Audit. Tax. Advisory.

Guide for Fiscal Year-End Closing in Costa Rica

Venegas Nexia

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1. Introduction

The fiscal year-end on December 31st is an essential process for businesses, professionals, and SMEs in Costa Rica. This exercise requires a thorough review of accounting and tax information.

The declarations for Value Added Tax:

Form D-150 (Monthly VAT Declaration)

The Income Tax declaration:

Form D-101 (Annual Declaration)

This guide provides a roadmap for an orderly fiscal year-end, taking advantage of special benefits and regimes and addressing the mechanisms for integrating income.

2. Verification of VAT D-150 Returns

- **Consistency Between Sales and Purchases:**
Ensure that monthly VAT returns accurately reflect the revenue and purchases consolidated in the financial statements. Discrepancies may lead to adjustments or assessments by the Tax Administration. Verify that your electronic invoices for sales match the revenue reported in the financial statements and the D-104 VAT return.

- **Pro-Rata Calculation (If Applicable):**
For businesses engaged in both taxable and exempt activities, it is essential to calculate the VAT credit pro-rata consistently with the amounts declared in the D-104-2 returns.

- **Verification of Credit and Debit Notes:**
Ensure that all issued and received credit and debit notes are properly recorded and reflected in both the VAT returns and financial statements.

3. Tax Reconciliation and D-101 Income Declaration

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The D-101 Declaration is the central document of the fiscal year-end closing. For its proper preparation, the following points should be considered:

- **Reconciliation between Accounting Profit and Taxable Base:**
Start with the accounting profit (according to IFRS) and perform a tax reconciliation to identify non-deductible items and differences between tax regulations and accounting records. It is essential to distinguish between temporary differences (which will reverse in future periods) and permanent differences, and to properly document everything for third-party review, including tax authorities.

- **Application of IAS 12 (Income Taxes):**
Analyze each temporary difference to determine whether it generates a deferred tax asset or liability, paying special attention to foreign exchange differences (realized and unrealized). Maintain an auxiliary record that clearly distinguishes these variations for proper deferred tax recognition.
Separate income and expenses from taxable activities under income tax from those that are not. For example, rental income that is subject to a separate tax on real estate income.

- **Deductible Expenses and Withholding Taxes:**
Ensure that expenses are "useful, necessary, and relevant" (according to Article 7 of the Income Tax Law - LISR) and that withholding taxes have been properly applied (Article 59 of the LISR). Proper documentation (invoices, receipts, contracts) is essential to support the deductibility of each expense. Confirm that income tax withholdings have been applied to salaries, dividends, or remittances to foreign suppliers.
To be considered deductible under Costa Rican tax regulations, an expense must meet key requirements:

- Relation to Taxable Income:
Expenses must be necessary to generate current or potential income subject to the Income Tax Law.

- Electronic Invoices:
All expenses must be supported by receipts authorized by the Tax Administration.

- Compliance with Labor and Social Obligations:
If an expense is subject to withholding taxes or must be reported to the Costa Rican Social Security Fund (CCSS), compliance with these obligations is required.

Additionally, there are categories of expenses with specific requirements:

- **Financial Expenses**
Financial interest must be well-documented and linked to the generation of taxable income. For non-banking interest, it is crucial to verify the applicable deductibility limits, as any excess may be deducted in subsequent periods (see point 7).

- **Bad Debts**
The deductibility of bad debts is a sensitive issue. According to the Income Tax Law, they can only be deducted after all legal recovery efforts have been exhausted. However, provisions for bad debts are not deductible, requiring companies to exercise prudence in credit management.

In summary, **tax reconciliation** is a crucial element in the accounting close process. This procedure involves **distinguishing** between taxable and non-taxable income, ensuring that **proper documentation** is available to justify the classification of the latter.

It is important to note that in 2023, Article 1 of the Income Tax Law was amended, impacting the principle of territoriality. This reform has raised questions regarding the treatment of certain income earned abroad, making it essential to assess each case in detail.

Additionally, it is necessary to identify and exclude non-deductible expenses from the taxable base. These include expenses that do not meet legal requirements, such as the absence of electronic invoices or a direct connection to the generation of taxable income.

4. Key Reviews Before Submitting D-101

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4.1 Identification of Temporary vs. Permanent Items:

- Temporary Items:
These are differences between accounting and taxable income that will reverse in future periods (e.g., accelerated depreciation, provisions, or bad debt allowances).

- Permanent Items:
These are expenses or income that do not reverse, such as fines or unauthorized donations. Proper identification is essential for determining current and deferred tax liabilities.

4.2 Deduction of Losses from Previous Years:

Companies that incurred losses in prior fiscal years may deduct them from future profits within specific limits and timeframes set by law. This allows businesses to offset past losses against future gains, reducing taxable income in subsequent years.

4.3 Exchange Rate Differences:

In recent years, there has been significant controversy regarding the treatment of exchange rate differences, whether as gains or losses. This refers to fluctuations in the value of foreign currency-denominated assets or liabilities due to exchange rate changes.

According to Article 5 of the Income Tax Law, businesses must report exchange rate differences on "assets and liabilities, arising between the time of the transaction and the recognition of income or payment of liabilities, or at the end of the fiscal period." This means that even if the gain or loss has not been realized by the end of the fiscal period, it must still be accounted for.

However, tax authorities have stated that the applicable criterion should be based on "realized" gains and losses, even though some taxpayers apply the "accrued" approach.

This discrepancy creates uncertainty and potential disputes with tax authorities. Companies should carefully analyze their position, considering both legal requirements and possible litigation risks.

4.4 Deduction of Donations:

Businesses may deduct donations made to authorized entities from their taxable base, up to 10% of their net income. It is crucial to ensure that donations are made to duly registered organizations and are properly documented.

4.5 Withholding Taxes and Salaries:

- Salaries Not Reported to the CCSS:
These are non-deductible expenses. Ensure that social security contributions have been properly reported and settled.

- Salaries Reported to the CCSS and INS:

Salary amounts should match what has been reported to the Costa Rican Social Security Fund (CCSS), the National Insurance Institute (INS), and company accounting records.

- Withholding Taxes on Foreign Services:
Ensure that the proper withholdings have been applied to avoid expenses being deemed non-deductible.

4.6 Electronic Invoicing Review:

- Verify that all income and expenses are backed by valid electronic invoices.
- If a supplier is legally exempt from issuing an electronic invoice, proper documentation of this exemption is necessary to avoid challenges from tax authorities.

4.7 Foreign Income:

Review whether income earned abroad is subject to corporate income tax or any other tax category.

5. Application of International Financial Reporting Standards (IFRS)

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For companies adopting IFRS, it is crucial to pay attention to at least the following:

- **IAS 12 (Income Taxes):**
Regulates the recognition and measurement of income taxes, including the treatment of exchange rate differences and the determination of deferred tax.

- **IFRS 16 (Leases):**
Defines the accounting treatment of leases, the impact of which must be integrated into the fiscal reconciliation.

- **IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from Contracts with Customers):**
These standards impact the estimation of provisions for credit losses and revenue recognition, generating temporary differences that need to be considered.

- **IFRS 18 (Presentation of Financial Statements):**
Establishes a new framework for the presentation of financial performance, prioritizing comparability and transparency in the income statements.

6. Other Obligations and Considerations

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- **Check your tax situation:**
Verify on the Ministry of Finance platform ATV under the "Consult Tax Information" option or at the link https://atv.hacienda.go.cr/ATV/frmConsultaSituTributaria.aspx.

- **Partial Payments (Income Estimation):**
Throughout the year, advance income tax payments must be made. Failure to do so will result in late payment interest.

- **Inactive Company Declarations:**
Inactive companies must submit the required informational returns through the ATV platform.

- **Beneficial Owner Registry (RTBF):**
Updating information with the Central Bank is essential to avoid penalties and restrictions.

- **Transfer Pricing:**
When part of an economic group, if transactions are carried out with related parties, it is necessary to have documentation supporting the value of the transactions to avoid penalties.

- **Transactions with Cryptocurrencies and Digital Assets:**
Although regulations are still evolving, it is advisable to keep a detailed record of all transactions and their accounting and tax justification.

- **Capital Gains Tax:**
Review whether any sales of assets, shares, or real estate were made during the year, as these transactions may have special tax treatments and might not require integration (see point 9).

- **Obtaining the Required Certifications:**
  - Request certifications from state entities that apply the 2% withholding tax.
  - Certifications from a certified public accountant for in-kind donations that are deductible for income tax purposes and for inventory write-offs.

7. Non-Bank Interests

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Article 9 bis of the Income Tax Law (LISR) in Costa Rica establishes a limitation on the deductibility of net interest expenses to prevent the erosion of the tax base through excessive indebtedness. This regulation, introduced with the Public Finance Strengthening Law, follows the recommendations of Action 4 of the OECD's BEPS Plan.

Definition of Non-Banking Interest:
Non-banking interest refers to interest generated or paid on credit operations that do not originate from regulated banking institutions. This includes loans granted by non-banking financial entities, cooperatives, or other specialized credit institutions.

Deductibility Limit:
Article 9 bis sets a maximum deductibility limit for net interest expenses, defined as a percentage of Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA). This percentage has been implemented gradually since the 2021 fiscal year, decreasing by two percentage points each year until reaching 20% in 2027. For the 2024 fiscal year, the deductibility limit is 26% of EBITDA.

It is important to note that this limit applies only to non-banking interest. Interest from debts with entities subject to oversight and inspection by the supervisory bodies under the National Council for the Supervision of the Financial System (CONASSIF) or with foreign banks and financial entities duly supervised by regulatory bodies in their country of origin is exempt from this limitation.

Calculation of Maximum Deductibility:
1. Calculate EBITDA: Add net profit for the period to deductible expenses for interest, depreciation, and amortization.
2. Apply the corresponding percentage: Multiply EBITDA by the deductibility percentage applicable to the fiscal period (e.g., 0.26 for 2024).

If net interest expenses exceed the permitted limit, the excess can be deducted in subsequent fiscal periods, provided the established limit is met in each period.

Procedure to Increase the Deductibility Limit:
Article 9 bis empowers the Tax Administration to authorize a higher deductibility limit in justified cases. The request must be submitted within 15 calendar days after the end of the fiscal period and must comply with the requirements established in the current regulations.

Conclusion:
The limitation on the deductibility of non-banking interest aims to prevent debt practices that artificially reduce the taxable base of the Corporate Income Tax. It is essential for taxpayers to understand and correctly apply these provisions to ensure compliance with their tax obligations and avoid potential penalties.

8. Special Considerations for SMEs

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Small and Medium Enterprises (SMEs) represent a significant part of the business landscape in Costa Rica. Due to their size, they can access special benefits and tax regimes. As the 2024 fiscal year-end approaches, it is essential to consider the following:

- **Simplified Processes and Tax Benefits for New Businesses:**
Under the new regulations, micro and small enterprises are eligible for graduated exemptions on income tax payments during their initial years of operation.

- **Graduated Income Tax Exemption:**
  - First three years: Full exemption (0% tax payable).
  - Fourth and fifth years: 75% reduction (the company pays only 25% of the applicable tax).
  - Sixth year: The exemption decreases to 50% (the company pays 50% of the income tax).

These benefits aim to reduce the tax burden in the early stages and encourage the growth of new businesses.

- **Formal Compliance and SME Registration:**
To access these benefits, the company must be registered and up to date in the SME registry with the relevant authorities (e.g., MEIC or MAG for the agricultural sector). Proper registration ensures eligibility for tax incentives and other government support programs.

9. Income Integration for Professionals and Businesses

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Income integration is the mechanism used to consolidate all sources of income to fairly determine the taxable base for Income Tax. It is important to note that when integrating income, one must consider whether the income-generating assets are directly related to the taxpayer's productive activity.

- **Determining Asset or Property Allocation:**
  - Only income derived from assets or properties that are fully or partially used in income-generating activities will be included in the taxable base.
  - If an asset generates income but is not directly linked to the productive activity, the income may be treated separately or through other mechanisms to avoid double taxation.

- **For Independent Professionals:**
  - Mandatory Income Integration:
Professionals earning income from their main activity (e.g., fees, consultations, and services) and additional capital income (e.g., rental income or asset use related to their profession) must integrate both sources, as long as the assets generating income are linked to their professional activity.
  - Consideration of Tax-Exempt Brackets:
If the professional earns salary income or other tax-exempt income categories, these benefits must be considered when filing their income tax return.

- **For Businesses:**
  - Integration of Multiple Income Sources:
Companies must consolidate income from operational activities, capital income, and other accessory income into a single taxable base, provided that the income-generating assets are related to the main economic activity.
  - Prevention of Double Taxation:
Mechanisms such as withholding taxes and advance tax payments should be applied to prevent double taxation on income classified under different categories.
  - Specific Adjustments and Deductions:
Proper application of tax adjustments and deductions is essential to maximize tax benefits and ensure fair taxation.

This comprehensive income integration, based on the economic use of assets, allows for a precise reflection of the taxpayer's tax capacity, preventing double taxation and ensuring the correct application of exemptions and deductions.

10. Taxation Option for Capital Income under the Income Tax Regime

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According to Resolution DGT-R-058-2019, as amended by MH-DGT-RES-0018-2023, taxpayers earning real estate and/or financial capital income have the option to tax these earnings under the Corporate Income Tax Regime, provided they meet specific requirements:

- **Requirements and Procedures:**
  - Employment Requirement:
The taxpayer must have at least one registered employee with the Costa Rican Social Security Fund (CCSS) dedicated to generating the capital income.
  - Notification to the Tax Administration:
The taxpayer must formally opt in by submitting Form D-140 through the Tax Administration's online platforms (e.g., TRAVI).
  - Minimum Permanence Period:
Once the taxpayer opts for this regime, they must remain under the Corporate Income Tax Regime for at least five years.

- **Non-Compliance Procedures:**
If the taxpayer fails to maintain at least one registered employee with the CCSS, they must notify the Tax Administration by submitting Form D-140 and will be transferred to the capital income tax regime starting the following month.

- **Income Allocation and Integration:**
Only income from assets or properties actively used in income-generating activities will be integrated into the taxable base. If an asset generates income but is not directly linked to the taxpayer's productive activity, it may be taxed separately to avoid double taxation.

- **Benefits and Key Considerations:**
This option integrates capital income into the Corporate Income Tax base, simplifying tax management and avoiding double taxation.
Taxpayers must maintain proper documentation to prove compliance with the established requirements and conditions.

11. Internal Control and Supporting Documentation

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- **Bank and Accounting Reconciliations:**
Keep reconciliations up to date to ensure consistency of balances and avoid unidentified items. Maintain bank account statements.

- **Document Organization:**
Systematically archive electronic invoices, receipts, contracts, and other supporting documents for each transaction.

- **Specific Ledgers for Special Items:**
Lleve registros auxiliares para partidas particulares (por ejemplo, diferencias cambiarias, arrendamientos según NIIF 16 y provisiones conforme a NIIF 9), lo que facilitará la elaboración del impuesto diferido y la conciliación fiscal.

- **Accounting Ledgers and Supporting Documentation:**
Maintain a detailed auxiliary record of properties, furniture, and equipment, cross-referenced with the Public Registry for assets or rights subject to registration. Given their nature and extended periods of use, such assets require documentation to be readily available when needed.

12. Deregistration for Those Who Ceased Operations

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Taxpayers who have ceased their economic activities must deregister from the Unique Tax Registry to avoid issues, including penalties. This step is crucial to ensuring there are no outstanding tax obligations once income is no longer being generated.
According to Article 78 of the Tax Standards and Procedures Code, failure to deregister may result in a penalty equivalent to 50% of a base salary for each month or fraction of a month of delay, with a maximum penalty not exceeding the equivalent of three base salaries.

To complete the deregistration process, taxpayers must submit the "Deregistration Declaration in the Unique Tax Registry" through the Virtual Tax Administration (ATV) portal. This procedure ensures that the taxpayer is released from future tax obligations related to the ceased activity.
It is important to note that as long as a taxpayer remains registered, they must comply with all applicable formal and material obligations. Therefore, timely deregistration is essential to avoid penalties and ensure tax compliance.

13. Conclusion and Final Recommendations

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- **Ongoing Updates:**
Regularly review official publications from the Ministry of Finance, the General Directorate of Taxation, and our firm's newsletters at Venegas Nexia Blog to stay informed about regulatory changes.

- **Timely Filing:**
Submitting the D-101 Tax Return on time and making correct advance payments are essential to avoid penalties and late interest charges.

- **Specialized Advisory Services:**
At Venegas Nexia, we are well-versed in Costa Rican regulations. Our advisory services help minimize errors and facilitate tax information integration.

- **Documentation and Internal Control:**
A strong internal control system and proper document organization are key to a successful fiscal year-end closing.

- **Use of Tax Shields:**
In Costa Rica's tax system, tax shields are legal strategies that allow individuals, SMEs, and corporations to reduce their tax burden through deductions and exemptions established in current legislation. Below are the main tax shields applicable to each group:

I. Individuals:
Voluntary Pension Plans: Contributions to complementary pension plans are deductible from income tax, encouraging retirement savings and reducing taxable income.

Tax Credits for Dependents: Individual taxpayers can apply tax credits for each child and spouse, reducing the amount of tax payable. For example, in 2025, the monthly credit per child is ¢1,720, and per spouse, it is ¢2,600.

II. SMEs (Small and Medium-Sized Enterprises):
Gradual Income Tax Exemption: Starting in fiscal year 2024, micro and small enterprises can benefit from a progressive exemption on Corporate Income Tax:

First 3 years: Full exemption (0% tax).
4th and 5th years: Pay 25% of the applicable tax.
6th year: Pay 50% of the applicable tax.

This benefit applies as long as annual gross revenue does not exceed 120,582,000, and the company is properly registered as an SME with the Ministry of Economy, Industry, and Commerce (MEIC).

Exemption from Corporate Tax: Micro and small enterprises registered with MEIC's SME Registry may be exempt from Corporate Tax, provided they meet the required conditions.

III. General Corporations:
Deduction of Interest on Debt: Interest paid on loans can be deducted from taxable income, serving as a tax shield. However, there are limitations on non-banking interest deductions, with a maximum deductibility rate that will gradually decrease to 20% of EBITDA by 2027. For 2024, the limit is 26%.

Accelerated Depreciation Deduction: Costa Rican legislation allows accelerated depreciation of certain assets, enabling higher deductions in the early years of an asset's useful life. This reduces taxable income in the initial years, deferring corporate income tax.

IV. Other Tax Shields to Consider:

- Incentives for Hiring Employees:
Law No. 10.079, the "Law to Promote Employment Opportunities for Individuals Over 45 Years Old," took effect in Costa Rica on January 25, 2022. This legislation aims to encourage hiring individuals over 45 through tax benefits for employers who meet specific conditions.

- Operational Leasing for Financial Purposes / Deduction of Operating Lease Expenses:
Operational leasing allows businesses to deduct 100% of lease payments as operating expenses, as they are considered rent rather than asset purchases. This facilitates equipment renewal and optimizes tax burdens.

- Deduction of Previous Fiscal Losses:
Companies that incurred losses in previous fiscal years can deduct those losses from future taxable profits within certain legal limits and deadlines. This allows past losses to offset future gains, reducing taxable income in subsequent years.

- Deduction for Charitable Donations:
Companies can deduct donations made to authorized entities from their taxable income, up to 10% of their net income. Donations must be made to registered organizations, and proper documentation must be maintained.

- Free Trade Zone Investment Incentives:
The Free Trade Zone Regime provides significant tax benefits to companies making new investments in Costa Rica, including exemptions from income tax, import duties, and export taxes. Companies establishing operations outside the Greater Metropolitan Area may access additional benefits.

- Renewable Energy Investment Incentives:
Tax benefits are available for companies investing in renewable energy projects, including tax exemptions and deductions for investments in clean technologies.

- Deduction for Early Severance Payments:
Costa Rican legislation allows employers to deduct early severance payments from taxable income, up to a limit of three times the legally established severance amount. This deduction applies even if employment termination has not occurred, and these payments are not considered taxable income for employees nor subject to social security contributions.

It is essential for both individuals and businesses to seek tax advisory services from Venegas Nexia to ensure the proper application of these tax shields, guaranteeing compliance with regulations and avoiding potential penalties.

This comprehensive guide is designed to help businesses, professionals, and SMEs in Costa Rica navigate the fiscal year-end closing for 2025 in an organized manner. It provides insights into leveraging tax benefits—including the gradual exemption for new ventures—and correctly applying income integration based on the allocation of assets to productive activities. For any additional questions or specific situations, it is recommended to consult a specialized tax advisor who can provide tailored solutions to each taxpayer's needs.

Consult with our experts to ensure tax compliance.
Contact us at **info@venegasnexia.com**.

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