

Paraguay

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Recent legislative changes in Paraguay

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On August 15 2003, Paraguay inaugurated a new administration under President Nicanor Duarte Frutos. Unlike his predecessors, President Frutos proposed major changes to the economic and political situation. Tax reforms presented to Congress, a letter of intent with IMF, the renewal of the Supreme Court – with the removal of six of its nine members – and other changes to the judiciary system, a new internet-based government purchase system and other administrative anti-corruption measures are signs of progress. One of the results has been a 44% increase in tax collection rates compared to a similar period a year before.

Paraguay is a full member of Mercosur, together with Argentina, Brazil and Uruguay. Mercosur is the largest commercial area in South America, with more than 11 million square kilometers, 200 million consumers and a combined GDP of more than \$1 trillion. Paraguay recently obtained a special treatment for origin rules within Mercosur for 10 years (beginning in 2004). By this agreement, goods made in Paraguay need to be added with just 40% of their final (cost) value, between any or all the four country members of Mercosur in order to be considered Made in Paraguay (up to 2008) – that means zero duties on imports of Paraguayan products into the Mercosur countries. From 2008 to 2014, this percentage will rise from 40% to 50%. General rules applied to the other Mercosur countries require the addition of at least 60% of the value in the region (20% higher). That makes Paraguay an interesting option for the production of those products or components currently imported into the region.

Paraguay and IMF

On December 15 2003, the IMF executive board approved a 15-month standby arrangement for Paraguay to support the country's economic programme. This programme is intended to create better conditions for sustained economic growth and poverty reduction, addressing long-standing governance problems by improving the efficiency and transparency of government operations. Fiscal surplus is one of the programme's goals and, as tax collection this year has shown a 40% average improvement compared with last year, success seems more likely. The programme also aims to attain structural reforms in the public sector and the public banking system.

This arrangement is opening the doors for new credits from international agencies, mainly for infrastructure improvement. Some

of these disbursements have already been made and the balance is expected for 2004.

Protecting foreign investors

Foreign Investment Law 117/91 gives foreigners the same guarantees, rights and obligations enjoyed by Paraguayan investors. Paraguay has signed the Multilateral Investment Guarantee Agency Agreement (Miga) of September 13 1991. The Miga, created under the umbrella of the World Bank, insures investors against risks such as expropriation, currency inconvertibility and damages caused by revolution, war or civil strikes. A similar agreement with the Overseas Private Investment Corporation of the US is in effect. The US agency has lifted restrictions regarding investments in Paraguay in recognition of its progress.

Dispute settlement: arbitration

Paraguay is a party to several international conventions and treaties intended to protect foreign investment: the World Bank Centre for Settlement of Investment Disputes as an independent international agency was ratified under Law 944/82; the Inter-American Convention on International Commercial Arbitration was ratified as Law 611/76; and the New York Convention for the Enforcement of Foreign Arbitral Awards and Judgments was ratified as Law 1.879/02.

Immigration

Nationals and foreigners are equal before the law. Foreigners can become residents if they comply with formalities and requirements established in the 978/96 Law. Foreign directors, managers and employees can apply for residence in the country, and a special temporary visa is granted to Maquiladoras employees.

Investment and exports promotion programme

The Investment Promotion Law 60/90

Paraguay actively promotes foreign investment in the industrial and service sectors. Investment projects require a presentation to the Investment Council, which is responsible for evaluation. Formal approval needs a bi-ministerial resolution, signed by the Ministry of Industry and Commerce and the Ministry of Finance. Some of the benefits of this law are: exemption of 95% of the corporate income tax on net profits for five years (and in some cases up to a maximum of 10 years) (the general tax rate is 30%, reduced to 1.5%); total exoneration of importation duties on capital goods (including VAT in some cases); duty free importation of raw materials and other inputs could be granted (application required); remittance of profits abroad is free (general withholding tax rate is 5%); exoner-

ation of municipal taxes and tax on loans are available under certain conditions.

Maquiladoras in South America: The Maquila Law 1064/97

The Maquila Law regulates the manufacture of goods for export. Some services are also eligible as long as they are exported. The Maquila Law requires a manufacturing contract between a non-resident person or company with a Paraguayan counterpart, and presentation of an investment proposal to the Maquila Council for its approval by bi-ministerial resolution (again, signed by the Ministry of Industry and Commerce and the Ministry of Finance).

Among the benefits of the Maquila programme are: substitution of the corporate tax on net profits (30%) by a 1% tax on national value added. The import taxes and duties on capital goods, raw materials, parts, components and inputs – including VAT – are suspended, and a guarantee for the same value is required.

Duty free areas

The introduction and storage of goods in the Paraguayan territory is permitted through the duty free areas, with suspension of all import taxes. They must operate in private properties and be approved by presidential decree. Commerce, industry and services could be performed in those areas. The tax rate is 0.5% on invoices, and no other tax applies as long as the goods are not sold in Paraguayan territory. There are two duty-free areas in the eastern area, near the borders with Brazil and Argentina.

Taxes

The most important aspects of the tax legislation in Paraguay are:

- **Corporate tax on net profits**
The tax rate on corporate net profits is 30%. Financial entities pay this tax only when profits are distributed, not if they are re-invested or incorporated as reserves.
- **VAT (IVA)**
The rate is 10%. It does not apply to bank loans, deposits and its interest.
- **Tax on acts and documents**
This applies to obligations, acts and contracts evidenced by documents. Acts involving financial intermediation are taxed. The rate is 1.5%.

Lowering taxes: The tax reform law project

Partial approval of the new tax code has been given by the Chamber of Deputies, but approval by the Senate is still pending. Discussions are still being held, but there is general consensus on the structure of the reform and its importance.

If approved, the tax on non-distributed net profits will be reduced to 15% during the first year of the Law's application and to 10% from the second year and after (the current rate is 30%) and remittance of profits abroad will be taxed by an additional 15% – the latter not applicable to companies covered by the Investment Promotion Law, which is set to continue in force. Personal income tax should be introduced with a 10% rate, and VAT rate will stay at 10% for most products and services, with a reduction to 5% for printed materials, interest on loans, assignment of use of goods and real estate sales. Agricultural products are exempt. Withholding tax on interest paid abroad will be 7% during the first year of the Law's application and 6% from the second year and after.

The Maquila Law (1064/97) will retain all of its benefits. The Investment Promotion Law (60/90) will continue in force but without the exoneration of 95% of the taxes on net profits for five

years, meaning that instead of paying 1.5% for five years – and 30% from the sixth year and after – there will be a permanent 10% tax rate.

Better climate for investment

Paraguay's new government has launched an ambitious reform programme intended to raise economic growth, reduce poverty, and improve governance. First results are encouraging and a better climate for investment can be felt. New agreements set the best conditions ever to take advantage of the country's Mercosur membership. Confidence, transparency and internal broad consensus are being actively sought both by government and civil society organizations. Hopefully, Paraguay is entering a new era.

Corporate and commercial

Recommended firms

Tier 1

Fiorio Cardozo & Alvarado
Estudio Juridico Gross Brown
Estudio Mersan
Moreno Ruffinelli & Asociados
Peroni Sosa Tellechea Burt & Narvaja
Vouga & Olmedo

Fiorio Cardozo & Alvarado

Boasting a well-earned reputation as “a smart banking outfit,” Fiorio Cardozo & Alvarado has provided its expertise on a diverse range of banking transactions this year, including bank mergers and the acquisition of bank assets and liabilities. The firm has also continued to be inundated with requests to act as external counsel to international and local banks.

Over the years, Fiorio has amassed a wealth of experience in the corporate arena, bringing a calm hand to transactions for domestic and international companies. Work of recent vintage has seen the practice close a number of investment projects, especially in the areas of river transportation, telecommunications and fast-food enterprises.

Leading lawyers

Rafael Marcelo Alvarado
José María Cardozo Saguier

Key contact partner

Rafael Marcelo Alvarado

Estudio Juridico Gross Brown

The well-regarded Jorge Gross Brown is at the helm of his four-partner firm, and is supported by the “capable” Atilio Gomez Grassi. International investment banks such as Lloyds Bank and Lehman Brothers, as well as leading foreign corporates such as British Aerospace, have recognised this expertise and have all instructed the firm in recent times.

Paraguay's economy has been languishing in a period of stagnation for the past 20 years, which does not seem to be abating given the lack of liberalization reforms undertaken by the current government. A significant consequence of this has been the lack of foreign investment into the country.

However, although the region may be a less attractive proposition for corporations wishing to set up a base, there are still a number of transactions passing through the region, and Estudio