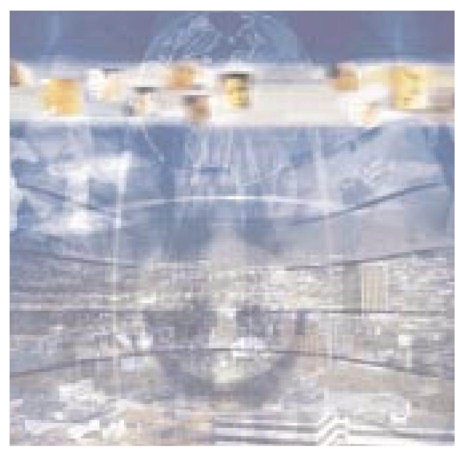
KPMG

INVESTMENT
IN COSTA RICA



CINDE and KPMG worked this publication together to offer the potential investor the opportunity to share a general vision about Costa Rica giving relevant information during the investment process.

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"KPMG is the global professional advisory firm whose aim is to turn knowledge into value for the benefit of its clients, its people and its communities. With more than 100,000 people collaborating worldwide, the firm provides consulting, legal, tax, financial advisory and assurance services from 820 locations in 159 countries, including every major city in Latin America. KPMG has made a long-term commitment to becoming the leading global professional advisory firm of choice for its clients and its people. The firm offers a full range of globally available professional services to meet client demands. State-of-the-art knowledge management technologies allow the firm to share its collective knowledge and expertise and provide global service solutions to its clients. When this is coupled with common business processes and global account management, the result is a seamless service across all industry sectors and national boundaries. KPMG is constantly developing new services to serve changing global markets.

KPMG Costa Rica was founded in 1958 and has grown to become the leading professional advisory firm within the country and the Central American region. Our professional personnel are made up of 230 individuals, a significant number of which are fully bilingual, with various academic backgrounds that include certified public accountants, attorneys, business administration, finance and others. Our multidisciplinary teams offer industry as well as line of business expertise, and include a specialized foreign investment team that provides a full range of professional services to foreign investors.

The key areas of functional expertise of KPMG are: consulting, legal, tax, financial advisory services, accounting, and assurance. In Costa Rica, the firm provides its legal services through KPMG Abogados, which in less than eight years of practice, has become one of the largest and best-positioned law firms in Costa Rica. It has been recently ranked as one of the most recommended law firms in Costa Rica, considered to have a growing reputation for rapidity of response and efficient service across a range of practice areas by the European annual publication "Latin Lawyer".

CINDE is the Costa Rican Investment Board and it promotes investment in the country. It is a private, apolitical, non-profit organization. Founded in 1982, CINDE was declared of public interest by the Costa Rican government in 1984. CINDE's mission is the attraction of foreign direct investment and the promotion of national investment in specific sectors.

Costa Rica gives a lot of importance to the influx of foreign investment into the country, as a contributor for the generation of employment, transfer of technologies and diversification of exports. CINDE works to foster Costa Rica's development, by serving as a catalyst and facilitator for the investment process in the country.

Promotion of Foreign Direct Investment: This program promotes Costa Rica as a competitive investment site, especially in areas such as high technology manufacturing (e.g. medical devices and electronics), services (e.g. call-centers) and infrastructure projects by concession. CINDE's offices in New York and California proactively look for expanding companies, and provide tailor-made services to investors.

Strategic Policy and Research. Market Intelligence Unit: CINDE's Market Intelligence Unit gives research support to the Investment Promotion Program. Through strategic market research, it identifies market tendencies, promising sectors and potential investors for Costa Rica.

Services for Investors Unit: This unit is in charge of pre-investment activities, such as benchmarking, SWOT analysis, and meeting investors' information demands. It also carries out post-establishment activities to improve the investment climate.

CHAPTER I

COUNTRY OUTLINE

Geography and Climate

Costa Rica is located strategically at the southernmost end of Central America, near the Panama Canal and with direct access to the Antilles. More precisely it is south of Nicaragua (northern border) and north of Panama (southern border), surrounded by the Atlantic and Pacific Oceans. Both coasts are just hours away from each other. In fact, there is a total distance of only 320 km. (200 miles) between the two oceans. Its neighbors, Panama and Nicaragua, can be reached in a half-hour by plane, and Miami, Florida is just a two- and- a- half-hour flight away. The country expands over an area of approximately 51,100-km2 (19,730 square miles). It is politically divided into seven provinces: San José, Heredia, Alajuela, Cartago, Puntarenas, Guanacaste and Limón. The capital city is San José, located in a valley in the central region of the country.

There is a dry season from December to April, and a rainy or “green” season from May to November. Although Costa Rica is a relatively small country, it enjoys a privileged global position that allows it to have a variety of micro-climates that range from the cool climate of the mountains to the dry beaches of the Pacific and the tropical climate of the Atlantic. Nonetheless, the climate in most areas, specially in the central region (San José), is moderate. The average annual temperature is 20.0ºC (70ºF), with a maximum temperature of 24.9ºC (76.8 ºF) and a minimum of 16.3ºC (61.3 ºF).

Summary:

Location: Between 8 and 11 north latitude; 83 and 86 west longitude; six hours west from the Greenwich parallel.

Area: 51,200 square kms. (around 32,000 square miles).

Capital city: San José.

Other important cities: Alajuela, Cartago and Heredia.

Coastal cities: Limón on the Atlantic side, and Puntarenas and Liberia on the Pacific side.

History and Government

Christopher Columbus discovered Costa Rica in 1502, during his fourth and final voyage to the New World. At that time, he anchored on a small island located just off the coast of what is now the Caribbean port city of Limón. It was Columbus himself who gave the name Costa Rica or “rich coast” to the fertile and wealthy land he encountered. In the following years, Spain colonized Costa Rica as it did most of the territory throughout Mexico, Central and South America. During the colonial period, trade was low and restricted to the other colonies. Costa Rica remained a Spanish Colony governed by Spanish Authorities established in Guatemala City. On September 15, 1821, Costa Rica achieved its independence from Spain and the gradual arrival of non-Spanish Europeans opened up trade with the outside world.
Costa Rica is a free and independent democratic republic with a representative Government comprised of three distinct and independent branches: the executive, the legislative and the judiciary. The Costa Rican Constitution conceives a Supreme Electoral Tribunal, which becomes active every four years for the Presidential and congressional elections, thus ensuring the legitimacy of the voting system. Costa Rica’s President is elected for a single four - year period by direct majority vote.
Costa Rica is one of the most stable and peaceful democracies in Latin America and the world. A democratic regime was established in 1821 and has continued with only brief interruptions to date. The national army was abolished in 1948, another factor contributing to the stability and peace prevailing in this country, and permanent neutrality in international conflicts has been implemented since 1983. As a result of the country’s peaceful nature, many international organizations have established offices in Costa Rica, including many United Nations agencies. The country has been nominated twice for a Nobel Peace Prize and ex President Oscar Arias was awarded this prestigious recognition in 1987.

Furthermore, the current Constitution, instituted in November 1949, establishes full respect for human rights.
The active President of the Republic is Dr. Miguel Angel Rodríguez, whose term runs from May 8,1998, to May 8, 2002.

There are 17 ministries in Costa Rica:

- Ministry of Agriculture and Livestock
- Ministry of Science and Technology
- Ministry of Foreign Trade
- Ministry of Culture, Youth and Sports
- Ministry of Economy, Industry and Commerce
- Ministry of Public Education
- Ministry of the Treasury
- Ministry of Justice
- Ministry of the Presidency
- Ministry of Public Works and Transportation
- Ministry of National Planning and Economic Policy
- Ministry of Foreign Relations
- Ministry of Public Health
- Ministry of Public Security
- Ministry of Labor and Social Security
- Ministry of Housing
- Ministry of Environment and Energy

State and private institutions related to the economy, commerce and trade are:

- Central Bank of Costa Rica
- Foreign Trade Corporation
- Costa Rican Investment Board
- Union of Chambers
- Chamber of Industry
- Chamber of Businessmen
- Chamber of Retailers
- Chamber of Exporters
- Costa Rican-American Chamber of Commerce

Population and Language

Costa Rica is a small Central American country with a low level of population density. In fact, as of January 1997, the total population was approximately 3,464,170 inhabitants. About 44% of the population lives in urban areas of San José, with 56% of the remaining population living in rural areas. Population density is approximately 65 inhabitants per square kilometer (169 per square mile) and the average family has 4 to 5 members.

Costa Ricans call themselves "Ticos". The affectionate nickname came from the "Ticos" penchant for adding the diminutive tico to all manner of words. A majority of the people of Costa Rica is of European (largely Spanish) descent. Whites and mestizos (people of Spanish and Native American ancestry) account for about 96% of the population. About 50% of the population is defined as rural.

In general people are amiable and polite. When doing business, it is wise to keep in mind that Costa Ricans may often place more priority on courteousness, conversation and their relationships with other people than in punctuality.

The country's work force is highly specialized. This has led important transnational companies to locate in Costa Rica. The majority of the working population, approximately 80%, is employed by the private sector, while the remaining 20% is employed by the public sector.

For all types of jobs, the Government of Costa Rica establishes a minimum salary, which must be observed by employers. However, only inexperienced workers get the starting salary, since experience, training and demand usually lead to better wages.

Although Spanish is the official language of Costa Rica, a significant percentage of the population speaks English. Other foreign languages are also spoken, but not as widely. This is a result of a private and public educational system that requires the study of a second language. However, although English is used very much in professional and business settings, all legal procedures must be carried out in Spanish. Official translators registered at the Ministry of Foreign Relations must perform translations of documents required by governmental authorities.

Roman Catholicism is the state religion, but freedom of worship is guaranteed by the Constitution.

Summary:

Population (1997): 3,464.170 inhabitants

Female population: 1,715.402

Male population: 1,748.768

Population density: 64 inhabitants/square km.

Growth rate (1999): 7 %

Ranking on the Human Development Index (1995): 3rd in Latin America, 34th in the world.

Literacy rate: 95%

Life expectancy at birth: 77 years

Homes with drinking water: 96%

Population covered by health services: 96%

Population with access to telephone service: 92%

Telephone lines per 100 persons: 13

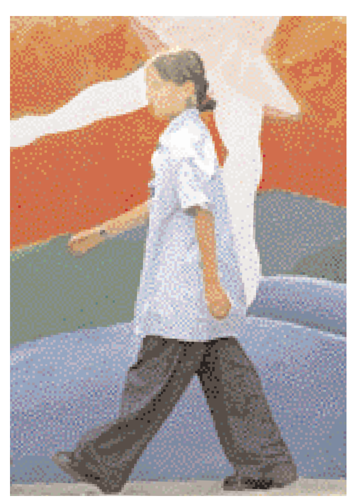
Official language: Spanish

Number of universities: 42: 4 state and 38 private

Labor force: 1,220.914

Education

The low illiteracy rate of 5% is due to a mandatory primary and secondary public school system. Primary and secondary education is free, and attendance is compulsory between the ages of 6 and 13. In the early 1990s about 453,300 pupils were enrolled in some 3,300 public primary schools and about 139,300 students attended about 256 public and private secondary schools. Private schools include world-class institutions with a cultural emphasis on the United States, United Kingdom, France, Germany and Israel. The universities are split between public (at nominal tuition) and private. The prominent University of Costa Rica, in San José, was founded in 1843, and has an annual enrollment of about 29,000 students. Also, technical and vocational institutions are abundant. The average Costa Rican is educated, with a working knowledge of English and an ability to develop a trade or skill.



Currency and Foreign Exchange Regulations

Costa Rican monetary unit is the "colón" (¢), which is divided into 100 "céntimos." The current foreign currency exchange system allows free possession and conversion of foreign currency into local currency and vice-versa; with the exception of certain export proceeds.
The only limitation that Central Bank regulations place on the conversion of non-export dollars to and from colones is that the conversion must be transacted through authorized agents (e.g. private and state-owned banks, hotels and most financial institutions).

The "crawling peg" system has been eliminated and the exchange rate is currently determined by a "managed floating system" whereby the Central Bank of Costa Rica intercedes in the market to maintain stability. The system results in slight devaluations of the colón during the year. Under this system the Central Bank of Costa Rica does not determine the exchange rate. The parity of the colón with respect to the USD is determined in a free exchange market, under the supervision of the Central Bank of Costa Rica. These exchange rates are calculated on the basis of the average of the exchange transactions of authorized entities as of 15:00 hours of the preceding day.

In the early 1990s the annual value of imports was about $2.9 billion and of exports was $1.9 billion. The chief exports included coffee, bananas, beef, textiles and sugar. In the last few decades the nation has also earned recognition for non-traditional exports, such as textiles, pineapple, flowers, ornamental plants, vegetables and other products. At present, electronic micro components, a new but significant line of exports thanks to the arrival of companies such as Intel, Lucent Technologies and Sawtek are in first place, followed very closely by textiles. Tourism leads foreign earnings in the area of services. In recent years, a large number of companies have invested in hotels, resorts and other tourism-related operations in the country due to the beauty of its natural resources and the warmth of the Costa Rican people. In 1995 Costa Rica joined in the formation of the Association of Caribbean States (ACS). A free-trade organization, the ACS comprises the members of the Caribbean Community and Common Market (CARICOM) as well as 12 Latin nations bordering the Caribbean. Moreover, Costa Rica is an active member of GATT since 1990 and a founding member of the World Trade Organization. Also, Costa Rica has been granted preferential conditions in both the U.S. (Caribbean Basin Initiative) and Europe (Generalized System of Preferences). In addition it has signed bilateral trade agreements with Mexico, the Dominican Republic and Chile.

Cost of Living

By international standards, the cost of living in Costa Rica is low. This does not mean, in any way, that the quality of life is low. The gross domestic product per capita in 1999 was approximately USD $ 3,943. The inflation rate for 1999 was 10.11% and is projected at 10% for 2000.

At 75 years, Costa Rica has one of the highest life expectancy rates in the world. Additionally, it has one of the lowest infant mortality rates (13 per one thousand) compared to other Latin American countries.

Infraestructure Advantages

Costa Rica enjoys a highly developed communication, electric and transportation infrastructure. The telecommunications system provides direct dialing telephone services worldwide, as well as telex, telegram, facsimile, internet and other data transmission services unsurpassed in Latin America.

Costa Rica maintains a self-sufficient power supply. The Costa Rican Electricity Institute (Instituto Costarricense de Electricidad) controls several hydroelectric power plants that produce enough electricity to fulfill the country's needs. New electricity production projects that include geothermal generators are currently being developed to meet the country's needs for the next century.

Costa Rica has over 15,000 miles of roads that run from coast to coast. There are two international airports (Juan Santamaría Airport which is located in Alajuela and offers access to principal markets all over the world and Daniel Oduber Airport located in the western province of Guanacaste, used particularly for tourism) and one airport (Tobías Bolaños in San José) mainly for local flights. Furthermore, thanks to its geographical position, Costa Rica has two international ports covered by important shipping lines on both the Atlantic and Pacific coasts.

There are 19 airlines authorized to carry passengers and 8 for cargo, along with 24 shipping lines and 115 shipping agencies located at the ports. Air and maritime shipping fees to Europe, North America and Asia are competitive.

Insurance

The insurance industry in Costa Rica is a state-owned monopoly in the hands of the National Insurance Institute (Instituto Nacional de Seguros). The National Insurance Institute offers policies covering most types of insurable interests (e.g., fire, earthquake, automobile, crops, life, medical, occupational risk, flood, avalanche, professional liability etc.). Insurance with foreign companies is allowed under certain limitations (mainly where there is no local insurance available for a given risk).

As with other industries currently controlled by the Costa Rican Government, there is now a clear tendency towards the lifting of the state monopoly on underwriting of insurance policies. Currently, the National Insurance Institute is one of the largest insurers in Central America, which is evidence of a significant insurance market in the region. Although it is not yet clear whether the National Insurance Institute itself will be privatized, it is highly probable that the above-referred monopoly will be eliminated in the near future, thus creating definite business opportunities for foreign insurance companies, which would find a virtually unexplored market.

CHAPTER II

FORMS OF BUSINESS ORGANIZATION

Costa Rican law recognizes the following forms of business organization:

1. Corporations
   (Sociedad Anónima)
2. Limited Liability Companies
   (Sociedad de Responsabilidad Limitada)
3. Limited Partnerships
   (Sociedad en Comandita Simple)
4. General Partnerships
   (Sociedad en Nombre Colectivo)

Corporations

Corporations are the most common entities given their structural flexibility. Since local laws define a corporation as a bilateral agreement, they must be formed by at least two parties. However, immediately after formation, a single party may legally acquire 100% of the shares of stock, without altering the legal status of the original corporation. In order to incorporate a legal entity, it is necessary to draft and execute a deed of incorporation before a notary public; publish notice of the incorporation in the official Gazette; and record the incorporation deed with the Public Registry.

Founding parties (and any shareholders thereafter) may be individuals and/or any type of registered legal entity, regardless of citizenship and domicile. By law, the entity must have the following corporate characteristics:

• COMPANY NAME:

It may be in any language as long as it is accompanied by the corresponding Spanish translation and shall consist of a word or a number of words with or without a meaning as long as it is not deemed generic and provided it has not been previously registered. In any event, the company name shall be followed by the words “Sociedad Anónima” or “S.A.” (equivalent to “Incorporated” or “Inc.”) which identify the nature of the business entity.

• LEGAL DOMICILE:

Since formation takes place in accordance with local laws, the corporation is by law domiciled in Costa Rica. Notwithstanding the above, agencies and branches may be created to carry out activities within or outside the country. Corporations are permitted to engage in worldwide operations.

• LEGAL TERM:

The law does not allow indefinite terms. Therefore, a fixed term must be determined at will. This term may be shortened or extended also at will and convenience. It generally ranges between 50 and 99 years.

• CORPORATE PURPOSE:

As opposed to other jurisdictions where comprehensive, meticulous and lengthy descriptions of the corporate purpose are required, business purpose and local activities are broadly implied in the laws of Costa Rica. Thus, although simple and general descriptions thereto are sufficient and very common, detailed descriptions are permitted.

• SHARE CAPITAL:

Consists of the amount of money used to capitalize the company. The share capital, necessarily a fixed amount, is divided into common par value shares each entitled to one vote. Since local regulations do not allow bearer or non-par value shares, these shares must be registered (i.e. they are nominative shares). However, shares may be endorsed openly and therefore perform, for all practical purposes, as bearer shares.

There is no minimum share capital requirement. Shares are freely transferable unless provided otherwise in the articles of incorporation (i.e. right of first refusal and other lawful restrictions). Shares may be issued as single units or as stock certificates thereof. Other than common shares the company may authorize, at formation or thereafter, issuance of other types of shares (such as preferred shares) with the privileges, restrictions, limitations and rights agreed upon by the shareholders, with regards but not limited to benefits, assets, specific activities, profits, vote and related matters, all of which must be set forth in the articles of incorporation.

• BOARD OF DIRECTORS:

Every corporation must have a board of directors comprised of a minimum of three individuals to hold the positions of president, secretary and treasurer. Additional board members may be appointed at will. Board members are not required to be simultaneous shareholders and there are no nationality or residence requirements. The scope of Powers to be granted to each board member and/or company executives is determined by the Shareholders Assembly.

Board members are appointed at the initial shareholders' meeting upon formation of the corporation and from time to time thereafter. Appointments thereof are for fixed time periods at will and made in accordance with provisions set forth in the articles of incorporation.
Unless otherwise provided in the company's articles of incorporation, board resolutions are valid when approved by 50% of the members. Official board meetings may be held at any location outside the country when so provided for in the articles of incorporation.

• ORDINARY AND EXTRAORDINARY SHAREHOLDERS' MEETINGS:

Each of these types of meetings is held for different purposes.

Ordinary: Annual meeting within the three-month period following the closing date of the tax year. Its purpose is to discuss and approve (or disapprove) the financial statements of the previous business year; distribution of earnings; appointment and/or revocation of officers; and any other matters provided for in the articles of incorporation.

Extraordinary: Meeting held at any time during the year for the purpose of resolving amendments, if any, to the articles of incorporation; changes and issues regarding share capital; and all other subject matter and issues referred to in the law and the articles of incorporation. Preferred Shareholders may hold Extraordinary Shareholders' Meetings. Quorum Rules are applicable for all above-mentioned meetings.

• STATUTORY EXAMINER:

Corporations may appoint one or more statutory examiners (individuals and/or corporations). The main responsibility of the examiner is to determine that all corporate rules, statutory obligations and procedures are duly and adequately followed to ensure protection of the interests of shareholders and other related parties.

• REGISTERED AGENT:

All corporations, business concerns of any nature, and foreign companies doing business locally must appoint a registered agent, whose sole (passive) legal duty is to be served with administrative and court actions on behalf of the corporation. Appointment thereto must fall upon a local practicing lawyer with registered business offices within the country. Nonetheless, the registered agent appointment may be waived if the legal representative of the corporation has a domicile in the country.

• LEGAL RESERVE:

Corporations are required to assign 5% of net earnings annually to form a legal reserve of up to 20% of its share capital.

• DISSOLUTION AND LIQUIDATION:

On or before expiration of its legal term, if so agreed by the shareholders, or given certain circumstances (e.g. achievement of its corporate purpose or impossibility thereof; or definitive loss of 50% of share capital unless the shareholders agree to replace it), corporations shall dissolve and a subsequent liquidation procedure shall be followed whereby remaining assets are distributed among creditors and shareholders.

• BOOKS AND RECORDS:

Corporations must maintain legal books (Journals, General Ledger, Financial Statements, Shareholders' Registry and Minute Books for Shareholders' and Board Meetings) that are bound and stamped by the Tax Authorities. Computer-kept accounting records may be used provided summary entries are duly posted in the legal books.

• INCORPORATIONS COSTS:

Regardless the amount of share capital, all entities are required to pay as incorporation fee, the equivalent to 10% of the minimum wage current at the moment of incorporation. Recording expenses plus other incorporation costs such as duties, stamp taxes, corporate books and legal and notary fees oscillate around USD 1,200.

Limited Liability Companies (LLC's)

A limited liability company is composed by partners whose liability is limited to their capital contributions. The LLC's legal structure is equivalent to the United States concept of "Partnerships," and thus, qualifies as such for US tax purposes. Incorporation procedures and costs for LLC's are very similar to those of corporations. The more significant differences being:

Share Capital:
LLC's divide their share capital into what local regulations call "quotas" as opposed to shares. Unless specifically provided otherwise in the articles of incorporation, transfer of "quotas" requires unanimous consent of all partners.

Management:
LLC's are run by one or more managers or assistant managers who hold power of attorney as provided for in the articles of incorporation.

Limited Partnerships and General Partnerships

These types of entities are seldom used mainly because of, among other disadvantages, direct personal liability, management and exposure. Formation procedures are basically the same as for corporations, although much simpler.

Other Forms of Business Entities through which Business may be Conducted

In addition to the aforementioned entities, foreign companies may conduct business in Costa Rica through branches of their parent company provided that the following requirements are duly met:

~ Appointment of a legal representative(s) with full powers of attorney to act on behalf of the branch.

~ Statement of the branch's corporate purpose.

~ Statement of the parent company's:
- *Corporate purpose*
- *Share capital*
- *Full names of all current officers and managers*
- *Legal term*

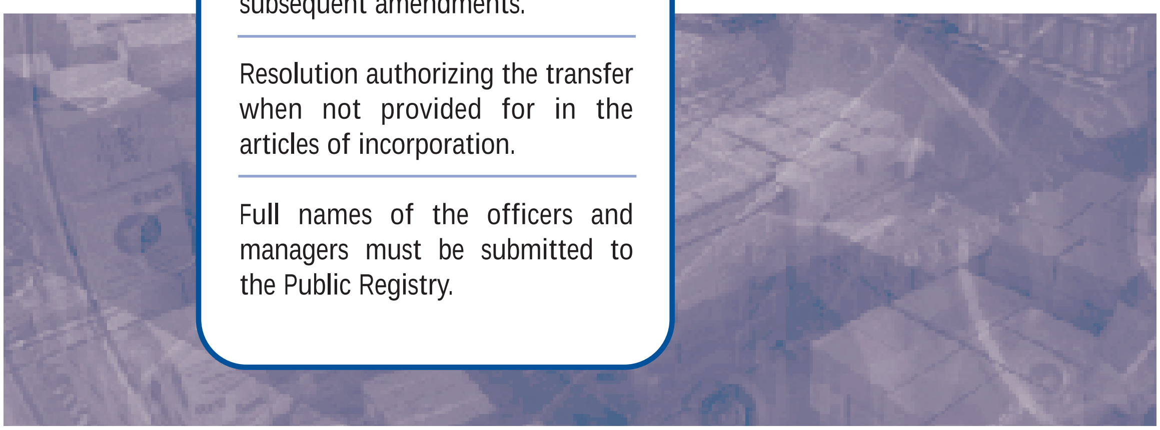
Formal statement whereby it is fully represented and acknowledged that the proxy (that will act on behalf of the Branch) and the Branch itself shall be subject to Costa Rican laws and jurisdiction with regard to those acts performed or that shall be executed within the country and that, consequently, the parent company submits a waiver of the laws of its domestic jurisdiction therewith.

The power of attorney must be notarized and legalized by the corresponding Costa Rican General Consul in the jurisdiction of the parent company where the power of attorney is granted.

Professional fees for incorporating a Costa Rican branch oscillate around US$ 2,000.

Transfer of Legal Domicile to Costa Rica

Foreign corporations may transfer their legal domicile to Costa Rica provided that their articles of incorporation allow such transfer. In order to achieve such transfer, certified copies of the following documents are required:



- The articles of incorporation and subsequent amendments.
- Resolution authorizing the transfer when not provided for in the articles of incorporation.
- Full names of the officers and managers must be submitted to the Public Registry.

Transfer of legal domicile does not imply dissolution of the parent company, which continues under the laws and jurisdiction of its original legal domicile. However, with regard to all activities performed within Costa Rican territory, the foreign corporation is subject to the local Public Law System including income tax regulations.

CHAPTER III

CORPORATE TAXATION

Territorial Principle

The Costa Rican income tax system is based on the territorial principle whereby only income derived within Costa Rican territory and from Costa Rican sources is subject to income tax. According to article 1 of the Income Tax Law, "a tax is imposed on occasional or continual revenues received by legal entities and individuals, obtained within the national territory, without regard for the Recipient's nationality or domicile". The aforementioned Law also imposes a levy on Costa Rican occasional or continuous revenues accrued or received by domiciled individuals and on any other type of income not exempt by law. Income obtained from foreign sources is not taxable in Costa Rica.

Tax Years

The statutory tax year for companies starts on October 1st and ends on September 30th of the following year. However, in case of local subsidiaries and branches of foreign entities, the Tax Authorities may authorize the use of the parent company's tax year. Banks use a calendar year and similar authorization may be granted to certain companies with agricultural activities. Taxpayers with close commercial or administrative relationships with foreign entities may adapt their tax year to that of the foreign company.

Income Tax

• GENERAL:

Following the territorial principle, a tax is applied on all income earned in Costa Rica or from Costa Rican sources, regardless of citizenship, domicile, residence, place of incorporation or meetings of the board of directors from:

- Real estate transactions (as a trade or business).
- Assets, goods and rights invested or used in Costa Rica.
- Commercial, and industrial, agricultural and any other trade or business activities carried out within the country.

Companies may deduct from gross income all costs and expenses necessary to produce taxable income as well as to protect investments. Expenses incurred to obtain exempt income are not deductible. If expenses produce both taxable and exempt income, the deduction is limited to the portion related to the production of taxable income.
Tax Authorities are empowered to deny the deduction of expenses if, by their judgment, any of the following criteria apply:

- Not considered necessary to produce taxable income.
- Excessive or unreasonable.
- Pertain to a different tax year.
- Not supported by appropriate documentation.
- Not registered in the accounting records.
- Proper income tax not withheld at source (if applicable).

• LOSSES:

Only industrial and agricultural companies are allowed to carry forward net operating losses. Losses incurred by commercial enterprises may not be carried forward. For agricultural companies, the carry forward period is five years and three years for industrial companies is. Industrial companies that began operations after 1988 are allowed net operating loss carry forwards for five years for the losses incurred within the first five years of operations. However, losses incurred after the five year period are permitted to be carried forward only three taxable years.

• RATES:

Tax legislation does not follow the "one income, one taxpayer" regime, though it categorizes taxpayers. Each group of taxpayers is subject to different scales, tax rates and dates of payment.
For small companies (i.e. gross income not exceeding ¢28.860.000 per year) the following are the rates established for the current tax period:

RATES		
	Up to ¢14.347.000 of gross income*	10%
	Up to ¢28.860.000 of gross income*	20%
	All other companies:	30%

The above are flat rates. Gross income is used as a parameter to apply the corresponding tax rate. Nevertheless, the resulting rate would be applicable to net income of the company.

• TAX RETURNS:

Taxpayers must file a tax return within the three months following the end of the taxable year (i.e. December 31st for companies using the statutory tax year).

• PAYMENT OF TAX:

Income tax liabilities are due when the tax return is filed. A system of estimated tax payments is in effect whereby estimates are made on a quarterly basis. Estimates are based on seventy-five percent of either the average tax cancelled in the previous three years or the tax liability of the previous tax year (whichever is greater). If the tax payer has not filled a tax return on the preceding three years, any tax return filled would be used to calculate the payments. In the event no tax returns have been filled by the tax payer, an estimate must be used. In the event of an overpayment, taxpayers have the possibility of applying the excess to the income tax liability of the following tax year or to other tax liabilities (except import duties and stamp taxes). In practice, cash refunds are not made. Nevertheless, in August of 1999 Congress approved an amendment to the refunds system by which, in theory, refunds would be possible.

• WITHHOLDING TAXES ON FOREIGN REMITTACES:

Payments remitted abroad, to individuals or corporations, from Costa Rican source income are subject to the following withholding taxes:

TYPE OF INCOME	PERCENTAGE
Transportation and communications	8.5
Wages, salaries, pensions under a labor relation	10.0
All other wages, salaries, pensions and professional services	15.0
Insurance related payments	5.5
Motion pictures, TV programs, soundtracks, etc.	20.0
Soap operas and similar items	50.0
Dividends and similar distributions of earnings	15.0
Dividends on shares registered and bought through a local stock exchange	5.0
Interest and other financial payments (if the recipient is a foreign financial institution recognized by the Central Bank of Costa Rica, the withholding is waived	15.0
Royalties, trademarks, franchises, formulas, technical and financial services and similar payments	25.0
Any other remittance of Costa Rican source income	30.0

• DIVIDENDS:

Dividends paid or credited by corporations to individuals (both local and foreign) or to foreign entities are subject to a 15% withholding tax. If the shares of the paying corporation are registered with a local stock exchange and the shares were bought through such exchange, the withholding is reduced to 5%. Dividends paid or credited to another Costa Rican corporation are exempt from the withholding. Furthermore, the withholding tax does not apply if the retained earnings are distributed to the shareholder in the form of nominative shares or social portions of the capital of the paying entity. Tax Authorities may authorize a waiver of the withholding tax on dividends, interest, commissions, royalties and insurance premiums remitted abroad, considering that the beneficiary can prove that he or she is not entitled to a foreign tax credit due to the tax assessed in Costa Rica and that the income will be taxed in the foreign country.

• OTHER WITHHOLDINGS:

Employers are required to withhold income taxes from employees on a monthly basis. Both employers and employees are subject to payroll taxes that are payable on a monthly basis through the Social Security Administration (see Chapter on "Social Security System" for further details).

• IMPUTED INCOME TAXATION:

For selected professional and technical fields, imputed net income is established by the Tax Authorities, unless proof to the contrary exists.

• Financing

In the absence of a formal loan agreement or interest determination, the Tax Authorities may impute interest on any transaction it deems to be a loan or financing transaction. The applicable presumptive interest rate would be the highest active interest rate charged by the Central Bank of Costa Rica, or, in the absence of this rate, the average active interest rates charged by the National Banking System banks.

• Non-domiciled Companies

Unless otherwise proven, there is an imputed minimum taxable income for branches, agencies, and other permanent establishments of entities not domiciled in Costa Rica. These entities are subject to the following taxes:

Transportation and Communications: Fifteen percent (15%) on gross income from freight, passenger and cargo operations, as well as from radiograms, telephone, telex and similar services provided in Costa Rica. Airlines, maritime shipping lines and similar companies may enter into a contract with Tax Authorities whereby taxable income is computed by applying the company's worldwide profit margin to Costa Rican source revenues derived from outgoing shipments.

Reinsurance: Ten and one-half percent (10.5%) on the net value of reinsurance, refinancing and insurance premiums of any kind, except life insurance, contracted or endorsed by the National Insurance Institute to foreign companies.

Media: Thirty percent (30%) on gross income from cinematography films, series and any similar form of public broadcast or exhibition of images or sound, as well as international news.

• CAPITAL GAINS TAX:

Capital gains are taxable and capital losses are deductible when derived from the sale of depreciable assets, and from the sale of assets sold in the ordinary course of a trade or business. The on-off (sporadic) capital gain derived from the sale of non-depreciable assets is exempt.
Taxable capital gains must be included within taxable income and are subject to the corresponding tax rate schedules.

• TRANSFER TAXES:

A one and a half percent (1.5%) transfer tax is imposed on the declared value of real property transfers or on the value registered before the Tax Authorities, whichever is higher. Normally, both the buyer and the seller of real property are jointly liable for the tax, except where the contracting parties have agreed otherwise. Article 5 of Law 7543 of September 14, 1995, the Tax Adjustment Law, established an excess of 0.01% to the Transfers of Real Property Tax, destined to finance the Costa Rican Red Cross. Currently, the tax is 1.51%. The tax is due on the date of transaction. In the case of vehicles, a two and a half percent (2.5%) transfer tax is imposed.

• SALES (Value Added) AND EXCISE TAXES:

The general sales tax is a value added tax that is levied on the sale of merchandise and the import of merchandise to Costa Rican territory. With the exception of certain services, such as advertising, most services are not subject to sales tax. This tax is assessed on value added and the final liability is calculated by subtracting total sales taxes paid on imports or purchases to total sales taxes derived from taxable sales during the same period. The sales tax is levied at the manufacturer, wholesaler, retailer or customs level.
All individuals, legal entities, and “de facto” companies, public or private, that habitually sell merchandise or render specific services in Costa Rica, or that import or introduce goods into Costa Rica, are treated as taxpayers and must register as such with the United Taxpayers Registry.
In addition to sales taxes, excise taxes apply to selected goods of importers and producers. However, taxpayers with sales under ¢2.000.000 (two million Costa Rican colones) over a three month period are exempt.

• Rates

The current sales tax rate is thirteen percent (13%). The excise tax rates vary according to a table.

• Payment of Tax

The sales tax is payable on a monthly basis and is calculated on the basis of sales made within Costa Rica during the previous month, minus the amount of tax cancelled, during the same month to suppliers. With respect to imports, the tax is paid as part of import duties prior to the release of the goods from customs.
The excise tax is payable when the invoice is issued or when the merchandise is delivered to the purchaser, whichever occurs first. In the case of imports, the excise tax is payable when import documents or forms are officially accepted by the customs office.

• REAL ESTATE TAX:

The tax is assessed on land, buildings and other permanent structures. This tax is managed, assessed and fiscalized by the municipalities having jurisdiction over the administrative locality ("canton") where the property is located. Local governments are the beneficiaries of land tax proceeds.

• Rates

The real estate tax rate is 0.25%.

• Computation and Payment

The Real estate tax is computed on a calendar year basis and must be cancelled annually, semiannually, or quarterly, depending on the local government. The local government must determine the taxable basis either through general or individual assessment.

• ASSET TAX:

A 1% asset tax was enacted in September of 1995. The taxable base is calculated as follows. Total assets minus current assets and investments in securities and equities, minus ¢46,700.000 (Forty six thousand seven hundred Costa Rican colones). The tax is creditable against the regular income tax liability. However, if in the same tax year the income tax liability is less than the assets tax liability, the latter must still be entirely cancelled. In the case of companies generating losses, the assets tax cancelled may be credited against income tax liabilities in the following year (i.e. one year credit carry forward).
Banks and financial institutions are subject to a different computation to determine their taxable basis.
The government grants tax holidays to companies in a preoperative phase and for newly acquired or constructed assets.
The asset tax was repealed as of fiscal year 2000. However, the 1999 return must be filed with the 2000 income tax return.

• STAMP TAXES:

Stamp taxes are levied on most legal documents and are based on either the monetary value stated in the document or on a stated amount per page.

• EDUCATION AND CULTURE STAMP TAX:

An education and culture statutory stamp tax is assessed on all business entities. There is a ¢750 stamp tax assessed at the time of incorporation, as well as annual fees ranging from ¢750 to ¢9.000 based on the capital stock of the company.

• LOCAL TAXES:

Normally, local taxes vary depending on regulations established for particular activities and regulations established among the different local governments or municipalities. Minor municipal taxes are similar between localities (i.e. garbage collection, street lighting, street cleaning, and others) and are normally paid on a quarterly basis.

• IMPORT DUTIES:

Import duties are established in the Central American Customs System Book (SAC), whereby each type of good has a number or classification for customs purposes. The rates vary depending upon the classification of the goods.
Although import duties are normally subject to a maximum of 20% and a base of 5%, certain "luxury items" (e.g. tobacco) still have customs duties that in some cases are close to 100% of the item's value. Moreover, there is a special tax (Law 6946) of 1% payable upon importation of certain goods.

• TOURISM:

Specific taxes assessed on tourism activities include the following:

- *A three percent (3%) tax applies to lodging. This tax is applied to daily room revenue only*
- *A five percent (5%) tax is assessed on international transportation, which includes air, maritime and land tickets. International transportation companies, as well as travel agencies, are responsible for collecting this tax.*
- *A departure tax is imposed to each individual (foreign or local) leaving the national territory from any of the international airports, maritime ports, or upon crossing international borders. Applicable tax rates are as follows:*

TAX PAYER	TAX RATE
Costa Rican	US$ 43
Foreigner residing in Costa Rica	US$ 63
Tourist	US$17*

* In case a tourist exceeds the time limit allowed for his or her stay in Costa Rica the tax rate would be US$ 43.

• FORESTRY:

A general forestry tax, equivalent to 3% of the wood's value, must be cancelled upon importation or processing.

• MINING:

Individuals or entities that are granted exploration permits and exploitation concessions must cancel the following taxes:

- **Surface Taxes**

Exploration permit: ¢3.000-per square kilometer. *

Exploration concession: ¢30.000-per square kilometer. *

Import duties are assessed on goods not covered by exemptions in the law.

A 2% tax is assessed on the commercial value of minerals obtained from exploitation concessions, taking into consideration the mineral's quality, price, market classification and other attributes determined by the Geology, Mines and Hydrocarbon Directorate of Costa Rica.

In cases where the explotation concession includes native Indian territories, the beneficiaries of such permits are subject to a 1% tax based on their annual earnings in order to benefit native Indian development associations.

Additionally, mining activities are taxable in accordance with the Income Tax Law.
Finally, a 10% tax on the total amount of exemptions granted is due. In essence, this is a tax based on the tax incentives' value.

• BEVERAGES AND TOBACCO:

Specific taxes are applied to sales of tobacco, national and international beer, carbonated soft drinks and wines. Examples of the rates are as follows: tobacco 2.5%; national brand carbonated soft drinks 10.0%; and national beer 13.0%.

• TAX EVASION: Felonies and Misdemeanors

The applicable legislation is intended to achieve the following:

- *Impose economic sanctions related to the violation of administrative tax rules.*
- *Establish minor tax-related crimes that are fined with strong economic sanctions.*
- *Establish tax-related crimes. Under the new legislation, tax evasion and other crimes are subject to a strict Criminal Code, including the imposition of imprisonment for up to ten years. These sanctions were previously unknown in the law and it is expected that the recent changes will produce a major turn around in the general attitude that most Costa Rican companies and individuals have towards taxation and tax payments.*
  Although companies are specifically excluded from criminal charges, individuals representing or working for companies which are involved in illegal activities may be personally prosecuted and held liable.
- *Increase the powers of the Tax Authorities to investigate companies suspected of tax evasion, including search and raid of premises, as well as seizure and confiscation of equipment, documents, books and records.*

• TAX TREATIES:

There is a Tax Information Exchange Agreement (TIEA) between Costa Rica and the US Government. This treaty allows the establishment in Costa Rica of Foreign Sales Corporations (FSC) as defined by the US Internal Revenue Code Sections 921-927. Moreover, under the terms of the agreement, convention costs incurred in Costa Rica are fully deductible for US tax purposes.

CHAPTER IV

INDIVIDUAL TAXATION

Income Tax

• INDIVIDUALS WITH BUSINESS ACTIVITIES:

As a general rule, individuals with business activities (i.e. sole proprietors) are subject to the same regulations as corporations, except for the fact that they are subject to a progressive tax rate schedule which is established as follows:

These taxpayers are allowed tax credits of ¢2.400 (Two thousand four hundred Costa Rican colones) for a spouse and ¢1.800 (One thousand eight hundred Costa Rican colones) for each child per year. These taxpayers must file an annual income tax return for these purposes.

Self-Employment Income Tax Table for 1999/2000

Taxable Income	Tax Rate
Up to ¢958.000*	0%
From ¢958.000 to ¢1.431.000	10%
From ¢1.431.000 to ¢2.388.000	15%
From ¢2.388.000 to ¢4.785.000	20%
From ¢4.785.000 and over	25%

** Exchange rates as of May 31, 2000: 306.63 colones per dollar with an average of 10% yearly devaluation.*

• EMPLOYED INDIVIDUALS:

These individuals are subject to a progressive withholding tax rate schedule which is established as follows:

Employment Tax Table for 1999/2000

Monthly Taxble Income	Tax Rate
Up to ¢215.600*	0%
From ¢215.600 to ¢324.100*	10%
From ¢324.100 and over*	15%

Monthly tax credits include ¢200 (Two hundred Costa Rican colones) for a spouse and ¢150 (One hundred and fifty colones per child). There are no other deductions or credits allowed.
For employed individuals the mandatory monthly withholding requirement substitutes the need for year-end tax return filings.

- *Nonresidents: either employed or self-employed, are subject to a flat 15% withholding tax, on all income derived from personal services performed in Costa Rica and are not required to file income tax returns in Costa Rica.*

- *Self-employed nonresidents receiving rental, or business income must file an annual tax return and are subject to the Self-employment Progressive Tax Rate schedule.*

Contributions created by the Employee Protection Law may be considered by the employer as a deductible expense for income tax purposes. In addition, those contributions are exempt from social security contributions and are income tax exempt for the employee.

• RESIDENT CONCEPT:

For income tax purposes, a resident is defined as any person who has continuously resided (i.e maintained a continuous physical presence) in Costa Rica for more than six (6) months during the same tax year, or who has obtained a work permit from the Immigration Authorities.

• TAXATION OF BENEFITS:

In general, cost of living allowances and other cash allowances paid directly to the employee (except the statutory Christmas bonus) are treated as salary and subject to the progressive rates that apply to employed individuals.
Bonuses (except the statutory 13th month bonus) and benefits in kind (i.e. housing, company car, education, etc) are subject to a flat 10% withholding tax with no deductions or credits allowed, and to social security contributions. However, for lower level employees that are in a low tax bracket or who pay no taxes, bonuses are commonly treated as salary and therefore subject to the progressive withholding tax rate schedule.

• PARTNERSHIPS:

These types of entities are seldom used mainly because of direct personal liability. The parties are liable for income tax.

CHAPTER V

LABOR REGULATIONS

Characteristics of the Labor Force

The Costa Rican labor force has been traditionally characterized as: relatively well educated, skilled and with a significant amount of potential. This is primarily the result of a historical emphasis on education significantly subsidized by the government. Universities, Technological Institutes and numerous vocational schools provide individuals of all levels with satisfactory technical and administrative training. The Costa Rican work force is known for its stability and productivity. Labor relations, in general, reflect the peaceful and democratic traditions of the country. Management/Labor conflicts and differences are normally managed through dialogue and mutual respect.

Labor related issues are governed by the 1943 Labor Code (Código de Trabajo). The Ministry of Labor and Social Welfare and Labor Courts throughout the country are responsible for ensuring its compliance.

General Labor Principles

• BASIC RIGHTS:

The Costa Rican Constitution guarantees basic rights for the work force within its territory. Such rights are specifically comprised in the Constitution, the Labor Code and in other legal provisions. Those rights cannot be waived by any employee in Costa Rica.

• FOREIGN LABOR:

Foreign nationals without residency status and/or labor permits are not allowed to work in Costa Rica. Local and foreign entities doing business in Costa Rica may apply for special authorization from the Immigration Office to bring temporary labor, namely high-ranked executives and/or technicians, into the country. In practice, qualified foreign labor, primarily white collar and specialized or highly trained individuals, are treated by the authorities in a flexible manner.

• EMPLOYMENT CONTRACTS:

As a general rule, Costa Rican Labor Laws require employment contracts. However, lack of contracts does not harm the parties or diminish their rights. Employment contracts are simple private agreements executed between the employer and the employee and are not formally recorded.

• TERMINATION OF EMPLOYMENT CONTRACTS:

An employer may terminate an employment contract when:

- *Management unilaterally resolves to terminate the contract, in which case the employee is automatically entitled to severance indemnities.*
- *The employee commits faults that allow the employer to issue an immediate dismissal without severance.*

An employee may terminate an employment contract upon:

- *Resignation.*
- *The employer committing a fault that allows the employee to immediately terminate the contract with entitlement to severance indemnities.*

Just causes whereby an employer may dismiss employees without severance pay and those where an employee may terminate the contract entitled to severance pay are restrictive and specifically listed in the Labor Code.

• SEVERANCE INDEMNITIES:

Employees are only entitled to severance indemnities upon termination of the employment contract without just cause. Severance indemnities consist of:

- **Advance Notice**

  After one year of continuous employment, both parties are entitled to one month's advance notice; from six months to one year, fifteen day's advance notice; and from three to six months, one week's advance notice. In lieu of advance notice, at the option of employer, the employee may remain at work during those same time spans and receive an equivalent salary;

- **Lenght of Service**

  After one year of continuous employment, the employee is entitled to one month's advance notice; from six months to one year of employment, twenty days' salary; and from three to six months of employment, ten days' salary.

Length of Service accumulates annually to a maximum of eight months (e.g. if an employee has worked for two years he is entitled to a two-month severance for length of service, if three years, three-month severance and so on until the eighth year when the limit is reached.)
Payment is computed on the average of the last six months salary prior to termination.
Although not part of the severance package, the Christmas Bonus must be computed and paid on a pro-rata basis upon termination of the employee. Also, accrued vacation must be paid out to the employee.

• CHRISTMAS BONUS:

The Christmas Bonus is an additional one-month salary paid to all employees after one year of employment and is payable each year during the first twenty days of the month of December. If the employee has not worked a full year, the bonus is paid pro-rata.

• VACATION:

All employees are entitled to a two-week paid vacation for every fifty weeks of continuous employment. Upon termination of the employment contract, if vacation was not taken or partially taken, the employee is entitled to payment at a rate of one day's salary for each month worked during any given year.

• MATERNITY AND ILLNESS LEAVES:

Maternity leave entitles the employee to a one-month leave prior to delivery and three months thereafter. Pregnant employees or within their nursing period, may only be dismissed with just cause. Leaves due to partial work disabilities (e.g. illness, disease) are granted by the Social Security System after a medical examination.

• OCCUPATIONAL RISK INSURANCE:

All employers must carry an insurance policy with the National Insurance Institute to cover occupational risks.

• WAGES:

Minimum wages are mandatory for each labor activity. Such wages are concurrent with an official cost-of-living index and are adjusted twice a year by the National Wages Council. Compensation structures may be chosen freely as long as the minimum wage is observed.

• OVERTIME:

The law allows work beyond the statutory workday provided it does not exceed twelve continuous hours, except in highly unusual circumstances.
Overtime wages are equivalent to the corresponding hourly rate plus 50% (i.e. time and a half). These rules only apply to regular workers and administrative employees. There are specific rules for night shifts.

• SOCIAL SEGURITY SYSTEM:

A Public Institution accessible nationwide known as the Costa Rican Social Security Office ("Caja Costarricense de Seguro Social") manages the National Health System together with the Ministry of Health. Therefore, employer and employee contributions are mandatory as a percentage of all monthly salaries and amount to 22% on behalf of the employer and 9% on behalf of the employee, with no upper limits on the amount of earnings subject to contributions.

The system includes two regimes, which are mandatory for all legally established employers and employees:

1. Ilness and maternity (medical treatment)
2. Disability, old age and death (pensions)

The Social Security System does not prevent employers or employees from creating or joining previously existing complementary pension, health or retirement plans.

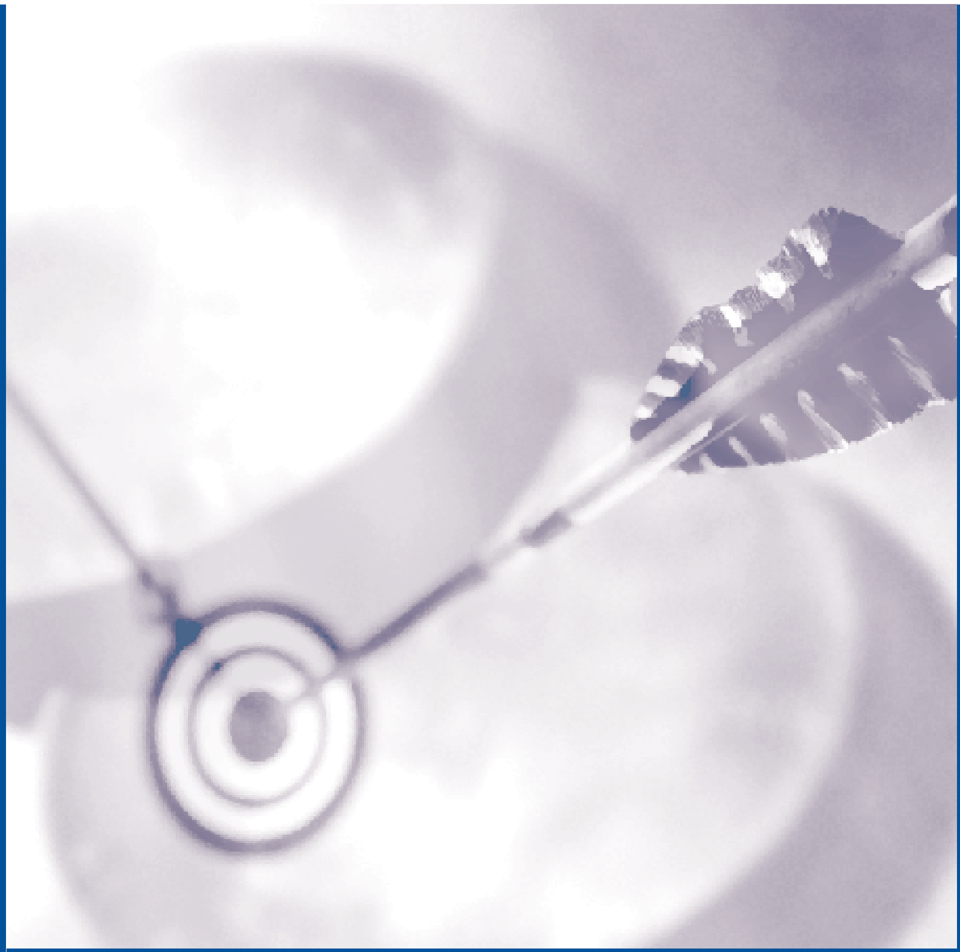
• EMPLOYEE PROTECTION ACT:

The Employee Protection Act ("Ley de Protección al Trabajador") number 7983, dated February 16th, 2000, creates a new contribution on the part of the employer that arises to a 3% calculated on the employee's monthly salary. This 3% shall be paid during the labor relationship, with no year limit, and it will constitute a Labor Capitalization Fund under the employee's name. A 50% of this contribution will be transferred annually to an entity that will administer the Mandatory Regime of Complementary Pensions, and the other 50% will be administered as a labor saving.

The Costa Rican Social Security Office through a Centralized Collection System will collect this contribution. This office is currently enabled to close a company or business for a period of five days, when the responsible person does not provide the information requested by the office's supervisors, or when two months of social security contributions are due.

CHAPTER VI

FOREIGN INVESTMENT



Attitude Towards Foreign Investment

Costa Rica has long been recognized as a regional leader in Latin America of social and economic development. It guarantees economic stability with the highest standard of living in the Caribbean Basin, and political stability with the longest standing democracy in Latin America. As a result, the business environment in Costa Rica is generally stable. The Costa Rican government welcomes foreign investment. This positive attitude is backed by all major political parties. Since 1982, Costa Rica has consistently improved investment conditions. The Costa Rican Coalition for Development Initiatives (CINDE), an association of private sector leaders, actively promotes investment through offices located in several countries.

The last successive governments have been moving away from state controls and towards an open economy in anticipation of free trade agreements with nations like Mexico (already in force), Chile, Panama, Trinidad and Tobago. Costa Rica is currently negotiating free trade agreements with Canada and the Dominican Republic. A number of Bilateral Investment Treaties (BITs) have been signed, such as the ones with Germany, France, Taiwan, Spain, Switzerland, Canada, Chile, United Kingdom, Venezuela, Argentina, Holland, Paraguay, South Korea, Poland and others.

Foreign investment in Costa Rica is strongly encouraged as evidenced by the wide range of incentives available.

Tourism Incentives

To apply for a tourism contract, the activity must first be officially declared as tourism oriented. The most significant criteria used in making such a declaration include contribution to the balance of payments of the country, generation of employment and satisfaction of the demand for tourist services. The major incentives offered are:

1. 100% duty free import of equipment and furniture. This includes vehicles with a minimum capacity of 15 passengers;
2. 100% income tax exemption on retained earnings for a 12 year period. This exemption is not included in tourism contracts granted after April 3, 1992;
3. Accelerated depreciation of assets in hotels and air water transport for tourists.

In general, the above mentioned tourism incentives are granted to the following activities: hotel services, air transportation for local and international tourists, vehicle rental for local and international tourists, water transportation for tourists and the receptive tourism business of travel agencies that are exclusively dedicated to this activity.

Export Oriented Operation

Export oriented investments in Costa Rica are normally structured under one of the following two incentive systems:

INCENTIVE SYSTEMS
Free Trade Zones (Free Zones)
Special Drawback

Free Trade Zone Incentive System

The Free Trade Zone is comprised of regulated, non-residential areas called "Free Trade Zone" parks. Within these parks, companies that process or manufacture goods to be exported to third markets and service industries or Science and Technological Development companies can be located, and can operate under a special status with significant tax incentives. Under certain limited circumstances, these same incentives may be granted to companies operating outside the Free Trade Zone parks.
Six types of companies can be established in a Free Trade Zone:

- *Export processing industries that produce and process for export.*
- *Trading companies that distribute non-traditional products.*
- *Service companies that provide services to export companies or to beneficiaries of the Free Trade Zone.*
- *Individuals or corporations dedicated to scientific research contributing to the improvement of the technology level of Costa Rica.*
- *Vessel construction, repair and maintenance industries which intend to provide and operate dry-docking facilities, shipwright services and similar work.*
- *Management firms to which concessions have been granted for the administration of the Free Zones.*

• NEW INVESTMENTS:

Incorporation into the Free Zone System is granted only to companies making new investments in Costa Rica, and under the following conditions:

- *An initial new investment in fixed assets of at least US$150,000.00 in companies located in an industrial park or authorized to operate under Free Trade status.*
- *An initial new investment in fixed assets of at least US$2,000,000.00 in companies located outside of an industrial park and authorized to operate under Free Trade status.*

• TAX INCENTIVES:

Under certain situations Free Trade Zone companies will have the following tax incentives:

- *Exemption from all taxes and consular fees corresponding to the importation of raw materials, processed or semi-processed products, components and parts, packing materials, and all other merchandise and goods required for operation.*
- *Exemption from all types of import taxes and consular duties which apply to importation of equipment, machinery and vehicles necessary for operation, production, administration and transportation. The vehicles and vehicle parts eligible for exoneration are:*

  ~ Chassis with one or two ton cargo capacity, single cabin.
  ~ Trucks or chassis for trucks.
  ~ One or two ton cargo capacity pick-up trucks.
  ~ Vehicles with a minimum passenger capacity of fifteen.

- *Exemption from all taxes and consular fees levied against the importation of lubricants required for operation.*
- *Exemption from all taxes associated with the export or re-export of products.*
- *A ten-year exemption, effective upon initiating operations, from taxes on net capital and assets, property, and real estate transfers.*
- *Exemption from sales and consumption tax on the purchase of goods and services.*
- *Exemption from all taxes for remittances abroad.*
- *Exemption from all taxes on profits or taxable income, dividends paid to shareholders, or sales in accordance with the following:*
- *For companies located in "greater relative growth" zones, the income tax exemption will be one hundred percent (100%) for the first eight years and fifty percent (50%) for the following four years.*
- *For companies located in "lesser relative growth" zones, the income tax exemption will be one hundred percent (100%) for the first twelve years and fifty percent (50%) for the following six years.*
- *Entities established in Free Zones located in "lesser relative growth" zones, as defined by the Ministry of Planning, will be eligible to receive a bonification equivalent to ten percent (10%) of the total sum paid out in salaries in the year immediately preceding the current year, upon submission of payroll documents to the "Caja Costarricense del Seguro Social" (Social Security Authorities).*

- *Customs clearance is simplified and takes place directly at the Free Zone park facilities.*
- *Companies classified as export processing or service industries can sell up to 40% of their total production in the Costa Rican market. Introduction of these products into the Costa Rican territory is subject to the same taxes and import duties as merchandise entering Costa Rica directly from abroad. However, no taxes of any sort will be paid on the Costa Rican value added.*

• INDEPENDIENT HANDLING OF FOREIGN CURRENCY:

Companies in the Free Zones are not obligated to remit foreign currency earned from sales to foreign markets to the Central Bank of Costa Rica. Instead, they are permitted to manage their foreign currency with flexibility and repatriate capital to pay for licenses, commissions, royalties and imports at their own discretion.

• SERVICES GRANTED BY FREE ZONES OPERATORS:

Once a project is established in a Free Zone, the newly established company will receive benefits such as:

- *Personnel recruitment.*
- *Arrangements to train personnel in Costa Rica's National Training Institute (INA) and the Technological Institute.*
- *Coordination with local industries and organizations for raw materials and procurement services.*
- *Educational and housing aspects.*
- *Medical facilities on site.*
- *Day care facilities on site.*
- *Round the clock security.*
- *General maintenance.*
- *Landscaping.*
- *On site customs.*
- *Courier services.*
- *Satellite communications.*
- *Post office and banking facilities.*
- *Sewage disposal plant.*

Special Drawback Incentive System

The Special Drawback Incentive System (Perfeccionamiento Activo in Spanish) incentive system allows companies to import raw materials into the country without paying import duties, to be processed or "improved", and then be re-exported (although a percentage may be sold locally). The main tax benefits of the system are:

- *Suspension of import duties on:*

  ~ Raw materials.
  ~ Semi finished goods.
  ~ Machinery and equipment.

- *VAT and consumption tax exemption on locally purchased goods.*
- *These benefits are granted in full to companies that re-export 100% of their production. If the company chooses to sell part of the production locally it must:*
- *Seek authorization to do so from local authorities.*
- *Pay import duties for the raw materials or semi-finished goods used in the manufacture of the locally purchased goods.*
- *Pay import duties for the import of machinery and equipment, equal to the percentage of production sold locally (i.e. if 20% of production is sold locally, then 20% of import duties must be paid).*

Forestry Incentives

Under Law 7575, the government grants Certificates for Forest Conservation (CCB) to compensate proprietors or landowners for environmental services rendered to Costa Rica through the preservation of forests which are located on the respective property. However, prior to applying for the certificate, the law requires certification that no lumbering activity has taken place during the two preceding years, and that there will be no lumbering during the duration of the certificate which carries a minimum of twenty years. These certificates are marketable instruments that may be bought and sold or used for the payment of tax liabilities or other contributions. The value of the certificates has not yet been determined under the new forestry regime. The holders of the certificates are also entitled to the following benefits:

BENEFITS	
	100% land tax exemption
	Special protection by police authorities against squatters that may invade the property
	100% Asset Tax exemption

The certificates must be registered with the Public Registry as liens on the property for a specified period of time that is indicated by the corresponding regulations of the Forestry Law.
Another system of incentives exists for proprietors who manage natural forests and provide environmental services to Costa Rica. The above-mentioned benefits are included among others.
Also, the same benefits are granted to proprietors of deforested land that engage in reforestation activities. The activities must meet certain technical criteria as set forth by the forestry authorities and the authorities record a lien on the property with the Public Registry.

The following benefits are also granted to proprietors engaged in reforestation activities:

BENEFITS	
	100% land tax exemption for cultivated land
	100% land tax exemption for uncultivated land
	100% Asset Tax exemption during the preoperative periods
	Special protection by police authorities against squatters that may invade the property.

Persons that engage in reforestation activities without the use of resources from prior forestry regimes (i.e. income tax deductions or CAFs) will enjoy the benefit of a 100% income tax exemption on all income derived from the commercialization of their products. In cases where the reforestation activities have been financed with benefits granted under prior forestry regimes, the income tax exemption would be proportional.

Mining Incentives

Costa Rica is attempting to attract investment in the mining industry. A new mining code, which is more favorable to investment, has been proposed to Congress.
The Ministry of Natural Resources, Energy and Mines grants two kinds of permits to individuals or companies interested in mining:

~ *An exploration permit*
~ *An exploitation concession. Investors may also invest in a functioning concession through lease or purchase.*

Beneficiaries of exploration permits and exploitation concessions are granted import duty exceptions on imported mining equipment. Exploration taxes are approximately USD 12 per square kilometer and exploitation taxes are approximately USD 120 per square kilometer.

Agriculture Incentives

The law establishes exemption from all duties and surcharges on imports of machinery, equipment and materials to be used for agriculture, or goods required for fishing activities (except for sport fishing).
Furthermore, agricultural entities are exempt from all tax and surcharges, except for custom rights on raw materials needed for manufacturing of components for agricultural activities and for banana packaging. Benefits also include fuel required for fishing activities.

CHAPTER VII

OFFSHORE CORPORATIONS

In practice and based on the regulatory environment, local companies may operate as offshore companies. Because Costa Rican tax legislation is based on the territorial principle, income earned outside Costa Rica (including distributions to shareholders) is not subject to local taxes. Therefore, a Costa Rican company may have investments in any currency and in any part of the world, and the related foreign-source income would not be subject to tax in Costa Rica.

The one crucial requirement for such a company is that no business be performed within Costa Rica. Tax Authorities have ruled that legal and accounting fees paid to local individuals or companies for the maintenance of such companies would not result in a violation of this rule.

All Costa Rican companies must file an annual tax return, regardless of whether operations are carried out or not.

Although the accounting records may be kept outside Costa Rica, a set of legal stamped books, which include journals, general ledger and financial statements must be kept in Costa Rica and in local currency.

Costa Rican companies are not allowed to issue bearer shares. Also, it should be noted that after incorporation, shares may be transferred by endorsement and such transfer need only be posted in the Stockholders' Registry. This registry is not filed with any government institution and can only be requested in judicial proceedings.

CHAPTER VIII

BANKING

Overview of the Banking System

The banking system is currently comprised of the Central Bank, three state-owned commercial banks, two service banks created by law, more than twenty private banks, two cooperative banks, and almost seventy financial institutions. The "General Supervisory Agency of Financial Institutions ("Superintendencia General de Entidades Financieras" or "SUGEF") monitors all financial institutions (both banks and non-banking financial institutions).
The Costa Rican Central Bank is responsible for monetary, credit, and foreign exchange policies. It is an autonomous public institution that possesses administrative independence. However, it operates in close coordination with the executive branch of Government. Its main function is to control monetary variables.

• STATE-OWNED BANKS:

The three Estate owned commercial banks are autonomous public corporations that are administratively independent yet subject to Government regulations. They operate under a Board of Directors appointed by the Executive Branch for an eight-year period.
State banks include the following institutions:

1. Banco Crédito Agrícola de Cartago
2. Banco de Costa Rica
3. Banco Nacional de Costa Rica

There are also two service banks created by law:

BANHVI (a home mortgage bank): Created as a source of financing for low-income families to acquire housing. This bank is funded by the Costa Rican Government.

Banco Popular: Funded through statutory national payroll withholdings.

• PRIVATE BANKS:

Private banking has traditionally been limited in Costa Rica, primarily in that private banks were not allowed to maintain checking and savings accounts. However, these limitations have been eliminated as of September 1996. Today, most private banks offer dollar denominated checking accounts through offshore subsidiaries as well as locally held foreign and local currency denominated checking and savings accounts. Other sight-fund financial vehicles are allowed and commonly used. There are over twenty private banks operating in the country.

• NON-BANKING FINANCIAL ENTITIES:

According to the law, non-banking financial entities are corporations that act as financial intermediaries on the local and/or foreign markets, to obtain working capital and general financial resources for activities carried out by individuals and business entities. Currently, finance companies represent a small percentage of the total financial system, and most of their transactions have a term of less than one year.

• SERVICES AVAILABLE:

Banks usually engage in the following services:

- *Finance production activities.*
- *Finance imports and exports.*
- *Provide loans to the general public.*
- *Furnish business credit in conjunction with the Central Bank.*
- *Receive time deposits in both local and foreign currencies.*
- *Accept fixed-period deposits.*
- *Provide checking and savings accounts in colones and United States dollars.*
- *Draft collections.*
- *Letters of credit.*
- *Direct payments.*
- *Credit card operations.*
- *Foreign exchange transactions.*
- *Wire transfer services.*
- *Working capital financing.*
- *Financial intermediation.*
- *Trust contracts.*
- *Bonded warehouses.*
- *Time deposits.*
- *24-hour automatic teller machines (ATMs).*

All banks also offer certificates of deposit in colones or U.S. dollars. No interest accrues after the expiration date.

• OTHER:

• Stock Exchanges

The National Stock Exchange, ("Bolsa Nacional de Valores"), started operations in 1976, and has rapidly grown since then. It has emerged into a stable and reliable fixture of Costa Rica's economic life involved in negotiating securities through brokerage firms at set rates and schedules. The Costa Rican Stock Exchange publishes daily, weekly and monthly bulletins with complete disclosure of all transactions. It also provides access to sellers and buyers in a regulated environment through registered brokers-dealers. Trading is focused almost exclusively on Government securities. The trading volume at the equity market amounts to approximately 1% of the total annual trading volume.

The General Supervisory Agency of Securities ("Superintendencia General de Valores" or SEGEVAL") is the governmental entity charged with regulating the local securities markets. The regulatory framework is set forth in the Securities Market Regulation Act of 1997 ("Ley Reguladora del Mercado de Valores" or "LRMV"). The National Supervisory Counsel of the Financial System ("Consejo Nacional de Supervisión del Sistema Financiero" or "CONASSIF") authorizes public offering of securities, which are subject to SUGEVAL's regulation and supervision.

The LRMV's regulation of primary market activities is based on the timely disclosure of material information regarding both the issuer and the issuance whenever a public offering of securities has been made. The LRMV defines a public offering of securities as any offer, explicit or implied, that proposes to issue, allocate, trade or deal in securities, transmitted through any means to the public or to given groups thereof. Filings to obtain CONASSIF's authorization to carry out a public offering include, among other documentation, i) a formal request thereto; ii) information on external audits performed on the issuer as well as affiliated companies, if it is so requested; iii) and the registration of an informative prospectus for the securities being issued.

SUGEVAL's authorization is needed to provide financial advisory or brokerage services if such services are publicly offered or marketed. To broker transactions at the local exchange, a firm must be a shareholder in the National Stock Exchange in addition to SUGEVAL's authorization.

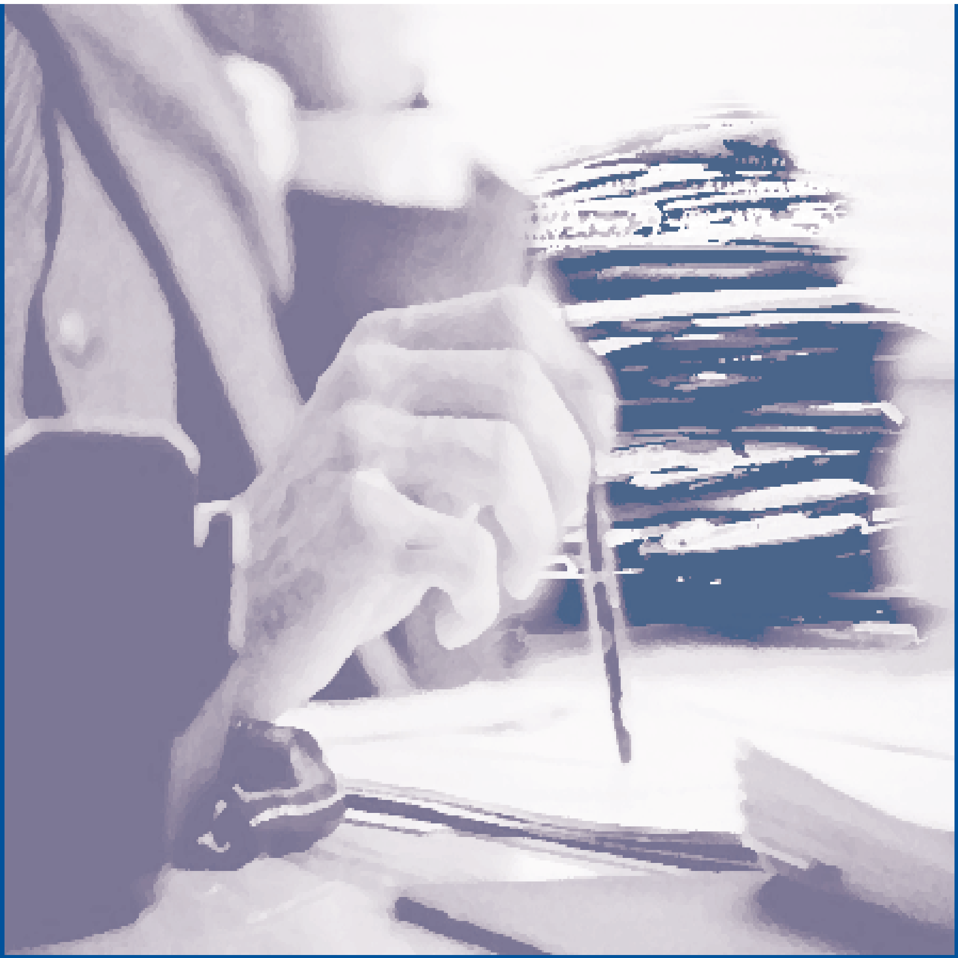
• Pension Funds

The recently enacted Employee Protection Act ("Ley de Protección del Trabajador"), above mentioned, is expected to strengthen the operation of private pension funds. These pension funds will complement the basic pension regime administered by the Social Security Administration (Caja Costarricense del Seguro Social). Funding will come from compulsory contributions by employers on behalf of their employees, which amount to 1.5% of monthly salary. An additional 1.5% is also contributed as a savings for the account of the employee. These savings are redeemable every five years. Pursuant to this new legislation, pension funds may only invest in securities issued by authorized banking and financial institutions or securities registered before SUGEVAL.

Pension funds are managed by special-purpose companies ("Operadoras de Pensiones Complementarias") which must be authorized by the Supervisory Agency of Pension Funds (Superintendencia de Pensiones) the pension system regulatory agency. It is expected that pension funds will become a major force in the development of a local capital market.

CHAPTER IX

TRUSTS



A trust is a legal entity created by a grantor for the benefit of designated beneficiaries under both the laws of Costa Rica and the rules of the trust instrument. In a trust, the trustee holds a fiduciary duty and is responsible of managing the trust's corpus and income for the economic benefit of the beneficiaries.

The Essential Elements of Trust are:
The founder (or grantor)
The designated beneficiary or beneficiaries
The trustee
An asset or right sufficiently identified to enable a title to pass to the trustee
Actual delivery to trustee with intention of passing title

Said parties may be either an individual (s) or a distinct entity (ies). Through a trust the grantor transfers property of assets or rights to the trustee. The trustee is thereby obliged and compelled to use the trust property for certain legitimate purposes predetermined in the trust instrument. Assets and/or rights of any kind may be transferred to a trust as long as they are subject to trade. The grantor may designate one or more trustees to act either jointly or separately.

Trusts are constituted in writing. If the assets in a trust are subject to registration under the laws of Costa Rica, the transfer itself must be registered in the corresponding Registry in the name of the trustee. Notwithstanding this, the entrusted assets and/or rights of any kind are fully and legally separated from those of the trustee.

In accordance with Costa Rican laws, a trustee is prevented from:

- *Delegating its fiduciary duties. However it can appoint agents or special proxies to perform certain actions or comply with specific duties there to under its own responsibility.*
- *Directly or indirectly being or becoming a beneficiary of the assets under its administration.*
- *Guaranteeing a fixed return on the entrusted assets.*

The trustee is liable for any losses suffered by the trust, caused by fault, negligence or any other mishandling of entrusted assets. In order to reduce the risk , the trustee may not, at any time, engage in investment activities exceeding one third of the total entrusted assets (or their proceeds) into a single venture unless specifically instructed otherwise by the grantor. Trusts with secret purposes are strictly prohibited.

In recent years, trusts have become highly effective instruments not only for their traditional purposes (testamentary) but also for investment purposes, flexible guarantee structures and a wide array of corporate, commercial and financial transactions. Trust agreements allow the parties to very freely design the particular terms and conditions that will rule their relationship outside of the often intricate and confusing provisions established in traditional legal rules. Although trusts are regulated by written law (Code of Commerce) the relevant set of rules thereto are of a very simple and straightforward nature thus allowing much room for creativity which in turn generate highly efficient business relations.

CHAPTER X

DISPUTE RESOLUTION

Costa Rican Courts provide a forum for a fair and adequate resolution of disputes, ranked among the best in Latin America. In the most recent assessment of Costa Rican judicial system, the United States of America Department of State found that Costa Rica's Constitution provides for the right to a fair trial, that is vigorously enforced by an independent judiciary. On numerous occasions United States' federal courts have dismissed a pending action on "forum non conveniens" grounds, finding that the courts of Costa Rica were an adequate and available forum.

Notwithstanding the above, Costa Rica has very modern alternative dispute resolution (ADR) provisions, specially in the mediation and arbitration areas. Since 1949 article 43 of the Costa Rican Constitution has recognized every person's right to settle disputes through the use of arbitration. Moreover, two very important international arbitration agreements have been ratified by Costa Rica (United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and the International Convention on the Settlement of Investment Disputes Between States and Nationals of Other States). Furthermore, in 1995 the Costa Rican Government submitted one of the most important cases of expropriation of foreign-owned property to the jurisdiction of the International Centre for Settlement of Investment Disputes (ICSID). This case has already been decided.

With regards to domestic legislation on ADR, on January 1998, Congress enacted the "Alternative Dispute Resolution and Promotion of Social Peace Act" (ADR Act). This act has become the primary legal instrument for dispute resolution mechanisms in Costa Rica. This Act was a result of the tendencies of the international legal community, specifically in the United States, and a response to requirements and suggestions made by of multilateral and international financial institutions, namely the World Bank and the Inter-American Development Bank. In its effort to attract foreign investors, Costa Rica decided to renovate and allow foreign investors to use neutral, efficient and, generally faster procedures to solve their conflicts with local partners, suppliers, the government, etc. In this sense, the ADR Act made very important changes to the situation of mediation and arbitration in Costa Rica that was in effect before the enactment of said law.
In general, the ADR Act stipulates that all lawyers must advise clients of ADR possibilities and that every citizen has a right to solve a dispute in an expeditious, efficient and peaceful way.

Prior to the enactment of the ADR Act, mediation was an unregulated area. The ADR Act establishes that parties are free to choose any procedure to mediate a dispute, either pending before a court, or not. Two very important aspects are: that the mediation agreement has the effect of a final judicial decision, and, that a mediator does not have to be a lawyer. Finally, the ADR Act governs the ethical aspects of the mediation process.

The ADR Act creates a very modern concept of arbitration. It is viewed as an independent process without judicial influence, except for a recourse allowed to set aside the arbitral award and declare it null and void in very limited circumstances. In addition, the parties are free to choose the process that will regulate the arbitration, and it gives autonomy to the arbitral clause through the kompetenz-kompetenz principle. The ADR Act allows the application of foreign law to resolve the dispute. Two important limitations, though, are that the procedures have to be conducted in Spanish, or in another language with proper translation, and that arbitrators must be Costa Rican lawyers. Finally, the Government and its agencies are free to submit their disputes to arbitration.

The final chapter of the ADR Act allows institutional mediation and arbitration. These institutions are regulated and supervised by the Ministry of Justice in accordance with the rulings of the law. This provision allows private entities to participate in the administration of ADR procedures. Currently, the most important alternative dispute resolution centers are the International Center for Conciliation and Arbitration of the Costa Rican - American Chamber of Commerce (AMCHAM) and the one of the local Chamber of Commerce. Both have a set of procedural and ethical rules and a panel of arbitrators and mediators.

CHAPTER XI

ENERGY MARKET AND REGULATIONS

Background

Costa Rica currently has enough electric generation capacity to sustain itself, and has in fact become an exporter of electric power to other Central American countries. With an area of just 51.000 square Km, it has more than 150 rivers with class 3 grading or higher. Costa Rica's three mountain ranges and low coastal plains, along with a tropical climate make this small nation a wealth of hydroelectric power potential. Also, its 64 volcanic formations, 8 of which are active, provide excellent geothermal resources. However, most of Costa Rica's installed capacity (77%) comes from hydropower, and most of its planned capacity additions are to be realized with water as well. Other smaller sources of installed power are thermal, geothermal and wind.

The Instituto Costarricense de Electricidad ("ICE"), Costa Rica's government-owned power and telephone company, maintains monopoly control over the generation, transmission, and distribution of electricity. ICE was created in 1949 and has total assets in excess of US$ 3 billion, with and annual budget of US$ 800 million. Since it's creation, ICE has been successful in providing the Costa Rican population with access to electric power with a 94% national electrification rate. However, the country's debt service, particularly with respect to internal debt, has made financing of large and new projects increasingly difficult and has required the gradually increasing participation of the private sector in power generation.

With a total installed capacity of about 1400 megawatts, the Costa Rican government projects it will need capacity additions of between 250-400 MW by 2004, and 500-1000MW by 2013. The country has about 1,600 Km of main transmission lines, and an additional 400 Km of lines need to be built in the next 2 to 3 years. While there are several small facilities under development or in construction, the government of Costa Rica, would like to reap the benefits of economies of scale by constructing one or more large and efficient facilities. ICE has completed feasibility studies on its Boruca dam project, which could potentially supply in excess of 1200 MW of power to Costa Rica and the Central American region (provided that the SIEPAC regional transmission line is built as projected). The cost of this project would be on the order of $U.S.2 billion-which is roughly 20% of Costa Rica's GDP. Launching a project of Boruca's magnitude is virtually impossible without private sector participation.

Costa Rica is grappling with regulatory challenges and with a difficult political environment with respect to the needed changes. The nation's dual party legislature had traditionally been divided on the issue of opening up the generation sector to private ownership. The current administration however, was able to successfully gather the needed votes from the two major parties in the legislature to approve a bill that would have resulted in the elimination of the government monopoly. However, initial approval of the bill was faced with stiff opposition and protests led by congressional minorities, ICE's unions, environmentalists and other pressure groups. These groups ultimately forced the

Government to withdraw the bill from the legislature and to appoint a Special Congressional Committee to review it and amend it. The bills future is, at best, uncertain. The legislative challenges that lie ahead for this and future administrations will determine the possibility of an increased participation of the private section in the different areas of the energy business. Until the monopoly is disbanded, any infusion of needed private capital will be limited and based on the currently existing legislation.

Current Regulatory Environment

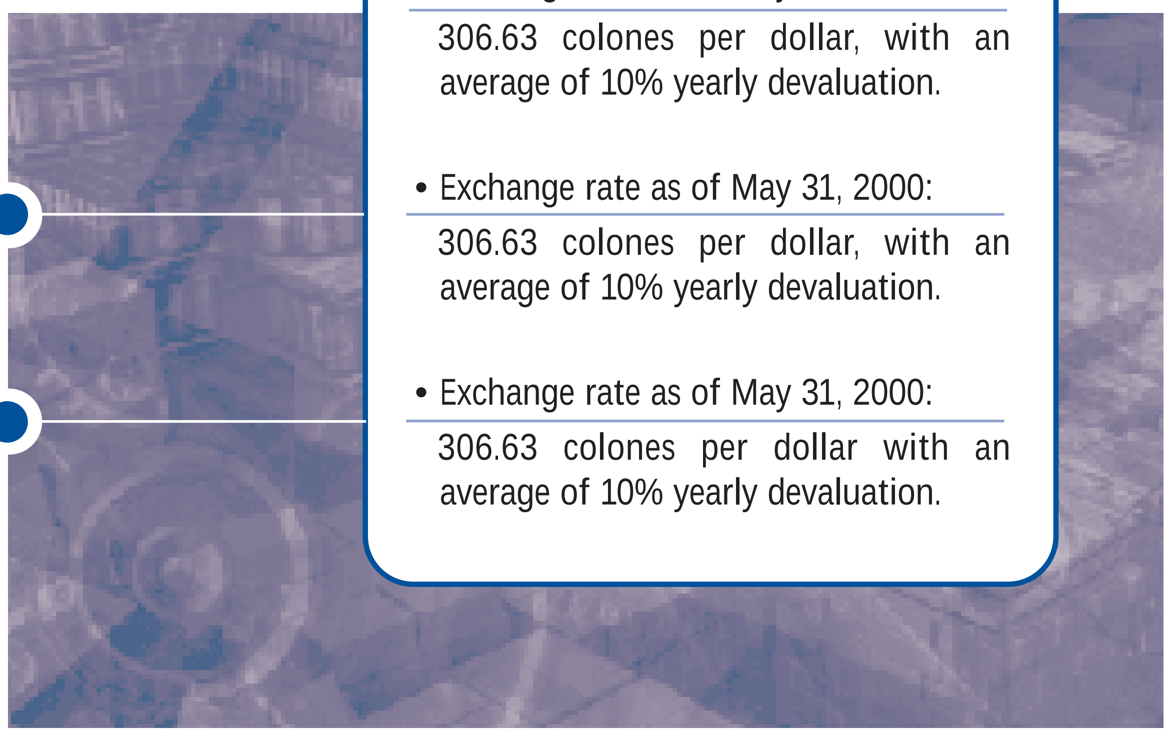
In 1990, the Costa Rican legislature enacted the Independent Power Producer Act (Ley que Autoriza la Generación Eléctrica Autónoma y Paralela - Ley No 7200), allowing for the development of small Independent Power Projects ("IPP's") with a capacity of up to 20MW. These projects are developed under a Build, Operate and Own ("BOO") and on the basis of a 15 year Power Purchase Agreement entered into with ICE for 100% of their production. However, in accordance with the same Act, power generated from BOO projects may not exceed 15% of the nation's total installed capacity.

The 1990 IPP Act was certainly a milestone for private power in Costa Rica, but it quickly became apparent that the 20MW / 15% limits were a serious restraint to the development of the required private power sector. As a result, the Act was amended in 1995 and a second chapter was added to it. Act 7508 of 1995, introduced important amendments to the provisions of the 1990 Act among which was the requirement that 65% of the equity in all generating facilities be held by Costa Rican nationals. The new legislation lowered domestic equity ownership requirements to only 35%. Also, it authorized ICE to purchase power equivalent to an additional 15% of the nation's total installed capacity from IPP's through public and international competitive bidding. These new power projects, regulated in chapter II of the IPP Act, have the ability to generate up to 50 MW, and must be structured as Build, Operate and Transfer ("BOT") projects on the basis of long term Power Purchase Agreements entered into with ICE for 100% of their production. The exact contract structures can vary, but the constant is that generating assets must revert to ICE at the end of a Power Purchase Agreement term, which is usually 15 to 20 years.

The current regulatory environment favors the development of small-scale projects by the private sector. If this trend continues, it may eventually displace the need for capacity from larger facilities such as Boruca. Smaller projects are easier to develop and raise fewer concerns from pressure groups (i.e. environmentalists tend to view large-scale foreign investment as contrary to sustainable development).

Overall, the IPP Act has been a successful and important piece of legislation. Over its 10 year lifespan it has allowed for the development of about 34 BOO and BOT projects with a combined generation capacity of about 225 MW. The Costa Rican Independent Power Producer Chamber estimates the investment for the construction of these power generation facilities to be around US$ 400 million. Furthermore, the investment and development opportunities that this Act created have attracted not only world class developers, but also world class financial institutions such as the Central American Bank for Economic Integration ("CABEI"), the Danish Development Agency ("Danida"), the International Finance Corporation ("IFC"), the Inter-American Investment Corporation ("IIC"), the Inter-American Development Bank ("IDB"), the Commonwealth Development Corporation ("CDC"), among others.

ICE has recently issued a request for bids for BOT projects totaling 150MW, and is seeking participation from several private operators, construction companies, and engineering firms. These solicitations represent still more steps in the right direction and show Costa Rica's eagerness to attract private and foreign investment.



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