



Panama: A Tax Update and Business Opportunities

As everyone in the Offshore Industry knows, Panama has a Tax System that is based on the Territorial Principle of Taxation. This principle that Panama has embraced means that only Panama-sourced income is taxed.

An entity or an individual which has its activities outside or from Panama will escape the obligation to file tax returns and further pay Income Tax on its foreign source income.

Recent Amendments to several taxes in Panama

With the enactment of Law 49 of September 17 of 2009 and Law 8 of March 15 of 2010 the new Government of President Ricardo Martinelli, has introduced amendments to several taxes and imposed taxes on sectors that before were not paying any and thus not contributing to the system.

Income Tax

As indicated above, a person or entity with foreign sourced income will immediately escape the obligation to pay income tax in Panama.

According to Paragraph 2 of Article 694 of our Fiscal Code, The income derived from the following activities is not considered from Panamanian source:

- a. Invoice, from an office established in Panama the sale of merchandises or products for a higher amount of that for which such merchandises or products have been invoiced against the office established in Panama, always that such merchandises or products only move outside.
- b. Manage, from an office established in Panama, transactions that perfect, consume or have effects abroad.
- c. Distribute dividends or participation quotas of juridical persons that do not require an Operations Notice or that do not generate taxable income in Panama,

when such dividends or participations derive from revenues that are not produced within the territory of the Republic of Panama, including those revenues derived from the activities mentioned in literals a and b of this paragraph.

The physical or juridical persons that, for reason of their activities of international business, develop operations outside the national territory that are necessary for the generation of the income declared in the Republic of Panama, will not be subject to effect the withholding over the payments that are made for those goods and services that are financed, contracted or executed completely outside the national territory, which will not be considered as taxable income.

If the income of a **Natural or Physical Person** is determined to be of Panamanian Source is therefore obligated to submit a tax return and pay an income tax on their net taxable income following a scale that ranges from 0% to 25%. Persons with a net income of US\$11,000.00 per year or less will not be subject to pay the income tax.

Corporate or Legal Entities will have to pay a fixed income tax of:

1. 27.5% of the net income starting January 1, 2010;
2. 25% of the net income from January 1, 2011 onwards

For companies engaged in the following businesses a rate of 30% is applied for 2010, 27.5% starting January 1 of 2012 and it goes down to 25% starting January 1 of 2014:

1. Generation and distribution of energy
2. Telecommunications in general
3. Insurance and reinsurance
4. Financial companies regulated per Law 42 of 2001
5. Cement manufacturers
6. Operation and management of gambling companies
7. Mining in general
8. Banks

Companies whose annual net income surpasses US\$1,500,000.00 will pay the sum that is higher between: applying the normal income tax to the aforementioned net income (depending on the activity per the above paragraphs) or to the net income that arises by applying to the total revenues of the company a rate of 4.67%.

Furthermore, all legal entities need to pay what we call locally as “AMIR” which stands for Adelanto Mensual del Impuesto sobre la Renta. It is a monthly advance of the income tax. This advance corresponds to 1% of the monthly gross income of legal entities.

Additional amendments have been made but they are too cumbersome to cover in one article, however, the above are the most relevant amendments to the Income Tax regime.

Taxes on Dividends

A company with Panamanian source income that distributes among its partner's dividends will have to withhold a 10% tax if the shares are nominative and 20% if the shares are issued to the bearer. By way of this mechanism the shareholder will not have to file a tax return of its own, thus preserving the anonymity of the shareholder.

Law 8 of 2010 introduces an amendment to Article 733 of the Fiscal Code whereby any legal entity that according to Law 5 of 2007 (Business Licenses) is obliged to obtain an Business License will be required to withhold a Tax on Dividends or Participation Quotas of 10%, when the dividends derive from Panamanian source income. When such income derives from a foreign source or from export operations, the withholding will be of 5%.

This amendment affects all types of companies doing business in Panama and that are required to have a business license, including those companies established in the Free Zones, which although are exempt of obtaining the License, nevertheless have to apply the same rules, however, for these companies located or operating in Free Zones, the withholding is of 5%, notwithstanding the fact these dividends derive from a local or foreign source.

It is important to point out that said Law 8 also introduces a paragraph that refers to the application of the rules regarding the distribution of dividends set forth in Treaties to Avoid Double Taxation negotiated by Panama with different countries. Where there is not a Treaty in force the Law states that the company will need to apply the 10% withholding tax to dividends that derive from Panamanian source income and 5% to those that derive from foreign source income.

Business License Tax

An increase on the business license tax payable by all companies or individuals that are obliged to obtain a business license was introduced also by Law 8 of 2010. The new tax on business licenses is of 2%. Such tax is applicable to the capital of the company, with a minimum payable tax of US\$100.00 and maximum of US\$60,000.00.

The amendment offers an exemption of this tax for companies whose invested capital is less than US\$10,000.00.

For companies or individuals operating within a Free Zone the tax on business licenses will be 1% with a minimum tax of US\$100.00 and a maximum of US\$50,000.00.

This tax is also applicable to financial entities that will pay 2.5% tax and it will not exceed US\$50,000.00.

Banks are subject to pay an annual tax depending on the assets. Such tax ranges from US\$75,000.00 to US\$1,000,000.00. Banks with international license will pay an annual tax of \$75,000.00 notwithstanding the assets of the bank.

Currency Exchangers will have to pay an annual tax of US\$10,000.00.

Tax on Transfer of Movable Assets and Services

Currently this tax is payable almost on every item one would normally purchase at the supermarket and services. The rate will be of 7% starting July 1, 2010. with the exception of food, medical expenses, school materials, such as books, pencils, pens, etc., among others of basic necessity. Starting January 1, 2010 banks and other financial institutions will also have to collect this tax at a rate of 5% on all the commissions generated for banking and/or financial services and starting July 1, 2010 it will be 7%.

Annual License

This refers to the annual fee that is payable to the government by any legal entity registered in Panama, whether they are Companies incorporated under Law 32 of 1927, Limited Liability Companies incorporated under Law 4 of 2009 or Private Foundations, incorporated under Law 25 of 1995. Such annual fee corresponds to the sum of US\$250.00 payable at incorporation and US\$300.00 payable from the second year onwards.

With Law 8 of 2010 the government amended Article 318-A of the Fiscal Code to include not only Anonymous Companies and Private Foundations, but also Limited Liability Companies and any legal entity, national or foreign, as contributors for the purpose of this annual license.

In addition, it is notable that the amendment introduced what is known in other jurisdictions as the re-activation fee and this would apply when a legal entity incorporated in Panama does not pay the annual fee for an uninterrupted period of ten (10) years is legally declared dissolved and one can apply for re-activation by paying all annual licenses owed, plus the corresponding penalties, fines and an extraordinary penalty of US\$1,000.00. This re-activation must be applied to within the term of 3 years after the company has been officially dissolved.

Tax Exemptions and other fiscal benefits

It is important to note that the Panamanian Fiscal Laws allow for exemptions and benefits that are clearly an advantage for the investor.

Among the exemptions we can find that interests accrued in accounts in Panama are not levied any type or kind of tax.

There are other tax exemptions contemplated in our laws that benefit the industrial, tourism and construction activities as well as companies established in the Colon Free Zone.

There are no taxes levied on wealth or capital, nor there is an inheritance tax, taxes on assets. There is only a tax on unmovable property (Real Estate), which is levied taking as base the cadastral value of the property over \$30,000. Properties with a cadastral value under \$30,000 are exempt from paying Real Estate tax. In addition, newly constructed properties enjoy an automatic exemption on Property Taxes that ranges from 5 to 15 years. It all depends on the value of the property as follows:

1. For residential use:		
	Value of the property	Exemption in years
	• Up to \$100,000	15
	• Over \$100,000 up to \$250,000	10
	• Over \$250,000	5
2. For other uses (commercial, industrial, etc):		
	Any value	10

Double Taxation Treaties

The Republic of Panama has manifested that it will cooperate with the OECD in an effort to have Panama taken off the grey list. In this sense, Panama has signed Treaties to Avoid Double Taxation with Mexico, Barbados, Portugal, Qatar, Luxembourg, Spain, The Netherlands, Singapour and South Korea. Treaties already negotiated, but pending signature are those with France, Belgium, Ireland and the Czech Republic. Currently the only Treaty in full force is the one with Mexico.

Other countries will surely follow soon after, effectively making Panama a more competitive jurisdiction and attractive for M&A operations, the establishment of banks and multinational companies and in general all sorts of business activities.

Tax Information Exchange Treaties

Currently Panama has in effect only one of these treaties with the United States of America.

Other International Agreements

- **Mutual Assistance Treaties:** Panama has concluded mutual legal assistance treaties with the US, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Colombia. The treaties operate at the administrative level: in other words, Court procedures are not required, although there is an appeal procedure. The treaties cover serious international crimes, but do not include tax matters.
- **Free Trade Agreements** At the conclusion of the fourth Taiwan-Latin American leaders' summit in Taipei in October, 2003, the Presidents of Panama and Taiwan signed a Free Trade Agreement that has already entered into effect and makes provision for greater market access between the two nations, as well as reduced duties on agricultural and industrial products, investments, services and telecommunications.

A trade agreement between the United States and Panama is pending approval at the U.S. Senate; however, Panama has effective free trade agreements with Canada, Singapore, El Salvador and its negotiating agreements with several other countries.

Business Opportunities in Panama

Why Panama? The answer is simple: Panama has it all and is now a proud member of a select group of Latin American countries (Chile, México, Brazil and Peru) that have Investment Grade. On March 23, 2010, Fitch Ratings granted Panama the rating of

BBB- with a positive perspective. This accomplishment will definitely bring more investments to the country than ever before.

Panama is no stranger to foreign investment. For centuries Panama was used as a trade and distribution center by the Spaniards. On more modern times, Panama is not only used for trade and distribution, but also as a Financial Center and a suitable jurisdiction to establish regional offices for multinationals as well as other types of businesses and of course, tourism.

Presently Panama has engaged several mega projects; most notable is the expansion of the Panama Canal with a cost of 8 Billion US Dollars. Another ambitious project is the construction of a metro rail system in Panama City at a cost of approximately 350 Million US Dollars and the replacement of the current bus service to a more friendly, safe and faster Metro Bus service. These projects provide an array of opportunities for companies that wish to offer their goods and services to the companies that are currently working on these projects. Everything from the supply of technology, to training and security, to more simple, but yet important things, like the provision of food.

Tourism is another area of opportunity. Panama has great incentives for the investor in the Tourism Industry as set forth in Law 8 of 1994, ranging from exemptions in income tax, to exemptions in import duties for constructions materials, cars, boats and any other means of transportation to be used in the tourism facility. The stability of the country, along with the incentives offered by Law 8 has attracted many hotel chains, which presently are either in the middle of construction of or at least on the initial stages of their respective projects. Many, if not most of these projects, are located on the Pacific Coast of Panama City and the “Dry Arch” area of the Pacific Coast of Panama with investments totaling Hundreds of Millions of US Dollars.

Panama has many other opportunities for business, such as those offered at the Colon Free Zone or the Panama Pacific Economic Area. Both have their incentives, but most notable, of course are the exemptions of taxes (except the 5% tax on dividends generated from foreign sourced income) and the multitude of businesses than can be done.

The Free Zone exists since 1948 and is located in the city of Colon at the Atlantic entrance to the canal, and has been extremely successful - more than 1,000 companies are established there, shipping more than \$9 Billion of goods annually. It is the second largest Free Zone in the world, next to Hong Kong. All kinds of processing and manufacturing are permitted within the Free Zone, while administration can be conducted from inside or outside the zone.

As for the Panama Pacific Economic Area, it is less known as the Colon Free Zone being that it was established only 5 years ago, but since its creation it has attracted major players because of the favorable business environment and of course, the tax incentives, facilities and location. The most notable companies that have established themselves in this area are DELL, Caterpillar and 3M.

The more salient features of this particular economic area are:

- A functioning airport on site

- Stability and flexibility for business growth and expansion
- Tax breaks, labor and legal incentives, through Law 41 of 2004
- Immediate access to infrastructure and if needed, the project has plans to accommodate future growth
- Immediate availability of all utilities
- Access to state of the art communications

In general Panama offers opportunities in all areas of business, whether it's in trade, manufacturing, services and tourism and above all, political stability, tax incentives, protection of investments through special Laws to name a few.

We invite you to come by and see for yourself this beautiful country and everything it has to offer.