

30 July 2020

Global Tax Alert

News from EY Americas Tax

Panamanian Ministry of Commerce and Industries proposes creating special regime for manufacturing services

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As part of the plan to boost and reactivate the national economy after the COVID-19 pandemic, the Panamanian Ministry of Commerce and Industries has proposed a bill that would create a Special Regime for the Establishment and Operation of Multinational Enterprises that Render Manufacturing Services (EMMA for its Spanish acronym). The bill is intended to promote investment, create new job opportunities and contribute to the transfer of technological knowledge in Panama.

Entities under the regime would qualify for various tax benefits, including corporate income tax (CIT) and dividend tax exemptions.

Incentivized activities

- ▶ To qualify for the EMMA regime, entities could only perform services related to:
- ▶ The manufacture of products, machinery and equipment
- ▶ Product, machinery and equipment assembly
- ▶ Product, machinery, and equipment maintenance and repair
- ▶ The re-manufacturing of products, machinery and equipment
- ▶ The conditioning of products
- ▶ Product or existing processes development, investigation or innovation
- ▶ Analysis, lab work, tests or other activities related to manufacturing services
- ▶ Logistics, such as storage, deployment, and distribution of components or parts, required for the provision of manufacturing services

Entities could only provide these services to the multinational group to which they belong. Thus, these services may not be provided to clients directly or to entities that do not belong to the same multinational group.

In addition, entities under the EMMA regime could provide services under the multinational headquarters regime (SEM) established by Law 41 of 2007, as long as they have the corresponding SEM license as well.

License requirements

The EMMA regime would be supervised and managed by the Commission of Multinational Enterprises (the same commission that supervises the SEM regime).

The Commission would establish the requirements entities must meet to obtain a License of Multinational Enterprises for the Provision of Services Related to Manufacturing. The Commission would create a form that entities would have to complete to request an EMMA license. Entities also would have to submit an affidavit expressing their intent to register under the regime and their compliance with all the applicable requirements, and any other documents required by the Commission. The form could require the following information:

- ▶ The multinational enterprise's assets
- ▶ Places of operation or related entities, subsidiaries or the parent entity of the multinational enterprise
- ▶ Commercial or industrial activities or operations carried out by the multinational enterprise
- ▶ Listing of shares on the local or international stock exchange markets
- ▶ The multinational enterprise's number of full-time employees and annual operational expenses in Panama (number of employees and amount of expenses should be adequate for the business carried out by the multinational enterprise)
- ▶ Any other requirement or information that the Commission requests

The entities under the EMMA regime would be required to perform the activities that generate income subject to a tax incentive in Panama.

The bill would allow entities under the SEM regime to expand their activities to include those of the EMMA regime. In this case, the Commission may consider the documentation already filed for the SEM license.

The license for the EMMA regime would be granted for an indefinite period.

Once a license is granted under the EMMA regime, entities would have to meet the following requirements:

- ▶ They would have to initiate operations or the construction of premises within the first year after the EMMA license is granted.
- ▶ They would have to file an annual report at the Technical Secretariat of the Multinational Enterprise License Commission, with statistics on their operations within the national territory.
- ▶ They would have to seek to exchange knowledge and training with local/national personnel for which they will have to create a technical training center within their premises, or they would have to adopt training programs with universities or teaching centers.
- ▶ They would have to apply the current legislation applicable to environmental matters in Panama, including conducting an environmental impact analysis.

EMMA applicants could hire foreign personnel for senior positions but might also have to hire a percentage of local personnel, as specified by the Executive Power. Entities with a license to operate under the EMMA regime would automatically benefit from the legal stability of investments regime under Law 54 of 1998.

Tax regime

Income Tax

Entities under the EMMA regime would be exempt from CIT for the first five years, beginning with their registry under the regime. After those five years, they would be subject to 5% CIT rate on the taxable income derived from the services rendered.

Entities would pay the CIT with their CIT return and could claim any salaries or wages as a deductible expense.

The bill would allow entities under the EMMA regime to claim a CIT credit for CIT or similar tax paid abroad on taxable income generated in Panama and derived from services provided to nonresidents. CIT withheld by Panamanian taxpayers would also be creditable against CIT.

Entities under the EMMA regime, however, would have to pay a minimum CIT equal to 2% of the net taxable income generated in Panama. CIT credits would apply up to a maximum of 3% of net taxable income. CIT credits exceeding that 3% maximum would not be carried forward or refunded.

Withholding tax (WHT)

After the five-year CIT exemption, local taxpayers would be required to apply a 5% WHT on payments for services rendered by entities under the EMMA regime, provided the services affect the generation of local-source income and are considered a deductible expense by the local taxpayer.

Entities under the EMMA regime would be required to apply a 5% WHT on 50% (i.e., effective tax rate of 2.5%) of the amount to be remitted to a nonresident abroad as fees, royalties, know-how, brands, patents, technological knowledge, or industrial or commercial secrets. The 5% WHT would apply as long as the services affect the generation of local-source income subject to tax and are considered a deductible expense by the entity under the EMMA regime.

The bill would require the entity under the EMMA regime to apply the WHT rate, even when it is in a loss position. In this case, applying the WHT would not depend on whether the service affects the generation of local-source income or is treated as a deductible expense by the entity under the EMMA regime.

Interest, commissions or any other payments to nonresidents for loans or financing granted to the entity under the EMMA regime and used in Panama would be subject to the 5% WHT rate.

Dividend and complementary tax

Entities under the EMMA regime would be exempt from the payment of dividend, complementary or branch tax, regardless of the income's source.

Capital gains tax

Gains or losses derived from the transfer of shares or securities issued by an entity under the EMMA regime would be subject to the capital gains tax under the Panamanian Fiscal Code and its regulations. A 2% capital gains tax applies to gains from eligible transactions.

In these cases, the buyer would be required to withhold 1% of the sales price as an advance payment of capital gains tax.

The seller may consider the amount withheld by the buyer as the definitive tax due.

Tax on the transfer of corporate movable assets and the provision of services (ITBMS for its Spanish acronym)

Services rendered by entities under the EMMA regime to entities that do not generate taxable income in Panama would not be subject to ITBMS in Panama. However, entities under the EMMA regime would not be exempt from the payment of ITBMS on goods or services purchased in Panama. ITBMS in Panama is equivalent to a Value Added Tax (VAT).

Operation Notice (Commercial license)

The bill would not require entities under the EMMA regime to obtain an Operation Notice. Therefore, they would not be subject to the payment of Operation Notice Tax established in Article 1004 of the Panamanian Fiscal Code.

Transfer pricing

Entities under the EMMA regime would have to apply the transfer pricing principle established in the Panamanian Fiscal Code to all transactions carried out with related parties in Panama, those that are tax residents abroad, and those that are registered under the Panama Pacific Regime, SEM regime, Colon Free Zone, Fuel Free Zone, City of Knowledge regime or any other free zone or special economic area regime currently existing or that may be created in the future.

Fiscal equipment

The bill would not require entities under the EMMA regime to use fiscal equipment (e.g., a cash register that keeps track of transactions for tax purposes); they would, however, have to document their activities by issuing invoices or equivalent documentation that would allow the Panamanian Tax Authority to carry out the corresponding control, registry, accounting and supervision of their transactions.

Custom duties

Entities under the EMMA regime could establish themselves in a special economic zone, a free zone or anywhere else in the Panamanian territory, as long as they create their own customs control and supervision area.

Moreover, entities under the EMMA regime would be exempt from paying all import taxes, levies or duties derived from the importation of all types of merchandise, products, equipment and goods in general, including machinery, materials, packaging, raw materials, supplies and spare parts used or required to render the services allowed under the regime.

Any products that entities under the EMMA regime manufactured, processed, assembled or re-manufactured in a special economic zone in the national territory, a free zone or any other area under control and supervision of the Panamanian Custom Authority could enter the Panamanian fiscal territory. However, customs duties on the value of the raw material and components from abroad incorporated into the product would have to be paid. Custom duties would be calculated by applying the appropriate custom tariff to each raw material or component incorporated into the product.

The importer, which should be an entity of the multinational group, would have to file any returns, documents or forms before the Panamanian Customs Authorities.

Migratory regime

The bill would allow the following visas to be granted to the foreign personnel hired by entities under the EMMA regime:

- ▶ *Visa for temporary personnel of entities under the EMMA regime:* These visas would be granted to foreign personnel hired to render operative or training services to the entity for two years and would be extendable. These personnel would only work for the entity under the EMMA regime. Any salaries received by these personnel would be exempt from income tax, social security contributions and educational tax, if the salaries are paid and registered as a payroll expense in the accounting of the entity under the EMMA regime.
- ▶ *Visa for dependents of temporary personnel of entities under the EMMA regime:* These visas would apply to dependents of the temporary personnel with a visa, such as a partner or spouse, children younger than 18 years old or 25 years old (as long as they are still in school), and parents. Visas for dependents would be granted for the same amount of time as the visas for temporary personnel.
- ▶ *Visa of permanent personnel of multinational enterprises:* These visas are the same as those contemplated under the SEM regime, and would be granted for five years, but would be extendable. Personnel under this type of visa would be exempt from income tax, social security contributions and educational tax, provided the salary and other remuneration is assumed and registered as a payroll expense by the entity under the EMMA regime. Additionally, the employee would not be subject to import duties triggered by a first-time move to Panama. After five years, the employee may request a permanent residence in Panama; at that time, the employee would be subject to the payment of income tax, social security contributions and educational tax on the salary paid by the entity under the EMMA regime.
- ▶ *Visa for dependents of permanent personnel of multinational enterprises:* These visas would apply to dependents of permanent personnel with a visa, such as a partner, children younger than 18 years old or 25 years old (if they are still in school), and parents. Visas for dependents would be granted for the same amount of time as that of the permanent personnel.

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EYG no. 005288-20Gbl

1508-1600216 NY
ED None

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