

Panama Economic Substance Rules for Foreign Passive Income

Forvis Mazars in Panama



Juan Esteban Sanín Gómez
International Partner of Tax & Legal
Forvis Mazars in Colombia,
Panama and Ecuador

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From fiscal years beginning on or after 1 January 2027, Panama's Law 526 of 28 May 2026 and Executive Decree 32 of 2 September 2026 apply to certain legal entities incorporated or domiciled in Panama, that are part of multinational groups, and that earn passive income from foreign sources. The regime preserves the territorial treatment of qualifying income where the entity demonstrates and reports adequate economic substance in Panama. Failure to qualify can bring the relevant net taxable foreign passive income within Panama's 15% income tax charge.

Who is within scope

Three conditions must be considered together: (i) the entity¹ is incorporated or domiciled in Panama, (ii) it forms part of a multinational group², and (iii) it earns one or more categories of foreign source passive income specified by the law³.

¹ A corporation, private interest foundation, trust, among others.

² A multinational group generally consists of at least two entities linked by ownership or control that are tax resident in different jurisdictions and included, or includable, in consolidated financial statements.

³ Passive income is defined as profit distributions, interest, royalties, capital gains, income from immovable property and other passive capital income as defined by the law

What constitutes adequate substance

The general test examines the activities connected with each income producing asset. The entity must have suitably qualified and remunerated people and appropriate premises in Panama, make and evidence the relevant strategic decisions and management or control in Panama, and incur adequate local operating expenditure linked to the assets and income. The scale of these resources must be proportionate to the nature and complexity of the activity, the assets and the risks. The decree sets operational and evidentiary criteria, including local personnel, decision making records and expenditure support.

A reduced test applies to a qualifying passive holding entity whose principal activity is the non habitual acquisition, holding or disposal of equity participations, provided it does not undertake substantial commercial or investment activity concerning those participations. A similar reduced approach applies to certain passive real estate entities. Their status and the activities actually undertaken must be examined before relying on the reduced standard.

¿Can substance be provided by a third party?

Yes, within limits. The law permits specified personnel, premises and operating functions to be outsourced to a provider in Panama that has real capacity to perform them. The decree requires the work to be performed in Panama, adequately documented and attributable to the entity. The entity must supervise the provider. Outsourcing does not replace the entity's own strategic decision making or cure an absence of genuine activity. A registered office or paper services arrangement alone should not be treated as sufficient substance.

Reporting and tax consequences

A qualified entity (or an entity within scope) must report the relevant foreign passive income and information supporting its substance position with its annual income tax filing, and retain reliable records in Panama for review. The supporting file should connect each asset and income stream to personnel, premises, decisions, contracts, expenses and, where relevant, an outsourcing provider. The decree also prescribes records and supporting information to be retained for five years.

If an entity fails to establish the required substance or reporting position, it may be classified as non qualifying. The relevant foreign passive income is then subject to a 15% rate on net taxable income, after properly attributable costs and expenses, rather than on gross receipts. A credit for tax effectively paid abroad on the same income may be available within the statutory limits. Incomplete, inaccurate or unsupported filings may also lead to assessments and applicable penalties and interest under the tax rules. Issues that call for a separate review

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Income from intellectual property has its own nexus based rules and asset level calculations. Income under preferential regimes and claims to statutory regulated entity exclusions also require specific analysis. Group charts, consolidation treatment, the legal owner of each asset, where investment decisions are actually made, and the origin of receipts can change the result. A Panama company owned by a foreign individual, without more, should not automatically be assumed to be part of a multinational group.

¿How can Forvis Mazars Panama assist?

Forvis Mazars Panama can determine whether an entity and its income streams fall within the regime, assess existing personnel, premises, decision making and expenditures, quantify potential tax exposure, design and implement compliant operating arrangements, provide permitted third party substance services in Panama, and prepare the supporting records, reporting and ongoing compliance process. The appropriate solution depends on the specific entity, assets, income and governance model.

Contact

Forvis Mazars in Panama

Panama City

PH Times Square Center, Office 24C
Costa del Sol Avenue

Marketing Forvis Mazars

marketing.co@forvismazars.com



Juan Esteban Sanin, International Partner of Tax & Legal
juan.sanin@mazars.pa

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