Tax Regulations in Panama: The Place to Invest In The Americas

by Elias Solis Gonzalez

Panama is a country located in the center of the Americas, with a republican, democratic and participatory political system, based on principles of rule of law and free enterprise. It has an extraordinary hotel and tourism infrastructure, as well as an international financial center, which together allow the satisfaction of anyone visiting our country.

Its tax system is based on the principle of territoriality. Only the income generated within the country will be subject to income tax, and the income of foreign source is exempt. Panama meets all international standards in taxation.

It is the most favorable place to invest in the Americas. It is the hub to develop multiple business in the region. Here are some of its tax advantages:

Income Tax

It is determined by applying to the annual income declaration of taxpayers, the traditional method or the alternative income tax method (minimum tax). The method used is the one that results in the highest amount.

Under the traditional method, the net taxable income is taxed at a rate of 25%. This income will be the result of deducting from the gross income, exempt or non-taxable income and the costs, expenses and deductible expenses (traditional method).

The alternative income tax method will apply only to entities whose taxable income exceeds USD$1,500,000.00. Therefore, the 4.67% of the net taxable income will be paid according to the 25% tariff. The taxpayer may request not to apply this method in case it incurs in losses or the effective tax rate exceeds 25%.

Individuals will pay tax at a rate of 15% after the tax allowance of USD$11,000.00 to 50,000.00 and the surplus at a rate of 25%.

Dividends tax

When a corporation distributes profits generated in Panama to its shareholders, it must retain the tax at a 10% rate. Income generated from sources outside Panama are subject to a 5% withholding.

There will be no withholding when the entity distributes profits that are generated from profits, as long as the juridical person that distributed such profits made the withholding and paid the corresponding tax.

The withholding will not apply over the portion of income generated from profits, as long as the juridical persons that made the distribution is exempt of withholding or has paid the corresponding tax in other jurisdiction.

The taxation regime provided in treaties to avoid double taxation entered into by Panama with other countries will always prevail.

However, due to the inexistence of a legal obligation to distribute profits periodically, in the event profits are not distributed or less than the 40% is distributed, likewise a tax rate of 10% will be applied over the income of the taxpayer after the payment of the income tax (complementary tax).

Notice of operation tax

To do business in Panama companies require a Notice of Operation, except those exempt by law. Annually there is a 2% tax tariff of the net assets of the company, with a minimum of USD$100.00 and a maximum of USD$60,000.00 payable as notice of operation tax.

Companies located at free international commerce (such as the Colon Free Zone or any other free zone established or created in the future), will not be subject to the notice of operation tax, unless special law provides otherwise, but will pay 1% over their annual income, with a minimum of USD$100.00 and a maximum of USD$50,000.00.

Capital gains tax

The transfer of shares or real property, that do not constitute the ordinary business of the taxpayer, will be subject to a capital gains tax at a rate of 10%.

For a sale of shares, bonds or other securities issued by legal entities, the buyer will retain 5% of the transfer value as advanced payment of the tax and will pay such tax to the Tax Authorities. The seller may consider the advanced payment as a definitive tax or request a reimbursement of the surplus, if he considers that the amount retained exceeds the tax applied over the capital gain at a rate of 10% or the recognition of a tax credit to pay other taxes.

In the sale of the real property, the withholding by the buyer will be of 3% over the selling price and the seller also can claim back the reimbursement of the surplus or the recognition of a tax credit.

Remittances to foreign entities

Payments sent to a person domiciled abroad for services received in Panama or from abroad, will be subject to income tax at a 12.5% rate over the total amount remitted, as long as the services: (1) have an incidence in the generation or the conservation of Panamanian source of income; and (2) its value has been considered as deductible expense by the taxpayer that received such services.

Public entities of the Central Government, autonomous, local governments, state-owned enterprises or joint stock companies in which the State is owner of at least 51% of the shares, as well as non-taxpayer entities and taxpayers that present losses will be subject to the withholding.

Foreign source income

It will not be considered produced within the Panamanian territory, income originated from the following activities, among others:

- Invoicing, from an office established in Panama, the sale of goods or products for a greater sum than the one invoiced for the same goods or products for the office in Panama, as long as the goods or products are transported exclusively abroad, as well as the invoicing of those in transit at national ports or airports.
- Managing from an office established in Panama, transactions that are consummated, perfected or take effect abroad.
- Wages and other labor related remunerations of the individuals that hold a permit as special temporary resident, that receive income directly from their headquarters located abroad, even if they reside in the country to perform those activities.

Tax Exempt Income

Several revenues are tax-exempt, for example: in regards to financing, interests paid over: (i) securities issued by the State and the profits derived from its sale: (ii) deposits in saving accounts, time deposits or of any other nature that are maintained at Panamanian banking institutions, whether local or foreign deposits; (iii) loans, acceptances and other funding instruments to obtain financial resources to banks or financial institutions abroad, through the Panamanian banking institutions, even though the product of such resources is used by the borrower bank in the making of productive assets.

For individuals, we must point out the sums that beneficiaries receive from retirement fund, pensions and other benefits are also tax-exempt.

Movable Assets and Services Transfer Tax (value added tax)

This tax (known as ITBMS in Spanish) is levied on the sale of movable assets and the rendering of services at a 7% rate, as long as the taxable events take place within the country. The law provides for a variety of products (food, medicine, school supplies) and some services that are exempt from this tax, such as the payments, including the interest rates, paid on banking and financial services, except for the fees charged for the services.

Double Taxation Agreements

Panama has endorsed the OECD recommendations to avoid international tax evasion and has subscribed 16 treaties to avoid double taxation with the following countries: Singapore, United Kingdom, Qatar, Portugal, Mexico, Luxembourg, Italy, Israel, Ireland, Netherlands, France, Spain, United Arab Emirates, Republic of Korea (south Korea), Czech Republic and Barbados.

Panama also has 9 agreements signed for the exchange of tax information with Canada, Denmark, United States, Finland, Greenland, Island, Faroe Islands, Norway and Switzerland.

Our domestic legislation has been modified to allow the application of the agreements, contemplating concepts such as the free market principle, related parties, comparison analysis, study and report of transfer pricing, permanent establishment and tax residency, among others.

Administrative Tax Court

This court was established under Law No.8 of 2010 as an autonomous agency, specialized and independent. It has competence to settle appeals against the decisions of the Tax Administration, representing a guaranty for the taxpayers. The World Bank has reviewed its creation as an important institutional advance.

Special Regimes

The Panamanian legislation includes special regimes created to promote foreign investment, to facilitate the flux of free trade and to promote the economic growth of the region.

- Multinational Headquarters Regime (Law 41 of 2007/Law 45 of 2012).

These are entities domiciled in Panama constituted to provide services to other entities located abroad, particularly to its headquarters, subsidiaries, affiliates and associated corporations.

They enjoy income tax exemption in respect of profits obtained on the services provided to any person domiciled abroad that does not generate taxable income in Panama. There is also an exemption on dividend and complementary tax.

The services provided by these entities are ITBMS exempt, as long as these are provided to persons that do not produce taxable income in Panama.

The wages and other type of labor remuneration that the workers with immigration permit for permanent staff in Multinational Headquarters receive from abroad will be considered foreign source income. This permit is granted for a period of 5 years renewable and with the right to opt out for a definitive residence.

Multinational Headquarter entities can carry out the following activities:

- Conduct and/or administer geographic operations in an specific or global location (strategy planning, business development, staff management and training, operation control and/logistic);
- logistics and/or component storage or product parts for manufacturing;
- technical assistance to corporations of the corporate group and to clients for their products or services;
- finance management, including treasury and accounting from the corporate group; and
- advise, coordination and follow up for the market and publicity of goods or services produced by the corporate group, among others.

– The Panama Pacific Special Economic Area

The corporations located in this area may carry out any kind of activities that are not forbidden by Law. Since the moment of its incorporation corporations shall enjoy the benefits of Law 54 of 1998 on legal stability of investments, which provides that any amendments to the taxation regime will not be applicable for a 10 year term.

It is a tax-free area for the corporations located here, except some exceptions established by Law.

For foreign personal hiring, there are several immigration alternatives that facilitates the permanency in Panama. Under this regime, the income tax exemption to foreign staff is not granted, regardless of the place of remuneration.

– Colon Free Zone (Decree Law No. 8 of 1948)

Among the operations that can be developed in this tax free area, we have introduction of goods and assets abroad; general handling (transformation, assembling, packaging and repackaging) any other goods stored in the zone; selling abroad goods stored or handled in the zone (import taxes will only be paid when the goods are sold within the national fiscal territory); and making transfers within the corporations located in the Zone.

In respect of foreign workers, there are also several immigration options. The special temporary worker permit would involve the exemption of the income tax if the wages come directly from the headquarters located abroad.

Conclusions

Panama´s tax system has been consolidated under the principle of territoriality, although in the present times it has been overshadowed by the foreign income taxation, without compromising the advantages that represent investing in Panama due to its geographical location and the connectivity that offers to the Americas.

Beyond the criteria that we are a capital importer country, with a territorial taxation system we have adhered to the subscription of treaties to avoid double international taxation and the exchange of tax information, cooperating with the policies aimed to prevent the tax evasion.

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