



## ▫ DOING BUSINESS IN EL SALVADOR

### 1. Fact Sheet

#### Geography

Location

Area 21,040 km<sup>2</sup>

Land boundaries and Coastline It borders on the Pacific Ocean between Guatemala and Honduras. It lies on the Gulf of Fonseca, as do Honduras and Nicaragua further south.

Climate El Salvador has a tropical climate with pronounced wet and dry seasons

Time zone (UTC-6)

#### People

Population About 7,185,218

Ethnic groups 90% Mestizo, 9% White (Spanish, Italian, French, Swiss, others), 1% Amerindian

Religion Mostly Roman Catholic and Protestant

Language Spanish

#### Government

Country name Republic of El Salvador

Government type Presidential republic

Capital San Salvador

Administrative divisions El Salvador is divided into 14 departments (*departamentos*), which, in turn, are subdivided into 262 municipalities (*municipios*).

Political situation The political framework of El Salvador is a presidential representative democratic republic with a multi-party system.



## **Economy**

GDP – per capita	\$3,823
GDP- real growth	4.2%
Currency (code)	USD
Labor Force	2.5 million

## **2. Business Entities and Accounting**

- Types of company structure available to foreign investors

There are six types of business corporations according to the Code of Commerce: S.A., Limited Liability Company, General Partnership, Joint Liability Company, Cooperatives and Joint Stock Company.

To register a legal entity takes about 10 working days and the cost depends on the foundation capital (registration fees) and legal fees. To dissolve a legal entity it needs to comply with different requirements established in the commerce code and it could take about 6 months.

There is no cash movement restriction only to comply on what is established in the money laundry law.

Companies are able to do payroll through an agreement with a local entity or constitute a corporation in El Salvador which takes less time than constituting a branch and also is less expensive and requires less paperwork.

In general, local companies and foreign companies choose to operate as S.A.s.



The main features of this corporate vehicle are as follows:

- a. A Stock company is the one that has the capital divided and represented by shares.
- b. The responsibility of each shareholder is limited to the total amount of shares subscribed by them.
- c. The company must be identified by a name.
- d. Each shareholder is free to transfer the capacity of shareholder to another party by share transference.

In case of establishing an S.A., the representatives of the company must fill out some documentation at the Registry of Commerce. In any case, it is necessary to have at least two shareholders. The capital requirement for the company is US\$2000.

It is possible to issue shares with some restriction or to issue preferred shares with preferred rights to profits but limited voting rights.

Anyone can be a shareholder, including a foreign person. The same applies to directors and managers.

The general meeting of shareholders has to choose to establish a board of directors with at least two directors or choose a sole administrator to manage the company.

Auditing, accounting and filing requirements (including language and currency requirements):



The Monetary Integration Law dollarized El Salvador in 2001, and the U.S. dollar now freely circulates and can be used in all transactions. One objective of dollarization was to make El Salvador more attractive to foreign investors.

Accounting systems are generally consistent with international norms.

Annually: Every company must present its general balance and financial statements at the Registry of Commerce.

Monthly: Every company must present a VAT declaration, paying the difference arising from the VAT collected from its sales minus the VAT paid to third parties, an income tax declaration, paying 1.5% of its gross income in advance of its annual income tax.

There are no foreign exchange controls in El Salvador. The U.S. dollar is legal tender.

### **3. Finance and Investment**

#### **Securities Market**

The 1994 Securities Market Law established the present form of the Salvadoran securities exchange, which opened in 1992, and has played an important role in the privatization of state enterprises and in facilitating foreign portfolio investment. Stocks, government and private bonds, and other financial instruments are traded on the exchange, which is regulated by the Superintendent of Securities.



## **Banking and sources of finance**

The Superintendence of the Financial System supervises banks and nonbank financial intermediaries.

Interest rates are determined by market forces and have decreased significantly since dollarization was implemented.

Foreign investors may obtain credit in the local financial market under the same conditions as local investors.

December 2004 fiscal reforms require that applicants for credit at Salvadoran financial institutions prove they are up-to-date in their tax obligations with the Salvadoran Government.

El Salvador's banks are among the largest in Central America and are owned by foreign financial institutions. The banking system is sound and in general well managed and supervised.

Under the 1999 Banking Law and amendments made in 2002, foreign banks are afforded national treatment and can offer the same services as Salvadoran banks. They can open branches and buy or invest in Salvadoran financial institutions. The law strengthened supervisory authorities and provided more transparent and secure operations for customers and banks.

The Non-Bank Financial Intermediaries Law regulates the organization, operation, and activities of financial institutions such as cooperative savings associations, nongovernmental organizations, and other microfinance institutions. The Money Laundering Law requires financial institutions to report suspicious transactions to the Attorney General and the Superintendent of the Financial System.



The Superintendence of the Financial System (Superintendencia del Sistema Financiero, SSF) is an independent regulatory agency that authorizes and supervises all financial institutions in El Salvador. By law, all transactions carried out in Salvadoran banks must be denominated in U.S. dollars. Interest rates and fees are set by market conditions.

Private Banks, branches of foreign banks, state-owned banks, and credit unions are authorized to collect funds from the public. The banking industry is very competitive due to the presence of foreign banks and the openness of the banking law.

### **Tariffs**

For imported products, the price structure includes import duty and the 13-percent value added tax (VAT) that must be added to the purchase price of all products, including basic food products and medicines. Import tariffs for capital goods are zero percent, raw materials range from zero to 5%, intermediate goods range from 5 to 10%, and finished goods are charged a maximum of 15%. Textiles, agricultural products, vehicles, and a few other non-essential products are charged higher tariffs that range from 15 to 30%. These new tariffs apply to products coming from outside the Central American Common Market.

For countries with which El Salvador does not have a bilateral trade agreement, most of El Salvador's tariffs do not exceed the maximum common external tariff of 15 percent established by the Central American Common Market (CACM) treaty, of which it is a member. However, there are several exceptions.

In general, the following documents are needed to import products into the country: (a) customs declaration, (b) invoice, (c) transportation documents, (d) certificate of origin, (e) licenses or permits; and (f) payment of duties and taxes (which can be made electronically).



## **Foreign investment incentives/restrictions**

The Government of El Salvador views foreign investment as crucial for economic growth and development and has taken numerous steps in recent years to improve the investment climate. However, inefficient and inconsistent commercial law enforcement remains a weak spot in El Salvador's otherwise generally positive record for encouraging investment. Increasing violent crime and concerns over a sometimes ineffective and erratic legal system are mitigating factors that merit additional monitoring.

The free trade agreement among Central American countries, the Dominican Republic, and the United States (CAFTA-DR) includes an investment chapter and other provisions that have strengthened investment dispute resolution for member state companies with interests in El Salvador.

The principal statutes governing foreign investment in El Salvador are the Investment Law, Export Reactivation Law, Free Trade Zones Law, and Services Law. Other statutes establishing the basic legal framework for investment include the Monetary Integration Law, Banking Law, Insurance Companies Law, Securities Market Law, intellectual property laws, special legislation governing privatizations and credit cards, Competition Law, and Tourism Law. Additional information on each of these laws is available later on in this article.

Customs may authorize temporary entry of foreign merchandise with temporary or partial suspension of duties for specific purposes under the condition that the merchandise is re-exported within the time authorized and without any modification. A bond must be presented as the guarantee that the temporarily imported goods will be re-exported within the time authorized. Temporary entry of goods for transformation, manufacture or repair is granted under laws that regulate free trade zones, and services. Every person entering the country may bring tax-free: two cameras, a personal computer, a printer, a typewriter and other goods valued at less than \$1,000.



Free Trade Zones in El Salvador: As of September 2008, there were 16 free zones operating in the country. These firms, mostly owned by Salvadoran, U.S., Taiwanese, and Korean investors, employ approximately 58,000 people.

Companies located in the free zones enjoy exemption from: 1) all duties and taxes on imports of raw materials and the machinery and equipment needed to produce for export, 2) income tax, 3) municipal taxes on company assets and property, 4) taxes for fuels and lubricants used for producing exports, if these are not domestically produced; and 5) taxes on real estate transfers that are related to export activity.

In 2005, the government approved a tourism law to spur investment in this sector. The law establishes fiscal incentives for those who invest a minimum of \$50,000.00 in tourism-related projects in El Salvador. Incentives include an income tax break of 100 percent for 10 years and no duties on imports of capital and other goods, subject to limitations. The investor also benefits from a five-year exemption from land acquisition taxes, as well as a 50 percent cut in municipal taxes over that period. To take advantage of these incentives, the enterprise must contribute five percent of profits during the exemption period to a government-administered Tourism Promotion Fund.

In general, there are no controls on prices in El Salvador. The exceptions are liquefied propane gas, public transportation rates, and energy, which the government regulates.

El Salvador's Investment Law does not require investors to export specific amounts, transfer technology, incorporate set levels of local content, or fulfill other performance criteria. Foreign investors and domestic firms are eligible for the same export incentives. Exports of goods and services are levied zero value added tax.

There are few trade barriers that affect the import of manufactured goods, but El Salvador does maintain some barriers to services. For example, notaries must be Salvadoran and certain professionals such as architects must be licensed locally.



#### **4. Employment Regulation and Social Security**

- **Entry visa and work permit requirements.**

Salvadoran law requires work permits for all foreign employees.

Customs may authorize temporary entry of foreign merchandise with temporary or partial suspension of duties for specific purposes under the condition that they are re-exported within the time authorized and without any modification. Those who plan to live and work in El Salvador for an extended period will need to obtain temporary residency, renewed periodically depending on the amount of time granted on the residency permit. Under Article 11 of the Investment Law, foreign investors with investments equal to or more than 4,000 minimum monthly wages, have the right to receive "Investor's Residence" permitting them to work and stay in the country. Such residency can be requested within 30 days after the investment has been registered.

The residency permit covers the investor and his family and is issued for one year, subject to extension on a yearly basis. There are few restrictions on the professional and technical jobs that can be held by foreigners.

- **Hiring local employees and Trade Unions**

The employment contract requires to be written and fulfill all the requirements of the Salvadoran labor code.

El Salvador has a labor force of approximately 2.5 million.

Salvadoran employees are perceived as hardworking and receptive to training and advanced study. The general educational level is low, and the skilled labor pool is shallow, which may pose problems for investors needing skilled, educated labor.



According to many large employers, there is a lack of middle management-level talent, which sometimes results in foreigners being brought in to perform such tasks.

Employers do not report labor-related difficulties in incorporating technology into their workplaces.

The constitution guarantees the right of employees in the private sector to organize into associations and unions.

Employers are free to hire union or non-union labor. Labor law is generally in accordance with internationally recognized standards, but is not enforced consistently by government authorities. The International Labor Organization's Committee on Freedom of Association has expressed concern in a number of cases about the government's failure to apply the protections of employee rights to organize and bargain collectively, as required by International Labor Organization conventions. In 2009, several businesses have expressed concerns about the government's application of labor laws, alleging a bias towards labor unions and a disregard of established legal procedures.

- **Social security system**

Tax resident employees must pay income tax at progressive rates on their income obtained in El Salvador up to a maximum of 25%.

In addition, employers and employees must make the following contributions:

- **Health contributions.** The employer must pay 7.5% and the employee must pay 3% of the employee's gross salary. However, the health contribution cannot exceed US\$72 per employee.



- **Retirement (pension fund) contributions.** The employer must pay 6.75% and the employee must pay 6.25% of the employee's gross salary.

## 5. Taxation

### Corporate and individual taxation

In late October 2004, El Salvador's Legislative Assembly approved fiscal reforms aimed at increasing tax collection by closing important loopholes and cracking down on tax evasion. The reforms to the tax code and income tax law include a mandatory 20% withholding tax on payments for services that have been provided to business/government in El Salvador by foreigners even if the service was performed entirely outside of El Salvador. Previously, income tax would be applied only if the service was provided in El Salvador.

The corporate income tax rate is 25 percent. VAT at 13% applies to the transfer of movable goods and the provision of services.

Tax resident employees must pay income tax at progressive rates on their income obtained in El Salvador up to a maximum of 25%.

Additional reforms approved by the Government in December 2009 increase taxes for alcohol, tobacco, and carbonated and non-carbonated drinks; and the first time registration of goods like yachts, ships, planes, and automobiles.

There are no restrictions on transferring funds associated with investment out of the country. Foreign businesses can freely remit or reinvest profits, repatriate capital, and bring in capital for additional investment. The 1999 Investment Law also allows unrestricted



remittance of royalties and fees from the use of foreign patents, trademarks, technical assistance, and other services.

Non-resident companies obtaining income in El Salvador are subject to withholding taxes of: 20% on all taxable income. In addition, each municipality has its own local taxes.

Although the dividends received are taxed as income with a 25% rate, dividends paid are not taxed.

The interest paid and intellectual property royalties are also taxed as income with a 20% withholding rate.