



# PanaManagement Corporation™

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## 2009 & 2010 TAX REFORMS IN PANAMA

### Part I

PAGE | 1

**Law 8 of March 15, 2010** (as published in the Official Gazette 26489 A as of March 15, 2010) contains comprehensive amendments to Panama's Fiscal Code, including reductions in the corporate and income tax rates and an increase in the current ITBMS (*Impuesto de Transferencias de Bienes, Muebles y Servicios*) rate ("Law 8").

Law 8 is a second tax reform recently carried out by the Government of Panama seeking to collect revenue to fulfill its educational, health and social projects.

Law 49 of September 17, 2009 (as published in Official Gazette 26370 C of September 17, 2009) became effective in September 2009 and introduced important changes in the tax system, such as extending the scope of the dividend tax to dividends paid out of foreign source income and to Colon Free Zone corporations ("Law 49").

We have prepared a two-part summary of these important legislative developments: Part I covering Law 49 and Part II covering Law 8.

### SUMMARY

#### LAW 49 OF SEPTEMBER 17, 2009

##### A. Annual Franchise Tax

National or foreign juridical persons, except non-profit associations, must pay as part of their registration fees an annual franchise tax in the amount of \$250 and of \$300 for subsequent years.

National or foreign juridical persons may be stricken-off from the Public Registry (same effect as being dissolved) due to lack of payment of said tax for 10 consecutive years. However, if said juridical person pay a \$1,000 fine within the 3-year dissolution period it could be reinstated.

##### B. Capital Gains

Gains from sale of real estate properties continue to be taxed at a fixed 10% (ten percent) rate, provided the sale is not carried out within the taxpayer's ordinary course of business.

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However, taxpayer will be required to pay a 3% rate over the value of the transfer or the Cadastral value of the real estate property, whichever is greater, as an advance of income tax. Said 3% tax may be considered at taxpayer's choice, as definitive tax.

Taxpayer may request the Treasury for a refund in cash or a tax credit. This tax credit may be assigned to other taxpayer provided the 3% tax rate paid in advance is higher than the 10% tax rate over capital gains from the sale of real estate properties.

Taxpayer was allowed to update the cadastral value of real estate properties if sale of said properties took effect before June 30, 2010.

As allowed by the Ministry of Agriculture, real estate properties destined for agricultural purposes must pay a definitive 3% tax rate.

### **C. Colon Free Zone and other free zone corporations**

Foreign operation activities carried out by Colon Free Zone and other free zone corporations are limited to billing services, repacking and similar provided they produce effects abroad. Commissions, storage and warehouse services, leases, transfer of merchandise and cargo in Colon Free Zone and other free zone corporations are considered as local, interior or domestic operations.

Colon Free Zone and other free zone corporations when distributing dividends or profits to their shareholders must withhold 5% of such amounts which correspond to the income tax on dividends. If dividends or profits are not distributed a so called complementary tax must be withheld over 20% of the net income after taxes as advanced income tax on dividends, or in other words at a 2% rate over the total net income after taxes.

Customs fraud and smuggling shall be punished with imprisonment from 1 to 3 years and from 4 to 6 years in case of recurrence, and fines from 5 to 10 times the value of the illegal goods provided they exceed \$50,000.

All loans granted in the Colon Free Zone shall be subject to payment of the Special Compensation Fund interest (known by the Spanish acronym of "FECE").

### **D. Real Estate Tax**

All land and real estate improvements thereon located in Panama are subject to real estate tax.

The tax base depends on the total value of the land plus all improvements.



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To calculate the tax base it shall be considered the highest value of any of the following:

1. Assessment of the property fixed by the Directorate of Cadastre.
2. Sale price of a property
3. Appraisal of a property in inheritance proceedings

PAGE | 3

An alternative real estate tax up to taxpayer's choice is established on the following terms:

Taxable base more than \$30,000 and up to \$100,000	-	0.75%
Taxable base over \$100,000	-	1%

The alternative rates apply only if real estate properties are updated in their payment of the tax, provided that the taxpayer has presented a sworn declaration (affidavit) indicating the estimated value of the real estate until June 30, 2010.

General or partial appraisals on properties cannot longer be requested by taxpayers. Now, the Directorate of Cadastre acting ex-officio is empowered to effect said appraisals.

Real estate properties with assessed value no higher than \$30,000 are exempt from this tax. Properties under Horizontal Property Regime are not exempted from this tax.

New rates for properties under Horizontal Property Regime are set forth, as follows:

<b>Taxable amount (US\$)</b>	<b>Rate</b>
Up to \$20,000	1.40%
\$20,000 up to \$50,000	1.75%
\$50,000 to \$75,000	1.95%
Over \$75,000	2.10%

Tax exemptions on real estate improvements for residential purposes:

<b>Assessed value of real estate improvements</b>	<b>Exemption period</b>
1. Up to \$80,000	20 years
2. \$80,001 and up to \$100,000	15 years
3. \$100,01 and up to \$250,000	10 years
4. Over \$250,000	5 years

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Real estate evasion is punished with a fine of no less than 5 times no more than 10 times the amount of tax evaded and imprisonment from 2 to 5 years.

## **E. Tax on transfer of tangible personal goods and rendering of services**

Effective as of July 1, 2010, Law 49 introduced a new 7% rate (instead of former 5% rate) and included the following:

1. Commissions from transfer of negotiable documents or securities in general.
2. Commissions from services rendered by entities legally authorized to perform banking and/or financial services.
3. Commissions or retributions from services rendered by real estate and goods brokers.
4. Professional services performed to persons domiciled abroad who do not generate taxable income in Panama.
5. Lease contracts for residential purposes with short time periods less than 6 months.
6. Fixed-line telephone services for commercial purposes
7. Legal services rendered to international commerce vessels.

Tax exemptions include the following:

1. Freight
2. Fixed-line telephone for residential purposes
3. Loading and unloading cargo operations
4. Transfer in or inside the ports and ancillary services rendered in connection with cargo in ports.
5. Repair, maintenance, cleaning and ancillary services rendered to vessels in transit in Panamanian territorial waters.

## **F. Tax on Notice of Operations**

Annual tax on Notice of Operations is equivalent to 2% on the capital and ranges from a minimum of \$100 up to a maximum of \$60,000. Former maximum amount of \$40,000 was increased to \$60,000 by Law 49.

Colon Free Zone and any other free zone corporations must pay a maximum amount of \$50,000.



Any juridical persons which require a Notice of Operation are obligated to withhold a dividend tax regardless the source of the income.

Multinational enterprises and other corporations under special regimes are exempted from the obtainment of notice of operations.

Financial institutions regulated by Law 42 of 2001 shall pay an annual 2.5% tax on their paid-in capital as of December 31 of each year. Said tax may not exceed \$50,000.

## **G. Modifications to Law Decree 2 of 1998 which regulates gaming activities**

A goodwill payment of \$1,000,000 must be paid by new managers and operators of casinos and of \$50,000 for the operation of slot machines halls type A.

Slot machines halls type A shall pay as of January 1, 2014 a 22% tax rate on their gross income. Currently the rate is 10%.

As of January 1, 2012 full casinos shall pay 15% tax rate on their gross income, currently the rate is 10%.

Gaming Control Board is the State entity in charge of the supervision on the transfer of shares and designation of board members and officers of corporations that have contracted with the State.

## **H. Dividend withholding tax**

Corporations when distributing dividends or profits to their shareholders must withhold 10% of such amounts which correspond to the income tax on dividends.

Corporations when distributing dividends or profits from export operations must withhold 5% of such amounts.

## **I. Capitalization of retained earnings**

Undistributed profits in any given fiscal year that are capitalized in any subsequent fiscal period shall now be subject to income tax on dividends.

## **J. Loans**

Loans secured by fixed-term deposits in banks located in Panama shall be subject to payment of 1% tax rate of FECl.



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Loans agreed as automatic loans in life insurance policies, secured by the mathematical reserve or cash surrender value that will be used to pay premiums for the same insurance policy are excluded from payment of FECI.

## **K. Selective consumption tax(known by the Spanish acronym of ISC)**

PAGE | 6

ISC on cigarette consumption was increased from 32.5% to 50% rate.

Services subject to the ISC include mobile telephone communications services and cable or satellite television, as well as the amount of winning paid by slot machines.

*By Juliette Passer, Esq., Ramon Valdes & Lynette Landau ©2010*

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