DOING BUSINESS IN PARAGUAY

January 2002

BDO

Introduction

This publication has been prepared for the exclusive use of BDO and its clients. Its aim is to provide background information for setting up and running a business in Paraguay in compliance with legislation in force on 1 January 2002.

It is written in general terms and is not intended to be comprehensive. For more detailed information, advice should be sought from the BDO office with which you normally deal.

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Contents

Preface

1. THE BUSINESS ENVIRONMENT **7**

General information **7**
Geography 7
History 7
Political system 8
Population 8
Climate and natural resources 9

Business entities **9**
Legal forms of business organisation 9

Labour legislation and working conditions **14**
Employer social security contribution 14
Employee benefits 14
Termination of employment 14
Employee's social security contribution 15
Trade unions 15
Expatriate personnel 15
Visas 15

2. FINANCE AND INVESTMENT **16**

Regulatory agencies **16**
Competition policy 16
Price controls 16
Monopolies, acquisitions, mergers 17
Securities market 17
Imports and exports 17
Consumer protection 17
Treaty on trademarks and industrial patents 18

Banking and local finance **18**
Monetary system 18
Managing the financial system 18
Relations with the state 18
Foreign relations 19

Banking market 19
Foreign banks 19
Financial markets 19

Accounting and audit requirements **21**
Statutory requirements 21

Investment incentives **22**
Regime of tax incentives for the investment of local and foreign capital (Law No. 60/90) 22
Extensions to the benefits of Law No. 60/90, to include the following services: 22
Beneficiaries and types of investment 22
Other legislation on foreign investments made in Paraguay 24
Exemption of raw materials from import taxes 26
Maquila programme 27

3. THE TAX SYSTEM **28**

Principal taxes **28**
National taxes: 28
Municipal taxes: 28
Income tax 28
Taxpayers 28
Taxable income 29
Exemptions 29
Value added tax 30
Selective tax on consumption 31

4. TAXES ON BUSINESS **32**

Corporate tax system **32**
Corporations and shareholders 32
Taxable entities 32
Territoriality 32
Gross income 32
Deductions 34
Non-deductible items 36
Treatment of losses 36

Taxation of foreign corporations **37**
Tax concepts 37
Imports 37
Sales subsidiary, branch 37
Repatriation of profits and capital 38
Transfer of branch profits 38
Income from subsidiaries 38

Capital gains and dividends 38
Acquisitions 38

5. BDO OFFICES **39**

Preface

Doing Business in Paraguay should be of use to anyone who is thinking of establishing a business in Paraguay as a separate entity, or a branch of foreign company, or a subsidiary of an existing overseas company, or anyone who is considering coming to work or live in Paraguay.

This guide describes the business environment in Paraguay and outlines the financial and legal implications of running, or working for, a Paraguayan business owned by foreign interests. The most important issues are included, but it is not feasible to discuss every subject in detail within this format. If you would like to know more, **BDO Rubinsztein & Guillén,** the Paraguayan BDO member firm, can provide you with information on any further issues.

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1. The business environment

General information

Geography

The Republic of Paraguay is located in South America. It is bordered by Bolivia and Brazil to the north, by Brazil and Argentina to the east, by Argentina to the south, and by Argentina and Bolivia to the west.

History

The original inhabitants of eastern Paraguay were the semi-nomadic Guaraní. Several hunter-gatherer groups, known as Guaycurú, populated the Chaco. In 1524, Alejo Garcia became the first European to cross Paraguay, with the aid of Guaraní guides. Three years later, Sebastián Cabot sailed up the Río Paraguay but founded no settlements. This was left to Pedro de Mendoza, whose expedition settled at Asunción after fleeing Buenos Aires. The colony flourished, becoming the nucleus of Spanish settlement in south-eastern South America and sparking an era of intriguing socialisation. The native population gradually absorbed the Spaniards, who in turn adopted Guaraní food, language and customs. Over time, a Spanish-Guaraní society emerged, with Spaniards dominating politically, and their *mestizo* offspring adopting Spanish cultural values.

Colonisation also meant that Jesuit missionaries were sent to civilize the Indians. This they did with alacrity and skill. The Indians were induced to leave their lands and settle in *reducciones*, theocratic communes, where they helped build churches, grew deft at masonry, sculpture and painting, and sometimes gained a classical education along the way. After the expulsion of the missionaries in 1767, the settlements quietly withered as the Indians ran away, or were employed by different masters.

Paraguay declared independence in 1811- which Spain did not oppose – and within a few years it was under the thumb of the xenophobic José Gaspar Rodriguez de Francia, also known as 'E*l Supremo*'. He sealed the country's borders, promoted a policy of self-sufficiency (even forcing the Spanish upper class to intermarry with the *mestizo*) and expropriated the properties of landowners, merchants and the Church. He died in 1840 and his remains were later disinterred and flung into a river. Francia´s successor, Carlos Antonio López, ended Paraguay's isolation and began its modernisation. Unfortunately, he also spawned a megalo-maniacal son who set about destroying the country by starting the catastrophic War of the Triple Alliance (1864-70) against Argentina, Uruguay and Brazil. When the dust had settled, Paraguay had lost over 150,000 sq km (58,500 sq miles) of territory, and almost a quarter of its population, including López junior.

After the war, Paraguay's agricultural sector was resuscitated by a new wave of European and Argentine immigrants, but political instability continued. At the turn of the century, cross-border tensions arose after Bolivia occupied disputed parts of the Chaco. The prospect of vast deposits of oil in the region (which proved non-existent) catapulted the two countries into war in 1932. The Bolivian army was pushed out of most of the Chaco and a subsequent treaty awarded Paraguay three-quarters of the territory.

Paraguayan politics became even more turbulent following the Chaco War, until a brief civil war brought the Colorado Party to power in 1949. A military coup in 1954 saw General Alfredo Stroessner installed as president. Stroessner remained in power for the next 35 years, was overthrown in 1989 and replaced by General Andrés Rodríguez. Despite considerable scepticism about his intentions (Rodríguez was Stroessner's former right hand man), the country's perennial state of emergency was cancelled, censorship was eliminated, opposition parties were legalised and political prisoners released.

In May 1993, President Juan Carlos Wasmosy, an engineer and successful businessman, was elected as the first civilian president since 1954.

In May 1998, the Colorado Party reconfirmed its staying power with the election of President Raul Cubas, an electrical engineer, who was forced to resign in March 1999, accused of abusing his powers. Luis Angel González Macchi, a lawyer, who had been president of the Senate, was then sworn in as president of Paraguay.

Political system

This is a representative democracy in Paraguay. There are several political parties representing different political trends, and democracy has been uninterrupted since 1989.

The State’s powers are divided into:

- Executive
- Legislative
- Judiciary.

Political administration

Paraguay is politically divided into 17 departments. Asunción is its capital city.

Population

Paraguay has a population of around 5.5 million inhabitants.

Climate and natural resources

The country's weather is hot for most of the year. Average summer and winter temperatures are 31° C (approx 88° F) and 15° (approx 60° F), respectively.

Paraguay's main natural resources are water resources and forestry.

Business entities

Legal forms of business organisation

The principal forms of business organisation in Paraguay are:

- Corporations
- Limited liability companies
- Branch offices
- Joint ventures
- Other.

Corporations

General requirements

The articles of incorporation must be drawn up in a public deed, which should also include the corporation's name, objectives, the amount of its capital, and the division of its capital stock; as well as provisions governing management and auditing, shareholders' meetings, shares, the distribution of profits and losses, and the winding up of the corporation.

Corporations obtain their legal entity status upon registration with the Public Registry of Commerce, and with the Registry of Individuals and Legal Entities. Approval from the executive is not necessary to form a corporation.

Minimum capital

There is no minimum capital requirement, except for banks, financial institutions, exchange houses, insurance and/or reinsurance companies, and brokerage firms, which are governed by special legislation. Corporations intending to operate in the capital market may be publicly held.

Shareholders

- Corporations must have two or more shareholders

- Shareholders may be individuals or corporate entities, and may be of Paraguayan or foreign origin

- The majority of shareholders of corporations engaged in shipping must be Paraguayan (whether individuals or corporations)

- At least 30% of the capital of corporations engaged in hydrocarbon research or production must be Paraguayan at the time of incorporation

- Shareholders are assured of controlling the corporation by holding 51% of the equity

- The liability of shareholders is limited to the amount of the shares held by them (aggregate shares subscribed for).

Managers or directors of corporations are liable to third parties for default in the performance of corporate obligations, and they are personally liable for any violations of the law or bylaws.

Shares and bonds

Corporations may issue registered or bearer, common or preferred shares. The latter have a preferential right to dividends and to the reimbursement of capital upon winding-up or liquidation.

Common shares entitle the holders thereof to one vote. The bylaws may create classes of shares with up to five votes per common share. This privilege is incompatible with preferential rights of a financial nature.

Management and supervision

A Board of Directors, consisting of one or more directors appointed by the Shareholders' meeting and/or upon incorporation, shall be responsible for the corporate management.

The bylaws may set the minimum or maximum number of directors allowed. Managers or directors need not be shareholders, and may be Paraguayan or foreign citizens.

The bylaws establish the requirements applicable to internal and external auditors. Banks, financial institutions and insurance companies are regulated by the Central Bank of Paraguay through the Bank and Insurance Superintendency. In the case of companies which make public offerings of securities or which operate through the Stock Exchange, the respective regulations are established by the National Securities Commission (CNV). In addition, as from 1998, borrowers from banking and financial institutions with risks amounting to US$ 1,000,000 will have to file annual financial statements audited by independent auditors with such companies.

Distribution of profits

Under the Civil Code of Paraguay, corporations may only distribute irrevocably realised and liquid profits.

Profits may only be distributed after the deduction of 5%, which should be appropriated to the annual compulsory legal reserve until such time as the reserve equals 20% of the subscribed capital stock.

Statutory registration and control entities

All business organisations must be registered with the Public Registry of Commerce, should obtain a trading licence, and comply with the following statutory requirements:

- Share/bonds register
- Register of Minutes of Board of Directors' meetings
- Register of Minutes of Shareholders' Meetings.

Such registers are specific for corporations, and must be kept in addition to the usual accounting books: journal and inventory.

Corporations are supervised by Government agencies such as, *inter alia*, the 'Supervision and Inspection of Corporations', reporting to the Treasury.

Corporations must report on their shareholders' meetings and keep records of their proceedings in the minutes of shareholders' meetings book.

Annual shareholders' meetings may consider only financial statements, distribution of profits and changes in the Board of Directors. Treasury inspectors often attend annual shareholders' meetings.

Duration and winding-up of corporations

The duration of a corporation must be established in the bylaws upon incorporation.

Corporations may be wound up due to expiration of their term, or for other reasons. Early winding-up resolved upon by the shareholders' meeting is usually carried out by the directors and/or the statutory auditor.

Limited liability company

General provisions

Limited liability companies are organised under articles of association, which must be drawn up in a public deed and include all pertinent information regarding their members.

Minimum capital

There is no minimum capital requirement for this kind of company. In cases where the capital stock is not fully paid up upon incorporation of the company, there is a maximum term of two years in which the capital must be paid up.

Members

- The capital must be held by at least two and not more than 25 shareholders
- The law makes no discrimination between Paraguayan or foreign citizens
- The directors of the limited liability company need not be members
- The articles of association must determine the manner in which members will approve the financial statements and other corporate resolutions
- Shareholders' liability is shared and limited to their capital contribution (in cash or in kind)
- Every director is personally liable for corporate acts and for any violation of the articles of association or the provisions of the law.

Distribution of profits

Only real or liquid profits may be distributed. Profits may only be distributed once the financial statements have been approved, and after appropriation of 5% to a legal reserve, until this reserve equals 20% of the subscribed capital stock. Financial statements must be prepared annually.

Supervision

Limited liability companies must register with the Public Registry of Commerce and must not engage in banking, insurance or mutual fund transactions. Auditing requirements are set out in the articles of association. The law does not require statutory auditing but each member must be able to participate in company decisions and be kept informed of company business.

Winding up

The articles of association must determine the manner in which the company is to be wound up. A limited liability company is not necessarily wound up due to the death, disqualification or insolvency of one or more shareholders, unless expressly provided for in the articles of association.

The bankruptcy of the company does not automatically affect shareholders.

Branch offices

Foreign corporations may set up branch offices in Paraguay, whose existence and capacity is governed by the law of Paraguay. Their nature fully qualifies them to exercise any actions and rights in Paraguay. Their day-to-day operations in Paraguay are governed by current legislation.

Foreign corporations which set up a branch or representative office in Paraguay are subject to all the provisions of the Civil Code as if they were Paraguayan companies. Representatives of such companies have the same liabilities with respect to third parties as directors or managers of Paraguayan companies.

Joint ventures

There is no legislation regulating joint ventures. Accordingly, all contractual provisions not inconsistent with the Paraguayan Civil Code may apply.

Under current legislation, consortia are the most similar to joint venture agreements.

Consortia are associations of two or more individuals or entities for one or several specific and temporary business transactions. They operate under their own names, without a corporate name or a common domicile.

Consortia are created for one or more business transactions, with objects, *modus operandi*, proportional interests and terms stipulated by the parties involved.

Other

Other types of business organisations worth mentioning are:

- Limited liability partnerships
- Capital and industry partnerships
- Cooperatives
- Sole proprietorships with limited liability.

Labour legislation and working conditions

Employer social security contribution

- Percentage: l6.5%
- Basis of calculation: current salary
- Manner of payment: monthly within 15 days following payment for each month worked, whatever the type of remuneration.

Employee benefits

Family allowance

All employees are entitled to receive an allowance equivalent to 53% of the minimum salary for each legitimate or acknowledged natural child under 17, provided the employee is responsible for their upbringing and education.

This allowance is automatically discontinued when the employee's salary exceeds 200% of the legal minimum salary.

l3th month salary (*remuneración anual complementaria*)

The l3th month salary provided by law is equivalent to one twelfth of the employee's remuneration accrued during the calendar year, including all items (salary, overtime, commissions or others) to be paid before December 31, or upon termination of employment.

Vacation

Vacation is a pre-established rest period to which the employee is entitled after one year's continuous employment by the same employer, the minimum duration of which will be as follows:

- After 1 and up to 5 years: 12 calendar days
- Between 5 and 10 years: 18 calendar days
- Over 10 years: 30 calendar days.

Termination of employment

The employer who dismisses the employee or terminates the contract of employment for reasons specifically provided for in the labour code incurs no liability, nor does he undertake any obligation to give notice or pay severance compensation.

If the contract of employment is for an indefinite period, none of the parties may terminate it without prior notice to the other party.

If the worker is dismissed without just cause, with or without notice, the employer must pay him a compensation equivalent to 15 days' salary for each year of employment or period in excess of six months.

If the worker fails to give notice, he must pay his employer an amount equivalent to half his salary in lieu of the period of notice.

Employee's social security contribution

- Percentage: 9%
- Basis of calculation: current salary
- Manner of payment: according to the provisions of the contract of employment regarding compensation. The employer must withhold the compulsory contribution from each salary payment.

Trade unions

The law recognises the right of both workers and employers to form trade unions without prior authorisation, for the study, defence, protection and promotion of professional interests, as well as to improve their organisations in the social, economic, cultural and moral fields. Every worker has the right to join, or resign, his membership in a trade union.

Expatriate personnel

Expatriate personnel require a work permit and a certificate of temporary residence to work in Paraguay. Theses documents are obtained upon application to the Paraguayan immigration authorities. Tourists cannot legally work in Paraguay.

Foreign personnel are, in principle, included in the social security system and entitled to all benefits.

The Labour Code establishes that Paraguayan personnel will be preferred over foreign personnel for any job position under equal technical and proficiency conditions. In practice, however, there are no problems in hiring foreign personnel.

Visas

The Tourist Card authorises the holder to stay up to 90 days, but does not give him the right to work.

Foreigners entering the country are classified into one of the following categories:

- Permanent resident
- Temporary resident
- Tourist
- In transit.

2. Finance and investment

Regulatory agencies

The executive branch of government, through different ministries and agencies, is charged with monitoring and, to a certain extent, regulating the economy. All investors at one point or another have dealings with the Ministry of Finance, the Ministry of Commerce and Industry, the Central Bank (for financial investors), and, to a lesser extent, the Ministries of Agriculture and Livestock, Justice and Labour, and Public Health and Social Welfare.

Paraguay's economy is becoming more market driven, and regulatory zeal has given way to a free-enterprise environment. While the economy still appears to be over-regulated and bureaucratic, the trend of reducing government intervention is expected to continue.

The Paraguayan Civil Code and Law 1.034/83 provide the regular framework for business and industrial activities within Paraguayan territory. At the corporate level, the main regulatory bodies are as follows:

- Ministry of Industry and Commerce: in charge of implementing the government's trade and industrial policies
- Ministry of Finance**:** taxation
- Paraguayan Central Bank: regulates banking and financing activities in Paraguay
- Public Trade Registry: registration is mandatory for individuals and legal entities that wish to perform any type of business, industrial or financial activity within Paraguay
- Government Controller's Office: monitors compliance with the regulations governing state financial administration and protects the public interest.

Competition policy

Government policy is to promote free competition in activities other than state monopolies (oil production, telephones, electricity and water utilities, cement, and steel).

Price controls

The Ministry of Industry and Commerce is in charge of setting the prices of some fuel refined from hydrocarbons. Likewise, the Asuncion City government has powers to set the price of public transportation.

The Ministry of Justice and Labour is in charge of regulating minimum salaries applicable to workers in urban Asuncion and rural areas.

Monopolies, acquisitions, mergers

The Paraguayan Constitution does not allow business combinations tending towards monopolies, nor does it allow the artificial rise or fall in prices or the creation of obstacles which may preclude free competition at any time or in any form.

Securities market

The current regulation for the local stock exchange is Law 94/91 of 20 December 1991, modifying the original Law 772/79.

The stock exchange started operations on 11 October 1993.

A National Stock Exchange Commission has been created to regulate and control companies participating in the securities market. This commission has established a mandatory accounting system and audit regulations which participating companies must comply with.

Fiscal and economic incentives have been introduced to promote and strengthen the capital market. These include a reduction of the corporate income tax to 15%, up to 1997, for corporations quoting or negotiating their shares or securities through the stock exchange.

Imports and exports

In general there are no restrictions on imports and exports.

Consumer protection

The Institute of Technology, an agency of the Ministry of Industry and Commerce, and the Asuncion City government are in charge of controlling the quality of products for human consumption, such as food and beverages. The Public Health Ministry is the government entity charged with protecting the consumer under Law 836, the Sanitary Code.

The Sanitary Code establishes the minimum conditions for the supply of food, water and other items for human consumption. The Code also provides for the control of consumer products imported from abroad, and establishes sanctions applicable upon infringement of the regulations.

Treaty on trademarks and industrial patents

Argentina, Bolivia, Brazil, Chile, Paraguay, and Uruguay have entered into a trade agreement establishing the right to use trademarks, industrial patents and invention rights in any of these countries, subject to the formalities and conditions established by their respective domestic laws. The civil and criminal liabilities incurred by those who infringe invention rights are to be determined in accordance with the laws of the country where the offence occurred.

In the General Inter-American Conventions for trademarks and protection of trade held in Washington in 1929, the governments of Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, the Dominican Republic, Ecuador, Guatemala, Haiti, Honduras, Mexico. Nicaragua, Panama, Paraguay, Peru, the United States, Uruguay, and Venezuela agreed to apply penalties on any unfair competition or infringement taking place in any of these countries.

Banking and local finance

The Paraguayan banking system includes the Central Bank of Paraguay, State development and promotion banks, and other private financial institutions. All these entities are governed by the Central Bank's regulations.

The Central Bank of Paraguay (BCP), accredited in 1952, has the following powers and functions:

Monetary system

- Sole right to issue currency
- Managing the monetary system, regulating the monetary base.

Managing the financial system

- Regulating the activities of financial entities
- Controlling the financial system
- Support lending to banks in financial difficulties.

Relations with the state

- Granting of credit to the Executive power to meet budgetary needs
- Administrating the internal and external public debt services (treasury bills and bonds)
- Advising the Executive power on financial and economic matters.

Foreign relations

- Regulating and controlling international exchange operations and remittances of capital abroad
- Administrating the country's international reserves
- Acting as the financial representative of the state.

Banking market

Private commercial banks are the largest financial institutions in the country. They offer a broad range of banking services, including deposit taking, short-term financing, foreign currency trading, letters of credit, foreign currency deposits, and local and foreign fund remittances.

The public sector operates in the form of banks; the private sector operates through banks or finance companies.

Banks, both local and foreign, may carry out all types of operations included in the concept of finance intermediation, which is defined as being an intermediary or mediator in the supply and demand of money, stocks, bonds, securities etc.

The financial companies may be intermediaries to any type of financial operation except the following:

- Receiving deposits in checking accounts
- Receiving demand deposits
- Carrying out foreign trade and foreign exchange transactions.

Foreign banks

In accordance with the law and BCP regulations, foreign banks are defined as those authorised to establish a branch. All others are treated as local banks, even if their capital stock is totally or partially owned by a foreign bank.

The branches of foreign banks have the same operating capacity and tax obligations as those constituted in Paraguay.

In accordance with the law, the home offices of branches established in Paraguay have full and unlimited responsibility for the operating results of their branches.

Financial markets

Securities market

As part of the financial reform started in 1991 in Paraguay, a Capital Markets Law was passed (Law 94/91), establishing free competition in this area and aiming at modernising and strengthening the Paraguayan economy. It created the Paraguayan

Securities Exchange Commission and provides regulations on the following subjects:

- Public security offerings such as corporate stocks, mortgage bonds on issuers' property, chattel bonds on registered chattel mortgages, monetary regulation treasury bills, savings depository certificates, etc

- Capital ceilings to be included in the bylaws of corporations issuing security holdings, requirements for authorisation for issuance and related obligations and prohibitions

- Intermediation in the securities market, entities involved therein, requirements for organisation such as stock exchange agents and companies (covered by detailed regulations established in Resolutions 53/92, 4/92, 14/92, 24/92, and 3919)

- Fiscal and economic incentives to promote and strengthen the capital market

- Competent regulatory authority for the stock market, creating an autonomous entity called the Securities Exchange Commission, with specific responsibilities defined by Decree 13467/92

- Penalties, including notification, fines, suspensions, prohibitions, and imprisonment.

The stock exchange, created by a 1977 law, resumed activities in October 1993, with newly defined specific objectives.

There is no restriction on foreign investment in the stock exchange. However, to offer securities for sale, a locally incorporated organisation is required.

Sources of funds

While there is a reasonably well-functioning credit system in the country, medium- and long-term credit is hard to obtain. When such credit is available, high collateral requirements are imposed.

Short-term credit (usually not exceeding 90 days) is in good supply and operates, in practice, on a revolving basis.

There are no restrictions on investors having access to local finance resources, or investing in state or private bonds or securities. There are no further restrictions to reinvesting in Paraguay funds or earnings that have not been repatriated.

Accounting and audit requirements

Statutory requirements

Books and records

The following books and records are to be kept by all companies in accordance with current legislation:

- General journal, to record daily operations
- Inventory book, to show the breakdown of all financial statement items at year-end
- Register of employers and workers
- Register of salaries and wages
- Register of minors employed
- Register of annual vacations.

Audited financial statements

Under new Central Bank of Paraguay regulations, from 1995 onwards banks and other financial entities must have annual independent audits.

Otherwise, there are no statutory audit requirements unless called for in the company's own formation deed or bylaws. However, since 1974, all financial statements and income tax returns filed with the Income Tax Bureau must be signed by a professional accountant registered for that purpose with the authorities, which will affirm that the financial statements are in accordance with the books of account and that the tax return has been prepared in accordance with income tax legislation. There are penalties for any infringement of the law by a professional accountant.

Accounting profession

There are two professional organisations with which graduates in the economics, administration and accounting disciplines may be associated: the Paraguayan Institute of Accountants, and the Paraguayan Institute of Graduates in Economic, Administrative and Accounting Science.

The adoption of the accounting standards issued by the international Accounting Standards Committee (IASC) has been resolved in recent national and regional accounting conferences in Paraguay. These standards are to be applied by the members of the Paraguayan Institute of Accountants when preparing financial statements. As yet, however, there are no sanctions for non-compliance.

Form and content of financial statements

Basic financial statements. In general, the basic financial statements found in reports issued for local purposes in Paraguay should include the following:

- Balance sheet
- Income statement
- Notes to the financial statements
- Statement of retained earnings
- Statement of changes in financial position.

Investment incentives

Regime of tax incentives for the investment of local and foreign capital (Law No. 60/90)

The objective of this law is to promote and increase investments of local and/or foreign capital. It grants tax benefits to individuals and corporate entities established in Paraguay, whose investments are made in accordance with the economic and social policies of the Government, in order to:

- Increase the production of goods and services
- Create permanent jobs
- Promote exports and substitute imports
- Incorporate technology to increase production efficiency and permit improved use of raw materials, labour and national resources
- Promote the investment and reinvestment of profits in capital goods.

Extensions to the benefits of Law No. 60/90, to include the following services:

- General communications systems
- Data transmission in various forms and by a variety of media
- Market research involving electronic audience measurement devices
- Investments in constructing, operating, and transferring public works and services
- Cinematography and audio-visual programmes with cultural content.

Beneficiaries and types of investment

Beneficiaries

The beneficiaries of this regime are local or foreign individuals, or corporate entities making investments in the country.

Types of investment

- Money, financing, credit from suppliers or other financial instruments

- Capital goods, raw materials and input for local industries for the manufacture of capital goods
- Trademarks, drawings, models and industrial processes, and all other forms of transfer of technology which can be licensed
- Specialised technical assistance services
- Leases of capital goods.

Benefits granted

Full exemption from federal taxes and municipal contributions related to the incorporation and registration of corporations and business enterprises.

Full exemption from all taxes of whatever nature levied on:

- The issuance, subscription and transfer of shares or partnership interests, capital increases, etc
- The import of capital goods, raw materials and inputs.

Full exemption from taxes and other assessments of whatever nature to be paid by borrowers, eg. pledges, mortgages, security and amortisations, for a term of five years. Foreign financing will be granted the same benefits, which will extend to remittances and payments abroad of interest, commissions and capital provided.

Exemption from 95% of income tax for five years, and full exemption from taxes on dividends and profits for the same period.

Full exemption from taxes of whatever nature levied on the payment of rents, leases, profits, royalties, rights to use trademarks, patents, drawings and industrial models as well as other forms of transfer of technology for five years.

Requirements

- The investment projects must be prepared by local professionals and/or consulting firms and submitted to the Ministry of Industry and Trade for approval
- Registration of leases and capital leases
- Register of additions to property, kept by the beneficiary.

Time required for approval

Approximately six months.

Guarantees regarding repatriation of capital and profits

Such guarantees are provided by the Executive Branch through the Treasury, from the 5th year following incorporation.

Remittances of capital and profits

No restrictions.

Legal forms of business organisation

Any of the forms provided for in commercial legislation.

Other legislation on foreign investments made in Paraguay

Law No 117/91 *on investments*

The objective of this law is to stimulate and guarantee both national and foreign investments under identical conditions, to promote the development of Paraguay.

The foreign investor and the companies or business enterprises in which such investor has an equity interest enjoy the same guarantees and have the same rights and obligations as local investors, with no limitations other than those established by statute.

Freedom of exchange is also guaranteed with no restriction on capital entering or leaving Paraguay, or on the remittance abroad of dividends, interest, commissions and royalties for technology transfers.

A system of free trade is guaranteed. National and foreign investments are subject to the same tax system. Joint investments between national and/or foreign investors are recognised on a shared risk basis (joint venture).

Tax incentives under **Law No 94/91** *on capital markets*

The Capital Markets Law, No 94/91, has been created to stimulate the democratisation of corporate capital, as well as to channel domestic savings to the country's productive sectors.

This law establishes a series of tax exemptions for companies operating through the stock exchange, as either open capital corporations, or closed corporations issuing bonds or debentures.

The tax exemptions are as follows:

- Income Tax**:** income tax exemption on the interest on debt securities issued by closed corporations or open capital corporations

  Premium income on the placement or sale of debt securities issued by closed and/or open capital corporations, as well as income from the purchase, sale, use as pledge or any other form of trade in the secondary market of closed and/or open capital corporations' debt securities.

The regular income tax rate is 30%. The income tax rate for open capital corporations was 15% for the tax years 1993-1997. This benefit is expected to be maintained although, so far, no laws or regulations have been issued in this respect.

- Tax on juristic acts and legal documents: the normal rates range from 0.2% to 2.5%, depending on the juristic act, terms and amounts regarding:

    - The placement or sale of debt securities and shares by closed and/or open capital corporations

    - The purchase, sale, use as pledge or any other form of trade in the secondary market of closed and/or open capital corporations' debt securities

    - The formalisation of interest payments on debt securities of open and/or closed capital corporations

    - The organisation of closed and/or open capital corporations on the amount of their authorised capital and increases thereof, and share issuances within the authorised capital, its extensions as well as increases, the transfer of property in kind as payment of start-up capital, and its subsequent increases

    - The issuance of non-convertible or convertible notes for shares in closed and/or open capital corporations.

Tax incentives established in the Forestation and Reforestation Law No. 536/95:

This law is aimed at stimulating the forestation and reforestation of Paraguayan soil. The tax incentives established are:

- For each area forested or reforested, the State will refund, once only, 75% of the direct plantation costs

- This refund will be granted to any legal entity or individual who has met the requirements set out in the Law and its administrative procedures

- In addition, during the first three years, 75% of the estimated direct cost of the following activities will be refunded: cleaning of plantations, pruning of trees, and pest and disease control

- Agro-forestation projects will also be eligible for the benefits of this law. These projects should combine the planting of timber-yielding trees with annual or permanent crops.

The administrative authority will establish the procedures and sureties necessary to implement the benefits of this law.

The refunds received and/or accrued will not constitute taxable income to the owner or re-forester. The latter will enjoy the benefits of the tax system established for income from forestation / reforestation.

Law 285/93 *on employee profit sharing*

This law aims to stimulate the granting of additional benefits to employees by business entities.

These additional benefits are considered deductible expenses, exempt from all taxes and not subject to any contribution by the business enterprise to the *Instituto de Previsión Social* (Social Security Department), or other entities requiring some kind of contribution.

A commitment is established for a minimum term of two consecutive fiscal years, but this does not oblige the employer to grant the benefits permanently.

If the benefits established exceed 10% of income after income tax, the excess will not qualify for the benefits provided under the law.

Exemption of raw materials from import taxes

Together with Argentina, Brazil and Uruguay, Paraguay forms part of MERCOSUR, a regional block that has set itself important goals related to regional trade, production agreements, tariff systems and other measures to integrate the area.

Also of interest is Decree No. 19339/97. This permits crop and livestock farming and industrial enterprises who import raw materials necessary for their production process from outside the MERCOSUR area to do so with a 'zero' tariff (with prior authorisation).

This applies where the import duty exceeds the 5% common external tariff in effect for MERCOSUR, and where the CIF value is equivalent to, or exceeds US$ 1,000.

Law No 1,295/98 *governing leases, rentals and financing and operating leases*

The value added tax base and taxable income for the year are calculated as the sum of net instalments accrued, ie. both the principal amortisation portion and financial charges, plus any other amount charged to the borrower, excluding taxes themselves.

In the case of goods imported under the provisions of Section 2 of this law the purpose of being rented or leased out under financing or operating leases, VAT will remain in suspense, ie. not charged, provided a bond satisfactory to the Customs Administration is posted.

The accrual of the agreed instalments is not subject to the tax on acts and documents.

Maquila programme

General

In order to improve Paraguay's competitiveness in terms of manufacturing and international trade, bylaws were issued on 17 July 2000 for Law No 1064 (dated 13 May 1997) which relate to '*Maquila*'. Both domestic and foreign companies may operate as *Maquila* companies. Among the many tax, customs and labour incentives under the *Maquila* programme, ones worth mentioning in this brief overview are:

- Exemption on taxes relating to licences on trade, industry, and independent professions

- Exemption from duties on buildings or constructions which form part of an industrial plant, or services which have been approved under the *Maquila* programme

- Exemption from taxes relating directly to the *Maquila* process

- Exemption from value added tax relating to operations involving machinery, leased or rented, and equipment which falls under the *Maquila* programme

- Exemption from any other tax, duty or rate, either national or local, current or future.

The benefits apply not only to new operations, but also to existing facilities which are currently idle.

Taxation

As noted earlier, the *Maquila* companies and *Maquila* subcontracting companies, which are actively running *Maquila* programmes, pay a one-time tax of 1% of the invoice value of services rendered within the *Maquila* programme. The system is modeled on a programme which has been in force in Mexico since 1970. Goods and equipment are imported free of tax, and then re-exported fully processed including local labour and service costs.

The Paraguayan package includes total exemption of taxes, rates and duties, current or future in exchange for a special once-only, definitive tax duty of 1% on the invoice value of services rendered in the *Maquila* process. Among other benefits offered to the international investor is the temporary immigrant permit, which includes the right to choose in which country social security taxes are remitted. Sales of the product can be made locally but only when local production is insufficient. If the imported parts and products are to be used by nationals, (ie. not re-exported) the total sum of import taxes and duties must be paid.

3. The tax system

Principal taxes

The taxation system covers the following:

National taxes:

- Income tax
- Unique tribute
- Value added tax
- Selective tax on consumption
- Tax on agricultural activities (IMAGRO)
- Tax on acts and documents.

Municipal taxes:

- Property tax
- Duties and taxes on motor vehicles.

The tax system follows territorial principles without taking into account the nationality or domicile of the entities receiving the income.

Adjustment for inflation is not allowed, but taxpayers must re-state fixed assets annually according to given inflation rates.

Following territorial principles, the law does not admit credits for taxes paid abroad.

Paraguay has signed several international treaties to avoid double taxation. The most prominent treaties among them are those concluded with Argentina and Chile on general freight. In addition, Paraguay has signed a double taxation treaty with the Federal Republic of Germany on airfreight.

Income tax

The taxation system only affects Paraguayan-source income derived from business, services and from industrial, agricultural and farming activities which are not of a personal nature.

Taxpayers

- Sole proprietorships, unincorporated associations, corporations, and other private entities

- State-owned companies, independent entities, decentralised entities, and mixed companies
- Persons domiciled abroad, or entities organised abroad with branches, agencies or establishments in Paraguay, pay taxes on net Paraguayan-source income.

Taxable income

Taxable income covers the following:

- Income derived form the sale of real estate, as a line of business
- Income generated by assets, as well as other income included in financial statements (excluding income derived from farming activities)
- All income earned by business organisations, whether incorporated or not, as well as by foreign entities or their branches in Paraguay
- Income from extraction activities
- Income from any business: insurance and reinsurance, financial intermediation, transportation, hotels and related businesses, travel agencies and any other craft, profession or trade for profit or business enterprise
- Equity increases, other than those arising from capital contributions, appraisal revaluations and other non-taxable income.

Exemptions

Exempt entities

- Religious institutions recognised by the competent authorities, with regard to income arising from the exercise of their faith, religious services, and the donations used for such purposes
- Social welfare and charity institutions, scientific, literary, or artistic institutions or trade associations, provided they are non-profit institutions and that they do not distribute profits among their members
- Taxpayers paying the single tax.

Exempt income

- Dividends and profits received by shareholders or partners of businesses carrying out taxable activities
- Interest on public debt securities issued by the Government or by municipalities
- Income derived from the benefits of the local and foreign capital investment law (law 60/90), up to 95%
- Interest on demand savings deposits and contracts
- Interest on drafts and notes in connection with financial activities in Paraguay.

Value added tax

Valued added tax (VAT) is levied on the following acts:

- The disposal of property
- Services rendered
- The import of goods and material objects with economic value.

Definitions

The disposal of property includes the following transactions:

- The allocation of corporate property to the private use or consumption of the owner, partners or directors of the business enterprise
- Leases with options to purchase, or with other provisions for the transfer of the leased property
- Transfers of companies; assignments of interests in unincorporated or corporate entities; consolidations; mergers; distributions to the owner, partners and shareholders made as a result of closure or total or partial winding-up and final liquidation of businesses, or of industrial or service firms
- Undertaking of agreements which provide for the take-over of the relevant property
- Goods on consignment.

Services

Services include any service rendered, whether or not for valuable consideration which, while not constituting a disposal, gives the other party an advantage or benefit, such as:

- Loans and financing
- Construction contracts not involving the delivery of materials
- Insurance and reinsurance
- Intermediations in general
- The assignment of the use of property
- The exercise of professions, crafts or trades
- Transport of goods and persons
- The personal use by the owner, partners and directors of the company of the services rendered by the latter.

Import

Import means the permanent entry of goods into Paraguay. Exports are not subject to this tax.

Tax rate

The tax rate is generally 10%.

Selective tax on consumption

This tax is levied on the import of goods, and at the first point of sale if produced locally.

Taxable goods	Maximum rates %
Tobacco in general, cigars and cigarettes	7/8
Mineral water, soft drinks, sweets and beverages in general with a maximum 2% alcoholic content	8
Beer in general, alcoholic drinks in general	10
Alcohol in general: absolute, rectified and fuel alcohol	10
Oil-derivative fuels	10

Taxpayers

The following are payers of this tax:

- Manufacturers, on the sales made in Paraguay
- Importers of goods brought into the country.

Tax base

The tax base is the factory sales price, excluding the tax itself and value added tax.

In the case of imports, the taxable amount is the customs value, stated in foreign currency, plus customs duties, excluding value added tax.

In the case of oil-derivative fuels, the tax base is the retail price set by the executive power.

Settlement and payment

The tax is paid monthly, except in the case of fuels, on which the tax is payable weekly. For imported goods, the tax is determined and paid at customs on each import made.

4. Taxes on business

Corporate tax system

Corporations and shareholders

The income tax system adopted by Paraguay follows the source principle, taxing annual income obtained by corporations. Partners or shareholders do not pay tax in respect of profit distributions or dividends, since such income is taxed at the corporate level. However, if a shareholder is a foreign resident, there is a 5% withholding tax on the amount of earnings remitted or credited to the recipient.

The Constitution establishes a general rule against double taxation, so that the same income is taxable only once in Paraguay. Accordingly, international double taxation relief is determined by treaty.

Taxable entities

Corporate income is taxed both at the corporate level and upon distribution to a foreign shareholder when dividends are remitted or credited to the latter.

Partnerships and limited liability companies are treated as corporate entities for income tax purposes.

Territoriality

Since the scope of the law is in general territorial, any form of foreign-source income remitted to local and foreign entities domiciled or resident in Paraguay is exempt from taxation. Related expenses are non-deductible.

Gross income

Accounting period

By law, accounting periods must coincide with the calendar year (except for bottling plants and insurance businesses where the period ends on 30 June). However, a different closing date may be permitted when justified by a business's economic or production cycle.

Accounting methods

The tax authorities will accept any accounting method adopted by the taxpayer, provided it is reasonable and technically appropriate to the nature of the business operations. Once the method has been adopted, it must be applied consistently: any change requires approval by the authorities.

Business profits

Gross profit is determined by deducting from gross income of Paraguayan source the related costs, which may include foreign expenses and those of other domestic operations, provided they are supported by appropriate original documentation and are necessary to obtain and preserve taxable income. The prices paid for goods bought from foreign affiliates should be comparable with international reference price listings, which are controlled by the customs authorities when determining the appropriate import duties and surcharges.

Inter-company dividends

Dividends paid by one domestic company to another are not subject to tax.

Inventory valuation

The taxpayer should value inventories at the lower end of the acquisition, production or local purchase cost, and may adopt any method of inventory valuation that is technically acceptable, eg. FIFO, LIFO, average cost. This must be applied consistently and may be changed only with the prior approval of the Undersecretary of State for Taxation. Damaged, deteriorated and obsolete inventories may be written down to their net realisable value.

Capital gains

Gains on the sale of real estate and other fixed assets are taxable as ordinary income, and are computed on the difference between the sale price and the restated residual tax value. If the sale results in a loss, this is deductible. A deduction is allowed for losses on obsolete or deteriorated assets, determined on the basis of the difference between probable liquidation value and restated residual tax value.

Interest, royalties and service fees

Interest, royalties and service fees received by a domestic corporation from local sources are taxed on an accrual basis. If received from a foreign source, they are tax exempt.

Dividends

Dividends are not taxable income. Dividends paid or credited to foreign shareholders are subject to a 5% withholding income tax.

Exchange gains and losses

Exchange gains or losses are included in income subject to income tax when they are accrued or realised on a cash basis.

Non-taxable income

Income from foreign sources, interest income from savings accounts.

Deductions

Business expenses

The general rule that is applied in practice in order to deduct business expenses is that they must have been incurred in connection with the company's domestic operations to obtain and maintain taxable profits. There are no prohibitions against payments made to foreign affiliates, provided the expenses are incurred in connection with their Paraguayan operations.

Expenses incurred outside the country that are related to import and export operations are deductible up to 1% of the FOB import and export values of the corporation or entity.

Depreciation

Assets depreciable for tax purposes, and the maximum depreciation rates allowed are as follows:

Asset	**% depreciation**
Furniture and fixtures	10
Equipment and fixtures	25
Industrial machinery	10
Tools	20
- Certain other tools	25
Data processing equipment	25
Automobiles, pick-ups and trucks	20
Buildings	
-Urban	2.5
-Rural	4
Improvements to rented property	10

Fixed assets and related depreciation are restated annually for past inflation. This revaluation is compulsory for tax purposes. The restated values result from applying an index published by the Central Bank of Paraguay.

In justified cases, the Undersecretary of State for Taxation may authorise the use of depreciation rates higher than those established by law. Depreciation is calculated by the straight-line method, applying authorised rates to the cost of revalued assets existing at the end of the financial year. The Undersecretary may also authorise the use of other depreciation methods, if technically justified and generally accepted.

Investment credit or allowance

Investments registered under Law 60/90 related to economic development are partially tax-exempt for five years. Taxpayers who do not have such benefits, and consequently do not make use of the 95% income tax exemption, may be able to benefit under a 1991 law that also established local reinvestment incentives for industrial and reforestation activities. The tax incentive is a reduction of the income tax rate from 30% to 10%.

Interest

Interest expense is an allowable tax deduction only in respect of payments made to local or foreign banks and to third parties. Interest paid to a head office is not deductible.

Royalties

Royalties paid or credited to beneficiaries located abroad are deductible, and subject to withholding income tax at 35% on 100% of the payment or credit in the case of branches to their head offices, and at 35% on 50% in all other cases.

Employee remuneration

All remuneration paid to foreign employees is deductible, except for high-level foreign executives working in Paraguay, the deductibility of whose remuneration is subject to a ceiling, as discussed below.

Executive remuneration

The remuneration of executives is deductible annually, up to the limit of 12 minimum wages per month (approximately US$ 25,775 per annum), for companies with annual sales of more than approximately US$ 20 million.

Executives are defined as directors, managers, administrators, and any others who manage or carry out the administration of the business.

Insurance premiums

There are no limits on the deductibility of premiums paid to affiliates abroad. They are, however, subject to withholding tax.

Inter-company charges

Management fees, research and development costs, and general and administrative expenses paid to foreign affiliates are wholly deductible business expenses. They are, however, subject to withholding tax when paid or credited to the foreign affiliate.

Other deductions

Special rules apply for the deduction of the following expenses:

- Donations: deductible up to 1% of the net income obtained by the company in a fiscal year
- Deferred expenses: organisation and constitution expenses may be deducted over a period of three to five years
- Taxes: all taxes are admissible deductions, except income tax, VAT, surcharges and fines
- Bad debts: bad debts are deductible three years after their original due date.

Non-deductible items

The following items are not deductible:

- Interest on capital, loans or any other investment by an owner, partner or shareholder in the business
- Personal expenses of the owner, partner or shareholder, and moneys drawn on account of future earnings
- Amortisation of payments for goodwill
- Direct expenses incurred while earning non-taxable income
- Earnings in any fiscal period retained in the business as capital increases or reserve accounts.

Treatment of losses

Tax losses incurred in one year can be carried forward, offsetting future years' net taxable income for up to three years after the loss has occurred.

Tax rates

Source or level of income	%
Commercial, industrial and service activity	30
Other (Unique Tribute)	3
Agricultural, cattle activity (IMAGRO)	25

Consolidation

Taxation of affiliated companies by groups is not practised in Paraguay. Consequently, no benefit can be obtained from offsetting the losses of one company against the profits of another.

Special industries

Agriculture and cattle production are subject to the income tax on agricultural and cattle activities (IMAGRO) at a rate of 25% on the basis of total hectares engaged in production.

Special legislation provides tax systems specifically designed for the mining and oil industries, public works and other project work implemented under international agreements and treaties.

Special legislation exists for mining and for industry, providing separate tax systems for each of these activities.

Holding companies

Tax legislation does not establish separate rules applicable to companies that hold shares in other domestic affiliates.

Taxation of foreign corporations

Tax concepts

Foreign corporations carrying out business activities in Paraguay are subject to the same tax rules for determining taxable income as domestic entities, provided they have formed a branch in Paraguay. Certain international agreements establish fiscal exemptions, provided requirements imposed by the governments concerned are complied with, such as reciprocal treatment.

Imports

There are no tax implications for a foreign corporation selling goods to customers in Paraguay through normal import channels, regardless of whether this is done without an agent, or through an unrelated agent or sole agent.

Import agents are treated as individual taxpayers, as long as they are independent and carry out their own business.

Sales subsidiary, branch

If such activity is carried out through a local sales subsidiary, corporation or branch, the net income is subject to income tax, plus withholding tax on any dividends or profits paid or credited to the foreign parent (5%).

Repatriation of profits and capital

There are no restrictions on repatriating capital introduced into Paraguay. However, interest, royalties and other income paid to recipients abroad from a Paraguayan source are subject to income tax withholdings.

Transfer of branch profits

Law 125/91 established a withholding tax of 5% on remittance or credit of profits to the head office.

Income from subsidiaries

Income of foreign subsidiaries located in Paraguay is taxable exclusively in respect of profits of Paraguayan source, obtained through utilisation or exploitation of tangible assets, rights or capital located within the Paraguayan territory.

Capital gains and dividends

The sale of the capital stock of a foreign subsidiary is taxable on the basis of the price obtained in excess of par value.

Dividends from share capital are subject to a withholding tax of 5% on remittances made to stockholders or parent companies located abroad.

Acquisitions

When assets are purchased in cash with a view to capitalising them in a new company, the purchase price of the assets will constitute the new tax value for the purpose of computing future depreciation allowances.

When a domestic corporation is acquired through the acquisition of shares, the residual tax values of the assets remain unchanged and cannot be increased to reflect the share purchase price. Interest paid by the buyer on borrowings to effect the purchase cannot be deducted from the earnings of the acquired domestic company.

5. BDO offices

BDO has offices in the following countries:

Argentina
Australia
Austria
Bahamas
Bahrain
Belgium
Bolivia
Botswana
Brazil
British Virgin Islands
Bulgaria
Canada
Cape Verde
Chile
China (PRC)
Colombia
Cyprus
Czech Republic
Denmark
Ecuador
Egypt
Estonia
Fiji
Finland
France
Germany
Gibraltar
Greece
Guatemala
Guernsey
Hong Kong
Hungary
India
Indonesia
Ireland
Isle of Man
Israel
Italy
Jamaica
Japan
Jersey
Jordan
Kazakhstan
Korea
Kuwait
Latvia
Lebanon
Liechtenstein
Luxembourg
Macau
Malaysia
Malta
Mauritius
Mexico
Morocco
Mozambique
Namibia
Netherlands
Netherlands Antilles
New Zealand
Nigeria
Norway
Oman
Pakistan
Panama
Paraguay
Peru
Philippines
Poland
Portugal
Qatar
Romania
Russia
St Kitts & Nevis
Saudi Arabia
Senegal
Singapore
Slovak Republic
South Africa
Spain
Sri Lanka
Sweden
Switzerland
Taiwan
Thailand
Tunisia
Turkey
Turkmenistan
Ukraine
United Arab Emirates
United Kingdom
United States of America
Uruguay
Vanuatu
Venezuela
Vietnam
Zambia
Zimbabwe

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