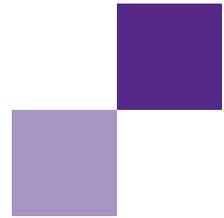


Doing business in El Salvador



Jose Roberto Romero and Antonio Mendez
Romero Pineda & Asociados (Lex Mundi Member Firm)

www.practicallaw.com/9-205-8990

LEGAL SYSTEM

1. What is the legal system (civil law, common law or a mixture of both)?

El Salvador's legal framework is derived from the Political Constitution of 1983. The Constitution is the highest legal body, followed by international treaties, laws and implementing regulations.

The legal system was originally based on the French civil code system. The Legislative Assembly enacts laws on the initiative of:

- Legislators.
- The President (through his ministers).
- The Supreme Court of Justice (on matters related to the judicial branch, jurisdiction and competition of the courts, and the exercise of notary publics).
- Municipal councils (on matters related to municipal taxes).

The Peace Accords signed in 1992 introduced important amendments to the Constitution, which focuses on the stabilisation of democracy and respect for human rights.

The Constitution grants a number of individual rights such as: freedom to contract, freedom of speech, private property, legal equality, *habeas corpus*, the right to legal proceedings, free disposal of one's property and the right to resolve disputes through arbitration.

FOREIGN INVESTMENT

2. Are there any restrictions on foreign investment (including authorisations required by central or local government)?

Foreign investment must be registered at the National Investment Office (*Oficina Nacional de Inversiones*) (ONI) to access incentives granted by the Investment Act (*Decree No. 732*). Foreign investors must also observe provisions against money laundering.

An important development has been the recent approval of the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA). This treaty not only reduces customs barriers, but introduces a complete set of trade regulations that implement the "equal treatment to foreign investors" principle through many areas of local regulation, such as labour, environmental, banking and public contracts.

3. Are there any exchange control or currency regulations?

The US dollar is the legal tender. The Salvadoran colon no longer circulates. However, it keeps a referential fixed rate of exchange of SVC8.75 per US\$1.

There are no exchange controls. Banks keep accounting records in US dollars. The state has the power to investigate suspicious transactions.

4. What grants or incentives are available to investors? Are any of these aimed specifically at foreign investors?

The following incentives and protections are provided to foreign investors (*Investment Act*):

- General expediting procedures to ensure the equal treatment of local and foreign investors.
- Freedom to make investments of any kind.
- Facilitation of the transfer of funds abroad.
- Foreign investors, making an investment of more than 4,000 monthly minimum salaries, have an automatic right to resident status, which grants the right to remain and work in the country. This residency can be temporary or permanent, and is extended to the family group of the foreign investor.
- Access to local financing.
- Protection and safety of the investors property.

In addition, the Free Trade Zone Law exempts those companies operating in free zone areas from income tax, value added tax (VAT), customs tax and local taxes; as long as the goods produced or services provided are exported. The portion of goods or services interned to the local market are taxed.

BUSINESS VEHICLES

5. What is the most common form of business vehicle used by foreign companies to conduct business in your jurisdiction?

In relation to this vehicle, please state:

- **Registration formalities (including timing).**
- **Minimum (and maximum) share capital.**
- **Whether shares can be issued for non-cash consideration, such as assets or services (and any formalities).**
- **Any restrictions on the rights that can attach to shares.**
- **Any restrictions on foreign shareholders.**
- **Management structure and any restrictions on foreign managers.**

- **Directors' liability.**
 - **Parent company liability.**
 - **Reporting requirements (including filing of accounts) and cost of compliance.**
-

The most common forms of business entity used are:

- A branch office.
- A local subsidiary corporation - that is, an anonymous company of variable capital (anonymous company).
- A limited liability subsidiary company (LLC), equivalent to a partnership.

The most common form of corporate vehicle to be established by a foreign company in El Salvador is an anonymous company, for which the following applies:

- **Registration formalities.** Incorporation must be granted before a notary public and then the document must be registered at the Registry of Commerce. It must be granted through a public deed, which is comprised of the company's articles of incorporation and bye-laws. Registration takes from three to five days.
- **Share capital.** A minimum of two shareholders (persons or companies) is required. The minimum capital required is SVC100,000 (about US\$11,428). At the time of incorporation, at least 25% of the subscribed capital stock must be paid. The outstanding 75% must be fully paid within a reasonable period of time (usually between one and five years) following incorporation. The minimum value of each share of the capital stock is SVC10 (about US\$1.14). There is no maximum share capital.
- **Non-cash consideration.** Shares can be issued for non-cash consideration, once the minimum capital is paid (*see above, Share capital*). However, there are a number of formalities which must be completed when issuing shares for non-cash consideration.
- **Rights attaching to shares.** There are usually no restrictions on rights attaching to shares. However, the shareholders can decide to issue preferred shares (which carry limited voting

rights but preferred rights to profits).

- **Foreign shareholders.** There are no restrictions on foreign shareholders.
- **Management structure.** The general meeting of shareholders elects either a board of directors (at least two directors and their corresponding alternates), or a sole administrator (and his alternate), to manage the company. The board of directors can appoint managers for different areas. Foreign individuals can act as shareholders, directors or managers.
- **Directors' liability.** Directors' powers are personal and cannot be delegated. The president and the secretary of the board, acting jointly or separately, are the legal representatives of the company, unless either:
 - the company's bye-laws provide otherwise;
 - a power of attorney is granted to a person residing in El Salvador, which gives them the legal capacity to sign documents and petitions on behalf of the company and act as its representative.

A director is liable for the decisions taken at board level, unless he votes against a particular decision and gives his reasons, and this is reflected in the board's minute book.

- **Parent company liability.** A parent company is only liable if it is a shareholder. In the case of companies, liability is limited to the value of the shares. In partnership-style companies, liability is personal to the partner (that is, all the partner's assets are liable).
- **Reporting requirements.** A company must file:
 - its general balance and financial statements at the Registry of Commerce annually;
 - a monthly VAT declaration, paying the difference arising from the VAT collected from its sales minus the VAT paid to third parties;
 - a monthly income tax declaration, paying 1.5% of its gross income in advance of its annual income tax;

- a monthly declaration of income tax retained from employees and individual service providers;
- monthly health contributions;
- monthly pension fund contributions.

EMPLOYEES

6. What are the main laws regulating employment relationships?

The Labour Code 1972 regulates employment relationships between employers and employees. The Ministry of Labour has administrative jurisdiction over inspections and conciliation hearings. Labour Courts have judicial jurisdiction over labour disputes, which are further reviewed by Labour Appeal Courts and the Supreme Court of Justice, if the case merits it. The Labour Code applies to all foreign and domestic employees working in El Salvador. All labour law is mandatory and cannot be contracted out of in the employment agreement.

7. Is a written contract of employment required? What, if any, other terms are likely to govern the employment relationship?

The Labour Code requires a written employment agreement. In the absence of an employment agreement, witnesses can be used to prove the employment relationship.

For companies with ten or more employees, internal labour regulations comprising disciplinary methods and procedures must be adopted and filed with the Labour Ministry.

8. Are employees entitled to management representation and/or to be consulted in relation to corporate transactions (such as redundancies and disposals)?

Employees are not entitled to management representation or to be consulted in relation to corporate transactions.

9. What statutory rules govern the termination of individual employment contracts?

Under the Labour Code, an employee can be dismissed with or without a just cause. If an employee is dismissed without just cause, he is entitled to a severance payment of one month's salary per year of work, plus proportional vacation and year-end bonus payments. This is limited to a maximum of four times the statutory minimum salary multiplied by the number of years at work, unless the company's custom is to compute severance pay based on current salary on dismissal.

10. Are redundancies/mass layoffs regulated? If so, please give details.

Redundancies and lay offs are not fair causes for dismissal (see *Question 9*) and therefore require severance payments to be made to the workers.

Layoffs are allowed under special situations and must follow a procedure (*Labour Code*). Layoffs do not terminate the individual employment agreement, but suspend the relationship during a period of time. Employees don't lose seniority during layoffs.

11. In relation to employees, what constitutes tax residency in your jurisdiction?

Employers are tax resident if they reside in El Salvador for more than 200 days in a year. In addition, if the income earned by a person in El Salvador forms the greater part of his total income for the year, that individual is considered to be domiciled in El Salvador for tax purposes.

12. What income tax or social security contributions must the following pay:

- Tax resident employees?
 - Non-tax resident employees?
 - Employers, in relation to their employees?
-

Tax resident employees

Tax resident employees must pay income tax at pro-

gressive 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 (about EUR56) 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.

Non-tax resident employees

Non-tax resident employees are subject to a 20% withholding tax on their Salvadorian-sourced income, and 13% from every VAT taxable payment.

Employers

See above, *Tax resident employees*.

13. Do foreign employees require work permits and/or residency permits? If so, how long does it take to obtain them and how much do they cost?

Foreign employees require a work permit (a temporary residence visa), which can be obtained from the Salvadoran consulate in their country of origin. However, the most common way to obtain it is to enter the country as a tourist and then apply for temporary residence. The process takes about three to five months. The official fee is approximately US\$35 (about EUR27).

TAX

14. In relation to business entities, what constitutes tax residency in your jurisdiction?

Traditionally, the opening of a branch office constituted tax residency. However, following recent tax reform, merely establishing a physical office space in El Salvador results in tax residency.

15. What proportion of a tax resident business entity's income is taxed and what are the main taxes that potentially apply (including rates)?

Tax resident business entities pay income tax on net worldwide income at a rate of 25%.

VAT at 13% applies to the transfer of movable goods and the provision of services.

16. How are the activities of non-tax resident business entities taxed?

Non-resident companies obtaining income in El Salvador are subject to withholding taxes of:

- 20% on all taxable income.
- 13% on all VAT taxable payments.

In addition, each municipality in has its own local taxes.

17. Please explain how each of the following is taxed:

- **Dividends paid to foreign corporate shareholders.**
- **Dividends received from foreign companies.**
- **Interest paid to foreign corporate shareholders.**
- **Intellectual property (IP) royalties paid to foreign corporate shareholders.**

- **Dividends paid.** These are not taxed.
- **Dividends received.** These are taxed as income with 25% rate for companies.
- **Interest paid.** These are taxed as income with a 20% withholding rate.
- **IP royalties paid.** These are taxed as income with a 20% withholding rate.

18. Are there any thin capitalisation rules (restrictions on loans from foreign affiliates)? If so, please give details.

There are no thin capitalisation rules.

19. Are there any controlled foreign company rules? If so, please give details.

There are no foreign company rules, as long as the subsidiary does not distribute dividends.

20. Are there any transfer pricing rules? If so, please give details.

Transactions between related companies must conform to regular market prices.

21. How are imports and exports taxed?

Imports are taxed according to duties ranging from 0% to 20%, plus 13% VAT.

Exports of companies not subject to free zone benefits receive a 6% reimbursement of FOB (free on board) from the government.

Recent approval of the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) has dramatically reduced and/or eliminated custom duties. However, for some products, customs will be eliminated only after an adaptation period.

22. Is there a wide network of double tax treaties? If so, please give details.

El Salvador has no double tax treaties.

COMPETITION

23. Are restrictive agreements and practices regulated by competition law in your jurisdiction? If so, please give brief details.

Competition is largely regulated under the Competition Law, the provisions of which are overseen by the Competition Superintendence. Competition law requires selective approval of mergers and acquisitions to ensure anti-trust provisions are met.

INTELLECTUAL PROPERTY

24. Please outline the main intellectual property rights that are capable of protection in your jurisdiction. In each case, please state:

- **Nature of right.**
- **How protected.**
- **How enforced.**
- **Length of protection.**

Patents

- **Nature of right.** For an invention to be patentable, it must be a solution to a technical problem. It must also be:
 - useful;
 - new; and
 - non-obvious to a technician in that particular field.
- **How protected.** Protection is obtained by filing a patent application with the Registry of Intellectual Property (Registry).
- **How enforced.** Infringements are sanctioned criminally through the Attorney General's office. Also, civil remedies (such as damages) can be recovered in civil and commercial judicial proceedings.
- **Length of protection.** Patents last for 20 years from the filing date and are non-renewable.

Trade marks

- **Nature of right.** Any word(s), two- and three-dimensional designs, trade-dress, sounds or smells can be registered as trade marks.
- **How protected.** Protection is obtained by filing a trade mark application with the Registry. The application must first be published and examined by local examiners at the Registry.
- **How enforced.** The methods of enforcement and the remedies available are the same as for patents (*see above, Patents*).
- **Length of protection.** Protection lasts for ten years, renewable indefinitely for ten-year periods.

Registered designs

- **Nature of right.** To be registerable, registered designs must be two- or three-dimensional forms or shapes that, when incorporated in a product, give it a special appearance and can be used to model or manufacture it.
- **How protected.** Protection is obtained in the same way as for patents (*see above, Patents*).
- **How enforced.** The methods of enforcement and the remedies available are the same as for patents (*see above, Patents*).
- **Length of protection.** Protection lasts for five years and is renewable for one further five-year period.

Copyright

- **Nature of right.** Copyright is provided for artistic, scientific and literary works.
- **How protected.** Copyright subsists from the moment of creation. However, it can be deposited at the Registry, which issues a deposit certificate.
- **How enforced.** The methods of enforcement and the remedies available are the same as for patents (*see above, Patents*).
- **Length of protection.** Protection lasts for the duration of the author's life plus 50 years. If a company is the author, protection lasts for 50 years from the year after it was communicated to the public.

Confidential information

- **Nature of right.** Confidential information is undisclosed information that provides its owner with an advantage over third parties in the market.
- **How protected.** Confidential information is protected in the same way as trade secrets and industrial secrets (that is, the company must keep it confidential). It cannot be registered, but best practice is to execute a confidentiality agreement with the recipient of the confidential information.
- **How enforced.** The methods of enforcement and the remedies available are the same as for patents (*see above, Patents*).
- **Length of duration.** When a specific agreement is not in place, protection lasts for as long as the information is kept:
 - in a confidential manner;
 - in a safe place; and
 - with restricted access.

Otherwise, it lasts for the length of the duration of the agreement.

MARKETING AGREEMENTS

25. Are marketing agreements regulated in your jurisdiction? If so, please give brief details in respect of the following arrangements:

- **Agency.**
- **Distribution.**
- **Franchising.**

- **Agency.** Agency agreements are regulated in the same way as distribution agreements (*see above, Distribution*).
- **Distribution.** Agency, distribution and representation agreements are regulated and provide strong protection to the local party. These agreements can only be terminated for a fair cause set out in the Code of Commerce 1970.

If the contract is unilaterally terminated, amended or not renewed, without fair cause by the principal, the distributor is entitled to an indemnity, which is composed of, among other things:

- gross profits for the last three years;
- investment in premises;
- reimbursement for credits to third parties.

However, DR-CAFTA regulations allow parties to expressly agree to waive applicable indemnities.

In addition, the local distributor can seek to obtain a final decision from the courts to stop imports from the distributor of the former principal's products until he is properly indemnified. This does not apply to principals who signed distribution agreements following their country of origin's approval of DR-CAFTA, if expressly agreed on in the contract.

- **Franchising.** Franchising is not specifically regulated and the parties can, therefore, freely negotiate most of the terms. However, many of the important aspects of a franchise agreement are regulated under other areas of law, including those on:
 - IP rights;
 - foreign investment registration;
 - arbitration;
 - taxes;
 - non-compete issues.

E-COMMERCE

26. Are there any laws regulating e-commerce (such as electronic signatures and distance selling)? If so, please give brief details.

E-commerce is allowed, based on the free contracting right provided by the Constitution. DR-CAFTA prohibits custom duties on electronic products sold through the internet. SVNNet, the entity responsible for domain name disputes, has adopted dispute resolution rules based on WIPO (World Intellectual Property Organization) rules.

DATA PROTECTION

27. Are there any data protection laws? If so, please give brief details.

There are no specific data protection laws. The closest regulations are those for trade secrets, bank secrecy and consumer rights under consumer protection legislation to guarantee accurate information. The Constitution grants protection to a person's honour, personal and family intimacy, and to his own image.

PRODUCT LIABILITY

28. Are there any laws regulating product liability and product safety? If so, please give brief details.

There are no specific product liability laws. However, consumer protection regulations apply to a consumer

and supplier relationship. They provide for the principle that the supplier is liable up to the price of the product for any defects arising out of its fabrication.

Also, civil law provides for the general principle that all entities are responsible for damages caused by their tortious intent or negligence. Following case law, clauses limiting such responsibility are considered to be unconstitutional.

PLC **FASTDRAFT**

Better documents, faster

PRACTICAL LAW COMPANY

Create better
documents in
half the time



PLC **FASTDRAFT** cuts drafting time by automating documents for key transactions. Spend less time typing and more time thinking - about the things that make a difference to your client. To find out more go to: www.practicallaw.com/fastdraft



RP&A

ROMERO PINEDA & ASOCIADOS
ATTORNEYS AT LAW
SAN SALVADOR, EL SALVADOR

HANDLING YOUR LEGAL INTERESTS
LIKE A MASTERPIECE.



*With a full range of capabilities we provide
counsel to the world's leading corporations,
financial institutions, local operating
companies and international organizations*

WORLD TRADE CENTER I, SUITE 305
COLONIA ESCALON
SAN SALVADOR, EL SALVADOR, C.A.
PBX: (503) 2505-5555
FAX: (503) 2505-5500

VIDEO CONFERENCE: (503) 2263-3914
E-MAIL: info@romeropineda.com • www.romeropineda.com