Panama

Tax Guide

2014

FOREWORD

A country's tax regime is always a key factor for any business considering moving into new markets. What is the corporate tax rate? Are there any incentives for overseas businesses? Are there double tax treaties in place? How will foreign source income be taxed?

Since 1994, the PKF network of independent member firms, administered by PKF International Limited, has produced the PKF Worldwide Tax Guide (WWTG) to provide international businesses with the answers to these key tax questions.

As you will appreciate, the production of the WWTG is a huge team effort and we would like to thank all tax experts within PKF member firms who gave up their time to contribute the vital information on their country's taxes that forms the heart of this publication.

The PKF Worldwide Tax Guide 2014 (WWTG) is an annual publication that provides an overview of the taxation and business regulation regimes of the world's most significant trading countries. In compiling this publication, member firms of the PKF network have based their summaries on information current on 1 January 2014, while also noting imminent changes where necessary.

On a country-by-country basis, each summary such as this one, addresses the major taxes applicable to business; how taxable income is determined; sundry other related taxation and business issues; and the country's personal tax regime. The final section of each country summary sets out the Double Tax Treaty and Non-Treaty rates of tax withholding relating to the payment of dividends, interest, royalties and other related payments.

While the WWTG should not to be regarded as offering a complete explanation of the taxation issues in each country, we hope readers will use the publication as their first point of reference and then use the services of their local PKF member firm to provide specific information and advice.

Services provided by member firms include:

- Assurance & Advisory;
- Financial Planning / Wealth Management;
- Corporate Finance;
- Management Consultancy;
- IT Consultancy;
- Insolvency - Corporate and Personal;
- Taxation;
- Forensic Accounting; and,
- Hotel Consultancy.

In addition to the printed version of the WWTG, individual country taxation guides such as this are available in PDF format which can be downloaded from the PKF website at www.pkf.com

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MEMBER FIRM

For further advice or information please contact:

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BASIC FACTS

Full name:	Republic of Panama
Capital:	Panama City
Main language:	Spanish, English
Population:	3.61 million (2014 estimate)
Major religion:	Christianity
Monetary unit:	Panama Balboa (PAB); United States Dollar (USD)
Internet domain:	.pa
Int. dialling code:	+507

KEY TAX POINTS

- Corporate income tax is only chargeable on revenue arising from business activities and assets situated in Panama.
- An alternative minimum income tax system applies to all companies except small companies invoicing no more than USD 150,000 per year.
- Tax is chargeable at 10% on the net profit arising on the sale of real estate property. A different tax calculation method applies on the sale of shares and securities.
- VAT is charged on the supply of goods and services at a standard rate of 7%, although some goods are subject to higher rates and others are exempt.
- Withholding taxes apply to the payment of dividends by Panamanian companies to all recipients. Services and fees, interest, commissions, royalties or technical assistance fees, etc., paid or accrued to foreign recipients are subject to withholding tax only if the local payer will take it as a deductible expense.
- Panama has not concluded any income and capital double taxation agreements.
- All individuals are subject to income tax on Panamanian source income. Progressive tax rates apply.

A. TAXES PAYABLE

FEDERAL TAXES AND LEVIES

COMPANY TAX

Panama's income tax law affects aggregate and annual revenue from business activities conducted in Panama or from assets situated in the country, when any of the causes of such revenue occur within the national territory.

Tax rate for companies is 25%, except for the following:

Banks and finance, insurance and reinsurance, electric power, telecommunications, portland cement, game and gambling, and mines have a 27.5% tax rate for 2012 and 2013, and 25% tax rate for 2014 and thereafter.

Companies in which the State has more than a 40% share will pay 30% income tax. The fiscal year of companies normally corresponds to the calendar year but it is allowable to have fiscal years ending on other dates if a request is made to the tax authorities (the 'Tax Department').

Corporate tax returns and payments are due by the end of the third month following the end of the fiscal year. An extension of one additional month may be granted if requested. Extensions to file a tax return, however, do not affect the time for payment of tax.

Corporations are required to prepay its estimated tax liability in three instalments, based on the income tax of the previous fiscal year.

ALTERNATIVE MINIMUM INCOME TAX

A tax rate of 25% is applied to the net taxable income on whichever is higher between:

(1) The amount of the net taxable income (traditional calculation of deducting costs and expenses from gross taxable income); and,

(2) The net taxable income that arises after deducting 95.33% from gross taxable income.

If, after applying the second alternative, the company incurs losses due to the payment of the tax or, if the effective rate of the income tax exceeds 25%, it can request the Tax Department not to apply the alternative calculation.

Small companies that invoice up to USD 1,500,000 gross taxable income in the fiscal year are exempt from applying the alternative calculation.

CAPITAL GAINS TAX

On sales of real estate there are two taxes involved. One is a 2% transfer tax and the other is a 10% income tax on the net profit.

The 2% transfer tax rate is applied on the higher of the sales price or the registered value of the property in the Public Registry plus a 5% surcharge for each complete calendar year for which the property is held.

The 10% income tax is calculated on the net profit of the transaction. Net profit is calculated by deducting the cost of the property plus any related expenses from the sales price.

The buyer of the real estate will withhold 3% of the higher amount between the sale price or the cadastre value and remit it to the Tax Department. The seller will calculate a 10% tax on the profit. If the 10% of the profit is higher than the 3% withheld by the buyer, the seller can opt to consider the

3% as the definite tax. If the 10% of the profit is lower than the 3% withheld by the buyer, the seller can request a reimbursement tor the difference.

Income from the sale of securities is taxable as follows: The buyer will withhold 5% of the sale price and remit it to the Tax Department. The seller will calculate a 10% tax on the profit. If the 10% of the profit is higher than the 5% withheld by the buyer, the seller can opt to consider the 5% as the definite tax. If the 10% of the profit is lower than the 5% withheld by the buyer, the seller can request a reimbursement for the difference. Income from the sale of government securities and those issued by companies registered with the National Securities Commission is not taxable.

BRANCH PROFITS TAX

Branches of foreign companies are subject to the same tax rates as Panamanian companies.

VALUE ADDED TAX (VAT)

Many consumer services and goods are subject to a 7% value added tax. Alcoholic beverages and hotel room rentals have a 10% tax rate and cigarettes and tobacco products have a 15% tax rate. The following items are exempt from VAT:

- Food (except restaurants that serve alcoholic beverages which are taxed);
- Medicines and medical services;
- House rentals with a contract period of more than six months. House rentals with contract periods of less than six months are subject to VAT.

LOCAL TAXES

Panama's income tax law affects the whole national territory equally.

OTHER TAXES

There are other taxes that are applicable in their various manifestations. These include:

PREPAID DIVIDEND TAX

Local corporations must pay a 4% complementary tax on each fiscal year's net taxed profit on behalf of their shareholders if no dividends are declared. This 4% will be applied to dividend tax when dividends are declared. The rate for companies established in a Free Zone is 2%.

FRANCHISE TAX

Foreign and domestic corporations registered in the Public Registry are subject to an annual tax of USD 300, regardless of whether they are doing business in Panama. There is a penalty of USD 50 for late payment and, after two years of non-payment of the franchise tax, there is a restoration fee of USD 300.

ANNUAL LICENCE TAX

All industrial or commercial business, except those exempted by specific laws, are required to have a license to operate. This tax is 2% of the company's net worth, including amounts owed to the foreign home office or foreign affiliated companies. The tax is payable annually up to a maximum of USD 60,000. For companies established in a Free Zone, this tax is 1% of the company's net worth, including amounts owed to the foreign home office or foreign affiliated companies. The tax is payable annually up to a maximum of USD 50,000.

SOCIAL SECURITY TAX

These are payments that are made monthly by employers and employees on the payroll of companies for the purpose of guaranteeing the functioning of the worker social security system and retirement benefits at the national level.

ANNUAL BANKING INSTITUTIONS TAX

Banking institutions are subject to an annual tax as follows:

Banks with a General Licence	Annual Tax (USD)
Assets up to USD 100 million	75,000.00
Assets between USD 100 and USD 200 million	125,000.00
Assets between USD 200 and USD 300 million	175,000.00
Assets between USD 300 and USD 400 million	250,000.00
Assets between USD 400 and USD 500 million	375,000.00
Assets between USD 500 and USD 750 million	450,000.00
Assets between USD 750 and USD 1,000 million	500,000.00
Assets between USD 1,000 and USD 2,000 million	700,000.00
Assets above USD 2,000 million	1,000,000.00
Banks with International Licence:	75,000.00

B. DETERMINATION OF TAXABLE INCOME

The net taxable income of a corporation or partnership is determined by subtracting all allowable deductions from gross taxable income. Generally, expenditures and/or losses are deductible provided they are incurred in gaining or producing taxable income, or preserving the source of income. Special rules apply in respect of certain expenditures.

ALTERNATIVE METHOD OF CALCULATING A MINIMUM NET TAXABLE INCOME

The net taxable income under this method arises after deducting 95.33% from the gross taxable income. Under this formula, the net taxable income will be 4.67% of the gross taxable income. The larger of the two amounts will be the net taxable income for the fiscal year.

The alternative method of calculating a minimum net taxable income is applicable to companies with gross taxable income of USD 1,500,000 and above.

DEPRECIATION AND DEPLETION

Depreciation is normally calculated by the straight-line method over the estimated useful life of the asset. The regulations also permit the use of the sum-of-the-digits and declining-balance methods. Depletion of mines and other natural resources is based on units extracted or produced. Using any other method requires the approval of the Income Tax Department.

STOCK / INVENTORY

The Income Tax regulations allow the use of the specific cost, FIFO, retail-inventory, or average-cost method according to the normal course of operations. The method used cannot be changed by the taxpayer for at least five years and will require a written notification to the Tax Department authorities.

DIVIDENDS

The corporation declaring the dividend must withhold a 10% tax on all dividends declared from income earned within the Republic of Panama.

Dividends declared by domestic subsidiaries on income earned within the Panamanian territory are subject to the 10% tax as well. However, dividends on bearer shares are subject to a 20% dividend tax.

Companies requiring a commercial operating license must withhold a 5% tax on dividends declared from income obtained on exports or from foreign source.

Companies established in a Free Zone must withhold a 5% tax on dividends, regardless of the source of income.

Loans and advances to shareholders are subject to 10% dividend tax, except for bearer's shares which is subject to 20% tax withholding.

Capital shares can be reduced only if the total retained earnings have been distributed and the dividend tax paid.

Dividends on some types of preferred shares are exempt of withholding tax if they comply with the following conditions:

- Maturity less than 5 years;
- Classified as debt under IFRS;
- Owned by common shareholders;
- Dividends/interest up to 6%;
- Non-transferable;
- Preferred shares not greater than 40% of the equity.

INTEREST INCOME

The following manifestations of interest earned are not subject to income tax:

- Savings and time deposits with banks;
- Panamanian government securities;
- Securities issued by companies registered with the National Securities;
- Commission, provided the securities were acquired through a securities exchange duly established to operate in Panama;
- Loans granted to the agricultural and agro-industrial sectors;
- Loans granted to the tourism sector.

INTEREST DEDUCTIONS

Interest is normally deductible on an accrual basis but must be capitalized if it relates to financing of real estate construction. Once the construction is completed, interest is then deductible from income.

LOSSES

Losses incurred in any given year can be taken as a valid deduction over the next five years at a carry forward rate of 20% of the loss per year, as long as this deduction does not reduce the current taxable income by more than 50%. Excess over this limitation for any given year will be lost.

SOURCE OF INCOME

Foreign-sourced income is not subject to income tax. Only income earned in the territory of Panama is subject to Panama income tax.

Income received by persons or companies domiciled outside of Panama will be considered from a Panamanian source if it arises from services or actions that benefit persons or companies located in Panama, including fees, interests and royalties. The income tax withholding is at the regular rates for individuals or corporations but only on 50% of the amount of income received by the recipient.

INCENTIVES

The following incentives are available to these qualifying industries and corporations:

(a) Companies operating in the Colon Free Zone, or any other Free Zone in the country, are tax-exempt on profit derived from sales from Free Zone to foreign countries;

(b) Companies operating in "Ciudad del Saber" (City of Knowledge) are exempt of income tax, import duties and VAT. Dividend tax of 10% or 5% applies when dividends are declared;

(c) For "small business" companies, income tax is calculated over a combination of the personal tax rate and corporate tax rate. Companies are considered small as long as they:

(1) Are not related or affiliated to other companies;

(2) Are not a result of the fractionalization of other corporations;

(3) Have an annual gross income of less than USD 200,000; and,

(4) Its shareholders are individual persons.

D. CORPORATE GROUPS

Group taxation is not permitted in Panama.

E. RELATED PARTY TRANSACTIONS

Transactions between related parties are treated normally as long as an "arm's length" basis is used.

TRANSFER PRICING

There is a transfer pricing system for the import and export with non-resident related parties of goods, services and rights. These prices are based on the following methods; comparative independent price method, resale price less profit method, production cost plus profit method, profit-split method, or the transaction net margin method.

F. WITHHOLDING TAX

Services and fees paid or accrued to individuals and to resident corporations are not subject to income tax, except payments on dividends distributed from retained earnings arising from Panamanian-source income.

Services and fees, interests, commissions, royalties or technical assistance fees, etc., paid or accrued to foreign recipients are subject to withholding tax only if the local payer will take it as a deductible expense. The income tax withholding is at the regular rates for individuals or corporations but only on 50% of the amount of income received by the recipient.

G. EXCHANGE CONTROL

The exchange rate in the Republic of Panama is always USD 1 = PAB 1.

H. PERSONAL TAX

The rates set out below are applicable to any individual's net income earned:

Net Income	Tax amount
Up to USD 11,000	0%
Over USD 11,000 up to USD 50,000	15% on the amount exceeding USD 11,000 up to USD 50,000
Over USD 50,000	USD 5,850 tax on the first USD 50,000, plus 25% on the amounts exceeding USD 50,000

I. TREATY AND NON-TREATY WITHHOLDING TAX RATES

	Dividends[2] (%)	Interest[3] (%)	Royalties[4] (%)	Service Fees (%)
Treaty countries:				
Barbados	5 / 7.5	5 / 7.5	7.5	7.5
Czech Republic	10	5 / 10	10	0
France	5 / 15	5	5	0
Ireland	5	5	5	0
Israel	5 / 15	15	15	0
Italy	5 / 10	5 / 10	10	10
Korea	5 / 15	5	3 / 10	15
Luxembourg	5 / 15	5	5	5
Mexico	5 / 7.5	5 / 10	10	12.5
Netherlands	15	5	5	15
Portugal	10 / 15	10	10	10
Qatar	6	6	6	15
Singapore	4 / 5	5	5	15
Spain	5 / 10	5	5	7.5
United Arab Emirates	5	5	5	0
United Kingdom[1]	15	5	5	0

NOTES:

1 Treaty with this country was signed in 2013.

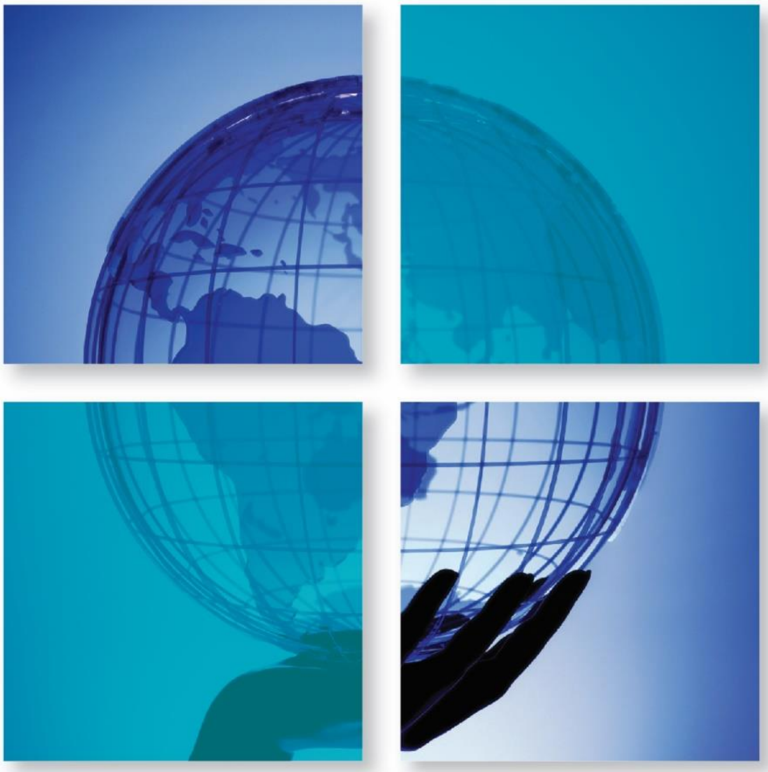
2 The lower rate applies to dividends paid to foreign corporations that own a particular percentage of share capital.

3 The lower rate applies to interests paid to foreign banks and the higher rate applies to others.

4 The lower rate applies to royalties paid for the use of commercial, industrial and scientific equipment. The higher rate applies to other royalties paid.

J. AGREEMENT FOR TAX COOPERATION AND EXCHANGE OF INFORMATION

The Republic of Panama has agreements for tax cooperation and the exchange of information relating to taxes with the following countries: Canada, Denmark, Finland, Greenland, Iceland, Norway, Sweden, The Faroes and the United States of America. These agreements apply to taxes of every kind imposed on the contracting parties.



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