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CENTRE FOR TAX POLICY AND ADMINISTRATION
COMMITTEE ON FISCAL AFFAIRS

OECD Summary Report: Taxation in Costa Rica

31 July 2020

Foreword

The OECD Council decided to open accession discussions with Costa Rica on 9 April 2015. On 8 July 2015, the Council adopted a Roadmap for the Accession of Costa Rica to the OECD Convention [C(2015)93/FINAL] (the Roadmap) setting out the terms, conditions and process for accession. The Roadmap provided that in order to allow the Council to take an informed decision on the accession of Costa Rica, Costa Rica would undergo in-depth reviews by 22 OECD technical committees, including the Committee on Fiscal Affairs (CFA).

This Summary Report has been produced at the request of Costa Rica and is based on the Secretariat's evaluation reports that contributed to Costa Rica's accession review in the field of taxation from 2016 – 2018.

In accordance with paragraph 14 of Costa Rica's Roadmap, the CFA agreed to approve and declassify this Summary Report and publish it under the authority of the Secretary-General, in order to allow a wider audience to become acquainted with its content.

Acronyms

BEPS	Base Erosion and Profit Shifting
CFA	Committee on Fiscal Affairs
CRS	Common Reporting Standard
EOI	Exchange of Information
EOIR	Exchange of Information on Request
FHTP	Forum on Harmful Tax Practice
FTZ	Free Trade Zone
MAP	Mutual Agreement Procedure
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
MNE	Multinational Enterprise
OECD TPG	OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
TFTC	Task Force on Tax Crimes and Other Crimes
VAT/GST	Value Added Tax / Goods and Services Tax
WP1	Working Party No. 1 on Tax Conventions and Related Questions
WP2	Working Party No. 2 on Tax Policy Analysis and Tax Statistics
WP6	Working Party No. 6 on Taxation of Multinational Enterprises
WP9	Working Party No. 9 on Consumption Taxes
WP10	Working Party No. 10 on Exchange of Information and Tax Compliance
WP11	Working Party No. 11 on Aggressive Tax Planning

1 Introduction

1. The accession review of Costa Rica in the field of taxation took place between 2016-18 in line with the Roadmap for the Accession of Costa Rica to the OECD [C(2015)93/FINAL] (the Roadmap)]. It was conducted by the OECD's Committee on Fiscal Affairs (CFA), on the basis of the technical reviews carried out by eight of its subsidiary bodies. The CFA accordingly evaluated the willingness and ability of Costa Rica to implement the substantive OECD legal instruments within the Committee's competence, and Costa Rica's policies and practices as compared to OECD best policies and practices in the field of taxation, through reference to the "Core Principles" listed in the Appendix to the Roadmap. The evaluation covered 20 OECD legal instruments: 17 OECD Council Recommendations, two international agreements and two Declarations, as well as eight Core Principles.

2. The review was based on Costa Rica's February 2016 "Initial Memorandum", in which Costa Rica set out its position vis-à-vis all OECD legal instruments in force at the time. It also took into account Costa Rica's answers to the accession questionnaire developed by the OECD Secretariat. Other written material provided by Costa Rica, as well as information obtained during several missions to San José over the course of 2016-18, also contributed to the evaluation.

3. On 10 April 2018, the CFA completed its review of Costa Rica. This Summary Report presents the main elements of the assessment and recommendations by the CFA.

2 Background

2.1 The Core Principles

4. The CFA carries out its accession reviews on the basis of the CFA Core Principles in the area of taxation, which were agreed by the CFA in 2013, and are listed in the Appendix to Costa Rica's Accession Roadmap and reflected in the OECD legal instruments within the Committee's competence. These are:

- Eliminating international double taxation on income and capital through complying with the key substantive conditions underlying the OECD Model Tax Convention.
- Committing to provide appropriate data for the CFA's comparative statistical publications and also to contribute actively to the analysis of tax policy in terms of its effects on economic performance and social well-being.
- Eliminating double taxation through ensuring the primacy of the arm's length principle, as set out in the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, for the determination of transfer pricing between associated enterprises.
- Committing to address Base Erosion and Profit Shifting (BEPS) in accordance with the OECD's work in this area.
- Engaging in effective exchange of information as reflected in the 2012 version of Article 26 of the OECD Model Convention and the Convention on Mutual Assistance in Tax Matters as well as emerging standards (e.g. on automatic exchange of information).
- Combating harmful tax practices in accordance with the 1998 Council Recommendation and related reports.
- Eliminating double and unintentional non-taxation through the development and implementation of International VAT/GST Guidelines designed to encourage greater coherence and clarity when applying consumption taxes to international transactions.
- Combating tax crimes and other crimes in accordance with the 2009 Council Recommendation, the 2010 Council Recommendation and related reports.

5. The CFA's accession review process for Costa Rica involved the following:

- Technical reviews carried out by the CFA subsidiary bodies responsible for the substantive areas underpinning the eight Core Principles;
- An OECD Secretariat questionnaire addressing the key areas of focus of the Core Principles on the basis of which Costa Rica would be invited to express its positions with respect to OECD instruments, standards and best practices in the tax area;
- Upon completion of the technical review conducted by each subsidiary body, a technical opinion to the CFA;
- Upon consideration by the CFA of those technical reviews, a formal opinion on Costa Rica's accession in the field of taxation, for transmission to the OECD Council.

2.2 The Core Principle on BEPS

6. BEPS refers specifically to tax planning strategies that exploit gaps and mismatches in the tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, or to erode tax bases through deductible payments such as interest or royalties. In many cases, these tax planning strategies are legal but produce unintended results. The OECD conservatively estimated that BEPS practices cost countries between USD 100 – 240 billion in lost revenue each year. Given its nature, the Core Principle on BEPS pervades other Core Principles, as explained below.

7. In June 2013 the CFA agreed to launch the OECD/G20 BEPS Action Plan, the most significant overhaul of the international tax rules in almost a century and as a result a critical overarching framework in the tax area for accession. Working together within the OECD/G20 Inclusive Framework on BEPS, over 135 countries and jurisdictions, including Costa Rica, have committed to and are collaborating on the implementation of the BEPS Package. The BEPS Package provides 15 Actions that equip governments with the domestic and international instruments needed to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment. The 15 Actions cover a wide range of international tax areas, including tax treaties, transfer pricing, harmful tax practices, and aggressive tax planning, among others, covered by the other core principles.

8. Consequently and in line with the CFA Core Principle on BEPS in the Accession Roadmap, the accession review process of Costa Rica was aligned with the BEPS Project from the outset. In summary, WP1 reviewed the BEPS Actions related to tax treaties (Actions 6, 7 and 15); WP2 reviewed Costa Rica's position with respect to Action 11; WP6 reviewed the BEPS Actions related to transfer pricing (Actions 8 – 10, 13, and 14); WP9 examined the part of Action 1 related to consumption taxes; the Forum on Harmful Tax Practices reviewed Action 5; and WP11 considered the remaining actions related to curbing aggressive tax planning area (Actions 2, 3, 4, and 12).

3 Costa Rica's Policies and Practices in the Tax Area

3.1 Position of Costa Rica vis-à-vis OECD legal instruments

9. In its Initial Memorandum, Costa Rica provided its initial position vis-à-vis the various OECD legal instruments applicable in the area of taxation in effect as at that date.

10. After Costa Rica's submission of its Initial Memorandum, the OECD Council adopted three new legal instruments in the areas of tax treaties, transfer pricing and VAT/GST: the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI), opened for signature on 31 December 2016; the Recommendation of the Council on Base Erosion and Profit Shifting Measures Related to Transfer Pricing adopted on 23 May 2016; and the Recommendation of the Council on the Application of Value Added Tax/Goods and Services Tax to the International Trade in Services and Intangibles adopted on 27 September 2016.

11. Costa Rica has accepted all of the OECD legal instruments in taxation, including the new instruments referred to above, and became a signatory to the MLI on 7 June 2017. The list of legal instruments in the area of taxation, updated as of 1 March 2018, and organised by the relevant Core Principle, is set out in Annex I.

3.2 Technical assessments by the relevant CFA subsidiary bodies

12. A summary of the review and assessment by each CFA subsidiary body, in relation to its relevant Core Principle, is set out below.

3.2.1 Tax Treaties

13. Tax treaties allocate taxing rights on income between the States that enter into them. The OECD Model Tax Convention on Income and Capital (OECD Model Tax Convention) provides model provisions for the negotiation of these treaties as well as a detailed Commentary on how to apply and interpret these provisions.

14. The accession Core Principle identified by the CFA in the tax treaty area is "Eliminating international double taxation on income and capital through complying with the key substantive conditions underlying the OECD Model Tax Convention." WP1 of the CFA is responsible for conducting the technical review on this Core Principle.

15. This Core Principle requires that a country commit to eliminating international double taxation in particular by:

- having a network of treaties that broadly comply with the key substantive principles underlying the OECD Model Tax Convention;
- applying those treaties in practice in a consistent manner with the interpretations of the Commentary on that Convention; and
- resolving disputes through the effective operation of the Mutual Agreement Procedure (MAP) mechanism under those treaties.

16. WP1 examined Costa Rica at its meeting in September 2016 based on Costa Rica's answers to a questionnaire and on its positions with respect to the OECD instruments that deal with tax treaties. During the review, Costa Rica confirmed that its reservations to the OECD Model Tax Convention and observations on its Commentaries would be substantially similar to its responses to the accession questionnaire. On that basis, WP1 did not identify any issues that raised particular concerns in the areas within the competence of WP1. Accordingly, WP1 did not make proposals for further action.

17. After the conclusion of the review by WP1, Costa Rica signed the MLI on 7 June 2017. The MLI will enable Costa Rica to implement BEPS tax-treaty related measures into its treaty network. Costa Rica has since communicated that it has completed its domestic procedures for the ratification of the MLI and is working towards deposit of its instrument of ratification.

3.2.2 Tax Statistics

18. In the areas of tax policy and tax statistics, the Core Principle requires "committing to provide appropriate data for the CFA's comparative statistical publications and also to contribute actively to the analysis of tax policy in terms of its effects on economic performance and social well-being." WP2 of the CFA is responsible for conducting the technical review on this Core Principle.

19. WP2 examined Costa Rica at its meetings in May 2017 and November 2017 based on Costa Rica's answers to a questionnaire prepared by the OECD Secretariat and on a presentation on their tax system and tax policy settings, completing its review in March 2018.

20. The Costa Rican Ministry of Finance worked together with the OECD Secretariat to provide the data needed for the main periodic tax statistics and tax policy comparative statistical publications, including: a) revenue data from 1990 to 2016 for the OECD Revenue Statistics, in particular for the publication on Latin America and the Caribbean[1]; b) taxing wages model and average earning figures from 2000 to 2016 for the OECD Taxing Wages; and c) entries on all tax database tables from 2000 to 2017 for the OECD Tax Database. WP2 found that the data provided by Costa Rica for these publications satisfies the OECD requirements.

21. Costa Rica has continued to provide the data on the agreed basis each year.

[1] Queries arose in relation to the reporting of social security contributions and specifically in relation to the consolidation of social security contributions paid by governments in respect of their employees. Following extensive communication with the Ministry of Finance, the approach followed was clarified and the figures obtained followed the Interpretative Guide.

3.2.3 Transfer Pricing

22. Transfer prices are significant for both taxpayers and tax administrations because they determine the taxable profits of associated enterprises in different tax jurisdictions. The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TPG) focus on the international aspects of transfer pricing. These aspects are complex to deal with because they involve more than one tax jurisdiction and therefore any adjustment to the transfer price in one jurisdiction implies that a corresponding change in another jurisdiction is appropriate (e.g. an adjustment to reduce the price of goods acquired by a purchaser would imply a decrease in the selling price of the counterparty). However, if the jurisdiction of the counterparty does not agree to make a corresponding adjustment, the MNE group will be taxed twice on this part of its profits. In order to minimise the risk of such double taxation, OECD member countries endorse the arm's length principle as embodied in the OECD Model Tax Convention (and in the bilateral conventions that legally bind treaty partners in this respect)[2]. The OECD TPG applies the arm's length principle to evaluate the transfer pricing of associated enterprises and are intended to help tax administrations and taxpayers by indicating ways to find mutually satisfactory solutions to transfer pricing cases, thereby minimising conflict and avoiding costly litigation.

23. In the context of accession to the OECD, the Core Principle identified by the CFA on transfer pricing requires "eliminating double taxation through the application of the arm's length principle, as set out in the OECD Model Tax Convention and in the OECD TPG." WP6 of the CFA is responsible for pursuing work on issues pertinent to transfer pricing and proposing amendments to the OECD TPG as necessary. WP6 is consequently also responsible for conducting the technical review in relation to the Core Principle on the arm's length principle.

24. WP6 assessed Costa Rica's implementation of this Core Principle at its November 2017 meeting. Based on the review undertaken, WP6 and the CFA recommended Costa Rica to work further on:

- incorporating the arm's length principle in its primary legislation.
- monitoring the tax administration approach for attributing profits to permanent establishments so it is consistent with the functionally separate entity approach.[3]
- ensuring there are sufficient resources, including trained personnel, to effectively conduct mutual agreement procedures[4].

25. Costa Rica reported at the CFA meeting in January 2020 that the arm's length principle had been introduced in its primary legislation as of 1 July 2019 in compliance with the first recommendation. Costa Rica also noted that they are progressing towards implementing the other recommendations made by the CFA, to be reported on a later stage.

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[2] The authoritative statement of the arm's length principle is found in paragraph 1 of Article 9 of the OECD Model Tax Convention, which forms the basis of bilateral tax treaties involving OECD member countries and an increasing number of non-member countries. Article 9 provides: [Where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

[3] The OECD 2010 Report on the Attribution of Profits to Permanent Establishments requires a permanent establishment to be treated as if it were a separate and independent enterprise.

[4] The mutual agreement procedure is a well-established means through which tax administrations consult to resolve disputes regarding the application of double tax conventions. This procedure, described and authorised by Article 25 of the OECD Model Tax Convention, can be used to eliminate double taxation that could arise from a transfer pricing adjustment.

3.2.4 Consumption Taxes

26. The accession Core Principle identified by the CFA on VAT requires "eliminating double and unintentional non-taxation through development and implementation of International VAT/GST Guidelines designed to encourage greater coherence and clarity when applying consumption taxes to international transactions." WP9 is responsible for conducting the technical review on this Core Principle.

27. The International VAT/GST Guidelines (the Guidelines) as incorporated in the VAT/GST Recommendation, build on the following two principles for the application of VAT/GST in an international context:

- the neutrality principle, whereby VAT/GST is a tax on final consumption that should be neutral for businesses, and
- the destination principle, whereby internationally traded services and intangibles should be subject to VAT/GST in the jurisdiction of consumption.

28. The Guidelines focus in particular on trade in services and intangibles, which poses increasingly important challenges for the design and operation of VAT/GST systems worldwide. They notably include the recommended principles and mechanisms to address the challenges for the collection of VAT on cross-border sales of digital products that were identified in the BEPS Project.

29. Following several accession review discussions, WP9 completed its review in January 2018, before the enactment of Costa Rica's reform of its general sales tax system in December 2018, on the basis that the forthcoming reform take into account the contents of the VAT/GST Recommendation.[5]

30. Specifically, WP9 noted that Costa Rica's general sales taxes were inconsistent with certain principles incorporated in the VAT/GST Recommendation and made the following recommendations:

- reforming the treatment of input tax incurred by businesses in line with the Guidelines 2.1 to 2.6 of the VAT/GST Recommendation, to ensure that businesses have the right to credit the input tax at each stage of the supply chain and that the tax burden eventually lies on the final consumer rather than on the intermediaries in the supply chain;
- implementing a mechanism to ensure that foreign businesses do not incur irrecoverable general sales tax, or value added tax, in Costa Rica in accordance with the Guidelines 2.5 and 2.6 of the VAT/GST Recommendation; and
- aligning the treatment of cross-border supplies of services and intangibles with the approaches recommended in the Guidelines 3.2 to 3.6. of the VAT/GST Recommendation for determining the place of taxation.

31. At the time of the review, Costa Rica informed WP9 that they were in the process of defining reforms to its sales tax system with the aim to increase revenue and make the tax less distortive to trade and investment, notably by aligning its system to the neutrality and destination principles as promoted by the VAT/GST Recommendation. WP9 welcomed Costa Rica's efforts and commitment to continue on the path to modernising its general sales tax and to continue its constructive engagement with WP9 in designing the reform of its sales tax system. WP9 and the CFA recommended that Costa Rica continue

[5] Costa Rica's narrow based sales tax system, that included sales of goods and a very limited number of services did not embody the basic features of a VAT as described in Chapter 1 of the VAT/GST Recommendation, i.e. a broad-based tax on final consumption collected from, but in principle not borne by, business through a staged collection process. However, the Costa Rican general sales tax system had several characteristics of a VAT, as it is a tax on final consumption that is collected by businesses through a staged collection process. WP9 therefore considered appropriate to evaluate the general sales tax against the internationally agreed principles for the consistent application of these taxes in international trade as incorporated in the VAT/GST Recommendation.

and successfully complete the reform of its general sales tax system with a view to addressing the above inconsistencies found with the VAT/GST Guidelines and report back on progress.

32. WP9 welcomed the report by Costa Rica at the CFA January 2020 meeting that the reform to the general sales tax was approved in December 2018 and entered into force on 1 July 2019.

3.2.5 Exchange of Information

33. As a key tool to achieve greater co-operation and transparency in tax matters, the OECD exchange of information (EOI) standards for tax purposes are putting an end to bank secrecy and have significantly decreased opportunities for tax evasion. The Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) is the multilateral framework that ensures that the standards on EOI are in place around the world through a peer review process. Costa Rica has been a member of the Global Forum since 2009.

34. The accession Core Principle identified by the CFA on EOI requires "engaging in effective exchange of information as reflected in the 2012 version of Article 26 of the OECD Model Tax Convention and the Convention on Mutual Administrative Assistance in Tax Matters, as well as emerging standards", in particular the 2014 Standard on automatic exchange of financial account information. WP10 of the CFA is responsible for conducting the technical review on this Core Principle, building on the work carried out by the Global Forum.

35. Costa Rica's situation before the WP10 accession review took place was as follows:

- Exchange of Information on Request (EOIR): Costa Rica obtained a rating of Provisionally Largely Compliant[6], based on an evaluation against the previously applicable terms of reference (the 2010 Terms of Reference), in July 2017. This provisional rating resulted from a proposed upgrade assigned by the Global Forum due to legislative reforms undertaken by Costa Rica earlier in 2017 further to recommendations made by the Global Forum. Specifically, Costa Rica expanded the scope of its legal framework to capture ownership information on relevant entities and arrangements by creating a registry of beneficial owners (Law 9416); enacted penalties for the failure to make ownership information available; and diminished the opportunity for inactive companies to conduct offshore activity without making ownership information available to the competent authority by initiating an aggressive strike off programme (Law 9024). Costa Rica also undertook legislative improvements to ensure that all relevant entities and arrangements maintain accounting records.
- Automatic Exchange of Information: Costa Rica committed in 2014 to implement the Common Reporting Standard (CRS) and automatically exchange financial account information starting in September 2018. The Global Forum reviewed the confidentiality rules and practices of Costa Rica and made recommendations to securely exchange information.

[6] Significant shortcomings in Costa Rica's legal framework and practices were identified in the peer review report published in October 2015, resulting in an overall rating of "Partially Compliant". Pressure to improve international tax transparency increased further in 2016 when the G20 Finance Ministers called i) all jurisdictions to "upgrade their Global Forum rating to a satisfactory level" by the time of the July 2017 G20 Leaders' Summit, and ii) the OECD to establish objective criteria to identify non-cooperative jurisdictions with respect to the tax transparency standards. In response, the Global Forum developed a fast-track review procedure to allow recognition of improvements made in implementing the EOIR standard and addressing Global Forum's recommendations, resulting in provisional upgrades. Jurisdictions like Costa Rica that were at risk of being identified as non-cooperative were eligible to opt for the fast-track review procedure to obtain a revised provisional rating.

36. WP10 conducted Costa Rica's EOI accession review at its meeting in October 2017. WP10 noted that Costa Rica accepts the various OECD legal instruments on EOI, including the Convention on Mutual Administrative Assistance in Tax Matters as amended by the Protocol of 27 May 2010 (The Convention). The Convention facilitates international co-operation for a better operation of national tax laws, including exchange of information on request, spontaneous and automatic. Costa Rica has been a Party to the Convention since 1 August 2013.

37. However, WP10 encouraged Costa Rica to swiftly implement the Recommendations made by the Global Forum as part of Costa Rica's Assessment Report on Confidentiality and Data Safeguards in the context of the implementation of the CRS.

38. In April 2018, the CFA reiterated WP10's encouragement to implement the recommendations concerning confidentiality and data safeguards. The CFA also requested Costa Rica to report on the outcome of its 2018 EOIR review.

39. Costa Rica reported at the CFA January 2020 meeting that Costa Rica had obtained a confirmed Largely Compliant rating in its 2018 EOIR review that was published in July 2019. The 2019 Report concluded that Costa Rica had addressed several deficiencies through the legislative measures taken in 2017, in particular, by enhancing the maintenance of ownership and accounting information and strengthening a strike-off process for inactive entities. Costa Rica's progress concerning the creation of the beneficial ownership centralised registry was recognised, and a recommendation on putting supervision programmes in place to monitor compliance with beneficial ownership and accounting information requirements was issued.

40. Costa Rica also satisfactorily addressed deficiencies concerning confidentiality and data safeguards and, based on the Global Forum's review, it is now in a position to receive CRS information in a secure environment. This was also reported during the CFA January 2020 meeting and welcomed.

3.2.6 Aggressive Tax Planning

41. One of the CFA Core Principles requires "committing to address BEPS in accordance with the OECD's work in this area". WP11 of the CFA is responsible for conducting the technical review on this Core Principle.

42. The review of WP11 focused on the introduction of domestic legislation to address some aggressive tax planning aspects of the BEPS Action Plan (actions 2, 3, 4 and 12). The other BEPS actions were assessed by the competent Working Parties of the CFA, as explained above.

43. The BEPS Inclusive Framework has developed recommendations for countries and jurisdictions to design domestic rules, as well as model treaty provisions where applicable, to address the challenges related to aggressive tax planning aspects of the BEPS Action Plan.

44. The review conducted by WP11 did not raise particular concerns on Costa Rica in the context of the work of WP11. Costa Rica created an internal working group to identify all possible legal and procedural improvement needed for the implementation of the BEPS Action Plan. In addition, provisions to limit net interest deductions to 20% EBITDA were introduced through Law 9635. Costa Rica has reported that the tax administration is working on a proposal for anti-hybrid rules following the BEPS Action 2 recommendations.

3.2.7 Harmful Tax Practices

45. Tax incentives (e.g. reduced tax rates) may support economic growth by encouraging particular activities, taking into account positive externalities and promoting social policy goals. However, when designed with certain "harmful" features, they may also hurt the economy of other countries (and the country granting the incentive). Such harmful tax practices, as defined by the OECD's set of criteria, have the potential to cause harm by affecting the location of financial and other service activities, eroding the tax bases of other countries, distorting trade and investment patterns and undermining the fairness, neutrality and broad social acceptance of tax systems generally. The relevant Core Principle requires "combatting harmful tax practices in accordance with the OECD 1998 Council Recommendation and related reports." The 1998 Council Recommendation contains recommendations and guidelines for dealing with harmful tax practices. The Forum on Harmful Tax Practices (FHTP) was created in 1998 to conduct reviews of preferential regimes in order to determine if the regimes could be harmful to the tax base of other jurisdictions. The FHTP is also responsible for conducting the technical review on the relevant Core Principle.

46. Harmful tax practices remain a concern, as evidenced by the inclusion of this topic in the BEPS Package. Action 5 of the BEPS package committed the FHTP to revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on a substantial activity requirement for any preferential regime. The measures developed under BEPS Action 5 are minimum standards, and as such they are subject to peer review in order to ensure timely and accurate implementation and thus safeguard the level playing field.

47. As part of its assessment of Costa Rica, the FHTP analysed each of the recommendations concerning domestic legislation and practices as set out in the Appendix to the 1998 Recommendation.

48. The 1998 Recommendation recommends that countries review their current regimes to identify those that constitute harmful tax practices and remove them, as well as refrain from adopting new measures, or extending or strengthening existing measures that constitute harmful tax practices. At the time of the October 2017 FHTP meeting, the Forum had reviewed Costa Rica's Free Trade Zone (FTZ) Regime. Costa Rica did not have any other preferential regime in scope of the FHTP work.

49. The FHTP came to the following conclusions regarding Costa Rica's FTZ regime in September 2017:

- The regime is not operational in respect of its intellectual property aspects.
- The regime covers, amongst other things, companies involved in the export of services (considered a geographically mobile activity) and provides a tax holiday of between 8 to 12 years and a rate reduction of 50% for a period thereafter. For these reasons, the regime, with regard to services companies, is within the scope of the FHTP work and needed to be assessed against the FHTP criteria.
- The regime contained features that identified the regime as potentially harmful:
  - Ring-fencing: (i) 50% maximum threshold for FTZ companies to provide services to the local market (may not exceed 50% of the companies' total sales/operations); (ii) a different (i.e. more burdensome) tax treatment for domestic transactions; and (iii) additional administrative burdens for operations carried out in the domestic market.
  - Substance requirements: the minimum amount of employees and the annual minimum operating expenditures to be maintained by the beneficiary of the regime were not established in the legislation or regulation. In addition, the Executive Agreements authorising an FTZ to operate, seem to suggest that these numbers (i.e. minimum amount of employees and minimum investment to be maintained) can be different for each taxpayer and this raises at the same time an issue in terms of transparency.

50. The FHTP consequently recommended that Costa Rica reform its preferential regime to comply with the 1998 Council Resolution on harmful tax practices and the minimum standard under BEPS Action 5. Costa Rica made a formal commitment to amend the FTZ regime in line with the OECD standards by the end of 2018.

51. The FHTP completed its review on the basis of this commitment, requesting Costa Rica report to the CFA the outcome of the review concerning the amendments to its FTZ regime.

52. In October 2018, Costa Rica amended the FTZ bylaws and addressed the FHTP's concerns regarding substance requirements and transparency. At its January 2019 meeting, the FHTP concluded the FTZ regime as "not harmful (amended) subject to final legislation" given that the legislative amendments to address the ring-fencing issues were not finalised. Costa Rica enacted Law 9689 of 29 May 2019 to amend the FTZ Law and removed the ring-fencing features from the FTZ regime. At its June 2019 meeting, the FHTP consequently confirmed the January 2019 conclusion that the Costa Rican FTZ regime was not harmful.

3.2.8 Tax Crime and Other Crimes

53. The CFA Core Principle on tax and crime requires "combatting tax crimes and other crimes in accordance with the 2009 Council Recommendation, the 2010 Council Recommendation and other related reports." The CFA's Task Force on Tax Crimes and Other Crimes (TFTC) is responsible for reviewing this Core Principle.

54. The 2009 Council Recommendation recommends that:

1. Member Countries and other Parties to the Convention on Combating Bribery of Foreign Public Officials in International Transactions (the OECD Anti-Bribery Convention) explicitly disallow the tax deductibility of bribes to foreign public officials, for all tax purposes in an effective manner. Such disallowance should be established by law or by any other binding means, which carry the same effect. Denial of tax deductibility is not contingent on the opening of an investigation by the law enforcement authorities or of court proceedings.
2. Each Member Country and other Party to the OECD Anti-Bribery Convention review, on an on-going basis, the effectiveness of its legal, administrative and policy frameworks as well as practices for disallowing tax deductibility of bribes to foreign public officials. These reviews should assess whether adequate guidance is provided to taxpayers and tax authorities as to the types of expenses that are deemed to constitute bribes to foreign public officials, and whether such bribes are effectively detected by tax authorities.
3. Member Countries and other Parties to the OECD Anti-Bribery Convention consider to include in their bilateral tax treaties, the optional language of paragraph 12.3 of the Commentary to Article 26 of the OECD Model Tax Convention, which allows "the sharing of tax information by tax authorities with other law enforcement agencies and judicial authorities on certain high priority matters (*e.g.* to combat money laundering, corruption, terrorism financing)."
4. Member Countries and other Parties to the OECD Anti-Bribery Convention, in accordance with their legal systems, are recommended to establish an effective legal and administrative framework and provide guidance to facilitate reporting by tax authorities of suspicions of foreign bribery arising out of the performance of their duties, to the appropriate domestic law enforcement authorities.

55. The 2010 Council Recommendation contains three key elements:

1. It recommends that Members establish, in accordance with their legal systems, an effective legal and administrative framework and provide guidance to facilitate reporting by tax authorities of

suspicions of serious crimes, including money laundering and terrorism financing, arising out of the performance of their duties, to the appropriate domestic law enforcement authorities.

2. It further recommends that Members consider to include in their bilateral tax treaties, the optional language of paragraph 12.3 of the Commentary to Article 26 of the OECD Model Tax Convention, which allows "the sharing of tax information by tax authorities with other law enforcement agencies and judicial authorities on certain high priority matters (e.g. to combat money laundering, corruption, terrorism financing)".
3. It encourages all countries to distribute widely within their tax administrations the 2009 OECD Money Laundering Awareness Handbook for Tax Examiners and Tax Auditors.

56. The TFTC reviewed Costa Rica in April 2017 and found that Costa Rica:

- Did not have at the time of the review a guide or procedure in place to report suspicions of serious crime, including money laundering and terrorism financing, to the appropriate law enforcement authority, but was working on the development of a guide for inspectors to act on such circumstances; and
- Was planning to create a Working Group to specialise in money laundering, and develop the necessary instruments, after which, they planned to distribute widely the 2009 OECD Money Laundering Awareness Handbook for Tax Examiners and Tax Auditors within the tax administration.

57. Taking into account the work in progress by Costa Rica, the TFTC considered that the country's policies and practices were moving in the direction of further convergence with OECD standards in the tax and crime area.

58. However, Costa Rica was asked to report to the CFA on progress concerning the development of the guide to report suspicions of serious crime, on the creation of the Working Group and the distribution of the 2009 Money Laundering Awareness Handbook within the tax administration. Costa Rica informed the CFA at its January 2020 meeting that they are making progress in addressing these recommendations on tax crime and other crimes.

3.3. Tax Policy Review

59. Costa Rica has been very engaged in the work of the CFA since the opening of accession discussions in 2015, including on topics that are not covered by the CFA Core Principles. Costa Rica participated in a tax policy review in 2016, published in 2017: "OECD Tax Policy Reviews: Costa Rica 2017". This review provides an independent, comprehensive and comparative assessment of the country's tax system from a tax policy perspective and includes concrete recommendations for tax policy reform.

60. The analysis was primarily based on desk research, OECD statistics and tax modelling tools as well as the findings from a fact-finding mission which took place in San Jose in October 2016. The report is divided into five chapters, starting with a general chapter providing an overview of key macroeconomic and tax revenue trends (Chapter 1), followed by an assessment of the main types of taxes of the Costa Rican tax system, including corporate income taxes (Chapter 2), personal income taxes and social security contributions (Chapter 3), the general sales tax (Chapter 4) and environmentally related taxes (Chapter 5). The review identified that Costa Rica's tax revenues are insufficient to finance the country's spending needs, notwithstanding the efforts to reduce expenditure.

61. The key recommendations included in this report are as follows:

- raise more tax revenues to balance the budget;
- move away from the excessive earmarking of tax revenues;
- gradually rebalance the tax mix away from social security contribution towards VAT, income taxes and environmentally-related taxes as the budget is returned to a balanced position;
- convert the sales tax into a modern VAT with a broad base that includes services;
- increase the standard VAT rate to help balance the budget;
- strengthen the role of the tax and transfer systems in lowering inequality by broadening the personal income tax base and raising top personal income tax rates;
- better integrate the personal income tax and social security contributions administrations, in particular through enhanced exchange of information;
- reduce exemptions for environmentally related taxes and align tax rates more closely with external costs;
- broaden the corporate income tax base by taxing foreign-source passive income, introducing a profit based interest limitation rule, and evaluate the design of the wide range of corporate tax incentives; and
- address tax avoidance and evasion by reinforcing the tax administration, harmonising the tax treatment of different types of income, and strengthening international tax rules.

62. Given that this review took place before the enactment of Costa Rica's last tax reform in December 2018, some of the recommendations included therein may have been addressed.

Annex A. OECD Legal Instruments in the Field of Taxation

International Agreements

Exchange of Information

OECD/LEGAL/0382 - Convention on Mutual Administrative Assistance in Tax Matters as amended by the Protocol Amending the Convention on Mutual Administrative Assistance in Tax Matters

BEPS

OECD/LEGAL/0432 - Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

Recommendations

Tax Treaties

OECD/LEGAL/0292 - Recommendation of the Council concerning the Model Tax Convention on Income and on Capital
OECD/LEGAL/0291 - Recommendation of the Council on the Granting and Design of Tax Sparing in Tax Conventions
OECD/LEGAL/0253 - Recommendation of the Council concerning Tax Treaty Override
OECD/LEGAL/0195 - Recommendation of the Council concerning the Avoidance of Double Taxation with respect to Taxes on Estates and Inheritances and on Gifts

Transfer Pricing

OECD/LEGAL/0424 - Recommendation of the Council on Base Erosion and Profit Shifting Measures Related to Transfer Pricing
OECD/LEGAL/0368 - Recommendation of the Council on Attribution of Profits to Permanent Establishments
OECD/LEGAL/0279 - Recommendation of the Council on the Determination of Transfer Pricing between Associated Enterprises

Tax Avoidance and Evasion

OECD/LEGAL/0158 - Recommendation of the Council on Tax Avoidance and Evasion

Consumption Taxes

OECD/LEGAL/0430 - Recommendation of the Council on the Application of Value Added Tax/Goods and Services Tax to the International Trade in Services and Intangibles

Exchange of Information

OECD/LEGAL/0407 - Recommendation of the Council on the Standard for Automatic Exchange of Financial Account Information in Tax Matters
OECD/LEGAL/0309 - Recommendation of the Council on the Use of the OECD Model Memorandum of Understanding on Automatic Exchange of Information for Tax Purposes
OECD/LEGAL/0287 - Recommendation of the Council on the Use of Tax Identification Numbers in an International Context
OECD/LEGAL/0269 - Recommendation of the Council concerning an OECD Model Agreement for the Undertaking of Simultaneous Tax Examinations

Harmful Tax Practices

OECD/LEGAL/0305 - Recommendation of the Council on Implementing the Proposals contained in the 1998 Report on Harmful Tax Competition
OECD/LEGAL/0297 - Recommendation of the Council on Counteracting Harmful Tax Competition

Tax and Crime

OECD/LEGAL/0384 - Recommendation of the Council to Facilitate Co-operation between Tax and Other Law Enforcement Authorities to Combat Serious Crimes
OECD/LEGAL/0371 - Recommendation of the Council concerning Tax Measures for Further Combating Bribery of Foreign Public Officials in International Business Transactions

Declarations

Exchange of Information

OECD/LEGAL/0404 - Declaration on Automatic Exchange of Information in Tax Matters

Base Erosion and Profit Shifting

OECD/LEGAL/0399 - Declaration on Base Erosion and Profit Shifting