

# FREE TRADE ZONE REGIME

ZURCHER  
ODIO  
& RAVEN

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Costa Rica is one of the preferred spots for foreign investment in Latin America. Our geographical location, time zone, short travel access, education levels, political stability, rule of law, and early development of investment attraction schemes **are reflected in the current level of investment from multinational companies**, which at the end of 2021 closed with record figures on the number of investment projects attracted as well as jobs created. Many of the companies already established in the country keep investing in Costa Rica, increasing their level of operation and consolidating their presence here. Our firm has played an active role in the process, from assisting in the design of the applicable legislation to rendering legal services to major investments projects, as well as becoming the leading legal firm for the Life Sciences sector.

## WHAT IS THE FREE TRADE ZONE REGIME?

The Free Trade Zone Regime (FTZ) is a **special tax and customs regime that exempts firms from the usual customs and regulations procedures applicable to domestic trade activities**. Instead, more expedite procedures and pro-trade regulations are in place. Also, a special tax regime with fiscal benefits applies for companies operating under such regime. The FTZ legislation originated in 1990 and is governed by Law N° 7210 and its bylaws. This legislation establishes PROCOMER as the government agency in charge of administrating the regime along with the Customs Office.

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## WHO CAN BENEFIT FROM THE FTZ STATUS?

FTZ law allows for different categories of companies to operate under the regime. One company may operate under different categories provided certain conditions are met:

- a. Manufacturing or processing companies,
- b. Service companies,
- c. Trading companies,
- d. Entities engaged in scientific or technological research, and
- e. FTZ park developers/operators.

All beneficiaries must meet certain requirements such as a minimum \$150,000 investment in fixed assets, provided the company is located inside a FTZ park. Otherwise, this minimum investment increases to \$2,000,000, and the company must abide by all FTZ controls implemented within the parks. These requirements vary if the company decides to operate outside the amplified Great Metropolitan Area (GAMA for its initials in Spanish).



## WHICH BENEFITS ARE GRANTED UNDER THE FTZ?

FTZ companies are granted the following permanent customs and tax benefits:

- A. Exemption of all import duties on raw materials, machinery, equipment, spare parts, supplies, fuels, oils, and lubricants.
- B. Exemption of all export and re-export duties on goods produced in Costa Rica and machinery previously imported into the country.
- C. Exemption of sales and consumption taxes, including value added tax.
- D. Exemption of remittance taxes to foreign countries, including tax on dividends distribution to parent companies.

Also, the following temporary benefits are granted:

- A. Exemption on gross and net income taxes (100% exemption for the first 8 years of operation and a 50% exemption for the following 4 years). Benefits vary for (F) category beneficiaries (manufacturing companies).
- B. Exemption on property, property transfer and municipal taxes (100% exemption for the first 10 years).



# HOW ARE MANUFACTURING BENEFICIARIES TREATED?

Manufacturing beneficiaries are regulated in paragraph (F) of article 17 of the FTZ Law. Potential beneficiaries are manufacturing companies that produce or ensemble goods, whether said goods are exported or not and, therefore, tax benefits and other incentives are not subject to export results. These paragraph (F) companies must be part of one of the strategic designated sectors (i.e., the medical devices sector) or operate in a less developed area. The company's project must constitute a new investment in fixed assets of at least \$150,000. Also, said investment shall be such that may be easily transferred to or established in another country. However, if a paragraph (F) company is or will be located outside a FTZ park, the minimum investment on fixed assets shall be at least \$2,000,000. In this case, the paragraph (F) company will have the obligation to establish the proper controls to operate outside a park as required in the bylaws of the FTZ law.

(F) companies enjoy all the incentives currently established for other beneficiaries, but gross and net income taxes are treated differently: The corporate tax rate will be of a 6% rate during the first eight years and a 15% rate during the following four years. If the paragraph (F) company operates in a less developed area, this rate will be a 0% rate during the first six years, a 5% rate during the second six years, and a 15% rate during the following six years. Additionally, if a paragraph (F) company makes a total \$10,000,000 investment in fixed depreciable assets during an 8-year term and maintains, at all times, at least 100 employees, the exemption on corporate income taxes will be of 100% during the first eight years and would become a 50% exemption during the following four years. Also, paragraph (F) companies will be granted the benefit to renew, totally or partially, the exemption terms in case of reinvesting in the country. Paragraph (F) companies, if established in less developed areas - that is, outside GAMA - have the complete tax holiday and will also be granted the benefit to delay the income tax payment until the controlling entity receives the corresponding dividends from the Costa Rican operation.

# HOW ARE SERVICE COMPANIES TREATED?

Service companies are regulated in paragraph (c) of article 17 of the FTZ Law, and benefits are granted regardless of the market to which services are rendered, but they are subject to certain specific criteria. Companies applying under the FTZ as service companies shall provide one of the services expressly included in the list of what is considered a strategic sector, and the applying entity must prove its operations in Costa Rica are new. Also, it must meet the requirements of the following formula:

$$\text{IIES} = s * (100 + g) * (W/I) \quad 1/150$$

Where:

S: equals 1 when the services rendered are classified as strategic, the company is not subject to income tax in Costa Rica, and the operations will not be the result of a purchase or absorption of current operations.

G: equals 1 when the percentage of services rendered to other strategic companies, but excluding related entities, is at least 45%; otherwise, it will be 0.

W: is the total remunerations to qualified employees (which will be a commitment of the company under the FTZ).

I: is the investment in fixed assets.

The result must be 101 or more to be an eligible entity.





## HOW TO APPLY FOR THE FTZ AND START OPERATIONS?

Any new investment in Costa Rica may apply to the FTZ, provided certain criteria, as detailed above, are met. To apply for the FTZ, the applicant must file an electronic application form in Spanish. Once the application is submitted, PROCOMER will review it and it may require additional information or partially modify the information submitted. Then, PROCOMER will review it and send it to the Ministry of Foreign Trade. If approved, an Executive Accord will be prepared and signed by the Minister of Foreign Trade and the President of the Republic. Before the signature of the Operations Agreement, a warranty of \$5,000 or the equivalent to three months of the FTZ fee (canon), whichever is higher, must be submitted by the applicant. Then, the Executive Accord will be published in the Official Newspaper, and Customs authorities will be notified of the FTZ grant for its final approval.





## WHICH ADDITIONAL OBLIGATIONS APPLY UNDER THE FTZ?

Companies benefiting from the FTZ regime must comply with the following additional obligations:

- A. Keep track in specific books and records of the company's operations related to goods and products that enjoy tax exemptions.
- B. Comply with the investment, employment, and value-added commitments as established in the Executive Accord and the Operations Agreement.
- C. Use the specific customs declarations, seals, and other instruments required by law or regulations for the documentation or control of their operations.
- D. Have accounting and operational systems that allow permanent control of the entry, permanence, and exit of materials and merchandise, owned or on consignment.
- E. Have the computer systems and media that allow the electronic transmission of 100% of the Single Customs Declarations (DUAS) corresponding to the different transactions under the regime.



- F. Inform Customs of the arrival and departure of goods and raw material by means of a notification known as “End of Trip” and “Departure of Trip.” This notification will be made through electronic data transmission using a software known as “VAN,” which must be downloaded by the company. Also, the beneficiary should have a digital signature device (token) to sign this notification. If the company will eventually subcontract another FTZ company, a custom declaration must be filed, and track must be kept to avoid sanctions and payment of taxes (subcontracting for a specific manufacturing process cannot be longer than 6 months).
- G. Submit an annual operations report to PROCOMER, which shall be revised and accepted within four months of the company’s fiscal closure.
- H. Render and maintain a security deposit in favor of PROCOMER (minimum \$5,000 or three times the monthly fee (canon) paid to PROCOMER).
- I. Comply with the environmental, urban, sanitary, and any other applicable regulations, according to the sort of activity that the company develops, and have the corresponding operating permits permanently in place.
- J. Monthly fee payments. Pay a monthly fee or canon (minimum of \$200) to PROCOMER for the use of the regime. This monthly payment will be calculated as follows:
  - i. Services, trading, and administration companies: the monthly fee rate shall be a 0.30% of total sales.
  - ii. Manufacturing companies: The monthly fee is based on the area of their industrial roof. If inside a park, the rate will be \$0.25 per square meter; if outside a park, it will be \$0.50 per square meter.

# HOW ARE LABOR RELATIONS HANDLED?

Regular labor laws and principles are applied to FTZ labor relationships. Costa Rica has an employment-at-will labor legal regime, supported by a mandatory Labor Code, which contains the **basic non-waivable workers' rights and benefits.**

The Labor and Employment legal area is in constant flux due to changing interpretations by the labor courts. Compliance with local legislation as well as strategical decisions to avoid unnecessary litigation require day to day legal labor services.

**All employers must register as such before the Social Security institution (CCSS), which issues a monthly payroll statement.**

Employers make a monthly contribution of approximately 28% of each salary, and employees of approximately 10%. Also, employers must obtain a worker's risk compensation policy from the government-owned insurance company; this is paid on a yearly basis, calculated as a percentage of the worker's salary. Taxwise, the employers serve as retainers of any applicable salary tax.



# WHICH PERMITS ARE REQUIRED TO OPERATE UNDER THE FTZ?

After obtaining the FTZ regime approval (or in parallel) and before initiating operations, companies must process and obtain different permits, licenses, and registrations before different governmental institutions. The main requirements any operation must obtain are the following:

- A. **Construction Permits.** All constructions are subject to previous authorization from SETENA (Environmental Technical Secretariat) (exceptions may apply); Engineers and Architectures Board; and the local government (Municipality).
- B. **Operation permits.** A Land Use Certificate, a Sanitary Permit from the Ministry of Health, and a Municipal Operation Permit must be obtained.
- C. **Tax-related registrations.** Once the company becomes a beneficiary of the Free Trade Zone regime, the fiscal benefits of the regime will apply. This means that there will be no payment of value added and income taxes; nevertheless, the company must register and file all tax declarations on a monthly and yearly basis.
- D. **Labor-related registrations.** The company must register as an employer before the Caja Costarricense de Seguro Social (CCSS) and before the Instituto Nacional de Seguros (INS) for social security and labor liability insurance policy purposes.
- E. **Digital signature.** The company's legal representatives must obtain a digital signature, which is necessary for many local proceedings such as public bidding and imports, among many others.

| PERMIT / REQUIREMENT  | INSTITUTION   | DESCRIPTION  |
|---|---|--|
| Registration of the company and its employees.                          | Social Security Entity (Caja Costarricense de Seguro Social)  | All employees in all operating facilities must be registered as required by the law.   |
| Taxpayer registration   | General Tax Office (Dirección General de Tributación)   | Companies under the FTZ regime must be registered according to tax regulations.  |
| Registration of final beneficiaries                                     | Registry of Transparency and Final Beneficiaries of the Treasury (Registro de Transparencia y Beneficiarios Finales del Ministerio de Hacienda) | Annual filing of shareholders' information must be carried out to comply with tax regulations. The information must be registered within 20 business days after the constitution of the company. |
| Obtaining a labor risk insurance policy (póliza de riesgos del trabajo) | National Insurance Institute (Instituto Nacional de Seguros)  | The insurance policy protects workers and employers in case of labor accidents. All employers and employees in all operating facilities must be covered by the insurance.                        |

| PERMIT / REQUIREMENT  | INSTITUTION   | DESCRIPTION   |
|---|---|---|
| Land use permit (certificado de uso de suelo)                   | Corresponding Municipality                                      | Approves the operation of the commercial activity in a determined location according to zoning regulations. This is a prerequisite to obtain the sanitary operation permit.   |
| Sanitary operation permit (permiso sanitario de funcionamiento) | Corresponding regional health office of the Ministry of Health. | Approves the operation of the commercial activity in a determined location if the activity and the facilities comply with applicable sanitary, environmental, and occupational health regulations, including Application of official protocols and guidelines regarding preventive measures against Covid-19 in the workplace. This is a prerequisite to obtain the commercial license. |

| PERMIT / REQUIREMENT  | INSTITUTION   | DESCRIPTION  |
|---|---|--|
| Commercial license (licencia comercial or patente)  | Corresponding Municipality  | Approves the operation of the commercial activity in a determined location if the activity and the facilities comply with applicable regulations. The commercial license tax exoneration granted to companies within the FTZ regime does not exempt such companies from the obligation to register and obtain the license before the Municipality. |
| An environmental Registration or License will be required depending on the activity undertaken and its potential impact on the environment. | National Environmental Technical Secretariat (Secretaría Técnica Nacional Ambiental - SETENA) | Approves the operation of activities in a determined location under certain guidelines, requirements, and commitments to avoid environmental contamination and damages.  |

Shall you have any questions or needs relating to this subject, please feel free to contact Alberto Raven ([araven@zurcherodioraven.com](mailto:araven@zurcherodioraven.com)), Francisco Chacon ([fchacon@zurcherodioraven.com](mailto:fchacon@zurcherodioraven.com)), Carla Baltodano ([cbaltodano@zurcherodioraven.com](mailto:cbaltodano@zurcherodioraven.com)) or any other member of our Free Trade Zone team.