

HE Juan Carlos Varela, President of Panama, on the country's commitment to working with the international community.

A recent expansion to the Panama Canal should allow it to remain a central part of the global shipping industry.

Growth projections for the coming years suggest the tourism sector is set to contribute more to GDP.

# PANAMA 2017

# the business year



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"Our priority is to provide women with the tools for them to achieve economic autonomy."

**Alcibiades Vásquez Velásquez**  
Minister of Social Development



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"We definitely made the right decision to expand the canal; the numbers are there."

**Jorge García Icaza**  
President, Chamber of Commerce, Industries and Agriculture of Panama



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"The transparency of Panama and its financial system is the key to attracting investors."

**Dulcideo de la Guardia**  
Minister of Economy and Finance



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"Determination gets it done. The Panamanian government made it a priority to expand the Panama Canal and it became an entire government and bipartisan approach."

**Andrew Holness**  
Prime Minister of Jamaica



# ALL THE DETAILS

Alvaro Aguilar-Alfu of Lombardi Aguilar Group runs down all the main legal issues to consider when looking to invest in Panama.

The Republic of Panama was formed when it seceded from neighboring Colombia in 1903. The Isthmus set itself to enact from the start innovative legislation that would encourage the arrival of foreign investors, a process that continues today. The Corporation Law of 1927 based on the Delaware legislation of the time and the Negotiable Instruments Law of 1917 translated from the US basic law are still in effect today. However, increasing globalization and the emergence of new technologies brought about the enactment of new laws with the resulting challenges and benefits.

The Constitution is the supreme law of the country, with fundamental principles and freedoms such as:

- Foreigners and nationals are equal before the government, with participation of foreigners in labor, property and protected industries subject to regulation by law.
- Individuals may do everything which is not expressly prohibited by law, while public officials may only act as authorized by law.
- Taxes and imprisonment penalties may only be imposed as described in a law enacted before the occurrence of the act that gave result to their imposition.
- Expropriation is an extreme measure for emergency cases, subject to fair compensation.

Laws are enacted by a legislature for enforcement by the executive power through regulatory decrees or specific regulations. Illegal actions of administrative officials are subject to appeal before their superior officer. Disputes between parties are resolved by local courts or—when previously authorized by law—by administrative officials. Laws and administrative decisions are subject to judicial review by the Supreme Court.

## SETTING UP A BUSINESS PRESENCE

Business may be conducted as individuals or companies. Forms of companies include:

- Corporations (or Sociedad anonima): This is the most popular form of business entity. The entity is managed by at least three directors and receiving investment from shareholders whose names are privately registered.
- Limited Liability Companies (Sociedad de Responsabilidad Limitada): The entity is managed by at least two administrators and comprised of limited liability partners publicly registered.
- Limited Liability Partnerships (Sociedad en Comandita): The entity is comprised of one general liability partner with limited liability partners.
- Civil Partnership (Sociedad Civil): The entity is comprised solely of general liability partners.
- Branch (Sucursal): Foreign companies for tax purposes may prefer this option by domesticating or registering to do business under said branch, which is part of the foreign entity.
- Private Interest Foundation (Fundación de Interés Privado): These entities can be formed for charitable or non-governmental purposes to hold assets for the benefit of individuals or the public.

These entities must be registered with the Public Registry ([www.registro-publico.gob.pa](http://www.registro-publico.gob.pa)), where information about their directors has always been available to the public, media and authorities for transparency purposes since 1917. Exceptions are:

- Joint Venture (Sociedad Accidental): An agreement under which at least two entities can enter into for a specific purpose, for which taxes on an optional basis can be paid through the venture as a separate taxpayer when registered with the Directorate of Revenue ([www.dgi.gob.pa](http://www.dgi.gob.pa)).
- Trusts (Fideicomiso): An agreement under which a settlor places assets under control of a trustee licensed by the Panama Superintendent of Banks ([www.superbancos.gob.pa](http://www.superbancos.gob.pa)) for a specific purpose. Registration is mandatory when real estate or ships in Panama are trust

assets. Taxes can also be paid through the trust as a separate taxpayer when registered with the Directorate of Revenue.

A Panama law firm must be appointed as Resident Agent by entities registered in the Public Registry and trusts. Dissolution and winding up must be in writing with registration being mandatory for registered entities. A complementary liquidation procedure before the courts is optional for entities that managers feel such procedure may be beneficial for satisfaction of creditor assets.

## TAXATION

Income earned by Panama taxpayers is subject to taxation independently of where it is earned or where the taxpayer is located. However, income from activities carried out under special incentive laws and foreign, non-Panama sources are exempt from taxes. Panamanian-source income is considered to be all income arising from any service or activity that benefits any person located in Panama, including fees, interests, and royalties. When said income is earned through individuals or legal entities located outside of Panama, the amount of the tax to be withheld is 50% of the amount which Panamanian-source income tax would normally be levied. Income earned either from activities or transactions performed abroad is considered to be of foreign source and therefore not taxable.

Income tax rates are of 25% of net taxable income for all types of business entities, with progressive income tax rates for individuals earning more than USD800 monthly. The following items are considered gross revenue of the taxpayer's overall income:

- Salaries, bonuses, travel allowances, commissions, and other payments for personal services, except medical insurance expenses;
- Proceeds or profits from business or agricultural activities;
- Leasing activities of any kind, interest plus proceeds from licensing of intellectual property;
- Dividends or share distributions;
- Profits earned from the sale of real or personal property, shares, bonds, and other securities;
- Proceeds or profits from public services such as electricity, telephone or gas;
- Activities of businesses operating established within free trade zones; and

- Any increase in personal wealth not justified within the relevant year.

Expenses deemed by the Tax Code as incurred for the preservation and generation of income and the protection of its source are deductible from gross income. The following are also deemed as deductible expenses or distributions:

- Donations to officially-designated local educational or non-profit charities up to USD50,000 (for individuals) or 1% of the donor taxable income (for entities);
- Dues paid to local non-profit bodies or associations or guilds;
- The difference between interest paid and interest earned on deposits used as collateral for loans (back-to-back loans);
- Employer earnings distribution among its workers; and
- Interest earned from Panama bank accounts.

Business entities with taxable annual income over USD1,500,000, are subject to Alternative Minimum Tax at the highest between 1) a rate of 25% of their net taxable income or 2) 4.67% of their gross taxable income. Individuals are levied income tax on a progressive rate: no tax for income up to USD11,000, 15% of the excess from USD11,000 to USD50,000 for incomes between USD11,000.01 and USD50,000, and USD5,850 for the initial USD50,000, plus 25% of the excess over USD50,000 for incomes over USD50,000.

Other taxes also applied to businesses are:

- ITBMS - Goods and Services Transfer Tax: applicable to delivery of all goods and services, as well as imports at a rate of 7%;
- ISC - Excise Tax: applicable to delivery of certain luxury goods and services (i.e. alcohol, cable TV), as well as their importation at rate of 7-15%;
- Real Estate Transfer Tax at rates of up to 2% payable by sellers of real estate except for the first sale of newly built improvements;
- Stamp Duty at USD2.50 for every USD1,000 of real estate value and at lower rates for several types of agreements
- Dividend Tax and Complementary Tax
- Business License Tax

Despite having been described by foreign media as a tax haven where no taxes are paid, Panama is ranked 170 in the PWC Paying Taxes Survey out of 190 economies when it comes to ease of tax compliance. Total tax rate is es-

estimated at 37.2%, with 417 hours required to comply with 52 payments every year. Tax returns are filed online before March 15 for individual and March 30 for entities. Tax refunds may take more than a year to be approved, although written applications for tax credits take less time.

Panama has also engaged in international tax cooperation by entering into 19 double-taxation agreements and 10 tax-exchange information agreements, the majority of which are currently in force. Agreements have been signed with Barbados, Canada, South Korea, the UAE, Spain, Finland, France, Greenland, Iceland, Faeroe Islands, Luxembourg, Mexico, Norway, Portugal, the Netherlands, Sweden, Vietnam, and the UK. A US Foreign Account Tax Compliance Act (FATCA) Intergovernmental Agreements (IGA) is being enforced. Panama has not been invited to be a member of the OECD but has adopted a transfer pricing regime that basically follows the OECD transfer pricing guidelines for multinational enterprises and tax administrations.

In addition to the abovementioned investment benefits, even lower tax rates as well as special labor and immigration regimes are available to companies registered in:

- Colón Free Trade Zone of the Atlantic side for warehousing of foreign goods and their re-exportation to foreign markets;
- Panama Pacific Economic Area;
- Export Processing Zones for companies involved in maquila operations and outsourcing for foreign markets;
- Multinational Headquarters Regime for regional offices of international business groups with capital above USD500 million worldwide;
- City of Knowledge Regime for educational and research & development facilities; and
- National Tourism Registry for lodging structures and—when in special tourism zones—restaurants and tourist entertainment facilities.

A number of business sectors are subject to increased compliance and due diligence measures in order to identify ultimate beneficiaries of their clients and must report any suspicious activity, when not covered by professional confidentiality laws, in order to avoid use of their services to prevent money laundering, the financing of terrorism and the proliferation of weapons of mass destruction. These regulated businesses are law firms, pawn shops, real estate brokerages, factoring companies, leasing agencies, credit card or e-money issuing agencies, businesses in free trade zones, casinos, construction companies, custodians of bearer shares and bonds, money transfer agencies,

dealers of precious metals and other bullion; jewelry dealers; saving and loans societies.

Monthly reports in specific formats must be provided regularly by these regulated businesses. Upon receipt of lists issued by the United Nations Security Council for preventive freeze of assets, a report must be issued immediately on whether said assets are held. Failure to comply with these compliance provisions are subject to fines of up to USD1 million.

## INVESTMENT PROTECTION

Proper legal advice is essential to have in place before entering into an agreement to avoid litigation and improve a position in case of a dispute. The World Economic Forum's Global Competitiveness Index 2015-2016 report ranks the independence of Panama's judicial system 119 out of 140 countries. According to the US State Department Investment Climate Statement (ICS) 2016, there are frequent claims of bias and favoritism in the court system and complaints about the lack of adequate titling, inconsistent regulations, and a lack of trained officials outside of Panama City. The ICS reports that politically connected businesses have benefited from court decisions, and there have been allegations that judges have "slow-rolled" dockets for years without taking action. Resolving disputes through the Panamanian court system can take years, depending on the issue, the location, the court calendar or the judge. There are often reports of corruption, bribery, inconsistent treatment, and a lack of transparency.

Many foreign investors rely on binding international or local arbitration clauses to resolve disputes and avoid litigation before the court system. Although foreign and local arbitral awards are subject to nullification in case violations of the Panama arbitration law or lack of service, the Supreme Court has a track record better than other courts in the region for upholding awards. Panama is a member of the International Center for the Settlement of Investment Disputes (ICSID) and party to the 1958 New York and 1975 Panama Conventions on arbitration.

Free trade agreements have been implemented by Panama with Canada, Chile, El Salvador, Peru, the EU, the European Free Trade Association, Mexico, and the US, as well as a partial scope agreement with Cuba. Bilateral Investment Treaties with the UK, France, Germany, Italy, Japan, Qatar, Singapore, South Korea, and Taiwan enhance investment protection for citizens of those countries by ensuring national treatment and providing arbitration for resolution of treaty disputes. ✖

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

TBY would like to thank Lombardi Aguilar Group for compiling this analysis.





TBY talks to **Alvaro J. Aguilar-Alfu**, Partner at Lombardi Aguilar Group, on the growing demand for legal advice from international players coming from around the globe to Panama.

**BIO**

Alvaro J. Aguilar-Alfu graduated from the University Santa Maria La Antigua with a degree in law and political science, going on to obtain a master's in international legal studies from the Washington College of Law, American University. After working as a legal assistant with a Panama business law firm, he served as an administrative intern of the Administrative Tribunal of the Organization of American States in Washington, D.C. He later worked as an attorney with a Panama commercial law firm. He is a Partner at Lombardi Aguilar Group.

# A GLOBAL *perspective*

**Could you describe the evolution of Lombardi Aguilar Group?**

My partner Jorge Lombardi and I founded the law firm in 2006. We decided to set it up as a result of the investment boom in Panama at the beginning of 2000. There was a demand from foreign clients for more specific and bespoke advice when they entered Panama as direct investors. Usually, major law firms assisted with the formation of investment vehicles; however, there was a demand from clients for more specific advice when entering Panama. Sourcing talent is competitive in our field of work. Unfortunately, there is a lack of training programs for paralegal and law office management here in Panama. This is a market that private educational programs could capitalize on and benefit from the growth of the sector in order to make it more competitive compared to some of our rivals in the Caribbean and Europe. About 95% of our clients are from abroad. Around 20% of our clients are from the US and Canada. Another 30-40% are from Europe, the Middle East and the CIS, while the rest are from Latin America, specifically Venezuela and Central America. The services that are most frequently in demand are the formations of a corporate structure or deciding to set up a branch in

Panama. Those are then followed by assistance in contracts for real estate, labor, as well as taxation issues.

**How do you position Lombardi Aguilar Group as a key asset for international investors?**

Unlike most local law firms, the founders of Lombardi Aguilar Group have an immigrant background. We are always aware of the perspective of the foreigner and try to find the best from Panama. We help clients avoid the pitfalls that have discouraged others. I am of Chinese descent on my mother's side while my partner is of Italian descent and we also belong to an international network of law firms that originally started in the GCC and Central Asia regions. That also gives us an advantage in assisting investors from regions that are traditionally not served by other Panamanian law firms.

**What is your vision for the law firm for the short and medium term, especially in light of growing competition in the local market?**

Our vision involves a two-pronged strategy. In the area of HR and talent formation, we have an internship program both with young lawyers as well as college students from Europe and the US. These interns seek exposure to the Panamanian business environment, Pan-

ama being one of the well-known emerging markets. On the other hand, we want to provide our local staff with an opportunity to be exposed to different ways of thinking and encourage diversity in beliefs among our staff. The other part of our strategy is working with groups, such as foreign bar associations and other international lawyer associations, in order to make presentations on how Panama compares to other jurisdictions. It is part of our strategy to become part of networks and new alliances with international firm associations. Because of greater regulations worldwide, there is a change in the market composition. There is an increase from countries in Latin America, in addition to the Far East. At this moment, though, it is still an evolving process.

**What targets and ambitions have you set for 2017?**

This year we have set a target to increase the number of jurisdictions in which we can provide investment solutions. This means obtaining what is called a company management license in the British West Indies jurisdiction. We also plan to further promote options in Panama for regulated entities, which can be available for public fundraising such as hedge funds and investment funds, rather than the usual unregulated company. We have to continue with training for our staff, not only in traditional legal areas, but also in the new transparency regulations for anti-money laundering and account record keeping, which Panama is becoming engaged in. ✖



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## We create value for you by *bringing solutions*

**Lombardi Aguilar Group** is a leading international business law firm in Panama. The attorneys at the firm provide their clients with fast, innovative, and effective solutions to their business challenges. The firm provides services to individual and corporate clients doing business in Panama as well as in the Americas, Europe, and Asia. Its partners maintain a commitment to professional ethics and social responsibility by participating on the board of directors of groups such as the Panama Bar Association, the Alliance Francaise, the German Chamber of Commerce Association, the American Chamber of Commerce (AMCHAM) of Panama, and as members of the Society of Trusts and Estate Practitioners (STEP)."

The firm advises in areas of corporate and commercial law, intellectual property, maritime law, real estate, securities, taxation, government contracts, e-commerce, foreign investment, and immigration law as well as related litigation that may arise from its client activities. Its attorneys also assist with private client services and the formation of business and charitable structures (private interest foundations, trusts), investment funds, tax planning, and consulting. Its partners conduct business in Spanish, English, French, German and Italian.

Lombardi Aguilar Group is a member of Prae Legal, an international global network of 242 independently owned law firms in more than 141 countries.

At Lombardi Aguilar Group we believe in a regular and direct communication with our clients that allow us to anticipate their needs and challenges in order to provide them with the best and cost-effective solution in the shortest period of time.



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