



Colon Free Trade Zone, amendments to Law 8 of 2016



Bill 620 (the “Bill”), which introduces modifications to **Law 8 of 2016 of the Colon Free Trade Zone (the “CFZ”)**, was approved in third debate by the Legislative Assembly on September 12.

In compliance with our constitutional process of law approval, the Bill is pending authorization or sanction by the President of Panama. Once the bill has been passed as law, the same shall be promulgated through the Official Gazette, as the last requirement for its entry into force.

This legislative initiative was presented by the Executive Branch with the objective of:

- Pair the CFZ regulation with the incentives offered by the different special economic regimes within the Republic of Panama.
- Include new activities to the current offer of services, allowing the CFZ to quickly meet the changes driven by the evolution of markets and economic needs, both for user companies and their customers.

- Empower the Board of Directors, the Executive Committee and the General Management of the CFZ to authorize respectively, greater amounts in connection with: judicial and extrajudicial transactions and investments and contracts; any operation, negotiation, lease or transaction in relation to the institution or its assets involving investment, expenditure and obligation; and all expenses in general.
- Create new powers related to the Coercive Jurisdiction, which will be exercised by the General Manager of the CFZ.
- Create a special labor regime.

Incorporation of New Activities

Although historically the CFZ has stood out as an international center for the distribution and sales of goods at the regional level, the inclusion of new activities to the provision of services, seeks to update the business model of the CFZ by expanding its productive capacity towards the following, to wit:

- Transformation center, generation of added value and distribution through various activities that allow converting inputs, materials, and parts into final goods, taking advantage of the idle installed capacities that currently exist in the CFZ or the capacities available for future expansion.
- Nearshoring model that enables the transfer of production processes to areas closer to customers due to geographical proximity, promoting activities such as inventory management, storage, shipping, packaging, labeling, package assembly, product reconditioning, among others.
- Incorporation of manufacturing models based on high technology, which could also lead to the emergence of another group of value-added activities, but with a more strategic approach, such as massive data analysis, predictive analysis of goods movement, visibility, and traceability of merchandise, among others.

Colon Free Trade Zone, amendments to Law 8 of 2016



The Bill also adds other activities, such as:

- The provision of services related to the execution of the film industry, including the development of areas for productions.
- The provision of real estate and/or property management and/or use services, including office spaces not dedicated to logistics activity.
- The provision of services related to the establishment and development of scientific research and innovation centers.
- The provision of services related to aviation and airports; ships and ports, including the transportation, handling and storage and supply of cargo and merchandise in general; the repair, maintenance, conversion, and manufacture of parts and/or pieces of aircraft, ships and ports either for import into the fiscal territory, export or transfer between companies in the CFZ, or other companies established in other free zones or special economic areas.

Under the Bill, CFZ companies are also allowed to access the benefits of the Special Regime for the Establishment and Operation of Multinational Companies for the provision

of services related to manufacturing, known as “EMMA”, maintaining the benefits and tax incentives that correspond to that regime, together with the special labor and immigration standards developed by the latter, and those established in **Executive Decree 320 of 8 August 2008**.

Tax Incentives

Regarding the tax regime that applies to CFZ companies, no changes have been introduced to the tax principle that applies to these companies, with income derived from activities that occur outside the Republic of Panama being exempt from income taxation. Income from commercial transactions with natural or legal persons located in the Panamanian fiscal territory, continues to be subject to the general income tax regime, which tax rate is twenty five percent (25%).

The Bill also provides the following tax benefits, to wit:

- Exemption from complementary tax on dividends, except for logistics and multimodal services that do not generate

any transformation, which will be subject to the payment of the complementary tax at the rate of two percent (2%) on the profit generated by the aforementioned activities. By way of clarification, all companies currently operating in the CFZ are obliged to pay complementary tax, if at the time of filing their income tax return they had not distributed dividends, or the amount paid was a percentage lower than the annual minimum established. The exemption contemplated in the Bill does not exempt from the payment of dividend tax, which will apply at the time profits are distributed.

- Exoneration of capital gain tax on the transfer of shares of CFZ companies, whether this transfer is evidenced directly or indirectly through the sale of shares of companies that in turn own the shares of companies operating within the CFZ.
- Exemption on real estate property taxation for commercial and industrial improvements, as well as from the real estate transfer tax.

Colon Free Trade Zone, amendments to Law 8 of 2016



- Exemption of excise tax, excluding land vehicles that are acquired under a benefit or incentive granted by any law that exempts from import tax.
- Exemption from stamp duty.
- Exoneration· payment for the surcharge from the Special Interest Compensation Fund on loans granted to finance operations of companies operating on the CFZ.

Regarding VAT, known in Panama as ITBMS, the following activities will be exempt:

- The transfer of goods introduced to the CFZ whose final destination is abroad.
- The services provided by the users of the CFZ to natural or legal persons established inside or outside the Republic of Panama, including the services provided to each other by the users of the CFZ.
- The services received by users of the CFZ, except for the exclusions established by the Tax Law.

Substance Requirements

The Bill introduces “Substance Requirements”, as a condition for the access to the income taxation incentive granted by this Bill, for two types of activities, to wit:

- Multimodal and logistics services, and those related to supply chain management, nearshoring, supply and inventory management.
- Provision of the service of centers of capture, processing, storage, switching, transmission and retransmission of data and digital information; the linking of radio, television, audio, video and/or data signals; research and development of digital applications for use of intranet networks and the internet.

In general terms, the Substance Requirements included in the Bill are quite similar to the substance standards contemplated by the legal provisions of the Panama-Pacific Special Economic Area, the SEM regime, and the EMMA companies, which aim to ensure that the activities benefiting from income tax incentives are effectively executed in the

jurisdiction granting the incentive, establishing mechanisms to ensure that the tax benefit is granted to the extent that it is proven that the “Main Activities” required for the generation of the income received, have been carried out in the respective jurisdiction, in terms of an adequate number of qualified full-time employees and an adequate amount of operating expenses, directly related to the Main Activity generating such income.

CFZ companies are obligated to submit a report attesting the compliance with the principle of substance on an annual basis; and the CFZ Administration to issue an administrative resolution deciding whether or not the user complied with this requirements within a period of six months, to be counted as from the expiration date to submit the annual report.

Colon Free Trade Zone, amendments to Law 8 of 2016



CFZ companies who do not comply with the Substance Requirements shall pay the income tax corresponding to said fiscal period in accordance with the general rate of twenty five percent (25%), with the fines, surcharges, interest, and penalties that correspond in accordance with the provisions of the Fiscal Code of the Republic of Panama. Companies operating within the CFZ under the “Representation System” will not be subject to the obligations described above.

Annual Tax Notice of Operation

The Bill also provides for an amendment to article 1004 of the Fiscal Code of the Republic of Panama, on the annual tax caused by Notice of Operation; establishing that CFZ companies will be exempt from paying this annual tax from January 1, 2023 until January 1, 2028, provided that they comply with notifying the CFZ Administration of the number of jobs they plan to preserve within the framework of the recovery and economic reactivation process experienced by the country.

Imports

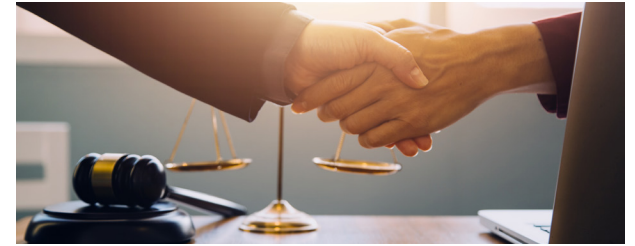
On the importation of products manufactured, processed, or assembled by CFZ companies to the Panamanian fiscal territory, the Bill establishes the following rules:

- Import tariff and customs duties shall be that of the finished product, calculated on the value of the foreign raw materials and components incorporated in the product. The importer must submit to the Panama Customs Authorities the product input relationship sheet, previously verified, and approved by the National Customs Authority of Panama, according to a format approved and provided by the Administration of the CFZ.
- For the calculation of such duties and taxes, the following will be excluded: amount corresponding to the value of foreign inputs or goods that have been incorporated in the finished product, which can be imported duty-free by virtue of trade treaties or agreements;; the amount corresponding to the value of domestic or nationalized components used for manufacturing, processing or assembly

purposes, and the domestic value added embodied in the finished product during the manufacturing, processing or assembly process in the CFZ.

- In the case of finished products manufactured or assembled in the CFZ, which are free of tariffs, taxes or import duties into Panamanian territory by virtue of international treaties or agreements signed by the Republic of Panama (and in particular compliance with rules of origin recognized in said treaties), the importation of said manufactured or assembled products in the CFZ to the Panamanian territory or to any zone or area within the Republic of Panama shall not cause any tax or duty or import duty.

Colon Free Trade Zone, amendments to Law 8 of 2016



Special Labor Regime

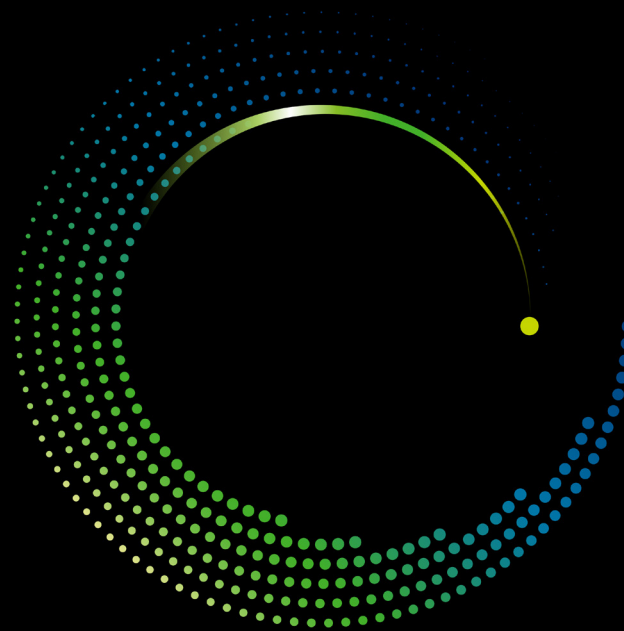
In connection with labor matters, the Ministry of Labor and Work Development (the “MITRADEL”) may grant work permits in a proportion greater of fifteen percent (15%) in favor of foreign specialists or technicians, subject to the CFZ company seeking the exchange of knowledge and training of national personnel with the intention of integrating them into its workforce. To this end, the Bill provides for the implementation of any of the following measures:

1. Create a technical education center within its facilities.
2. Use the services of the training center or institute of higher studies that creates the CFZ.
3. Adopt training programs with universities, institutions, or centers public or private education.

The above will be validated with the presentation of an annual report to the MITRADEL, where the CFZ company will

describe the initiatives executed for the benefit of Panamanian workers through any of the modalities established in the Bill.

Wrapping up on the review of the Bill that introduces amendments to **Law 8 of 2016 of the CFZ**, it is clear the need to make significant adjustments in the way and mechanisms of doing business in this zone. To avoid the loss of competitiveness by maintaining a model oriented to the reception, storage, sale and dispatch of goods, this Bill seeks to boost the operations of the CFZ by migrating to an operating model based on a logistics and strategic value-added activities, taking advantage of the benefits of a generous geographical location, transport connectivity and financial facilities, which still maintains the CFZ.



Contacts

Business Area

Michelle Martinelli

Partner Tax & Legal
mmartinelli@deloitte.com

Yira Cobos

Partner Tax
ycobos@deloitte.com

Eira Herrera de Bello

Director Tax & Legal
eherrera@deloitte.com

Desiree Esáa

Partner Tax & Foreign Trade
desaa@deloitte.com

Editorial Committee

Written by:

Michelle Martinelli

Partner Tax & Legal
mmartinelli@deloitte.com

Edition:

Juan Fábrega

Manager Senior Tax & Legal
jufabrega@deloitte.com

Edition:

Marifé Cruz

Consultant
marifcruz@deloitte.com



Deloitte refers to Deloitte Touche Tohmatsu Limited, a UK private limited liability company, its network of member firms and their related entities, each as a single and independent legal entity. See www.deloitte.com for more information on our global network of member firms.

Deloitte provides professional audit and assurance, consulting, financial advisory, risk advisory, tax and legal services related to our public and private clients from various industries. With a global network of member firms in more than 150 countries, Deloitte provides world-class capabilities and high-quality service to its clients, bringing the expertise needed to address the most complex business challenges. Deloitte's more than 330,000 professionals are committed to making a significant impact.

As used in this document, Deloitte Inc., which has the exclusive legal right to engage in, and limit its business to, the provision of auditing, consulting, tax consulting, legal, risk and financial advisory services respectively, as well as other professional services under the name of "Deloitte".

This presentation contains general information only and Deloitte is not, by means of this document, rendering accounting, business, financial, investment, legal, tax or other advice or services. This presentation is not a substitute for such professional advice or services, nor should it be used as the basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional adviser. No representation, warranty or promise (either express or implied) is given as to the accuracy or completeness of the information in this communication and Deloitte shall not be liable for any loss suffered by anyone who relies on this presentation.