

Expert Guide

www.corporativewire.com

Mergers & Acquisitions

May 2012

CORPORATE *LiveWire*



AMAA

IMAP

Deloitte

Skadden

Merrill Datasite

and more...

Changes in the Law & Their Effect on Transactions in El Salvador

By Ana Mercedes López

In El Salvador, in the decade between 1992 and 2001, positive reforms that created excellent conditions for foreign investment were promoted, such as a crisis-free dollarisation, the homogenisation of tariff norms and pension privatisation, to mention a few.

The Investments Law of 1999 created the Oficina Nacional de Inversiones or National Investment Office (“ONI”) as the governmental agency in charge of promoting the local and foreign investments in El Salvador.

Pursuant to the Investments Law, capital contributions for the incorporation of new companies in El Salvador as well as the capital to acquire interests in Salvadoran companies are deemed as foreign investments, among others that are established in such law.

The Investments Law also provides protection for foreign investors and their investments by providing the same treatment as the one provided to local investors. This law guarantees the return of capital such as the profits and dividend payments.

However, even though the ONI represents a general framework for foreign investment, recently, from a tax perspective, the dividend distribution became an event subject to income tax in El Salvador by means of the tax reform that became effective on January 1, 2012. According to this tax reform, dividend payment is subject to a 5% income tax or 25% if the stockholder receiving payment is incorporated or domiciled in a jurisdiction that is considered to be a tax haven or a low tax country.

The impacts of said reform have hit both organisational structures as well as the legal analysis that potential investors might make upon considering El Salvador as a jurisdiction where to conduct their businesses and establish their operations.

It is very important that prior to closing any acquisition of shares or interests in an existing Salvadoran company or establishing a Salvadoran subsidiary, the corporate chart of the target company is analysed in order to anticipate the tax impact as a consequence of any payment distribution.

With respect to a more specific business activity, another change in the law that has impacted transactions in El Salvador has been the amendment to the Free Zones Law along with the effectiveness of the International Services Law. Upon the effectiveness of the International Services Law, the operations related to the transfer of goods are carried out under the Free Zone Law within the free zone facilities authorised by the Ministry of Economy; on the other hand, the operations related to services such as call centers, BPO and others, are now subject to the International Services Law and must be rendered in services park duly authorised by the Ministry of Economy.

Another change in the regulation that has taken place recently in El Salvador is with respect with the energy sector which affects investors and transactions related to such industry. For more than 10 years, the energy market in El Salvador operated under a system of prices declared by the market participants that injected energy into the system such as energy generators. Under this system what basically happened was that the market participant sent the offers to the market operator in terms of blocks of energy and its price. The market operator then determined the market price and the offers that were accepted. In this type of market the generators specified the amount of power that they were willing to sell or produce at a determined price (price of injection).

On the other part, effective from August 1, 2011, the energy system and market in El Salvador now operates under a system based on production costs.

This new system aims for a more competitive market and more stable prices of energy because under the system based on production costs, the remuneration for the generators is not only based on the energy but also in the reliability that they provide to the electric system, i.e. for energy and for capacity. Therefore this system has a double retribution: one for capacity and other for energy.

Now, the market participants (generating units) must supply all the information of its production costs and the necessary technical information to elaborate the dispatch. Generators are not remunerated only for the energy but also for the firm capacity that they bring; that is why it has been said that the generators recover their investment and obtain a margin of profit through two ways: incomes for energy and for capacity.

The results expected from the market based on costs, are greater transparency in the performance of the market which reduces the risks perceived by new generators, and to produce economic efficiency at the producers’ and consumers’ level.

Ana Mercedes Lopez has participated in Project Financing deals surpassing US\$ 200 million, for aviation and electric companies, among others.



She graduated from the Universidad Dr. Jose Matias Delgado (1997) with a degree in law practice and is authorised as a Practicing Attorney and Notary Public by the Supreme Court of El Salvador.

She has a Masters Degree in Entrepreneurial Law from Universidad Navarra, Spain (1999) as well as a Diploma in Family Education from the European Institute of Education (2008). Ana is also a member of the Center of Judicial Studies of El Salvador and of the Banking Association of El Salvador.

Ana speaks English and Spanish and can be contacted via email at anamercedes.lopez@ariaslaw.com

