

Petroleum Free Zones

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When the original Petroleum Free Zones legislation was passed back in 1992, we said that Panama was poised to become a major oil and downstream products redistribution centre for two main reasons: one is the existence of the Panama Canal creating a natural bunkering market as well as a transshipment point and the other reason is pricing. During the last 10 years, Panama also privatized its container ports, which were substantially revamped into state-of-the art facilities, plus new modern container ports were built, moving Panama into the No.1 position in container movements in 2002 in Latin America.

The global oil industry has changed dramatically in the last 10 years, and in what relates to this part of the world, important factors in Panama also changed, forcing the restructuring of the industry and thus requiring a revised legislation.

Cabinet Decree No.36 of September 17th, 2003 was enacted to fulfill those industry changes, develop the ground rules for a national petroleum policy and drive the development of the petroleum free zones into the next stage.

1. Concept:

The free zone concept is inherent to Panama's historical condition as an international commercial, maritime and trade centre due to its strategic geographical position. The free zone is mainly an area within which all transactions are tax free. As a consequence, Panama developed the Colon Free Trade Zone, the second biggest in the world after Hong Kong, and now is pursuing the Petroleum Free Zones.

2. Legal Aspects:

Cabinet Decree 36 of September 17, 2003 (the "Decree"), superseded, while at the same time, embraced many provisions of the prior legislation, creating the legal framework necessary to establish a petroleum policy and the market liberalization of all products derived from petroleum in the Republic of Panama, as one of the indispensable factors to achieve the modernization of the economy and offer new investment opportunities for local and foreign companies, who thereby could take advantage of the country's strategic geographical position, the installed storage capacity for petroleum by-products, the human resources that the country has, the legislation in force to develop the traditional activities, and the new opportunities offered by the changing industry in order to create an international processing, distribution and redistribution centre for petroleum and its by-products in Panama.

2.1. Scope of Operations

Within any Petroleum Free Zone, individuals or corporations, national or foreign, may perform multiple operations under a special tax regime, as follows:

- a) Introduce, storage, refine, transform, manufacture, mix, purify, bottle, market, transport, transfer, pump, sell for the domestic market, export, reexport, and, in general, manage and supply crude oil, semi processed or any of its by-products;

Petroleum Free Zone Users Type B are only permitted to introduce, storage, dry, mix, export and reexport crude petroleum, semi processed or any of its by-products in or from a Petroleum Free Zone.

b) Build, install and operate petroleum refineries and other transformation or processing means of crude oil or semi-processed, storage tanks, oil pipelines, gas pipelines and poly-pipelines, pumping installations and pipes, buildings for offices, warehouses, or workshops and any other installations; introduce machinery, equipment, spare parts, containers, bottles, vehicles, furniture, equipment for fire or spill prevention, construct buildings for offices, warehouses, workshops for the use of the beneficiaries of the contracts to operate in the Petroleum Free Zones in any of the activities mentioned in subsection (a) hereinbefore;

c) Lease, acquire or in any other manner use lands, easements, right of way and other real or personal rights in regard to bona mobilia located in the areas designated as Petroleum Free Zones;

d) Establish water services, electrical power, gas, energy, heat, refrigeration or any other kind of services, upon previous coordination and approval with the respective public entities;

e) Build ports, piers, dry docks, shipping and unloading places for ship and airplanes, railroad stations for loading and unloading on land or granting contracts for the construction and exploitation of such works; and

f) In general, all kinds of operations or activities proper or incidental to the establishment and operation of the Petroleum Free Zones for the introduction, storage, pumping, transference, distribution, marketing and/or crude refining and petroleum by products.

2.2 Market Destination

Furthermore, crude oil and products derived from petroleum which are introduced into the areas of the Petroleum Free Zones, may come out tax-free of said areas for the following purposes:

a) For exportation and re-exportation.

b) For its sale or delivery to the Contractor or other users that operate legally in the Petroleum Free Zone or in another Petroleum Free Zone.

c) For its importation to be used or consumed within the customs territory of the Republic of Panama.

d) To be sold to ships that pass through the Panama Canal with destination to foreign ports or that ship between any qualified port of the Republic and foreign ports;

e) To be sold to airplanes that use the national and international airports that operate in the Republic, as long as the quality requirements are met, according to the international standards of the Joint Operation System;

f) To be sold to official entities of the foreign governments or international entities that have the right to import into the customs territory of the Republic goods which are exempted from the payment of an importation tax.

g) To be sold to companies of generation of electricity for public utility, authorized by the Regulating Entity for Public Utilities.

2.3. Investment and Related Requirements

Corporations interested in investing or operating within a Petroleum Free Zone to perform any of the activities detailed in section 2.1. hereinbefore must qualify and fulfill the requirements for one or more of the different categories available, as follows:

- Petroleum Free Zone Contractor (“Contratista de Zona Libre de Petróleo”)
- Petroleum Free Zone User Type A Permit.
- Petroleum Free Zone User Type B Permit.
- Permit to Provide Products derived from Petroleum by means of Barges.
- Permit as Importer-Distributor of petroleum derived products for sale in the domestic market.
- Permit as Importer-Distributor of petroleum derived products for electric generation.
- Permit as Sub-Distributor of petroleum derived products in wholesale distribution in the domestic market.
- Permit as Importer-Distributor of Liquid Petroleum Gas (L.P.G.) for the Domestic Market.
- Permit to Recycle or Permit for Lubricant Plants (Oils and/or Greases).
- Permit for Importers of Lubricants (Oils and/or Greases).
- Permits for Analysis Laboratory.
- Permit for Independent Inspector.
- Contractor to Refine Hydrocarbons.

The contractor of a Petroleum Free Zone is solidarily responsible with the permitted persons that operate in said Petroleum Free Zone for the losses and damages done to the State. In the event of any accident and/or contamination within the Petroleum Free Zone caused by the activities of the Contractor, the companies established in the Petroleum Free Zone and their suppliers, the Contractor must make the corresponding works of decontamination, clean-up and repair, without prejudice of any other responsibility of the Contractor, of the companies established in the Petroleum Free Zones and their suppliers that may come with third parties or the competent authorities, without prejudice of the right of the Contractor to repeat against the originator of the accident and/or contamination.

2.4 Tax Considerations

In accordance with the Tax Code, crude oil and petroleum by-products shall enter into the Petroleum Free Zones without having to pay taxes, fees, levies and other duties related to their importation, exportation or re-exportation, and may be transferred without having to pay taxes, fees levies and other taxes provided that the sale is done for the cases mentioned in subsections a), b), d), e), f) and g) of point 2.2. hereinbefore.

All income arising from transactions within PFZs or others specifically determined by law shall be exempted from income tax.

3. Conclusion:

Following up what we expressed at the outset of this article, Panama indeed has turned into an important oil and downstream products redistribution centre for two (2) main reasons: one being the existence of the Panama Canal creating a natural bunkering market as well as a transshipment point, and the other is pricing. Still, there is much room for improvement and growth.

The projected US\$5 billion expansion of the Panama Canal to allow the passage of Post-Panamax ships and naturally larger oil tankers will add a totally new dimension to the Petroleum Free Zones.

If the original legislation for the Petroleum Free Zones was the first serious attempt to promote and stimulate the development of a petroleum service industry in Panama, proven successful during the last 10 years, with this new legislation we can expect more investment opportunities and more competition with new players entering the market.

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