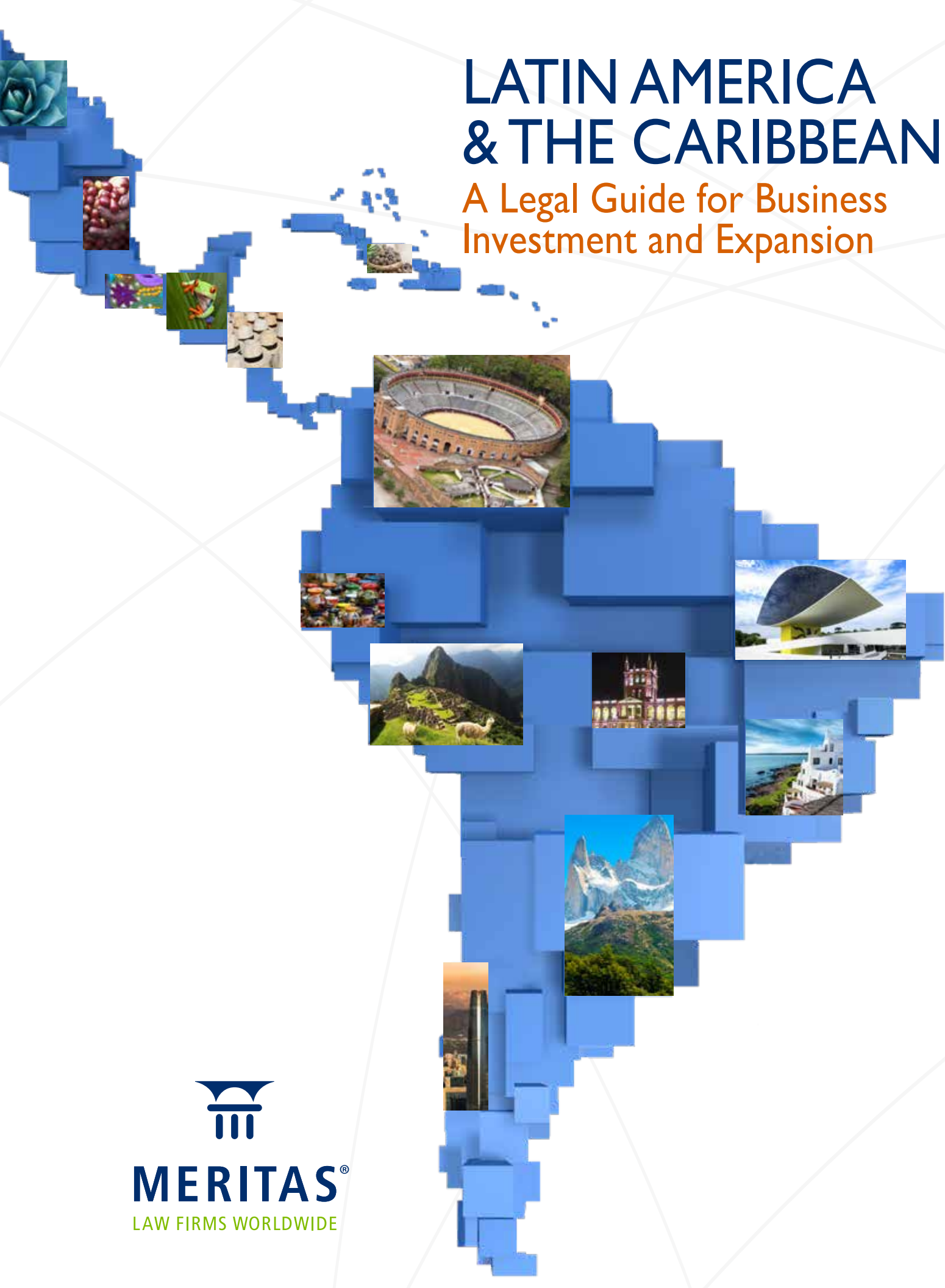


LATIN AMERICA & THE CARIBBEAN

A Legal Guide for Business
Investment and Expansion



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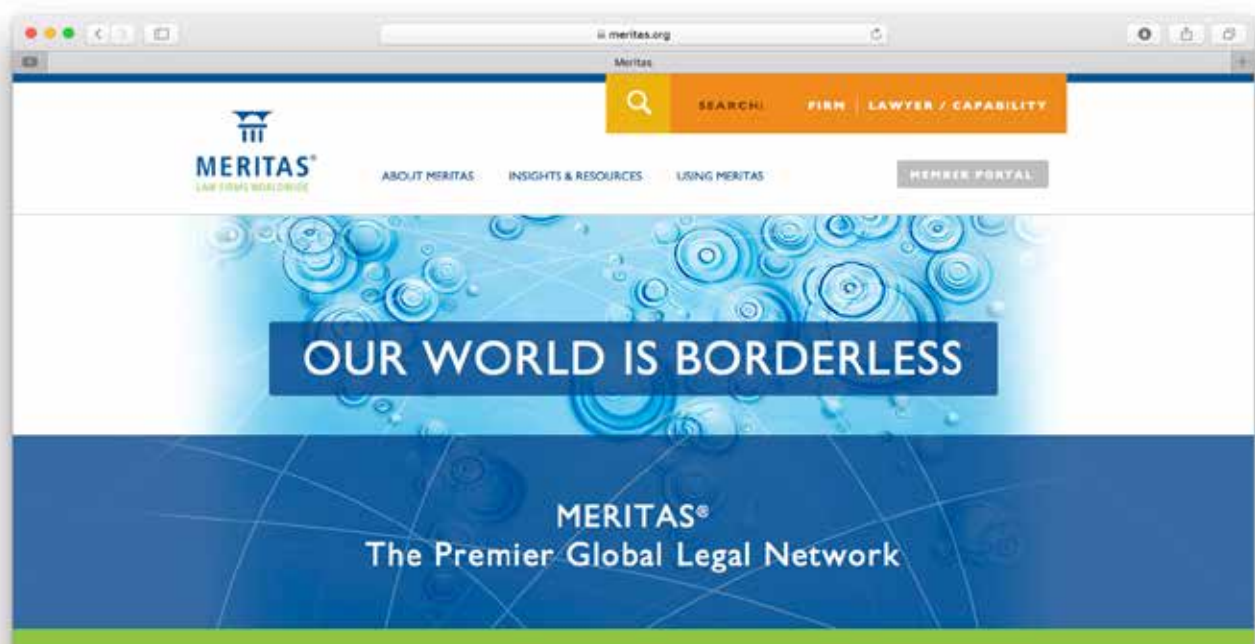
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PARAGUAY

FIRM PROFILE:

PERONI SOSA TELLECHEA BURT & NARVAJA

Peroni Sosa Tellechea Burt & Narvaja (PSTBN) is one of the largest firms in Paraguay, established in 1968. PSTBN has been an active participant in legal innovation in Paraguay, advising the government on development strategies, working closely with the Congress to enact new legislation, and taking active part in university education.

PSTBN offers a broad range of legal services for clients from renowned professionals. The firm's specialization includes: mergers and acquisitions, real estate, foreign investment, maritime and aviation, logistics infrastructure, project financing, antitrust, telecommunications, banking and international finance, mineral and oil exploration projects, labor relations, general civil litigation, taxation, environmental law, counseling before local government agencies and legislative bodies, maquila projects, distribution agreements, franchising and licensing agreements and intellectual property matters.

Representation before courts of law and administrative governmental agencies is an important activity of PSTBN, as plaintiffs or defendants in several landmark civil and commercial cases. PSTBN prides itself for keeping its tradition in the practice of law, providing personal attention to clients with great involvement from all partners.

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1. What role does the government of Paraguay play in approving and regulating foreign direct investment?

The government of Paraguay welcomes foreign investment in various sectors of the economy and has created a number of incentives to attract foreign investment. However, it does not play a direct role in approving and regulating foreign direct investment, except where these investments were subject to any of the special regimes for tax incentives, etc. which will be detailed in the questions below.

Main areas in which investment is needed and encouraged are banking and finance, infrastructure, real estate, capital markets, maquila and agribusiness.

2. Can foreign investors conduct business in Paraguay without a local partner? If so, how does the Paraguayan government regulate commercial joint ventures between foreign investors and local firms?

Foreign investors can conduct business in Paraguay without a local partner and they in fact do very often.

The most common way of structuring it is through the incorporation of a local company, whether in the form of a Sociedad Anónima or Sociedad de Responsabilidad Limitada, or the creation of a branch office, which we will refer to in detail below. The foreign entity and the local partner can agree on the shareholding each will have in the company; there are no limitations to that extent.

SOCIEDAD ANÓNIMA

There are no minimum capital stock requirements for SA or a maximum number of shareholders (there must be a minimum of two) and their participation in the company is represented by shares. Their liability is limited to the amount of their shareholding. The capital stock must be completely subscribed at the moment of incorporation. The process of incorporation takes from 45 to 60 days approximately. Administrative and legal fees pertaining to the incorporation of an SA depend on its capital stock, but the minimum is generally at USD300. Share purchase agreements of an SA are not subject to the Value Added Tax.

SOCIEDAD DE RESPONSABILIDAD LIMITADA

Incorporation process of a SRL is the same as for an SA. An SRL can be incorporated by two or more partners, but a maximum of twenty-five, and their participation in the company is represented by quotas. There are no minimum capital requirements but it must be fully subscribed at the incorporation and a minimum 50% of the contributions in cash must be effectively paid-in in a two-year term following incorporation. The balance of the capital stock can be contributed in goods or assets, which will have to be transferred to the SRL. Incorporation takes from 45 to 60 days approximately. As for an SA, administrative and legal fees pertaining to the incorporation depend on its capital stock, but the minimum is generally at USD300.

BRANCHES

Foreign companies can incorporate a local branch in Paraguay. Branches are subject to all applicable legal

provisions, such as publication of the bylaws in a local newspaper and registration of the document in the Public Records. Estimated time for incorporation and administrative and legal fees are similar to those estimated for SA and SRL. In order to incorporate a local branch, the following requirements must be met: (i) incorporate a representative domiciled within Paraguay, (ii) evidence that the company has been duly incorporated pursuant to the laws of its country of origin, (iii) justify the intention to open a branch, the capital stock allocated to it, and where applicable, appointment of representatives. All documents issued in the country of origin must be duly certified by a notary public and legalized or apostilled. The branch must comply with all applicable tax regulations and will be subject to control by the Ministry of Finance. Branches are subject to Income Tax at a 10% rate on the benefits obtained locally, and an additional 5% on remittance of profit to shareholders. If profits are remitted abroad for foreign shareholders or mother companies, an additional tax of 15% will be applicable.

3. What laws influence the relationship between local agents and distributors and foreign companies?

Law No. 194/93 governs relationship between foreign companies and firms (collectively, "Principal") and local representatives, agents and distributors (collectively, "Dealer") in Paraguay.

Parties may freely regulate their rights by contracts governed by Civil Code, but waiver of rights recognized by Law 194/93 is not allowed.

Principal may cancel, revoke, amend or refuse to renew representation, agency or distributorship, without statement of cause, but with an obligation in such case to pay Dealer a minimum compensation pursuant to following criteria: a) duration of relationship; b) average gross benefits derived from relationship during last three years of activity.

Representation, agency or distributor relationship may be cancelled, revoked, amended or not renewed for just cause, without obligation to pay compensation for following reasons: a) noncompliance of contract clauses; b) fraud or breach of trust on part of Dealer; c) inability or negligence of Dealer in sale of products or services; d) continued reduction of sales or distribution of products or services for reasons attributable to Dealer, except if caused by quotas or restrictions on imports and sales, fortuitous events or force majeure; e) any act attributable to Dealer that affects or prejudices marketing, sale, or distribution of products or services; f) conflict of interest due to the representation, agency or distribution of products or services that may be in competition with the products or services contemplated by relationship.

Prior to termination, Principal shall require Dealer to cure the cause invoked within a term of 120 days. Non compliance by Dealer allows Principal to exercise its rights immediately. Curing period is not required if termination is related to fraud or breach.

Stated causes shall be proved before Paraguayan courts or by arbitration if thus agreed; otherwise, cancellation, revocation, amendment or refusal to renew shall be deemed to be unjustified.

Parties shall submit to the territorial jurisdiction of the courts of Paraguay. They may compromise in all patrimonial matters or submit to arbitration before or after suit is filed, provided that no judgment shall have been issued.

4. How does the Paraguayan government regulate proposed merger and acquisition activities by foreign investors and are there any areas of the economy where they are prohibited (e.g., natural resources, energy or telecommunications)?

As a general rule, the Paraguayan government does not specifically regulate mergers and acquisitions, and there are no limitations as to areas of the economy. No areas are reserved to Paraguayan investors only, given that the Investment Law grants foreign investors that same capacity and rights as local investors.

With regard to mergers and acquisitions, our legislation does regulate their function and set some requirements. There are two alternatives of merger under Paraguayan law: (i) Merger by absorption and (ii) Merger by the creation of a new company. Limitations for mergers are set forth by Competition and Antitrust Law No. 4956/13. Mergers will be subject to notification, assessment and approval, conditional or not, or

rejection by the Enforcement Authority (CONACOM), where at least one of the two following circumstances apply:

- a) As a result of the operation being acquired or being assessed a fee equal to or greater than 45% of the national market of a particular product or service, or a geographic market defined therein; or
- b) The overall gross turnover in Paraguay of all participants subject to a merger exceeds in its last financial year the amount of 100,000 minimum monthly wages.

5. How do labor statutes regulate the treatment of local employees and expatriate workers?

Labor statutes do not regulate treatment of local employees and expatriate workers differently. The only difference is when the foreign employee does not have the Paraguayan permanent resident or a Paraguayan I.D. card. In that case, the employer and the employee will enter into a Deferred Execution Employment Agreement, which fixes a term within which the employee will have to obtain the necessary documentation. Parties agree that once this is accomplished, a new employment agreement will be executed, but the employment relationship will begin with execution of the first agreement.

The agreement must be registered before the Institute of Public Welfare for the employee to have the mandatory social security coverage.

6. How do local banks and government regulators deal with the treatment and conversion of local currency, repatriation of funds overseas, letters of credit, and other basic financial transactions?

The financial system in Paraguay is regulated by the Central Bank of Paraguay.

Banks and other financial entities work freely in the market, with no restrictions on interest rates or in the use of funds. Currently it is possible to make deposits and obtain loans in both local and foreign currency.

There is a system of free and fluctuating exchange in Paraguay, without the intervention of monetary authorities. Currency and exchange rates are the result of free circulation of offer and demand, for both import and export of goods and services as well as for the movement of capital, including financial and public payment.

There are no restrictions for incoming and outgoing foreign currency, or the sums involved.

However, in the framework of regulations governing money laundering, all transfers for more than USD 100,000 must be duly justified and supported, as well as unusual transactions.

There is no obligation to report financial activity with other countries to monetary authorities.

Capital markets are rather small, given that most of the companies operating in the country are closed or foreign. As a result of the creation of legal instruments to increase the number of listed companies, it has in fact increased.

Supervision of capital markets is exercised by the National Securities Commission.

7. What types of taxes, duties, and levies should a foreign investor in Paraguay expect to encounter?

In Paraguay, corporate entities are levied with taxes, such as income, capital and consumption tax, depending on the economic activities they carry out. In this chapter they will be briefly explained, to help readers get to know and understand the influence of each of them on different transactions, and the income generated by them.

Administration and application of Tax Law 125/91 and its amendments by Law 2421/2004 falls to the Undersecretary of Taxes (“Sub-Secretaria de Estado de Tributación”), and Ministry of Finance (“Ministerio de Hacienda”).

The **income tax** is imposed on income generated from a Paraguayan source which may be generated from commercial, industrial or agricultural activities and services; thus, it is subdivided into four categories, depending on the economic activity of the company, the volume of revenue, and whether the derived income is purely personal, which applies exclusively to individuals and partnerships.

Corporate income tax levies all income from Paraguayan sources derived or earned from commercial, manufacturing or service activities other than personal services. The tax rate for IRACIS is 10%. Distribution of net profits to owners, shareholders or partners is subject to 5% additional tax. Dividends paid abroad or credited to head offices, partners or shareholders distributed by branches, agencies, or businesses located in Paraguay are subject to 15% additional income tax.

Taxpayers are considered to be all of the individual businesses, partnerships, associations, corporations and other private businesses; government-owned enterprises, decentralized government corporations, and mixed capital corporations; branches, agencies or businesses owned by foreign corporations. Corporations incorporated overseas shall pay tax on income paid or accredited to them, as shall individuals applying capital resources and personal labor jointly, for the purpose of obtaining economic income, except those involving strictly personal services or those engaged in farming, corporations, when performing the same activities as other commercial/industrial companies.

Beneficiaries of Paraguayan-sourced income domiciled abroad are subject to withholding tax, separately from their local branch or agency.

The property tax (Impuesto Inmobiliario) is the only tax that can be qualified as a “patrimonial tax”. It is applied exclusively to real estate property located in national territory, and taxpayers are owners or users thereof. When ownership is shared, tax is paid by any one of the owners. The **tax base** is a fiscal valuation of real estate as set by the National Survey Service. The **tax rate** for the property tax is 1% of fiscal value per year, reduced by 50% in case of rural properties under five hectares, in areas utilised for small-scale farming, and rural properties with approved forestation/reforestation program, under Law 536/94.

Value-Added Tax (VAT) (Impuesto al Valor Agregado) is one of the consumption taxes and it is applicable to transfer of property

or goods from one person or company to another; and rendering of personal services and importation of goods. Excluded are personal services performed under employment.

Taxpayers of this tax are individuals providing personal services when their gross income in the previous year exceeded an average of one minimum monthly wage; cooperatives; individual businesses engaged in commercial, manufacturing or services businesses; partnerships and private entities in general; independent government entities, government enterprises and decentralised agencies engaged in businesses; importers of goods; nonprofit organisations (NGOs) when performing commercial/ industrial services/activities, subject to Business Income Tax; and insurance services, when they assume risks produced in Paraguay, and the goods or the people are located or residing in the country at the moment when the contract is signed.

All sales of goods and services in Paraguay are taxable, whether it is in case of technical assistance when used or profited from in the country; in case of assignment of rights or lease of goods, when used within national territory; or in case of insurance and reinsurance when they cover risks within the country; or when goods or persons covered are situated in, or residents of, the country.

The tax rate for VAT is 5% for assignment of rights of use of goods; 5% for transfer of real estate; maximum of 5% for sales of basic alimentary goods; 5% on interests, commissions and charges for loans; 5% for sales of pharmaceutical products; and 10% for the rest (the general tax rate is 10%).

TAX EXEMPTIONS

Law No. 60/90 establishes incentives to encourage economic development, promote growth in production of goods and services, create employment opportunities, generate exports and substitute imports utilizing national resources, and incorporate efficient technology for increased and better use of national raw materials, labor and energy resources. Legal and fiscal framework allows national and foreign investors, without discrimination, to formulate investment projects, facilitating their full operational productivity.

Investment projects enjoy the following benefits:

1. Total exemption from all taxes applicable to constitution, recording and registration of corporations and companies;
2. Total exemption from all taxes and charges applicable to foreign exchange transactions arising out of capital contributions or operations contemplated in investment project;
3. Total exemption from customs duties and similar taxes, including specific Internal Revenue levies on imports of capital goods;
4. Total exemption from all taxes and other levies on remittance of interest and fees related to foreign loans, during entire term of loan, provided that loans are at least USD5 million, and lenders are well known financial institutions;

5. Total exemption from all taxes applicable to dividends and profits generated by investment project for maximum term of ten years, provided that investment be superior to USD5 million, and taxes paid in Paraguay cannot be considered tax credit in country origin of investment.

Rights acquired by beneficiaries under the law are irrevocable, provided corresponding obligations are met.

The **Maquila Regime** is regulated by Law 1064/97, inspired in the Mexican Maquiladora System, by which a local company/subsidiary/ branch (“Maquiladora”) signs a contract with a foreign entity (“Matriz”) to produce goods and/or provide services for export only, operating “for account and risk of” the foreign entity, who can supply all the raw materials and other inputs to the Maquiladora from any local or foreign supplier.

The Maquiladora must file an application for a “Maquila Program” with details of the estimated operation. Once the program is approved it can be modified as necessary.

Raw materials and other inputs required for the performance of the Maquila Program can enter Paraguayan territory with suspension of all the applicable taxes and duties; a guarantee for a value equal to the suspended taxes will be required by Customs Authority in the form of insurance policies, warrants, or bank guaranties.

Production under this regime is subject to a 1% tax on the value added in Paraguayan territory, with no other applicable taxes.

Fiscal exemptions extend to the following taxes: Income tax; Value Added Tax; Customs Duties; Customs Valuation Tax; Consular duties; Port and Airport taxes and duties; any type of tax, rate or charge that pertains to guarantees issued to companies using the Maquiladora System; any type of tax, rate or charge applied to loans financing Maquiladora operations; any taxes that might be placed on remittances of funds related to the Maquiladora System.

8. How comprehensive are the intellectual property laws of Paraguay, and do the local courts and tribunals enforce these laws regardless of the nationality of the parties?

Paraguay has in place a comprehensive set of intellectual property laws that protect the rights relating to literary and artistic works; performances of performing artists, phonograms and broadcasts; inventions in all fields of human endeavor; industrial designs; trademark, service marks and commercial names and designations; and protection against unfair competition. These laws are enforceable by local courts and tribunals regardless of the nationality of the parties. The Paraguayan Intellectual Property Office (DINAPI) has quasi-judicial functions in the administration of industrial property systems. Furthermore, civil actions for infringement are available, as well as actions against serious criminal offenses of counterfeiting and piracy. Criminal sanctions include both fines and imprisonment.

Free Zone Regimes is a duly delimited area with regard to the customs territory, where commercial, industrial and service agreements are permitted, free of customs fees or taxes. In these areas, investors are exempted of all taxes on import of capital goods destined for infrastructure in the Free Zone; Value-Added Tax on services rendered to other users; all taxes on the port facilities provided to users; and on payment of professional fees, interests, remuneration for services, technical assistance, transfer of technology, loans and financing, lease of equipment and other services provided by third countries.

9. If a commercial dispute arises, will local courts or will international arbitration offer a more beneficial forum for dispute resolution to foreign investors?

It would depend largely on the matter in dispute.

In general, arbitration will offer a more beneficial forum, considering some of its inherent characteristics compared to some lengthier procedures before local courts. Parties are free to decide mutually on the forum where to resolve disputes. Pursuant to the novel Law No. 5393/2015, parties are also free to decide on the applicable law to international commercial agreements and can choose foreign law as applicable, with a number of express exceptions set forth in Article I (employment agreements, distribution, agency and representation agreements, franchise agreements and consumption agreements).

There are also certain matters under which, should any dispute arise, it would have to be submitted to local courts or local arbitration, such as disputes under the Distribution, Agency and Representation Law No. 194/93. Case law has established that any controversy or conflict under these types of agreements must be exclusively submitted to the jurisdiction of Paraguayan tribunals and subsidiarily, an arbitration procedure in Paraguay before the Paraguayan Arbitration Institution (CAMP).

10. What advice can you provide for how best to negotiate or conduct business in Paraguay?

In the first place, it is advisable to research and focus on sectors for investment that are currently in the spotlight and growing at a fast pace, such as the agribusiness sector.

In terms of deals, Paraguay is highly globalized and negotiations are conducted on the same level as negotiations worldwide. There are no differences in negotiations in Paraguay and internationally.

We recommend foreign investors or companies looking to establish and conduct business in Paraguay seek reliable professional advice to structure the transaction and to follow up on the project.

Peroni Sosa Tellechea Burt & Narvaja (PSTBN) is a full-service firm with more than 40 years of experience in the Paraguayan market, dealing mainly with international clients.

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