public subscription. The organizers must execute a deed of incorporation before a Costa Rican notary public, register the deed of incorporation in the Commercial Section of the National Registry, and publish notice of the incorporation in the Official Gazette (La Gaceta). The corporation must establish a street address domicile in Costa Rica.

2. Shareholders and Shares

The corporation must be formed by a minimum of two organizers. After formation, the corporation may reduce its number of shareholders to a sole shareholder or may receive participations from any number of additional shareholders. Corporations have no minimum capital requirements, but at least 25% of the subscribed capital must be fully paid-in upon formation. Any shares to be subscribed by in-kind contributions must be fully paid-in at formation. The organizers must state a number of authorized shares of stock in the deed of incorporation and establish a par value, either in Costa Rican colones or in any recognized foreign currency.

Common shares have equal rights and one vote each. However, the deed of incorporation may provide for the issuance of different classes of shares with different denominations, preferences, privileges, restrictions and limitations, as well as the establishment of other terms and conditions regarding profits, assets, a specific business or any other corporate features. Voting rights of shares other than common shares may be restricted, but never with respect to special meetings convened to modify the purpose or duration of the corporation, to effect a corporate transformation or merger, or to change the corporate domicile to a place other than Costa Rica. The elimination of any preference of a class of stock must be approved by the holders of the stock of that class in a special meeting. The corporate secretary maintains a private stock registry book not open to the public, to record share ownership and transfers. Shares are freely transferable unless the deed of incorporation provides otherwise. Bearer shares are not permitted by law. Dividends may only be paid from profits (see section on Taxes below regarding withholding taxes).

3. Shareholders Meetings

The shareholder meeting is the ultimate authority in the corporation and it retains all the powers not vested in any other corporate body by the deed of incorporation. Unless otherwise specified in the deed of incorporation, shareholder voting on the election of directors is cumulative. Meetings may be held by proxy or outside Costa Rica when so provided by the deed of incorporation, but may not be held by circular resolution or by telephone.

Ordinary meetings must be held at least once a year for (i) approval or rejection of the financial



statements pursuant to the auditor's report; (ii) distribution of profits; (iii) appointment or dismissal of members of the board of directors and auditors when necessary; and (iv) any other matters proposed in the agenda and not reserved for special meetings.

Special meetings must be convened for: (i) amendment of the bylaws; (ii) issuance of classes of shares not provided for in the bylaws; and (iii) other purposes when so required by law or the bylaws. Shareholders representing at least 25% of the capital of the corporation may request that a special meeting be called.

4. Management

A Costa Rican corporation is managed by a board of no less than three directors (directores), who must be individuals but need not be shareholders. The directors may be named in the deed of incorporation or appointed later by a shareholders meeting, which may also remove them at any time. If specifically contemplated in the deed of incorporation, board of directors meetings may be held outside Costa Rica but may not be held by circular resolution or by telephone.

The corporation must name at least one local representative agent (who must be an attorney and may but need not be a director) to be vested with management powers and legally authorized to represent the corporation (agente residente). In practice, the chairman (presidente) of the board is usually the managing director and the other two directors act as treasurer and secretary. Thus, directors, officers and managers are often the same people. The deed of incorporation may designate other legal representatives and may permit them to delegate some or all of their powers to other persons. The board of directors may also appoint one or more corporate managers (gerentes) with powers and authorities of the board's choosing.

5. Supervision and Auditors

One or more statutory controllers (fiscal) report to the shareholders on the performance of management. Although technically required only for publicly held corporations, the local practice is to appoint a controller for every corporation. The controller is appointed by the shareholders, and cannot be a member of the board, hold any other office or be related to any other officer. In most privately held companies, the controller may be a figurehead employee of the company. The controller's legal duties include requesting monthly balance sheets, reporting on yearly balance sheets, calling shareholders meetings, being present at board of directors and shareholders meetings, receiving complaints from shareholders and reporting on such complaints to the board of directors.

6. Time and Expenses of Formation and Registration

Formation and registration procedures typically take three to four weeks from the time of filing. Government filing fees and legal fees for establishing a simple wholly-owned corporation average



less than US\$4,000.

B. LIMITED LIABILITY COMPANIES

1. Formation

A Costa Rican limited liability company possesses many of the same attributes as the corporation, such as having independent legal existence and providing liability limited to the capital contributions of its owners. The organizers must execute the deed of organization before a Costa Rican notary public, register it with the Commercial Registry and publish notice of the organization in the Official Gazette.

2. Members and Membership Interests

The SRL (LLC) must be formed by a minimum of two organizers, whether individuals or companies, each of whom subscribes at least one membership interest. Upon formation, however, the membership interests may legally be concentrated in a single member. The minimum capital requirement (200 colones, which is less than US\$1) is nominal, but at least 25% of the stated capital must be fully paid in upon formation. All membership interests must be fully paid-in within one year of the SRL's constitution. Subscription of membership interests cannot be offered to the public. The number of membership interests and the value of each in Costa Rican colones (at least 100 colones, or some multiple thereof) must be stated in the deed of organization. Any member that allows the use of its name in the SRL name will be liable to the same extent as the member with the largest capital contribution.

Membership interests have equal rights and one vote each, and for this reason the SRL may be less suitable for special or complex control or equity structures than the corporation. Membership interests may only be transferred with the prior approval of members representing at least three-quarters of the company's capital.

3. Members Meetings

Members meetings may be held outside of Costa Rica when so provided by the deed of organization. Members meetings must be held at least once a year for (i) approval or rejection of the financial statements, (ii) appointment or dismissal of managers and assistant managers when necessary and (iii) dealing with other matters not delegated to a manager or representative. The manager or assistant manager must call the meeting, which may be attended by proxy, but not by telephone or circular resolution.



4. Management

A Costa Rican SRL is managed by one or more individual managers or assistant managers, who need not be members. The managers are either named in the deed of organization or appointed later in the members meetings, which may also remove them at any time. The SRL business form does not require a controller.

The managers are attorneys-in-fact of the company, with their powers defined in the by-laws. They may have either a general power of attorney or an administrative power of attorney. The latter grants full powers except that it does not allow the representative to purchase or sell assets.

5. Time and Expenses of Formation and Registration

Formation and registration procedures are similar to those applicable to corporations.

C. BRANCHES

Foreign companies may establish branch offices in Costa Rica by appointing a representative with a general power of attorney for all of the branch's business.

The power of attorney must set forth:

- The business purpose of the branch and the capital "assigned" to it;
- The business purpose, capital, complete names of officers or administrators, and the duration of the foreign company;
- An express declaration that the representative and the branch submit themselves to the laws and courts of Costa Rica with respect to acts or contracts that they enter into or that are to be executed in the country, and that they expressly renounce the protection of the laws of their domicile that would otherwise be applicable to their investment in Costa Rica; and
- Evidence that the grantor of the power has sufficient authority to make the grant.

The foreign investor branch establishes the branch by presenting the power of attorney to the Commercial Registry, along with a certificate of good standing with respect to the foreign company's establishment and existence in its home country, as well as an acceptance of the power of attorney's terms by the representative. The certificate of good standing must be legalized by the appropriate Costa Rican consulate abroad.

Branches cost approximately the same amount to establish, and usually require approximately the same amount of time to form as subsidiaries (three weeks).



V. TAXES

A. INTRODUCTION

Costa Rica only taxes income that is generated within the national territorial boundaries (domestic source or “source income”): it does not tax based on residence or citizenship. The Costa Rican Congress is at this time reviewing its tax system to replace the current tax incentives granted to Free Trade Zone manufacturing companies (see section on Free Trade Zones). The rates under discussion range from 15% to 30%. In addition, the Congress is considering other significant changes to the Tax Code, including replacement of the sales tax with a value added tax.

B. INCOME TAX

1. General Principles

The Income Tax Act (1988) and its regulations, taxes income under various headings including profits, employment income, “available income,” and remittances to foreign countries. Unless exempt under one or more provisions (such as Free Trade Zone status), all entities with a “permanent establishment” in Costa Rica are subject to the income tax. Individuals are taxed at 30% for income over CRC 3,600,000 (approx. US\$8,500 at CRC420/US\$). Corporations and SRLs are currently taxed at 30% for net income over CRC 43,000,000 (approx. US\$100,000 at CRC420/US\$).

A Costa Rican subsidiary of a foreign company may deduct as expenses certain payments to its foreign parent company. Specifically, the subsidiary may deduct from gross income payments to its foreign parent for technical, financial or other assistance, or for patents, formulae, trademarks and similar items, up to an aggregate of 10% of gross sales. The deduction is available only if the Costa Rican company has duly withheld any corresponding withholding tax due.

Capital gains are excluded from gross income and not taxed at all, provided that the activities generating them are not “habitual” or “derived from the sale of depreciable assets.” In addition, distributions to owners of a Costa Rican entity are excluded from gross income, although they may be subject to a tax on remittances abroad (see section 3 below).

By law, the fiscal year of Costa Rican taxpayers ends on September 30th. However, companies, individuals and other taxable entities may request a special fiscal year if they reasonably justify their need for it. Costa Rican tax law does not allow for consolidation of tax reporting. Costa Rican corporate taxpaying entities may carry forward up to three years operating losses for most activities, and up to five for losses arising from agricultural activities. Carrybacks are not allowed. Although Costa Rican legislation generally requires accrual method accounting, companies may



use cash-flow accounting upon prior approval of the tax authorities. Costa Rica does not currently have any asset or equity tax.

The Costa Rican Congress is currently debating what may be a significant overhaul of its fiscal system, but the details are not yet clear. Costa Rica does not have any tax treaties currently in effect, except for a tax information exchange agreement with the United States.

2. Reorganizations

Costa Rican tax law and regulations do not include any specific provisions governing corporate reorganizations, including mergers and spin-offs. However, Costa Rican tax authorities have taken the position that transfers of real estate that are related to mergers are exempt from real estate transfer taxes, unless the real property is depreciable. All fiscal attributes of the merged company are transferred to the surviving company.

3. Tax on Remittances to Foreign Countries

The Remittance Tax is a withholding tax on income sourced in Costa Rica that will be remitted to a person or company in a foreign country. The types of income to which the tax applies include: dividends, salaries, rents, royalties, and interest. The withholding tax rate for profit distributions and interest payments for royalties is 25%, for privately held entities or branches 15%, and for salaries 10%. For all other categories, the tax rates vary between 5.5% and 30%. Interest payments to foreign companies, financial entities or banks recognized by the Central Bank of Costa Rica as institutions regularly performing international financial operations or as first order financial institutions are exempt from this tax.

The Tax Administration has the discretion to fully or partially exempt remittances that are taxed abroad as income but that are not fully compensated by credits, deductions or other exemptions in the country of origin. The exemption is proportional to the unrecognized portion of the tax.

B. SALES TAX

The Costa Rican Sales Tax (Impuesto de Venta) of 13% applies to all imports and sales of goods unless exempted, but only to a limited number of services. Unlike a typical sales tax in the US, it applies to all levels of the supply chain, not just to the retail level. However, unlike a value added tax (VAT), it does not provide for monthly set-offs between amounts paid and amounts collected to arrive to an amount payable to the tax authority. Most raw materials are exempt. In addition to the sales tax, some imported goods may be subject to a selective consumption tax (Impuesto Selectivo de Consumo) applied at various rates depending on the goods. The Costa Rican Congress is at this time considering replacing the Sales Tax with a traditional value added tax.



C. REAL PROPERTY TAX

A yearly national property tax of 0.25% of appraised value is collected and managed by each municipal government locally. Sales of real property are taxed at 3% of the property's registered value (see Reorganizations above for exemption).

D. PATENTES AND MUNICIPAL INCOME TAXES

Companies that desire to operate in Costa Rica must pay an activity-specific license tax (often referred to as a patente) to the relevant local government. These license tax works as an income tax usually based on gross profits generated by operations. Local governments have the constitutional right to levy additional taxes and fees, which vary by location.

VI. IMPORTS AND EXPORTS

A. INTRODUCTION

The backbone of Costa Rica's current Customs Regime was established in 1960 when Guatemala, El Salvador, Honduras and Nicaragua signed the Central American General Economic Integration Treaty (Tratado General de Integración Económica Centroamericana) and formed the Central American Common Market. Costa Rica signed on to the treaty in 1962. Other related treaties and regulations affecting customs in Costa Rica have subsequently been approved, including a common Tariff Schedule for the countries.

Since 1993, the Central American countries have adopted a Central American Tariff Schedule (Sistema Arancelario Centroamericano) (the "SAC"), which is based on the Harmonized Commodity Description and Coding System ("HTS"). Costa Rica formally adopted the SAC in November of 1993.

Costa Rica also became a Contracting Party to the General Agreement on Tariffs and Trade ("GATT") in 1990. Costa Rica is now a member of the World Trade Organization ("WTO") established in 1995 as part of the Uruguay Round of Multilateral Trade Agreements.

In Costa Rica, imported goods are subject to import duties in accordance with the SAC classification. Central American integration rules require that all member countries apply the same import duties. However, there have been exceptions for many years, and one of the integration treaties, the Agreement on the Central American Tariff and Customs Regime (Convenio sobre el Régimen Arancelario y Aduanero Centroamericano), ratified in 1985 allows countries to modify import du-



ties unilaterally in certain cases. That provision has been broadly interpreted and used by the Central American governments. Specifically, Costa Rica has used this unilateral modification authority in relation to the computation of import charges on various types of goods.

Costa Rica has bilateral trade agreements with Mexico (1995), Dominican Republic (2002), Chile (2003), and Canada (2003). In addition, Costa Rica has concluded January 2004 region-wide negotiations with the United States for a free trade agreement (Central American Free Trade Agreement -- CAFTA) scheduled to enter into force on January 1, 2005. Each treaty imposes various different reduced import duties on originating goods.

B. CUSTOMS LAW

The Customs Act of 1995 (Ley General de Aduanas) governs imports to and exports from Costa Rica. The customs territory of Costa Rica is the territorial, aquatic and aerial space over which the State of Costa Rica exercises full and exclusive authority and sovereignty.

It is divided into two portions:

(a) The Primary Customs Zone or Customs Operation Zone ("COZ") is made up of all areas where customs services are performed (including FTZs). Products must pass through the COZ to enter or exit the country legally.

(b) Secondary Customs Zone is the remaining area of free circulation.

Upon import, goods are subject to import tariffs and duties. The SAC classification, along with any applicable trade agreements, determines the applicable ad valorem tariff rate in accordance with the type of goods. The sales tax, selective consumption tax, and other applicable taxes are regulated by their respective legislations and are collected upon importation. Costa Rica has enacted several temporary importation regimes to encourage value-added manufacturing activities that use foreign-sourced inputs.

C. FREE TRADE ZONES

Costa Rica created its Free Trade Zone program in 1990, and currently has approximately 170 active companies operating under its provisions, located in 13 different Free Trade Zone Parks and approximately 41 companies reside in stand-alone facilities. Under current WTO Subsidies and Countervailing Measures Agreement provisions, Costa Rica (along with most other countries in the world) must eliminate or modify this program by 2007. The principal requirement for establishing a FTZ company is to show an initial new investment of US\$150,000 or more.



The advantages of the Free Trade Zones are:

(a) A temporary exemption from all taxes that are based on gross or net income, profit distributions and sales income. The full exemption is for eight years, and a 50% exemption applies to years nine through twelve. If the operations are to be located in government-designated less developed areas, the full exemption is for twelve years and the 50% exemption is for years thirteen through eighteen.

(b) A permanent exemption from all import duties and taxes imposed on raw materials and other materials required in the production process, machinery and equipment, spare parts and supplies, and fuels, oils and lubricants. The FTZ company acts as its own customs agent under these provisions.

(c) A permanent exemption from all export and re-export duties on goods produced in Costa Rica and on machinery previously imported to the country.

(d) A ten-year exemption from all property and property transfer taxes, as well as from all other municipal taxes, such as patentes.

(e) A permanent exemption from sales and consumption taxes.

(f) A permanent exemption from all taxes on remittances to foreign countries.

Most FTZ companies establish operations in one of approximately 13 FTZ parks authorized by the government. These FTZ parks are restricted non-residential areas with infrastructure designed to meet industrial needs. With the exception of the exemptions listed above, all FTZ companies must comply with the laws of Costa Rica, including environmental and employment laws. If the company qualifies for FTZ treatment and can also show special needs and an initial new investment of at least US\$2,000,000 in fixed assets, it will not be limited to FTZ parks.

The FTZ Act benefits four principal categories of companies:

(a) Manufacturing or processing companies receive all available tax incentives and benefits;

(b) Trading companies (principally market and sell products) receive all available tax incentives and benefits except the income tax exemption;

(c) Service companies (provide export services) are treated the same as manufacturing companies;

(d) FTZ park operators receive all available tax incentives and some special benefits that the others do not obtain;



(e) Companies that perform scientific research for improvement of industrial or agro-industrial activities are treated the same as manufacturing companies; and

(f) Companies that operate shipyards or dry docks are treated the same as manufacturing companies.

The Foreign Trade Promotion Authority of Costa Rica (Promotora del Comercio Exterior de Costa Rica, Procomer) receives and issues recommendations on all applications for FTZ status. The Procomer review typically takes around two weeks. If Procomer recommends the application, the Executive Branch decides whether or not to approve the application. This review normally takes around two weeks. If the Executive branch approves the application, it proceeds to issue an Executive Decree, and the FTZ company signs an operating agreement with Procomer.

Mandatory Contribution. With the exception of trading companies, which cannot sell any product in Costa Rica, most FTZ companies may make up to 25% of their total sales locally in the Primary Customs Zone. For companies that export services, local sales may reach a maximum of 50%. Products sold in Costa Rica (i.e., in the Primary Customs Zone) will be subject to all standard (non-FTZ) import duties and procedures. Tax exemptions for the FTZ company will be reduced on a pro rata basis depending on percentage of sales made locally.

Manufacturing companies must pay a nominal monthly fee based of their number of export shipments. All other types of Free Trade Zone companies must pay a monthly fee equal to 0.30% of monthly sales volume, with a yearly minimum of US\$2,400, and nominal fees on import and export customs filings.

D. TEMPORARY IMPORTATION STATUS (REGIMEN DE PERFECCIONAMIENTO ACTIVO)

For companies that will process goods in Costa Rica for export but do not qualify for FTZ treatment because of insufficient initial investment, Costa Rican law has a temporary importation or maquiladora program. Although the maquiladora company does not qualify for exemption from income-based taxes, it does benefit from customs tax relief and does not have to pay the Mandatory Contribution applicable to FTZ companies and it is free to establish its operations anywhere a comparable national company would be permitted to do so.

Once it has paid the customs bond required by law, a maquiladora company may import merchandise, raw materials, machinery and any other resources directly related to its operations free of customs tariff or sales tax, selective consumption tax and other customs-related taxes. The TIP company must engage in transformation, repair, re-manufacture, assembly, or other similar processes with the imported goods and then re-export them within the required time-period (6 months, with extensions of up to six months). On a case-by-case basis, the government (Procomer) may allow the TIP company to sell some of its product locally after payment of relevant



customs duties for initial importation.

VII. INTELLECTUAL PROPERTY AND TECHNOLOGY TRANSFER

Trademarks, trade secrets, and copyrights generally receive adequate protection under the relevant Costa Rican legal regimes, which comply with international standards. Costa Rica does not restrict or require prior authorization for licensing agreements. Costa Rican laws do not set any absolute limits on fee royalties but, as discussed above, the tax laws limit their deductibility.

VIII. CONSUMER PROTECTION AND ANTITRUST

A Law for the Promotion of Competition and the Effective Defense of the Consumer took effect in Costa Rica in early 1995. For the first time, the law codified various consumer protection and competition principles and deregulated various aspects of the Costa Rican economy. Since then, the legislature has expanded the law into a more complex legal structure. The section concerning monopolistic practices closely follows the Mexican model.

IX. LABOR AND EMPLOYMENT

Employment and labor laws are an important part of Costa Rica's legal structure. Basic labor rights include minimum conditions of liberty and dignity for all workers; minimum wages and equal pay for equal work; an 8-hour workday and 48-hour workweek; time-and-a-half pay for overtime; and severance payment (but not the right to reinstatement as contemplated by other Latin American legislations) for "unjust" dismissal. The 1943 Labor Code follows the principle of minimum standards that can only be negotiated in the direction of improvements for the employee. The Labor Code also addresses collective bargaining rights, including the right to unionize and the right to strike pursuant to a mandatory conciliation process.

The Labor Code defines an employment relationship as one in which the employee receives money in exchange for services and is subject to direction and control by the employer. Employment agreements need not be in writing, but oral agreements are typically interpreted in favor of the employee. Even in the case of written agreements, the minimum standards of employment in the Labor Code cannot be reduced; however they may be improved by agreement among the involved parties.

The Employer may also implement internal work policies which do not need the approval of any



government agency and may be considered as part of the conditions of the labor contract.

Work Schedule. Standard working hours: 8 hours per day, 48 hours per week in ordinary or mixed shift. The latter in cases in which the labor is not unhealthy, heavy or hazardous. Special circumstances: Night shift (6 hrs./day, 36 hrs./wk), non-hazardous work accumulative shift (10 hrs./day, 8 hrs./night), trustworthy workers (12 hrs./day), other variations based on circumstances. Two 10-15 minute breaks (not regulated by law, but established by the parties) and a 30 minute lunch break are typically part of the paid day's work. Lunch time may be longer but this additional period is not paid by the employer. One required day of rest per week.

Overtime. Payable as time-and-a-half, with the workday not to exceed 12 hours. Overtime is not permitted when the working conditions are dangerous or unhealthy.

Holidays. Nine mandatory paid holidays: January 1, April 11, Thursday and Friday of Holy Week, May 1, July 25, August 15, September 15 and December 25. Work on these holidays is voluntary and must be paid at double-time rates. August 2 and October 12 are also holidays, but payment is not mandatory. The Law allows to take the October 12th holiday on the Monday following the date.

Wages / Payment. Minimum wages are adjusted by the National Salary Council (made up of representatives from labor, employers and Government) twice a year based on the inflation index. The current minimum wage for unskilled labor in the San José metropolitan area is approximately US\$280 per month. Payment is by time period or unit/piece of work. The company is free to determine method and timing of payment, but blue-collar workers must be paid at least bi-weekly and white-collar and domestic workers, monthly.

Paid Vacations. Employees have a right to two weeks uninterrupted paid vacation per year. With employee consent, the vacation time may be divided into two portions. The Employer may determine when vacations are taken as long as it is no later than fifteen weeks from the end of the year in which the vacation was earned. Vacation time can only be compensated with money in the event of termination. Employees may not allow vacations to accumulate unless for technical or confidentiality reasons the Company asks the employee to take an earned vacation during a later period.

Trial period. The law permits a three-month trial period. If the employee is dismissed without cause during this time, only pro-rata vacation pay and Christmas bonus accrue.

Social Security and employee income tax retention. Costa Rica has a mandatory social security system that provides all citizens with medical care, disability payments, and retirement benefits. The employer acts as a collector of percentage deductions made to the employee's salary (9%). In addition, the employer contributes 25% of payroll.



Sick Leave. The employer must pay 50% of salary for the first 3 days of a approved sick leave. From the 4th day on, Social Security pays 60% of the employee's salary. The employer is not forced to pay any additional amount. Maternity leave is payable at 50% of salary for 4 months (1 month before birth and three months after), and Social Security covers the remaining 50%. In the event of on-the-job injuries, the mandatory insurance policy contracted by the employer pays the worker 75% of salary until the worker is able to resume work.

Christmas Bonus. The law requires payment of a Christmas Bonus (aguinaldo) equal to one-twelfth of total salary received during the twelve months ended November 30 of each year, to be paid within the first 20 days of December. In the event of termination before the Christmas Bonus is paid, the employer must pay immediately the amount accrued at the time of dismissal.

Reserve Provisions. The Law suggests that employers should keep cash reserves for the payment of vacations (3.85% of total payroll), Christmas Bonus (8.33%), holidays (2.47%), severance (3% mandatory and 5.33% recommended, for a total of 8.33%). The new law states that, instead of the auxiliary cease benefit being paid at the end of the contract, all employers must pay 8.33% of each workers monthly salary as a "real right" and unemployment insurance. From that percentage, 5.33% will be deposited in a Labor Capitalization Fund, and the rest in a Complementary Pension Fund. The immediate financial effect, will be a actual salary increase. Since the new law the 8.33 percent will be deposited each month, independently to the cause by which the contract was breached

Termination of employment. Costa Rican employment law does not recognize the concept of at-will employment common in the United States. To avoid severance payments, an employer must only dismiss an employee if the employer has "just cause" as defined by the Labor Code. Employees terminated for just cause are due only accrued vacation time and Christmas Bonus, and any current wages. The following, among others, constitute "just cause" for termination:

- Physical or moral acts or libel committed against the employer or against a fellow worker at any time.
- Criminal acts or property damage related to the workplace
- Acts that endanger security and working conditions in the workplace.
- Release of the employer's confidential information.
- Unjustified absence for 2 consecutive days or 3 or more days during any month.
- Disobeying rightful instructions or orders from the employer.

In the event of termination for any of these causes, action must be taken within thirty days of the employee's behavior and should be documented fully to avoid minimize liability in any future lawsuit.

The employee may also terminate employment in some cases with "just cause", and in these cases the employer will also be liable for severance payment:



- Nonpayment of agreed salary.
- Dangerous working conditions or contagious diseases in the workplace.
- Moral or physical damage, or defamation against the worker by the employer at any time.
- Intentional damage to worker's tools by employer.

In the event of dismissal without "just cause" or employee resignation with "just cause," the employer must give termination notice and severance payment, proportional to the total time worked by the employee.

Notice of Termination (Pre Aviso). In the event of termination without "just cause," the employee is entitled to notice according to the amount of time the employment has lasted, or to the salary that would correspond to the notice period. For periods between 3 and 6 months, the notice period is one week; for 6 months to a year, two weeks; and for employment periods over one year, a month. Employees must also give notice if they quit without "just cause".

Severance Pay (Cesantía). If the employer dismisses an employee without "just cause" or if the employee quits for a "just cause" attributable to the employer, the employee will be entitled to severance pay of roughly 20 days' salary for each year worked, calculated based on average salary over the last six months and it may vary also depending on the time worked and the Labor Code regulations. The maximum paid is 22 days' salary per each year worked.

Accumulated Vacation Pay. Independently of the cause, the employee is entitled to payment for unused vacation time upon termination.

Workers compensation insurance. All employers must obtain workers compensation insurance. Government inspectors can shut down businesses that do not comply with mandatory insurance, and employers are liable for all expenses incurred by the employee as a result of an injury if the employer was not insured. Employers must notify the authorities within 8 days of an accident and the policy must cover medical services and rehabilitation, as well as 75% of employee's salary until the employee recovers. The employer may also be responsible for independent contractors if they are under the employer's direction and not otherwise covered. Insurance premiums are based on the risk level of the employment.

Foreign employees. At present there is no limit on the percentage of foreign employees that may be hired. Foreign employees must obtain work visas from the immigration service (Dirección General de Migración y Extranjería). The free trade zone program allows some companies to obtain temporary work visas for managerial and technical staff.

Workplace Discrimination. The Costa Rican constitution guarantees employees the right to work in an environment free from discrimination based on ethnicity, sex or religious beliefs. The legislature has not yet attempted to implement these rights in more specific legislation, however, and this area is not a source of significant litigation at this time.



XI. PROTECTION FOR DISTRIBUTORS AND SALES REPRESENTATIVES OF FOREIGN COMPANIES

Costa Rica has enacted regulations protecting dealers (both buy-sell distributors and commission sales representatives) of foreign companies, entitling them to damages similar to wrongful employment termination damages. Under Costa Rican law, once a foreign company has appointed a dealer in Costa Rica (either by written agreement or by course of dealing) it may not terminate the dealer without paying potentially substantial damages unless it can establish “just cause” as defined by law. Termination by the dealer pursuant to “just cause” of its own also entitles the dealer to these damage payments, based on gross profits or commissions earned during the relationship.

Costa Rican courts consider the registration of the relationship by the local party in the register of representatives of foreign companies to create a presumption of the existence of a dealer relationship entitled to protection by law. After entry into force of the Central America Free Trade Agreement, this law will not apply to new relationships.

XII. PLEDGES AND MORTGAGES

Costa Rica has a centralized national Pledge Registry and its law generally allows pledges over property that remains in the pledgor’s possession. The subject matter of the pledge can include any movable property, and may cover a collection of items that need not be individually listed as well as after-acquired property, such as new items coming into inventory. Mortgages over real estate are also available.

XIII. THE ENVIRONMENT

Despite its international reputation for conservation and sustainable development efforts, most Costa Rican attorneys agree that Costa Rica continues to struggle in the enforcement of its sparse pollution and environmental norms. Costa Rica’s environmental legislation is scattered among various laws, decrees and internal regulations, which vary from the Health Code to the Wildlife Protection Law to ministerial circulars. The Costa Rican legislature passed a comprehensive Basic Law of the Environment in late 1995. Among other goals, the law attempts to organize companies’ and individuals’ obligations to mitigate pollution and conserve wilderness areas, but the obligations are drafted in very general language. The law places broad responsibility on polluters for the damage they cause, establishes governmental agencies for approving required environmental impact studies, and creates an Environmental Tribunal to hear environment-related complaints. Foreign investors should keep in mind that, as in all nations of the world, foreigners who degrade



the environment may be resented and even singled out for prosecution because of political pressures. This is especially the case when the legislation in the foreign investor's country of origin would have prohibited the offending behavior.

XIV. REGISTRATION REQUIREMENTS AND PERMITS

Company registration. Every company that desires to do business in Costa Rica must register either as a Costa Rican company or a branch of a foreign company with the Costa Rican National Registry.

Taxpayer registration. Before beginning operations, the corporate vehicle must register as a taxpayer (for income and other taxes) with the Ministry of Treasury's General Tax Administration (Tributación Directa). The filing includes a description of activities, as well as a designation of legal representatives.

Construction and land use permits. Construction and land use permits must be obtained from local governments prior to groundbreaking.

Health operation permit. All operations that will include employees must obtain a health permit from the Ministry of Health (Ministerio de Salud), which includes a ministry inspection of the premises.

Municipal patentes. Must be obtained immediately after the beginning of operations (see taxation section of this memorandum).

Environmental impact assessment. All new physical projects must file a preliminary environmental assessment application (FEAP) with the Technical Environmental Secretary (SETENA) to determine whether a partial or full environmental impact assessment will be required, or whether a more moderate plan for environmental management will suffice.

Free trade zone status grants and permits. Companies desiring to operate under FTZ provisions must file with the Foreign Trade Promotion Authority as discussed in the section of this memorandum dealing with free trade zone status.

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**Respectfully submitted,
Zurcher Odio & Raven**



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