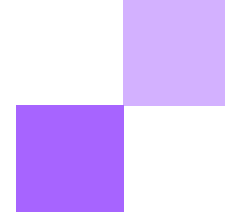


Doing business in El Salvador

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LEGAL SYSTEM

1. What is the legal system in your jurisdiction (civil law, common law or a mixture of both)?

El Salvador's legal framework is derived from the Political Constitution of 1983. The Constitution is the highest legal body, followed by international treaties, laws and implementing regulations.

The legal system was originally based on the French civil code system. The Legislative Assembly enacts laws on the initiative of the following:

- Legislators.
- The President (through his ministers).
- The Supreme Court of Justice (on matters related to the judicial branch, jurisdiction and competition of the courts, and the exercise of notary publics).
- Municipal councils (on matters related to municipal taxes).

The Peace Accords signed in 1992 introduced important amendments to the Political Constitution, which focuses on the stabilisation of democracy and respect for human rights.

FOREIGN INVESTMENT

2. Are there any restrictions on foreign investment (including authorisations required by central or local government)?

There are few restrictions on foreign investment, apart from the following:

- Small sized industry and commerce is restricted to Salvadorans or Central Americans.
- Radio and TV operations must have at least 51% of Salvadoran capital.

Foreign investment must be registered at the National Office of Investments (NOI) to access incentives granted by the Investment Act Decree No. 732 (see *Question 4*).

Foreign investors must observe provisions prohibiting money laundering.

The ratification of the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) in 2005 also provided a friendlier environment for foreign investment.

3. Are there any exchange control or currency regulations?

US dollars are the legal tender. The Salvadoran colon, which no longer circulates, is always converted to US dollars at a fixed rate of SVC8.75 per US\$1.

There are no exchange controls.

4. Are any grants or incentives available to foreign investors?

The following incentives are available under the Investment Act Decree No. 732:

- General expediting procedures to assist with establishing and developing investment and to facilitate repatriation of profits and any liquid assets.
- Equal treatment of local and foreign investors.
- Freedom to make investments – that is, any individual or entity, national or foreign, can make investments of any kind (within the limits of the law).
- Facilitation of the transfer of funds abroad.
- Foreign investors, making an investment of more than 4,000 monthly minimum salaries, have an automatic right to resident status, which grants the right to remain and work in the country. This residency can be temporary or permanent, and is extended to the family group of the foreign investor.
- Access to local financing.
- Protection and safety of property – the Constitution recognises and guarantees:
 - specific legal rights for national and foreign investors;
 - protection for investors' property; and
 - the right to the free disposition of investors' assets.

Also, foreign investors that produce goods and services in El Salvador for re-export purposes may qualify for exemptions from customs, income, value added tax (VAT) and local (municipal) taxes (*see Question 22*).

BUSINESS ENTITIES

5. What are the most common forms of business entity used by foreign companies to conduct business in your jurisdiction?

The most common forms of business entity used are:

- A branch office.

- A local subsidiary corporation – that is, an anonymous company of variable capital (anonymous company).
- A limited liability subsidiary company (LLC), equivalent to a partnership.

6. In respect of the corporate vehicle most likely to be used by foreign companies conducting business in your jurisdiction, please state:

- Registration formalities (including timing).
- Minimum (and maximum) share capital.
- Whether shares can be issued for non-cash consideration such as assets or services (and any formalities).
- Any restrictions on the rights that can attach to shares.
- Any restrictions on foreign shareholders.
- Management structure and any restrictions on foreign managers.
- Directors' liability.
- Parent company liability.
- Reporting requirements (including filing of accounts) and cost of compliance.

The most common form of corporate vehicle to be established by a foreign company in El Salvador is an anonymous company (*see Question 5*).

- **Registration formalities.** Registration must be granted before a notary public at the Registry of Commerce. It must be granted through a public deed, which is comprised of the company's articles of incorporation and bye-laws. Registration takes from three to five days.
- **Minimum (and maximum) share capital.** A minimum of two shareholders (persons or companies) is required. The minimum capital required is SVC100,000 (about US\$11,435). At the time of incorporation, at least 25% of the subscribed capital stock must be paid. The outstanding 75% must be fully paid within a reasonable period of time (usually between one and five years) following incorporation. The minimum value of each share of the capital stock must be SVC10 (about US\$1.14). There is no maximum share capital.

- **Shares issued for non-cash consideration.** Shares can be issued for non-cash consideration, once the minimum capital is paid (*see above, Minimum (and maximum) share capital*). However, there are a number of formalities which must be completed when issuing shares for non-cash consideration.
- **Restrictions on rights attaching to shares.** There are usually no restrictions on rights attaching to shares. However, the shareholders can decide to issue preferred shares (which carry limited voting rights but preferred rights to profits). In addition, the incorporation documents can provide for higher quorum requirements for decision-making at the general meeting.
- **Restrictions on foreign shareholders.** There are no restrictions on foreign shareholders.
- **Management structure and foreign managers.** The general meeting of shareholders elects either a board of directors (at least two directors and their corresponding alternates), or a sole administrator (and his alternate), to manage the company. The board of directors can appoint managers for different areas. Foreign persons can act as shareholders, directors or managers.
- **Directors' liability.** Directors' powers are personal and cannot be delegated. A director is liable for the decisions taken at board level, unless he votes against a particular decision and gives his reasons, and this is reflected in the board's minute book.

The president and the secretary of the board, acting jointly or separately, are the legal representatives of the company, unless the company's bye-laws provide otherwise or a power of attorney is granted to a person residing in El Salvador which gives them the legal capacity to sign documents and petitions on behalf of the company and act as its representative. The legal representatives are responsible for the company's compliance with all its legal obligations.

- **Parent company liability.** A parent company is only liable if it is a shareholder. In the case of companies, liability is limited to the value of the shares. In partnership-style companies, liability is

personal to the partner (that is, all the partner's assets are liable).

- **Reporting requirements.** A company must file:
 - its general balance and financial statements at the Registry of Commerce annually;
 - a monthly VAT declaration, paying the difference arising from the VAT collected from its sales minus the VAT paid to third parties;
 - a monthly income tax declaration, paying 1.5% of its gross income in advance of its annual income tax;
 - an annual income tax return form;
 - an annual tax audit report;
 - a monthly declaration of income tax retained from employees and individual service providers;
 - monthly health contributions (*see Question 12*);
 - monthly pension fund contributions (*see Question 12*).

EMPLOYEES

7. What is the jurisdictional scope of the regulatory environment for employment issues?

The Labour Code (enacted in 1972) regulates employment relationships between employers and employees. The Ministry of Labour has administrative jurisdiction over inspections and conciliation hearings. Labour courts have judicial jurisdiction over labour disputes, which are further reviewed by Labour Appeal Courts and the Supreme Court of Justice, if the case merits it.

The Labour Code applies to all employees working in El Salvador, foreign and domestic.

All labour law is considered to be a matter of public order. Therefore, it is mandatory and cannot be contracted out of in the employment agreement.

8. Is a written contract of employment required and what, if any, other terms are likely to govern the employment relationship?

The Labour Code requires a written employment agreement. In the absence of an employment agreement, witnesses can be used to prove the employment relationship.

For companies with 25 or more employees, internal labour regulations comprising disciplinary methods and procedures must be adopted and filed with the Labour Ministry.

Labour law is considered to be a matter of public order. Therefore, all rights of employees provided for by law are implied into the contract, even if no mention of them is included in the contract itself.

9. Are employees entitled to management representation and/or to be consulted in relation to corporate transactions (such as redundancies and disposals)?

Employees are not entitled to management representation or to be consulted in relation to corporate transactions.

10. What statutory rights do employees have against dismissal in your jurisdiction?

An employee can be dismissed with or without a just cause. If an employee is dismissed without just cause, he is entitled to a severance payment of one month's salary per year of work, plus proportional vacation and year-end bonus payments. This is limited to a maximum of four times the statutory minimum salary multiplied by the number of years at work, unless the company's custom is to compute severance based on current salary on dismissal.

11. How are redundancies regulated?

When making redundancies, employers must pay the redundant employees a severance payment, since redundancy is not considered a just cause for dismissal (see *Question 10*).

12. What is the cost of employment for companies and employees (such as mandatory taxes and social security contributions)?

Employers and employees must make the following contributions:

- **Health contributions.** The employer must pay 7.5% and the employee must pay 3% of the employee's gross salary. However, the health contribution cannot exceed US\$72 (about EUR58) per employee.
- **Retirement (pension fund) contributions.** The employer must pay 6.75% and the employee must pay 6.25% of the employee's gross salary.

Employees must pay income tax at progressive rates, depending on their level of income, up to a maximum of 25%.

13. How are employees of foreign companies who are seconded to your jurisdiction from abroad taxed?

Employees of foreign companies must pay income tax on their net income obtained in El Salvador. They must file an income tax return during the first four months of the following year if they earned more than US\$5,714.28 (about EUR4,632) during that year.

For individuals domiciled in El Salvador, the amount of tax varies according to the level of income (see *Question 12*). For non-domiciled individuals, a fixed rate of 25% on net income is levied. Non-domiciled individuals must also pay a 20% withholding tax (which is credited on filing a return) and 13% VAT on services rendered.

A person is considered to be domiciled if he has been in El Salvador for more than 200 consecutive days during the previous year. In addition, if the income earned by a person in El Salvador forms the greater part of his total income for the year, that individual is considered to be domiciled in El Salvador.

14. Do foreign employees require work permits? If so, how long does it take to get a permit and how much does it cost?

Foreign employees require a work permit (a temporary

residence visa), which can be obtained from the Salvadoran consulate in their country of origin and which lasts from six months to one year. However, the most common way to obtain it is to enter the country as a tourist and then apply for temporary residence. The process takes about three to four months and the employee cannot work during that time. The official fee is approximately US\$35 (about EUR28).

TAX

15. What is the basis of taxation of companies that are incorporated and/or tax resident in your jurisdiction?

Income tax is paid on net income (that is, the difference between revenues and expenses) earned by the company during the tax year (see *Question 17*). Under the principle of territoriality, only income received by companies from assets or investments located in El Salvador, and from work performed or used in El Salvador (even when that work is performed or paid overseas), is taxable.

VAT is subject to the same territoriality principle (see *Question 17*).

16. How are the activities of non-tax resident companies in your jurisdiction taxed?

Non-resident companies obtaining income in El Salvador are subject to withholding taxes of:

- 20% on all taxable income.
- 13% on all VAT taxable payments (that is, all payments received for services performed in El Salvador or used in El Salvador).

VAT is affected by the concept of "introduction of services", which means that if a service is performed overseas for an entity domiciled in El Salvador, and it uses the service in El Salvador, that service is taxable.

17. What are the main taxes that potentially apply to companies (including rates)?

Income tax

Companies must pay income tax at a rate of 25%.

VAT

VAT applies to the transfer of movable goods and the provision of services and is levied at a rate of 13%.

Municipal tax

There are 264 municipalities in El Salvador and each has its own tax tables and rates.

18. Please explain how each of the following is taxed:

- **Dividends paid to foreign corporate shareholders.**
 - **Dividends received from foreign companies.**
 - **Interest paid to foreign corporate shareholders.**
 - **Intellectual property (IP) royalties paid to foreign corporate shareholders.**
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- **Dividends paid to foreign corporate shareholders.** These are not taxed, provided the company has paid income tax on its income (see *Questions 15 and 17*).
 - **Dividends received from foreign companies.** These are taxed at the normal income tax rate (see *Question 17*).
 - **Interest paid to foreign corporate shareholders.** This is treated as income and is therefore subject to withholding tax at a rate of 20% (see *Question 16*). However, if the corporate shareholder is a financial entity and registered with Salvadoran Central Bank, interest is tax exempt.
 - **IP royalties.** These are subject to VAT at a rate of 13%, as they are considered to be originating from services provided in El Salvador (see *Question 16*). If the owner of the IP right is a non-domiciled entity, the royalties are treated as income and are therefore also subject to withholding tax at a rate of 20% (see *Question 16*).

19. Does your jurisdiction have thin capitalisation rules (restrictions on loans from foreign affiliates)?

There are no thin capitalisation rules.

20. Must the profits of a foreign subsidiary be imputed to a parent company that is tax resident in your jurisdiction (controlled foreign company rules)?

The profits of a foreign subsidiary do not have to be imputed to a tax-resident parent company, unless the subsidiary is directly owned by the tax-resident parent company.

21. Does your jurisdiction have transfer pricing rules?

Although there are no specific transfer pricing regulations, a transfer between related companies, at a price clearly different to normal market prices, can be deemed to be a tax fraud.

22. How are imports and exports taxed?

Imports are taxed at rates ranging between 0% and 20%, plus 13% VAT.

Exports are exempt from income tax but VAT at a rate of 13% applies.

However, the Export Reactivation Law Decree No. 460 provides that the government will reimburse to exporters 6% of the value of non-traditional exports.

Those companies operating under the free zone regime (see www.elsalvadortrade.com.sv/incentivos/i_html/leyzonf.html) must waive the above incentive, as they receive other incentives from the government, including exemption from:

- Import duties.
- Income tax and VAT, except for the part of the product that enters the local market.
- Municipal tax.

23. Does your jurisdiction have a wide network of double tax treaties?

There are no double tax treaties.

ANTI-TRUST

24. Are restrictive agreements and practices regulated by anti-trust law in your jurisdiction? If so, please give brief details.

Traditionally, El Salvador's competition rules were derived from many different sources. However, a new anti-trust law was recently passed by the Legislative Assembly (effective from January 2006). Although it is too early to properly assess its influence, this law will clearly affect how El Salvador deals with restrictive agreements and practices in the future.

INTELLECTUAL PROPERTY

25. Please outline the main intellectual property rights that are capable of protection in your jurisdiction and, in each case, please state:

- Nature of right (that is, the conditions that must be satisfied for the right to arise and what the right-holder is entitled to do).
- How protected (for instance, by registration, by agreement, by common law). If an application is needed, where should it be filed?
- How enforced and, if any, what penalties arise for breach.
- Length of protection.

Patents

- **Nature of right.** For an invention to be patentable, it must be a solution to a technical problem. It must also be:
 - useful;
 - new; and
 - non-obvious to a technician in that particular field.

Patents protect the temporary exclusive use of the invention.

- **How protected.** Protection is obtained by filing a patent application with the Registry of Intellectual Property (Registry). Before filing, an examination services agreement between the applicant and the Registry must be made and the examination fees paid. The extract must then be published and the invention, as a whole, examined by either the

local examiners at the Registry or by a foreign technical institution of the Registry's choice.

- **How enforced.** Infringements are sanctioned criminally through the Attorney General's office. Also, civil remedies (such as damages) can be recovered in civil and commercial judicial proceedings.
- **Length of protection.** Patents last for 20 years from the filing date and are non-renewable. Pharmaceutical patents are granted for 15 years.

Trade marks

- **Nature of right.** To be registerable, a trade mark must consist of words or design marks. Salvadoran legislation on trade marks is modelled on US law.
- **How protected.** Protection is obtained by filing a trade mark application with the Registry. The application must first be published and examined by local examiners at the Registry.
- **How enforced.** The methods of enforcement and the remedies available are the same as for patents (*see above, Patents*).
- **Length of protection.** Protection lasts for ten years, renewable indefinitely for ten-year periods.

Registered designs

- **Nature of right.** To be registerable, registered designs must be two or three-dimensional forms or shapes that, when incorporated in a product, give it a special appearance and can be used to model or manufacture it. Salvadoran legislation on registered designs is modelled on US law.
- **How protected.** Protection is obtained in the same way as for patents (*see above, Patents*).
- **How enforced.** The methods of enforcement and the remedies available are the same as for patents (*see above, Patents*).
- **Length of protection.** Protection lasts for five years and is renewable for one further five-year period.

Copyright

- **Nature of right.** Copyright is provided for artistic, scientific and literary works. Salvadoran legislation on copyright is modelled on US law.
- **How protected.** Copyright subsists from the moment of creation. However, it can be deposited at the Registry, which will issue a deposit certificate.
- **How enforced.** The methods of enforcement and the remedies available are the same as for patents (*see above, Patents*).
- **Length of protection.** Protection lasts for the duration of the author's life plus 50 years. If a company is the author, protection lasts for 50 years from the year after it was communicated to the public.

Confidential information

- **Nature of right.** Confidential information is undisclosed information that provides its owner with an advantage over third parties in the market. Salvadoran legislation on confidential information is modelled on US law.
- **How protected.** Confidential information is protected in the same way as trade secrets and industrial secrets (that is, the company must keep it confidential). It is not registered. However, confidentiality agreements can be signed.
- **How enforced.** A contract establishing confidentiality obligations must be in place. If so, the right-holder can bring a civil or commercial claim to recover damages. If a legal authority has the power to request confidential information, violation of confidentiality agreements does not bring legal consequences for the entity revealing the information. The tax authority has the power to require any information for tax purposes, even when a confidentiality agreement is in place.
- **Length of protection.** When a specific agreement is not in place, protection lasts for as long as the information is kept:
 - in a confidential manner;
 - in a safe place; and

- with restricted access.

Otherwise, it lasts for the length of the duration of the agreement.

MARKETING AGREEMENTS

26. Are marketing agreements regulated in your jurisdiction? If so, please give brief details in respect of the following arrangements:

- Agency.
- Distribution.
- Franchising.

- **Agency.** Agency, distribution and representation agreements are regulated and provide strong protection to the local party. These agreements can only be terminated for a fair cause set out in the Code of Commerce (enacted in 1970).

In the case of unilateral termination, refusal to renew a contract or unilateral amendments (other than for a fair cause), the local party is entitled to be indemnified.

When an exclusive relationship is unfairly terminated, not renewed or unilaterally amended, the local party can judicially seek a preliminary injunction to stop imports (by a new distributor) of the former principal's products until they are properly indemnified.

However, the above provisions only apply to contracts signed before January 2006, because DR-CAFTA established that clauses which exclude the right to seek indemnification are valid from January 2006 onwards.

- **Distribution.** Distribution agreements are regulated in the same way as agency agreements (*see above, Agency*).
- **Franchising.** Franchising is not specifically regulated and the parties can, therefore, freely negotiate most of the terms. However, many of the important aspects of a franchise agreement are regulated under other areas of law, including those on:

- IP rights;
- foreign investment registration;
- arbitration;
- taxes;
- non-compete issues.

27. Are there any laws or codes of practice relating specifically to e-commerce (such as electronic signatures and distance selling)?

There are no specific e-commerce laws. However, e-commerce is allowed, based on the free contracting right provided by the Constitution. DR-CAFTA also sets out general regulations on e-commerce (but these are limited to DR-CAFTA member states).

DATA PROTECTION

28. Does your jurisdiction have data protection laws? If so, please give brief details.

There are no specific data protection laws. The closest regulations are those for trade secrets, bank secrecy, and consumer rights under consumer protection law to accurate information. The Constitution grants protection to a person's honour, personal and family intimacy, and to his own image.

PRODUCT LIABILITY

29. Does your jurisdiction have product liability laws? If so, please give brief details.

There are no specific product liability laws. However, consumer protection regulations apply to a consumer and supplier relationship. They provide for the principle that the supplier is liable up to the price of the product for any defects arising out of its fabrication.

Also, civil law provides for the general principle that all entities are responsible for damages caused by their tortious intent or negligence. Following case law, clauses limiting such responsibility are considered to be unconstitutional.

