



Proposal on Economic Substance Requirements for Foreign-Source Passive Income in Panama

Tax Newsletter

KPMG Panama
March 10, 2026

Economic Substance and Foreign-Source Passive Income in Panama

At the end of 2025, the Ministry of Economy and Finance of the National Government of Panama presented to professional associations and industry groups a proposal on Economic Substance Requirements for Foreign-Source Passive Income, which forms part of the national strategy to achieve the removal of Panama from the “*EU List of Non-Cooperative Jurisdictions for Tax Purposes*,” aligning the Panamanian tax regime with international standards.

One of the criteria for Panama’s inclusion on this list relates to the principle of tax fairness, which requires jurisdictions not to maintain preferential measures considered harmful, such as Foreign-Source Income Exemption regimes (FSIE).

The EU Guidance establishes that, in order to remedy an FSIE regime considered harmful, countries must:

- Introduce taxation of foreign-source passive income; or
- If certain types of foreign-source passive income (interest, dividends, royalties, capital gains) are excluded from taxation, they must:
 - a) Implement **adequate economic substance requirements** for the entities involved, in accordance with the EU Code of Conduct on Business Taxation.
 - b) Apply specific substance requirements for royalties derived from intellectual property rights.
 - c) Have **robust anti-abuse rules**.
 - d) Eliminate any **administrative discretion** in determining income excluded from taxation

It is important to note that the EU Guidance **does not require eliminating the territoriality principle** nor taxing all foreign-source income but rather ensuring that jurisdictions can substantiate the economic reality of operations, particularly regarding **foreign-source passive income received by multinational groups**.

The objective is to prevent the use of FSIE regimes for the artificial shifting of profits or erosion of the tax base, in line with international standards and global efforts against tax avoidance (BEPS).

Below are the main aspects included in the Draft Bill:

- **Scope**

The proposal applies to multinational groups, defined as groups of two or more entities linked by ownership or control, resident in different jurisdictions, including headquarters, subsidiaries, and permanent establishments.

- **Covered Income**

Foreign-source passive income subject to economic substance requirements includes:

1. Dividends.
2. Interest.
3. Royalties (for the use of intellectual property: patents, inventions, formulas, processes, techniques, trademarks, etc.).
4. Capital gains.
5. Real estate capital income (income from leasing, subleasing, use, enjoyment, or transfer of rights over real property).
6. Other movable capital income (income from assignment of own funds, leasing, subleasing, establishment or transfer of rights of use or enjoyment of movable property).

- **Territoriality Principle**

The proposal maintains the current territoriality regime in Panama, under which only income generated within the national territory is taxed. However, it introduces an exception for foreign-source passive income received by multinational group entities that do not demonstrate economic substance in Panama.

- **Economic Substance Requirements**

Entities forming part of a multinational group and receiving foreign-source passive income must demonstrate economic substance in Panama to maintain the exemption on such income.

Requirements include:

1. Employment of qualified and remunerated human resources in Panama.
2. Adequate facilities for the development of the main activity.
3. Strategic decision-making and assumption of risks within Panamanian territory.
4. Operational expenses related to the income-generating assets.
5. The tax authority will annually assess compliance through review of documentation submitted by entities.

- **Reporting Obligations**

Entities subject to the law must:

1. Submit an annual sworn declaration demonstrating economic substances.
2. Maintain supporting information and documentation in Panama.
3. File an income tax return reporting foreign-source income.
4. Have Audited Financial Statements.

- **General Anti-Avoidance Rule**

A general **anti-abuse rule** is introduced, allowing the tax authority to reclassify transactions whose main purpose is to obtain improper tax advantages and to tax the corresponding passive income.

- **Taxation of Foreign-Source Passive Income**

If the entity does not meet the economic substance requirements, it will be considered “non-qualified,” and its foreign-source passive income will be taxed in Panama at the general income tax rate, and will also be subject to fines, surcharges, and interest for failure to comply with reporting obligations.

It is expected that the proposal will be formally submitted to the National Assembly of Deputies during the following months of the current year, so that it becomes Law of the Republic before the next review of the list (October 2026).

KPMG: Perspectives

From our preliminary analysis of the draft bill, we highlight the following relevant points for our clients:

- An increase in compliance obligations is expected, including the filing of a Sworn Income Statement, Sworn Economic Substance Declaration, and the requirement to have Audited Financial Statements.
- The draft bill limits the shared use of resources (personnel, facilities, functions) to demonstrate substance in more than one entity, which could require the consolidation or restructuring of companies with similar functions to optimize costs and operational capacity.
- Although the territorial tax regime in Panama remains in place, the tax treatment of foreign-source income (non-taxable) would become conditional upon demonstrating that the entity meets the economic substance requirements, representing a substantial change compared to the current regime.
- Countries with territorial systems such as Costa Rica, Uruguay, Hong Kong, and Singapore have already reformed their regulations aligned with these requirements, achieving removal from the EU List. These reforms have required adjustments in the structure of multinational groups that receive passive foreign-source income, and in Panama, similar changes will be required to implement what is established in the European guidance.
- It is essential that companies analyze in advance the potential impact of these changes and consider adjustments in their operating structures and compliance processes to anticipate the possible entry into force of the regulation.

If you have any questions about this topic or related matters, please do not hesitate to contact our Tax Services specialists.

Contacts

Tax Services

Jair Montúfar

Lead Partner

E: jmontufar@kpmg.com

Jony Afú

Partner

E: jafu@kpmg.com

Jaime Carrizo

Partner

E: jcarrizo@kpmg.com

Eduardo Choy

Partner, Tax Outsourcing

E: eduardochoy@kpmg.com

Maria Isabel Espinel

Director, Transfer Pricing

E: mariaespinel@kpmg.com

Andrés Kosmas

Partner

E: akosmas@kpmg.com

Zita Segismond

Director

E: zsegismond@kpmg.com

Jose Song

Author of this edition

E: josesong@kpmg.com

KPMG Panamá

Ave. Samuel Lewis and East 56th Street,
Obarrio, Panama City

T: (+507) 208-0700

E: pa-fminformation@kpmg.com

kpmg.com.pa

KPMG in Panama, Samuel Lewis Avenue and 56th Street East, Obarrio, Panama, 0816-01089

© 2026 KPMG, a Panamanian civil partnership and member firm of the global organization of KPMG member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we strive to provide accurate and timely information, there is no guarantee that such information is accurate on the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.