Setting up your Business in El Salvador
Issues to consider

KRESTON INTERNATIONAL

El Salvador is strategically located in the heart of Central America, which makes it a natural fit for communications and business with countries in the region; also the use of the US currency (dollar) as legal tender represents a strong appeal for foreign investment, as they do not have to contend with exchange speculation for the use of a currency that it is not internationally accepted.

However there are a number of issues which one must consider when looking to set up a business in El Salvador (Central America). This document answers some of the common questions we come across and provides practical information about the issues any potential investor needs to consider.

What type of Business Structure should we use?
There are advantages and disadvantages to all of the business structures, and there is no one correct answer, it all depends on the specific business circumstances and needs. A brief overview of the main structures is below:

Establishment (a branch of your overseas business)

- It is not a separate legal entity, but an extension of the parent company abroad;
- Limited liability to transactions in El Salvador;
- Through a branch (permanent establishment), the company acquires the category of "domiciled", allowing the entity to enjoy its own commercial and tax benefits as a local company;
- Presentation of information from the Headquarters is required, inspection or supervision of the State is limited to the capital invested and the operations conducted by the branch.

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- Provides limited liability and the definition of the operations in the country;
- It gives a perception of a local company with longevity;
- The tax is based on earnings or profits;
- The financial statements required to be audited individually, regardless of the amount of income or assets; and
- Must appoint an auditor for opinion and tax report on compliance with formal and substantive aspects of tax crimes; provided that the income from the previous fiscal year are greater than USD 571,428 or its total assets at the end of the immediately preceding fiscal year exceeding USD 1,142,857.

LIMITED Company:

- Provides limited liability and the definition of operations in the country;
- Members (partners) have limited liability to their equity;
- It gives a perception of a local company with longevity;
- The tax is based on earnings or profits;

- Financial statements are required to be audited individually, regardless of the amount of income or assets; and
- Must appoint auditor for opinion and tax reports on compliance with formal and substantive aspects of tax crimes; provided that the income of the previous fiscal year are greater than USD 571,428 or its total assets at the end of the immediately preceding fiscal year exceeding USD 1,142,857.

Limited Liability Partnership:

- Members (partners) have limited liability
- Profits are allocated to members who then pay Income Tax on these profits personally
- The tax residence of the member, and where the profits in the LLP originated will determine in what jurisdiction and how these profits are taxed

How much Corporation Tax will the business pay?

Current Corporation Tax rates in El Salvador are:

Entities with gross income up to	USD 150,000.	25%
Entities with gross income exceeding	USD 150,000	30%

the percentage is calculated based on the net profit earned during the fiscal year.

(NB: rates are for the tax year to 31/12/2013)

The current government also plans to create new taxes to counteract the current fiscal deficit. The tax rate of an "establishment" is determined by the amount of assets to which the entity operates in El Salvador.
If an entity incurs a loss, it can offset it only against future profits from the same entity; they cannot be offset against profits from the parent company.

What if we use El Salvador to set up our holding company?
El Salvador's tax law treats each integrated holding entity as an individual taxpayer, you will pay taxes based on the benefits obtained independently of other entities that make up the holding. Therefore the income received by the holding company will be comprised of dividends generated by the member companies.
Dividends received by a parent company in El Salvador, either from El Salvador or from abroad are exempt from income tax in El Salvador; provided that the company that distributes the corresponding tax has paid such in the host country, and it is greater than or equal to the rate to which he would pay in El Salvador; otherwise the company must pay the supplemental tax to match the rate which it would pay in El Salvador.

In El Salvador, a special tax on dividends is applied; this corresponds to 5% of the value distributed, to be raised through "retention" by the distributor. This tax is applicable only in the first leg of distribution, to avoid the cascading effect.

All this makes El Salvador appealing to provide investors with an advantageous structure for operation of holdings.

What if we make cross-border transactions between group companies?
El Salvador follows the Transfer Pricing of International Recognition (TP) rules where cross-border trade and financial transactions between affiliated entities must be conducted at arm's length. The price and conditions should be the same as if the transactions were between completely independent parties.

Typical transactions between affiliated entities that are covered by the rules of TP are:

- ✓ Sale and purchase of goods;
- ✓ Provision of rental expense related to management of the property;
- ✓ Transfer of intangible assets, such as trademarks, patents;
- ✓ Sharing of knowledge, experience, business contacts, etc.
- ✓ Provision of financial support, such as inter-group loans and collection of "market" interest rates for loans.

A company will have to prepare a report showing the transfer prices based on the full responsibility of the transactions. The report shall include a functional analysis and risk analysis, model and price adopted benchmarking the competition.

All taxpayers who conduct transactions or transactions with related subjects are subject to the pricing transfer regime in El Salvador, and such operations either individually or together are equal to or greater than five hundred seventy-one thousand four hundred United States North America dollars (USD $ 571,400).

What Employment Taxes and Social Security will need to be paid?
If an individual is a resident of El Salvador, then he/she is subject to all tax, commercial and social security laws of the country.
The social security system is divided into two categories:

a) The social security "health" insurance; which is administered by the Salvadoran Social Security Institute (ISS). This system operates with a "maximum wage worker wage of $ 1,000 USD" and the contribution rate are:

	Tax rate (%)
Employer	7.5%
Worker	3.0%

b) The social security entrusted to companies "Administrators of Pension Funds" (AFP). The system operates with a "maximum wage worker quotable, of $ 6,319" and contribution rates are:

	Tax rate (%)
Employer	6.75%
Worker	6.25%

What is Value Added Tax (VAT) and should the business be registered?

VAT is a "tax on the consumption of goods and services", the applicable rate is 13%. Companies are required to register as taxpayers for this tax, when they have made transfer of tangible personal property or services, taxed and free, in the previous twelve months, in an amount equal to or greater than $ 5,714 USD.

Because the tax is levied on the "final consumption of the product or service" companies which are taxpayers, but are not the end users are involved in the collection of taxes in aggregate; therefore must collect sales tax upon completion of the transaction; but before submitting the collection to the Tax Administration they shall deduct all the tax credits accumulated during their purchases; thus reporting only the taxes imposed by the aggregate values, thereby avoiding the cascading effect.

The VAT is not a cost or expense to the company, unless it is acting as the final consumer of the good or service being purchased.
In export transactions, the VAT rate corresponds to "zero percent", therefore, if a Salvadorian entity sells goods or services to its foreign parent company, then there is no VAT payable for this transaction.

Can we provide Share option plans to our staff?

Many companies see option plans as an important way to attract, motivate and retain key personnel.

El Salvador has a number of "approved" share option plans that provide tax advantages to employees and employers alike and that it is often possible to adapt an "approved" stock option plan abroad to fit into one of these plans.

However this is a very technically complex area and careful planning needs to be undertaken as soon as share option plans are being considered for implementation in El Salvador.

How else can we compensate our employees?

In El Salvador, the law explicitly define the minimum benefits to which employees are entitled; however, the company can offer additional benefits or other compensation and in return receive some tax incentives. These benefits can include: private hospital health insurance, life insurance and partial or total disability; and other post-employment benefits.

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The information in this document was prepared as at 1 July 2016.