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# Doing Business in Panama

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*MSI's guide on Doing Business in Panama provides current information about the financial, regulatory and legal considerations that could affect business dealings within Panama. For further assistance please contact our MSI member firms in Panama.*

## Country overview

### Population

Panama has an estimated population of 4.4 million inhabitants. (est. for 2022.)

### Government

Panama is a representative democratic republic, where the President is both head of state and head of government. The government is divided in three branches; the Executive branch is led by the President, the Legislative branch by the National Assembly and the Judicial Branch is led by the Supreme Court.

After the demise of military dictatorship in 1989, the political landscape has been peaceful, with five total transfers of power between opposing parties. Among the last few presidents are Former President Martín Torrijos, who is the son of general Omar Torrijos. He succeeded Mireya Moscoso, the widow of Arnulfo Arias. Panama's most recent national elections occurred on May 2019, with the candidate of the long-time opposition party Partido Revolucionario Democrático (PRD), Laurentino Cortizo, declared as the victor.

### Languages

The official language of Panama is Spanish. However, many people speak English as well, especially in Panama City. English is the de facto commercial and maritime language in Panama.

### Currency

The national currency is the Balboa, however the US Dollar are legal tender and used for all paper currency in the country.

### Economic summary

GDP: US\$59.2 Billion (est. for 2022)

Income per capita: US\$13,849

Inflation: 2.0%

### Main sectors of the economy

Panama also possesses a very healthy logistics sector, providing transport and merchandise distribution to the area. The Panama Canal is the centre of the logistical hub, however it is also composed by ports and container terminals in both the Atlantic and the Pacific side of the country, the inter-oceanic railway, as well as a modern International Air Transportation platform, with its hub located in Tocumen Airport.

Another key strategic area of the Panamanian economy is the country's financial centre, which provides banking, insurance, securities, and financial planning services.

Tourism is, and has always been, a very relevant sector of the Panamanian economic landscape. Due to its world-class port infrastructure, it has become a hub for cruise ships in the region, and several ships have Panama as their base port. There are also many attractive tourism opportunities for big and small investors, due to its warm, mild climate rarely affected by severe weather, several eco-tourism spots such as Boquete, Bocas del Toro and the Azuero Peninsula, its bilingual population, ease of transportation to the country, relatively affordable real estate, safety, and peaceful political climate. It is becoming common for big and small investors to view Panama as an opportunity to expand their earnings through tourism.

Panama is an attractive base for doing business and for investment. Its open and international outlook, well-educated work force and strategic location are contributors. Panama is a strategic destination for the operation of multinational enterprises in diverse sectors.

The country has become the preferred destination in Latin America for leading companies in the high tech industry and services.

## Setting up a business

Under Panamanian law, a foreign individual or company may operate in the country through an incorporated entity or branch. Panamanian's corporate law provides a flexible and liberal framework for the organization of subsidiaries or branches. There are no special restrictions for a foreign entrepreneur to do business in Panama. Business operations can be set up in Panama with a legal personality. If a legal entity has legal personality, the entrepreneur cannot be held liable for more than the sum it contributed to the company's capital.

### Legal types of business entities

1. Corporation
2. General Partnership
3. Simple Limited Partnership
4. Limited Liability Companies
5. Joint-stock Partnerships
6. Private Interest Foundation
7. Limited Liability Entrepreneurship

In international business, the Corporations and the Limited Liability Companies are most commonly used. The Corporation is incorporated by two or more incorporators pursuant to



the execution of a notarial deed of incorporation before a public notary.

The minimum share capital is B/.10,000. It is possible to choose for another currency than the Balboa.

All legal entities must be registered in the Public Registry of Panama to have legal personhood.

Foreign entities may also be registered and conduct business in Panama, either as their own entity or as a branch or subsidiary.

#### *Process of how to set up a business*

Legal entities are created through a notarial deed, which is then protocolized and recorded at the Public Registry.

Once recorded, the legal entity or the individual if no entity was created, can obtain a commercial license from the Ministry of commerce, and will need to pay a commercial license fee depending on the business. After this step, the business will need to be registered with the local government (Municipio) office, in order to determine the yearly Municipal tax, and may also need to register with the Social Security office, if the entity will become an employer.

#### *Financial year of taxes and financial accounts*

The financial year is equal to the calendar year. However, legal entities may choose for a different financial year if they wish. The Corporation or a Limited Liability Company (LLC) are subject to corporation income tax for all local activities.

#### *Accounting and auditing*

The accounting principles accepted in Panama are the International Financial Reporting Standards (IFRS). For the banking sector and for entities supervised by the National Securities Commission, IFRS or US GMP are used upon previous notification to the regulatory entity.

A Panamanian company that operates in Panama, although it does not generate Panamanian source income may be subject to reporting obligations and/ or preparation of audited financial

statements. Panamanian companies operating in Panama, and companies in free zones and qualified foreign companies operating in the country require the filing of tax returns.

The minimum corporate accounting books required for a Panamanian company are:

1. Shareholders Register
2. Acts Register
3. Journal
4. General Ledger.

In 2021, the Law 254 established in its article 17 the following:

Legal entities will be obliged to provide the resident agent with accounting records or a copy of them on an annual basis. These records must be kept for a minimum period of 5 years.

Accounting books, reports, statements, and certifications must be endorsed by a Panamanian accountant.

There are no requirements for the formal delivery of financial statements to the authorities in Panama. However, the companies listed on the National Securities Commission, commercial and governmental banks and the insurance and reinsurance companies are required to refer to the regulator. In other cases, if the capital of the taxpayer exceeds B/. 100,000.00 or the annual sales or gross income exceeds B/. 50,000.00, the annual income tax return must be countersigned by a Panamanian Certified Public Accountant (CPA) and financial statements shall be duly audited by a CPA.

#### *Economic and fiscal incentives*

Panama offers several incentive schemes in various sectors to support companies in their business operations.

Panama has competitive tax incentives. The Free Trade Zone Regime, Tourism, the law for Entrepreneurs are some of the incentives and benefits granted by the government to companies making new investments in the country and it provides tax incentives.

#### *Incentives foreign investors/ local investors*

##### **Inward Investment**

Investment in industries, agroindustry, marine resources transformation, industries dedicated to extracting and transforming raw agricultural and forestry materials may get industrial promotion certificates which allow crediting the investment against taxes such as income tax, but limitation of depreciation of referred assets.

##### **Accelerated depreciation**

According to tax law, a taxpayer can apply accelerated depreciation depending on the use of the assets without any authorization from the Tax Authorities but will be limited to minimum useful life period described by law.

##### **Tourism, industry, and agriculture allowances**

Tourism development: The Law for Tourism Development grants several incentives and tax benefits, such as exemption from import duties on certain tourism service-related goods for companies dedicated to tourism, but only for those corporations with a signed tourism agreement with the Tourism Authority. In some special cases, income tax exemptions apply.

Income related to forestry activities is totally exempt from income tax if the final disposition of the plantations derived from property are registered in the Forestry Registry of the Environmental National Authority from 2017 within the next 20 years.

## **Taxation**

The Panamanian tax system is regulated by the Tax Code and many other complementary laws that regulate specific matters. Our most recent structural reform is Law No. 8 of 2010. It reduces tax rates, raising the overall rate of VAT, and sets the new Tax Tribunal, among other relevant provisions.

Additionally, the Law 33 of 2010, adapts the Panamanian tax system, for the application of double taxation treaties and formally recognize the

comprehensive legislation of transfer pricing rules included in the OECD regulations.

The main taxes you must pay in Panama are:

1. Income Tax
2. Corporate Annual Tax
3. ITBMS - Tax on Transfer of Goods and Provision of Services (VAT).
4. ISC - Excise Tax
5. Fuel other Petroleum Derivatives Tax
6. Capital Gain Tax
7. Dividends Tax and Complementary Tax
8. Operation Notice Tax
9. Stamp Tax
10. Real Estate Tax

#### VAT

The general VAT rate is 7%. On tabaco 15% and alcoholic beverage the rate is 10%.

#### Corporate income tax

The tax rate is 25%. For companies in which the State owns more than 40% of the shares, the tax rate will remain at 30%. The tax base (amount to which the tax rate will apply) for companies whose taxable income is greater than B/. 1,500,000 will be the greater of one of the following:

- Net taxable income calculated by the traditional method, or
- 4.67% of the gross taxable income (excludes exemptions of non-taxable income and foreign source of income) - this is called the Alternate Calculation of Income Tax Alternative Calculation (CAIR).

#### Corporate Annual tax

Corporate annual tax must be paid by all corporations and private interest foundations. The deadline for payment depends on the date of the entity's incorporation. If the company was incorporated during the first six months of the year, the due date for payment will be July 15th of each year. If the company was incorporated during the

last six months, the due date will be January 15th of each year.

Non-profit organizations, cooperatives and partnerships are not subject to franchise tax

#### Registration procedures

Private persons and companies are registered with the tax authorities and are given a fiscal registration number. Communication with the tax authorities by way of tax returns and tax assessments is done in an electronic way.

#### Participation exemption

Participation exemption or substantial holding exemption in Panama occurs when it is considered part of the distribution of profits by the companies in which we have a shareholding in them.

#### Wage tax

The basis and rates of wage tax is similar to the income tax for individuals. Wage tax is a withholding tax and as such it is an advance payment on income tax.

#### Withholding taxes / Dividend Tax

Companies' profits are taxed, in addition to the corporate income tax, with a dividend tax of 10%. This tax is reduced to 5% in the cases of entities that operate in a Free Zone, if the income subject to dividends is considered an exempt income or from non-Panamanian source of income .

In cases where entities belong to tax residents in countries which Panama has subscribed to a Double Taxation Treaty (DTT), tax rates over the dividends vary according to what is established in the applicable treaty.

Dividend tax foresee a presumptive annual distribution of 40% of the profits after income tax, and in case it is not executed, requires the tax payment according equivalent to the minimum distribution, which is the Complementary Tax of 4% (10% over the 40% of the profits ).

Services that take effect in Panama have a withholding tax with a rate of 12.5%.

## HR/ Labour Law

### Employment law

There are three different types of employment contracts established by Panamanian law: permanent contracts, defined termination contracts and contracts for defined services.

Companies that need to employ foreigners must obtain permission from the Ministry of Labor. Work permits issued to foreigners are valid for one year and may be extended for up to five years.

It is mandatory by law to give employees a day of rest per week as required by law, preferably on Sundays. However, if the type of employment requires to work on Sunday, another day should be given in lieu of it, and Sunday will be paid with an extra charge of 50% per hour. Each employee is entitled to thirty (30) days of paid vacation after eleven (11) months of continuous work.

In Panama is mandatory for the employer to pay a yearly additional month of salary (XIII Month) and shall be paid in three parts (April 15, August 15 and December 15). This salary is calculated based on the total wages received. The XIII Month is subject to social security contributions and income tax.

Please find below a summary of the most important requirements of the Labor Law.

### Wages and salaries

Panama has a minimum wage system by economic activity, which is adjusted periodically. The minimum wage system is applicable in practice only to non-skilled employees. The effective average wages are substantially higher than the minimum wages, especially in metropolitan areas.

### Profit sharing

Companies are not obliged to share the company's profits with the employees.

### Christmas bonus

Companies are not required to pay the worker a Christmas bonus.

### Complementary Benefits

Housing and children's education are among the most common complementary benefits, which are treated as salary in kind for both calculations: income taxes and social security contributions.

### Paid Holidays and Vacations

Every employee has the right of 30 days full-paid for vacations after 11 months of continuous work.

### Social security

The Social Security is an autonomous government agency that provides retirement due to illness or maternity, age or disability pensions to widows and orphans, funeral assistance and compensation for occupational injuries and death. Since the enactment of the Social Security Law (Law No. 51 of 2005), is mandatory for the employer the affiliation of its employees to the social security regime. This obligation applies to both national and foreign employees performing services in Panama. The current contribution for the employee is 9.75% Social Security (S.S.) and 1.25% Educative Security (S.E.) and 12.25% Social Security (S.S.) and 1.50% Educative Security (S.E.) plus Professional Risk rate 2.10%-5.64% for the employer.

Apart from the mandatory obligation of the Employer to register as such in the Compulsory Regime of the Social Security Fund, the employer has the following main obligations towards the institution:

a. Affiliation of their employees: The employer has the responsibility to affiliate their employees, at the time they enter their service, if they are not, or declare the general information of the employee in case they are affiliated, within a period of six (6) business days counted from its entry. (Article 87, Organic Law).

b. Notify in case of closure of operations, whether temporary or permanent (Article 88, Organic Law).

c. Keep a mandatory labor registry of its employees (Article 89, Organic Law).

d. Deduct workers' contributions, at the time of payment of the salary, and deliver them to the Social Security Fund together with the employer's contribution. (Article 90, Organic Law). Both the Employer and the Worker must make a contribution to the Social Security Fund, which comprises the instalment payments.

e. Utilize the technological tool for payroll control, implemented by the Social Security Fund (Article 93, Organic Law).

f. The employer has the obligation to notify in case of employer substitution, formally in writing, within thirty calendar days following the date thereof (Article 96, Organic Law). The replacement will be jointly and severally liable with the new employer, for the obligations towards the Social Security Fund, born before the date of the substitution and up to a term of one year counted from the notification (Article 95, Organic Law).

g. To participate in public acts, as well as to receive the payments settled by the Government, the employer must provide a certificate that proves that they are in good standing in the payment of social security contributions (Article 99, Organic Law).

### Pension

The age the pension start varies depending on the future mortality rates but will be at least 57 years for women and 62 years for men.

### Payroll

When starting a business and employing staff, the company must register with the Caja de Seguro Social (Social Security Fund). Wage tax and social security is paid monthly to the "Caja de Seguro Social" and tax authorities. The process of registration in both institutions takes around one to two weeks.

### Visa and work permits

#### Foreign Personnel

Panama recognizes joint investment with no restrictions. Labor Code is applied

equally to Panamanian and foreigners. However, the exercise of retail trade is restricted for foreigners. Most foreign personnel wishing to work in Panama are required to have a work permit and/or resident visa.

Under the Labor Law, foreign personnel may not exceed 10% of a company's total workforce, and the monthly payroll for foreigner employees, may not exceed 10% of the total company payroll. In the case of technicians, up to 15% may be foreign personnel. Under special regimens, foreigners may be able to work in Panama with a special immigration permit not requiring a work permit, granting this individual exemption from income tax and social security contributions

### Special Economic regimes

With the purpose of attracting foreign investment, various special zones have been established within Panamanian territory, accompanied by the corresponding legislation, offering benefits to multinational companies or companies with foreign capital that establish themselves in them. Here we detail the most important:

1. Panama Pacific Regime: The Panama Pacific Special Economic Area is created by Law No. 41 of July 20, 2004, with the purpose of encouraging and ensuring the free flow and movement of goods, services and capital, the generation of jobs and the attraction of foreign investment. This Special Economic Area has a regime with tax, customs, labor and immigration incentives. It is located in the District of Arraiján, province of Panama Oeste, west of Panama City, and is characterized by its proximity to the City.

2. Colon Free Zone: The Colon Free Zone is a free zone established in the Province of Colon, north of Panama City, and is one of the most important commercial centres in the continent. Created in 1948 with the purpose of encouraging international trade, it offers labour, migratory, corporate and, above all, fiscal advantages.

3. Headquarters of Multinational Companies (SEM): Companies registered under the framework of Law 41 of 2007 and its regulations; SEM companies receive a series of tax, immigration, labour and logistics benefits. To benefit from the SEM Company Regime, it is necessary to comply with various requirements, and there are relevant sanctions for companies that, having a SEM license, do not fully comply with the requirements set by the Law.

The advantages offered to companies with an SEM license are also characterized by convenience of a migratory nature, opening the framework for the hiring of trusted foreign workers which are covered by the migratory benefit, being able to work in the Republic of Panama without the need for additional procedures.

The relations between the workers and the company with a SEM License will be subject to the provisions of the Labour Code of the Republic of Panama and other provisions in force related to labour matters, without prejudice to the exceptions established in Law 41 and its regulations.

4. City of Knowledge Regime: City of Knowledge is established in the Republic of Panama, as a Foundation with the support of the Panamanian State, with a view to establishing a geographic area within Panama City for the establishment of technology companies, foundations, non-governmental organizations and educational institutions, with fiscal, migratory and labour incentives. It is regulated by Decree Law 6 of 1998.

The State will grant special visas to foreign personnel who enter the country to contribute to the development of the City of Knowledge project. The companies affiliated with the City of Knowledge are authorized to hire the international personnel necessary for its operation.

## Contact us

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The information provided in this guide cannot be exhaustive and we recommend anyone considering doing business in Panama should seek professional advice from our member firms before making any business or investment decision.

### Contact our member firms in Panama to discuss your requirements:

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