

EL SALVADOR



Law and Practice

Contributed by:

Manuel Telles Suvillaga and Rolando Suria
Mayora & Mayora, SC

Contents

1. Types of Business Entities, Their Residence and Basic Tax Treatment p.4

- 1.1 Corporate Structures and Tax Treatment p.4
- 1.2 Transparent Entities p.4
- 1.3 Determining Residence of Incorporated Businesses p.4
- 1.4 Tax Rates p.5

2. Key General Features of the Tax Regime Applicable to Incorporated Businesses p.5

- 2.1 Calculation for Taxable Profits p.5
- 2.2 Special Incentives for Technology Investments p.5
- 2.3 Other Special Incentives p.5
- 2.4 Basic Rules on Loss Relief p.6
- 2.5 Imposed Limits on Deduction of Interest p.6
- 2.6 Basic Rules on Consolidated Tax Grouping p.6
- 2.7 Capital Gains Taxation p.6
- 2.8 Other Taxes Payable by an Incorporated Business p.6
- 2.9 Incorporated Businesses and Notable Taxes p.7

3. Division of Tax Base Between Corporations and Non-Corporate Businesses p.7

- 3.1 Closely Held Local Businesses p.7
- 3.2 Individual Rates and Corporate Rates p.7
- 3.3 Accumulating Earnings for Investment Purposes p.7
- 3.4 Sales of Shares by Individuals in Closely Held Corporations p.7
- 3.5 Sales of Shares by Individuals in Publicly Traded Corporations p.7

4. Key Features of Taxation of Inbound Investments p.7

- 4.1 Withholding Taxes p.7
- 4.2 Primary Tax Treaty Countries p.7
- 4.3 Use of Treaty Country Entities by Non-Treaty Country Residents p.7
- 4.4 Transfer Pricing Issues p.7
- 4.5 Related-Party Limited Risk Distribution Arrangements p.8
- 4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards p.8
- 4.7 International Transfer Pricing Disputes p.8

5. Key Features of Taxation of Non-Local Corporations p.8

- 5.1 Compensating Adjustments When Transfer Pricing Claims Are Settled p.8
- 5.2 Taxation Differences Between Local Branches and Local Subsidiaries of Non-Local Corporations p.8
- 5.3 Capital Gains of Non-Residents p.8
- 5.4 Change of Control Provisions p.8
- 5.5 Formulas Used to Determine Income of Foreign-Owned Local Affiliates p.8
- 5.6 Deductions for Payments by Local Affiliates p.8
- 5.7 Constraints on Related-Party Borrowing p.8

6. Key Features of Taxation of Foreign Income of Local Corporations p.9

- 6.1 Foreign Income of Local Corporations p.9
- 6.2 Non-Deductible Local Expenses p.9
- 6.3 Taxation on Dividends From Foreign Subsidiaries p.9
- 6.4 Use of Intangibles by Non-Local Subsidiaries p.9
- 6.5 Taxation of Income of Non-Local Subsidiaries Under Controlled Foreign Corporation-Type Rules p.9
- 6.6 Rules Related to the Substance of Non-Local Affiliates p.9
- 6.7 Taxation on Gain on the Sale of Shares in Non-Local Affiliates p.9

7. Anti-Avoidance p.9

- 7.1 Overarching Anti-Avoidance Provisions p.9

8. Audit Cycles p.9

- 8.1 Regular Routine Audit Cycle p.9

9. BEPS p.9

- 9.1 Recommended Changes p.9
- 9.2 Government Attitudes p.10
- 9.3 Profile of International Tax p.10
- 9.4 Competitive Tax Policy Objective p.10
- 9.5 Features of the Competitive Tax System p.10
- 9.6 Proposals for Dealing With Hybrid Instruments p.10
- 9.7 Territorial Tax Regime p.10
- 9.8 Controlled Foreign Corporation Proposals p.10
- 9.9 Anti-Avoidance Rules p.10
- 9.10 Transfer Pricing Changes p.10
- 9.11 Transparency and Country-by-Country Reporting p.10
- 9.12 Taxation of Digital Economy Businesses p.10
- 9.13 Digital Taxation p.11
- 9.14 Taxation of Offshore IP p.11

Contributed by: Manuel Telles Suvillaga and Rolando Suria, **Mayora & Mayora, SC**

Mayora & Mayora, SC is a leading law firm in Central America established more than 55 years ago, with offices in Guatemala, El Salvador and Honduras (Tegucigalpa, San Pedro Sula and Roatán). The firm has a team of over 35 legal specialists who are ready to assist clients in a wide range of legal matters. Renowned for its excellence and ethical approach, the firm of-

fers legal assistance in multiple practice areas. It has been the exclusive member for Guatemala of the largest network of private law firms in the world, Lex Mundi, since its inception in the early 1980s. The firm and its attorneys have been recommended by the most reputable and renowned legal ranking agencies.

Authors



Manuel Telles Suvillaga of Mayora & Mayora provides legal advice to national and foreign banks and financial institutions, as well as to various companies, on their capital raising

structuring such as individual and/or syndicated loans, securitisations, international issue 144A/Reg S bond issuances, investment funds, leasing and project financing. He has participated in multiple M&As, as well as in the creation, incorporation and operation of companies in El Salvador. He specialises in providing financial, banking fiduciary, and corporate advice, serving recognised clients such as Banco General, SA, Banco Internacional de Costa Rica (BICSA), Credit Suisse, JPMorgan Chase & Co, Mobile Cash/Millicom, NEOEN, Grupo Terra, Laboratorios Vijosa, Crowley and OTIS.



Rolando Suria is part of the litigation department at Mayora & Mayora in the El Salvador office. To expand his domain in the procedural field, he has carried out various studies and

specialisations in the procedural aspects of commercial, administrative, tax and labour matters, among others. His experience includes providing judicial and extrajudicial advice and representation to national and international companies in these matters, for mediation, obligations, recovery, municipal taxes and contracts with the state.

Mayora & Mayora, SC

Avenida Los Espliegos No 30
Colonia San Francisco
San Salvador
El Salvador

Tel: +503 2212 0100
Fax: +503 2212 0120
Email: info@mayora-mayora.com
Web: www.mayora-mayora.com/en

MAYORA

MAYORA
Est. 1966

1. Types of Business Entities, Their Residence and Basic Tax Treatment

1.1 Corporate Structures and Tax Treatment

Businesses in El Salvador generally adopt a corporate form. Regardless of the corporate form adopted by the business, each entity is taxed as a separate legal entity from its members, partners or shareholders. The Salvadoran Commercial Code regulates five basic types of corporate entity:

- general partnership (*Sociedad Colectiva*);
- limited liability company or LLC (*Sociedad de Responsabilidad Limitada*);
- limited partnership (*Sociedad en Comandita Simple*);
- stock corporation (*Sociedad Anónima*); and
- limited partnership with share capital (*Sociedad Comandita por Acciones*).

Foreign corporations may organise branches.

The most commonly used corporate form is the stock corporation (*Sociedad Anónima* or SA). American corporations often adopt the corporate form of a limited liability company (*Sociedad de Responsabilidad Limitada* or SRL) for their subsidiaries in order to achieve look-through tax treatment.

As mentioned above, the corporate entity is taxed separately and must obtain a separate taxpayer number.

Since 16 February 2024, a new “*simplified corporation by stocks*” has been available, with minimum capital requirements and no formalities (in comparison to the traditional corporate forms). It can be organised as “*one-person company*”.

1.2 Transparent Entities

Under local law, there are no transparent entities for tax purposes. However, the Salvadoran LLC is commonly used by US corporations in order to achieve transparency before the US tax authorities.

1.3 Determining Residence of Incorporated Businesses

El Salvador has a double taxation treaty (DTT) with Spain (which is currently in force). Under this treaty, the general rule is that residence is determined on the basis of the criteria under the law of each state (indicated below) that make a person liable to pay taxes there. If under those criteria any person may be considered “*resident*” of both states, then the following criteria will be used to determine the tax liability:

- the state they have a permanent home available to them in;
- if they have a permanent home available to them in both states, the state where their centre of vital interest is;
- if the centre of vital interest cannot be determined, the state in which they have a habitual abode; or
- if they have a habitual abode in both states or in a third one, the competent authorities of the contracting states will settle the question by mutual agreement.

In addition to this DTT, the Salvadoran Tax Law sets out certain standards regarding residence. A corporation is considered “*resident*” for tax purposes if:

- it has been organised under Salvadoran law;
- the corporation is managed in/from El Salvador;
- the corporation has a tax or corporate seat in El Salvador;

- the corporation's centre of economic interests is located in El Salvador; and
- the corporation has a permanent establishment in El Salvador which is subject to taxation in El Salvador (not the foreign corporation).

1.4 Tax Rates

The Salvadoran income tax system differentiates between certain kinds of income. However, corporate and individually owned businesses are taxed at the same rate of:

- 25% on net income up to USD150,000 annual income; or
- 30% on net income above USD150,000 (the first USD150,000 will be taxed at 25%).

2. Key General Features of the Tax Regime Applicable to Incorporated Businesses

2.1 Calculation for Taxable Profits

As a rule, profits are taxed based on the accounting profits subject to some adjustments. The most common tax adjustments are certain limits to deductible expenses. Profits are taxed on an accrual basis.

2.2 Special Incentives for Technology Investments

Computer programming, software development, cybersecurity, and generative AI, among others qualify as technology investments by the Ministry of the Economy and are eligible for:

- income tax exemption for 15 years;
- import duties on the equipment and hardware required for the development of the eligible activities; and
- VAT on purchases and sales.

2.3 Other Special Incentives

There are currently tax incentives in the following industries:

- renewable energy-based power generation projects: eligible for an exemption from income tax for a period of five to ten years depending on the project's output measured in megawatts, and a total exemption from import duties on machinery, equipment, raw materials, and supplies for the construction of the power plant for the first ten years;
- manufacturing for exportation to foreign markets within free trade zones, as qualified by the Ministry of the Economy: eligible for an exemption from income tax for a period of ten to 15 years, from municipal taxes for a period of ten to 15 years, from real estate transfer tax on properties used for the eligible activity, and from VAT on purchases of local and/or foreign goods required for the eligible activity;
- provision of telecommunications services (including call centres and BPO): eligible for an exemption from income tax for a period of 15 years, from municipal taxes for ten years, from real estate transfer tax on properties used for the eligible activity, and from VAT on purchases of local and/or foreign goods required for the eligible activity;
- a National Tourism Industry Interest Project, as qualified by the Salvadoran Tourism Institute, requiring an investment equal to or greater than USD25,000: eligible for an exemption from income tax for ten years, from import duties, and from real estate transfer tax on the acquisition of properties intended for the project;
- issuers of digital assets, digital asset service providers, certifiers, and acquirers: exempt from all types of taxes, levies, duties, fees, or contributions on the nominal value and returns of digital assets, as well as on capital

gains or ordinary income derived from any type of digital asset transfer, as established in the Digital Assets Issuance Law;

- transactions related to digital assets: exempt from VAT and from withholding of any type of tax under the Digital Assets Issuance Law; and
- shareholders of companies engaged in digital assets: eligible for tax exemptions on the distribution of profits or dividends derived from digital asset-related activities, in line with the Digital Assets Issuance Law.

2.4 Basic Rules on Loss Relief

Losses incurred during a fiscal year can only be offset against profits for the same period. No carry forward or carry back is therefore allowed. However, in the case of capital losses, a five-year carry forward is allowed.

2.5 Imposed Limits on Deduction of Interest

Interest is deductible if paid in order to generate taxable income. Interest can only be deducted up to the rate determined by the Central Reserve Bank.

2.6 Basic Rules on Consolidated Tax Grouping

Group consolidation is not permitted for tax purposes. Each entity is considered a separate taxpayer.

2.7 Capital Gains Taxation

The taxable gain is determined by the difference between the book value or purchase value (as applicable) and the selling price. The capital gain will be the income minus the cost and improvements and will be taxed at 10%.

2.8 Other Taxes Payable by an Incorporated Business

Transactions are subject to VAT depending on their nature. In general, goods, services and merchandise transacted on commercial markets are subject to VAT at a rate of 13%.

Real estate transactions are subject to a real estate transfer tax of 3% on the transaction price if this is higher than approximately USD29,000.

Securities transactions are generally exempt from VAT.

2.9 Incorporated Businesses and Notable Taxes

There are no other notable taxes.

3. Division of Tax Base Between Corporations and Non-Corporate Businesses

3.1 Closely Held Local Businesses

Most closely held local businesses operate in a corporate form.

3.2 Individual Rates and Corporate Rates

Corporate rates are lower than individual professional tax rates from an annual net income of approximately USD23,000 up to approximately USD150,000. If the annual net income is higher than this, the rates are the same.

There are no rules preventing individual professionals from earning income at corporate rates.

3.3 Accumulating Earnings for Investment Purposes

There are no rules preventing closely held corporations from accumulating earnings for investment purposes. It is mandatory to create a 5%

reserve on net earnings every year, but when this surpasses one-sixth of the corporation's capital, it can be capitalised. Thereafter, the obligation to make a 5% reserve on earnings continues.

3.4 Sales of Shares by Individuals in Closely Held Corporations

Dividends are taxed at a final 5% withholding tax, independent of where the beneficiary resides, unless the beneficiary resides in a tax haven or low-tax jurisdiction. In this case the withholding tax rate will be 25%. Gains on the sale of shares are taxed at 10%. The taxable gain is determined by the difference between the book value or purchase value (as applicable) and the price at which the shares are sold.

3.5 Sales of Shares by Individuals in Publicly Traded Corporations

There are no differences between closely or publicly held corporations.

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

Withholding taxes applicable to non-residents without a permanent establishment are as follows:

- dividends and profit distributions: 5%;
- interest: 10% (foreign fully licensed banking and financial institutions are exempt); and
- royalties: 15%.

It is important to note that the notions of “*interest*” and “*royalties*” under the law are wider than usually understood.

No reliefs are available.

4.2 Primary Tax Treaty Countries

El Salvador only has one bilateral tax treaty with Spain.

4.3 Use of Treaty Country Entities by Non-Treaty Country Residents

El Salvador has no other in force tax treaties.

4.4 Transfer Pricing Issues

Transfer pricing rules have been in force in El Salvador since 2009. There are no particular issues specifically affecting inbound investors.

4.5 Related-Party Limited Risk Distribution Arrangements

Limited-risk distribution arrangements have not yet surfaced as a focus for the tax administration. However, any related-party arrangement that does not comply with transfer pricing rules could be challenged by the tax authorities.

4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards

Transfer pricing in El Salvador generally follows the methods established by the OECD.

4.7 International Transfer Pricing Disputes

There do not appear to be any precedents where the DTT between El Salvador and Spain has been used for mutual agreement procedures (MAPs) to resolve international transfer pricing disputes.

5. Key Features of Taxation of Non-Local Corporations

5.1 Compensating Adjustments When Transfer Pricing Claims Are Settled

Within the proceedings leading to a transfer pricing-related claim, the tax administration and the taxpayer can voluntarily review the matter and settle the disagreement. Where the settlement calls for compensating adjustments, tax administration officials have reported that the taxpayer proceeds with the compensating adjustments.

5.2 Taxation Differences Between Local Branches and Local Subsidiaries of Non-Local Corporations

Local branches of non-local corporations and local subsidiaries of non-local corporations are taxed in the same way.

5.3 Capital Gains of Non-Residents

The Income Tax Act does not tax indirect disposals of Salvadoran companies. However, their direct disposal is subject to capital gains tax.

5.4 Change of Control Provisions

There are no change of control provisions that trigger any tax or duty.

5.5 Formulas Used to Determine Income of Foreign-Owned Local Affiliates

No formulas are used to determine the income of foreign-owned local affiliates.

5.6 Deductions for Payments by Local Affiliates

Local affiliates are allowed a deduction for payments for management and administrative expenses by a non-local affiliate on condition that:

- the payment is duly supported;

- the expense is necessary to generate taxable income;
- where applicable, the withholding tax has been charged to the non-local affiliate; and
- the applicable international financial reporting standards allow the expense to be recognised as such by the taxpayer.

5.7 Constraints on Related-Party Borrowing

Besides transfer pricing rules and a 10% withholding tax, interest paid to a non-local affiliate is not deductible, unless the beneficiary is a fully licensed financial institution. It is necessary that the agreed-upon interest is within the limits established by the Central Reserve Bank.

6. Key Features of Taxation of Foreign Income of Local Corporations

6.1 Foreign Income of Local Corporations

The foreign income of local corporations is exempt from corporate tax. The Salvadoran system is fundamentally one of domestic-sourced income.

6.2 Non-Deductible Local Expenses

Intangibles developed by local corporations can be used by non-local subsidiaries in their business at prices complying with transfer pricing rules. The price paid to the local corporation will be taxed at 20%.

6.3 Taxation on Dividends From Foreign Subsidiaries

Dividends from foreign subsidiaries of local corporations are not taxed.

6.4 Use of Intangibles by Non-Local Subsidiaries

Under transfer pricing regulations, intangibles developed by a local company (as its main source of business) cannot be used by non-resident related parties without incurring local corporate tax.

6.5 Taxation of Income of Non-Local Subsidiaries Under Controlled Foreign Corporation-Type Rules

Local corporations are not taxed on the income of their non-local subsidiaries or non-local branches under CFC-type rules. There are no CFC-type rules.

6.6 Rules Related to the Substance of Non-Local Affiliates

There are no substance-related rules applicable to non-local affiliates.

6.7 Taxation on Gain on the Sale of Shares in Non-Local Affiliates

Provided the sale takes place in a jurisdiction other than El Salvador, the capital gain on the sale of shares in non-local affiliates will not be taxed.

7. Anti-Avoidance

7.1 Overarching Anti-Avoidance Provisions

El Salvador does not have general anti-avoidance rules, other than those related to the tax adjustments for determining the taxable base.

8. Audit Cycles

8.1 Regular Routine Audit Cycle

El Salvador does not have a regular routine audit cycle.

9. BEPS

9.1 Recommended Changes

El Salvador is not a member of the OECD. It has therefore not yet strictly implemented BEPS. However, the Income Tax Act (issued in 2012) includes some provisions that partly reflect BEPS guidelines, such as transfer pricing regulations which have been heavily influenced by Action 13.

9.2 Government Attitudes

The government seeks to comply with most OECD guidelines, including BEPS. However, there is no strict policy for this purpose.

9.3 Profile of International Tax

Since the Salvadoran taxation system follows the territorial principle, international taxation does not have a high public profile in the jurisdiction.

9.4 Competitive Tax Policy Objective

El Salvador's tax policy is not highly influenced by BEPS.

9.5 Features of the Competitive Tax System

The most important features of the Salvadoran tax system are its basis on the territorial principle and its simplicity. These features do not conflict with BEPS.

9.6 Proposals for Dealing With Hybrid Instruments

Since El Salvador has not yet implemented BEPS, the proposals for dealing with hybrid instruments are not likely to be a pertinent issue in the near future.

9.7 Territorial Tax Regime

El Salvador has a territorial tax regime. Interest is deductible regardless of whether or not the beneficiary is a resident, but only up to the interest rates published by the Central Reserve Bank. The only condition is that the interest is connected to the generation of taxable income. It is unlikely that interest deductibility proposals will affect people investing in and from El Salvador.

9.8 Controlled Foreign Corporation Proposals

El Salvador follows a strict territorial tax principle and therefore, foreign-sourced income is not relevant to the local authorities. Since El Salvador does not have CFC rules, the general drift of CFC proposals should not affect current practice greatly.

9.9 Anti-Avoidance Rules

Salvadoran tax law does not grant any DTC limitation to outbound investors. However, if other jurisdictions were to create limitations on any DTC allowed to inbound investors, this would likely have some impact on direct foreign investments into El Salvador.

9.10 Transfer Pricing Changes

Transfer pricing changes introduced by BEPS after the transfer pricing rules came into force in El Salvador in 2009 are not having a radical effect on the Salvadoran regime. The taxation of profits from intellectual property is not a particular source of controversy in El Salvador.

9.11 Transparency and Country-by-Country Reporting

Salvadoran law includes some rules related to transparency. However, country-by-country reporting is not yet in force in El Salvador.

9.12 Taxation of Digital Economy Businesses

There are no specific proposals in this jurisdiction in relation to the taxation of transactions effected or profits generated by digital economy businesses operating from outside El Salvador at the present time.

9.13 Digital Taxation

El Salvador has not taken a position in relation to digital taxation and no proposals have so far been brought forward.

9.14 Taxation of Offshore IP

Payments to non-residents for intellectual property deployed in El Salvador are taxed at 20% withholding tax if the non-resident is not in a tax haven and at 25% if the non-resident is in a tax haven.