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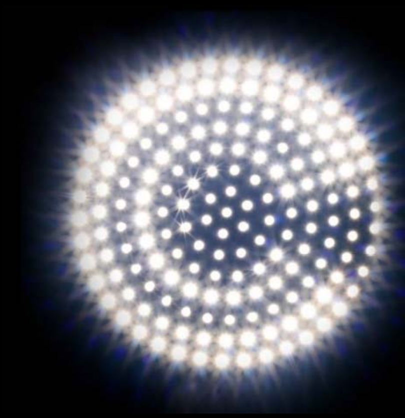
International Tax
Panama Highlights 2018



Investment basics:

Currency – Panamanian Balboa (PAB) and US Dollar (USD)

Foreign exchange control – The state-owned bank, *Banco Nacional de Panamá*, is responsible for supplying USD from the US Federal Reserve Bank of New York under a treaty signed in 1904. There are no restrictions on other banks importing USD into Panama.

Accounting principles/financial statements – IFRS is required. Banks, insurance and reinsurance companies and companies registered with the National Securities Commission as issuers or that hold a license granted by the Commission are required to file audited financial statements. Companies operating in the Colon Free Trade Zone (FTZ) and other FTZ, and companies in general, are required to maintain (as opposed to file) audited financial statements on their premises.

Principal business entities – These are the corporation, limited liability company, limited liability partnership, general partnership, joint venture and branch of a foreign corporation.

Corporate taxation:

Residence – A company is resident if it is incorporated under Panamanian law and if the company's central management and control is exercised in Panama.

The following factors are taken into account in determining whether a legal entity is resident in Panama: (i) whether meetings of the board of directors, in which decisions that affect the direction or management of the company are made, are carried out in Panama; and (ii) whether business activities or activities to support other companies are carried out from a headquarters located in Panama, regardless of the source of income.

Basis – Panama operates a territorial tax system, under which residents and nonresidents are taxed only on Panama-source income. Income that does not arise in Panama or is not derived from Panama is not subject to tax in Panama.

Taxable income – Taxable income includes all income derived from business activities in Panama, less expenses incurred wholly and exclusively in the production of assessable income or the conservation of its source.

Taxation of dividends – Dividends received by a Panamanian resident company from another Panamanian company are exempt from corporate tax. (See "Withholding taxes," below.)

Capital gains – Capital gains derived from the sale of securities and negotiable instruments are subject to a 10% tax. The purchaser must withhold 5% of the sales price as an advance payment of income tax and remit that amount to the tax authorities.

Gains from the sale or transfer of real property are considered capital gains. If the transaction giving rise to the gain is part of the taxpayer's ordinary business activities, the gain is subject to the corporate tax rate; if the transaction is not part of the taxpayer's ordinary business activities, the gain is tax at a reduced rate of 10%. However, in the latter case, the purchaser must withhold 3% of the higher of the purchase price or the rateable value of the property as an advance payment of tax.

Losses – Losses may be carried forward for five years, with a maximum of 20% of losses deducted per year. However, the deduction of losses may not exceed 50% of taxable income in any year. The carryback of losses is not permitted.

Rate – Tax is assessed at the greater of a 25% flat rate on net taxable income or a 1.17% rate on gross taxable income; the latter is the alternative minimum tax (CAIR) (see below under “Alternative minimum tax”).

Surtax – No

Alternative minimum tax – The CAIR is assessed at a general rate of 1.17% on gross taxable income. A taxpayer can request the CAIR not to be applied when it has net operating losses or where the effective tax rate is higher than the standard 25% rate. The tax authorities have discretion to grant an exemption from the CAIR for the period requested and three subsequent years. Companies whose taxable revenue is less than USD 1.5 million are not required to calculate the CAIR.

Foreign tax credit – Since Panama operates a territorial system of taxation, there is no unilateral foreign tax credit. A foreign tax credit may be granted, however, under Panama’s tax treaties.

Participation exemption – No, but see “Taxation of dividends,” above.

Holding company regime – No

Incentives – Various investment incentives provide lower tax rates or exemptions.

- The Howard (Panama-Pacific) Special Economic Area regime provides tax exemptions for the following: offshore services; gains from the sale or transfer of shares of companies established within the area; income from the transfer of goods and services between companies within the area and other FTZ; income from the sale of goods or services to visitors and passengers while in transit to other countries or to vessels crossing through the Panama Canal or aircraft using authorized ports to overseas destinations; income from aviation and airport services; income from the manufacture of high-tech products; and income logistics and call center services.

  In-bond manufacturing companies may import equipment and raw materials on a duty-free basis and subsequently export 100% of production, receiving a tax-free benefit. Such companies do not have to pay VAT on imports.

  Based on the territoriality principle, gains derived from "re-invoicing" operations are deemed not to be derived in Panama, provided the merchandise being re-invoiced does not enter the Panamanian territory.
- Licensed multinational headquarters companies (MHQs) are exempt from income tax on services provided to nonresident entities that do not derive Panama-source income, from dividend tax and from Panamanian VAT on export services provided to nonresidents that do not generate taxable income in Panama. Foreign employees working in Panama for an MHQ are exempt from income tax on their wages and other remuneration that is not paid by the MHQ.
- A variety of tax incentives are granted to encourage investment in new projects and activities relating to tourist facilities, including an exemption from income tax, property tax, import taxes and other taxes, depending on the amount of investment and location. The incentives will expire between 2016 and 2020. Incentives also are available in the Petroleum FTZ, the Colon FTZ, etc.

Withholding tax:

Dividends – Companies holding a “notice of operations” or otherwise carrying out business in Panama must withhold tax at a rate of 10% on dividends distributed out of domestic profits (20% in the case of bearer shares) and 5% on dividends distributed out of foreign-source profits or export profits. Companies located within Panama’s FTZ (except for companies within the Howard (Panama-Pacific) Special Economic Area) that require a notice of operations must withhold a 5% tax on distributions.

The subsequent distribution of dividends will not be taxed if tax already has been withheld at the 10% or 5% rate.

If a corporation does not declare dividends in a particular year, it must pay a retained earnings tax of 10% (20% in the case of bearer shares) of 40% of its after-tax income.

A 2% retained earnings tax is withheld on profits distributed by a company established in an FTZ or related to foreign-source income taxed at the 5% rate.

A 10% dividend tax (20% in the case of bearer shares) is withheld on all loans or advances granted by a company to its shareholders, regardless of the income source. The withholding tax rate applicable to the distribution of dividends from real estate investment companies is 10%.

Under domestic law, Panama can apply “retaliatory” measures against jurisdictions that discriminate against Panama economically or commercially. One of the sanctioned measures is the imposition of a higher rate of withholding tax. In the case of dividends paid to an individual or legal entity resident in jurisdiction that discriminates against Panama, the withholding tax rate is increased to 20% or 40% of the gross amount.

Interest – Interest paid to a nonresident is subject to a 12.5% withholding tax (50% of the interest is subject to the general 25% corporate tax rate).

Royalties – Royalties paid to a nonresident are subject to a 12.5% withholding tax (50% of the general 25% rate) if the payment benefits a Panamanian resident or if the expense has been considered as deductible in Panama.

Technical service fees – Fees for technical services paid to a nonresident are subject to a 12.5% withholding tax (50% of the general 25% rate).

Branch remittance tax – A branch of a foreign corporation must pay 10% of its after-tax income as a dividend tax, in addition to the corporate income tax.

Other – All Panamanian-source income paid to nonresident entities or individuals or accrued by government entities, companies owned 51% or more by the Panamanian government, "noncontributing" entities (i.e. entities not subject to income tax) and taxpayers incurring losses, is taxable and subject to withholding tax.

Based on the law that allows Panama to apply retaliatory measures against jurisdictions that discriminate against Panama, interest, royalties, commissions, fees or any other types of income generated in Panama and paid to individuals or legal entities resident in a jurisdiction that discriminates against Panama will be subject to a withholding tax at the standard individual or corporate tax rate on the entire payment (i.e. the lower effective rates of withholding tax will not apply).

Other taxes on corporations:

Capital duty – No

Payroll tax – In addition to social security contributions (see "Social security," below), the employer must pay educational insurance tax at a rate of 1.5% of an employee's remuneration. The employer also pays workers' compensation insurance premiums at rates ranging from 0.56% to 5.67% of the remuneration (depending on the risk associated with the occupation).

Real property tax – A real estate tax is levied on Panamanian-situs real property, at rates ranging from 0% to 0.7% in the case of real property subject to family wealth or main residence benefits and rates ranging from 0% to 1% for commercial and industrial real estate, other residences, land, etc.

Social security – The employer must make social security contributions in an amount equal to 13.5% of the total remuneration of the employee and withhold 9.75% on the employee's behalf and remit it to the authorities.

Stamp duty – Stamp duty generally is 0.001 per PAB or fraction thereof, and is applicable to the issuance of certain documents.

Transfer tax – Transfers of real property are subject to tax at a rate of 2% of the greater of the value in the deed of transfer or the cadastral value on the date of transfer.

Other – Panama imposes a retained earnings tax on companies that do not declare dividends in a particular year (see "Withholding tax," above.)

An operation notice tax is levied at a rate of 2% of a company's net worth, up to a maximum of USD 60,000.

All commercial and industrial businesses must have a notice of operations to engage in business unless they are specifically exempt. Companies that operate in the Colon FTZ or other FTZ, including licensed MHQs and companies operating under special regimes relating to international awards for contractor selection (e.g. the Howard (Panama-Pacific) Special Economic Area), are not required to obtain a notice of operations. However, companies operating in the Colon FTZ or other FTZ or special economic area are subject to an annual notice of operations tax of 0.5% on the capital of the company (a minimum of USD 100 and a maximum of USD 50,000).

Individuals and companies already established or to be established within any of the international FTZ or the Colon FTZ do not need a notice of operations for the sale of wholesale goods to persons or companies located within Panama's customs territory.

Municipalities may impose a tax on gross sales in an amount based on the type of activities carried out by a business. A business carrying on more than one business activity may be taxed on each activity. Municipal taxes, which are deductible, generally range from USD 10 to USD 2,000 per month.

Anti-avoidance rules:

Transfer pricing – Transactions between related companies must be valued according to the arm's length principle, applying the standards in the OECD guidelines.

A transfer pricing study must include a comparative analysis of transactions carried out by independent parties, taking into account the operations, significant economic functions or activities, contractual terms, market characteristics, and risks and commercial and business strategies. After making the comparative analysis, one of the five transfer pricing methods stated in Panamanian law must be selected.

An annual disclosure statement of related party transactions must be submitted to the tax authorities within six months after the end of the fiscal year.

The tax authorities can make adjustments if the arm's length principle is not followed.

Thin capitalization – No

Controlled foreign companies – No

Disclosure requirements – See "Transfer pricing," above.

Compliance for corporations:

Tax year – The calendar year generally is used, although the taxpayer can request a special 12-month fiscal year in certain cases.

Consolidated returns – Consolidated returns are not permitted; each company must file a separate tax return.

Filing requirements – Companies must file a tax return within 90 days after the end of the fiscal year, although a one-month extension may be obtained upon request. Three advance payments of tax are required in June, September and December, with a final payment of tax due at the time the annual return is filed. Except for companies operating in FTZ, corporations with no Panamanian-source income are not required to file an income tax return.

Penalties – Interest and surcharges are levied on late payments. Penalties may be imposed for late filing of the annual income tax return.

Rulings – No

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

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

Personal taxation:

Basis – Residents and nonresidents are taxed on their Panama-source income.

Residence – An individual is resident in Panama if he/she is in the country for more than 183 days in a calendar year or has established permanent residence in Panama. The center of economic and family interests is a relevant factor in determining residence status.

Filing status – Joint tax returns are permitted.

Taxable income – Individuals are taxed on wages and salaries, income from the carrying on of a commercial or an agricultural business and investment income.

Capital gains – Capital gains derived from the sale of securities and negotiable instruments are subject to a 10% tax. The purchaser must withhold 5% of the sales price as an advance payment of income tax and remit that amount to the tax authorities.

Gains from the sale or transfer of real property are considered capital gains. If the transaction giving rise to the gain is part of the taxpayer's ordinary business activities, the gain is subject to the corporate tax rate; if the transaction is not part of the taxpayer's ordinary business activities, the gain is taxed at a reduced rate of 10%. However, in the latter case, the purchaser must withhold 3% of the higher of the purchase price or the rateable value of the property as an advance payment of tax.

Deductions and allowances – Individuals are entitled to a basic deduction of USD 800 (on a joint tax return) and deductions for the following: mortgage interest (up to USD 15,000 per year); donations to a nonprofit organization (up to USD 50,000 per year) and political contributions (up to USD 10,000); individual contributions to individual retirement plans up to USD 15,000 per year that do not exceed 10% of gross income; payments made for medical and hospitalization insurance; and medical expenses incurred in Panama that were not covered by insurance.

Rates – The first USD 11,000 is exempt; a 15% rate applies to income from USD 11,000 up to USD 50,000; and the rate is 25% on income exceeding USD 50,000. Nonresident individuals hired or otherwise rendering services to Panamanian residents for periods of less than 183 days in a calendar year are subject to withholding tax at source at a rate of 12.5% of their gross income.

Other taxes on individuals:

Capital duty – No

Stamp duty – Stamp duty generally is 0.001 per PAB or fraction thereof, and is applicable to the issuance of certain documents.

Capital acquisitions tax – No

Real property tax – A real estate tax is levied on Panamanian-situs real property, at rates ranging from 0% to 0.7% in the case of real property subject to family wealth or main residence benefits and rates ranging from 0% to 1% for commercial and industrial real estate, other residences, land, etc.

Inheritance/estate tax – No

Net wealth/net worth tax – No

Social security – An employee is required to make social security contributions in an amount equal to 9.75% of his/her remuneration. Independent contractors and professionals must contribute 13.5% of their fees.

Compliance for individuals:

Tax year – Calendar year

Filing and payment – Employment income is taxed by withholding. Individuals with only one salary as their source of income are not required to file an income tax return. Individuals with more than one salary or that derive other taxable income not subject to income tax withholding must file a tax return.

Individuals who are required to file a return must do so by 15 March following the end of the tax year, but this deadline may be extended by one month upon request.

Penalties – Interest and surcharges are charged on the late filing and late payment of tax.

Value added tax:

Taxable transactions – VAT (ITBMS) is levied on the invoice value of the sale, lease or transfer of goods or services, except for intangibles.

Rates – The standard rate is 7%, with special rates of 10% for accommodations and alcohol and 15% for tobacco. Exemptions apply for food, medicine, medical services and crude oil

Registration – Registration is mandatory for businesses with monthly turnover exceeding USD 3,000 or annual turnover of USD 36,000.

Filing and payment – VAT returns must be filed monthly, except for professionals who may file quarterly returns.

Source of tax law: Fiscal Code and complementary laws, decrees and resolutions

Tax treaties: Panama has 17 tax treaties and nine tax information exchange agreements.

Tax authorities: Ministry of Economy and Finance, Revenue General Office, Cadastral General Office, Customs General Office

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