



cutting through complexity

Investment in Panama

KPMG in Panama

2012



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To our clients and friends:

Investment in Panama is one of a series of booklets prepared by KPMG and designed to provide information on a number of subjects important to those contemplating making investments or doing business in the Republic of Panama.

The economic policy in Panama welcomes foreign and local investments, which is evidenced by various Government and tax incentives discussed in this booklet. Investors, however, are subject to a number of governmental regulations and tax laws. This booklet provides a summary of the rules, regulations, and tax laws that could affect investors.

The information in this booklet is of a general nature and should be used only as a guide for preliminary planning purpose. Comprehensive advice should always be obtained before implementing any plan to invest in or immigrate to Panama.

KPMG would be pleased to assist you. For further information, please contact us.

KPMG
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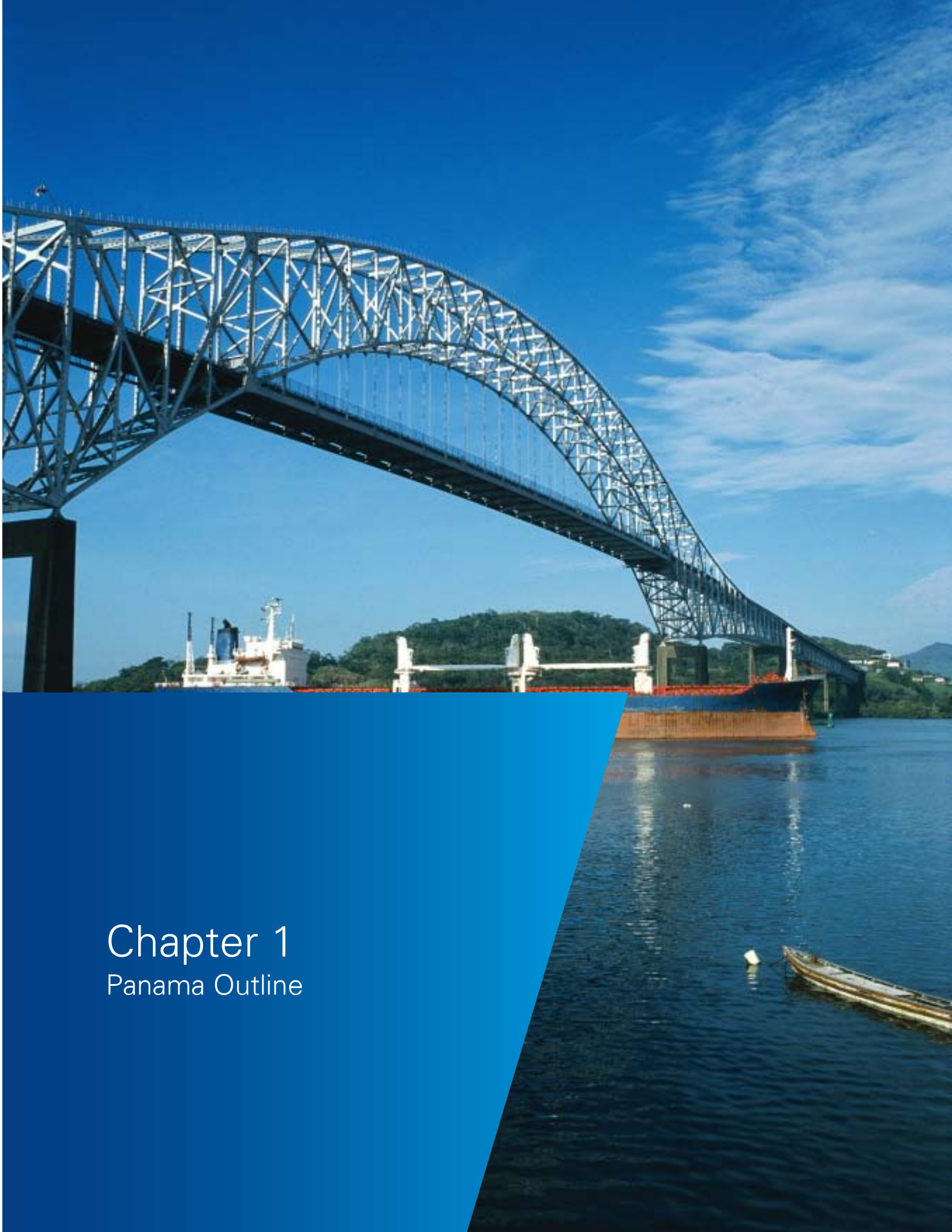
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Chapter 1

Panama Outline

Chapter 1

Panama outline

For over a century, the Republic of Panama has played the role of being a heterogenic, multiethnic country in addition to having a trans-isthmus canal, buoyant commercial and financial infrastructures as well as proving an emerging tourism destination. Its strategic position is bordered by two oceans, containing lush tropical rainforests, rivers and national and marine parks with a unique diversity of flora, fauna and sea life. In native languages, Panama meant “an abundance of fish, birds and butterflies”. Alongside these natural sceneries is the dynamic and vibrant City of Panama - a modern and cosmopolitan capital -, whose coastline is bordered by an ever expanding central business district and a skyline beaming with high-rise offices and residential towers.

Geography and climate

The Republic of Panama, located between the Republic of Costa Rica and the Republic of Colombia, is indeed at the heart and pulse of the Americas. Panama connects Central and South America opening its doors and borders for the purpose of doing business, enhancing world trade and uniting people from various countries.

Being a true crossroads, it is only 80 kilometers wide at its narrowest point. Its Caribbean Sea coastline extends 1,287.7 kilometers and on the Pacific Ocean side is 1,700.6 kilometers long. The isthmus's land mass is 75,517 square kilometers. Panama has a tropical climate throughout the year with two seasons: the windy season - from January through April - and the rainy season - from May through December -. The temperature at sea level averages 27°C to 33°C during the day (80°F to 85°F); however, the temperature is typically cooler and more pleasant at night.

The country lies in a hurricane-free zone and has had relatively few earthquakes or other natural disasters. Its mountainous areas and protected reserves on the eastern and western extremes benefit from cooler temperatures. Its official time zone is five hours behind the GMT

History

Panama emerged from the ocean much more than three million five hundred thousand years ago joining North and South America. Before the arrival of the Spanish conquerors, the native people

known as “the Cuevas” inhabited this land. Rodrigo de Bastidas is known as the discoverer of the Isthmus of Panama in 1501; some years later, Vasco Nuñez de Balboa led an expedition across the isthmus that discovered the Pacific Ocean in 1513. After other settlements were founded on the Atlantic shore, Panama was the first Spanish village on the Pacific side, established in 1519. The site of this original settlement is nowadays called ‘Panama La Vieja’ o ‘Panama Viejo’.

In 1538, the village became the seat of the Royal High Court of Panama, and the colonial region was valued not only as the departure point for ships leaving to conquer South America, but also valued as a commercial route from the Peruvian Inca Empire to Spain. It was in 1671 when the English pirate Henry Morgan attacked the City of Panama and burnt it to the ground. The City was rebuilt in 1673 in a new site known as ‘Old Part of the City’ or ‘Casco Antiguo’ within the district of San Felipe, approximately eight kilometers southwest from the original settlement.

In 1997, both villages the 16th and 17th century ‘Old Parts of the City’ were declared a world heritage site by the United Nations Organization (UNO).

Panama remained a Spanish colony until 1821, when it declared its independence from Spain and became part of The Great Colombia. In November 1903 however, after several failed attempts at emancipation during the nineteenth century, Panama broke its alliance with the remains of The Great Colombia, the Republic of Colombia, to become a fully independent republic. More recently, the consolidation of democratic institutions since 1989 has brought a sustained reduction in political risk. The participation of the Government in economic activities is limited to regulation of the markets and provision of social and infrastructure services in areas where private capital is not available. Having more than one century as an independent country, and with a strong history of openness and dealing with foreign investors, today, Panama continues with a strong policy of encouraging national and foreign investments.

Government

The Republic of Panama is politically a representative democracy divided into nine provinces and four indigenous reservations. Panama enjoys a presidential system of Government divided into three separate branches: the Executive, the Legislative and the Judicial. An independent Public Minister belongs to the governmental structure, headed by a General Prosecutor. The President and the Vice President (only one Vice President from 2009), who are elected by direct vote for a five-year term, without the possibility of an immediate re-election, and at the moment a Cabinet of 13 Ministers, appointed by the President, makes up the Executive Branch. Their election is by direct popular vote. The Legislature (National Assembly) is a one-chamber body composed of 71 members who are elected by direct popular vote and who are responsible for passing laws.

The Judicial Branch is composed of nine Senior Judges appointed to the Supreme Court of Justice, and both the Superior District Courts and other lower courts are established by law. Supreme Court Judges are appointed by the President (Executive Branch), and are subject to the confirmation by the National Assembly. The Supreme Court of Justice is responsible for the judicial revision of laws, and its Chamber III reviews the issuance of illegal dispositions including administrative matters.

An independent Electoral Tribunal governs the political elections.

Population, languages and religion

Growing at a rate of 2 percent, the Panamanian population is estimated to be over 3.3 million inhabitants; 48 percent of its total population lives in Panama City, located on the Pacific coast of the Isthmus.

The official language of Panama is Spanish. However, English is widely spoken as a second and commercial language, particularly in the main cities of Panama and Colon. Minority groups speak Arab, Chinese, French, Greek, Hebrew, Hindus and Italian, amongst others. The literacy rate is approximately 92.6 percent, and unemployment rate is 4.6 percent, according to the Office of the Comptroller General's statistics.

Freedom of religion is enshrined in the Panamanian Constitution, although most Panamanians are Roman Catholics, as declared by the Political Constitution itself. State affairs are separated from religious ones.

State general budget

Yearly issued, the Panama's budget is feed by different sources: tax revenues are added to non-tax revenues (current income), in addition to capital revenues or State assets. No income could be derogated or modified without proper substitutive revenue authorized by law.

Currency

The Panamanian official currency is the "Balboa" (B/.) or Panamanian Balboa (PAB), which has the same value as the US dollar. However, the "Balboa" does exist in the form of coins and are minted in the same size of US coins. The US dollar is the legal tender throughout the country as stipulated by Fiscal Code and has circulated freely alongside Panamanian coins prior to 1903 but legally since 1904 when Panama signed the Monetary Treaty with the United States.

Although Panama has its monetary currency, it does not have a central bank, like most countries do. The banking act amended in 1998, modified in 2008, organized the Superintendence of Banks; it also functions as a central bank by determining a reserve system and interest rates. Panama enjoys monetary stability as a result of its fully dollarized economy. The state-owned bank, *Banco Nacional de Panama*, is in charge for the supply of US dollars from the Federal Reserve Bank of New York. As the US dollar is a legal tender currency in Panama, it has free circulation and there are neither foreign exchange regulations nor restrictions on other banks importing US dollars into Panama.

Because of Panama's monetary system, inflation tends to be low. For expatriate executives, the cost of living in Panama is very similar to that of major cities such as Miami (USA), San Juan (Puerto Rico) and Sao Paulo (Brazil).

Economy

The Investment Grade (BB-) was conceded to Panama by three prestigious experts in 2010. Panama's economy is heavily service-oriented, with more than 70 percent of the Gross Domestic

Product and 50 percent of the Nation's employment resulting from this sector.

Panama has been a member-State of the World Trade Organization (WTO) since 1997 according to Law 23 of 1997. As a consequence of such affiliation, a number of economic measures have been implemented by successive governments, including the privatization of State-owned companies, the adequacy of internal laws to international standards, as well as the drastic reduction in import tariffs and tariff process in the agricultural sector. The country has signed comprehensive bilateral trade agreements with its major trading partners (e.g. the United States – Panama Free Trade Agreement, 2007, recently in force since 2011), and it has been and it is also currently engaged in negotiations of additional free trade agreements (FTA) with other important trading partners in order to enhance the country's competitiveness in the international economy.

Taxation system

National and municipal taxes are ruled by law on the grounds of the territoriality principle. The national network includes direct and indirect taxes collected by tax authorities; meanwhile the municipal taxation power resides on the Municipality Counsel of each district based on its law. With respect to national tax matters, a two-year term work has resulted in the signature of more than ten treaties for the avoidance of double taxation (TDT) under the standards of the OECD. In addition of those TDT, a tax information exchange agreement (TIEA) has been signed with the USA.

Housing

A reasonable selection of executive-standard apartments is normally available for rent. Currently, the market is adequately supplied with rental or properties up for sale ranging from studios and lofts to apartment and houses with a garden. These are available both, furnished or unfurnished. Condominiums are being built as second residences for foreigners. Remarkably, housing is growing fast in the trans-isthmus area as well as in rural areas.

Transportation infrastructure

Within the City of Panama, a modern metro-bus system is already running transforming the public transportation service and also a subway system is being constructed and it is expected to be operational by 2014. Domestic and international cargo transportation services are provided by more than 50 companies based in Panama. Some of the international cargo offers transportation services on a regular basis to the Western Hemisphere. Most major American car rental agencies are established in Panama. Panama is well serviced by international airlines with daily flights to major cities in Canada, the United States, Mexico, Central and South America, the Caribbean and Europe from the Hub of the Americas at the Tocumen International Airport. Additionally, flights are available to Asia, Africa, Oceania and the Far East. Throughout the country, indeed, four international airport projects are envisaged in the soon coming future.

Inaugurated in 1855 and quite improved during the last decade, the Panama Tran-Isthmus Railroad offers a cargo and passenger's service, traveling parallel to the Panama Canal. Additionally to the railroad and to a huge port coming in the future (apart from Vacamonte) on the Pacific side, the following five international ports are located near the Panama Canal area: Balboa (on the Pacific coast as well) and Cristobal, Manzanillo International Terminal, Colon Container Terminal and Colon

Port Terminal (on the Caribbean coast).

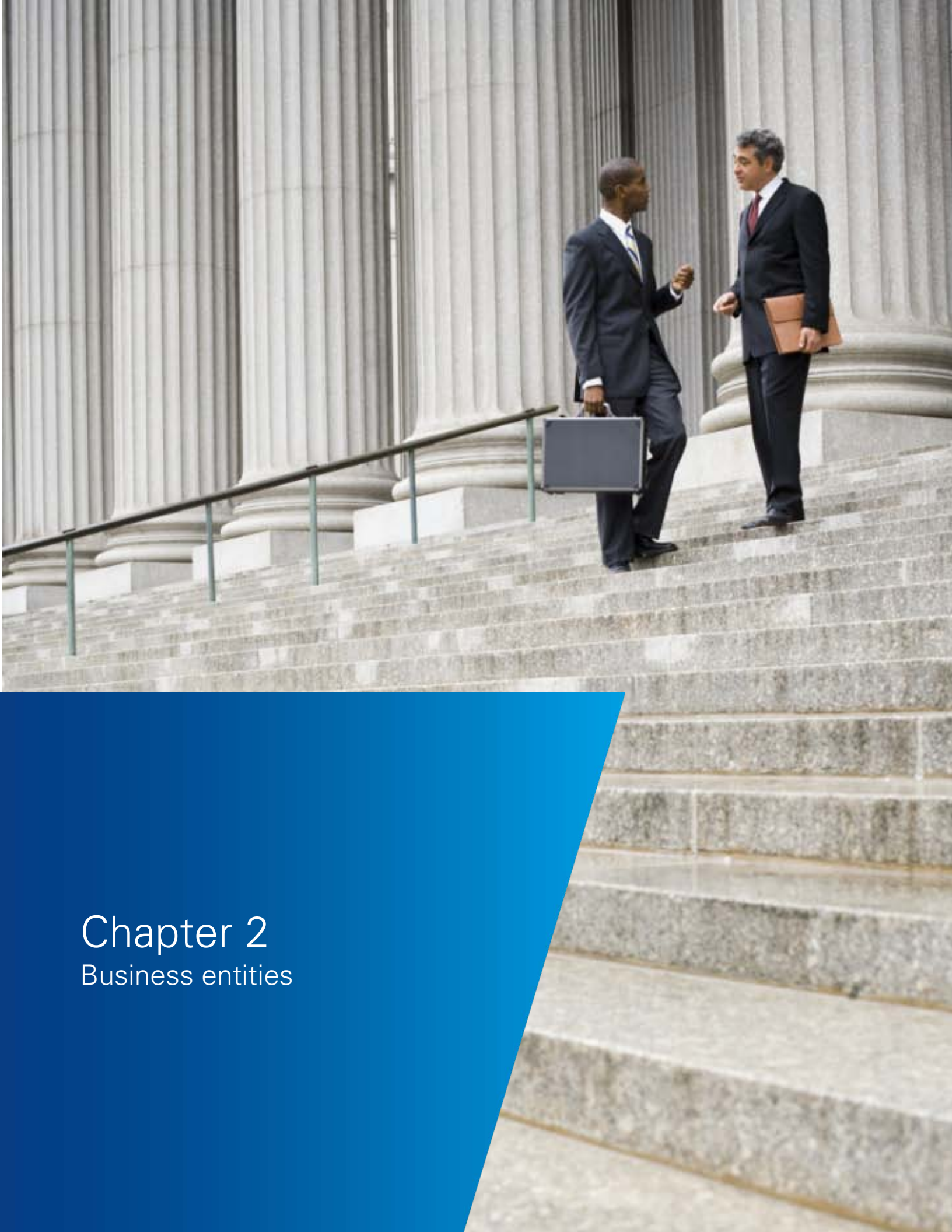
The Panama Canal, its expansion

Since it was handed over to Panama in 1999 the Canal has been successfully managed, operated and maintained by the Panama Canal Authority (ACP as per its acronym in Spanish). The ACP is an autonomous entity of the Panamanian Government, which is duly recognized by the Constitution, directed by an administrator under supervision of an eleven-member board of directors, and whose workforce consists of approximately 9,000 people. The authority is currently overseeing the construction of the third pair of locks as part of expansion program for the Canal that will be finished by October 2014.

After its secession from Colombia in 1903, Panama signed a treaty with the United States for the construction of the waterway. The Panama Canal Commission was a USA Government Corporation (agency) that managed, operated, and maintained the Canal until December 31, 1999, when its administration was transferred to Panama. Since 1914, the Panama Canal has provided transit services to more than 800,000 vessels. At least 13,000 ocean-going vessels transit the Canal every year, at an average of 40 per day.

Following the handing over, the ACP assumed the responsibility for the modernization of the Canal as well as the protection and conservation of its watershed. The average transit time was formally nine hours; however sound improvements have been achieved since the Panamanian administration took over the Canal, cutting the vessel transit time to 7.4 hours. Foremost, the Canal has experienced an increase in traffic with regard to net tonnage, total transits and transits of Panamax vessels (100 feet or more in beam are the largest vessels that can pass through the Canal), in addition to improvements in workplace health and safety standards.

The Panama Canal is crossed by two public bridges: one known as 'Centennial Bridge' (*Centenario*), inaugurated in 2004 and the 'Bridge of the Americas' (*Puente de las Americas*) inaugurated in 1962. A third bridge is being planned at the moment.



Chapter 2

Business entities

Chapter 2

Business entities

All national and foreign business entities have equal rights under the Panamanian Constitution and must fulfill the same basic requirements to organize and operate business activities in Panama. However, there are restrictions for foreigners operating retail trade activities as well as certain professional practices. Individuals may engage in business activities under their own names or through legal entities.

Types of legal entities

The following are the different types of legal entities that may be formed, based on Panamanian civil and commercial laws. A foreign entity may also re-domicile in Panama or open a Panamanian branch.

Partnerships

- General partnerships ("sociedades colectivas"): Partners responsibilities are unlimited, unless the partnership instrument provides that a partner will be liable only for a limited sum (which cannot be lower than her/his contribution to the partnership).
- Simple limited partnerships ("sociedades en comandita simples"): Limited partnerships with general and limited partners. General partners share management responsibilities and are jointly and severally liable for partnership debts. Limited partners are liable only up to the amount of capital that they have invested.
- Joint-stock partnerships ("sociedades en comandita por acciones"): Limited partnerships, similar to simple limited partnerships, but with the partners' capital represented by shares.
- Limited liability companies or LLC ("sociedades de responsabilidad limitada"): Under this form of organization, liability of shareholders is limited to the individual capital participation. The name of the partnership must include the words "Sociedad de Responsabilidad Limitada", the initials "S. de R. L.", or the abbreviations "Sdad. Ltda.", otherwise, the partners' liability will be unlimited.

Joint ventures

- Joint ventures (“asociaciones accidentales o cuentas en participación”): This partnership type is utilized for temporary association for commercial purposes without incorporation; joint ventures are widely accepted in Panama although they have no separate juridical registry.
- Therefore for this type of association of persons to carry out a single business enterprise to profit, the Directorate General of Revenue may assign a tax number to the joint ventures to pay taxes.

Private interest foundations

As per Law 25 of 1995 the Panamanian legislation created a new type of entity known as private interest foundations inspired by Liechtenstein's Family Foundation Law.

- These private interest foundations shall not be profit oriented;
- They may nevertheless engage in commercial activities in a non-habitual manner, or exercise rights deriving from titles representing the capital of business companies held as part of the assets of the foundation provided that the economic result or proceeds from such activities are used exclusively towards the foundation's objectives;
- The law also allows that one or more natural or juridical persons register under their own name, or through another, to constitute a private interest foundation;
- A private interest foundation may be formed with an amount of no less than US\$10,000 authorized capital;
- The founders must select a name to identify the foundation;
- The objectives, duration, domicile, and board of the foundation must also be indicated, along with beneficiaries;
- Its charter of organization must be notarized and registered;
- The private interest foundation is very similar to a trust in its operation, but unlike the trust, there is no need to transfer the assets to a third party;
- When its assets are located outside of the territory of Panama, no taxes are levied, when these assets (whether movable or immovable, shares, bonds, and others) are transferred.

Corporations

- Two or more persons, either nationals or foreigners, may establish a local corporation known as “sociedad anónima” (stock company) in Panama;
- Corporate law does not require any minimum paid-in capital;
- Bearer shares are also permitted;
- A single person or a corporation may own all shares;
- Under corporations law, every corporation must prepare the articles of incorporation (pacto social), and register in a public deed before a Panamanian notary;
- The public deed must then be registered in the Mercantile Section at the Public Registry;
- The usual procedure is for two attorneys within the same law firm, to incorporate it, and then assign their rights to the clients.
- The identification of the shareholders does not need to be disclosed in the articles of incorporation unless exceptions.
- A lawyer as resident agent is needed.

Legal requirements for incorporation

Law 32 of 1927 and its amendments regulate corporations. The following requirements must be satisfied in order to incorporate a company in the Panamanian Public Registry:

- The Panamanian law requires registration of a name for the corporation;
- A statement of the main objectives of the corporation is required; although the law entitles the corporation to perform any legal business aside from the specified principal objective;
- Disclosure of information regarding the amount of authorized capital is required, including the number of shares;
- In the event of shares without a par value, information regarding the amount of authorized capital, including the number and nominal value of shares is required;
- No minimum or maximum capital is required to start operations.

Share structure

- Under the Panamanian law, shares may be issued with or without par value;
- These shares may be of different classes, values and rights;
- Also, shares may be issued in a nominative form, bearer form or both.

Identity of directors

- The Panamanian law requires a minimum of three directors, with no restriction on a maximum number of directors;
- Full names and addresses of directors must be provided;
- Citizens from any country may be appointed as directors;
- Also, legal entities (juridical persons) may act as directors for a corporation.

Identity of corporate officers

- Full names and addresses of corporate officers must be provided;
- The Panamanian law requires a president, secretary and treasurer;
- The same person may hold more than one position; for practical purposes, it is not recommended that the same person be appointed as president and secretary.

Duration and domicile of corporation

- Duration of the corporation may be an indefinite period;
- The domicile may vary although it is usually in the Republic of Panama.

Resident agent and annual tax fees

The Panamanian law requires every corporation to hire a local attorney acting as resident agent of the corporation. Fees for this service start at US\$250 per year. Additionally, there is an annual franchise duty of US\$300.

Procedures

The procedures to form a Panamanian corporation are as follows:

- Provide required information to the resident agent;
- A corporation chart must be prepared by the resident agent (articles of incorporation). A notary public must notarize this chart;
- The notarized document will be registered at the Public Registry of the Republic of Panama;

- The resident agent will prepare share certificates and legal books of the corporation;
- Foreign corporations may be registered in Panama. In such a case, documents certifying the authenticity and good standing of the corporation are requested. These documents have to be certified by the Panamanian Consul at the place of origin.

Registration fees

Registration fees vary according to the registered authorized capital, as follows:

AUTHORIZED CAPITAL	REGISTRATION FEE
For the first US\$10,000	US\$50
From US\$10,001 up to US\$100,000 Plus for each US\$1,000 or fraction from US\$10,001 up to US\$100,000	US\$50 Plus 0.90 cents
From US\$100,001 up to US\$1,000,000 Plus for each US\$1,000 or fraction from US\$100,001 up to US\$1,000,000	US\$131 Plus 0.60 cents
Over US\$1,000,000 Plus For each US\$1,000 or fraction from US\$1,000,001	US\$671 Plus 0.12 cents

Accounting requirements

- All companies operating in Panama are required by law to maintain accounting records according to generally accepted accounting principles in the Republic of Panama: International Financial Reporting Standards (IFRS) or NIIF as per its abbreviation in Spanish;
- The following records are required for corporations operating in Panama: a general journal, a general ledger, a minute book, and a stock register (shareholders registry). Only two books are mandatory for merchants: a general journal and a general ledger;
- All accounting records must be maintained in Spanish;
- Accounting records, supporting documents and correspondence must be kept in Panama, as long as the operations are carried on locally. They must be up to date and ready to be inspected by authorities at any time;
- According to Commercial Code, endorsement by a certified public accountant is required when capital is higher than US\$100,000 or sales volume is over US\$50,000;
- For companies that exclusively perform offshore operations, the legal and accounting records and correspondence may be maintained anywhere in the world;
- For all companies operating in the Republic of Panama, tax regulations require taxpayers to maintain the financial statements at the disposition of the Directorate General of Revenue and attested by a certified public accountant according to the generally accepted auditing standards

in Panama;

- Although not required, financial statements can be inscribed in the Public Registry of Panama;
- There is a statutory audit requirement in Panama for banks, insurance companies and reinsurance companies, as well as for companies registered under the National Securities Commission and for companies operating in a free trade zone. The financial statements must be certified annually by independent auditors;
- When the accounting records are maintained on technological or electronic means, specific certification from certified public accountant is required;
- Accounting records must be prepared following the accrual system on the grounds of the International Financial Accounting Standards (IFAS) with few exceptions.
- Banking institutions are authorized to keep their accounting records through either IFRS or US-GAAP.

Legal entity annual franchise duty

- Every registered corporation, Limited Liability Company or any other legal person, domestic or foreign, must pay the Treasury an annual tax of US\$300 (*"tasa única anual"* or TUA).
- Private interest foundations must also pay this annual tax, but the applicable fee is US\$350.00 for the first year and US\$400.00 for all subsequent years.
- Notwithstanding the non-profit or non-governmental organizations (NGO), cooperatives and civil partnerships are exempted from TUA; these last ones (civil partnerships) were called to pay for a specific period (between 2009 last semester and 2010 first semester). Refer to Executive Decree 539 of 2011.
- According to the law, penalties are applied when lack of payment of the fee for two consecutive or alternate periods.
- Payments should be made by legal the representative or registered/resident agent.

Operation notice

To engage in commercial or industrial activities, all corporations, partnerships, or individuals must obtain a permit, called "operation notice" (in Spanish, *aviso de operación*). The application and granting of the business notice of operation is done through the electronic system www.panamaemprende.com, from the Ministry of Commerce and Industries. Law No. 5 of 2007 regulates this matter

Process to obtain an operation notice

All enterprises doing business in Panama are asked to adhere to the following procedure in order to obtain an operation notice, in addition to specific procedures for each of the field activities:

- Previous authorization must be obtained for certain activities before receiving the operation notice;
- Registration of activities must be completed in the *PanamaEmprende* system;
- All taxes, fees or contributions must be satisfied;
- The system will issue the number of notice of operation which includes a code number and the tax identification number (or RUC as per its acronym in Spanish).
- The RUC must be used for payment of all taxes (central and municipal taxes).

Process requirements

In order to begin the procedure, the users' registry must be submitted. Then, the following steps must be completed:

- Filing of a request form, including necessary information to identify the solicitor, such as name of the establishment, name and address of the person requesting the notice, as well as the capital and activities in which the company will be involved;
- A sworn declaration must be attached to the notice;
- A US\$15 fee for natural/individual person or of US\$55 for legal entity must be paid;
- An additional cost for obtaining a business notice depends on the activity;
- There are two types of activities to conduct business: commercial or industrial.

Industrial activities

Industrial activities are described as extractive and manufacturing activities. Said activities include: wholesale and sales of products to the Government; construction companies hiring workers; manual, homemade and handcrafts industries employing more than five workers.

Wholesale commerce

According to Law 5 of 2007, "wholesale commerce" is defined as follows:

- The performance of services in general, except those qualified as retail operations according to current legislation;
- Sales to the Government and enterprises;
- The performance of all types of commercial activities with the exception of those qualified as retail operations;
- Examples of wholesale commerce activities include commercial and mortgage banks, financial companies, international financial brokers, insurance and reinsurance companies, international transportation agencies, mutual funds, public utilities, and high technology service companies.

Retail commerce

According to Law 5 of 2007, the coverage of retail commerce contains:

- Sales of goods to consumer;
- Representation or agency of a producer or mercantile enterprise;
- Any other activity qualified as such by the law;
- According to the Constitution, only Panamanian citizens are allowed for a retail commerce activity, and foreigners may be individually authorized to do so or be incorporated to a manufacturing enterprise.

Activities exempt from the operation notice

- Exemption for business notice registry is granted to natural/individual persons or legal entities engaged either in agricultural activities or in the handcraft business or in homemade goods with no more than five employees.
- Non-profit associations like those engaged in charitable activities do not require business notice of operation either.
- A free trade zone company is also exempted.

Other approvals and licenses

- Among other activities, banks and trust companies must obtain operating licenses from the Superintendence of Banks.

- Insurance companies, insurance brokers, reinsurance companies, reinsurance brokers, captive insurance companies and insurance administrators must also obtained authorization from the Superintendence of Insurance and Reinsurance.
- Securities brokers must obtain licenses from the National Securities Commission.

Commercial and industrial protection

Registration of products

- In general, all food products and beverages sold in cans, bottles or any other form of packaging, should be registered with the Ministry of Public Health, and must comply with requirements of hygiene and quality control.
- The imports of food products to the Panamanian territory are forbidden, if products are not authorized in the country of origin.
- The Executive Branch is responsible for creating sanitary regulations at the request of the Ministry of Public Health, regarding the manufacturing, warehousing, importation, and sale of medicines and related products.
- These products cannot be manufactured or imported to the country without prior analysis and registration.
- In the case of foreign products, a certificate of free sale issued by the sanitary authority of the country of origin, authenticated by the Panamanian Consul, should be accompanied with the application of the sanitary registration.
- National Authority of Food deals with new imports.
- Based on Law Decree 11 of 2006, it is charged with introducing and managing food security standards in the country.

Patents

- Law 35 of 1996 enacted a substantial reform for the protection of industrial property in the Republic of Panama.
- Panamanian law protects and recognizes the right of the author of any invention, through a patent of invention license issued by the Ministry of Commerce and Industries, which will assure the inventor the exclusive rights to use the invention for a term of twenty years.
- No patent will be issued if it creates conflict with previous acquired rights.
- Patents will be cancelled when they are issued to the detriment of third parties' rights, or when they are not used.
- Inventors who have obtained patents in other countries can obtain a corresponding patent of invention in Panama, provided that the inventions are not in the public domain.

Trademark

- Trademark protection of products and services underwent substantial reform in Law 35 of 1996 mentioned above. The new legislation updates industrial property protection and complies with international standards and treaties in this area.
- Trademarks may be represented by a word, a phrase and a symbol, or a combination of these elements, or any other means capable of individualizing a product or service in commerce.
- They should be sufficiently different one from the other, so that a given trademark can be clearly distinguished and no confusion arises in the course of its use.
- Any owner of a trademark, either foreign or a Panamanian citizen, may request a registration from the Ministry of Commerce and Industries, in order to acquire the exclusive right to use it in

the Republic of Panama.

- The application should be published once in the Industrial Property Bulletin, and if after two months (60 days) from the date of publication, no claim to the contrary is filed, registration of the trademark should be made.
- Registration is granted for a ten-year (10) term, renewable for equal periods of time, provided that the renewal is requested a year in advance or six months following the date of expiration; if renewal is not requested within the period specified above, the registration will be cancelled, and the rights acquired will be lost.

Copyright

- In addition to the international agreements approved by Panama, Law 15 of 1994 is issued to protect the intellectual property rights of literary, educational, scientific or artistic works regardless of kind, manner of expression, merits or destination.
- Proof of title to the work is required by the law, but the work does not need to be registered to obtain the protection granted by the law; the author is recognized unless the contrary is proved; the author is basically granted moral and patrimonial rights.
- The copyright is granted to the author while she/he is alive and to heirs for a fifty-year (50) period after her/his death.

Electronic commerce and issues surrounding

The Law 51 of 2008 defines and regulates electronic documents and electronic signatures and the provision of storage of technological documentation and certification of electronic signatures and takes other provisions for the development of electronic commerce.

This law confers jurisdiction of the Directorate General of Electronic Commerce (sited at the Ministry of Commerce and Industries) to regulate this area as well as to register the service providers regarding certification of storage (or file) technology (or digital) of documents and signatures, without leaving the Public Registry of execution because the Law 51 repealed Law 11 of 1998 which at the time, ten years ago, gave this power to the Public Registry.

To mention some peculiarities of Law 51, it allows all trader keep their accounts using books, electronic documents or other legal mechanisms that are always ensure that such records cannot be modified or eliminated by subsequently, including in the Panamanian law in 2008, the electronic document as valid, without the need for accounting records are printed, as adopted in 1997 under the commercial law (article 71 of the Commercial Code).

Also, Law 51, referring to the commercial transactions made via Internet, makes the use of electronic invoices that their broadcast is given in the terms and conditions determined by the Government, through the tax authorities (Directorate General of Revenue or DGI), which, to date, has regulated electronic invoicing through the fiscal equipment dispositions on the grounds of Law 8 of 2010 and Law 72 of 2011.

Since 1996, it had been required prior authorization of the DGI for the use of any system billing computer (based on Executive Decree 26 of February 1, 1996).

On the other hand, the use of the Web for information consistent of registration certificate has been launched by Ministry of Commerce and Industries (MICI) for that at no cost one for the users, officials of MICI accredited before Public Registry (PR), to verify any information in responsibility of the PR in the procedures required for MICI.

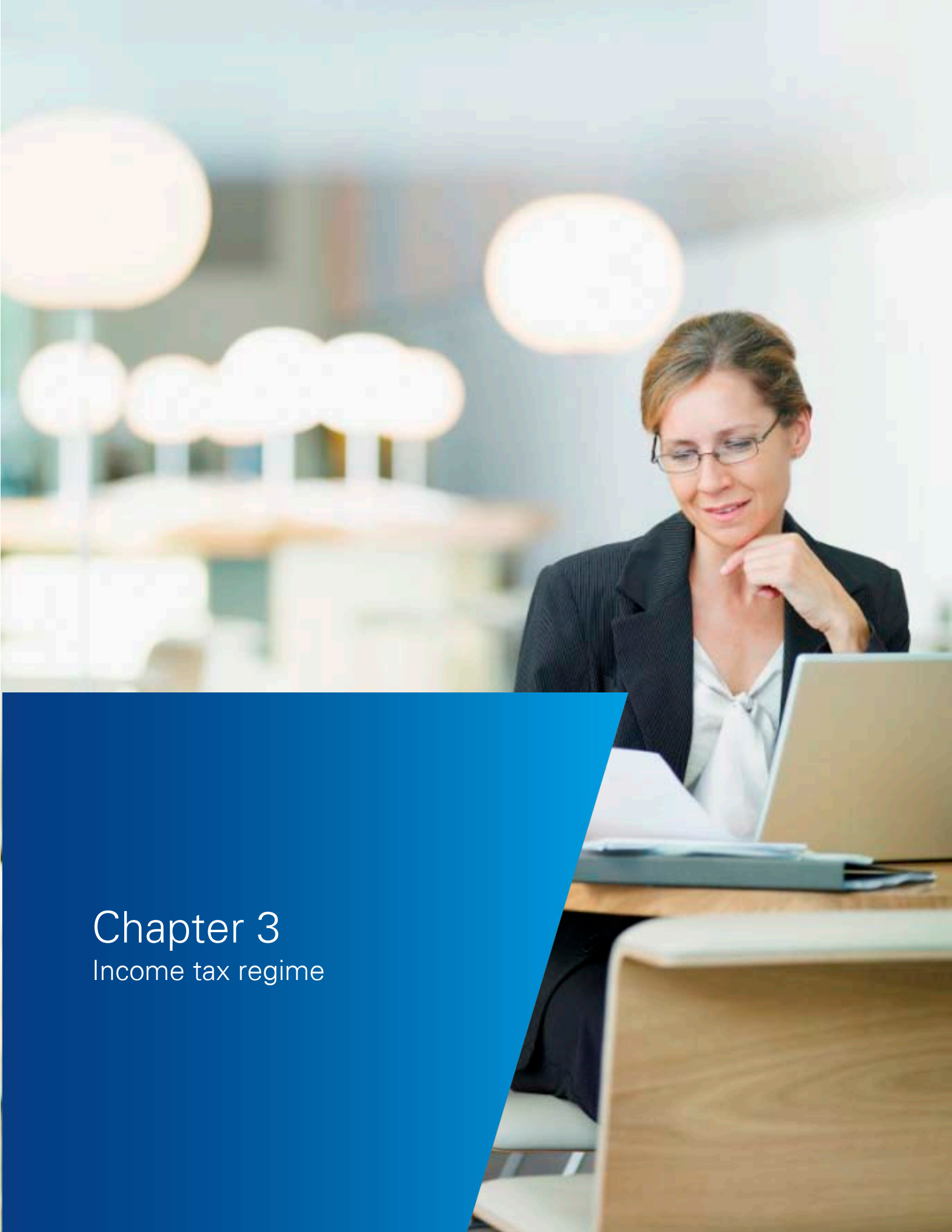
Bookkeeping

Panamanian commercial regulations require that accounting records be kept on file for at least five years. Supporting documentation of the accounting records transactions, such as invoices issued or received, withholdings made, and so far must be retained for a period similar to the statute of limitation of any action that could arise from them. However, information regarding social security contributions should be kept for at least 20 years according to the Social Security Law. Thus, it would be advisable to elaborate an inventory of the supporting documentation in order to establish on a category by category basis the necessity to maintain on file the different documents. Electronic filing is mandatory unless few exceptions and authorized by the administrative tax authority.

A summary chart of statutes of limitations is below for referring record retention duties and rights and obligations of businessmen, merchants, employers and taxpayers.

CHART OF BOOKKEEPING AND STATUTES OF LIMITATIONS

Topic	Time (years)
Constitutional limit period for redeeming obligations	20
Social security matters	20
Taxation (general rule)	15
Withholding income tax	15
Debts and credits of National Treasury	15
Real estate tax collection	10
Income tax collections and refunds	07
Income tax assessments	03
Income tax credit (for giving it back in cash)	03
ITBMS (or VAT)	05
Commercial matters (general rule)	05
Accounting records (retention period after closing)	05
Auxiliary records (retention period after closing)	05
Technological storage of documents	Same time



Chapter 3

Income tax regime

Chapter 3

Income tax regime

Overview of Panamanian system

It is a fundamental constitutional principle in the Republic of Panama that no tax, duty or contribution be levied unless such tax has been legally established as requires the Political Constitution (Article 52), following the standard ruling and Roman aphorism that reads 'no tax without law' ("*Nulle taxe sine lege*").

The Supreme Court of Justice oversees constitutional control through judicial review of laws and rulings, and has a crucial role in providing certainty to the legal system. The Third Chamber of the Supreme Court or Chamber III, on its part, oversees the legal control of administrative acts, e.g. tax matters.

As national tax, income taxation is covered by the Tax Sections of the Fiscal Code and some other laws; hereinafter this edition refers to 'Tax Code' when addressing the Tax Sections of the Fiscal Code.

International taxation (TDT/TIEA)

Since June 2011, Panama's income tax treaty network includes more than ten countries, indeed twelve. Panama has completed income tax treaty negotiations with few more. Tax treaties already passed as laws by the National Assembly have demanded tax reforms and might request other changes in the coming future. Ahead, refer briefly to international taxation that characterizes the new Panamanian system.

As of 2010, Law 33 introduced an adequacy normative in order for Panama adjusts to tax treaties, such as:

- Arm's length principle is introduced in order to value operations made by taxpayers with related parties, in addition of methods for its application;
- Definition of related parties is introduced;
- Authorizes the Directorate General of Revenue in order to tax authority can oversight

- authorized operations to taxpayers;
- Scope of application of these provisions is delimited;
- Applicable specific treatment for services between related parties is also delimited;
- Simultaneous proofs and general principles of information and documentation are delimited;
- Concepts of permanent establishment and tax residence are introduced;
- This entire adequacy normative is applicable to tax treaties;

Income tax treaties

Panama currently has tax treaties in force with Mexico, Barbados, Spain, The Netherlands, Luxemburg, Qatar and Singapore. The treaties with Portugal, France and South Korea will be applicable from 2013. A treaty with Italy has been signed but it is pending ratification from the Italian government.

Basic principles in levying income taxes

On the grounds of the Constitution, taxes are not collected unless it is specifically stated by law. The Panamanian Tax Code adopts the territoriality principle and defines a taxpayer as any natural/individual person or legal entity (corporation or partnership), national or foreign, receiving or perceiving taxable or assessable income.

Territoriality principle

The Republic of Panama bases its income tax system on the territoriality principle, as opposed to worldwide taxation method used in most countries. This means that all income derived from local (or domestic) operations is subject to income tax while income arising from foreign sources is exempt. According to the territoriality principle, income produced in Panama or considered to be as Panamanian sourced is taxable regardless of the place the contracts are signed or even of the place where the amounts are paid.

Then, the tax regime is structured by the territoriality principle as governing rule of law whereby residents and nonresidents are taxed on Panamanian source income. Otherwise, income exempted or from foreign source is not taxed.

Taxpayer and taxable income

Article 694 of the Tax Code defines a taxpayer as: *"the individual or juridical person, either Panamanian or foreigner, who receives taxable income which is subject to income tax."* As taxpayers, rulings also add trusts (in Spanish *fideicomisos*) as well as all joint ventures or any entity perceiving assessable income; then, excluding non-profit organizations.

Taxable income is defined as income produced, from any source, within the Panamanian territory, regardless of the place where the income is perceived.

However, for the first time in the Panamanian legislation, a tax reform that passed on February 2005, established that income derived from any act or services provided outside of Panama is subject to income tax. This also applies when said income benefits individuals or corporations residing in Panama and are related to the generation or continuance of their Panamanian source income.

This utmost reform represented a modification of the previous understanding that income arising from any service or act rendered overseas was not considered Panamanian sourced.

Tax year

As general rule, the tax year runs from January 1 to December 31 each calendar year; otherwise needs to be authorized by the tax authority in different way.

Procedures to pay

Either by own filing or withholding by another person in charge, taxable income is triggered.

Gross income

Gross income is the total cash, in-kind and securities, received or accrued by a taxpayer in the tax year, minus refunds and discounts. Items to be included in gross income are provided by law.

Gross income includes:

- Personal labor rendered on behalf of another and in an economic employment relationship or legal subordination, in accordance with the Labor Code, such as wages, salaries, overtime payment, daily wages, director fees, gratuities, commissions, pensions, old-age retirement pensions, fees, representation allowances, bonuses, profit participation, productivity premiums, thirteen month bonus, in-kind income and subsidies, among others;
- Working in any professional field, performing artistic and scientific activities and other services carried out without an employment relationship;
- Commercial, industrial or financial activities; insurance, bonds, capitalization and communications;
- Transport activities, included international transportation on the part corresponding to freight, tickets, load and other services whose origin or destiny is the Republic of Panama;
- Operations on mining, construction and from rendering public or private services ;
- International telecommunication services rendered by enterprises established in Panama;
- Land and cattle activities, fish farms, poultry farms or forestry activities as defined on article 710 Tax Code;
- Hunting, and fishing;
- Disposal, transfer and leasing of real estate or personal property (goods); cession of rights and transfer of securities;
- Gains in the disposal, transfer and leasing of ships and airplanes, except those referred to the Panamanian register for international trade;
- Employment or investment of capital in any form or nature, such as interests on loans, certificates, bonds and private securities or profits;
- Subsidies paid periodically and life annuities;
- Rentals paid by way of contracts of financial leasing to which Law 7 of 1990 refers, and income derived from trusts formed on the basis of Law 1 of 1984;
- Temporary or final transfer of goodwill (“derechos de llave”), trademarks, invention patents, royalties and other similar rights;
- Obligations for not competing or abandon or stalled activities or rights;
- Increase of net wealth not justified by the taxpayer;
- Any gain or prize not exempt by law, obtained by luck and chance in entertainment or amusement activities, operated by persons under private law;
- Any revenue received in a compensatory manner, that is not exempt by law;

- Generally, any other activity not expressly exempted by the law, or that constitutes a business of production, purchase, sale, trade in, exchange or disposal of property, or derived from the rendering of personal services or generated by a combination of productive factors of capital and labor, or that is expressly taxable by provision of law.
- Rule of law: Article 2 of the Income Tax Regulation based on Article 696 of Tax Code.

Sources of income

According to the Tax Code, as previously said, a territorial system governs income taxation.

Regulations

Besides the territoriality general rule exposed above, the current Income Tax Regulation defines in more detail three different kinds of income sources that an individual or legal business entity may have. Refer to Executive Decree 170 of October 27, 1993 as amended lately. This regulation has punctually classified certain items of income as Panamanian (local), foreign and exempt income that will be briefly mentioned in order to clarify the rules.

Panamanian local income

Subject to tax in Panama, income from the following are considered Panamanian sourced. Rule: Article 9 of the Income Tax Regulation based on Article 694, Paragraph 1, of Tax Code.

- Generated from civil, commercial, industrial or similar activities; and from working in any professional field, other occupations and all services performed, carried out or fulfilled within the territory;
- Generated from international transportation activities on the part that corresponds to freight, passenger thickets, cargo and other services whose origin or destiny is Panama, regardless the place of incorporation or domicile;
- Personnel remunerations from those working within Panamanian territory regardless they work in free zones or entities receiving foreign source income;
- Personnel remunerations from those working at diplomatic or consular Panamanian missions;
- From real estate property located in Panama;
- Produced from goods or rights used economically in Panama and capitals and securities invested economically in Panama;
- Net income obtained by communication and telecommunication companies on the part that corresponds to the telephone calls and/or any other transmission or reception of images or sounds;
- Insurance companies (insurance and re-insurance operations covering domestic risks);
- All income received by natural/individual or juridical persons whose domicile is outside of Panama that arises from any service or action that benefit persons located in Panama is considered Panamanian source, including fees, copyrights, royalties, goodwill, trademarks, patents, know-how, industrial or commercial secrets. The amount should be considered as expense by the receptor of such services in Panama. When remitting, the amount of taxes to be withheld is based on one-half of the sum remitted at regular rates for legal entities and natural persons respectively (refer to articles 699 and 700 of the Tax Code).
- Within a free zone, transfers on securities, goods and real estate property at any concept, including rentals;

- k) When the final destiny is the Panamanian customs territory, all income received from storage, bond, internal moving of merchandise and cargo, invoicing, re-packing and the like, including commissions for services to entities or individuals established in any free zone;
- l) Any income not contemplated above that constitutes civil or natural yield, as long as obtained within Panama, either by the use of goods or the rendering of services.

Foreign source income

Income earned either from an activity or a transaction performed abroad is considered foreign source by Article 694, Paragraph 2°, of Tax Code that reads as follows: *“Any income arising from the following activities is not considered derived within the territory of the Republic of Panama”*. Refer ahead. These incomes are not Panamanian sources:

- (a) Income from invoicing sales, merchandises or products for amounts greater than billed costs from an office in Panama, provided that the merchandise or product does not enter Panama;
- (b) Income from directing transactions which are finished or produce effects outside of Panama from an office located within Panama;
- (c) Dividends and other profits distributions from legal entities that do not require notice of operation or do not generate taxable income, when such dividends or profits are paid out of income not produced in Panama, including income from activities mentioned in paragraphs (a) and (b).

Briefly, clarifying the rules for income tax purposes and according to Executive Decree 170 of 1993, income derived from the following activities is not considered income earned within Panama or derived from Panamanian sources; and therefore that income is not subject to income tax. Rule of law: Article 10 of the Income Tax Regulation based on Article 694, Paragraph 2, of Tax Code, as follows:

- a) Invoicing from an office in Panama the sale of merchandise or products for a sum, larger than the one invoiced to the office established in Panama, provided that such merchandise or products are only transferred abroad, or in transit through national ports or airports;
- b) To direct, from an office established in Panama, transactions that should be completed, consumed or taken place abroad. Bearers of a temporary visa as special visitor (TVSV) to work in Panama are here included as foreign source income;
- c) Rendering of services, outside the Panamanian territory, when they are not economically related to taxable activities that the taxpayer performs within the national territory;
- d) To distribute profits or dividends from legal entities that do not require notice of operation or key, permit, registry, license or any other authorization for operating in the Colon Free Zone or in any other free zone or do not generate taxable income in Panama, when such profits or dividends are derived from income not produced within Panama;
- e) Interests, financial commissions, and other similar receipts, obtained by an individual or legal entity, regardless of the place of their domicile (where they reside) or incorporation, derived from loans, cash deposits, or from any other financial transaction carried out with borrowers outside the country. The furnishing and the use of the cash, however, must take place outside of Panama, even if the reimbursement of the capital and interests is made in the country;
- f) Interests, financial commissions, and other similar receipts, derived from loans, credits, or from any other financial transaction carried out with legal entities, regardless of the place of their domicile (where they reside) or incorporation. It includes life annuities, old-age or sick retirement pensions or other similar revenues granted abroad as long as beneficiated persons

perceive exclusively non-taxable income within Panama, including here non-taxable income derived from interests, financial commissions and the like they might perceive;

- g) Income from freights, passenger tickets and passenger or cargo-in-transit services and income derived from maritime passenger tickets and other services obtained by cruisers enterprises as long as having Panama as home port (even though international transportation is taxed on the part corresponding to freight, tickets, cargo and other services whose origin or destiny is the Republic of Panama);
- h) Trusts ("fideicomisos"), established by Law 1 of 1984, in regards to properties abroad, cash deposited by an individual or legal entity, whose income is not of Panamanian source; stocks or securities of any kind, issued by companies whose income is not of Panamanian source, regardless if the cash, stocks or securities are deposited in the Republic of Panama;
- i) Rentals payments from leases that are paid to the lessor in the case of international financial leasing contracts, which is referred to in Law 7 of 1990;
- j) Premiums derived from insurance and reinsurance that cover personal or property risks abroad; and reinsurance premiums under cession to companies located abroad;
- k) The disposal of stocks and shares of legal entities formed, under the laws of the Republic of Panama, when the activities of such entities are carried out exclusively outside of the Panamanian territory;
- l) Payments to non-residents engaged in international business activities such as those related to hotels and car rental companies, ship and airplanes repairs, freights on the account of international ship agencies and international tourism operators as far as goods or services payments are financiered, contracted or executed abroad;
- m) International business activities as long as abroad operations are needed for generating income declared in Panama and goods and services payments are financiered, contracted or executed abroad;
- n) Cruisers operation by foreign persons on the profit of sales of passenger tickets, tourism excursions in Panama driven by third parties in Panama, marketing on board by companies established in Panama, services to their passengers meanwhile in waterways and ports, or payments received when disembarking on Panamanian ports.

Tax-exempt income

Following is a list of Panamanian-sourced income exempt from income tax:

- Income derived from freights, tickets and services to passenger or cargo in transit in the territory of Panama, as well as income from tickets and other services provided by cruise ship operators whose home port is Panama,
- Income from the embarkation, disembarkation or both, in a Panamanian port of passengers on boats crossing national waters, or through the Panama Canal,
- Income from the disposal of ships or airplanes registered in the National Merchant Marine or in the Panamanian Registry Office, engaged in international trade;
- Income from the operation of boats or airplanes registered in foreign countries, if the country in which said boats or airplanes are registered applies the principle of reciprocity, insofar as the taxation of income obtained in said country, by ships registered in the Panamanian Merchant Marine or airplanes of Panamanian registration;
- Income from the operation of ships or airplanes of any nationality, by foreign persons whether or not resident in the national territory, provided that the country of nationality of the individual or the country under whose laws the legal entity was formed, grants an equivalent exemption to individuals of Panamanian nationality, or to legal entities formed in

accordance with the laws of the Republic of Panama, or to persons who have established their domicile in the Republic of Panama, by virtue of the principle of reciprocity;

- Income from rentals from leases, derived from international financial leasing contracts, and from merchant ships or airplanes engaged in international maritime trade;
- Interests and commissions paid, or credited by banks established in Panama to international banking or financial institutions established abroad, for inter-banking loans and credit facilities;
- Interests paid on local or foreign saving accounts and time deposits maintained in banking institutions established in Panama;
- Interests paid to persons or corporations on loans to finance the construction of social interest housing units, as determined by the Ministry of Housing;
- Income from interest that national or foreign banks receive or accrue derived from loans granted to farmers in Panama, within the planting cycle. The proceeds from these loans are to be used in the planting of rice, corn, beans and sorghum, with an interest rate no greater than eight (8) percent per year;
- Income from interest, commissions, and other expenses that the Government, and autonomous public entities contracted, by reason of loans;
- Interests and commissions earned by banks, financial, or credit institutions on loans or other credit facilities, granted to the agricultural, livestock, or agricultural industry sector, provided that the requirements of the law are met;
- Prizes paid by national lotteries, or in raffles, bets and games of chance operated by the Government or by non-profit entities duly authorized by the Gaming Board of Control, and prizes obtained in contests or events held for publicity purposes;
- Sums received as compensation for labor accidents and insurance in general, alimony allowances, and benefits paid by the Social Security Agency;
- Income from sums received by individuals at the termination of an employment relationship, in concept of notices, seniority premium, indemnity, bonus and other benefits established in collective conventions and individual labor contracts, up to five thousand US dollars (US\$5,000);
- Pensions funds under Law 10 of 1993, when periodic sums are received by beneficiaries;
- Income from sums received or accrued by a person abroad from royalties paid by persons established in the Colon Free Zone;
- Properties received as inheritance, legacy, or donation;
- Income of individuals up to an amount of USD11,000.00;
- Any other income exempted by a special law.

The following persons are exempt from Income Tax:

- Individuals or corporations exempt from taxes as a result of public treaties or contracts with the Government;
- The State, Municipalities (including their associations), autonomous and semi-autonomous institutions State institutions;
- Churches of any religion, seminars and religious or charitable societies, when such income is obtained as a direct result of worship or charity;
- Nursing homes, orphanages, non-profit foundations and organizations duly recognized, provided that such income is destined exclusively to civic, enterprise and gremial activities, social assistance, public welfare, education, or promotion of sports. Such entities from two items above should be registered at tax authority;

- Salaries and fees paid to foreign personnel of diplomatic entities accredited in Panama;
- Salaries and fees paid to foreign personnel of consular corps accredited in Panama provided that the same treatment is given to Panamanian consulates abroad;
- Individuals or legal entities that possess such exemption due to public treaties or of contract authorized or approved by law;
- Foreign investors on interest they may receive, provided that the capital on which the interest is paid is invested exclusively in the construction of housing for persons of lower income, as determined by the Ministry of Housing. Foreign Governments or governmental institutions must guarantee the loan of the capital;
- State and private institutions dedicated to agricultural research, provided that these are non-profit in nature, for the sums donated to the development of their programs, and those institutions of research for the improvement of systems and technological transfer;
- Artists, or classical music groups, contracted by a non-profit organization registered at the National Institute of Culture (INAC). This organization must be involved in the promotion, execution and broadcasting of cultural, musical and artistic values and use the profit from such activities to meet their objectives. Prior authorization must be obtained from the Directorate General of Revenue, but only for a specified amount;
- Agricultural producers that have annual gross income of less than two hundred fifty thousand US dollars (US\$250,000). Certain restrictions apply for legal entities;
- Cooperative associations covered by Law 17 of 1997, provided that they comply with the requirements established by Executive Decree 137 of 2001;
- Industrial companies covered by Law 3 of 1986 provided that their total production is exported;
- Industrial companies covered by Law 3 of 1986 under certain other conditions;
- Tourism companies under the special tourist zone regime ruled by Law 8 of 1994;
- Micro, small and medium businesses, under certain conditions;
- Hydrocarbons companies under Law 8 of 1987;
- Free Trade Zones (formerly denominated "Export processing zones") governed by Law 25 of 1992 and Law 32 of 2011
- Any other person expressly exempted by a special law.

Stability of investments regime

Freedom of investment is allowed under the Panamanian Constitution such as private property acquisition. For foreigners, protection of property is not limited to measures found in the Constitution and other domestic laws. Foreigner investors' intellectual and industrial property is subject to the same regulations as national investors. The benefits and conditions of investing in Panama offered under international agreements and signed by the Panamanian authorities apply to national and international investors alike. Apart from bilateral trade agreements, Panama is also a signatory to the Multilateral Investment Guarantee Agreement (MIGA) for promoting and protecting investments.

Among other benefits, the stability of investments made in Panama is guaranteed by Law 54 of 1998 which defines investment, provides equal treatment for national and foreign investors, grants stability for direct taxes regime and guarantees repatriation of capital, dividends, interests, profits and capital gains.

The stability regime applies to investment activities within the Panamanian territory, such as: the tourism industry, agro-export, agro-forest, mining, export processing zones (now named free trade

zones), commercial and oil free zones, telecommunications, constructions, railroad and port developments, electric energy generation, distribution and transmission, irrigation projects and efficient use of hydro resources and other approved activities for improving technology.

The law for stability of investments (Law 54 of 1998) reads as follows:

- For investors, obligations include planning of investment of no less than two million US dollars (US\$2,000,000) and paying a fifty US dollar (US\$50) fee to get registered at the Minister of Commerce and Industries (MICI);
- Stability of direct taxes for a ten-year period is granted to any national or foreigner individual or corporation that meets the requirements; unless causes such as public interest presents conflicts;
- Indirect taxes are excluded from this regime (e.g. ITBMS or Panamanian VAT);
- Stability for local regime (municipal taxes) is granted for a five-year period;
- In case of legal dispute, conciliation and arbitral decisions are acceptable except for taxation disputes, which should be submitted to courts.

In 2007, Cabinet Decree 17 extended the stability regime to include the following activities:

- Hydrocarbons exploration and exploitation, as well as refinery, storage and transport of petroleum, its derivatives and natural gas;
- Production of alternative fuel energy;
- Activities engaged in research within the City of Knowledge, such as laboratories and specialized training centers.

Tax reforms

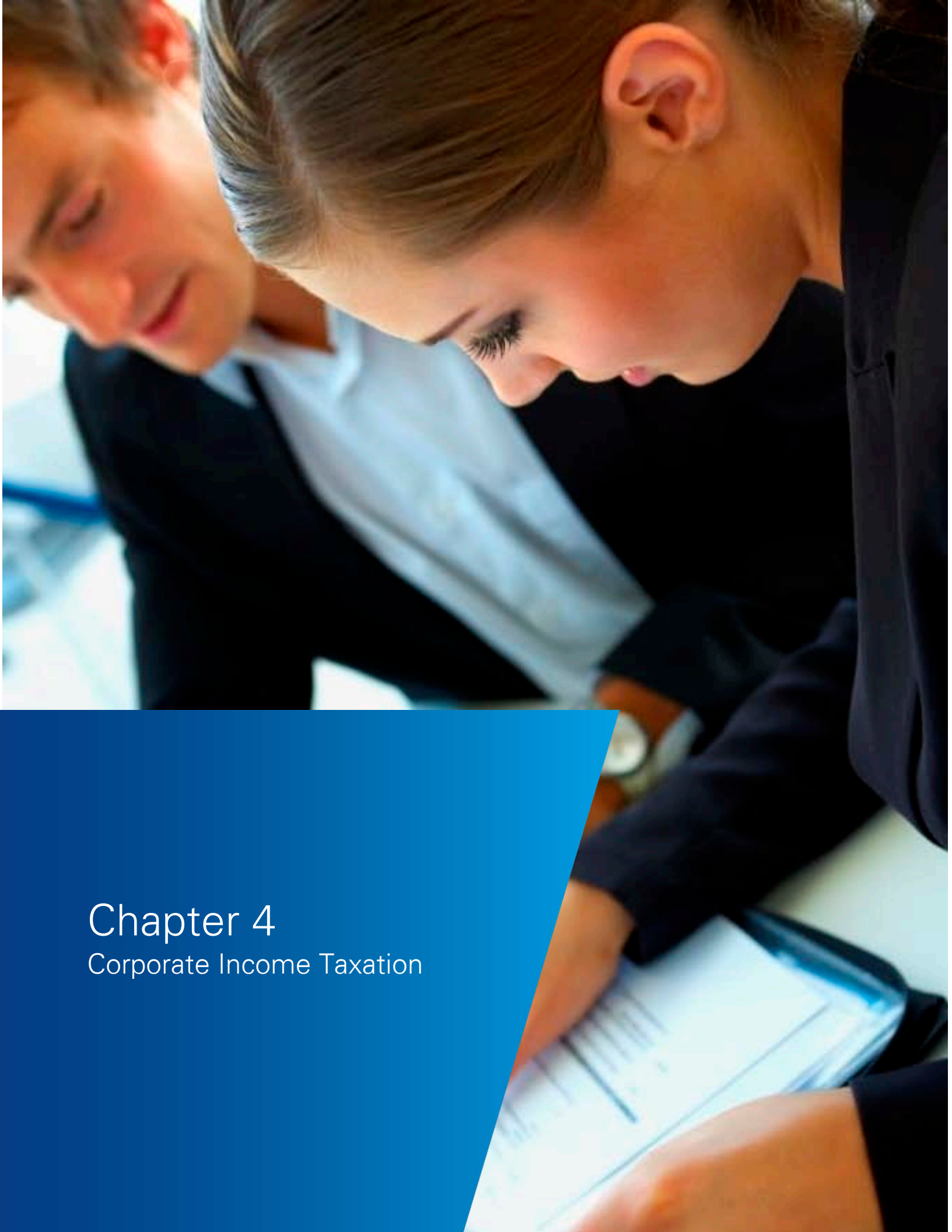
Panama's taxation system relies upon the beginning of the Republic when the first Fiscal Code was issued on 1916. Then the second one dated from 1956, effective today, several times amended: Law 8 of 1956. Chronologically decreasing, recently, on 2011, Panama approved Laws 72, 67, 32, 31 and 5; on 2010, Laws 8 and 33; and on 2009 approved Laws 49 and 69 modifying certain relevant taxation covered by Tax Code and other laws and adopting other fiscal measures, whereby the investment grade of the country has been partially attributed as one of the utmost factors for such recognition. On 2005, there had been approved Law 6 for implementing what was denominated then as an equal fiscal system that also covered tax issues of 2002 reform approved as measures for reorganization and simplification of the tax system.

Ultimately, there have been several minus reforms whose relevant matters are chronologically divided into two periods as follows:

- *From 1991 to 2001.* In 1991, the Tax Reform Act was approved;
- The provisions set forth in said law promoted tax justice by reducing tax rates and modernizing the tax administration;
- In 1995, another tax reform was enacted through the Tax Incentives Globalization Law, which introduced important changes to local income tax, even for the Colon Free Zone;
- On February 2000, a commission was appointed to analyze the process of modernization and simplification of the tax policy; the Inter American Development Bank (IDB) and the Inter American Centre for Tax Administrators (CIAT in Spanish) were involved as consultants;
- *From 2002 to 2011.* As a result of those reviews, there have been three tax reforms approved, firstly on December 2002 (Law 61), secondly on February 2005 (Law 6) and thirdly since September 2009 through December 2011 (Laws 49 and 69 of 2009, Law 8 of 2010 and some other laws during 2011) which have modified the taxation system in a substantial way; these tax

reforms have primarily reoriented the income tax system and caused indirect taxes.

- Law 6 of 2005 and its modifications had varied the tax regime not only on the concept of income tax as for the principle of territoriality but also on the methods of its calculation for both individuals and legal entities; mainly, items which had been introduced are as follows: number of days working in Panama, individual tax burden as per taxable income brackets, a new method for calculating income tax and social security threshold; other changes to tax system are in force since 2005, basically on administrative matters;
- During the last eight years (2005-2012), changes have been moving into new tax system considering not only different tax rates (progressive ones) but also the interpretation of the territoriality principle on the praxis.
- Since August 2009, a new tax reform was discussed at the National Assembly, and a moratorium was approved by Law 45 (August 5) of 2009. Law 49 of 2009 introduced changes to the taxation of dividends, real estate and capital gains as well as extended the scope of the Panamanian value added tax (ITBMS); Law 69 of 2009 introduced some other changes to withholding tax on dividends and remittances.
- On its side, Law 8 (March 15) of 2010 reduced income tax rates for both individual and corporations or legal entities effective on 1st January 2010, in addition of eliminating some individuals' deductible items; also introduced the one percent monthly advanced income tax for legal entities (instead of the estimated income tax) effective on 1st January 2011, introduced the concept of tax resident for individuals, introduced new rules for the income taxation on dividends, increased some indirect taxes rates (ITBMS and ISC) and created the Tax Administrative Court for Appeals independent of tax authorities and the Minister of Economy and Finances.
- Law 33 (June 30) of 2010, as referred at the beginning of this chapter, mainly introduced the adequacy for the international taxation in order the tax treaties could be adapted to the domestic rules and also made certain adjustments to the previous legal changes and tax authorities.
- During 2011, principal topics have been fiscal equipments and adjustments to income taxation on dividends.
- In 2012 a new reform modifies several provisions of the Fiscal Code, including those related to capital gains on the sale of securities and to dividends from preferred shares.

A photograph of two business professionals, a man and a woman, looking down at a document. The woman is in the foreground, her face partially visible in profile as she looks at the paper. The man is behind her, also looking at the document. They are both wearing business attire. The image is partially obscured by a blue geometric overlay in the bottom left corner.

Chapter 4

Corporate Income Taxation

Chapter 4

Corporate income taxation

Taxable income

Taxable income of corporations is the balance of gross income less deductible disbursements and expenses. Expenses and cost of doing business necessary to generate assessable income in Panama are deductible if they are adequately documented; and from 2010 if they comply with a formula of maximum limit to deduct (as it might be seen ahead on this chapter).

Tax rates

- Tax rates between 25 percent and 30 percent govern income taxation for legal entities.
- As a general rule, income tax for legal entities is at rate of 25 percent for 2011 and 27.5 percent for 2010. Therefore, legal entities such as corporations, branches and partnerships pay their income tax at these rates.
- On 2011 and so on, again, the general tax rate is 25 percent.
- Notwithstanding the general tax rates approved on 2010 (Law 8), certain activities are taxed at higher tax rates, gradually decreasing from 30 percent to 25 percent. These activities are power energy, telecommunications (except call centers), insurance, reinsurance, financial companies (ruled by Law 42 of 2001), production of cement/ concrete, gambling management, mining and banking, as follows: on 2010 and 2011, the tax rate remains at 30 percent; on 2012 and 2013, it decreases at 27.5 percent, and since 2014 the tax rate is 25 percent as the general one is from 2011. Subsidiaries and affiliates that have the same principal activity are taxed in such a way as well.
- However, those companies where the State participates as shareholder or partner with more than 40 percent of shares continue to be taxed at 30 percent as it was before 2010.

Methods for taxable income calculation

There are two mutually exclusive calculation methods for calculating the income tax payable by a taxpayer with gross income higher than one million five hundred US dollars (US\$1,500,000).

These methods operate by applying the general rate or the adequate one, according to both activity and tax year, to the greater of:

- The amount of the net taxable income (calculated under normal or conventional principles); or
- The net taxable income that arises after applying 4.67 percent to the total taxable income (defined as the amount resulting from deducting the exempt income and foreign source income from the total income), resulting in an effective tax rate of 1.4 percent;
- Deductions are only admitted for this second method of calculating income tax, based on legal presumption of revenues (known in Spanish as *cálculo alterno*, well known as per abbreviation "CAIR" even though this terminology has been eliminated by Law 8 of 2010).
- Micro, small and some medium enterprises (those that invoice up to US\$1,500,000) are exempt from applying the alternative calculation as individual persons are from 2010.

Alternative calculation method on income tax (highlights)

- For income from commissions, the calculation will be made on the total of the commissions.
- Enterprises that have included in their sales prices the tax on consumption of fuels and the selective consumption tax, are allowed to deduct from their total income the amounts of these two taxes to determine taxable income; hence, the alternative calculation.
- For taxpayers engaged in the importation, distribution and sale of certain fuel products such as 91 and 95 octane gasoline, LPG and diesel, the cost of acquisition of these products is also allowed to be deducted.
- If the legal entity incurs in tax losses, or if the effective income tax rate of the taxpayer exceeds the general rate percentage (or the applicable one), it can request the Directorate General of Revenue (DGI) for a non-application of the alternative calculation. The DGI can authorize the taxpayer to use the first option (traditional calculation instead of alternative, as determined by a formula provided by the law).

Monthly advanced sum on income tax (AMIR)

By virtue of Law 8 of 2010, all legal entity with few exceptions should pay an advanced sum on income tax in replacement of the estimated income tax. Due on monthly basis since January 2011, this AMIR (as per its acronym in Spanish) or 'MASIT' is equivalent to one percent of monthly taxable income and a return must be filed within the first twenty days of next month. Only agricultural and agro-industrial sectors might pay at a rate of 0.5 percent. Refer to Tax Code, Article 710. Tax credit from previous fiscal periods might be used for paying the AMIR.

Pecuniary penalties range between US\$1,000 and \$5,000 if compulsory filing is not provided; increased up to \$10,000 when repeated. Furthermore, when there is no taxable income, or only non-taxable income is perceived, it is understood that there is no filing obligation as well as for those whose annual taxable income is less than US\$36,000. Refer to Law 31 of 2011.

Deductible expenses for corporations or other legal entities

- Deductible expenses are those incurred in the generation of taxable income or in the maintenance of its source.
- Expenses incurred must be related to Panamanian source income.
- Consequently, expenses incurred to produce foreign source or tax exempt income are non-deductible. If the proportion that actually corresponds to each kind of income cannot be

determined, the expenses incurred to obtain both taxable and non-taxable income must be allocated in proportion to the ratio of taxable and non-taxable income. All expenses or disbursements must be supported by proper documentation in order to be deductible.

- Deductibility of expenses, originated between a corporation and its subsidiaries and affiliates, or its directors, officers, executives and shareholders, or their relatives within the fourth degree, and in-laws within the second degree, are restricted when both parties do not use the same accounting system.
- Expenses are only deductible in the tax year in which they are actually paid.
- Some of the more important deductible expenses are discussed in more detail below.

Bad debts

- A taxpayer may choose one of two methods for deducting bad debts: direct write off or through the creation of a reserve.
- In order to be considered a bad debt, an account must satisfy two requirements: first, it must be duly accounted for and be included as taxable income; and second, the debtor's insolvency or the statute of limitation of the debt must be proved.

Bonus and other extraordinary remuneration

- It is included as deductible expenses the profits that employers distribute among their workers, limiting the deductibility to one month of salary in those cases where the family relationship between the owner and the employee is within the fourth degree of consanguinity or the employee holds more than 15 percent of the shares of the enterprise.

Depreciation

Depreciation is determined by the economic useful life of assets. The minimum depreciation for movable goods is three years, and for immovable goods is 30 years. Depreciation must take into consideration the actual useful life of the assets, its maintenance and working schedules, among others.

Donations

Other deductible items are donations, as follows:

- Donations to non-profit educational and charitable institutions of Panama provided that these institutions have been previously approved for such purposes by the corresponding authority. The deductibility is limited to a maximum or top sum of one percent of the donor's gross taxable income. In the case of individuals, the limitation is established at a maximum of US\$50,000 for being considered as deductible sum;
- Donations to the central Government, its institutions, the Municipalities and the Community Boards.

Interest and royalties

- Interest and royalties are deductible expenses under general principles and are taxable income to the recipient.
- When payments are made to non-resident individuals, or corporate entities, the payer must withhold income tax at regular rates over 50 percent of remitted sum.
- Royalties paid by companies located in the Colon Free Zone to non-residents are not taxable and thus, not subject to withholding.

Labor benefits

Indemnities and other labor benefits are deductible to the extent that they are not covered by insurance.

Representation allowances

- Representation allowances are defined as expenses paid to employees who have to represent the firm at outside events, liaise with clients and entertainment provided for persons or entities linked to the taxpayer's regular activity.
- These expenses must be incurred for the production of taxable income in the normal course of business and as a necessary consequence.
- These expenses may be paid directly by the taxpayer, by means of reimbursement, or by allocation of fixed amounts to its employees.
- In the first two instances, expenses must be duly documented.
- When expenses are paid through fixed allocations, the amounts must be added to the receiver's gross income, and ten percent rate be withheld as definitive income tax.
- The amount of representation allowances received by an employee is subject to social security quotas like ordinary salary.

Salaries

- Salaries paid to employees are fully deductible.
- Contributions to private pension funds under trust according to Law 1 of 1984 are deductible on the portion up to 10 percent of the employee's annual gross income.
- In addition, employees might receive a US\$350 food voucher from the employer (deductible as expense) and not taken as in kind salary on behalf of the employee.
- Moreover, a special tax regime was established for entities hiring disabled or handicapped employees and youngsters taking into account that:
 - 1 Hiring people with physical disabilities allows the employer to deduct as expense 200 percent of the paid salary to the employee up to six months according to Law 1 of 1992;
 - 2 Tax benefit for the employer on the basis of first employment contracts to young people according to Law 12 of 2002.
 - 3 After the employer's taxable income is determined, it may deduct again the salary and labor benefits paid to youngsters between 18 and 25 years old hired for a one-year contract with the minimum wage established by regulations and not enrolled in the social security system. The number of first employment contracts to be authorized depends on employees' number of the enterprise.

Formula for maximum limit on deductions of expenses and costs

Maximum of Expenses and costs deductible = taxable income / total income

Special tax regimes

Several specifications on income tax are in force, and thus, some of the most relevant special regimes are briefly described below.

Agriculture and livestock

- Production expenses incurred in connection with a harvest may be deducted either in the fiscal year when it is incurred or paid, or it can be deferred and deducted in the fiscal year when crops

are sold.

- If a crop is sold in two or more different fiscal years, deferred production costs must be allocated on a prorated basis.
- Monthly advance sum on income tax (AMIR) does not apply to these sectors unless gross income is over \$250,000. 00.

Artists, performers, musicians, athletes and other professionals

The total revenue received by artistic groups, musicians, singers, athletes, and other professionals coming to the country is taxed at a 15 percent fixed rate.

Branches of foreign corporations

- For tax purposes, branches of foreign corporations established in the Republic of Panama must keep their accounting records for Panamanian operations separate from head offices or other branch records.
- Foreign corporation branches must withhold 10 percent of their total net income after taxes.
- This withholding is paid along with the annual income tax return.
- There are no special rules to levy taxes to branches of foreign corporations, and all general rules apply to them.
- Tax consolidation is not permitted.

Capital gains

- Capital gains are considered taxable income, except those arising from the sale of securities in companies registered with the National Securities Commission or issued by the Panamanian Government.
- Therefore, capital gains derived from the sale of either tangible property or securities are taxed at a 10 percent fixed rate.
- Capital gains resulting from the sale of real estate are subject to 10 percent rate as definite tax. This is a special tax rule discussed later in this chapter.
- .
- Notwithstanding the 10 percent definitive rate, the seller should pay an advanced three percent (3%) tax over the sales price and consider this advanced tax as definitive. This 3% is to be paid before the deed closure at the notary and registration of the deed at the Public Registry.

Civil partnerships

In the case of civil partnerships integrated by licensed professionals, the alternative calculation of income tax (CAIR) can be performed by the partnership in the format already described above or by partners based on the amounts of taxable income distributed as participation at the rate of six (6) percent.

On the other hand, the monthly advanced sum on income tax (AMIR) is due unless total distribution of profits did not take place the previous year.

Construction companies

Construction companies with operations covering more than one fiscal year may use the completed contract method, the percentage of completion method or a gross-margin method on payments received.

Cruise ships

Maritime tickets and services obtained by cruise ship enterprises are tax-exempt as long as they have Panama as home port, even though international transportation is taxed on the part corresponding to freight, tickets, cargo and other services whose origin or destiny is the Republic of Panama, as general rule.

Emergency system SUME 9-1-1

- A Special Fund, Sole System for the Management of Emergencies or SUME 9-1-1, has been created under the umbrella of a Patronage and Government and private representation on the grounds of Law 44 of 2007.
- In order to partially provide it with funds, the following services will be taxed on one percent of their invoicing:
 - 1 Commercial users/consumers of Local Basic Telecommunications (101, 102, 103);
 - 2 Corporate plans and small and medium enterprises plans as well as Government plans for the cellular telephony (106) and personal communications (107);
 - 3 Users with contracts for data transmission (208), commutation of data (209) and Internet (211).
- Concessionaires of such services become withholding agents in favor of the Patronage of the 911 System, and its revenues will be deposited quarterly by concessionaires to the National Bank of Panama, supervised by the Office of the General Controller of the Republic.

Film and audiovisual industry

- Promoting film studios and the like: Law 36 of 2007 grants incentives to film and audiovisual industry on the grounds of Law 25 of 1992 (Export Processing Zones).
- Enterprises in such areas should be exempt from direct and indirect taxes and the film producer must be registered at the Ministry of Commerce and Industries in order to obtain the incentives.

Free trade zones companies (Colon Free Zone and other ones)

- Defined as those in which sales are made from the free zone to clients outside Panama, including transfer of merchandise within the CFZ and Tocumen International Airport Free Zone or from one free zone to another, foreign or export and re-export operations are tax-exempt.
- Local, interior or domestic operations are those where sales are destined to the Republic of Panama.
- Profits arising from local operation sales are not subject to any special treatment.
- Companies operating from any free zone must separate the accounting systems of operations carried out abroad from local or domestic ones.
- Income tax on dividends is withheld whether the income from which the dividends are paid is generated in Panama although they come from a free trade zone company but at lower rate than general rate. Refer to *Withholding tax on dividends* at the end of this chapter.
- Special rules applied to petroleum free zones.
- Individuals working within a free zone pay income tax at regular rates as which is discussed in Chapter 5.

Hydrocarbons

- Enterprises under Law 8 of 1987 (hydrocarbons), signing contracts of exploration and exploitation, should be exempt from the payment of the income tax on the profits derived from their activities, during the first 15 years of production, or until they have recovered the total

initial investment, whichever occurs first.

- Subsequently, the contractor should pay 25 percent of the net production of hydrocarbons, in lieu of income tax and in substitution of any other tax or receipt to which it would be subject as a result of its operation.
- Payment, under this type of contract, should be retained by the State and included within the 50 percent that the State shall retain in accordance with article 47 of Law 8 of 1987.

Insurance companies

Insurance companies, regardless of their domicile or place of incorporation, are subject to income tax on income derived from risks located within the Republic of Panama, including life, accident, and health insurance for legal residents of Panama.

Interests, commissions and other charges on foreign financing

- Interests, commissions, and other financial charges credited or remitted abroad should pay income tax at regular rates (either for legal entities or individuals) over 50 percent of the remitted sum.
- The 50 percent from the total amount paid to the foreign creditor by the natural persons or legal entities that make the payment is therefore the taxable base.
- Consequently, remittance of payments is at 15 percent as effective rate for legal entities.

Interest on fixed-period bank accounts

Exempt on savings accounts.

Interest on registered securities

- Interest paid or credited by natural persons, or legal entities on debentures, bonds, financial instruments, mortgage documents or any other securities not registered with the National Securities Commission are taxable at ordinary rates.
- Except for interest paid by companies registered with the National Securities Commission which pays an income tax of five percent on the total of such interests which must be withheld by the corporation that pays or credits the interests.
- If the financial instruments were acquired through an organized stock exchange, the interest is tax exempted.

International transportation

- International transportation corporations are taxed, regardless of the place of incorporation or domicile, on the income obtained from freight, passengers, cargoes, and other similar services provided, if they originated in Panama, or whose destination is Panama. They are exempt when in transit.
- Then, the former rule of determining the taxable income referring the three percent of the total gross income is no longer applicable at the taxpayer's discretion.
- Exemption to this rule may be applicable due to article 708 of the Tax Code or by tax treaties. Airplanes, vessels engaged in international commerce.
- Income from the operation of cruise ships whose home port is Panama is exempt.

International telecommunications

Telecommunication companies are subject to an income tax rate of 27.5% at the moment, and will be subject to a 25% rate from January 1, 2014.

Loss carry forward

- Net operating losses for a given fiscal year can be carried forward to each of the next five taxable years, deducting a maximum of 20 percent of the loss per year.
- The deduction cannot reduce the net taxable income for that year, by more than 50 percent.
- Portions not deducted in the corresponding year cannot be carried forward to subsequent years, nor should they be subject to refund.
- Any compensation received for the losses (e.g. from insurance), must be reduced from the loss originally declared, and the taxpayer must present an amended tax return to make the necessary adjustments.
- The right to carry over is non-transferable among taxpayers, even in cases of acquisitions and mergers.

Maritime transportation companies

Although there are some exceptions, income generated by international maritime transportation companies from freights, tickets, cargo and other similar services is considered to be of Panamanian source, regardless of the place of incorporation of the company or of its domicile.

Mergers and acquisitions

Panama allows two types of mergers:

- By absorption ($A+B = A$), and
- By integration or creation of a new company ($A+B = C$).
- All acts, agreements and operation necessary in order to carry out a merger will be exempt from income tax, income tax on dividends, value-added tax (VAT/ITBMS), real estate transfer tax, and complementary tax, as long as the merger complies with the approved rules.
- Mergers that do not comply with the provisions should be considered, unless proven otherwise, as taxable operations.
- The merger agreement between the merging companies must comply with the provision of Law 32 of 1927, which regulates corporations, and for the merger to become effective, the agreement must be registered at the Public Registry.

Subway Agency contractors

Contractors of the agency for the construction of a city subway are benefited from tax exemption, on customs duties, VAT and selective consumption tax as states Law 62 of 2010 (modified by Law 72 of 2011). The exempted amount tax should be deducted from the contract value in order to Metro agency be credited.

Non-profit or non-governmental organizations (NGO)

As far as the NGO complies with its authorized purposes for being a non-profit organization, it is tax-exempt on income tax and might be benefited in order to its benefactors can deduct donations from their income tax returns. In this sense, the NGO should maintain a Web site where its donators appear.

Offshore Panamanian branch

- A foreign company has no impediment to generate or maintain local taxable income.

- This statement relies upon the territoriality system that applies in the Republic of Panama, which seeks to tax only income (regardless of the taxpayer's nationality) from a Panamanian source, unless otherwise expressly exempted.
- Therefore, a foreign company may not only generate and maintain local taxable profit, but also be registered as a legal entity at the Public Registry or not be registered.
- This applies even in situations where a foreign company is not registered because, on the grounds of the Tax Code, a foreign entity that provides services from abroad to a local taxpayer is subject to income tax in Panama over the component that relates to Panama (the half-part of the sum remitted).
- To constitute taxable profits, the main characteristics to identify are taxable events and whether it constitutes offshore operations from Panama.
- Thus, offshore operations from Panama are not taxed due to the expressed exemption stated in the Tax Code, article 694, paragraph 2°.
- On the contrary, a foreign company may perform or complete local operations subject to income tax.

Radio and television program producers and distributors

Radio and television program producing and distributing companies are taxed at a rate of six percent (withholding tax) over the total amount paid or credited by local distributors and television companies.

Real estate business

- Sellers of real estate must pay a two (2) percent tax for each transfer of property. Transfer tax is explained in more detail in Chapter 8.
- In addition to the transfer tax, capital gains are taxable as follows:
 - 1 Sellers of real estate property are subject to a capital gain special regime which establishes a special and reduced capital gain tax rate (10 percent rate). However, this is rather a nominal tax rate, due to the operations of a tax collection mechanism based on advance income tax payments, to be made before the registration of transfer of the property, as described in 2 and 3 below;
 - 2 When the seller ordinary course of business is not the sale of real estate, the applicable tax rate will be three (3) per cent. The rate shall be applied on whichever is higher between the value of the transfer and the cadastral value. The taxpayer may opt to consider the three percent advance tax as the definite capital gain tax;
 - 3 When the seller's ordinary course of business is the sale of real estate, the applicable progressive rate ranges between 0.5% and 4.5%. The rate shall be applied on whichever is higher between the value of the transfer and the cadastral value. The taxpayer may opt to consider the three percent advance tax as the definite capital gain tax.

Reinsurance companies

- Reinsurance companies are taxed on their income from Panamanian sources.
- Premiums and profits from reinsuring foreign risks are not subject to taxes.
- Reinsurance premiums paid by local insurance or reinsurance companies to foreigner reinsurance companies is considered foreign source income, and, therefore, non taxable.

Rental activities

- Gross income from rental activities includes rents received in either cash or in kind, and the value of improvements made by the tenant to the property, and left for the benefit of the landlord.
- Apartment building owners bear the burden of proof to show that apartments were not rented throughout the entire taxable year.

Sales of securities

- As per income tax and according to Law 18 of 2006, gains from sales of bonds, shares, and other securities issued by corporations, as well as those obtained from the sale of any other personal property, are taxable at ten (10) percent rate to be paid by the seller.
- The acquisition of the public stock offers is subject to the tax regime mentioned.
- As for the sale of securities, the buyer must withhold an advance of five (5) percent upon the sale value and remit it to tax authorities within a ten-day period after the due date. The entity which issues the securities is jointly responsible for the non-paid tax.
- The seller (taxpayer) may consider the advanced sum withheld by the buyer as definite income tax upon the capital gain, and a tax credit may be requested whenever the withholding amount is bigger than the income tax due.
- On the other hand, gains from the sale of shares, bonds, and other securities issued by companies registered at the National Securities Commission are exempted when such income is derived through a stock exchange or an organized market, or as the result of a corporate merger, consolidation or reorganization, as long as the shareholders receive other shares from the surviving corporation.

Withholding tax on dividends

- Companies that distribute taxable dividends must pay the tax withheld to the National Treasury within ten days following the withholding.
- The withholding tax is 10 percent in case of nominal shares and 20 percent in case of bearer shares.
- Therefore, corporations distributing dividends or profits to their shareholders must withhold 10 percent of such amounts, which corresponds to the income tax on dividends.
- If dividends or profits are not distributed, or the total dividends or profits distributed are less than 40 percent of the net income, a complementary tax must be withheld over 40 percent of the net income after taxes as advanced income tax on dividends; in other words, at a four percent rate over the total net income after taxes.
- The other six percent will be paid when such dividends or profits are actually distributed.
- Branches of foreign corporations must withhold and pay 10 percent of their total net income. The tax rate subject to withholding will be 20 percent if the stock of the corporation is issued in bearer form.
- In the case of a corporation with both types of stock, the tax must be paid according to the rates for each kind, unless the dividends distributed were less than 40 percent of the net profits.
- Also, if no distribution were made, the rules for the complementary tax will apply regardless of the type of stock.
- The distribution of profits of non-taxable or foreign source income is subject to a 5% dividend tax withholding.
- The distribution of earnings derived from export and re-export sales (exterior operations) from companies established in the Colon Free Zone is subject to the same 5% rate mentioned in the

previous bullet point. The distribution of earnings derived from internal sales of these companies in the Republic of Panama is subject to income tax on dividends.

- Loans or credits granted to shareholders and reduction of social capital for legal entities are considered to be implicit distributions of profits..
- Loans or credits granted to shareholders are subject to ten (10) percent withholding tax, whether or not they are granted by a legal entity under reduced five (5) percent rate such as Colon Free Zone or Oil Free Zone.
- Reduction of capital is admitted only when undistributed profits are totally distributed and tax is paid. Otherwise, an implicit distribution of profits might be determined by tax authority.
- Preferred shares are subject to tax exemption on dividends if those shares have been paid in cash among other conditions.

Withholding tax on remittances

On the other hand, for services and acts perfected and provided within the Panamanian territory, the withholding tax also applies on the half amount paid to the non-resident beneficiary instead of the full amount.

Notwithstanding the withholding general rule, the reform 2010 introduced the requirement of non-registration of the foreign beneficiary as taxpayer before the Directorate General of Revenue in order for the payer to withhold income tax. Otherwise, if such beneficiary abroad is registered before the tax authority as taxpayer, the withholding does not proceed and the registered beneficiary must file income tax return in Panama.



Chapter 5

Income Taxation of
Individuals

Chapter 5

Income taxation of individuals

Taxable income

Taxable income of individuals is determined under different rules applicable to corporations and legal entities but based on the territoriality principle as well.

Tax rates

From 2010, new progressive tax rates are applied to individuals; and they vary between 25 percent and 10 percent according to gross income and category of income.

- Firstly, the maximum income tax rate for taxpayers is 25 percent on the excess of fifty thousand US dollars (US\$50,000). Then, on the grounds of progressive tax rates of 15% and 25%, individuals are taxed depending on their gross income between US\$11,000 and US\$50,000 by 15% and then by 25%, as shown on charts ahead in this chapter.
- Secondly, representation allowances are taxed separately on progressive tax rates of 10% up to US\$25,000 and then 15% on the excess.
- Thirdly, additionally, the total calculation will constitute the estimated tax for next year.
- In the case of merchants, organized as legal entities, they will apply the alternative calculation established for legal entities.

Exemptions

Citizens, residents and non-residents are not taxed on exempt income. Thus, they are only taxed on income earned from Panamanian sources.

- The Tax Code added, to the exemptions of income tax, the amounts received from pension and retirement funds in accordance with Law 10 of 1993 when individual begin to receive periodic payments.
- There is tax exemption on gross annual income of US\$150,000 or less for persons dedicated to agriculture and cattle activities.
- The amounts received by an employee from retirement and pension funds are exempt, as long as the labor termination arises from a retirement or indefinite withdrawal of the employee.

Individual tax burden

According to Panamanian tax law, only Panamanian-sourced income is taxable.

Despite the territoriality basis of the Panama's tax regime, special rules have been established to bring into the tax net the following:

- Income arising from the exercise of professions, occupations and all kind of performances of services by individuals within the territory whenever the taxpayer receiving income has remained consecutively or alternatively in Panama.
- Panamanian income is determined by the physical presence of the individual in the country for generating taxable income or its maintenance regardless of the place where the compensation is paid or where the contract is signed.
- Tax resident is defined under the rule of 183-day per year.
- As for the 183-day threshold applied to expatriates taxpayers working in Panama, the payment related to Panamanian-sourced income is subject to the individual's progressive rates up to 25 percent over the net taxable income; however, educational tax and social security contributions are withheld over gross remunerations.
- Filing is not required if the individual has only one-sourced withholding income and has the proper amount withheld from employer even though she/he is paid on salary and representation allowances.

Foreigners working temporarily in Panama

- All foreigners who remain in Panama for 183 days or more in a calendar year, either in a continuous or non-continuous form, are considered as tax residents for income tax purposes, regardless of their immigration status. And they are subject to the payment of income tax as regular taxpayers.
- If the individual remain less than 183 days in the calendar year, they are taxed at the 15 percent preferential fixed rate on gross income with no right to deductions, plus educational tax at 2.75 percent rate and social security contribution.
- For periods longer than the 183-day threshold, individuals must pay net income tax according to the regular progressive tax rates (see chart ahead) as resident taxpayers.

Regime of individuals: variable scenarios

- A local employee is neither tax-exempt nor classified due to onshore or offshore activities from Panama.
- Panamanian, local workers or employees are not tax-exempt. They are taxable on any amount perceived/received for her/his work in Panama, and the company is not exempted from social charges.
- As for foreign citizens adopting temporary residency in Panama, in case of individuals working on offshore activities, a special exemption regime may apply, as long as the following conditions are met:
 - 1 The foreign citizen holds a special temporary visitor visa to work in Panama or the bearer of a visa for permanent personnel of a Multinational Enterprise Headquarters (or SEM, as per its acronym in Spanish) company ; and,

- 2 The foreign citizen is paid directly by her/his parent company abroad. Otherwise, if she/he is paid locally by a branch or subsidiary (for instance), although working for offshore activities, she/he will be taxable for income tax, educational tax and social security.

Note: The special exemption regime does not apply to foreign citizens working in activities related with local projects or local businesses carried out within Panamanian territory. These foreign citizens will be subject to the same rules as local employees.

In kind income

As a general rule, in kind benefits arising from services performed in Panama are fully taxable when provided under a labor relationship and the benefits are related to generate taxable income in Panama.

Taxable benefits

- Food and fuel allowances;
- Club memberships and subscriptions to publications;
- Car for personal use;
- School tuition and educational allowances;
- Housing and utilities allowances;
- Personal debt payments;
- Insurance premiums;
- Non-business mobile phone;
- Clothing allowances;
- Reimbursements of taxes; and
- International service premiums.

Housing allowances and the imputed value of housing directly provided by the employer are fully taxable. The imputed value is determined by the market price (which is normally the cost charged for the housing). Where the employer bears the costs of utilities (e.g., water, electricity and others), this creates an additional income tax. Social security contributions are also payable on housing benefits.

In kind tax-exempt income

Moreover, special tax treatments are available for certain benefits. The following items are not considered payments in kind of the employee:

- Stock option plans;
- Business meals;
- Contributions to pension funds;
- Benefits granted as a general basis to employees;
- Transportation provided for business purposes;
- Quota to business or professional organizations;
- Training and education related to the business;
- Insurance premiums such as life and health insurance, pensions and employee's automobile insurance when vehicle is not payment in kind;
- Reimbursements of business expenses;
- Travel allowances related to the business except for vacations; and,
- Business mobile phone.

CHART OF SALARIES IN KIND

HEADING	INCOME TAX	SOCIAL SECURITY
Food		
Private clubs	Subscriptions to various publications as well	
Fuel		Over 20% of the salary or over US\$ 450.00 monthly
Education	No impact on the generation or retention of income	
Room or main dwelling or recreation	100% of the amount: <ul style="list-style-type: none"> • of depreciation or; • financing or; • rent paid 	Rent at market value
Insurance premiums		
Basic services for residential use (electricity, telephone, water, other)		
Cellular telephone		Services for Families
Taxes		
Vehicle for personal use	Seventy percent (70%): <ul style="list-style-type: none"> • of the depreciation or; • the monthly finance charge or; • the amount of rent; Will be counted as wages provided that the employer will deduct the cost	Seventy percent (70%): <ul style="list-style-type: none"> • of the depreciation (straight line method over 5 years); • of the value of the bill for monthly lease
Vehicles - maintenance and repair	All	70% of the amount of repairs
Clothes		

Per the approved regulations, the following segments are not considered in kind salaries:

CHART OF NOT CONSIDERED IN KIND SALARIES		
HEADING	INCOME TAX	SOCIAL SECURITY
Stock option plans		
Food	<ul style="list-style-type: none"> • Meal vouchers; • Business Dining; • Transfer from the workplace 	<ul style="list-style-type: none"> • Meal vouchers; • Business Dining; • Travelling allowance
Contributions to pension funds and retirement plans		
Benefits provided by collective agreements or the community		
Fuel and transportation	Sums of money for drivers, salesperson, interns and messengers	<ul style="list-style-type: none"> • Less than 20% of the salary or B/. 450.00 monthly; • Payments for reimbursement; • Direct purchase from a supplier
Contributions	Guild related activity in the company	Business associations and related unions
Education	<ul style="list-style-type: none"> • Collective agreements; • Arrangements for equitable access of no less than 70% of employees; • Academic merits of children; • Scarce resources; • Disabled children; • Job related incident; • Overcoming/conquering 	<ul style="list-style-type: none"> • Collective agreements; • Arrangements for equitable access of no less than 70% of employees; • Academic merits of children; • Scarce resources; • Disabled children; • Job related incident; • Overcoming /Conquering
Employer's obligations under the labor code		
Insurance premiums	Policies <ul style="list-style-type: none"> • Life; Health; Pensions; • Liability coverage of the employee or the employee's vehicle when such vehicle is not salary in kind 	Policies <ul style="list-style-type: none"> • Life; Health; Pensions; • Liability coverage of the employee or the employee's vehicle when such vehicle is not salary in kind
Reimbursements	Responsibilities of the company covered by the employee or per diem coverage	

Cellular telephones	Purchase of a mobile device and its service	Service for a mobile unit
Free transportation		
Employer vehicles	Use within office hours	
Vehicles - maintenance and repair	Maintenance payment for vehicle when it is a hiring requirement	
Clothes	Work uniforms	Uniforms or special clothing
Travel allowance	Lump sum which are not readily available to employees (travel, food and/or lodging in or outside the country)	Traveling and meal expenses due to job related expenses
Housing	For collective use by staff	<ul style="list-style-type: none"> • Labor law and the labor codes; • Farming activities; • Houses of recreation for collective use among employees

Fuel

- Referring to fuel, it considered as in-kind salary. However, when the fuel allowances are granted to certain employees (such as drivers, messengers, salesmen and the like), these amounts will not be considered as in-kind salary.

Deductions and non-deductible expenses

Basic rules are set out below.

Deductions

Taxpayers are entitled to the following deductions from taxable income:

- Married couples filing jointly - US\$800 annually;
- All medical expenses incurred within Panama, if duly substantiated, such as medical insurance premiums and the sums paid for hospital and medical expenses not covered by insurance;
- Interest paid on mortgage loans for acquiring, constructing, or improving the principal dwelling of the taxpayer in the Republic of Panama, up to a maximum of US\$15,000 per year;
- Interest on loans for the education of the taxpayer or her/his dependents in the Republic of Panama, or on loans granted by the Institute for Education and Improvement of Human Resources (IFARHU), a governmental entity;
- Donations to qualified institutions (according to legal amount limits);
- Dues paid to non-profit organizations, associations, or societies;
- A deduction of one percent of the total sum received by workers as a result of terminating the labor relationship, for each completed period of twelve (12) months (with the same employer), plus a basic deduction on the first US\$5,000 of the balance. The sums received by this means must not be added to the salary or any other kind of income of the taxpayer for tax purposes.

Non-deductible expenses

The following items are not considered as expenses or disbursements incurred in the generation of

income or in the maintenance of its source; and they are therefore non-deductible expenses:

- Personal expenses for the taxpayer and her/his family subsistence;
- Expenses incurred in construction works or improvements made to increase the value of any personal or real property when such construction works or improvements are subject to depreciation or amortization;
- Prior year expenses;
- Amounts paid for recreational trips, festivities, entertainment and donations (except for advertisement and announcements);
- Any other expenses that although deductible cannot be verified satisfactorily when requested by the Directorate General of Revenue.

Tax rates

The first US\$11,000 of an individual's net taxable income is exempt from income tax. Income over US\$11,000 is taxed on progressive rates over the total net taxable income as follows.

CHART OF NET TAXABLE INCOME			
Taxable income		Tax on (US\$) over column I	Percentage (%) over excess of column I
From (Column I)	To		
0	11,000	0	0
11,000	50,000	0	15
50,000	and above	5,850	25

CHART OF REPRESENTATION ALLOWANCES			
Taxable income		Tax on (US\$) over column I	Percentage (%) over excess of column I
From (Column I)	To		
0	25,000	0	10
25,000	and above	2,500	25

Withholding regime of individuals

The individual tax burden has a progressive rate structure, and the income tax is withheld by employer from employee's salary and wages, including payments in cash and in kind.

Withholding of taxes (specific rules)

- Tax on any type of income paid to employees must be withheld by the employer.
- Withholding agents that do not withhold taxes or do not remit the amounts withheld to the Treasury cannot claim as deductible the payments that generated the obligation to withhold,

except if the tax is paid during the same fiscal period.

- Income tax must be withheld from payments to all employed personnel, from distributed dividends and from payments to non-residents in accordance with the following rules below.

Salary withholding

Every employer is responsible for withholding income tax from the salaries and other remunerations paid to employees according to charts prepared by the tax authorities.

- Each employee must present her/his employer a declaration of personal deductions.
- The employer must withhold the corresponding taxes for workers hired.
- Employees who receive salaries from more than one employer at the same time or obtain taxable income from other sources, except for dividends, which have been subject to dividend tax withholdings, must file a personal income tax return.
- Amounts withheld must be paid to the National Treasury, through the Social Security monthly payroll, within the first seven days of every month.
- For individuals it is included, as subject to withholding at source, the payments for professional services under the labor relationship.
- Representation allowances are subject to a 10 percent and 15 percent definitive withholding tax.

Withholding of taxes for non-residents

Every company remitting payments or credits on the account of persons abroad regarding taxable income must withhold, at the time of paying or crediting these sums, the corresponding taxes.

- Regular and progressive rates up to 25 percent (as stated before in case of individuals) are applied upon 50 percent of payment remitted.
- The beneficiated from services deducts the payment or sum remitted from its taxable income.

Provision of services

For services provided abroad, an individual will be taxed only on services that benefit a resident taxpayer who becomes the withholding agent of the income tax, applied on a tax basis which equals half of the amount remitted abroad.

- Here we are faced with a legal fiction extension of the territoriality principle, referring to what the Tax Code considers Panamanian source income.
- Two conditions are requested for taxation purposes:
 - 1 Deduction of the expense by the local taxpayer beneficiated by those actions or services;
 - 2 Related to the generation or continuance of Panamanian source income.

Expatriates taxation

- The tax status of expatriate workers not only depends from the offshore activity classification - but it also depends on the authorized work permit and special temporary visitor visa for performing, as employees, offshore activities only.
- A nonresident worker without an employee status is subject to both: income tax over gross income at a fixed rate (not progressive) and educational tax. In addition, social security might be quoted.

Expatriates special status

- Since 2005, the Income Tax Ruling (Executive Decree 170 of 1993 as amended) exempts expatriates (on an individual basis) who fulfill the requirements listed below.

- Thus, an expatriate is not taxable as long as she/he works only for offshore activities from Panama, under the following premises:
 - 1 He is the bearer of a Special Temporary Visitor's Visa to work in Panama; and
 - 2 He is paid directly by her/his parent company from abroad.
- If an expatriate is paid locally by a branch or subsidiary (for instance), although working on offshore activities, she/he will be taxable for income and educational tax.
- Bearers of a Special Temporary Visitor's Visa are entitled to an income tax exemption if such bearers are paid from abroad.
- Thus, in case of working for offshore activities, a foreign citizen is taxable if she/he is paid locally and not directly from a parent company abroad. Otherwise, individual taxation may be exempted.
- The Social Security Authority expressly acknowledges that, generally, any international executive with such special visa is not required to participate in the Panamanian social security system, and her/his employer should not make withholdings from salary for social contribution.
- Immigration provisions do not address the social security status; it is rather governed by its own rule (Resolution of Affiliation).

We can then conclude that:

- The tax status of an expatriate worker depends on the offshore activity classification of the company, on the kind of visa as well as whether the expatriate is being paid from abroad or locally;
- In order to take advantage of the exemptions granted for holders of a Special Temporary Visitor's Visa, employees must be paid from abroad (by a parent company or headquarters) and be exclusively engaged in offshore business activities in Panama;
- These conditions provide the tax-exempt status for foreigner individuals working in Panama;
- In this sense, any local activity or internal sales must be separated from the company requesting work permits and also in charge of payroll;
- Social security matter may be exempt on the basis of the Temporary Visa as a Special Visitor but the employee must also be paid from offshore and be hired by a company only engaged in offshore business.
- It is expressly included in gross income an individual use of vehicles, houses, representation allowances, and employee's family educational expenses, as well as leisure travels and similar remunerations for personal services under the labor relationship.

Tax resident

In this sense, the tax resident is an individual who remains consecutively or alternatively in Panama at least 183 days per calendar year.



Chapter 6

ITBMS

Chapter 6

ITBMS

Tax on the transfer of tangible personal goods and rendering of services (ITBMS)

The ITBMS is a value added tax (VAT), referred to as ITBMS herein.

In general, all transactions involving the transfer of tangible personal property (commodities and products) and services are subject to the ITBMS. The tax base of ITBMS has been expanded since April 2003. Effective on February 3, 2005, Law 6 introduced some amendments to the tax; and effective on September 18, 2009, Law 49 newly modified its angle of coverages, also spread with Laws 8 and 33 of 2010 (both effective on July 1).

Transactions

Transactions subject to ITBMS include:

- a) Transfer of movable goods, such as:
 - The sale or contract involving ownership exchange;
 - The personal use of corporate or non-corporate property by the owner, partner, directors, legal representatives, board of directors or shareholders;
 - The contracts of sale promise;
 - The adjudications to the owner, partners or shareholders as a result of definitive closure of the enterprise;
- b) Provision of services:
 - Works with or without the delivery of materials;
 - Intermediation in general;
 - Personal use by the owner, partners, directors, legal representatives, board members or shareholders of an enterprise;
 - The rental of real property and tangible property or any other convention or act that implies or is intended to give the use or enjoyment of the property.

And,

c) Importation of tangible goods or merchandise used either for personal consumption, charity, educative, scientific or commercial purposes or for the transformation, improvement or production of other goods and furthermore for other legal objectives.

Collectors and taxpayers

Individuals or entities providing professional services and sellers, including State-owned industrial and commercial enterprises are liable for the collection and payment of this tax, which must be paid either monthly or quarterly, depending on the gross monthly income of the seller. Independent or self-employed professionals are advised to pay it quarterly. Penalties as well as interests are assessed for late payments.

There are two different types of taxpayers:

- Taxpayers class one, with an average monthly gross income over US\$5,000 and which are required to file their ITBMS tax returns on a monthly basis;
- Taxpayers class two, with an average monthly gross income over US\$3,000 but under US\$5,000, and which must file their ITBMS tax returns on a quarterly basis.
- A gross annual income not higher than US\$36,000 inhibits the taxpayer condition.

In the case of domestic supplies, the amount of tax due under ITBMS to the Directorate General of Revenue must be remitted within 15 days after the close of the filing period for each type of taxpayer. As for imports, the tax is due within three (3) days after the filing of customs declaration.

Tax rates

Since July 1, 2010, the tax rate is seven (7) percent of the amount of the professional fees or of the value of the transfer of personal property or commodities, except for the import, wholesale, and retail sale of alcoholic beverages which carries a ten (10) percent tax rate. Additionally, the import, wholesale, and retail of all kinds of cigars carries a fifteen (15) percent tax rate (see chart); the tax base increased to include all kinds of cigars or tobacco products in addition to cigarettes.

Moreover, an addition was made to indicate that an amount of the tax collection will be for the benefit of the National Oncological Hospital Institute.

CHART OF ITBMS RATES

ZERO	7% Regular rate	10%	15%
Medicines Food Books	Goods Services	Alcoholic beverages Public hostelry	Tobacco products

Exemptions

Exemptions from this tax include:

- The import and transfer of food and medical and pharmaceutical products as specified;
- The export or re-export of goods;
- Goods transferred within the free zones such as Colon Free Zone and others when made through negotiable documents;
- Newspapers, books and scholar supplies;
- Negotiable documents and securities;
- Financial lease contracts under Law 7 of 1990 are considered financial contracts, and as such, are not taxed with the ITBMS.
- Transfers of fuel oil, jet fuel or turbo fuel except by lubricants.
- Expropriation, sales and rendering of services made by the State, except for those made by its industrial, commercial and financing entities (e.g. Banco Nacional, Caja de Ahorros, Banco Hipotecario).

The ITBMS is a major source of income for the Government, along with the income tax and import duties – it works as a value added tax (VAT). It is applicable to every transfer of products, until it reaches its final destination. The tax base is the price of the product, including the value of any additional service furnished along with the merchandise, such as transportation, freight, and interests for financing.

However, the seller will deduct from the tax received the ITBMS previously paid by the seller, remitting to the Treasury only that portion of the tax sum that corresponds to the value added to the product. This tax may be considered a tax levied on consumption, since it is the consumer who finally assumes its total impact.

The ITBMS is not only applicable to supplies of goods transferred but also services provided within the territory. Since 2005, its tax base has been expanded to cover new services but delimiting exclusions such as retail sales of food on canteens not offering alcoholic beverages.

Up-to-date, the following services provided are excluded from ITBMS:

- Services related to the health of human beings;
- Rental or sub-rental of real property with exclusive purpose of being the house or room of the person who leases it for a period bigger than six (6) months;
- Services associated with education or educative entities;
- Loans from the State;
- Transportation except by passenger airplane tickets;
- Electric energy;
- Fixed-line telecommunication (telephone);
- Media (social communication) except for the grant of advertising space;
- Mail provided by the State;
- Gambling in casinos and racetracks;
- Insurance and reinsurance;
- Export services;
- Internet access service provided to residential households and educational entities recognized by the Ministry of Education;

- Sewer system and garbage recollection;
- Stock-exchange activities;
- Retail sales of food in commercial premises in which no alcoholic beverages are sold;
- The payments, including interest paid and received, arising from financial services, performed by entities duly authorized for rendering such services except by commissions unless those commissions charged for credit facilities;
- Load operations, logistic and auxiliary services rendered to load within ports and special economic zones; as well as repair, maintenance and cleaning services to vessels in transit within national waters.
- Sportive public spectacles when a registered non-profit organization is in charge.
- Services provided by persons who during the last year had an average gross monthly income not higher than US\$3,000 and a gross annual income not higher than US\$36,000;
- Services based on a labor dependency relationship, as defined in article 62 of the Labor Code, as well as the activities of directors, managers and administrators.
- Professional services that are performed to persons domiciled abroad who do not generate taxable income in Panama, as well as legal services provided to international commerce vessels;
- Services as registered or resident agent (lawyers);
- Public shows and spectacles, such as seminars, conferences, speeches, artistic, musical, sportive or professional performances;
- Passenger airplane tickets, either domestic or international;
- Commissions charged by persons engaged on sales of goods and real estate.



Chapter 7

Other relevant taxes

Chapter 7

Other relevant taxes

Selective consumption tax (SCT)

A selective consumption tax (ISC as per its abbreviation in Spanish) was introduced in 2005. This is basically an excise tax on the importation of specific goods (such as luxury vehicles, motorcycles, jewelry, and firearms), alcoholic beverages/liquors and all tobacco derivative goods (cigarettes and cigars) or on the first transfer or sale by local manufacturers of these products (such as sodas, wines, and beers). The ITBMS (VAT) is excluded from the tax base of SCT.

The following goods and services are subject to this tax:

- Automobiles with a CIF value of over US\$8,000.00 (some exceptions apply);
- Motorcycles with engines over 125cc, outboard motors larger than 75 horse power (HP), yachts, sail boats, ships and recreational or sport boats, jet-skies, vessels and aircrafts of non-commercial use, and helicopters;
- Jewelry and firearms
- Cable, microwave and satellite television services;
- Mobile telephone service, except for prepaid mobile phone service;
- Prizes over US\$300 won in slot machines of private enterprises dedicated to activities of luck and chances. The rate in this case is established at seven percent;
- Taxpayers are the manufacturer or the importer of the product or the individual or company that carries out the above mentioned services;
- Taxpayers must charge the tax and remit the sums collected to the National Treasury within the first 15 days after the end of the filing period and within three days after customs declaration has been filed, in the case of imports;
- The tax base is the price agreed for the goods or services. In the case of imports, the tax base is the CIF value plus of all import duties.
- The SCT is based on Law 45 of 1995.

Operation notice (license tax)

- An annual tax is levied, based on the net worth of the company at a rate of two (2) percent with minimum and maximum sums, as stated in the income tax return. Net worth is understood as the difference between total assets and total passive. Refer to Article 1004 of Tax Code and Executive Decree 539 of 2011.
- As antecedent, except for those operating in the Colon Free Zone and other special economic areas (refer below), all individuals or firms engaging in commercial or industrial activities (either manufacturing or construction) are required to obtain a business license called operation notice (*aviso de operación*) on the grounds of Law 5 of 2007 (as described in Chapter 2), and pay tax on net assets.
- Then, the annual tax is based on the net assets of the entity, which is equivalent to two (2) percent of the net assets and ranges from a minimum amount of US\$100 up to a maximum of US\$60,000 on regular basis.
- Amounts due to foreign head office or affiliated companies are expressly excluded from the tax base, and they should not be considered on the formula for calculating the total passive of such a local company.
- Executive Decree 539 of 2011 states tax-exemption for those persons engaged on less than \$10,000 invested capital.
- On the contrary and on the grounds of exceptional commercial basis, the notice of operation is not required for those operating within free zones but the tax is levied anyhow with different extreme sums. This type of taxation is addressed to those operating in the Colon Free Zone and other free trade zones which are called to pay at one percent of net assets, from minimum US\$100 to maximum US\$50,000.
- Total exemption: Special economic areas, e.g. Multinational Enterprises Headquarters (SEM, as per its acronym in Spanish), and entities operating under special regimes referring to international awards for contractor selection such as Panama-Pacific Special Economic Area (PPSEA or Howard) are not called for this taxation.

Educational insurance tax

- Both employees and employers must pay a tax assigned for educational purposes. Employers must deduct 1.25 percent from their employees' salaries, and pay an additional 1.50 percent.
- Self-employed individuals must pay the total 2.75 percent of their annual income subject to income tax.
- Non-resident taxpayers performing services in Panama are also subject to the tax.
- This tax is deductible from taxable income for both employees and employers.
- Withholdings are paid on a monthly basis to the Social Security Administration together with social security contributions and income tax.
- Individuals must add real estate sales in order to calculate the educational tax on their income tax return.

Stamp tax

- In Panama, official or stamped paper costs eight US dollars (US\$8) per page and it must be used for administrative petitions, certificates, and notarized documents.
- Commercial papers and documents, such as contracts, checks and other negotiable documents must pay stamp tax by submitting a declaration form within 15 days after the end of the month following the transaction or by other authorized mechanism.

- The amount of stamp tax depends on the value of the document, and on whether the document is a check, negotiable instrument, landing permit, bill of lading, or any other document.
- Contracts and documents must be taxed at a rate of ten (10) cents for each US\$100 of the value stated in the document.
- Receipts of money, bills of sales and services and legal recourses are exempt.
- Stamp tax can be imprinted by means of a postal meter.
- Taxpayers can also pay this tax every month, trimester, or semester by filling out a form.

Import duties

- All imports are subject to import duties unless specifically excluded by law or through incentive contracts with the Government.
- Import duties must be paid within three working days from the day that the import documents are presented.
- Rates vary according to the local availability of items and tariffs applied in each case.
- The tax base is defined as the cost, insurance and freight (CIF) price to the importer.
- In the case of goods imported by air, or when the CIF value is unknown, the same is determined by adding 15 percent to the freight on board (FOB) value.
- In some cases, specific duties, such as per kilo or linear foot, are maintained.
- Sworn import declarations are processed through customs brokers.
- The Executive Branch (through the Council of Cabinet) grants the authorization to increase or decrease import duties.

Tax on insurance premiums

- All insurance operations in Panama are subject to a tax levied on the issuance of insurance policies.
- The tax is payable by the insurer, while the taxpayer is the person subscribing the policy.
- Tax is levied at two (2) percent of the premium for all insurances sold in the Republic of Panama covering local risks.
- An additional tax of five (5) percent is applicable to fire insurance premiums, whose total tax percentage is seven (7) percent - five (5) percent of which is assigned to fire departments in Panama.
- Stamp tax is calculated on the amount of premiums involved.

FECI (or one percent tax on loans)

- When borrowing money for expanding plants, the industrial sector is exempt from paying the one percent over rate (Interest Compensation Special Fund or FECI).

Other taxes

CHART OF SPECIFIC RATES						
Tax	ITBMS	ISC	License	Educational	ITBI	Insurance premiums
General Rates	7%	5%	2%	2.75%	2%	2%
Exceptional Rates	10% 15%	7%				7%

Municipal taxes

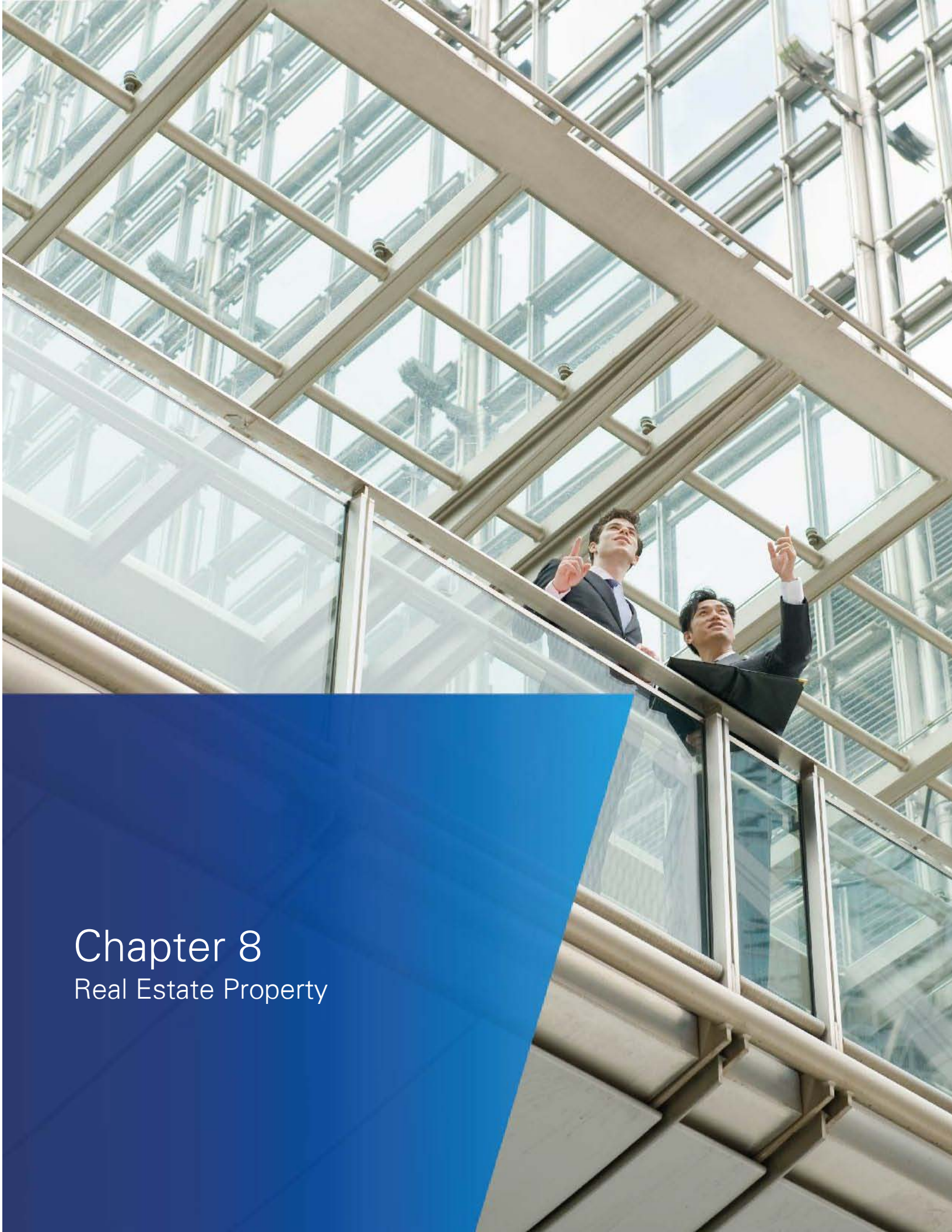
- Municipal regimes have specific rules in the Panamanian Constitution and Law 109 of 1973. Taxes are based on the type of activity and the gross income amount or the sales volume.
- Taxes may be assessed by municipalities, among other taxes, on automobile licenses, buildings and improvements, sidewalks, streets and municipal grounds.
- Also, most commercial and industrial activities are subject to municipal taxes, from small businesses and workshops to power generating companies.
- Private piers, for instance, generate twenty thousand US dollars (US\$20,000) per month of tax in Panama City.
- The Municipality of Panama has its own clearance certificate ("paz y salvo municipal"). It costs one US dollar and is required for the following purposes:
 - Signing contracts with the Municipal Government;
 - Obtaining a new automobile license each year;
 - Receiving a license or permission to operate profit-oriented businesses within the city.

Tax on banking institutions

- A special tax is levied on all banks established in Panama regulated by Law Decree 9 of 1998 and also on exchange houses.
- These taxes are transferred to the Superintendence of Banks for its operation.
- Payment is due within the first 90 day-period after the closing of the tax year.

CHART OF ANNUAL TAX ON BANKING INSTITUTIONS*

Type of financial institution (PAB)	Amount of tax (US\$)
Banks with general license	
Up to 100 millions in total assets	\$75,000
From 100 million to 200 million in total assets	\$125,000
From 200 million to 300 million in total assets	\$175,000
From 300 million to 400 million in total assets	\$250,000
From 400 million to 500 million in total assets	\$375,000
From 500 million to 750 million in total assets	\$450,000
From 750 million to 1,000 million in total assets	\$500,000
From 1,000 million to 2,000 million in total assets	\$700,000
More than 2,000 million in total assets	\$1,000,000
During their first year of operations, the new banking entities with general license are asked to pay the 50 percent of this annual tax.	
Banks with international license	\$75,000
Banks of investment promotion and micro-finance	\$30,000
Exchange bureau	\$10,000
*Legal base: Article 1010 of Tax Code	



Chapter 8

Real Estate Property

Chapter 8

Real Estate Property

Different taxes on real estate property

Three different types of taxes are addressed to real estate property depending on the tenancy, transfer transaction and capital gain.

Real estate tax (IBI)

- All land and real estate improvements located in Panama are subject to real estate tax.
- The tax base depends on the total value of the land plus all improvements.
- Real estate transactions at prices above the appraisal value automatically increase the value of such properties for tax purposes.
- Real estate is appraised by Directorate General of Cadastre, an agency formerly of the Ministry of Economy and Finances, today included in the National Authority of Lands (ANATI).
- Certain properties and improvements are exempt or can obtain exemption from real estate tax according to special incentive tax laws.
- Real estate properties with assessed value of less than US\$30,000 are exempt from this tax, while the previous ceiling was US\$20,000.
- Notwithstanding this exempted base is enforced, condominium property (horizontal or vertical property) is not exempted while benefiting from the incentive period of exemption for payment of real estate tax, a regular practice states by law on all other cases.
- Real estate tax has priority over all encumbrances on the property, and can be paid in three installments: April 30, August 31 and December 31.
- A tax clearance certificate must be obtained before any real estate transaction can be completed.
- Five different tables are enforced since 2009. Refer below.
- Tax rates are progressive as follows:

CHART OF RATES FOR REAL ESTATE TAX

Taxable Amount	Rate percentage (%)	Accumulated (US\$)
Under US\$30,000	Zero	Zero
US\$30,001 to US\$50,000	1.75	350
US\$50,001 to US\$75,000	1.95	837.5
Over US\$75,000	2.1	

Law 8 of 2010 modified the alternative combined progressive real estate tax, as following terms:

- 0.70 percent on the taxable base in excess of US\$30,000 up to US\$100,000;
- One (1) percent on the taxable base in excess of US\$105,000.

These alternative rates apply only to real estate properties that are up to date in their payment, provide that the taxpayer has presented an affidavit indicating the estimated value of the real estate together with a certification by a professional appraisal company, and authorities declare it as an assessed valuation for five (5) years. The Law 18 of 2006 granted this incentive which was effective until December 31, 2007.

CHART OF ALTERNATIVE RATES FOR REAL ESTATE TAX

Taxable Amount	Rate percentage (%)	Accumulated (US\$)
Under US\$30,000	Zero	Zero
US\$30,001 to US\$100,000	0.75	
Over US\$100,000	1.00	

Real estate exemption

Law 28 of May 8, 2012 establishes exemptions on real estate tax based on the value of the improvements. The chart below details the applicable exemption periods:

Value of improvements	Years of exemption
Improvements for residential use	
Up to US\$ 120,000	20
US\$ 120,001 – US\$ 300,000	10
US\$ 300,001 or more	5
Other constructions	
Any value	10

- The exemption is granted as of the first date between the following:
 - (a) The date of registration of the improvements date at the Public Registry; or
 - (b) The date of issuance of the occupation permit.

Likewise, those properties whose construction permits were issued before July 1, 2009 are subject to a 20 year exemption.

On the other hand, properties whose construction permits are issued between July 1, 2009 and December 31, 2011, the following exemption table will be applicable:

Value of improvements	Years of exemption
Improvements for residential use	
Up to US\$ 100,000	15
US\$ 100,001 – US\$ 250,000	10
US\$ 250,001 or more	5
Other constructions	
Any value	10

Preferential interest rates

Pursuant to Law 28 of 2012, the preferential interest rates on residential mortgages have been changed and submitted to the following new features:

- The preferential interest rates for residential mortgage interests have changed from US\$35,000 to US\$65,000 and from US\$65,000 up to US\$120,000;
- Maximum percentages of preferential interest rates -exempt up to US\$ 65,000- and four percent (4%) and two percent (2%) respectively for each span;
- Tax credit cannot be deducted from the income tax.

Tax on the transfer of real estate - TTRE (ITBI)

A two (2) percent tax is levied on the transfer of real estate, whichever is higher, based on:

- The sale price stated in the official deed; or,
- The official assessed valuation of the property.

The official property value is calculated on the registered value of the land, plus the value of the improvements on the property. Also a sum equivalent to five percent (5%) of the value of the property and improvements for each calendar year between the acquisition date and the selling date is added.

Exemptions

- Sale of a new residential property is exempt from this tax if the buyer uses it as a personal residence and if the sale is performed within two years after having obtained official occupational permit;
- Exemptions are running to the donations made to the State and to relatives within the first degree of consanguinity (parents to children or children to parents) and spouses.

False declarations on the transfer value of the real estate property will be considered as fraud by the tax authority for both the seller and the buyer and both can be subject of stiff penalties.

With regard to Law 5 of 2006, the ITBI two percent tax is deductible from income tax but only for real estate companies or natural persons doing business on real estate (have sold more than ten properties).

Capital gain tax (GC)

- CGT on the transfer of real estate property (see law 33 of 2010)
- There are new rules for calculating the income tax on the sales of real estate property, what it is called capital gain tax.
- Special regime for agriculture land as well as for those real estate properties dedicated for living in rural areas (geographically apart from metropolitan areas) whose cadastral value is up to US\$10,000.
- Habitual vendors.

A man in a dark suit is walking away from the camera down a long, arched tunnel. The tunnel's ceiling and walls are made of a series of concentric, curved glass and steel ribs, creating a strong sense of perspective and depth. The floor is a light-colored, tiled walkway. The lighting is bright, casting shadows on the floor. A large blue triangle is overlaid on the bottom left of the image.

Chapter 9

Traditional areas for doing
business

Chapter 9

Traditional areas for doing business

Panama encourages investment from both foreign and national investors, by offering equal constitutional protections and non-discriminatory laws and regulations. Furthermore, there are a number of taxes and financial incentives for firms that chose to operate in Panama.

Micro, small and medium ('MSM') businesses

For the purposes of Law 33 of 2000, micro, small and medium businesses are defined as those enterprises whose annual gross income or invoicing ranges between the sum of US\$150,000 and US\$2,500,000 as shown on the chart below:

CHART OF MSM BUSINESSES	
Enterprises	Gross income or invoicing
Micro	Up to US\$150,000
Small	From US\$150,001 to US\$1,000,000
Medium	From US\$1,000,001 to US\$2,500,000

There is a special regime for these commercial types of enterprises on which addresses financial, administrative and tax matters. With respect to the administrative aspect of MSM businesses, the Government will introduce more streamlined procedures in addition to the unique official stand for transactions, named unique window ('ventanilla única').

Tax matters

Tax Code and incentives allowed by Law 33 of 2000 are as follows:

- For micro businesses, the alternative calculation of income tax (CAIR) introduced in 2005 to tax regime is not mandatory and will not be applied; they are also exempted from income tax for the first two years of operation; small businesses are also excluded of alternative calculation, because it only applies to those medium businesses whose taxable income is higher than

US\$1,500,000.

- For legal entities, the portion of taxable income attributed to annual gross income up to US\$100,000 is treated in the same way as individuals or natural persons (thus, it pays with the individual income tax rates instead of the corporate income tax rates);
- Legal entities are responsible for the portion of taxable income attributed to annual gross income exceeding US\$100,000 up to US\$200,000 using corporate income tax rate; also, legal entities are not subject to complementary income tax on dividends nor to dividend tax.

In order to benefit from the tax regime discussed above, the Tax Code (article 699-A) states that:

- The enterprise should not be the result a business that was broken up into different legal entities, nor a subsidiary, affiliate or business controlled by another legal entity;
- Annual gross income of the business should not exceed US\$200,000;
- The enterprise stocks or participations should be nominative and shareholders should be individuals.

On the other hand, all benefits for small business offered by Law 9 of 1989 still effective until their scheduled term ends.

Agricultural sector

The Ministry of Agricultural Development is responsible for the agricultural sector, which benefits from general tax incentives as well as specific export oriented benefits. According to the Tax Code, the following exemptions are granted to agricultural activities:

- Annual gross income of farmers of less than US\$250,000 is totally exempt from income tax, and there is no obligation of filing income tax return;
- Total exemption from real estate tax on farms utilized in agricultural or livestock raising activities valued under US\$150,000;
- A special income tax regime is disposed for an agricultural real estate transfer at three percent rate of capital gain;
- Total exemption from income tax on sums donated to non-profit research agricultural business institutions.

In addition, the Interest Compensation Special Fund (called FECl as per its abbreviation in Spanish) aims to benefit the agricultural sector according to Law 4 of 1994 which also offers an interest rate discount on local loans for agricultural and livestock activities.

Executive Decree 74 of 2008 was introduced with the purpose of eliminating the developing worldwide food crisis. The decree offers interest discounts for financing the production of certain products such as rice, corn, kidney beans, meat, and fresh milk. The Superintendence of Banks created top interest discounts of 3.5% (for the qualified agricultural sector and export agro industrial sector) and four percent through resolution FECl 053-2008. Financing from the National Bank and Agricultural Institute was set at two percent.

Certificate to foment agro-exports

Law 82 of 2009 introduced the Certificate to foment agro-exports (or CEFA by its abbreviation in Spanish). However, these certificates are set to expire on May 31, 2013.

Agricultural, livestock production and exports

- Law 2 of 1986 establishes incentives in favor of the agricultural and livestock production and exports;
- Activities that receive the benefits of this law are: (1) production of food, forest and agricultural raw materials; (2) commercial raising of cattle, hogs, poultry, marine and other animals; (3) transformation of the above mentioned products utilizing no less than 50 percent of local raw material; (4) production of fertilizers and other chemicals for agricultural use, even though no local raw materials are used; and, (5) the financing of equipment, goods, and animals for agricultural and livestock production and processing;
- Tax incentives are granted, through Decree 51 of 1990, to banks and financial institutions providing credit facilities and loans aimed for improving the agricultural, livestock and agricultural industry sectors;
- Revenues from interests and commissions earned from such loans are exempt from income taxes, provided that: (1) such loans are used exclusively in the financing or refinancing of investments in these sectors; (2) the term for the payment of the loan must be no less than three years, including a grace period of no less than one year for the payment of the capital; (3) the loan earns interests at a rate no greater than the market rates; and (4) the lender is a bank or credit institution.

Industrial sector

Since the 1950's, the Panamanian Government has shown a continued commitment to attract foreign direct investment (FDI) on industrial activities. For these purposes, the Republic of Panama has granted a number of tax measures (including exemptions, targeted tax deductions, tax credits and tax rate reductions) designed to attract economic investment.

Certificate to foment industry (or CFI)

Law 76 of 2009 creates the CFI, a certificate to promote the manufacturing, agroindustrial and marine resources transformation industries. There certificate is not available for some types of enterprises but those which qualify are entitled to receive a refund ranging from 25% to 35% of the amounts they invest in research and development. That refund can be used to pay all of its national taxes.

Types of regimes

- Enterprises registered with the Official Register for National Industry (ROIN); or have signed a contract with the Government; or are entitled to a contract benefit from the tax incentive regime until its scheduled expiration;
- Enterprises not registered with the ROIN were subject to a revised extension until 2007 as a result of World Trade Organization (WTO) rules.

Industrial benefits

- By issuance of the Law 11 of 2008, enterprises continue under the special regime if:
 - 1 Registered at the Official Register for National Industry (ROIN); or

- 2 Having signed a contract with the Government under the umbrella of Cabinet Decree 413 of 1970; or
- 3 Entitled by a law contract.
- The primary consequence of the new law is the extension of ROIN up to December 31, 2015. Thus, benefits from Law 3 of 1986 or law contracts are still in force for them.

Export-oriented companies

Export-oriented companies are addressed by Laws 28 of 1995 and 26 of 2001. These laws created an import tax preferential rate of three percent (3%) from cost, insurance, freight (CIF); granted to specific raw materials, intermediate goods and capital assets, whether or not the importers are registered at the Official Register for National Industry.

The Tax Code establishes special import duty regimes, as follows:

- Customs repayment shall permit the investor to obtain a return of all taxes paid at the time of import on the merchandise used in the process of production of the exported goods, at the time of export;
- An exporter who claims the benefit shall receive a refund of the taxes paid at the time of import;
- Replacement of inventories with customs exemption should permit the import, with the exemption of import duties, of equivalent merchandise, that is similar in kind, quality and technical characteristics, to the legally imported merchandise, that should be utilized to obtain products previously permanently exported;
- Temporary admission of goods for active finishing should permit the investor to receive, within a custom territory, with suspension of import duties and taxes, prior a guarantee bond for the amount of the respective import duties and taxes, any merchandise to be exported. It is for a determined period, after having been subject to a process of transformation, manufacture or repair.
- Temporary admission of goods for passive finishing permits the investor to export, for a determined period of time, domestic or nationalized merchandise, to be subject abroad to transformation, manufacture or repair, to be re-imported later with a total or partial customs exemption from import duties and taxes.

Pharmaceutical industries

- Law 28 of 1995 states parts, packing materials and raw materials for pharmaceutical industries needed for the manufacturing of medical products shall be declared free from import tax and the tax on the transfer of personal goods and the provision of services (ITBMS);
- The Executive Branch through the Ministry of Commerce and Industry is authorized to regulate this matter;
- Local purchases of packing materials that manufacturers use for the packing of medicines shall be exempt from the ITBMS;
- According to article 1057-V of the Tax Code, medicine and pharmaceutical products are exempt from the ITBMS;
- Furthermore, transfers made by importers, manufacturers of food and pharmaceutical or medicine products for human consumption shall be assimilated to those made by exporters for the purposes of applying to a CPC tax credit.

Unfair business practices

- Law 29 of 1996 adopted a regulation that addresses antitrust, unfair business practices and antidumping measures. This regulation was introduced in order to modernize the legal system

according to the requirements of the World Trade Organization (WTO);

- Unfair business practice includes subsidies, subventions and dumping;
- The main objective is to protect the national industry and production against uncompetitive foreign trade activities that threaten the development of national industries;
- The antidumping measures are designed to protect the national production from massive foreign imports of similar or equal goods;
- Antidumping measures can be adopted by increasing in tariffs, establishing contingency rates, implementing restrictions on the amount of imported goods, and any other measure that complies with international agreements subscribed by the Republic of Panama.

Fossil fuel operations

Several oil companies have explored regions in almost all the provinces of the country.

Law 8 of 1987 promotes and regulates:

- 1 Exploration and exploitation of oil fields, asphalt in its natural state, natural gas and other fossil fuel activities;
- 2 Refining and transportation by pipelines;
- 3 The storage, marketing and export of exploited or refined substances.

The Ministry of Commerce and Industries, through the Department of Hydrocarbons, is the entity in charge of granting exploration permits for geological, geochemical, and geophysical exploration.

- Concessionaires undertake all the risks, liabilities, and costs by supplying capital, machinery, equipment, materials, personnel, and technology;
- Partial or total assignation of rights and subcontracting are allowed provided that the Department of Hydrocarbons grants the authorization;
- Petroleum free trade zones are described ahead on Chapter 12, refer to that chapter for hydrocarbons import and trade regulations.

Tax benefits

For fossil fuel operations, tax benefits are as follows:

- During the term of the contract, contractors shall pay between 20 to 50 percent of the net production of the fossil fuel, for the periods in which either the contractor is recovering from its initial investment or the contractor has recovered from its initial investment, whichever comes first;
- Contractors are granted total exemption from import duties on machinery, equipment, parts and any other items necessary for the execution of the activities under the contract;
- Total exemption from income tax on profits derived from activities during the first fifteen years of production or until the initial investment is recovered, whichever comes first;
- After said period, contractors shall pay income tax of 25 percent of the net production of hydrocarbons;
- This amount will be retained by the State, and considered as part of the 50 percent payment mentioned above;
- Special depreciation schedules for machinery and equipment;
- Special carry-over provisions for income tax purposes.

Maritime registry

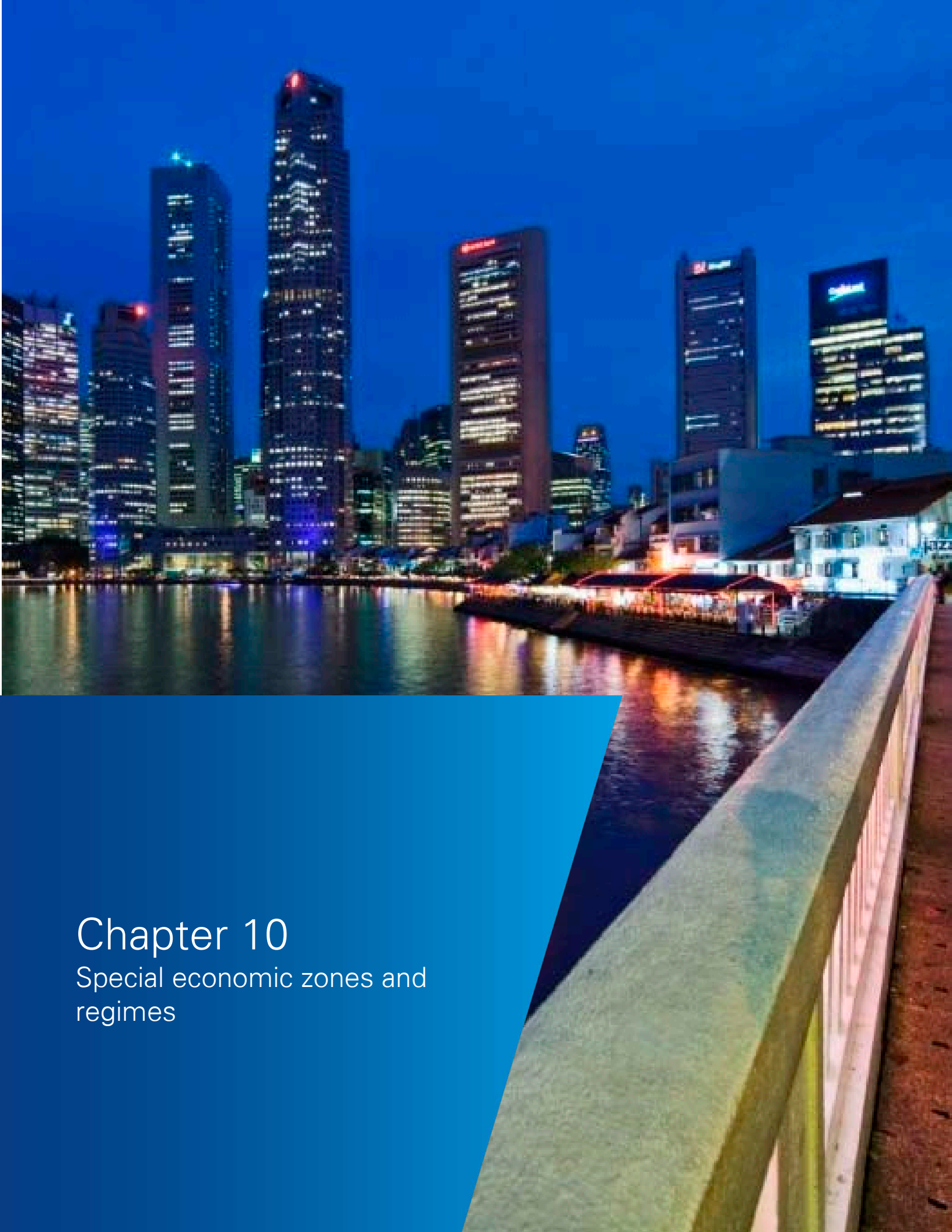
Since its creation in 1925, the Panamanian Maritime Registry has experienced a tremendous growth.

Law 8 of 1925 created the National Merchant Marine, when the open registry system was adopted and restrictions concerning nationality and residence were eliminated.

Since then, the Panamanian Maritime Registry accepts ships belonging to nationals and foreigners alike, provided that all legal provisions in force are complied with, especially those related to the administration of vessels, safety pollution control standards with technical criteria and fiscal matters.

The Panamanian Maritime Registry offers ship owners the following advantages:

- Open registry policy - Any person or company, not withstanding nationality or place of incorporation is eligible to register ships under the Panamanian flag;
- Total exemption from income taxes on income derived from the operation of vessels engaged in international trade;
- Minimum tonnage not required. However, vessels that are 20 years or older will have to pass a special inspection in order to obtain a permanent navigation patent;
- A provisional ship registration valid for six months may be obtained in Panama through a lawyer, or in ports where an authorized Panamanian Consul is present;
- A dual registry, as long as this is allowed by the country which granted the vessel's original registration;
- Flexible regulations to contract crewing for the vessel;
- The bareboat charter system - this system allows a foreign vessel to register in Panama for a two year period without losing its previous registration. A certificate of consent from the country where the vessel is originally registered will be required.
- Law 55 of 2009 covers maritime commerce and substitutes the Commercial Code section referred, and Law 57 of 2008 deals with general maritime trade.



Chapter 10

Special economic zones and regimes

Chapter 10

Special economic zones and regimes

Colon Free Zone

Since its origin in 1948, the Colon Free Zone (CFZ) has been a segregated free trade area for wholesale operations. Located on the Atlantic entrance to the Panama Canal and 90 kilometers from Panama City, the CFZ offers the world a unique place for international commerce, becoming the leading free zone in the Western Hemisphere and one of the largest global logistics centers.

Goods (except firearms or petroleum products) may be imported, stored, modified, repackaged, and re-exported without being subject to any customs regulations, and those goods entering the CFZ are exempt from import duties. A surveillance service fee is charged by customs authorities for the custody of exported goods. The fee charged varies depending on the exported goods.

More than 2,000 companies are operating from the area; the re-exportation of products is the most important activity carried out.

Starting operations in the Colon Free Zone (CFZ)

- To operate from the Colon Free Zone, companies must obtain authorization from the CFZ Administration (an autonomous governmental institution).
- No business license (Operation Notice) is required at the moment, nor does any company need to comply with any minimum investment requirements, although a tax on capital must be paid at a rate of 1% of the company's capital, with a minimum of US\$100.00 and a maximum of US\$50,000.00
- The CFZ Administration charges US\$200 annual fee for an operation code applicable to all companies and/or an operation permit, which requires a US\$3,000 annual fee.

Operations may be carried out in any one of the following ways:

- A company may lease land lots to build warehouse facilities for its own use or for the use of

other companies;

- A company may lease warehouse facilities owned by CFZ established companies;
- A company may sign a contract with an established CFZ firm that will represent it, and representation contracts should be authorized by CFZ Administration;
- A company may use the public warehouse, where goods may be received and stored.

Sales operations

Staff working within the CFZ pays income tax at regular rates, subject to territoriality principle as discussed in Chapter 5.

Companies operating from the CFZ may carry out the following operations:

Local or domestic operations

- To sell merchandise from CFZ to buyers located within the customs territory of Panama, provided that import duties are paid, as well as ITBMS;
- Commissions and services emerging from storage, bond, lease or sublease, internal moving of merchandise and cargo, invoicing, re-packing and the like when effects of these services are not sorted abroad;
- Income tax is levied on interior operations, and therefore profits obtained from these operations by companies within the CFZ are taxed at a single rate of 25 percent.

Export operations

- Sales transactions of local or foreign merchandises for export or re-export operation;
- The transfer of merchandise to be exported, within the CFZ and International Airport Free Zone or from one free zone to another;
- Commissions and services emerging from storage, bond, lease or sublease, internal moving of merchandise and cargo, invoicing, re-packing and the like when effects of these services take place abroad;
- Operations not having effects abroad will be considered local or domestic operations.

Tax incentives granted to companies within the CFZ

- No income tax on profits obtained from external operations;
- Dividends paid on profits, obtained from export operations, and from direct sales (drop shipments), are subject to dividend taxes at a reduced rate of 5%, instead of the ordinary 10% rate;
- In addition, companies established within the zone are exempt from taxes on the re-export of capital;
- Royalties paid to companies established abroad are not taxable to the recipient, but the expense is not deductible for the payee;
- There are no consular fees, nor any other charges, levied on shipments destined to the Free Zone, or on shipments from this area to consignees abroad;
- Free movements of goods and exemption from import duties;
- Municipalities are not allowed to collect taxes or any other charge for goods entering or departing the CFZ.

Tocumen International Airport

Tocumen International Airport is currently under the management of a corporation owned by the Panamanian State according to Law 23 of 2003. In Latin America, Panama is a logistics and transportation hub easily reached.

Baru Free Zone

- Law 19 of 2001 establishes a free trade zone in the western side of the Republic, within an area called Baru. Law 29 of 2010 redefines its regime;
- This zone has a tax-free regime, a national tourist development status and a fiscal pier structure for cruise ships;
- In addition, the oil free zone regime is included among the incentives.

Petroleum or oil free zones (PFZ)

- Cabinet Decree 36 of 2003 established a new national policy regarding hydrocarbons in Panama and included a chapter dedicated to petroleum tax free zones where companies are granted tax benefits;
- Within these free zones, companies can import, re-export, store, trade and sell oil products to domestic markets and ships in transit through the Panama Canal;
- Crude oil and petroleum derived products can enter and exit petroleum free zones without paying income tax, import tax and any other tax except when destined to Panamanian custom territory;
- Export and re-export sales operations are exempt including sales made to ships in transit through the Canal or those sales made to ships and airplanes on international traffic that use the Panama's ports and airports facilities;
- For consumption purposes, power generation companies are totally exempt from import tax when acquiring crude oil and derived products even when products are introduced within the custom territory.

City of Knowledge and the International Technologic Park (or Clayton)

Law Decree 6 of 1998 approved the contract-law contract for the City of Knowledge, which is a foundation created to promote educational and scientific research within an area formerly used as a military base (Clayton). The International Techno-Park of Panama is located in the City of Knowledge and its objective is to host innovative businesses that produce, assemble, process or render services for high tech products destined for sale in the local or international market. This area is given with the following tax exemptions:

- Import tax upon materials and equipment related to projects;
- ITBMS;
- Real estate tax;
- Taxes on funds related to projects remitted abroad;
- Taxes on equipment related to innovative enterprises with high technology standard goods and services.

- Also, private foundations with non-lucrative purposes may be settled at this special area in order to accomplish a social mission such as education or conduct research.

The seventieth century Old Panama City (or 'Casco Antiguo')

Restoration of Historical Patrimony became a trendy development last decade when incentives for the seventieth century Old Panama City begun. Law Decree 9 of 1997 grants special tax incentives for restoration of historical monuments and buildings located in "Casco Antiguo".

Tax incentives were available during ten years and are as follows:

- Banks lending money for restoration at present interest rates will be granted tax credit applicable to their income tax;
- This credit is equivalent to the difference between the regular interest rate and preferential interest rate charged to a special secured loan for restoration;
- This benefit will last up to the term of the loan, and will not be transferred if the loan is extended in time or refinanced;
- Individual or corporate income tax deduction of the total amount invested in construction, restoration, enlargement, maintenance, illumination or improvement of parks, historical walls, green areas and churches within the "Casco Antiguo" (in conformity with legislation for the Historical Patrimony);
- Total exemption on import duties related to equipments and materials in order to construct, restore, and equip establishments within the historical area, provided that those materials or equipments are not produced in Panama or are barely produced and that they are not sold to third parties.

Terms for other exemptions are as follows:

- A ten-year income tax exemption either on the sale or on the rental income of any property within the historical area;
- A thirty-year exemption of real estate tax over land and improvements effective once the law was published and from the date in which the occupational permit was granted;
- A five-year income tax exemption on profits derived from commercial, professional or industrial activities carried out by the owner as long as the building was built or rebuilt within ten years once the law was published (up to August 30, 2007);
- A person renting within the historical area may deduct the rent from her/his income tax return, for the following five years from the date in which the occupational permit was granted;
- A ten-year income tax exemption for profits derived from public parking lots built within the historical area from the date of the occupational permit.

Call centers

For telecommunications, Law 54 of 2001 offered Call Centers the same incentives granted to export processing zones by Law 25 of 1992, which has been repealed by Law No. 32 of 2011, the law on Free Trade Zones. Therefore, call centers are now under the umbrella. The most relevant incentives are similar to those granted to EPZ:

- No income tax, sales tax, import duty or any other national taxes levied on call centers export operations;
- Special vacation schedules;

- Market fluctuations as a justified cause for labor contract termination.

Any person exploiting call center activities duly authorized by the Panamanian Authority of Public Services may benefit from the tax benefits granted to companies operating in 'Free Trade Zones. Activities benefiting are those considered 'export' services (e.g. the final destination of telecommunication services provided used outside the Panamanian territory). Under the regular regime, there are no specific exemptions preventing the application of ITBMS to all types of international telecommunications services (with the exception of fixed line telephone services and internet access to households and educational entities).

Tax benefits include tax exemptions applicable to activities, operations, transactions, transfers of movable or immovable goods/ property, acquisition and importation of equipment and construction materials, raw materials, machinery, tools, accessories and any other goods or services required to conduct exportation activities which are carried out within the export processing zone. Said exemptions refer to direct and indirect taxes (including ITBMS) as well as any duties, charges or excises.

Free trade zones (former EPZ)

The free trade zones are special export-oriented areas with a particular tax and labor regime mainly based on Law 32 of 2011. The FTZs are free zones for the establishment and development of industrial, commercial and service enterprises.

Although in principle exempt from all direct and indirect taxes, companies established in FTZs will be obliged to pay the following taxes from the year 2016:

- Income Tax and ITBMS on local leasing and subleasing activities;
- Dividend Tax, at a rate of 5% and Complementary Tax, at a rate of 2%;
- Annual tax, at a rate of 1% on the company's capital, with a minimum of US\$100.00 and a maximum of US\$50,000.00;
- Selective Consumption Tax;
- FECl, except on loans guaranteed by bank deposits;

Social security contributions are currently payable.

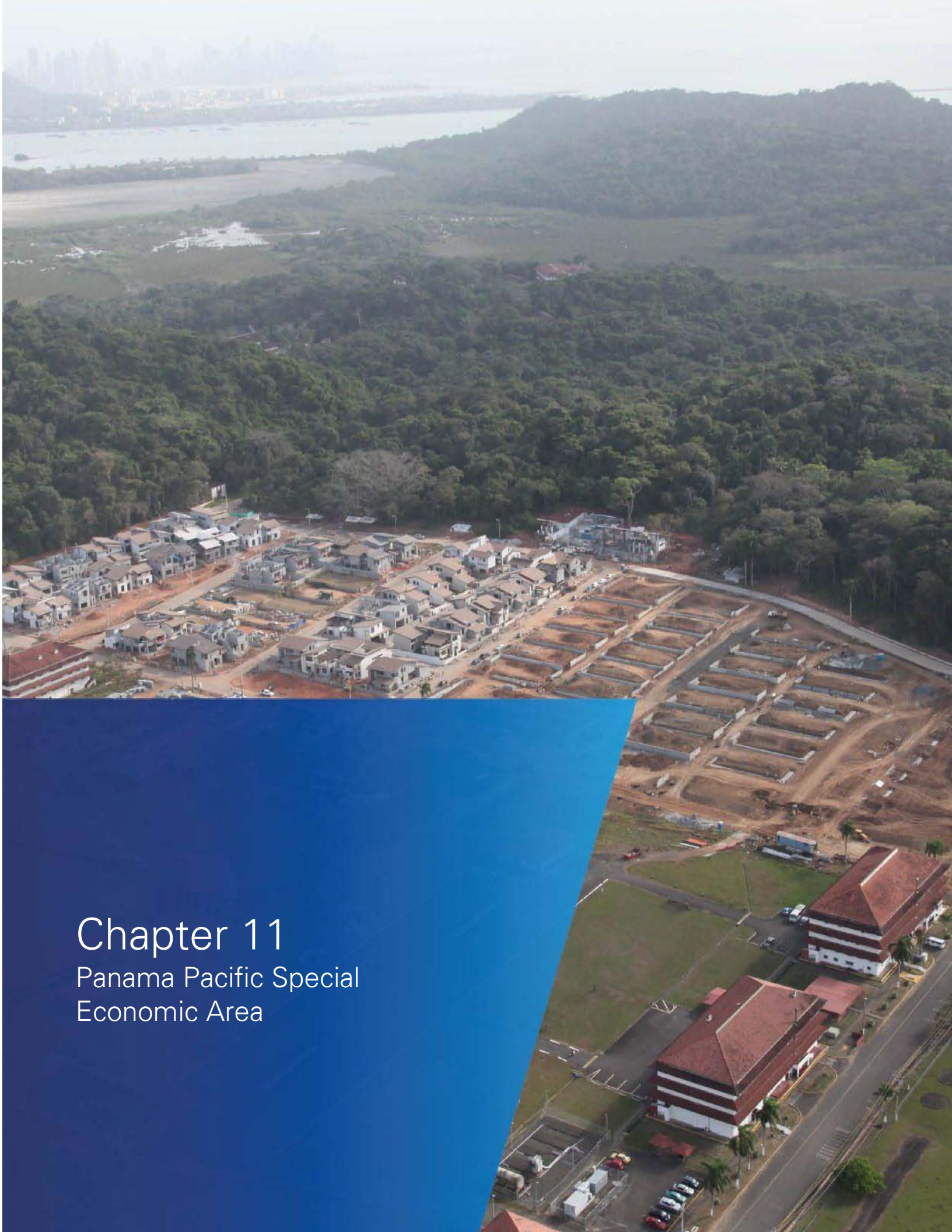
Concerning labor regime:

- The employer may rotate employees between different positions, as long as the employees' work conditions are not lessened.
- Overtime may not exceed three-hours per day and shall be remunerated with a flat 25 percent surcharge on the hourly salary.; and
- Furthermore, there is flexibility to fix vacation periods according to production cycles.
- It is allowed to terminate employment relations on the basis of fluctuations in the market..

Free Trade Zones also have a special migratory regime.

Other economic zones in Panama

Business incentives in Panama predominantly focuses on certain business activities and are centered on specific locations or zones, as outlined above. In addition to other zones mentioned, the following special zones are also closely regulated.



Chapter 11

Panama Pacific Special
Economic Area

Chapter 11

Panama-Pacific Special Economic Area

Panama-Pacific Special Economic Area (PPSEA) or Howard

Through a Government agency created for PPSEA and a private Developer (London & Regional), PPSEA offers real estate opportunities under the umbrella of Law 41 of 2004 which creates and regulates this special area.

Location

PPSEA, located in the former Howard US Air Force Base on the Pacific coast of Panama (western to the Canal), is a tax free zone with a special legal, tax, customs, labor and immigration regime. It carries the purpose of increasing the trading of goods, services and capital, offering real estate opportunities (over land and installations) and also promoting investment and employment.

Scope of business

Unlike the CFZ, which is mainly to import and export operations, the PPSEA has an extremely broad scope of business, and Law 41 of 2004 states that natural or juridical persons that establish themselves in the PPSEA will be allowed to carry out all kinds of activities as long as they are not expressly forbidden by law.

Taxation regime

The special regime of PPSEA can be summarized in the characteristics below, taking into account general and specific tax exemptions.

PPSEA is a tax free zone where companies are exempt from income tax, income tax on dividends, withholding tax, import tax and ITBMS (VAT) that may arise from the following:

- Services provided to individuals or juridical entities outside the Republic of Panama;
- Transfer, by any means, of stock from companies in the PPSEE;
- Transfer, by any means, of goods and merchandise, and also services provided to ships crossing the Panama Canal with foreign ports as their destinations, or to ships sailing between any Panamanian port and a foreign port, unless the transfer is made by the manufacturer or a member of the manufacturer's economic group;
- Transfer of all kinds of chattel and/or provision of services to aircrafts that use airports in Panama, with destination to foreign airports, unless the transfer is made by the manufacturer or a member of the manufacturer's economic group;
- Transport, handling and storage of air cargo in general, and also the repair of aircrafts or aircraft components to be imported, exported or transferred by any means to other companies in the PPSEA or in other special economic zones;
- Manufacture of high-tech products, components or spare parts;
- Multimodal and logistic services, as well as the sale of merchandise manufactured outside of the PPSEA, with destination abroad, provided that the sale is carried out by a multinational company, or a subsidiary or affiliate thereof;
- Call Center services.
- Reception, processing, storage and broadcasting of digital data and information; uplink of radio, television, audio, video and/or data signals, and also research and development of digital resources and applications to use in Intranet networks or Internet.

The income arising from the transfer of goods that have not been subject to any kind of transformation or alteration process inside the PPSEA will be subject to the abovementioned taxes, regardless of the transfer destination, except for those that are transferred to companies located in petroleum or oil free zones. The abovementioned benefits will not be applicable if such income is taxed but subject to credit in the transferor's country of origin.

PPSEA has a special customs regime that allows companies located in this area to introduce all kinds of merchandise and goods to the PPSEA without limitations and are exempt from paying taxes, import duties and other fiscal contributions, except for those established in Law 41 of 2004.

Merchandise can be sold to other companies within the PPSEA. All types of merchandise and equipment will be allowed to enter the PPSEA without previous consent of any authority, except for imports that may be subject to restrictions or forbidden altogether.

If products are imported to the Panamanian fiscal territory (Panamanian territory outside the special economic zones), they will be subject to payment of all corresponding taxes and all applicable tariff regulations. All merchandise, products or equipments that enter the PPSEA from the Panamanian fiscal territory will be treated as an export.

The PPSEA has special labor regulations, and although it is based on the Panamanian Labor Code, the PPSEA is more flexible, particularly in the following ways:

- Unlike the rest of the territory, labor contracts must be in written form and verbal agreements are not allowed;
- The labor regime is designed to allow 24 hours operation, at a competitive scheme;
- Overtime is subject to a 25% surcharge on hourly wages ;
- Working on days off are subject to 50% surcharge;

- Employers and employees are free to agree on a weekly days off ; the PPSEA labor regime does not consider Sundays as mandatory days off ;
- Companies in the PPSEA can remain open on Sundays and national holidays;
- Agreement between employers and employees regarding vacations should be notified to the representatives of the Ministry of Labor in the PPSEA;
- Employees may be required to work in different positions as long as their salaries are not reduced and their role remains significant;
- Decrease in sales volumes, service demand, cancellation of purchase orders or services requested are considered valid reasons to end a labor contract, as long as the employer requests authorization;
- Employers may hire foreign personnel as long as it does not surpass 10% of the total of employees, or 15% when they are specialized workers;
- The Ministry of Labor may grant labor permits to foreigners exceeding the abovementioned 15% if they are hired specifically to train Panamanian personnel. Said employees may receive a visa for a period up to three years;
- The representatives of the Ministry of Labor in the PPSEA may conduct inspections in companies to verify compliance with the applicable labor regulations. Companies that violate said regulations will be subject to fines up to US\$100,000.00, and in case they become repeat offenders, the fine may be raised up to US\$250,000.00.

The PPSEA has special immigration regulations. Foreign workers must apply for a PPSEA Workers Visa. Foreign workers who are awarded said visa will have the right to reside in the Republic of Panama or in the PPSEA, and to work for companies in the PPSEA. The visa for PPSEA Workers may be issued under the following terms:

- For workers within the ordinary 10% of foreign employees, valid for up to five (5) years;
- For foreigners hired by companies in the PPSEA, or by the Developer or the Operator of the PPSEA, as specialized technical or administrative personnel who do not exceed 15% of the ordinary employees, valid for up to three (3) years, which can be extended up to five (5) years, as long as the person continues to work;
- For foreigners hired by companies in the PPSEA, or by the Developer or the Operator of the PPSEA, as specialized technical or administrative personnel exceeding 15% of the ordinary employees, valid for up to three (3) years;
- For foreigners hired as trustworthy employees in charge of running the offices and directing transactions whose effect take place outside of the country, which will be issued according to the applicable national legislation;
- For foreigners who work for companies with less than 10 employees, which will be issued according to the applicable national legislation;
- Foreigners who invest a sum of at least US\$250,000.00 in companies in the PPSEA or in PPSEA Developing or Operating companies will have the right to request a PPSEA Investor Resident Visa, which allows the grantee to live in Panama for up to five (5) years, to leave and enter the country freely and without limitations and to have a Panamanian Identity Card as a legal resident;
- The abovementioned visas will be extended to the applicant's spouse, their offspring, both underage and of legal age, as long as they depend economically on the applicant and have not yet reached the age of twenty-five (25), and single and have no children. Visas will also be available to the applicant's parents, as long as they are older than sixty-two (62) years of age;

- In case a person who has been granted a PPSEA Worker's Visa ceases to work for the company that hired them, the visa and the working permit will be immediately revoked;
- The grantees of all the above-mentioned visas, except who have an ordinary 10% foreign worker visa, will be entitled to import, exempt from all taxes, all kinds of domestic and personal articles valuable for a sum up to US\$100,000.00. They will be obliged to keep a registry such items;
- Grantees of the abovementioned visas will also be obliged to pay income taxes, make Social Security contribution, inform the Immigration and Labor authorities of their current domicile and/or report any changes to it, and to comply with any other obligations established by the PPSEA law or by any other regulations that may be issued by the Government. The companies in the PPSEA must make sure that these obligations are met by their foreign employees.

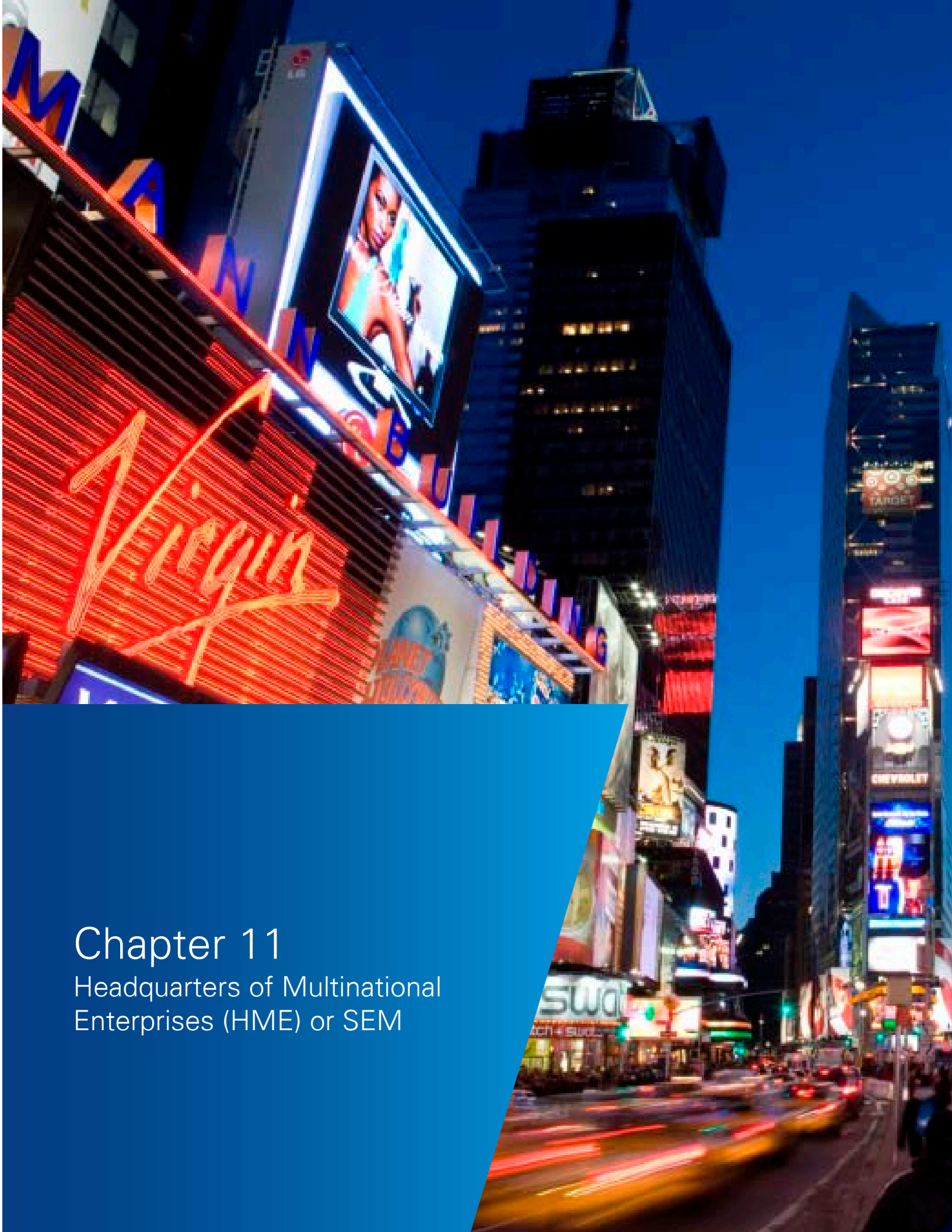
The wholesale of import and export of finished products will not be allowed until the Panama Colon Highway, currently under construction, is completed. This prohibition was included in the law that creates the PPSEA in order to equalize competitiveness conditions between the PPSEA and the Colon Free Zone.

The abovementioned prohibition has the following exceptions:

- Supplying ships and aircrafts;
- Products that leave the PPSEA by air transport;
- The wholesale of import and export of finished products, as long as the products are complementary to companies in the PPSEA;
- The wholesale of import and export of finished products related to aircraft related operations;
- Logistics transport activities;
- The import and export of products related to the oil free zones that may operate in the PPSEA;
- It is also necessary to point out that no showrooms are allowed for products that are available for wholesale in other tax free zones in Panama.

General exemptions: Notice of operation (former *licencia comercial*) is not required. Nor are required the following tax types:

- Income tax over remittances to foreign creditors (on certain activities);
- Real estate tax on improvements and traded land as well as tax on the transfer of real estate /if the properties have a commercial nature);
- Stamp tax;
- ITBMS (VAT);
- Import tax when introducing merchandise, (e.g., equipment goods) and services into the PPSEA.



Chapter 11

Headquarters of Multinational
Enterprises (HME) or SEM

Chapter 12

Headquarters of Multinational Enterprises (HME) or SEM

Legal regime of MEH or SEM

Law 41 of August 24, 2007 created a special regime for the establishment and operation of Headquarter of Multinational Enterprise or SEM as per its Spanish abbreviation. The primary objective of the law is to promote investments, employment and technology transfer, as well as making Panama more competitive in the global economy.

Law 41 aims to attract multinational enterprises to set up offices in Panama for the purpose of providing intra-group services. A Commission of HME has been created to authorize permanent licenses to establish HME.

Definitions

- To qualify as a HME, services must be provided from the Panama Headquarter to the head office/parent company abroad, its subsidiaries, affiliated or associated companies.;
- Law 41 defines multinational enterprise (ME) as a juridical person whose head office/parent company is in one country and commercial operation is taking place in different countries or different regions of such country, which decides to establish a branch, affiliate, subsidiary or associated company in Panama, with the purposes of doing business under premises of commercial transactions within the region.

As per the HME, the law refers to a multinational enterprise that performs the services listed in the law from Panama to either:

- 1 Its head office company or its subsidiaries or affiliates or associated companies, or if
- 2 It establishes its head office company in Panama (hereinafter Enterprise Group or EG). The headquarters shall always be part of multinational enterprises with international or regional operations.

Types of enterprise

- The HME may be set up, either as foreign company registered in Panama or a Panamanian company belonging to the multinational enterprise, its subsidiaries or affiliates;
- Law firms or companies rendering services directly to clients or enterprises that are not interrelated cannot become a ME or subject to the HME regime.

HME license

To obtain a HME license, the following criteria must be taken into account: ME assets, operation sites or headquarters, commercial activities or operations, shares quoted at local or international securities exchange, and any other element or relevant information.

Services

The HME is expected to provide the following services (or a combination) described below:

- Direction and/or management for geographical operations (in an specific area or globally) of a company of the Enterprise Group: strategic planning, business development, management of personnel training, operations control and/or logistics;
- Logistic and/or storage of components or parts of manufacturing products;
- Technical assistance not only for the companies of the EG but also for the clients of products and services of the EG;
- Financial management, including treasury to EG;
- Accounting of the EG;
- Preparing blueprints that form part of the design and/or construction that constitute the ordinary course typical the business activity of the head office company or any of its subsidiaries;
- Processing electronic data of any activity including consolidations of the EG operations and network operations ;
- Advisory, coordination and following up of the EG goods and services, marketing and advertising;
- Support of operations and research, and EG goods and services development;
- Other analogous services previously approved by the Counsel Cabinet according to the Law 41.

Taxation regime

The HME license is granted along with the following tax exemptions:

- 1 Tax on the transfer of tangible goods and services provided to persons located abroad who do not generate taxable income in Panama; however, acquisitions of goods and services in Panama are to be taxed, as well as importation. This exemption relies on the exportation of services.
 - 2 Income tax associated with services provided in Panama to entities abroad that do not generate taxable income within Panama.
- Notwithstanding the corporate income tax exemption just mentioned above, a withholding tax is to be applied over the half part of revenues paid by a local company to the HME from performing of services which have effects on the generation or maintenance of the Panamanian

sourced income of the local company when such revenues are considered as deductible expense. Effective tax rate is 12.5%.

- At the end of the fiscal year, the HME must file an income tax return and report its exempt income along with the income tax paid as withholding tax.
- No tax credit is allowed for losses caused by operation costs and expenses.

Migratory regime and other special considerations

- Personnel of the HME shall be granted a visa for Permanent Personnel of a Headquarter of Multinational Enterprise to stay and work in Panama, , for up to five years, which can be extended.
- Temporary personnel shall be granted a three month visa to work at HME rendering technical training or services to the HME.
- Bearers of a Permanent Personnel of HME Visa are income tax exempt when receiving payment directly from parent company abroad, and are not obliged to make social security contributions (unless permanent residence in Panama is asked).

Other considerations

A tax agreement may be negotiated between the HME enterprise and tax authorities in order to consolidate the enterprise profits and to pay income tax on revenues arising in other countries.

Moreover, compared to other countries Panama is considered one of the region's most efficient countries to establish corporate coordination, regional headquarters, back office facilities and distribution centers for multinational corporations. From both practical and regulatory viewpoints, Panama offers great flexibility and possibilities for structuring international transactions.



Chapter 13

Working conditions and visas

Chapter 13

Working conditions and visas

Visas

Foreigners planning to work for a local company will require a work permit from the Ministry of Labor and Employment Development. Under the Panamanian immigration laws, there are different kinds of visas that authorize an alien to either visit or reside in Panama, as long as the immigrant meets the requirements established in the Law Decree 3 of 2008 (and subsequent amendments and regulations).

The new Law Decree 3, as substitute of the Law Decree 16 of 1960, became effective on August 27, 2008 and establishes four categories of foreigners:

- 1 Non-residents;
- 2 Temporary residents;
- 3 Permanent residents; and
- 4 Foreigners under protection of the Republic of Panama.

The category of “non-residents” includes the following categories:

- Tourists. When visiting Panama, foreigners are allowed a stay of ninety days;
- Passengers and crew in transit;
- Marines;
- Other aliens like crews of sailing ships and yachts, short stay visitors, domestic workers, performing or show workers, visiting relatives of these non-residents and employee of the aviation companies located in Panama.

Additionally, temporary residents may enter the country for employment purposes, special politics and other matters (e.g., education, cultural, religious, humanitarian and family reasons). This category of foreigners and their dependents are allowed to reside with a one-year permit renewable for up to six years.

Moreover, permanent residents are those foreigners that enter the country for economic and investment reasons, special politics, demographic matters, international agreements and other subcategories of aliens whose main purpose is relocating to Panama on a permanent basis.

Initially, a renewable two-year permit is granted.

Under the scheme of special politics, for temporary residents and permanent residents, the new ruling of 2008 recognizes visas for the following regimes:

- Enterprises hired by the Panama Canal Authority (ACP) ruled by Law 45 of August 31, 1999;
- Panama-Pacific Special Economic Area (former military base of Howard) ruled by Law 41 of July 20, 2004;
- Export processing zones ruled by Law 25 of November 30, 1992;
- Call centers ruled by Law 54 of October 25, 2001;
- Film and audiovisual industry ruled by Law 36 of July 19, 2007;
- Headquarters of multinational enterprises (HME), ruled by Law 41 of August 24, 2007.

Tourist visa requirements

- Most foreigners enter Panama, first, with a tourist visa or a tourist card, which allows them to stay in the country for a 90-day period.
- Such tourist period may be extended up to 60 days, at the discretion of the competent authority, when changing the category.
- Almost all Latin Americans and USA citizens are allowed to enter Panama with a tourist card.
- At present, the tourist cards can be obtained from almost all airlines flying into Panama, while the tourist visas are issued by the Panamanian Consuls.
- All foreigners that stay in Panama for more than 90 days must be registered at the Immigration Office, and need an exit permit to leave the country.
- All foreigners authorized to reside temporally in Panama will need a re-entry permit to travel abroad and return to the country, which may be valid for one or multiple trips.

Resident and work visas

The most common visas for businessmen are immigrant visa, temporary visa and a temporary visa for special visitors.

- An immigrant visa is recommended for foreigners who intend to reside permanently in Panama while working or do business.
- The investor's visa, an immigrant visa that is available to foreigners who wish to invest in commercial, financial and industrial activities.
- A temporary visitor's visa applies to technicians, specialists, students, and other aliens that will have a transitory stay in Panama up to six years.
- A temporary visa for special visitors, also known as the "executive visa", is suitable for personnel of international companies and banks who have a monthly salary of at least one thousand US dollars (US\$1,000) which comes from sources located outside of the Panamanian territory or non-Panamanian-sourced income.
- Since 2005, the temporary visa for special visitors is provided to foreigners working in Panama for an offshore business and it grants an income tax exemption.
- Effective 2007, other businessmen types of visas became available: a visa for permanent personnel of headquarters of multinational enterprises (up to five years) and a visa for temporary personnel of such headquarters (up to three months). The visa is also available for dependents.

Temporary visa as a special visitor

The temporary visa as a special visitor (TVSV) is based on the Cabinet Decree 363 of 1970 and the Migration Services which grants this type of visa to expatriate executives with a minimum salary of US\$1,000.00 who work in Panama for an offshore business.

The visa has been available for all foreign executives who entered Panama to work for international companies (or for Panamanian subsidiaries of said companies that carry out business operations outside of Panama).

Because of labor issues, the Ministry of Labor (which is in charge of work permit issuance) makes top priority foreign personnel who are working in Panama and satisfy the 90%-10% statute. The issuance of this type of visa may slightly exceed the 10% statute; however, both companies and expatriates in this situation must fulfill the offshore activity and minimum salary requirements.

This special visa is granted for a one-year and can be extended for up to six years. The visa is available even after August 27, 2008 (the date when new immigration requirements commenced per Law Decree 3 of 2008).

Visas for pensioners and annuitants

According to Law 9 of 1987 and its corresponding amendments, the following visas are issued based on pension or annuity income:

- The tourist pensioner visa;
- The retired annuitant visa.

The main features of these types of visas are:

- Having a retirement pension or a private retirement fund;
- The tourist visa is not compatible with an immigrant visa;
- The tourist pensioner visa is for persons receiving a pension of at least five hundred US dollars (US\$500) per month, plus one hundred US dollars (US\$100) per each dependent;
- The retired annuitant visa is for those receiving a monthly income of at least two thousand US dollars (US\$2,000.00), coming exclusively from interests earned during a five-year period from an account held at the National Bank of Panama or Savings Bank of Panama.
- In the case of a tourist pensioner visa, the pensioned status should be proved with legal documentation. In addition, competent authority shall confirm the pension status of foreigners with their pension companies (including private pensions);
- In the case of a retired annuitant, the visa gives the foreign retired annuitant the right of obtaining a special Panamanian passport;
- All aliens applying for any Panamanian visa are required to submit the following documents: police records of themselves, their spouse, and all dependents over age 18, medical certification of health with no less than three-month expiration, marriage and birth certificates of the children, four photos, a declaration of personal background, valid passport of no less than six-month expiration and legal copy of passport.

Investment is widely welcomed and expressly authorized. Therefore, business operations under said status are allowed; however, employment is forbidden without be authorized.

The following exemptions are granted concerning employment and tax payments:

- Working exemptions: rendering specialized services to the Government which are not provided by Panamanians; when doing business, she/he invests significant sums in an enterprise and is previously authorized by the Ministry of Labor; when she/he is board of director member of owned companies (self-employed);
- Tax benefits of having a visa to reside in Panama are: import duties exemption upon domestic goods and vehicles, no fee relating to the acquisition of the visa, and tax-exempt income upon pension or annuity due to foreign source income.

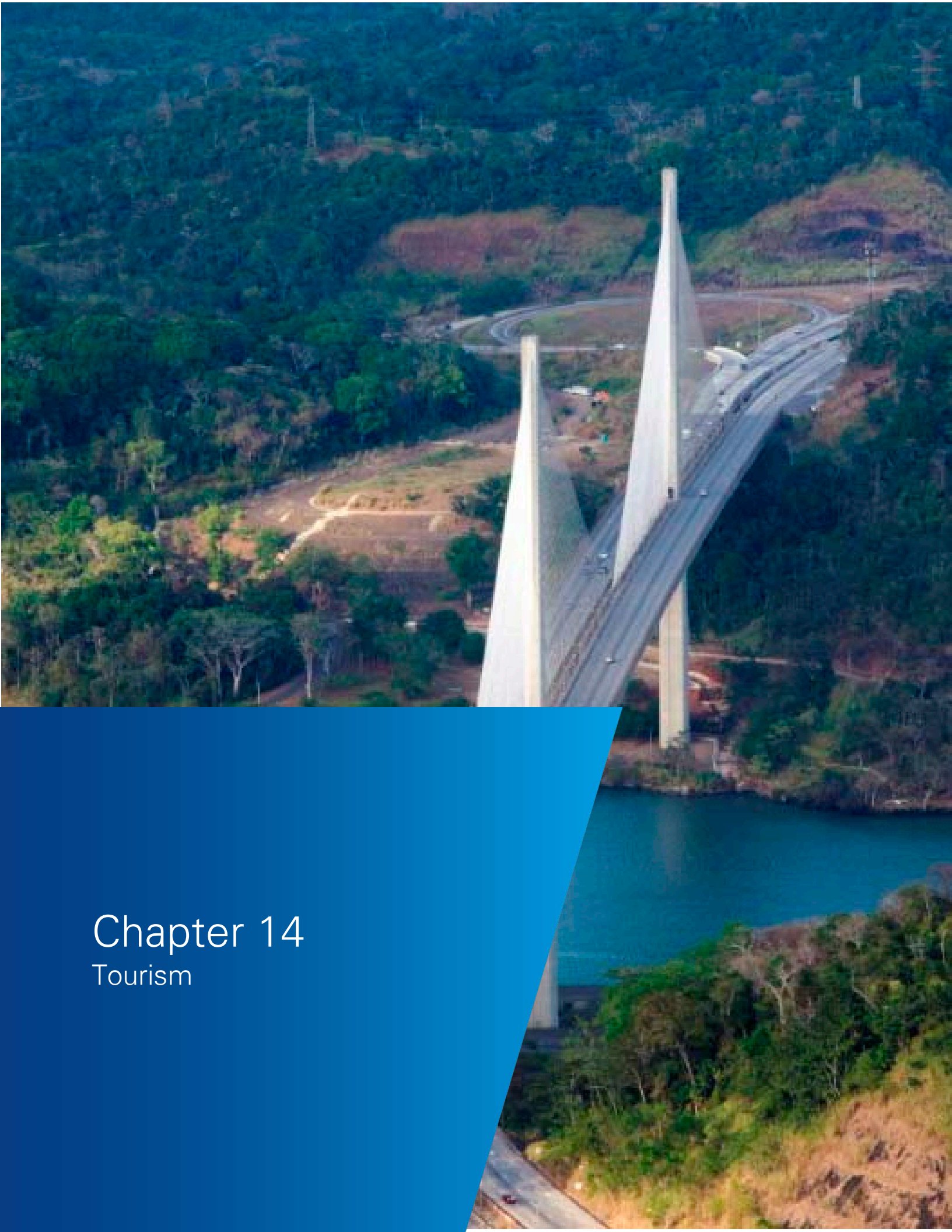
Bearers of certain tourist visas

Citizens of any country who are bearers of visas from either United States, Canada, Australia, United Kingdom or any country of the European Union have no need to request a Panamanian visa to enter into Panama as a tourist, as long as the bearer of such a visa has already enter the referred country that granted the visa. Instead of requesting the visa, the solicitor will pay a tourist card of US\$30.

Discounts on the basis of age

According to Law 6 of 1987 (as amended), any individual, citizen or foreigner, who is fifty-seven (57) years of age if female, or sixty two years (62) of age if male, will be offered discounts by service providers and retailers. Some of the discounts are:

- A 50 percent discount on admission to recreational or entertainment activities such as theaters, movies, sports and several public shows.
- A 25 percent discount on air fares;
- A 50 percent discount when staying in hotels from Monday through Thursday and 30 percent from Saturday through Sunday;
- A 25 percent discount on individual food consumption invoices (of first and second class restaurants).
- A 15 percent discount on fast food establishments
- A 25 percent discount on electricity services, residential telephone and water supply repair (certain restrictions may apply);
- A 20 percent discount on the value of drugs obtained. ;
- A 15 percent discount on the private hospital services;
- A 20 percent discount on professional and technical services.
- A 50 percent discount on commission expenses and closing transactions in personal or commercial loans.
- A 15 percent discount on the maximum interest rate allowed by law, to be charge by banks, or credit institutions.
- A 20 percent discount on coffins and urns for retired, pensioner or third age persons;
- Exemption starting one percent over rate applied to all local personal or business loans above five thousand US dollars (US\$5,000);
- Total exemption from payments to Public Registry when registering board of directors, certifications, and new legal entities of retired, pensioner or third age non-profit organizations.
- Real state tax freeze on the property in the house that is on its name and is the only one house.



Chapter 14

Tourism

Chapter 14

Tourism

Traditionally, people visiting Panama, usually do it for business purposes. The banking center area, the Colon Free Zone, the offshore services and many other activities have attracted international visitors. Recreational tourism offers great opportunities for development too. The tourism sector is experiencing a rapid recovery and there are ample opportunities for investing, especially in the field of ecotourism, cruisers and residential tourism.

Investing under Law 8 of 1994

Law 8 of 1994 regulates tourism activities in the Republic of Panama for incentives and benefits granted to projects including hotels, restaurants, nightclubs, convention centers, condominiums, airports, ecological tourism, infrastructure and restoration of historical buildings and monuments. The Panama Authority for Tourism or PAT (formerly ATP as per its abbreviations in Spanish) is responsible for this area. Only investments in areas of public interest (which are considered special tourist zones) will be granted benefits until December 31, 2015.

Special tourist zones¹

For those investing in tourist development zones, the following incentives are granted:

- Twenty-year exemption on real estate tax for land acquisition and improvements;
- Fifteen-year exemption on income tax derived from the exploitation of activities;
- Twenty-year exemption from import duties, contributions, and value added tax (ITBMS) over the importation of furniture, materials, equipment, parts and accessories used for the construction of premises, as long as they are not manufactured in large quantities in Panama. Vehicles for at least eight passengers, aircraft, helicopters, boats, vessels and sport goods exclusively for tourist activities are considered for this type of benefit;
- Twenty-year exemption on taxes and duties or fees levied on the use of ports and airports built by the company;
- Twenty-year exemption on income tax for interest derived from credits conceded for investments in tourist activities.

¹ Special tourist zones as declared by the Panamanian Executive Branch Council of Cabinet at request of the Panama Authority for Tourism (former IPAT).

Lodging facilities

- Law 8 of 1994 limits the possibility for incentives to be used for investments related to hotels, except for golf and tennis courts, sauna baths, gymnasiums, discotheques and restaurants.
- Exemption on any tax levied over the net worth of the company.

Other constructions

For the construction, equipment, rehabilitation and operation of convention centers, parks, zoo, marines and cultural and historical centers, the following incentives are granted:

- Exemption for three years of import duties on the importation of equipment and materials not manufactured in large quantities in Panama and/or not of the same quality as required. Previous recognition by ATP must be obtained.
- Accelerated depreciation of building facilities in ten years.
- Exemption on real estate tax on improvements for a twenty- year period.

Receptive tourism

For those companies exclusively dedicated to exploit “receptive tourism”, an exemption from import duties will be granted every three years for the importation of terrestrial and maritime vehicles, upon approval from the ATP.

- Vehicles may eventually be sold, once the import tax is paid;
- Exemption on import duties for the importation of motor vehicles exclusively for tourist activities providing collective transportation services in airports, ports and hotels. Prior approval from ATP is required.

Film companies

For film companies and promoters of cultural or sport events of international status or companies conducting international broadcast internationally (which enhances or promotes tourism in Panama), will be granted the following incentives:

- Exemption of all income tax on the proceeds of the event, except when the tax paid in Panama is creditable in the respective countries;
- Exemption of national taxes or duties, on the event;
- Temporary exemption of import duties on the introduction of equipments, materials and parts utilized to broadcast the event internationally, all of which will need to be re-exported at the end of the event;
- All free publicity material used to promote tourism will be exempt from import duties, with prior approval from the ATP.

Other incentives

- For lodging enterprises and restaurants dedicated exclusively for tourist activities and operating out of the metropolitan area, a certificate of tourist employment (CEDT) will be granted, provided that the enterprise does not benefit from other incentives described in Law 8 of 1994;
- Tourist yachts not exceeding a 90-day stay will be exempted from all taxes and duties levied on their arrival and use of ports;
- Investment in restoration, maintenance or illumination of historical monuments and national municipal parks will be treated as deductible expenses when the Ministry of Economy and Finances and the Panama Authority for Tourism (PAT) considers that the investment promotes the development of tourist activities.

Investing under Law 2 of 2006

Tourist projects built on properties of the State

- According to Law 2 of 2006, a special regime governs real estate concessions and islands transference on properties of the State such as coastline lands, insular territories and other State's properties;
- Concessions shall be granted for lodging facilities, tourist projects or economic development;
- Administrative concessions may be up to forty years as a general rule, plus an additional thirty years (seventy years altogether);
- Contracts shall be performed up to seventy years on insular territories, coastline zones (with beachfront view) and other State's properties;
- Due to a longer term necessity, concession contracts may be up to sixty years, and prorogate by thirty years added when investment, economic impact and employment potential are settled (ninety years altogether);
- Real estate concessions for purposes of vacation or retirement are also authorized. Constructions shall be made within tourist development zones declared by the Cabinet Council in order to be granted tax incentives during the construction and sales period according to Law 8 of 1994 (tourism regime);
- Transference of insular real estate properties for tourist purposes cannot exceed fifty (50) percent of the island surface; it cannot be transferred to other State;
- Tourist projects within special development areas cannot surpass thirty (30) percent of the island surface;
- A 30 percent panoramic vision of the insular coast zone must always be preserved in all tourist projects, according to Law 2 of 2006.

Investing under Law 58 of 2006

Hotel industry based on Law 58 of 2006

In order to promote public tourist accommodation, Law 58 of December 28, 2006 grants incentives to construction, equipment and rehabilitation improvements; conditions are as follows:

- Location of projects may be inside or outside of a special tourist development zone declared as national interest;
- Minimum investment amount is US\$3,000,000 for metropolitan area and US\$50,000 for the rest of the country;
- By August 30, 2008, every project outside of a special tourist zone should be submitted to the tourism authorities and be registered by December 31, 2008. This deadline superseded the cutoff date set Law 8 of 1994 (December 31, 2005);
- By August 30, 2015, every project inside a special tourist area should be submitted and be registered before December 31, 2015;
- Golf and tennis courses, saunas, gyms, discotheques, restaurants, convention centers and marines are not granted incentives separately; incentives are granted along with the principal hotel investment.

Tax incentives

- Twenty-year exemption on import tax for materials, equipments, ships and eight persons motor vehicles;
- Twenty-year exemption on real estate tax;
- Exemption on any tax for enterprise capital, including tax on net assets (two percent tax);
- Exemption on pier tax and any landing tax in piers, airports or heliports owned, or rehabilitated, or constructed by the enterprise;
- Exemption on income tax for the interest perceived by banking or financing creditors;
- Depreciation of real estate property –excluded land value- may be calculated for ten years instead of thirty years;
- Local loans will not be subject to FECI (one percent surcharge) as long as proprietors are registered with the tourism authority.
- As for the Law 58 of 2006 benefits for the investments, will be for activities such as: golf courses and tennis courts, sauna baths, gyms, clubs, restaurants, convention centers and marine long as they are integrated hotel investment.
- The tax incentives that Law 58 of 2006 promotes could be transferred to others similar companies its incentive rights and the company who receive the incentives rights should be register in the National Tourism Register.



Chapter 15

Labor legislation

Chapter 15

Labor legislation

Labor contracts

The Labor Code states that labor contracts must be in writing and the employer, employee and labor authorities must each have a copy; otherwise, any fact or circumstance alleged by an employee will be presumed to be true, unless the employer can prove otherwise beyond a reasonable doubt.

The most important features are the following:

- The contract may be for an indefinite or a definite period of time, or for a specific project;
- An employee can be hired on for a probationary period of three months, provided that the type of service requires special skills, and it has been expressly written in the contract;
- The maximum term for a definite period contract is one year;
- A definite period contract becomes indefinite, if the employee: (1) continues working after the definite period expires; (2) continues working after the specific project for which the employee was hired is completed; or, (3) when succeeding contracts for a definite period or contracts for a specific project are negotiated;
- Employees cannot waive their rights when entering a contract, nor can they be diminished.
- Any provision, act, or declaration of the employee that provides or implies lessening or relinquishment of any right is considered null and void, even if stated in the labor contract or in any other pact;
- The division of the enterprise, in diversified or separate companies does not affect employees' rights. The concept of an economic conglomerate prevails, so that employees can furnish claims against the employer.
- Local legal advice should be sought before making any decision concerning labor law.

Salaries

Work permits

Foreigners wishing to work in Panama must obtain authorization, in the form of a work permit, from the Ministry of Labor and Employment Development.

- Work permits are valid for one year, and may be renewed.
- Firms employing foreign personnel must maintain certain proportion between local and foreign workers.
- Local personnel are defined as Panamanians, foreigners married to Panamanians, and foreign employees with at least 10 years of legal residency in Panama.
- Employers are allowed to hire up to 10 percent of foreign employees from the total number of administrative workers, and up to 15 percent in the case of specialized or technical personnel.
- Exceptions can be made under special conditions.
- Corporations established in Panama exclusively to supervise operations or transactions carried out abroad, are exempt from these ratio requirements.

Salaries and minimum wages

- Salaries can be fixed by unit of time (month, fortnight, week, day or hour), task, or by a specific job.
- Salaries include any money, gratuities, bonus, premiums, commissions, profit sharing, and any other income or benefit employees receive as payment for their work such as representation expenses and in kind salary.
- Employees must be paid at least twice a month.
- The Government establishes minimum wage based on the hourly wage, economic activity, company size and region.
- Minimum wages in the Region 1 ranges from US\$1.22 per hour for small agricultural and livestock businesses to US\$2.36 Region 1 and US\$2.24 Region 2 for the construction industry. In the domestic service the minimum salary for Region 1 will be US\$200.00 and for Region 2 will be US\$175.00. The chart for minimum wages is located on chapter 17.
- In reference to the canal activities related with the use, manage, maintenance, protection and defense of the Panama Canal, the minimum wages will be US\$2.90 for private company's workers in commercial activities, canal, activities related to transfer property or provision of services to a person who have a private or public right.
- Average salaries paid to skilled employees in Panama's metropolitan areas far exceed the minimum rate.

Work day

According to the Labor Code, four different work shifts are established. These are as follows:

- Day shift, consisting of a maximum of eight hours; from six hours to eighteen hours (6:00 a.m. to 6:00 p.m.) with a maximum of 48 hours in a week;
- Night shift, consisting of a maximum of seven hours; from eighteen hours to six hours (6:00 p.m. to 6:00 a.m.) with a maximum of 42 hours a week;
- Mixed shift, consisting of seven and a half (7-1/2) hours including both the day shift and the night shift, with a maximum of 45 hours a week. A mixed shift with more than a three night shift hours is considered to be a night shift;
- Rotational shift, for companies required to employ personnel during different hours according to the companies' activities and needs.

For the night, mixed, and rotational shifts, employees receive the same payment as for the day shift, even though their working hours are shorter. A working day consists of the total time the employee cannot freely use, when at the service of the employer.

Overtime

Hours worked in excess of the maximum hours defined above must be paid as overtime.

Overtime rates are as follows:

- Twenty-five (25) percent surcharge for hours worked during the day shift;
- Fifty (50) percent surcharge for hours worked during the night shift, for hours worked in excess of a mixed shift initiated in the day period, or for work performed on any days off (i.e., Sunday);
- Seventy-five (75) percent surcharge for hours worked in excess of the night shift or a mixed shift initiated in the night period;
- A hundred and fifty (150) percent surcharge for hours worked on a holiday or national mourning day and an additional day off must be provided and paid. Hours worked in excess of the regular shift on a holiday must be paid at the same rates as above, in addition to the 150 percent surcharge;
- An employee cannot be required to work overtime except under special circumstances (e.g., export industries) or by a written contract;
- Three hours per day and up to nine hours per week are the maximum legal overtime hours;
- For overtime in excess of this limit, the employee is entitled to receive a 75 percent surcharge.

Export industries and small businesses have special dispensations regarding overtime. These companies pay a unique 25 percent surcharge over regular salary for overtime, and 50 percent for work performed on holidays or mourning days.

National holidays and mourning days

Twelve days are legally considered national holydays or mourning days.

CHAR OF NATIONAL HOLYDAYS	
Month	Day
January	1 (New Year Day) 9 (Martyrs Day)
Mardi Grass	One day in February or March
Good Friday	One day in March or April
May	1 (Labor Day)
November	3 (Independence Day) 5 (Independence Day, Colon only) 10 (Cry for Independence Day) 28 (Independence Day from Spain)
December	8 (Mother's Day) 25 (Christmas Eve)
Every five years	July 1- 2014 (Presidential Inauguration)

Note. Consider August 15th (Foundation of Panama City, Panama City only), November 4th (Flag Day), and December 24th (Christmas Eve) as feasible public holidays but not labor-free holidays.

Vacations

- Employees are normally entitled to one month (30 days) of annual vacation every year.
- Annual vacation is accrued at the rate of one day for every eleven (11) days of work.
- The employee in exchange may not waive annual vacation for payment.
- However, it can be accumulated for up to two years by mutual agreement, but there is a minimum rest period of 15 days during the first period.
- The thirty-day period can be divided into no more than two equal parts.
- Employees working for companies established in export processing zones might enjoy annual vacation in advance, even if not earned, provided that the operating cycle demands it.

Leaves and benefits

Following are sick leave, maternity leave, thirteen month bonus and worker's compensation.

Sick leave

- Paid sick or disability leave must be provided for each employee when required, up to one and a half days per month, or 18 days per year.
- Sick leave can be accumulated for up to two years, and may be enjoyed entirely or in part during the third year of service.
- If an additional sick leave is required, employees covered by the social security agency may receive an additional period of leave.

Maternity leave

- Female employees are entitled to special benefits under Panama's Labor Code. Once pregnant, they can be dismissed only for cause with judicial assent. This same privilege is extended for one year following childbirth.
- Maternity leave must be granted for at least 14 weeks, six weeks before delivery, and eight weeks after childbirth. While in maternity leave, no communications or actions, sanctions or measures provided in the Labor Code can be taken by the employer.
- The social security agency provides a subsidy to cover female employees for this period. The employer must pay the difference between this subsidy and the employee's salary.

Thirteenth month bonus

- All employers must pay their employees a special bonus called the thirteenth month bonus. This bonus is estimated at one-salary day for every twelve (12) days of work.
- The thirteenth month bonus is paid in three equal installments: on April 15, August 15, and December 15 of every year.
- Sums paid for the thirteenth month bonus is subject of social security's contributions for the employer and they are not subject to any other type of withholdings except for the employees' income tax and social security contributions.
- Educational insurance tax is therefore not withheld.

Workers' compensation

- All employers must enroll their employees in the social security system, which includes workers' compensation.

- This is an additional premium paid depending upon the risks involved in the activities performed.

Termination of employment

Either an employee or an employer can terminate a working relationship. There are six ways to end an employee-employer relation:

- By mutual consent.
- Expiration of the agreed term, or conclusion of the work.
- The death of the employee, or dissolution of the employer.
- A justifiable cause (as defined in the Labor Code).
- Resignation of the employee, and
- A unilateral decision of the employer, subject to the formalities and limitations established in the Labor Code.

Relevant issues:

- Exceptions are provided for temporary workers, domestic workers, apprentice workers with less than two years of service, and agents with less than five years of service.
- In this case, the employer must either provide a thirty-day notice or must pay a one month severance (equivalent to a month's salary).
- Employees who wish to resign must give at least a 15-day notice.
- Technical workers must give at least a two-month notice.
- If the termination is by mutual consent, it must be in writing and should not involve the waiving of any of the employee's rights.
- This document must be submitted to the General Director of Labor, at the Ministry of Labor and Employment Development, in order to be valid.
- Non-compliance with this requirement can result in reinstatement within the next thirty calendar days, with the payment of all accumulated unpaid salaries.
- Resignation by the employee must be ratified before the Ministry of Labor and Employment Development, which has the authority not to ratify said resignation if it implies waiving any of the employee's rights.
- The Ministry of Labor and Employment Development must also authorize the termination of collective labor relationships.

Seniority premium

- When a working relationship ends, the following items are relevant: seniority premium, justified causes and unjustified cause premiums.
- Employees, who leave an employer for any cause, are entitled to receive a lump sum payment equivalent to a one-week salary for each year employed.

Justified causes

The Labor Code allows an employer to dismiss an employee for disciplinary reasons, non-fault reasons, or economic reasons. In the last case, the employer must obtain previous approval from the labor authorities and pay an indemnity to the dismissed worker.

Justifiable causes for dismissal of an employee for disciplinary reasons include:

- Deceitful representations regarding the employee's special skills;
- Disobedience;
- Engaging in acts of violence;

- Absenteeism;
- Use of alcohol or drugs on the job;
- Theft;
- Damage inflicted upon the company's physical or intellectual assets;
- Sexual harassment; and
- Low productivity according to standard evaluation systems.

Some non-fault reasons are:

- The firm's closure resulting from an act of God;
- Imprisonment of the worker;
- Retirement;
- Permanent disability or loss of capacity to exercise a profession.

Economic reasons include:

- Bankruptcy;
- Insolvency;
- Reduction in sales causing a reduction in the company's activities;
- Cancellation of requests or buying orders, decrease in production activities or in sales.

Unjustified cause premium

- As previously mentioned, any employer who dismisses an employee without legal cause is liable for payment of a compensation premium.
- This lump sum of money is based on the indemnity tables.
- For employees hired after August 14, 1995 it will consist of three point four (3.4) weeks for each year employed, for the first ten years.
- For the subsequent years, it will be set at one week for each year employed.
- Indemnities are subject to income tax based on a special procedure, but not to social security or educational tax.

Labor unions

Panamanian labor laws recognize the right of employees to form or join unions. Workers also have the right to strike in order to protect their working conditions or to improve them.

Collective conflicts may be submitted totally or partially to arbitration. New companies established after October 1990 are not forced to sign collective bargaining contracts during the first three years of operation.

Severance fund

Law 44 of 1995 states that employers must create a severance fund for the payment of seniority premiums and the indemnifications due to unjustified dismissals or justified resignations concerning contracts of an indefinite period.

- The severance fund must be created through a trust.
- Contributions to the severance fund will be made totaling one point ninety two (1.92) percent of the payroll as seniority premium and covering five (5) percent of the monthly quota (meaning

0.327 percent) to which the employees would have a right in the event of an unjustified dismissal or justified filed resignation.

- Interests and payments will be made in the name of the employer.
- The employer will be able to make withdrawals of the fund if there is a surplus with regards to current labor liabilities.
- Contribution to the severance fund is deductible.
- Employees can make individual contributions to the severance fund, through an individual account.

The following will be charged to the severance fund:

- Seniority premium;
- Termination of employment due to unjustified dismissal, after a statement from the corresponding authority has been made;
- Justified resignation of the employee declared by a competent authority;
- Termination of employment by mutual agreement that includes partial or total delivery of the indemnification for unjustified dismissal.

Minimum wage

The minimum wage by law was enacted and became effective as of January 1, 2012 so as to regulate hourly rates, economic activity, company size and region.

Following the Constitution of the Republic of Panama that guarantees a minimum wage or salary, the Executive Decree 240 of December 28, 2011 repeals and replaces the former Executive Decrees 263 of 2009 and 13 of 2010.

The new decree is published in the official gazette (Government news bulletin) of December 28, 2011 and sets the new minimum wage rates; the decree provides regulations for the constitutional principle and the Labor Code –specifically Article 173 which reads as follows: *“The minimum wage is the lowest monetary amount payable by the employer to the employee according to the time unit set for the region, business or profession in question.”* The Political Constitution indicates in its Article 66 that the law will establish how to adjust the minimum wage periodically; also, Article 174 in the Labor Code states that the minimum wage will be set periodically by executive decree taking into account recommendations from the appropriate committee.

The national territory is segregated by regions – districts are grouped as follows:

- Region 1: Panama, Colon, San Miguelito, David, Santiago, Chitré, Aguadulce, Penonomé, Bocas del Toro, La Chorrera, Arraiján, Capipe, Chame, Antón, Natá, Las Tablas, Bugaba y Boquete.
- Region 2: Remainder of the country's districts.

Note: Regions 2 and 3 have been merged – hence, there will be difference/variance (rates for minimum salaries).

Entities employing ten (10) or fewer staff are considered *small business* so as to differentiate it from *large enterprises*. However, entities that employ 10 staff and fall under any of the following categories are indeed considered small business (exceptions): agriculture, livestock, services or retail enterprises require 10 employees; otherwise, manufacturing companies require 15

employees or less and agro-industrial companies require 20 employees or less for being small businesses.

The decree also refers to the automatic modification of wages that are less than the minimum amount, in regulation of article 176 of the Labor Code - which states: "The setting of minimum wages automatically modifies clause wage contracts and labor agreements that stipulate a lower wage."

With this in mind, said decree states that the fixed rates are minimum monetary compensations to be paid to workers and, therefore, it modifies the lower wages stipulated in any law or regulation, employment contract or collective agreement. Moreover, for higher wages, there would be no automatic change as the decree mentions that *"similarly, wages that are higher than those set out in the Decree will continue to be the same, including higher salary that are set forth in any provision or contractual agreements, and business practice related to higher compensation."*

As of minimum wage rates per hour, some few examples are provided on the chart below {Depending on the region, economic activity and company size, existing throughout the country}

Economic Activity	Region 1	Region 2
Agriculture, cattle ranch, hunt, forestry, Aqua-culture.		
• Small Business	1.22	1.22
• Large Business	1.43	1.43
Fishing (domestic)		
• Artisans	1.72	1.72
• Industrial	1.79	1.79
Mining and quarries	2.14	2.14
Manufacturing Industries		
• Small Business	1.76	1.47
• Large Business	2.14	1.77
Electricity, gas and water	2.36	2.36
Construction	2.36	2.24
Wholesale and commission trades	2.14	1.76
Retail trade		
• Small Business	1.74	1.45
• Large Business	2.14	1.76
Hotels		
• Small Business	1.78	1.48
• Large Business	2.08	1.71

Restaurants and bars			
• Small Business	1.76	1.47	
• Large Business	2.14	1.76	
<hr/>			
Transport	2.14	1.76	
<hr/>			
Storage, deposits and post office/mail	2.08	1.76	
<hr/>			
Communications network	2.14	2.14	
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Financial and insurance activities	2.36	2.36	
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Real estate activities	2.36	2.15	
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Rental activities	2.14	2.14	
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Business support activities	2.08	2.08	
<hr/>			
Professional, scientific and technique services	2.08	2.08	
Lawyers and audit firms (15 employees and up)		2.14	2.14
Lawyers	2.36	2.36	
Human health services	2.14	1.76	
<hr/>			

For domestic service, the decree regulating the monthly minimum wage is as follows:

- US\$ 200.00: Panama, Colon and San Miguelito Districts, David, Santiago, Chitré, Aguadulce, Penonomé, Bocas del Toro, La Chorrera, Arraiján, Capipe, Chame, Antón, Natá, Las Tablas, Bugaba y Boquete.
- US\$175.00: Remainder of the country's districts.

This decree should be adjusted every two years as established by law; therefore, on December 2013 a new decree will replace the one explained above.

As a reminder, the regular working week is 48 hours (full-time) which could be lower depending on evening part-time hours worked or a combination of day and night shifts, as well as simply working fewer hours than the maximum amount.

A photograph of a row of red metal lockers. The lockers are arranged in a grid, with silver-colored metal frames. A locker door in the foreground is slightly ajar, revealing a silver handle and a small red square on the lock mechanism. A large, solid blue triangle is positioned in the lower-left corner of the image, partially obscuring the lockers.

Chapter 16

Social security system

Chapter 16

Social security system

This chapter summarizes the social security system. It discusses both the employer and employee contributions and taxation matters (e.g., deduction and withholding). Additionally, detail for the old age retirement pension is provided.

Social security levies

The social security system in Panama replaces many of the employee's benefits usually provided by private insurance in other countries.

Highlights

- Management of the social security system is provided by the Social Security Administration ("*Caja de Seguro Social*").
- It not only provides retirement benefits, but also health, dental, maternity, disability, and death benefits. Therefore, the cost of employee's benefits may be reduced, yet the coverage provided is not different than a private insurance coverage.
- For workers, there are two legal regimes: the mandatory enrollment and the voluntary enrollment.
- All employees working for the Government, individuals or enterprises operating in the national territory, including foreigners, are subject to the mandatory system of social security.
- The social security system grants benefits to the insured and their dependents.

Mandatory affiliation and enrolling

- Every company organized to carry out activities in Panama must request an employer's inscription number from the Social Security Administration, six days after starting operations and hiring workers.
- Employers must be registered with Social Security Administration and employees must also be enrolled.
- The mandatory enrollment includes dependent workers (employed by other, working for another person or on account of another) as well as independent workers (account of oneself or self-employed workers) with a gross income over nine thousand six hundred US dollars (US\$9,600) a year.

- Nationality is not considered, what is relevant is that the service is performed within the Panamanian territory (including diplomatic and consular assignments).

Self-employed workers

- There are two categories created by law: taxpayer self-employed workers and non-taxpayer self-employed workers. Both are only responsible for fees.
- In addition, a mandatory enrollment for a self-employed person who is less than 35 years old is established by Law 51 of 2005. Beginning in January 2007, this mandatory system of social security pensions for independent workers is based 52 percent of their income, acquitted through the Directorate General of Revenue of the Ministry of Economy and Finances.
- Non-taxpayer self-employed workers. Persons, who earn less than nine thousand six hundred US dollars annual gross income, can keep their voluntary affiliation status (e.g. informal, eventual, domestic workers).
- Salary and fees received by a worker at the same time pay quotas for each category of income.

Withholdings (or contributions)

- Part of the Social Security income to cover the benefits is made up of obligatory payroll withholdings paid by the employees and the employers.
- Moreover, employers pay a rate between 0.98 percent and seven percent of salaries to cover worker's compensation, depending on the activity.
- Employers must pay contributions every month. Late payment could result in a 15 percent penalty, plus one percent interest charge for every month or fraction of delay.
- The action for the collection of premiums from employers has a 20-year statute of limitation.

Meaning of salary for labor law purposes

- For withholding purposes, salary is understood to be the total compensation, including commissions, vacations, and monetary amounts or in kind that workers may receive from their employers, such as:
 - 1 Bonus payments,
 - 2 Director fees (director per diem) exceeding 25 percent of the monthly salary,
 - 3 Production premiums exceeding 50 percent of the monthly salary and representation expenses.
- Additionally, in 2006, the withholding became applicable (gradually) over a portion of the representation expenses as follows.

Social security and representation expenses

With respect to representation expenses, effective July 1, 2008, the total social security contribution increased due to a change in its taxable base – which changed from twenty five percent (25%) to fifty five percent (55%) in force through June 2010.

- Effective July 1, 2010, representation expenses are taxed at 100% by the Social Security Authority – according to Law 51 of December 27, 2005. Refer to chart below.
- Representation expenses are taxed at 55% for social security contributions as of July 1, 2008.

CHART OF REPRESENTATION EXPENSES

Time period	Taxable income
From 07/01/2006	25%
From 07/01/2008	55%
From 07/01/2010	100%

Income not considered as salary

The following sources of income are not considered salary and therefore, not subject to social security contribution:

- The three installments of the thirteenth month bonus;
- Severance notice;
- Termination indemnities;
- Participations in profits that benefits 70 percent of enterprise's employees as a minimum. Hence, no withholdings are made from profit-sharing benefits granted to employees, provided that these benefits include no less than 70 percent of the workers, and do not exceed nor substitute the total annual salary;
- Dividends (as long as they do not substitute salary);
- Gratuities or Christmas bonus less than one-month salary;
- Seniority premium;
- Travel and food allowances;
- Production premiums not exceeding 50 percent of one-month salary.

Quotas and payments

Subject to changes by Law 51 of 2005, quotas increased in January 2006. Furthermore, it is understood that both cash income and in kind income for both dependent and self-employed workers pay quotas.

- Higher percentages have been approved for regulating the social security system.
- Self-employed workers are obligated to make quotas for pensions when they are less than 35 years old.
- Thus, the progressive schedule chart applies to both employee and employer.
- Quotas and percentages payments vary. Regarding the employee-employer quota, it continued at 7.25 percent for the employee through December 2007 and it was established at eight percent for three years since 2008. This changed to nine percent in 2011 and will change to 9.75 percent in 2013.
- For employers, it continued at 10.75 percent of the paid salaries through December 2007, and changed to 11.50 percent for the next two years, effective in January 2008; it increased to 12 percent in January 2011 (for two years) and it will change to 12.25 percent on January 2013. Employers must pay an additional quota to contribute to the health and maternity program. This percentage is already added on the following chart.
- Self-employed workers pay quota on 52 percent of their annual gross fees as follows: 9.5 percent in 2007, 11 percent in 2008, 12.50 percent in 2012, and at 13.50 percent in 2013.

For comprehensive social security quotas (either withholdings or contributions), the chart below indicates what employers, employees and self-employed workers must pay:

Social security quota percentages rates

CHART OF SOCIAL SECURITY QUOTAS			
Time periods	Employees	Employers	Upon 52% of self-employed revenues
2006	7.25%	11.00%	0.00%
2007	7.25%	11.25%	9.50%
2008	8.00%	12.25%	11.00%
2009	8.00%	12.00%	11.00%
2010	8.00%	11.75%	11.00%
2011	9.00%	12.00%	12.50%
2012	9.00%	12.00%	12.50%
From 2013	9.75%	12.25%	13.50%
XIII Month Bonus***	7.25%	10.75%	-

Thirteenth month bonus

As per the table, employers are responsible for 10.75 percent of social security contribution for bonuses paid (on the 15th day in April, August and December). Additionally, employees are responsible to contribute 7.25 percent of bonuses paid into the social security system.

Disabled, retired persons and subsidies

The quota to be paid from a pension fund by the Social Security Administration is 6.75 percent of the monthly pension - due to invalidity, advanced age, dead or permanent disability. . Temporary disability or maternity leave compensation were paid out at 7.25 percent through December 2007; eight percent through December 2010 for three years, nine percent through December 2012 and will change to 9.75 percent beginning in January 2013. These contribution percentages and timeframe applies to employees as well.

Note. Law 51 of December 27, 2005 was the provision enacted to manage social security matters. Said law had been subject to the second administrative regulation (in order to determine the scope of its concepts and definitions among other important issues) through a resolution effective from June 1, 2006.

Social security benefits

The benefits, except for the payment of subsidies, covers the spouse of the insured, children up to eighteen (18) years of age (age 25 if they are students), disabled children and the parents (under certain conditions).

Medical, dental and hospitalization

- The Social Security Administration grants medical, surgical and dental care, prescription drugs, and hospitalization services to those insured as well as a subsidy in the case of temporary disability when an insured employee is unable to work.
- An insured employee is entitled to medical care which becomes effective when the employee starts working.
- Hospitalization services are available once an insured person has made at least two monthly payments within the first four months.
- After involuntary termination of employments, a worker is entitled to medical care, for three additional months, or one year if the employee has already paid social security for 15 years.

Disability subsidy

- Payments under the temporary disability subsidy are based on 60 percent of the monthly salary earned by the employee, and 1.25 percent of the monthly base salary for each month of withheld payments in excess of 180.
- The minimum amount of the subsidy is US\$145, and the maximum US\$1,000 per month.
- To be eligible for benefits, an employee should comply with either of the following: (1) declared disabled by the Social Security Administration; (2) have paid social security for a minimum of three years; and, (3) at the moment of becoming disabled, have an accumulation of no less than half of the required premium payments (which should be accumulated three calendar years prior to the disability).
- If the insured person has credited a minimum of 180 payments at the moment that the disability occurs, the requirement of the accumulation of payments is no longer valid.
- Any insured person, who has not fulfilled the requirements mentioned at the time of the disability, is entitled to an indemnity.
- Every disability pension is provisionally granted for a maximum of two years.
- If the disability continues after two years, the pension is for life, but subject to the Social Security Administration's periodical review, which will determine if the disability will continue.

Maternity leave

- During the course of pregnancy, childbirth, and post birth, insured female workers are entitled to any prenatal and obstetrical care as necessary.
- In addition, insured women who have paid social security for a minimum of nine months the year prior to seventh month of pregnancy, receives a maternity rest subsidy paid by the Social Security Administration, for six weeks prior to giving birth and an additional eight weeks following childbirth.

Workers' compensation (occupational hazards)

- Occupational hazards are defined as accidents and illnesses that workers are exposed as a result of the duties they must fulfill.
- Workers' compensation premiums are established in proportion to the amount of salaries paid; it is also based on the company's industry and its inherent risk.
- In the case of accident or illness, the insured person has the right to receive any necessary medical, surgical and hospital treatment, and obtain medicine supplies and other therapeutic treatments as required.
- In addition, the insured is entitled to the normal supply, repair, and renewal of any orthopedic or prosthetic apparatus, these treatments are deemed necessary due to the injury suffered.

- In the case of permanent disability, the insured person is entitled to a sum, which is established according to a disability scale, up to a maximum of 60 percent of the monthly salary.
- If the insured person dies on account of an occupational hazard, the person's beneficiaries are entitled to a pension.

Death benefits

- In the case of the insurer's death, those surviving the deceased are entitled to a pension if the deceased fulfilled the withholding requirements (for disability or if the deceased paid social security for a minimum of 15 years).
- Likewise, if the insured person was disabled or was receiving an old-age pension on the date of death, the beneficiaries are entitled to a pension.
- A surviving spouse is entitled to 50 percent of the disability or old-age pension received by the insured as of the date of death. This pension is payable for five years.
- However, if after this period elapses, the widow is disabled, has reached normal retirement age, or, is in charge of minor children receiving family allocation, the pension will continue to be paid for life (in the first two instances), or until the children are 14 years old (or 18 if they are students). The surviving spouse's pension is suspended the spouse remarries.
- If there are no surviving spouse or children, a pension on a lesser scale is payable to the deceased worker's mother, father (under certain conditions).
- If the deceased worker has not fulfilled the withholding requirements, the worker's survivors are entitled to an indemnity.

Funeral subsidy

To help cover funeral expenses associated with the death of an insured person, whether active or pensioned, the Social Security Administration pays a fixed amount of US\$250.

Retirement pension

The objective of the retirement pension is to replace, within certain limits, the salary no longer received by the insured upon retiring.

- A new system became effective as a result of Law 51 of 2005.
- At once age requirements and number of quotas are asked.
- The minimum age for obtaining a pension is between 55 and 62 years old (depending on gender).
- Effective January 1 of 2008, to be entitled to the old-age pension, women must be 55 years old and men must be 60 in order to apply for a special retirement pension (substantially lesser than standard pension).
- Generally, women must be 57 years old and men must be 62 as minimum ages, in addition to having paid social security for at least 20 years.

Old-age retirement pension

CHART OF OLD-AGE PENSION

Date	Quotas number
Until 12/31/2007	180
From 01/01/2008	216
From 01/01/2013	240

The minimum number of quotas is 180 to become eligible for an old age retirement pension through December 2007. The quotas increased to 216 paid quotas from January 2008 and it increases to 240 quotas from January 2013.

Maximum amounts on retirement pension

- Until December 2006, the maximum amount for a pension was US\$1,000 per month. However, if a person contributed to the pension for a period no less than 25 years, and earned an average salary of no less than US\$1,500 during 15 years, the maximum amount is US\$1,500.
- Since January 2007, the maximum amount was set at US\$1,500 unless fulfilling requirements to qualify for US\$2,000.
- If the insured person has not paid social security for the full 20 years upon completing the minimum age required, and wishes to retire from employment, the insured person may request to be granted an indemnity (lump sum amount).
- Prior to December 2009, the monthly base salary for calculating the old-age pension was the average salary received during the insurer's best seven years in which social security was paid.
- Effective January 2010, the average salary will increase to the insurer's best ten years.
- The amount of the monthly old-age pension is equal to 60 percent of the monthly base salary, plus 1.25 percent for withholdings collected in excess of 20 years.
- When the insured fulfils the requirements for old-age pension at a normal age and continues working, an additional two percent will be applied for every year.
- In addition, a family allocation of US\$20 is paid to the spouse or companion and US\$10 for every child under the age of 18.
- This family allocation is limited to a total of US\$100 per month.
- The amount of the pension plus the family allocation cannot exceed 100 percent of the base salary used to estimate the pension, with a minimum monthly benefit of US\$175 and a maximum of US\$2,000.
- The minimum amounts will be revised every three years or before, and if the financial situation allows it, the pensions may be increased.
- When the insured person has paid at least 30 years and the average monthly salary is no less than US\$2,500 during a 20-year period, the maximum pension will be US\$2,500 per month.

If an employer has not paid social security withholdings due to bankruptcy or insolvency (which allows the employee to complete old-age pension) the employee may cancel the corresponding debt.

Working after retirement age

The Supreme Court decision that was highlighted is generally applicable to the public and private sectors. However, there are regulations in the labor code (which is not addressed in this court decision) that employers from the private sector may apply.

A decision from the Supreme Court of Justice makes clear that it is not necessary to stop working in order to obtain (old age) pension.

The court decided that various phrases contained in two articles of the Social Security Law -Law 51 of 2005– was unconstitutional. The court determined that various phrase violated the constitution which protects the right to work, the freedom to pursue any profession or trade and the right to acquire private property in accordance with the law.

In this way, it is understood that upon satisfying the age requirement and density of contributions (when applying for an old age pension), the policyholder rights are advanced to an acquired category (which becomes part of the estate of the policyholder) – This is guaranteed by the Constitution; the policyholder has to stop working to benefit from the pension.

Expatriates

Panama's Social Security authority (*Junta Directiva de la Caja de Seguro Social*) approved Resolution 34, 498 -2007-J.D. of March 23, 2007 implementing General Regulation for Registering with the Social Security System (*Reglamento General de Afiliación e Inscripción en el Régimen de Seguridad Social*). We briefly discuss the provision in the Regulation that concerns international executives.

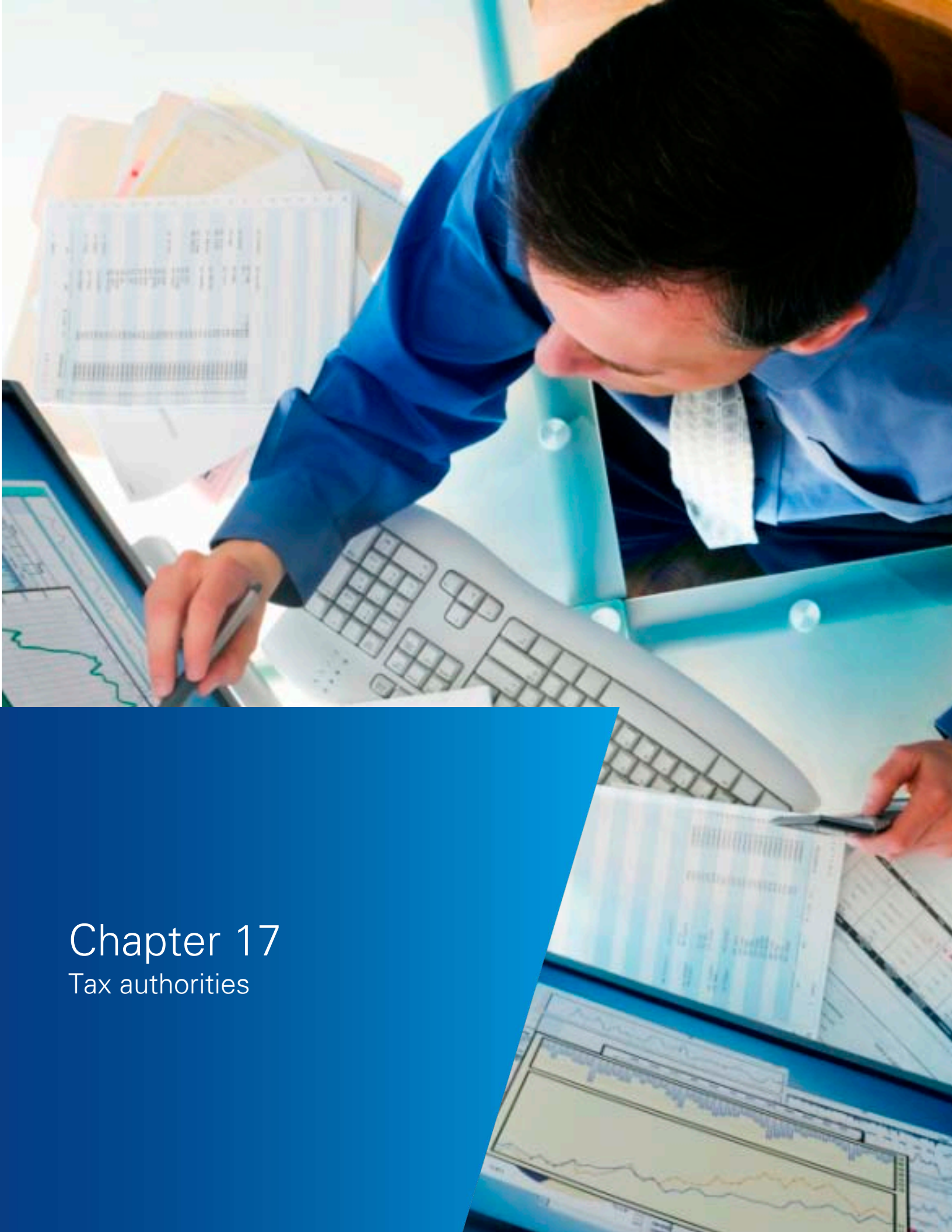
Article 21 of the regulation expressly states, "Every employee whose salary is paid from a foreign source or possesses a special temporary visitor's visa (*visa de visitante temporal especial*) is exempted from compulsory participation in the social security system, in line with the provisions of Cabinet Decree 363 of December 17, 1970 and Decree 236 of 16 June 1971."

Although a new migration regime has been enacted in 2007, the status of this special visa has not been modified.

Cabinet Decree 363 of December 17, 1970, contains the rules determining the temporary residence and visa status of executives working for international companies doing offshore business in Panama. Decree 236 of 16 June 1971 regulates the Cabinet Decree by further stipulating the qualifications for coverage under the Cabinet Decree.

The new rules provide clarity concerning the obligations of qualifying international executive vis-à-vis Panama's social security system.

The Social Security Authority expressly acknowledges that, generally, any international executive with such special visa needs not to participate in the Panamanian social security system, and her/his employer should not make withholdings from salary for social security contributions. The new migration rule (Law Decree 3 of 2008) does not address the social security status as the social security matter is governed by its own set of rules (Resolution of Affiliation).



Chapter 17

Tax authorities

Chapter 17

Tax authorities

Taxation Administrative Court of Appeals (TAT)

By virtue of Law 8 of 2010, the *Tribunal Administrativo Tributario* (TAT) has been called to attend appeals emerging from the governmental or administrative litigation (first level). This tax administrative court of appeals, the second and final administrative level for plaintiffs, replaced a former agency and deals with tax litigation coming solely from the Directorate General of Revenue which manages the majority of national taxes, except by Duane duties, tax of autonomous agencies and social security contributions. Municipal taxation is also apart. The TAT decisions might be revised by the Third Chamber of the Supreme Court of Justice.

Directorate General of Revenue

The Directorate General of Revenue of the Ministry of Economy and Finances (known as DGI; its initials in Spanish), is the Government institution in charge of overseeing and collecting revenues, services, rights, taxes, tolls, fees, duties, and excise taxes for the State, except by those referred above.

Since January 2006, it has been in charge of collecting social security contributions from self-employed workers to assist the Social Security Administration (CSS).

Returns and payments

- Any person, individual or legal entity obligated to pay income tax must file an income tax return.
- The due date is March 15 for individuals, and March 31 for legal entities with calendar fiscal periods.
- Legal entities with different fiscal periods should file their tax returns within two (2) months after the closing of their authorized special fiscal year.

Taxpayers may request the Directorate General of Revenue, prior to the expiration of the term for

filing the tax return, an extension of up to two months. Nevertheless, the income tax assessed by the taxpayers should be paid by March 31, at the latest.

The taxpayer must pay the corresponding interest and surcharges if there is a balance due at the time of filing the tax return. The return must include an affidavit of income obtained during the preceding taxable year, dividends, or earnings that were distributed to shareholders or partners, and interests paid to creditors.

Companies conducting local business are required to prepare and file annual tax returns.

- The fiscal year usually ends on December 31, except when a different fiscal period is authorized by the Directorate General of Revenue.
- Tax returns are due for filing three months after the closing of the year (March 31). Upon request, an extension of up to two months is granted for filing, provided that the taxpayer pays the estimated tax and interests (May 31).

Various scenarios

- In the event where a taxpayer requested an extension for filing the income tax return, such extension will expire on May 15 for individuals and May 31 for legal entities;
- As a reminder, individuals with balances are required to pay income tax, which expires on March 31. This is the case even if the taxpayer missed the March 15 deadline to file the mandatory income tax return or request an extension;
- Likewise, for legal entities: the payment term expires the same day as the deadline to file their income tax return or an extension – which is March 31. Legal base: Article 710 of the Tax Code

Income tax return

- The extension to file a tax return is limited to two months.
- A charge is imposed for the filing of amended returns whenever they are filed after twelve months of filing of the original return: US\$100 for individual or US\$500 for legal entities. In addition to the income tax return corresponding to the current fiscal year, legal entities must pay a Monthly Advance Income Tax (“AMIR” as per its acronym in Spanish), equivalent to one percent (1%) of the total taxable income of each month.
- Individuals or legal entities established in the Colon Free Zone must file a tax return for income derived from interior and foreign operations. Nevertheless, only local operations are subject to Income Tax.
- Credits are deducted from future tax liabilities, or may be transferred or assigned to other taxpayers.
- Each employer must remit to the tax authorities a report on the total annual amount of wages, remuneration, or salaries paid to each permanent or temporary employee and the amount of tax withheld. This report is due by May 31.
- Taxpayers must report the amounts of fees and commissions paid to other persons for professional services as well as rent and representation expense payments with their annual income tax return.
- Tax returns must be prepared using special forms provided by the income tax authorities. Failure to secure such a form on time does not release the taxpayer from the obligation to prepare her/his/its tax return.

- Additionally, tax returns must be prepared electronically with special software provided by the tax authorities

Making a false affidavit is sanctioned with fines of between two to five times the evaded tax or imprisonment from two to five years.

Legal entities

In the case of legal entities, sworn declarations must be signed by the legal representative, the general manager and the chief financial officer. Whether the legal representative of the company has at the time operative duties, her/his signature as legal representative should be replaced by the treasurer, the secretary, or other member of the board of directors who do not have operative duties within the enterprise. The signers of this declaration are severally liable for its accuracy.

Disputes

Examination of returns, assessments and appeals

- Returns are filed at the DGI electronically (www.DGI.gob.pa).
- A certificate of reception is issued to the taxpayer as evidence of filing. If the DGI, after auditing a tax return, decides that more tax is due, an assessment is issued through a resolution.
- A taxpayer may request an administrative review of the assessment from the Directorate General of Revenue (Province Division), in writing, and within 15 days following receipt of the assessment.
- If the request for reconsideration is rejected, the taxpayer should appeal at *Tribunal Administrativo Tributario* (TAT). If the appeal is also rejected, the taxpayer may proceed with filing a claim before the Supreme Court of Justice (Third Chamber) – at this level, the decision is final. All evidence admissible under the Procedural Code is also valid in tax matters.

Priority of credits in favor of the National Treasury

The law establishes that the National Treasury credits have preference over any other credits except for the following: (1) credits guaranteed with mortgage or lieu, (2) salaries and compensations owed to the workers, (3) social security premiums and, (4) special case foreseen in the Civil Code.

Surcharges and interests

- Penalties for late payment consist of a 10 percent surcharge.
- In addition, an interest of two (2) percent over the reference market rate set by the Superintendence of Banks, applicable per month or fraction, is charged on late payments of tax liabilities applicable in certain cases. This market reference rate will be set according to the rate charged for commercial loans, by local commercial banks six months prior.
- The Directorate General of Revenue is allowed to reach agreements to settle past-due tax debts.
- The 10 percent surcharge can be avoided if the taxpayer: (1) pays voluntarily, (2) pays within 15 working days following the notice of collection or, (3) pays within 15 working days as of the day of service of the corresponding resolution.
- If, as a result of a tax audit, a balance due arises, and at the same time the taxpayer maintains

credits with the National Treasury, such a balance will not be subject to the surcharges. Neither would it be subject to interest up to the amount of the credit owed by the Treasury to the taxpayer.

Payment of taxes

All checks for the payment of taxes must be certified. Taxes may also be paid through the national banking network, which is widely used.

Compensation and assignment of tax credits

Since the 1991 Tax Reform, the DGI has been able to authorize the compensation of liquidated and outstanding tax credits which originated since January 1, 1992, against equally liquidated tax debts of non-prescribed periods. It starts with the oldest (and even if the tax debt and the tax credit originate from different taxes), provided that they are administered by the Directorate General of Revenue. In the same way, the taxpayer is allowed to transfer her/his/its liquidated and outstanding credits originated since January 1, 1992, in order to compensate them with tax debts of the assignee.

Seizures and attachments

The Directorate General of Revenue is bestowed the power to order, along with the service of the resolution requiring the payment of a tax debt, the seizure, confiscation or attachment of any of the taxpayer's properties, in order to guarantee the collection of taxes and fiscal debts.

Coercive collection of debts (modification on procedures see Law 33-2010)

In the event that a legal action must be taken to collect taxes and import duties, an additional 20 percent surcharge is imposed. The Executive Branch may hire agents for the collection of past-due payments and taxes when the debt is at least two years old.

Tax evasion

Simulation of losses and other misrepresentations aimed to obtain an illicit benefit, incentive, exemption, reduction, deduction, or fiscal credit is considered tax evasion.

Filing requirements

An income tax return must be prepared and countersigned by a certified public accountant when the taxpayer's net worth exceeds US\$100,000 or when the yearly sales volume of the taxpayer exceeds US\$50,000.

Cessation of business activities

Individuals and legal entities no longer subject to income taxes because of cessation of business activities must submit tax returns and final balance sheets, within the following thirty days.

Taxpayers must pay taxes up to the time of cessation of business. The debt of an estate must pay taxes due by the individual who died.

Statutes of limitations

- Assessments for additional income tax issued after three years following the date of filing of the tax return are null and void, and the taxpayer is under no obligation to pay them.
- However, the statute of limitations for collecting income tax is seven years from the last day of

the year in which taxes were due.

- In the case of tax evasion a special statute of limitations of ten years applies.
- For individuals and entities responsible for withholding income taxes, the statute of limitations is 15 years from the date the tax should have been withheld.

Issuance of documents and forms

Tax clearance certificate

A tax clearance certificate ("Paz y Salvo Nacional") indicates that the taxpayer has paid the income tax, the tax on transfer of tangible personal goods and rendering of services, the educative tax and/or social security contributions to either the National Treasury or the Social Security Administration.

A tax clearance certificate is required in order to perform the following operations:

- Payments by the National Treasury, Municipal Treasury and others except for labor remunerations;
- Annual revision for commercial vehicles;
- Sale of tickets and permission for leaving the country to travel abroad (only for non-permanent residents);
- Added by Law 51 of 2005, a tax clearance certificate for social security obligation is also due when operations of business ended as well as when applying for business contract with the Government or any of its autonomous or semi-autonomous institutions;
- Tax clearance certificates are issued for a specific period of time.

Invoicing

- Copies of issued invoices can be stored in magnetic files, digital or other technological methods whenever they are requested by a taxpayer and authorized by the Directorate General of Revenue.
- Legal entities and independent professionals are obliged to use Fiscal Printers ("Equipos Fiscales") to issue invoices to their customers and clients (Exceptions apply).
- The Free Zones form is discontinued and it is replaced with the "Income Tax Return - Special Regimes", which must be used by taxpayers in the following categories:
 - Colon Free Zone (Law Decree 18 of 1948);
 - Tocumen International Airport (Law 23 of 2003/Cabinet Decree 30 of 2003);
 - Fuel Free Zones (Law 8 of 1987);
 - Tax Free Zones (Law 32 of 2011);
 - Panama Pacific Special Economic Area (Law 41 of 2004);
 - City of Knowledge (Decree Law 6 of 1998);
 - Any other regime that has specific taxation.

Be aware of additional reports that must be submitted to the tax authority – refer to the General Directorate of Revenue: :

- 1 Certification of interests on mortgage loans (residential without preferential interest). By lenders/credit companies;
- 2 Retirement funds, pensions and benefits report. By Entities;

- 3 Insurance companies report – certification of medical expenses of policyholder. By transmitters of policies;
- 4 Report of purchases and importing of goods and services. By legal entities and natural/individual persons according to gross income and/or total assets of one and three million US dollars, respectively;
- 5 Non filer report (according to gross income and/or total assets of one and/or three million US dollars, respectively).

Taxpayer identification number (TIN) or RUC

- Every individual or entity that pays taxes must apply for a taxpayer identification number (TIN) through the filing of the TIN form, or RUC by its initials in Spanish. This stands for Taxpayer Unique Record number based on the grounds of Law 76 of 1976.
- For an individual, a TIN refers to the Panamanian tax identity number at the Civil Registry or passport.
- For a legal entity, a TIN refers to the Panamanian tax identity number related to its inscription at the Public Registry.
- Also, a taxpayer number (TN) is given to foreigners either individual or entity including joint ventures.
- Should need in Spanish, a TN is called NT (*número tributario*).

*Executive Decree 539 of 2011 states that any payment shall be applied to the oldest debt.



Chapter 18

Financial sector

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Financial sector

Banking system

Law Decree 9 of 1998, which reformed the banking regime established by Cabinet Decree No. 238 of 1970 and created the Banking Superintendence, was updated and modified by Law Decree 2 (February 22) of 2008, in order to both conform to international regulatory standards and improve the banking sector's competitive edge.

Panama as international banking center

Panama's geographic location, its function as an international commercial center and the growth of the Eurodollar market are some of the most important elements contributing to Panama's growth as an international banking center. As of now, Panama has been awarded investment grade by Fitch Ratings, Standard & Poor's and Moody's..

Banking facilities

For more than 40 years, Panama has grown rapidly as an international banking center. The country has 92 banks, of which 48 are under a general license, 28 under an international offshore license, and 14 are representative offices. Some of these institutions are Panamanian-owned banks, as well as two Government institutions (owned by the State) and the remaining banks are international operations.

The Banking Superintendence

The Banking Superintendence is the entity responsible for the supervision and control of the banking system, including the prevention of money laundering in the banking system and the financing of terrorism. The entity is also entrusted with the protection of the clients' consumer rights.

This institution has legal personality and its own patrimony, independent of its exercise, but subject to inspection by the Office of the Comptroller General of the Republic of Panama. The Superintendence is composed of the Superintendent and five members Board of Directors. Banks must pay a fee which was approved by the Superintendence in order to finance the operations of the Superintendence of Banks.

The following are some of the Superintendence responsibilities:

- Authorize and issue licenses to engage in banking business;
- Determine, at the administrative level, the interpretation and scope of legal provisions on banking matters;
- Periodically set forth the legal reserves and the percentage of liquidity applicable to banks;
- Carry out inspections on banks so as to determine their financial situation and compliance with regulatory provisions;
- Intervene, when necessary, in the affairs of banks, appointing a trustee who will assume the administration thereof;
- Sanction the violation of the law decree; and
- Inspect banks to determine their financing situation and fulfillment with provision of the law.

A foreign supervisory entity may request information and carry out inspection visits to branches and subsidiaries of foreign banks in Panama over which they exercise consolidated supervision. Information that is obtained in this manner is subject to strict reserve and cannot be disclosed without previous authorization of the Superintendence.

Licenses to engage in banking business

Except for Panamanian official banks, no person or entity can engage in a banking business without having been previously authorized by the Superintendence.

Three types of licenses exist, as follows (article 48):

- General License: issued to banks organized under Panamanian laws and authorized branches of foreign banks to engage in local and offshore banking business, as well as in other activities, authorized by the Superintendence;
- International License: issued to banks organized under Panamanian laws and authorized branches of foreign banks to conduct, from an office established in Panama, transactions that are completed or accomplished outside Panama, and to engage in other authorized activities;
- Representation License: issued to banks organized in accordance with foreign laws to establish a representative office in Panama, and to engage in other authorized activities.

Banks may be established either as branches or subsidiaries of foreign banks. General licensed banks may engage in both domestic and foreign transactions, while international licensed banks can only engage in foreign transactions. There are no restrictions on the type of services that can be offered, as long as they are within the scope of normal banking business practices.

Capital requirements

- Every general licensed bank doing business in Panama must meet the minimum requirement of US\$10 million paid-in or assigned capital established by the Superintendence;
- Banks engaged exclusively in business abroad (international licensed banks) must maintain US\$250,000 deposited in the National Bank of Panama as guarantee and must have a minimum paid-in capital of US\$3,000,000 to guarantee the proper fulfillment of their obligations under the banking license.

Deposits

A bank established in Panama, under an international license, is free to accept all types of foreign deposits (e.g., demand and time deposits).

Foreign deposits must be payable to:

- (a) Panamanian and foreign citizens residing abroad;
- (b) Foreign legal entities residing abroad (e.g., banks and corporations);
- (c) Legal entities, organized in accordance with Panamanian laws, that do not earn taxable income in Panama (offshore companies); and, (d) Banks operating in Panama (having a general license), provided that the funds were obtained from foreign sources.

Liquidity reserve requirement

Every bank holding a general license must maintain a legal reserve of cash assets not exceeding 35 percent of its total local deposits (excluding deposits from related entities).

Securities market

Law Decree 1 of 1999, as amended, established the Securities Market Superintendence (hereafter the 'Superintendence') and regulated the securities market in the Republic of Panama.

As per definition, the Superintendence is an autonomous governmental institution with legal personality, its own patrimony and administrative independence. Other characteristics associated with the Commission are:

- It has a Board of Directors of seven members, which acts as its maximum consultation, regulation and policy making body.
- It has a Superintendent;
- The commissioners must adhere to the Ethical Code which was established by an Executive Decree so as to avoid conflicts of interests and unethical practices;
- Decisions made by the Commission may only be appealed by the Commission itself for reconsideration;
- If however, only one of the members makes a decision, an appeal for reconsideration may be done by either the commissioner involved in the decision making or the Commission as a whole; this will not cause any administrative ramifications for the Supreme Court of Justice.

Law Decree 1 regulates the following areas among others:

- Investment administrators;
- Investment advisors;
- Securities houses;
- Brokerage ;
- Custody
- Forex;
- Investing corporations (mutual funds); and
- Auto-regulated organizations.

Brokerage entities must however comply with the following regulations:

- All equity must be issued in a nominative form and the holder must be reported to the Superintendence;
- In case a change of ownership is to take place, previous consent from the Superintendence must be granted;
- Banks with international license may obtain a license from the Superintendence in order to address, from their office, transactions pertaining to securities - including those registered at the

Superintendence;

- Earnings from transactions processed in Panama and sold overseas will not be considered as income earned within the Panamanian territory for income tax purposes;
- The Superintendence will establish norms regarding bookkeeping, records and financial statements;
- Transactions for registered securities that are traded outside a stock exchange must be reported to the Superintendence as well as to investors;
- Brokerage entities must keep all assets of their investors in investment accounts, in conformity with dispositions as regulated by the Superintendence;
- The Superintendence will regulate confidentiality, ethical norms, conflicts of interest and investment advice;
- Brokerage entities as well as brokers are prohibited to handle aside discretionary transactions or to get involved in the sharing of profits or losses derived from any transaction;
- The Superintendence will dictate ethical conduct rules in order to avoid money laundering;
- The Superintendence, in order to comply with Law Decree 1 may request the appointment of a compliance officer to each brokerage entity;
- Brokerage entities and brokers must obtain a license from the Commission in order to perform any type of securities operation within the country;

Law Decree 1 establishes the following rules concerning stocks, bonds, shares and any other securities:

- Each offer or public sale must be registered at the Commission;
- An offer sold to people living in the country is considered a public offer done in Panama, whether it has been made from or to the Republic of Panama;
- Public offerings sold in Panama to investors not living in the country are to be regarded as public offers not done in the Republic of Panama;
- Exempted from registration at the Commission are: (1) the State, (2) private placement, (3) offers through institutional investors and, (4) offers and exchanges of a corporate pass over nature;
- The law decree also regulates both the securities exchange seat, and the administrator involved in any securities exchange activity.

Tax incentives

- No income tax, income tax on dividends or complementary tax is imposed on gains or losses resulting from the transfer of securities issued by the State;
- Gains and losses on the transfer of securities registered at the Commission may not be taxed if such disposal is done:
 - (1) Through a stock exchange or another organized market; or,
 - (2) As the result of a corporate merger, consolidation or reorganization, as long as the shareholder receives only other shares from the surviving or affiliated corporation.
- Income derived from shares registered at the Commission will be taxed at a five (5) percent standard rate – the entity paying said interest must withhold the total amount. The income will not be considered for taxation, and there is no obligation to include it in the income tax report;
- No stamp tax is required for shares registered at the Commission, or any other document related to contracts, subscription, sale, payment, pass-over or exchange;
- Capital gains derived from a non-exempt transfer of securities shall be taxed at a ten (10) percent fixed rate;

- Moreover, in these transactions the buyer must withhold an advanced five (5) percent amount on the sale value and remit it to authorities within a ten-day period of the due date. In case of non-compliance to the withholding tax, the issuer entity is jointly responsible for the unpaid tax. The seller (taxpayer) may consider the advanced sum withheld by the buyer as definite income tax upon capital gain.

Capital requirements

Stock exchanges must have a paid-in capital of no less than one million US dollars (US\$1,000,000), free of encumbrances and the confidentiality of their operations must be assured. Also, stock exchanges must post a report of all transactions, stock exchanges, prices, volumes and any other statistical data of interest to investors and the general public at the end of each day.

Audited financial statements

Audited financial statements prepared by an independent public accountant must be submitted to the Commission at the end of each fiscal year.

Trust operations

One of the legal advantages of trusts is the protection offered to assets. Tax advantages granted to trusts include:

- No taxes are levied upon the transfer or transmittal of trust assets located abroad and from sources not taxable in Panama; and,
- No income tax is levied if such assets, even if it is from sources taxable in Panama; said assets are invested in housing development projects or urban industrial development parks located in Panama provided that investment has been made before February 3, 2005. Additionally, proper authorization must be requested from the Directorate General of Revenue and the occupational permit is should be dated before December 31, 2008.

As per Law 1 of 1984, regulated by Decree 161 of 1984, trust regulations include supervision from the Superintendence of Banks.

- In addition to the commercial license granted by the Ministry of Commerce and Industries, trust activities must obtain a fiduciary license from the Superintendence.
- The word “trust” or its derivatives in any language can be used only by persons or companies authorized by the Superintendence of Banks.

Local finance companies

Finance companies, although small, are part of Panama’s financial center, and contribute to the economic development of the country by providing financial resources through loans and credits facilities to the public.

- The Ministry of Commerce and Industries authorizes the operation of these companies, which must obtain a commercial license and must have a minimum paid-in capital of US\$500,000, according to Law 42 of 2001.
- Local finance companies are separately regulated from banks, insurance companies, cooperatives, pawnshops, mutual funds companies and furniture companies.

Financial leasing activities

Financial leasing activities are conducted by licensed banks and non-banking companies authorized by the Ministry of Commerce and Industries. Some of the benefits granted are:

- Depreciation on the number of years of the leasing contract, with a minimum of three years;
- Deductibility of expenses inherent to the leasing contract, such as insurance premiums;
- For ships and airplanes engaged in international trade, the income from the lease will not be considered as taxable income in the Republic of Panama;
- At the end of the contract, the lessee has the option to depreciate the asset according to its residual value;
- The value of the lease will be considered a deductible expense for the lessee as long as she/he utilizes the leased asset in the production or maintenance of the source of her/his taxable income;
- The amounts paid by the lessee are not subject to tax on transfer of personal goods and rendering of services (ITBMS or a Panamanian VAT); this is because the contract is considered a financial contract.

The lessor must normally be engaged in leasing contracts and be the owner of the leased goods. Goods such as ships, airplanes, machinery, equipment, vehicles and any other movable goods capable of being specifically described can be the subject of leasing contracts. The contract must be signed for a term of no less than three years.

International leasing contracts are also granted incentives such as total exemption from income taxes, stamp and sales taxes. Parties involved can also agree on changing local contract into an international contract, or vice versa.

Money remittance houses

Remittance of money through a company established appropriately is fully regulated by Law 48 of 2003 - said law requires a minimum capital of US\$50,000 to begin operations in Panama as well as a US\$50,000 fidelity bond in favor of National Treasury. Furthermore, a commercial license is required as well as a fee of paying one thousand US dollar for the issuance of an authorization certificate by the Ministry of Commerce and Industry.



Appendix

KPMG in Panama

Appendix

KPMG in Panama

KPMG operates as a network of member firms offering audit, tax and advisory services. We work closely with our clients, helping them to mitigate risks and grasp opportunities.

KPMG member firms can be found in over 152 countries. Collectively they employ more than 145,000 people across a range of disciplines.

In Panama, we operate nationally with 12 partners and more than 250 people. Our local experience, enhanced by the technical and industry knowledge of our global network, means we bring a deep understanding of our clients' business. It enables our professionals to deliver informed and timely advice.

Our leadership

In response to an ever-changing and increasingly complex business environment, we continually invest in our people, services and quality processes.

KPMG is also committed to appropriately delivering on our capital markets responsibilities, as well as assisting our clients in effectively communicating true business performance to stakeholders.

Why select us

Independent, clear and practical advice

Fast, effective and informed decision making is a business imperative in an increasingly complex business environment.

Our clients find our independent, objective and professional advice to be clear, concise and jargon free. We're known for providing practical recommendations that get to the heart of complex issues.

That's why we have a significant track record of having successfully worked with most of Panama's and the world's top performing organizations.

Multidisciplinary, industry focused approach

Delivering independent, professional advice requires a multidisciplinary, industry focused approach. We can establish dedicated teams of professionals with deep industry experience from across KPMG's service divisions. It means our clients receive advice from professionals who understand their business.

Global knowledge sharing

We understand that keeping our professionals constantly up-to-date on global technical and industry developments allows our clients to receive comprehensive advice, no matter where in the world they do business. KPMG's global knowledge-sharing system puts the latest technical and industry knowledge at our people's fingertips.

We listen to you

Before we give advice and make recommendations, our professionals listen to our clients' needs, concerns and business objectives. We make sure that we understand what the business challenges and priorities are.

We're with you from start to finish

Our professionals like to see things through. We have the knowledge, resources and skills to not only offer clear and practical advice, but also work with our clients to facilitate the effective implementation of our recommendations.

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