



Tax Newsletter

Updates on El Salvador taxes

Tax treatment of interest paid on foreign financing

El Salvador-resident companies that make interest payments on financing arranged with foreign institutions or entities are required to comply with domestic income tax withholding and VAT reporting obligations.

Income tax withholding

Article 4.11 of the Income Tax Law provides that interest payments on loans granted abroad by the following types of institutions and entities are not subject to income tax and, therefore, are not subject to income tax withholding:

a) International bodies; development agencies or institutions of foreign governments; foreign governments; and public corporations and foundations headquartered abroad that are recognized by the relevant authorities of their country of origin and whose non-profit nature is found in their articles of association. Nonprofit foundations must be authorized by the El Salvador Central Reserve Bank (CRB); and

b) Investment funds, private fund managers, specialized public or

private funds headquartered abroad that are recognized by the relevant authorities in their country of origin and authorized by the CRB and make loans to El Salvador cooperative savings and loan associations, as well as corporations, and public law and public utility foundations (whose own objective is to provide financing to micro and small enterprises).

The El Salvadoran taxpayer must maintain documentation to demonstrate the legal existence of the foreign institution or entity and to

support the availability of the exemption.

If the income tax exemption does not apply, the El Salvador taxpayer must withhold tax at a rate of 10%, 20% or 25%.

The reduced rate of 10% applies where the financing agreement was concluded with a financial institution that is supervised by a financial regulatory agency or authorized or registered by a relevant authority in its country of origin and it obtained a special authorization from the CRB.

The general 20% rate applies where the financing agreement was concluded with a related foreign person or a foreign financial institution that has not been authorized by the CRB.

The 25% rate applies where the financing agreement was concluded with an entity that is incorporated, headquartered or resident in a jurisdiction with a preferential tax regime, a jurisdiction that imposes a low tax or a jurisdiction that is a tax haven. However, if the financial institution has been authorized by the CRB, 10% rate will apply.

Taxpayers should review the list of foreign financial institutions that have been authorized by the CRB to determine which institutions qualify for the reduced withholding tax rate. This list is updated quarterly and is posted on the web sites of the Ministry of Finance (www.mh.gob.sv) and the CRB (www.bcr.gob.sv).

Tax on Transfer of Moveable Property and Provision of Services (VAT)

According to articles 14 and 15 of the Law on the Tax on the Transfer of Moveable Property and the Provision of Services (VAT), interest payments made in the context of foreign financing arrangements are subject to VAT.

As a result, an El Salvadoran taxpayer must report and pay 13% VAT on interest payments arising from a financing agreement signed with a foreign institution or entity. The taxpayer should request the relevant tax form from the El Salvador tax authorities.

Interest payments made to foreign financial institutions that have been authorized by the CRB are VAT-exempt.

As in the case of withholding taxes, El Salvadoran taxpayers should periodically review the list of authorized foreign financial institutions to identify interest that is VAT-exempt.

Instructions for Qualifying Foreign Financial Institutions

Foreign financial institutions that wish to receive CRB authorization must complete specific procedures and requirements.

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