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Economic Substance Regime for Foreign-Source Passive Income

Law 526 of 2026 and its implementing regulations under Executive Decree No. 32 of 2026

Amendment to the Fiscal Code of the Republic of Panama

Law 526 of 28 May 2026, published in Official Gazette No. 30534-B of 28 May 2026.
Executive Decree No. 32 of 2 September 2026, published in Official Gazette No. 30603-B of 2 September 2026.

Effective: fiscal periods beginning on or after 1 January 2027.

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A. Purpose and regulatory framework

Law 526 of 2026 added Chapter II, *Economic Substance Rules for Foreign-Source Passive Income*, to Title I of Book IV of the Fiscal Code. The regime sets out the conditions that entities forming part of a multinational group and incorporated or domiciled in Panama must satisfy in order for their foreign-source passive income not to be treated as taxable, by way of exception to the principle of territoriality. **Executive Decree No. 32 of 2 September 2026 was subsequently issued, specifying the scope of the substance conditions, the criteria of sufficiency and proportionality, the reporting and record-keeping obligations and the verification procedures.** This report addresses both instruments on an integrated basis.

B. Scope of application: entities and income covered

The regime applies to entities that simultaneously meet three conditions: (i) being incorporated or domiciled in the Republic of Panama; (ii) forming part of a multinational group; and (iii) obtaining foreign-source passive income of the types listed in article 707-C of the Fiscal Code, namely dividends or profit participations, interest, royalties, capital gains, income from immovable capital and other income from movable capital.

A **multinational group** is a group of two or more entities related by ownership or control and resident for tax purposes in different jurisdictions, including the parent company, its subsidiaries and its permanent establishments. An entity forms part of the group where: (i) it is included in the group's consolidated financial statements or would have been required to be included; (ii) it would be required to be included if its equity interests were listed on a public securities market; or (iii) it is excluded from consolidation on grounds of size or materiality.

Regulatory clarification. Executive Decree No. 32 confirms that the regime applies both to entities obtaining Panamanian-source income together with foreign-source passive income and to those obtaining *exclusively* foreign-source passive income. In addition, and significantly, it defines **entity** as any person or legal vehicle, including, without limitation, the corporation, the limited liability company, the **trust** and the **foundation**.

C. Classification of entities and applicable rate

Qualified entity

Evidences and reports economic substance in respect of each type of passive income generated. Its foreign-source passive income **is not subject** to taxation in Panama, the ordinary territorial treatment being preserved.

Non-qualified entity

Falls within one of the grounds set out in article 707-F. Its foreign-source passive income is taxed at a **single and definitive rate of 15%** on the net taxable income of the relevant fiscal period, without giving rise to any other tax (art. 707-D).

Net taxable income is determined by deducting from gross income the costs and expenses necessary for obtaining, preserving and maintaining that income, duly documented and directly related to the generation of the foreign-source passive income.

An entity is non-qualified where it: (i) fails to comply with the duty to report the foreign-source passive income obtained in its income tax return; (ii) fails to meet the conditions for evidencing adequate economic substance; (iii) fails to provide, or provides only in part, the information relating to such income; or (iv) submits false information in the tax return, or information manifestly inconsistent with the reality of the activities, assets, risks, human resources, premises or operating expenses declared. The determination is made in accordance with the procedure and safeguards of the Tax Procedure Code.

D. Economic substance conditions

Article 707-E requires the entity to evidence, in respect of each income-generating asset, three concurrent conditions. Executive Decree No. 32 develops each of them.

1. Adequate human resources and premises

The Law requires the entity to have adequate, remunerated and duly qualified human resources dedicated to the core activities — the administration, direction and/or control of the income-generating assets — and to have adequate premises in Panamanian territory. The Decree specifies:

- An adequate number of human resources holding the required qualifications, experience or technical knowledge, which **may in no case be fewer than one (1) person** employed or engaged **under any arrangement, including through service providers**, duly qualified and remunerated.
- That such person's role or professional occupation be directly connected with the management, administration and control of the core activities generating the foreign-source passive income, and that the person devotes time, whether in full or in part, quantitatively adequate to those activities.
- Physical premises located in Panama, which may consist of offices, commercial units or business centers owned, leased, used or otherwise made available under any form of contractual arrangement, **including shared use**, proportionate and equipped with the necessary material and technological resources. The title for exclusive or shared use **must be documented**.

2. Strategic decision-making and risk assumption

The Law requires strategic decisions necessary for operations to be taken in national territory and the associated risks to be borne from Panama. The Decree defines *strategic decisions* as the key management, direction and/or administration decisions that determine the general orientation of the entity, the administration of its income-generating assets, the assumption of economically significant risks and the conduct of its activities generating passive income. To evidence this condition the entity must have:

- A board of directors or equivalent body responsible for the direction, administration and supervision of the core activities and for the management of the associated risks, which holds **a minimum of two (2) meetings with physical presence in Panamanian territory during the fiscal period**, with documentary record of their being held and of the strategic decisions adopted. The Decree clarifies that the number and frequency of in-person meetings will depend on the nature, scale and complexity of the activity.
- A board of directors or equivalent body whose members, taken as a whole, possess the knowledge, experience and/or competencies necessary to direct and supervise the core activities.
- Minutes or records supporting the decisions adopted, the original or a copy of which must be kept in Panama and remain available for review by the competent authority.
- Articles of incorporation, bylaws, constitutive document or shareholders' or partners' agreements governing the entity's organization, administration and operation, including the transfer of shares or participations and the calling and holding of meetings of shareholders and of the board of directors.

Express limitation. The direction, administration and control functions inherent to strategic decision-making **must be exercised directly by that body and may not be outsourced, delegated or subcontracted**.

3. Operating costs and expenses

The Law requires the entity to incur adequate operating costs and expenses in Panama, other than staff remuneration and premises, directly related to the income-generating assets. The Decree requires them to be proportionate to the nature, scale and complexity of the core activities and calls for:

- The acquisition of goods or the procurement of services in national territory for the conduct of the core activities. For these purposes, **staff remuneration and premises-related expenses are considered separately and may not be counted towards this requirement**.
- Supporting evidence demonstrating a direct and verifiable connection between the operating costs and expenses incurred and the core activities carried out.
- Accounting records, contracts, invoices and other supporting documentation evidencing the nature and amount of those costs and expenses and their connection to the core activities.

Sufficiency criteria: both the Law and the Decree make the sufficiency of human resources, premises, operating expenses, direction, control and risk management subject to a proportionality test. *Adequate* means what is suitable, necessary and appropriate for the conduct of the core activities, having regard to the nature, scale and complexity of those activities; to the type and amount of passive income obtained; to the number of income-generating assets; to the degree of risk assumed; and to the operating structure of the multinational group in Panama.

E. Reduced regime: holding of equity interests and of real estate

The Law relieves certain entities from compliance with items 2 and 3 of article 707-E. These are entities whose core activity is the holding of equity interests in other entities, whether local or foreign, and the non-habitual acquisition, preservation and disposal of those interests, **provided that they carry out no substantial commercial or investment activity in respect of the interests acquired**; and entities whose core activity consists exclusively of the non-habitual acquisition, holding or transfer of real estate. In both cases item 1 (human resources and premises), the reporting and information obligations and the legal provisions applicable to their incorporation or registration in Panama continue to apply.

Regulatory clarifications. The Decree defines when such entities are deemed to carry out substantial commercial or investment activities, namely **where they actively participate in the day-to-day operational decision-making of the legal entities in which they hold interests, where they provide financing services to unrelated third parties, or where they carry out regulated financial intermediation activities**.

In addition, the Decree establishes a **presumption of compliance** as regards human resources where the entity meets at least one of the following conditions: (i) it has at least one remunerated director, officer or administrator resident in Panama holding the experience or qualifications appropriate to the exercise of those functions; or (ii) it has adequate and remunerated human resources resident in Panama holding the experience or qualifications necessary for the conduct of the core activities. The adequate-premises condition is evidenced on the same terms, including shared use, and the title to use must be documented.

F. Outsourcing

The core activities referred to in items 1 and 3 of article 707-E may be carried out by third parties, provided that they are performed in Panamanian territory. The Decree sets out the conditions for evidencing this:

- That a contractual relationship with the service provider exists and that the amount of the operating expenses incurred with that provider in Panama be identified.
- That the number of the service provider's human resources assigned to the conduct of the core activities be adequate and that they hold appropriate experience and technical and/or professional qualifications.
- That the service provider's premises be proportionate and equipped with the necessary material and technological resources.
- That the core activities be carried out by the service provider **exclusively within the territory of the Republic of Panama**. The outsourcing of core activities outside national territory, whether in whole or in part, will not be taken into account. The entity must maintain mechanisms for monitoring, controlling and supervising the outsourced activities.

- That, where the service provider renders services to more than one entity of the multinational group, **the working periods or time actually incurred by the employees assigned may not be counted simultaneously** towards the economic substance requirement of another entity.

G. Reporting obligation: income tax return

Every entity forming part of a multinational group and incorporated or domiciled in Panama must file annually, within the deadlines set by the Fiscal Code, the income tax return reporting the foreign-source passive income obtained and the information supporting compliance with the substance conditions, **even where it is classified as a qualified entity**. The Decree sets out the information to be included in the return and its annexes:

- General information on the reporting entity and a detailed description of the core activity or activities carried out to obtain each item of passive income.
- A list of the human resources engaged in the conduct of the core activities during the fiscal period, stating names, type and number of personal identification document, position or function, whether the person works full time or part time, and remuneration received. For entities engaged in the mere holding of equity interests and of real estate, the list may include directors, officers or administrators carrying out their activities in Panama.
- The total amount of expenditure incurred in respect of those human resources; a description of the premises and the amount of the related expenditure; and details of the nature and amount of the remaining costs and expenses incurred in carrying out the core activities, other than human resources and premises.
- Confirmation that the strategic decisions relating to the core activities were taken in Panamanian territory, and details of the risks assumed by the entity in national territory.
- A statement of whether the entity outsources the core activities relating to items 1 and 3 of article 707-E, with details.
- Taxes paid abroad in respect of that passive income, solely where the entity claims the foreign tax credit.
- Where the income derives from intangible assets, a detailed description of the type of intellectual or industrial property concerned.

H. Record retention and language

The entity must keep at its domicile in Panama, in physical or digital format and for a period of **five (5) years from the close of the relevant fiscal period**, all supporting documentation enabling the accuracy and sufficiency of the information reported to be determined and verified, and compliance with the economic substance requirements presented in the income tax return and its annexes to be assessed. The Decree defines supporting documentation as the set of documents, accounting and non-accounting

records, financial statements, contracts, minutes, communications, reports and any other documentation or mechanism enabling compliance to be verified. Supporting documentation **must be submitted in Spanish**.

I. Entities under preferential tax regimes

Entities benefiting from a preferential tax regime (Multinational Enterprise Headquarters — SEM, EMMA, free zones, City of Knowledge and similar regimes) are not outside the scope of the regime. They must evidence qualified-entity status in respect of each type of foreign-source passive income and report it, together with the substance information, in the income tax return for the relevant fiscal period. This applies whether or not their regime already imposes a substance return before its administrator; where it does not, the evidencing is carried out before the Ministry of Economy and Finance on the terms set out above.

J. Foreign tax credit

The Law allows the entity to credit against the tax payable in Panama the amount actually paid abroad in respect of the same or an analogous concept. The Decree confines this to the **non-qualified entity**, which is the entity taxed at 15%, and sets out the following conditions:

- That the tax has been actually paid abroad by the entity, or that the applicable withholdings have been made abroad, on the same foreign-source passive income taxed in Panama.
- That the tax paid abroad be in the nature of income tax or of a nature analogous to income tax.
- That supporting documentation evidencing actual payment of the analogous tax abroad be submitted, **duly legalized or apostilled**.

The credit is applied in the tax return for the fiscal period in which the income was received and the tax was paid abroad. Where the foreign tax is paid or determined in a fiscal period other than that in which the income was received, the taxpayer may apply the credit in the period in which that income is recognized, provided that actual payment is conclusively evidenced within the applicable statutory term in the jurisdiction concerned. The maximum limit is the amount of tax that would be payable in Panama on the same income, and **no offsetting is permitted between credits generated by different items of income**. The credits are strictly personal, are not subject to refund, assignment or transfer to third parties and may not be applied in subsequent fiscal periods.

K. Income derived from intangible assets

The Law establishes a special regime for income derived from the assignment or exploitation of intangible assets registered under Panamanian law and disposed of or economically exploited outside Panama, where obtained by a qualified entity. The income will be non-taxable in the amount resulting from the

application of a ratio based on the development expenditure incurred in Panama. The Decree develops this method.

Numerator and denominator

Numerator: the direct costs and expenses incurred in Panama for the creation, development or improvement of each intangible asset — research and development personnel, materials and equipment, testing and experiments, other directly attributable expenses and locally provided services — taking into account only those of the developer and those contracted with unrelated third parties or with related parties resident in Panama. Those expenses are increased by thirty percent (30%), without exceeding the denominator.

Denominator: the total expenses of the intangible asset, that is, the qualifying costs and expenses plus those of acquiring the intangible asset or a license to use it from third parties, and payments to providers located outside Panama for services connected with its creation and improvement.

$$\text{Non-taxable income} = \frac{\text{Direct costs and expenses} + 30\%}{\text{Total costs and expenses}} \times \text{Net income derived from the assignment or exploitation of the intangible asset}$$

Restricted definition of intangible asset

For the purposes of this calculation, only intangible assets protected by patents, utility models, registered industrial models or designs and software protected by copyright qualify, in accordance with Panamanian law and subject to registration and approval before the competent authority. Trademarks, image rights and any marketing-related intangible asset are expressly excluded.

Individual calculation, losses and records

Non-taxable income is determined individually for each intangible asset, with no offsetting between profitable intangible assets and those generating losses. The entity must keep separate accounting and non-accounting records for each intangible asset — income and type of asset, attributable expenses, costs and losses, acquisition costs, useful life and the calculation of the numerator, the denominator and of net and non-taxable income — as well as a loss register traceable across successive periods, and must keep both the records and their supporting documentation in Panama, available to the competent authority.

L. Sectoral exclusions and certification by regulators

The Law excludes from the regime financial institutions, insurance and reinsurance entities — save for captives forming part of a multinational group — securities market intermediaries, managers of investment or pension funds and commercial operators of vessels registered in Panamanian registries, provided that the foreign-source passive income is directly and effectively connected with their ordinary

regulated activity. The exclusion is not automatic, since the entity must evidence to the Ministry of Economy and Finance its current license or registration, its continued compliance with prudential and supervisory requirements, and effective direction, administration and resources in Panama. The Ministry of Economy and Finance may require this certification from the entity itself or directly from the competent sectoral authority, and its receipt neither limits nor replaces the Ministry's tax audit powers.

M. Administration, tax audit and confidentiality

- **Competent authority.** The Ministry of Economy and Finance administers, assesses, supervises, verifies and audits compliance with the regime, without prejudice to the powers of other sectoral or supervisory authorities. It will maintain a register of the entities subject to the regime and may verify compliance at any time.
- **Anti-abuse clause.** The Ministry may, by reasoned resolution, disregard arrangements or mechanisms which, having been established with the principal purpose of obtaining a tax advantage that defeats the purpose of the regime, are improper because no valid commercial reasons reflecting the economic reality of the transaction exist. In such cases the passive income becomes subject to the 15% rate.
- **Confidentiality.** The information reported is confidential and for the restricted use of the Ministry, and may be communicated to third parties only under international tax information exchange agreements executed and ratified by Panama, or in the other circumstances expressly provided for by law.

N. Entry into force

The Law and the Decree take effect as from fiscal period 2027. The first reporting exercise will therefore be the income tax return for fiscal period 2027, filed in 2028 within the deadlines set by the Fiscal Code, as a general rule, by 31 March. The substance conditions, by contrast, must be satisfied *during* fiscal period 2027, so that decisions on structure, hiring of personnel, premises and corporate governance must be adopted before it begins.

O. Points to note

1. **Vehicles covered.** The definition of entity in article 3 of the Decree expressly comprises trusts and foundations. Wealth-holding structures that were not analyzed as subjects of the regime under the text of the Law may fall within its scope where they form part of a multinational group and receive foreign-source passive income.
2. **The quantitative minimums are floors, not compliance standards.** One person and two in-person meetings per year are the minimum threshold. The substantive standard remains the test of what is adequate and proportionate. The number and frequency of meetings will depend on the nature, scale

3. and complexity of the activity, and sufficiency will be assessed having regard to the type and amount of the income, the number of income-generating assets and the degree of risk assumed.

4. **Corporate governance of groups with boards meeting abroad.** It is advisable to review articles of incorporation, notice practices and board calendars of Panamanian entities that currently meet outside the country or by electronic means, and to ensure documentary record of the holding of meetings and of the decisions adopted.

5. **Prohibition on outsourcing direction.** The impossibility of outsourcing, delegating or subcontracting the direction, administration and control functions inherent to strategic decision-making has a bearing on arrangements involving directors or officers provided by third parties who do not practice effective direction.

6. **Prohibition on double counting of expenditure.** Staff remuneration and premises-related expenses do not count towards the operating costs and expenses requirement. The entity must evidence a third block of genuine local expenditure, such as the acquisition of goods or the procurement of services in Panama, documented and connected with the core activities.

7. **Overlapping hours in shared service providers.** Where the same provider serves several entities of the group, its employees' time may not be counted simultaneously towards the substance of more than one entity. In practice this will require time records and differentiated allocation by entity, as well as contractual clauses supporting it.

8. **Scope for holdings.** The definition of substantial commercial or investment activity may capture holding companies that actively participate in the day-to-day operational management of their subsidiaries, with the consequence of losing the reduced regime and becoming subject to the three economic substance requirements.

9. **Matters still pending administrative development.** The Decree does not create the specific form or annex to the tax return, nor does it regulate the procedure for the register of entities. Adjustments by the Directorate General of Revenue and complementary resolutions are to be expected before the start of fiscal period 2027.

This document provides a high-level summary of Law 526 of 28 May 2026 and of Executive Decree No. 32 of 2 September 2026. It does not constitute legal or tax advice. To assess the specific impact on your organization, please contact us. This is a courtesy translation of the Spanish original; in the event of any discrepancy, the Spanish version prevails.

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