

# *Latin American Tax Newsalert*

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*Costa Rica repeals soak-up tax,  
removing a barrier to creditability for  
US taxpayers*

## *In brief*

In Rev. Rul. 2003-8, the IRS ruled that the withholding taxes referred to in Article 61 of the Costa Rican income tax law are non-creditable soak-up taxes under IRC sections 901 and 903. Costa Rica repealed Article 61 on December 11, 2012.

For US multinational companies (MNCs), this development should remove the obstacle of soak-up tax treatment to the ability to credit the Costa Rican withholding tax.

## *In detail*

Article 61 of the Costa Rican income tax law granted the Costa Rican tax authorities (DGT) the ability to waive, fully or partially, Costa Rican income tax withholding on items of Costa Rican source income (including, but not limited to, profits and dividend distributions) when either the withholding agent or the payment beneficiary proved, to the satisfaction of the tax authorities, that:

- No credit or deduction could be claimed in the beneficiary's country of residence with regard to the income tax paid in Costa Rica, or
- A credit could be claimed but it was lower than the income tax paid in Costa Rica. In this case the waiver could only be granted for the portion that was not creditable in the beneficiary's country of residence.



Law No. 9104 repealed the provisions of Article 61 effective December 11, 2012. As such, the Costa Rican income tax withholding on Costa Rican source dividends, royalties and similar items may be as high as 25% in the absence of an income tax treaty.

## *Actions to consider*

Although the soak-up tax treatment barrier to tax creditability has been removed, the Costa Rican withholding tax must meet other requirements in order to be a creditable tax.

If US MNCs incur Costa Rican withholding tax, they should consider whether such withholding tax is now creditable.

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