Latin American Tax Newsalert

A Washington National Tax Services (WNTS) Publication

January 4, 2013

Nicaragua reduces tax rate, adds transfer pricing rules and adds permanent establishment definition

In brief

The Nicaraguan government has enacted Law 822, significantly overhauling its tax regime. The law's provisions, effective January 1, 2013, may affect multinational corporations (MNCs) engaged in business in Nicaragua. We have summarized some relevant aspects of the new law below.

Corporate income tax rate

The corporate income tax rate of 30% is scheduled to drop 1% each year from 2016 through 2021. However, this reduction may be pushed forward or back -- subject to the approval of the Nicaraguan congress -- depending on whether Nicaragua meets certain revenue goals and/or its economy experiences growth.

Permanent establishment definition

Law 822 has incorporated a definition of permanent establishment (PE) into the Nicaraguan income tax regime. In this regard, the term PE refers to a place through which a non-resident taxpayer wholly or partially conducts its business, including the following: a place of management; a branch; an office or agent; a factory; a workshop; and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

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The definition also includes: a building site or construction or installation project or connected supervision activities, but only if the duration of such activities exceeds six months; and the performance of consultancy services, provided they exceed six months within a 12-month period.

A PE may also be created where a person, other than an agent of independent status, acts on behalf of a non-resident taxpayer if:

(a) The person has the authority within Nicaragua to habitually conclude contracts or undertake acts in the name of the non-resident taxpayer; or

(b) Even if the person does not have such authority, he habitually maintains, in Nicaragua, a warehouse of goods or merchandise from which he regularly delivers goods or merchandise in the name of the non-resident taxpayer.

Capital gains

Capital gains derived by non-residents, including gains from the sale or transfer of Nicaraguan shares, are generally subject to a 10% income tax. Note that non-residents are not permitted to utilize capital losses to offset capital gains.

Transactions occurring on an authorized local securities exchange are exempt from Nicaraguan national and local taxes (except for the capital gains tax).

Withholding rates

In general, cross-border payments to non-residents are subject to the following statutory withholding tax rates:

Reinsurance premiums	1.5%
Insurance premiums	3%
Air and maritime transportation	3%
International telephone communications	3%
Royalties	10%
Dividends	10%
Interest	10%
Other	15%

Transactions with tax havens

Expenses that are paid by Nicaraguan residents to an individual or entity that is a resident of a tax haven are subject to a 17% withholding tax. For this purpose, a tax haven jurisdiction may include:

1. A foreign territory where the income tax is substantially lower than the Nicaraguan income tax.

2. A foreign country or territory that has been listed, for the corresponding taxable year, as an uncooperative jurisdiction by the Global Forum on Transparency and Exchange on Information for Tax Purposes.

3. A foreign territory that is listed by the Nicaraguan Public Credit and Finance Ministry.

Transfer pricing rules

OECD-based transfer pricing rules have been enacted for the first time ever, although Law 822 provides that these rules will not be effective until January 1, 2016. These rules require the taxpayers to have contemporaneous documentation to support the transfer price with regard to their related-party transactions.

Specific tax regimes

Law 822 introduces certain amendments that affect specific tax regimes or industries including exporters, manufacturers, the fishing industry, the hospitality industry, investment funds, etc. For instance, certain forestry industry associated benefits have been extended until December 31, 2023.

Actions to think about

The Nicaraguan tax overhaul is broad. It addresses income taxes and other taxes such as VAT and excise taxes. Law 822 mandates the enactment of regulations in connection with the new law. As these new rules take effect -- even in the absence of immediate regulations -- MNCs should consider how the corporate income tax rate reduction, the new transfer pricing rules, the new permanent establishment definition, and other relevant modifications may affect their existing or anticipated tax structure in Nicaragua.

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