

Tte. Vera 1761  
Villa Morra  
Asunción – Paraguay  
Emprendimientos Nora Ruoti SRL

Tel.: 595 21 660088  
Celular (0981) 405.373  
[nrc@noraruoti.com.py](mailto:nrc@noraruoti.com.py)  
[www.ruoti.com.py](http://www.ruoti.com.py)

### **PARAGUAY'S MAQUILADORA SYSTEM**

**Paraguay's Maquiladora System** opens the way for foreign businesses to establish themselves in the country or to subcontract another company already present, for the purpose of processing or finishing goods and services for re-export, with the consequent value added. At the same time, the regimen allows the company to import raw materials, machinery and necessary inputs under a system of temporary admission in which payment of duty is suspended. It also provides for contracting local workers and services, and the re-export of the product to the regional as well as international market. Although the objective of the maquiladora system is to export the entire production, it is possible to sell a small portion of it locally without losing the tax advantages mentioned above.

The maquiladora operations are exempt from all taxes or other charges having to do with the production process, including the Value Added Tax (VAT). A small tax of one percent is charged on the value added to the product within Paraguay.

***The fiscal incentives contemplated in the Maquiladora Law and its corresponding regulations together with the geographic location of the country in the center of South America, among other advantages, make Paraguay a valid option for direct foreign investment.***

### ***General Characteristics of Paraguay's Maquiladora Industry***

The maquiladora industry is governed by Law 1064/97 which defines *the Maquiladora Industry of Exports* and by decree number 9585/00 which contains the implementing regulations for the law.

Through a "Maquiladora Contract," a foreign-based company or "Matriz" contracts the services of a local Paraguayan company, the "Maquiladora Company", in order for the latter to carry out industrial processing, in total or in part, or through lending its services, for the purpose of transforming, repairing or assembling merchandise of foreign origin. The legal modality is referred to as international subcontracting.

### ***Legal Status of a Maquiladora Company***

Maquiladora companies may operate under any of the legal forms established by Paraguayan law. These include status as either a physical or legal entity, national or foreign, resident in the country.

### ***The legal structures most used in Paraguay are:***

1. Incorporation as anonymous shareholders (*Sociedad Anonima* or S.A.)
2. Limited liability firm
3. Local representative of a foreign based company

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There are no restrictions on capital participation. It can be 100% national capital, 100% foreign capital, or a joint venture.

### ***The Maquiladora Program***

In order to operate as a maquiladora company, approval is required for the *Maquiladora Program*, which would consist of a detailed explanation of all the activities associated with the Maquiladora Operation, and which would conform to what is stipulated in the Maquiladora Contract between the Matriz and the Maquiladora Company.

The Maquiladora Program, and related permits required by the maquiladora regime, are approved by means of a resolution authored by the Ministry of Industry and Commerce and the Ministry of Finance, channeled through the National Council of Maquiladora Industries for Export (CNIME in Spanish, for Consejo Nacional de Industrias Maquiladoras de Exportación).

### ***Types of Maquiladora Programs***

The maquiladora system contemplates various types of programs, such as the Maquiladora for the production of goods, for the rendering of services, including intangible services, and the sub-maquiladora. There are no limitations on the quantity of goods that can be produced or the amount of services that can be rendered within the maquiladora industry, whether tangible or intangible.

#### ***Maquiladora for the Production of Goods***

Comprises any type of material that can be submitted to industrial processing, whether it be transformation, elaboration, repair or assembly.

#### ***Maquiladora for Services***

Refers to services rendered by residents in the country for which foreigners benefit under the concept of “Maquiladora Operations for Export.” The Maquiladora law does not put limits on services rendered that are destined for export.

#### ***Maquiladora of Intangible Services***

Has as its objective adding the benefit of intellectual value, or a value of the type similar to intangible goods, which can enter the country or be exported as intangibles, or be transformed to tangible goods, and viceversa.

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### ***Sub Maquiladora***

Is a Paraguayan company which is a subcontractor of the Maquiladora Company which completes the production process on the activity which is the object of the Maquilador Program. In this case both companies are national, requiring that the subcontracting company also be inscribed by the CNIME and that it present its “Sub Maquiladora Programs”.

### ***Ways in Which the Maquiladora Operates***

Maquiladora companies may operate in any of the following ways:

#### ***Pure Maquiladora***

When the Maquiladora Company is responsible exclusively for all the operations that fall within the “Maquiladora System.” In addition, a company is called a pure maquiladora or duty free company in the case where the Matriz provides to the Maquiladora Company all of the administrative and technical infrastructure, technology, training, machinery, inputs and components, including financing, in addition to carrying out the administration of the company and control of production, for which the Maquiladora provides the service exclusively and charges for it.

#### ***Maquiladora Based on Unused Capacity***

When a company, or legal entity, which has been established and is producing for the national market, has unused capacity in its installations and has received authorization under the Maquiladora Program for Export.

#### ***Sub Contracts***

When the Maquiladora is the owner of the installations, machinery and equipment, exercising its own administrative control and that of the production process; having control over importation and exportation, receiving from the Matriz all raw materials, such as inputs and components, with a system of pricing for piece or unit of production.

#### ***Twin Plants***

Is the plant which compliments that structure in a foreign country which carries out the production and which has been authorized in Paraguay in compliance with the Maquiladora Program.

#### ***Shelter Program***

A Shelter is a company that charges a fee for providing all basic services for a foreign manufacturer with operations in Paraguay. The Shelter assumes the vast majority of the

*Estudio Nora Ruoti & Asoc.*  
***Asesoría Jurídica Tributaria Contable Integral***

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risk associated with establishing operations in Paraguay, thus allowing the foreign manufacturers to focus on quality control and meeting production schedules.

In this case foreign companies provide the technology and production materials, but do not operate the project directly.

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## ***BUSINESS INCENTIVES***

### ***The Tax Structure***

Taxes in Paraguay are the lowest in MERCOSUR and among the lowest in the world, amounting to 10% of GDP in 2000. The low tax rates are the result, among other things, of the fact that Paraguay has proportionately fewer taxes than other countries and does not have a personal income tax.

The country has adopted a relatively simple tax structure with goods and services, including value added, amounting to three-fourths of total tax collections. VAT (value added tax) is the single most important tax, representing 47% of GDP, even though the 10% rate is one of the lowest in the world.

Corporate taxes represented 20% of tax receipts in 2000, equal to 2% of GDP. The general corporate tax rate is 30%, although there are various exemptions in whole or in part, for capital investments (Law 60/90), the maquiladora (Law 1064), the opening to capital in the stock market (Law 1106), operating in duty free areas (Law 523), forestation (Law 536), leasing (Law 1295), among others.

### ***Fiscal Incentives of Maquiladoras***

The Maquiladora System offers fiscal incentives that include exemptions on all types of taxes, local or national, and customs charges on imports and exports. The only charge is a 1% tax on the value added.

#### ***Fiscal exemptions extend to the following taxes:***

1. Income Tax
2. Value Added Tax
3. Acts and Documents tax
4. Customs Duties
5. Customs Valuation Tax
6. Consular Duties
7. Port and Airport Taxes
8. Payment for Regulatory Information
9. Any type of tax, rate or charge that pertains to the guarantees enjoyed by companies or third parties related to the Maquiladora System.
10. Any type of tax, rate or charge applied to loans destined for financing maquiladora operations
11. Any taxes that might be placed on remittances of funds related to the Maquiladora System
12. Any other tax, rate or charge in existence now or adopted in the future, that taxes income or payments on goods coming within the provisions of the Maquiladora System.

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### ***Exonerations Provided for Under the Maquiladora System***

The following goods are exempt from all national, departmental and municipal taxes:

1. The importation of goods that are specified in the Maquiladora Contract.
2. The re-exportation of goods that were imported under said contract.
3. The exportation of goods that have been transformed, elaborated, or assembled under a Maquiladora Contract.

### ***Additional Exemptions for Operations Pertaining Solely to the Maquiladora Contract.***

The Maquiladora System is intended to provide incentives for the creation of companies that carry out activities exclusive to the operations of the maquiladora (Pure Maquiladora), and offers the following additional benefits to those already outlined in the preceding point.

1. Exemption of the tax on commercial, industrial, professional or occupational patents.
2. Exemption of the tax on construction that would affect the industrial plant and/or services that conform to what has been approved in the “Maquiladora Program.”
3. Exemption of municipal taxes that directly affect the “Maquiladora Process.”
4. Exemption of the Value Added Tax placed on the rental or leasing of machinery and equipment that are included in the “Maquiladora Program.”
5. Any other tax, rate or national or departmental expense currently in existence or created in the future.

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### ***Establishing the Income Tax***

Article 29 of the Maquiladora Law establishes that only one tax (the income tax) applies to activities that come within the terms of the Maquiladora Contract, and that tax is one percent of the value added within Paraguayan territory.

The above applies to those maquiladora and submaquiladora companies that are in full compliance with a duly approved Maquiladora Program, regardless of the type of program in question or the form in which it operates, as long as it has complied with all the requirements of the Maquiladora Law and applicable regulations.

The tax is determined on the basis of value added, which is established in the corresponding regulations as “the amount of the costs that are related to the services rendered under the Maquiladora Program.”

### ***Determining the Value Added Tax***

Maquiladora operations are exempt from payment of the Value Added Tax (VAT). Fiscal credits that correspond to the purchase of goods and services pertaining directly or indirectly to the operations of the Maquiladora may be recovered by means of the mechanisms established in Law No. 125/91 and its implementing regulations.

Submaquiladora operations and national suppliers for maquiladora companies are subject to the payment of VAT, as established in the “Tax Regulations”, Law 125/91. Therefore, they must charge the Maquiladora Companies the corresponding VAT. They are not eligible to recover the VAT, since that privilege is exclusively reserved for Maquiladora Companies.

Credits applicable to the Maquiladora Companies for taxes paid under the VAT, can be debited from any VAT those companies owe the state for any part of the production that was permitted within the national market, as well as towards the payment of any other tax that may be owed.

### ***Selling in the Local Market***

The Maquiladora Law allows the Maquiladora Company to sell its product or service in the local market. In order to effect such a sale, the company must apply for permission to substitute the temporary import system for the permanent import system, and must pay all applicable taxes. Local sales may not exceed 10% of the volume exported the previous year.

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Earnings on local sales are subject to payment of income taxes through the estimated net taxable income established in Article 10 of Law 125/91, to which the rate laid out in the general tax regimen would be applied, which is 30%.

## ***Paraguay' Labor Force***

### ***Population***

Paraguay is home to 5.7 million inhabitants with a population density of 14.6 per square kilometer. The population, mostly concentrated in the eastern half of the country, is 54% urban. By the year 2010, it is estimated that the population will grow to 7,103,087, which would be a 26% increase over that of 2001, given a rate of birth of 2.6%.

Forty-two percent of the population is of working age. The population pyramid is rather striking, with 65% under the age of 30. Agriculture is the primary economic activity, employing 30% of the economically active population, followed by the services sector at 22% and the commercial sector at 21%. Manufacturing employs 12% of the economically active population.

### ***Social Security***

In addition to complying with the norms set out in the Labor Code, Maquiladora Companies must comply with Law number 98/92, which regulates the social security system for workers.

### ***Treatment of Foreign Staff Involved in Maquiladora Operations***

The Maquiladora Law also regulates the entry into Paraguay of persons in charge of management operations in a Maquiladora Company for the length of time that the corresponding maquiladora contract is valid. To obtain proper immigration status, applicants must process their paperwork through the One-Stop Window at the National Council of the Maquiladora Industry for Export (CNIME, initials in Spanish) by presenting the approved Maquiladora Program and/or the Service Contract.

Once approved, the Directorate of Immigration will issue the so-called "Maquiladora Visa", which will permit its bearer to enter and leave the country.

Foreign personnel have the option of contributing to the local Paraguayan Social Security System or to one outside of Paraguay.



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### ***Applying to Operate as a Maquiladora Company***

Individuals or companies wishing to qualify for any of the various types or forms of maquiladora industries must apply for the status of “Maquiladora and/or Submaquiladora Company” at the National Council for Maquiladora Industries (CNIME). Their applications must include the following information:

1. Full name of the applicant
2. Local taxpayer number (RUC)
3. Legal Residence and / or other address
4. Authenticated copy of the public deed constituting the company, if appropriate
5. Authenticated copy of the identity document of those persons making the application, or the legal representatives of the company making the application.
6. Other information that the CNIME might request.

### ***Maquiladora Program Presentation Guide***

The implementing regulations for the Maquiladora Regime requires that the CNIME provide a Presentation Guide, or packet of information, containing all applicable forms for the various types of maquiladoras, which can be modified and / or updated as necessary. The Maquiladora application, in turn, must be submitted to CNIME in the Spanish language with all documents translated by a registered professional.

### ***The Maquiladora Program Application to be Submitted to the CNIME must contain:***

1. Application for approval of the Maquiladora Program;
2. Maquiladora Contract, or Letter of Intention;
3. Information pertaining to the applicant;
4. Characteristics of the Maquiladora Program, specifically the type of Maquiladora Program to be implemented and the manner in which it will operate;
5. Information regarding activities to be developed or services to be rendered pertaining to the Maquiladora Program; and
6. Other relevant information regarding the particular specifications of the program in question, and documents required in order to evaluate it.