

Panama

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1.0 OVERVIEW

Panama operates under a territorial tax system where residents and non-residents are taxed only on Panama-sourced income. Income that does not arise in Panama, such as foreign-source income, is not subject to tax in Panama.

Companies with commercial activities or services provided in or from the Republic of Panama, irrespective of the company's nationality or the location of its operational office, are subject to tax from income derived from its activities within Panamanian territory.

Income received by non-residents is considered to be from a Panamanian source if the income arises from services or actions that benefit persons or companies located in Panama, including fees, interest and royalties.

2.0 LEGAL SYSTEM

In Panama, the legal and regulatory framework that defines the tax system is the Political Constitution of the Republic of Panama, the tax code and its reforms, and complementary laws, decrees and resolutions. Panama and its provinces operate under a civil law legal system and a unitary, republican, democratic, representative government. The president is elected for a non-renewable term of five years.

Judicial authority rests with the Supreme Court, composed of nine magistrates, all appointed by the president (subject to approval by the National Assembly) for 10-year terms. The National Assembly (*Asamblea Nacional*) is a unicameral body that consists of 71 members, who are elected by popular vote for five-year

terms and are eligible for re-election. The National Assembly initiates legislation, rules on international treaties, approves the budget and establishes political divisions.

Since the legal tender and most common unit of exchange in Panama is the US dollar, funds can move to and from the country freely. There are no currency or exchange controls, nor is there a central bank.

3.0 TAXATION AUTHORITIES

The General Revenue Department (*Dirección General de Ingresos*, or DGI) is the local authority with the power to administer tax collection and public revenues under the control of the Ministry of Economy and Finance.

4.0 BUSINESS VEHICLES

Panama strongly encourages and promotes foreign investment, and has made the process relatively easy and straightforward. There are no prior approvals or registration requirements for direct foreign investments in Panama.

A non-resident may either establish a Panamanian business vehicle to carry on business in the country or operate directly through a foreign entity. However, all entities doing business in or from Panama (as opposed to simple foreign investment) must obtain some type of recognition as a legal entity in order to operate, requiring the foreign entity to be registered as a foreign company or a branch.

An Operations License is legally required to carry out any commercial, industrial and services-related activities in or from Panama. For certain regulated activities, the entity must request

and be granted special licenses by the relevant regulatory agency before the Operations License filing can be completed.

Panamanian law recognizes different forms of legal entities, with the corporations or stock company (*Sociedad Anónima*, or SA) and the limited liability company (*Sociedad de Responsabilidad Limitada*, or SRL) being the most common business vehicles. The choice of entity is driven by the internal policies and/or tax planning in the country of origin, since the entities receive equal tax, contracting and regulatory treatment in Panama.

Generally speaking, the SA and the SRL both allow for great flexibility in the management and operation of the entity. Both types of entities allow for the operation of any legal civil or commercial activities, and the equity owners need not be Panamanian citizens or residents.

4.1 Corporations/stock company (SA)

SAs are corporations of which ownership is represented by shares. There is a minimum requirement of one shareholder and no maximum limit on the number of shareholders.

The articles of incorporation of the SA, which set forth the purpose of the company, its directors and officers and other key information related to its management and operation, must be publicly registered as part of the incorporation process. Any amendments to the articles of incorporation, as well as the removal or addition of any directors or officers, must be registered.

The shareholders of an SA are not listed with the Public Registry of Panama, unless the articles of incorporation provide otherwise. Shareholders may freely dispose of their shares to third parties. Classes of shares with different rights, responsibilities and/or obligations, such as varying economic, voting or other rights, may be authorized and issued, provided that all shares of the same class possess the same rights, responsibilities and obligations.

An SA is taxed as a corporation and is taxed at the corporate level on income earned on its operations in Panama. The applicable tax rate is 25%. Shareholders would be taxed at a personal level for any dividends received at a rate of 10%.

4.2 Limited liability company (SRL)

A SRL is a business corporation in which the social capital is divided into participation quotas, and owners of a participation quota are members. There must be at least two members in an SRL, however the minority ownership interest may be fractional. The members of an SRL must be recorded in the Public Registry, and any changes to the ownership structure (i.e., the addition or subtraction of members) must be duly registered with the Public Registry.

One important difference between an SA and an SRL: The law requires that, in order to become a new member of an SRL, all existing members must accept the new member. This requirement can be pre-accepted or waived in the SRL's publicly registered articles of incorporation, but in the absence of the same, admission of a new member lies at the unfettered discretion of the existing members.

An SRL is also subject to the corporate tax rate of 25% and the partners will be taxed with dividend tax at a rate of 10%.

5.0 FINANCING A CORPORATE SUBSIDIARY

5.1 Equity financing

The subscription of shares does not subject the issuer nor the subscriber to taxation. If the issuer offers the subscriber a financing option (i.e. payment in installments), the corresponding interest will be subject to the standard income tax rate of 25%.

5.2 Thin capitalization

There are no thin capitalization rules on taking additional shares.

5.3 Debt financing

Head offices are allowed to finance a subsidiary, in which case the transaction needs to be formally documented. If the head office is located outside Panama, a 12.5% withholding tax will apply to the interest paid to the foreign parent, and transfer pricing rules will also apply. If the head office is located in Panama and is Panamanian taxpayer, the withholding tax will not apply, and the head office will have the obligation to declare the interest received and pay income tax on the net taxable income at the standard rate of 25%.

6.0 CORPORATE INCOME TAX

Panamanian income tax law affects the whole territory equally. Taxable income includes all income derived from business activities in Panama, minus income-generating expenses, incurred wholly and exclusively in the production of assessable income or the conservation of its source. Income

earned by companies is taxed at a flat corporate tax rate of 25% over net income. The tax base for companies whose taxable income is greater than US\$1.5 million is the greater of (i) the net taxable income calculated on the normal basis, or (ii) 4.67% of the gross taxable income, known as the alternate calculation of income tax (CAIR).

A taxpayer can request the CAIR not to be applied when it has net operating losses or where the effective tax rate is higher than the standard 25% rate. The DGI has the discretion to grant an exemption from the CAIR for the period requested and for three subsequent years.

A taxpayer is subject to tax on its profits from carrying on its business. Profit is generally considered to be revenues minus deductible expenditures. Losses may be carried forward for five years, with a maximum of 20% of losses deducted per year, as long as the deduction of losses does not exceed 50% of taxable income in any given year. The carryback of losses is not permitted.

The calendar year generally is used as a taxation year, although the taxpayer can request a special 12-month fiscal year in certain cases. Consolidated corporate returns are not permitted. Each company must file a separate corporate tax return. Companies must file a tax return within 90 days after the end of the fiscal year, although a one-month extension may be obtained upon request.

Three advance payments of tax are required in June, September and December, with a final payment of tax due at the time the annual



return is filed. Except for companies operating in Free Trade Zones, corporations with no Panamanian-source income are not required to file an income tax return. Interest and surcharges are levied on late payments. Penalties may be imposed for late filing of the annual income tax return.

Resident legal entities that do not carry out operations within Panama, or offshore entities, must maintain accounting records and supporting documentation for at least five years from: (i) the last day of the calendar year during which the transactions covered in the accounting records took place, or (ii) the last day of the calendar year in which the legal entity ceases operations.

Accounting records and documentation must be retained in the office of the resident agent of the offshore entity, or in any other place determined by the entity's management, subject to certain notification requirements. If the accounting records and supporting documentation are held outside Panama, the legal entity will be required to provide the necessary documentation to its resident agent within 15 business days of a request from the Panamanian tax authorities. Penalties apply for failure to comply and may include the forced resignation or removal of the resident agent.

6.1 Capital gains

Capital gains derived from the sale of shares, securities and negotiable instruments are subject to a 10% capital gains tax. The purchaser must withhold 5% of the sales price as an advance payment of income tax and remit that amount to the tax authorities. The seller will calculate a 10% tax on the profit. If the 10% of the profit is higher than the 5% withheld by the buyer, the seller can opt to consider the 5% as the definite tax. If the 10% of the profit is lower than the 5% withheld by the buyer, the seller can request a reimbursement for the difference. Income from the sale of government securities and those issued by companies registered with the National Securities Commission is not taxable.

Gains from the sale or transfer of real property are considered capital gains, and involve two types of taxes: transfer tax and income tax on the net profit of the sale. If the transaction giving rise to the gain is part of the taxpayer's ordinary business activities, the gain is subject to the corporate tax rate. If the transaction is not part of the taxpayer's ordinary business activities, the gain is taxed at a reduced rate of 10%. However, in the latter case, the purchaser must withhold 3% of the higher of the purchase price or the ratable value of the property as an advance payment of tax. The seller will then calculate a 10% tax on the profit. If the 10% of the profit is higher than the 3% withheld by the buyer, the seller can opt to consider the 3% as the definite tax. If the 10% of the profit is lower than the 3% withheld by the buyer, the seller can request a reimbursement for the difference.

6.2 Annual license tax

All industrial or commercial business, except those exempted by specific laws, are required to register for an Operations License. The Operations License automatically grants applicants with a Unique Taxpayer Registration number (RUC) for the purposes presenting filings before the General Revenue Office of the Ministry of Economy and Finance. A new business will also become automatically listed as a municipal taxpayer, but will still need to complete the corresponding registration process related to use of the RUC, as well as complete registration with the municipality in which the entity operates.

The annual license tax is an annual tax on equity at a rate of 2% of the company's net worth, including amounts owed to the foreign home office or foreign affiliated companies. The tax is payable annually up to a maximum of US\$60,000.¹

6.3 Dividend tax

In Panama, dividend tax applies to corporations registered in Panama as well as branches of foreign entities. Companies holding an Operations License or otherwise carrying out business in Panama must withhold tax at a rate of 10% on dividends distributed out of domestic profits (20% in the case of bearer shares) and 5% on dividends distributed out of foreign-source profits or export profits.

Local corporations must pay a 4% complementary tax on each fiscal year's after tax profit on behalf of their shareholders if no dividends are declared. This 4% complementary tax will be applied as a credit to dividend tax when dividends are declared in the future.

6.4 Withholding tax on service fees

Royalties and commissions on services paid to foreign entities are taxed at a rate of 25% on half (50%) of the paid amount, making the effective tax rate 12.5%. Payment on capital in financial transactions are not subject to withholding tax. The taxpayer may decide not to withhold taxes and consequently not deduct the expense. Payment of interest is also subject to income tax on 50% of the interest paid

to a beneficiary abroad on loans invested in Panama, but the payor must proceed with the withholding tax even if one does not deduct the interest expense.

If the beneficiary is registered as a taxpayer in Panama before the DGI, no withholding tax is required. If, according to a special law, the payment of interest, royalties, dividends or fees is exempt from withholding tax, said exemption will not apply if the beneficial owner of the payment can credit the taxes that would have been paid in Panama in its country of residence. In the event that the tax credit is not allowed in the taxpayer's country of residence, the taxpayer must request a formal opinion from an independent expert stating the non-applicability of the tax credit in the country of residence.

7.0 CROSS-BORDER PAYMENTS

7.1 Transfer pricing

Panama's transfer pricing regime conforms to the arm's length principle of the Organisation for Economic Co-operation and Development (OECD). Transfer pricing obligation is extended to all transactions carried out with foreign-related parties, where operations affect the tax base of Panama. The operations with related parties in a free trade zone in Panama are also required to comply with transfer pricing rules. The tax authorities can make adjustments if the arm's length principle is not followed.

The law requires a taxpayer utilizing transfer pricing to prepare a Transfer Pricing Study. As part of the

¹ For companies established in a Free Trade Zone, this tax is 1% of the company's net worth, including amounts owed to the foreign home office or foreign affiliated companies. The tax is payable annually up to a maximum of US\$50,000.

Transfer Pricing Study, the taxpayer is obligated to file an annual Form 930 Transfer Pricing Informative Statement, a sworn affidavit that provides basic information to the tax authority and declares that the taxpayer has prepared the required Transfer Pricing Study. The Transfer Pricing Informative Statement includes information on all the operations carried out with foreign-related parties during the fiscal year under analysis. This report should be filed within six months after the fiscal year has ended. Failure to submit or late submission of the Transfer Pricing Informative Statement will result in a fine equivalent to 1% of the total sum of operations carried out with foreign-related parties with a maximum fine of US\$1 million.

The Transfer Pricing Informative Statement must be based in the Transfer Pricing Study. However, the taxpayer does not need to present the Transfer Pricing Study unless the Panamanian tax authority requires it, in which case it should be presented within 45 working days from the day after the notification.

8.0 PAYROLL TAXES

8.1 Social security and educational tax

Social security and educational taxes apply to salaries and most other types of remuneration paid to employees. No cap applies to the amount of remuneration (in-kind benefits) subject to these payroll taxes. An employer must withhold the employee's portion of social security (9.75%) and education (1.25%) taxes. In addition, the employer must pay the entire workers' compensation insurance

at rates based upon the type of business and risk of the employee, which range between 1% and 7% of the employee's salary.

The employer's obligations for social security is 13.5% of the employee's salary, and 1.5% for educational tax. Since employers must deduct contribution-quotas from their employees and pay them within the following month, employers are jointly and severally liable with the employee for any social security and educational tax owing

9.0 INDIRECT TAXES

9.1 Value-added tax (ITBMS)

Consumer services and goods are, for the most part, subject to a 7% ITBMS (in its Spanish acronym). Some products are subject to a higher ITBMS rate, such as alcoholic beverages and hotel room rentals at 10%, and cigarettes and tobacco products at 15%.

The following items are exempt from ITBMS:

- Food (except restaurants that serve alcoholic beverages)
- Medicine and medical services
- House rentals with a contract period of more than six months (house rentals with contract periods of less than six months are subject to ITBMS)

9.2 Property tax

Property tax rates are progressive. Primary residency properties with a registered value of US\$120,000 or lower are exempt from property tax. This new exemption amount became effective on January 1, 2019, raising the exemption amount from US\$30,000.

For primary residency properties, the tax base for property tax is the registered value of the property in excess of US\$120,000. The property tax rate is 0.5% from US\$120,001 to US\$700,000, and 0.7% from US\$700,001 on up. For secondary residencies, commercial properties and industrial properties, the tax base for property tax is the registered value of the property in excess of US\$30,000. The property tax rate is 0.6% from US\$30,001 to US\$250,000; 0.8% from US\$250,001 to US\$500,000; and 1.0% from US\$500,001 on up.

9.3 Import duties

All goods imported onto Panamanian territory from another country are subject to import duties. The Panamanian Customs and Tariffs Office provides the import duty rates, which range from 0% to 15% depending on the product.

9.4 Stamp tax

All documented monetary transactions that are not subject to ITBMS are subject to a stamp tax. For every US\$100 in transactional value, there is a US\$0.10 stamp tax. A fractional rate applies for any part of the transactional value under US\$100.

9.5 Municipal tax

Lucrative activities in any municipality shall pay local tax upon gross income, calculated according to the companies' category and activity. The rate varies from one municipality to the other. Lucrative activities are considered those activities which produce private income (as opposed to nonprofits/charities).