Costa Rica's Fiscal Plan Is Really A "Tax Plan"

By John R. Holtz

A Quick Primer on the Fiscal Plan and Possible Cardiac Arrest!

First, based on what we have been presented on January 17, 2011, this is not a “Fiscal Plan” but rather a “Tax Plan”. After all this time I would have expected something far more detailed and with more far more academic rigor than a single reference to cutting government operational costs. However, that ball was handed off to the Executive Branch which has only said, so far, it plans to cut 20% of government costs, “across the board” and put a freeze on hiring.

Note: According to Juan Carlos Hidalgo of the Cato Institute, the Central Government hired 5,000 new people in December before the so called “hiring freeze”.

Secondly, where is the cost cutting plan detail, like line items? Certainly developing a tactical police force that abates our “PACIFISM” culture and an additional National Security Tax using up to 4% of the GDP to create some kind of paramilitary border guard is a horrific expenditure.

Does that mean the roads do not get repaired, the hospitals will not pay off last year´s debt, and the education budget gets cut? We all know the “critical needs” of Costa Rica and Lady Laura has the obligation to present those priorities in detail for a closer examination rather than a sophomoric broad brush stroke of convenient political generality.

Because, according to the now standing government budget, it is 10% more in 2011 than 2010. No change and no reduction at all.

By the Central Government´s own accounting, between the years 2008 to the end of 2010, during both the good economic times and the mother of all recessions, Costa Rica´s GDP fell only 7%. However, government spending for this same period, increased 28.7% resulting in a 21.7% net loss of revenue.

A Fiscal Plan absent of cost cutting means more than a house of cards. Once again, in a year (Maybe if well disguised, two years) Costa Rica will be bankrupt again.

Third, the World Bank is clear that out of 183 countries Costa Rica came in 155 as to the ease of paying taxes. The average business person spends 272 hours per year figuring taxes. In OECD developed countries, business pay into taxes, employee benefits, insurance and all other government contributions 43% of their gross profits. On the other hand Costa Rican enterprise already pays in 55% of gross profits, a 12% net difference. (Source, Cato Institute and OECD)

Hidalgo concludes that one of the substantial reasons 65% - 67% of businesses do not pay taxes at all is the complexity and time consumption factor. He estimates this type of evasion alone represents 3.6% of our Gross Domestic Product (GDP) and I am not arguing his point.

The best example of this is the infamous Luxury Home tax which only an estimated 27% of taxable owners paid. It is a very, very complicated calculation and evasion is far more simple. Then if, for some rare event the owner gets caught, a “mia culpa”, negotiate a deal and pay up.

Fourth, in the proposal there are simply too many taxes on too many things to be manageable. A Ticoism is get as complicated as possible in theory to make sure all basis are covered and never worry about connecting the dots and this tax plan personifies this part of our culture.

As of now we are not really sure what food items will be taxed and which will not? It was reported that only 50 of the 400 basic items would remain unscathed by the 14% VAT tax. Later, the reverse, only 50 luxury basic products will be eligible for taxation?
Water, unless you use more than 40 cubic meters in a month, it is not taxable. Electricity is limited to 250 Kilowatts per month. Check your bill! Try that for thirty days!

Fifth, the 15% passive tax means even Banco Popular will need to pay and guess who supports Banco Popular?
The proposal asks for a 15% on passive income such as, interest, dividends, income from rents and income from foreign remittances. (Is US Social Security and 401Ks passive income? (After all pensionados do not do anything but live to die. That´s pretty passive, right?)

Sixth, The all new capital gains tax and while not really thought out, it is a killer to business.

For years, forever, Costa Rica attracted a lot of foreign investment because we do not have the capital gains and passive income tax.

Bringing this down to our level, the home or finca you may have purchased for $300,000 but was recorded, for real estate cheating tax purposes, at $100,000 value and then later sold for $300,000; you will need to pay a 3% transfer tax plus a 15% tax of the gross profit on the $200,000 that you really did not make but did on paper = $39,000, 14% tax on legal services, 14% on notary service, 14% on the 5% realty commission and finally 14% on the cost of a title search.

The cost of this transaction can come to approximately $56,000 and you just lost money on the deal. (Source, Lic. MBA, Jose Pablo Mata (jpmata@amnet.co.cr Tel: 2257-2575)

But you rented! Sorry, another 14% tax on rents* that you or the landlord need to pay. I am betting on you because the landlord needs to pay 14% on gross profits as well. (Double taxation) But that depends on the amount of rent and so far this is an undisclosed number. On $1,000 per month rent, it will go up by $140 not to mention water and electricity.

Speaking of betting, nothing mentioned, so far, on sports books and casinos, not call centers either. The “Untouchables”.

Summary:

- For obvious reasons this is not the right time to hit the panic button and move out of town.

- There is a ton, meaning a lot, of opposition to the Tax Plan. What we must accept is that we do not have a Fiscal Plan which incorporates a true budget of expenditures and other sources of income and that is the most critical issue of all.

- My advice is relax, and let’s see how this plays out before jumping off the bridge. There is plenty of time for comment and expat comment and investor comments are critical to the decision making process.

* The amount of rent to be exempt has yet to be announced

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