080994/EU XXVII. GP
Eingelangt am 22/11/21

Council of the
European Union

**Brussels, 22 November 2021
(OR. en)**

**14226/21**

**FISC 199**

**OUTCOME OF PROCEEDINGS**

| | |
|---|---|
| From: | General Secretariat of the Council |
| To: | Code of Conduct Group (Business Taxation) |
| Subject: | Panama's Foreign source income (FSIE) regime (PA008)<br>– Final description and assessment |

**STANDSTILL REVIEW PROCESS (SEPTEMBER 2021)**

Panama did not commit to repeal or amend their harmful FSIE regime. The Code of Conduct Group meeting of 21 September 2021 recommended to mention Panama in Annex I. This conclusion was endorsed by the ECOFIN Council on 5 October 2021.

*Annex 1: Assessment of the PA008 regime*



www.parlament.gv.at

**ANNEX 1**

## Assessment of the PA008 regime (standstill)

**Assessment of FSIE regime**

| | 1a | 1b | 2a | 2b | 3 | 4 | 5 |
|---|---|---|---|---|---|---|---|
| **Panama – Foreign Source Income Exemption** | V | ? | V | ? | V | V | X |

V: Harmful; X not harmful

**Gateway criterion – Significantly lower level of taxation:**

*"Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code"*

The general tax rate in Panama is 25%. The Panamanian Tax Code[1] and Executive Decree No. 170 of 1993 provide for a non-exhaustive list of types of income which are considered as earned in Panama. Income that does not arise in Panama or is not listed in the provisions mentioned above as *de-lege* sourced in Panama[2] is considered to be non-taxable. In addition, income that could fall into

[1] 1. Art. 694 in most cases and Art. 696 with regard to leasing of real estate located within Panama.
[2] Art. 9 of Executive Decree No. 170 of 1993 mentions:
1. Income from real estate located in the territory of the Republic, such as leases, agricultural, forestry, mining, quarrying and other natural waste;
2. Income received non-residents individuals or companies, as a result of any service or act, documented or not, that benefits individuals or legal entities, national or foreign, located within the Republic of Panama which includes, but is not limited to fees and income for IP royalties, trademarks and invention patents, technology transfer ("know-how"), technological and scientific knowledge, industrial or commercial secrets, as long as this services affect the production of income from Panamanian sources or the conservation, and this payment has been considered as a deductible expense for income tax purposes by the taxpayer in Panama.
3. Income arisen by things or economic assets utilized in the Republic and by capital or economic values invested in the national territory, such as interest on loans and on money deposits,



www.parlament.gv.at

the scope of a preferential tax regime would also follow the general rule. Certain types of income would be subject to separate taxation (withholding taxes[3]). This is particularly the case for dividends. In all cases, income would result in being not subject to tax or taxed at a lower level than the headline CIT.

As the Code of Conduct looks at the effects that tax legislation may have on the location of business activities in general terms, a full or partial tax exemption may be regarded as one of the reasons for a business to establish in one jurisdiction instead of another. In this sense, the provisions are relevant for the Code.

The Code of Conduct uses a broad term ('tax measures') to describe what should be assessed under its criteria. This definition is not limited to specific pieces of legislation nor does it circumscribe the meaning of what should be intended as a 'tax measure'. In the specific case of the measures of the Panamanian Tax Code, it is relevant to take into account the general tax system to understand if the legislation provides for a significantly lower level of taxation. This is the case here, as certain types of income with foreign source are exempted from taxation or taxed at a lower level than the headline CIT. The provisions are therefore potentially harmful and should be evaluated under the Code.

**Criteria 1 and 2 – Ring-fencing**

The exemption from taxation of foreign source income applies only in respect of transactions carried out with non-residents and does not affect the national tax base. Such exemption is by its nature targeted to non-residents and so, ring-fenced. We would therefore propose a tick ("V" – harmful) for criteria 1.a and 2.a.

---

interest on securities and dividends, or other distribution of profits among shareholders or partners, the profits of branches established in Panama of parent companies located abroad, leasing of personal property utilized within the country, periodic allowance by government, life income or other income with similar characteristics triggered in the Republic of Panama.
Art. 2 and 118 refer additionally to interest on bonds.

[3] Article 733 of Panama's Tax Code.



www.parlament.gv.at

With regard to possible de facto ring-fencing aspects of the regimes, there are 1,586 companies which are registered in Panama and generate 100% of their income abroad. The amount of income generated abroad and reported by these companies represents 27% of the total income reported by all companies (i.e. companies generating both local and foreign income). Panama was not able to further break down this information as companies that generate only income from a foreign source are not required to file their annual income tax return. It is also worth noting that the exemption on foreign income also applies horizontally, including to companies that benefit from a preferential tax regime. Based on the above we would propose a tick ("V" – harmful) both criteria 1.b and 2.b.

**Criterion 3 – Substance:**

"*whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages*"

Substance requirements

Panama's legislation does not require companies to fulfil substance requirements in connection with income from a foreign source, unless they fall into the scope of a preferential tax regime.

Anti-abuse rules

Art. 20 of Law 76 of February 13, 2019 introduced a GAAR in the Panamanian tax system. The provision will enter into force on 1 January 2022. The GAAR seems to focus on the income generated in Panama. While this is understandable considering Panama's territorial tax system, this may hinder the possibility for the GAAR to be applied to foreign-sourced income. Art. 733 paragraph 1 of Panama's Tax Code covers situations where a company unlawfully re-qualifies dividends as loans (i.e. recurring loans to its shareholders that, regularly, did not carry any interest and were not returned by the shareholders to the company). This provision has been interpreted by Panama by administrative and judiciary authorities as a targeted anti-abuse rule. While this rule can be used by the tax administration to requalify vested dividends, the provision would apply only to income which is connected with Panama, i.e. foreign sourced dividends would not fall within the scope of application of the provision.We would propose a tick ("V" – harmful) for criterion 3.



www.parlament.gv.at

**Criterion 4 – Internationally accepted principles:**

"*whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD*"

Permanent Establishment (PE) definition

Article 762-M of the Tax Code lays down the domestic definition of PE. This seems not to be in line with the latest amendment to Art. 5 of the OECD MC, in particular with regard to the identification of a PE in case of commissionaire arrangements. In its tax treaty network, Panama applies the OECD definition of PE in most cases. Both the domestic and treaty definitions of PE seem in line with the international standard. However, it does not appear that Panama takes into account the PE definition to avoid cases of double non-taxation in all instances. In particular, it does not seem that Panama considers the income earned in another jurisdiction as non-taxable in Panama only if that other jurisdiction considers the income attributable to a PE in that jurisdiction.

Panama also ratified the MLI.

Accounting principles

Art. 733-A of the Tax Code and Executive Decree No. 263/2015 provide for a mechanism on which the tax administration can rely, to ensure that tax exempt income, in particular outbound payments, do not benefit from double non-taxation. This includes a declaration by a certified expert, who is liable to provide information on why a company has not been able to offset abroad taxes paid in Panama. However, such mechanism does not apply to inbound payments. This does not seem to be in line with accounting principles. Additionally, Panama does not require companies with purely foreign-sourced income to file an income tax return on this income.

Based on the above, we would therefore propose a tick ("V" – harmful) for criterion 4.



www.parlament.gv.at

**Criterion 5 – Transparency:**

"*whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way*"

All conditions necessary for granting the tax benefits under the FSIE regime in Panama are clearly laid down in the legislation.

Therefore, we propose a cross ("X" – not harmful) for criterion 5.

**Overall assessment**

In light of the analysis above, the regime is considered as overall harmful.

---



www.parlament.gv.at