SPECIAL INDEPENDENT COMMITTEE

INTERIM REPORT

July 2016

I. INTRODUCTION

This document does not represent the final result of the work done by the Commission. It is a reflection with recommendations of immediate action with the objective of maintaining the competitiveness of the Republic of Panama (Panama) as a regional financial center and of international operations of companies and nonprofit organizations, and to enhance its benefits to opportunities and threats of a globalized worlds and the changing standards affected in a significant manner by the fiscal difficulties primarily of the countries of the G-20.

For that, it has been identified the necessity of establishing immediate commitments with the international community, and this job pretends to be a based guide in the comparison of some jurisdictions that have maintain its competitiveness against the rest of the world and offer services that are positive results to their economy.

The categorization of a city as “financial center and of international operations” follows a wide spectrum of factor which behave in different ways each, and follow a wide spectrum of competitive factors:

- Availability of qualified workforce and professional and executive personnel.
- Regulatory regime
- Access to international financial markets
- Business, logistics and connectivity infrastructure
- Accessibility of suppliers and clients
- Just and fair business climate.
- Response capacity from the Government
- Tributary corporative regime
- Operational costs
- Access to professional services providers
- Quality of life
- Multiculturalist and multilingualism
- Dynamics of the real estate market
- Tributary regime for natural persons
- Efficiency in the establishment of new organizations.

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1 Z/Yen Limited, 2013.
Although Panama stands out in many of these factors, the study analyzed shows that bakers surveyed mention that the clarity and the implementation of a regulatory regime that meet the international standards is vital when considering establishing operations in any jurisdiction. At the same time, the organizations that wish to use the business and legal platform of Panama to establish their international operations – multinational corporations, private institutions and non-governmental non-profit organizations – search for a favorable environment in regulatory terms and of financial and institutional stability to establish their operations and investments.

In the knowledge that the country looks to attract the big platers for the establishment of operations, we start then from the believe that is necessary commitments and execute actions that maintain its competitiveness and at the same time raise the existing standards.

Panamanian Economy

The primary characteristic of the Panamanian economy is the connectivity. Marine connectivity, aerial connectivity and connectivity of telecommunications with the submarine cables of fiber optics. This characteristic has made it an economy, eminently, of services focuses in the international market, because its domestic market is small for its capacity.

The Panamanian economy is 83% of services; which means, the 83% of the Gross Domestic Product (GDP) are services, of which only 1% corresponds to legal services. The 90% of the exportations are services. Approximately 25% of the GDP are comprise by the services of the Panama Canal and its activities, the container ports, the Colon Free Zone, the marine services to ships like gasoline, reparation and maintenance of ships and containers; in addition, tourism of cruises that pass through the Panama Canal.

When the banking and financial services are added, the services from Tocumen International Airport and aerial lines, the merchant navy, the tourism (not from the Canal), the telecommunications, the City of Knowledge, the Panama-Pacifico zone, the service of lawyers, insurances and accountants, among others, the contribution of the services reaches the 45% of the GDP, approximately. To this, it is necessary to add the contribution of the 124 multinational businesses that locate in Panamanian territory their regional offices.

In other words, the conglomerate of 26 activities of the region of transit produce more than 45% of the GDP.

The economy grew on average, 8.1% annually since 2003 to 2015. Exportations (primarily of services) grew in those years on average 14.5% yearly. Investments were of 27% of the GDP on average yearly, the highest level of any country in the hemisphere. Approximately, a third of them where private national investments. Another third were public national investments and another third were foreign direct investment in Panama. This levels of growth were the best of Latin America and one of the highest of the world.

This growth is due primarily to the raise of the demand caused by the raise of the exportations, the expansion of the capacity installed because of the total investments and a
banking system and open credit to the development of consistent projects with the dynamic of the sector.

As a result of all of this, during the 2003-2015 period, unemployment was reduced from 13% to 4.5% of the job force. Poverty dropped from 39% to 23% of the population.

The financial and banking center represents a 9.5% of the GDP and moreover is a primary source of the expansion of the economy. Furthermore, as an international financial center, it exports its services. The banking center is a fundamental support of the economy.

The deposits of foreign sources are an important part and complement of the local bank deposits. Both support the credit of the local economy and provide international credits, primarily to South America countries. The bank sector employs more than 24,000 people, in general in job positions that are well paid and sustainable.

The sectors that are more dynamic among those added, other than the financial-banking, have been the construction, the telecommunications, the electrical energy, the wholesale trade and retail trade, tourism, maritime activities, and the activities of Tocumen International Airport, among others. The Panamanian economy is well diversified. The sectors of less development have been the agricultural and the manufacturing industry, even though in some sub-sectors they had good sporadic years.

Qualifications of International Organizations and other nations

In recent times, and in particular after the terrorist events of September 11, 2001, and as a result of the increase in illicit flows of money caused by the drug trafficking, human trafficking and the illegal trade of firearms, among others, and the continuing growth of fiscal control that look for most of the nations, have begun to promote on an international level new standards of control over the flows of international capitals.

This is not a problem of the Republic of Panama, but an international situation that from the OECD, the United Nations, the World Bank and the International Monetary Fund, as well as from some Governments, have begun analysis in the search of solutions. The true purpose is to reduce, -minimize until possible- the illicit capital flows and for that we must act among many nations instead of reload the responsibility of the changes in just a few.

The current situation of Panama in this manner, according to evaluations by third parties are:

1. Global Forum of Transparency and Exchange of Information for Fiscal purposes of the OECD – Peer Review according to 2010 is in progress- with final evaluation to take place in October 2016. Panama is being evaluated in Phase 2, which monitors implementation (monitoring compliance with the legal framework). To pass the evaluation, the country needs to comply with 8 out of 10 standards. As things are right at this moment, it seems that Panama is only complying with 7 of them.

2. Financial Action Task Force ( FATF: Panama was removed from the FATF grey list in February 2016. As a member of FATFLAT, the country will be evaluated in the
context of the Fourth Round of Mutual Evaluation next year (2017). Given that the framework is in place, the evaluation will measure compliance of the same vis a vis the 40 recommendations and whether the enforcement mechanisms are effective.

3. United Nations: [IN PROCESS – ISABEL FERNANDEZ]
4. United States of America (US): The US does not operate establishing discriminatory or black lists. Nevertheless, through one of its Government Agencies (OFAC) has included one of the most important commercial and economic groups in our country in the so called Clinton Lists, which aims to create an alert on entities or individuals being investigated for money laundering.
5. European Union (EU): Panama is the subject of qualification from EU countries through organizations like FATF and the OECD. The so called Panama Papers have raised an alarm and countries are seeking to unilaterally apply sanctions to operations coming from or being done with Panama.
6. Other countries: [IN PROCESS – ISABEL FERNANDEZ]

II. JURISDICTIONAL COMPARISON

The committee has made a comparative analysis of such jurisdictions that offer structures of services comparable in a way with the Panamanian, and have maintain its offer in front of the international community, making front to the significate challenges imposed by the international organizations (OCDE, G-20), updating its platform of services—in matter of regulation, cooperation and supervision—that have allowed them to stay out of the discriminatory lists issued by some of said organizations.  

This analysis has allowed us to conclude that an international center, with both corporate and financial offer, with an offer of services, including legal and corporative structures, free economic zones, and transactions of multiple nature, can only result successful—in the following years—if they alienate from the offers that aggressively laminate the taxable income of third countries and ease down their tributary regime, in particular for non residents, making it responsibly attractive and competitive. In the same way, the centers of international and financial services should count with mechanism that assure the transparency in a matter of international cooperation for tax issues and money laundering.

In Panama operate international businesses like: a) clients of their logistic, connectivity services, legal and accountant services; b) foreign operations that use their infrastructure base and human capital to lend their international services to other divisions of their businesses or to international clients and suppliers; c) legal base of multinational organizations with operations in other nations; d) legal headquarters of nonprofit foundations and organizations with international operations; e) businesses of free economic zones of manufacturing and or services; f) regional distribution centers for international property companies.

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2 Léase: Singapour, Bahamas, Hong Kong, Colombia, Bermuda, Lichtenstein, Luxemburgo, Suiza, Inglaterra, Islas Vírgenes Británicas
Panama legislation allows a high degree of flexibility to these operations in tributary terms and of report obligations to the respective authorities in each case; which results in organizations with legal validity in Panama with few mechanism of control in their nation of origin. All of these operations have legal and potential strategic nature for their organizations, but create a real risk in terms of illicit capital flow because of its laxity in controls and necessities of report.

A minimum system of financial statement and/or strategic-operational is necessary to create the minimum control needed from a perspective of international control.

The experience of other regions indicate that on an international scale, it is not questioned the offer of services with practically zero taxation: to the extent that such offer is public, transparent and subject to certain limitations. For example, the successful SGPF offered by Luxembourg are taxed at a privileged group – lower than 1% - and there is no debate in the European Union regarding its legitimacy, given the possibility of sharing information that allows the requesting State to apply its own tax rule, if that were the case.

At the same time, various jurisdictions have modified substantially, its domiciliary and residence norms in order of attracting international talent, always over the base of an attractive tax deal.

Similarly, multiple rules of international scale exists that permit the application of certain standards in a limited manner to the extent that the subject does a financial quotation in a stock market that fulfills certain quality conditions. The facility of the financial quotation, to competitive prices, with the compliance of the standards of the IOSCO and some additional technical rules, makes possible to offer this solution to a plurality of societies and investors that at the moment do not even think of Panama as an alternative that facilitates its international legitimate businesses.

From a practical point of view, the institutional framework of a nation that wants to have the minimum controls over the variety of types of corporative operations, operative and philanthropically must include the maintenance of financial statements, the obligation of reporting, -- even without tributary implications—to the legal authority or other over the quantitative and qualitative nature and results of their operations.

In this sense the country has some gaps of control to close to create an environment that – without affecting the operational competitiveness of the companies and organizations with legal residence in Panama – provides the security needed in terms of potential illicit flows.

Overall exist six levels of mechanisms that a nation must have to establish its relation with the companies and organizations that can operate within: a) institutions that include superintendence, for example; and that can have reporting requirements from part of the organizations that will have to control and monitor them, such as the ones that exist in the financial sector; b) laws, in other words legislation that establishes requirements of reports to ministries or organisms of control and supervision ; c) incentives and sanctions, regulations or norms applicable to those who violate their legal obligations and, or of the
report; d) norms and regulations of mandatory compliance which will require human capital prepared to measure, evaluate and report properly and according to the tax regulatory framework; e) infrastructure and technology, in other words the physical, technological and or digital platforms where the control and necessary reports will be given; and f) security and confidentiality, in other words the mechanisms that guarantee a selective, transparent and adequate use of the information supplied by the organizations under control. All of the above under a legal, tributary, commercial environment, properly regulated.

III. PRELIMINARY RECOMMENDATIONS

The country strategy must have as an objective to maintain us out of any list or qualification of opacity or lack of transparency to our system, as a way of strengthening the service sector and the different platforms that revolve around them. Our system must also try to reduce and if possible, eliminate all forms of illicit flow that are given because of the lack of control and report system.

Panama must react in an immediate, consistent and define way in front of the international community. Following, a series of recommendations for the decision-making based on the jurisdictional comparative analysis, the visits to Panamanian regulatory entities and the analysis of the concepts evaluated by OECD and FATF, and the way in which this are evolving in the understanding that Exchange of Information for tax purposes is effective when reliable information, foreseeably relevant to the tax requirement of a requesting jurisdiction is available, or can be made available, in a timely manner and there are legal mechanism that enable the information to be obtained and exchanged:

1. Availability of the Information
   a. Present to the National Assembly, most briefly, a bill that demands the legal entities “offshore” to maintain financial statements available through its register agent, similarly to how the information of the shareholders is maintain, and establish the obligation of private annual reports, that will be required and maintained in strict confidentiality, except in cases of dubious illicit flows, in which case it will be taken to the respective authority.
   b. Establish, in short term, the parameters to adapt the requirement to maintain the identity of the last beneficiary (and not the shareholder) available through de register agent (more than established in the Law 23/2015, that requires it only for subjects relative to money laundry).
   c. Establish clear rules for the identification of the last beneficiary in the foundations of private interest, partnerships and trusts, to be prepared for the changes to come based in the standards of the OECD 2016.

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3We refer to the term offshore to refer to juridical entities that do not contribute income tax in Panama for not performing taxable operations inside the Panamanian fiscal territory.
2. Access to the information

a. Agents’ providers of information: We consider necessary to establish – at short term—rules that differentiate the services of registered agents and the legal services of the exercise of advocacy. The services of registered agents must be provided by individuals properly licensed and identified for that.

b. Quartermaster of Supervision and Regulation of Non-Financial Subjects: Its capacity of accessing its regulated effectively is doubted. For that manner we propose the following:
   i. Immediately: Should be granted the necessary resources for its operability and professionalism, as well as the preparation of a report that will take it to split in diverse regulatory bodies, divided by a type of activity.
   ii. In short-term: Separate it from the Ministry of Finance and Economy
   iii. In medium-term: Splitting the entity in several controllers

c. Financial Analysis Unit: Must separate from the Presidency of the Republic and orient themselves in a professional and institutional manner to the analysis of the illegal handling of capitals in all its shapes.

d. Institutional Framework: Strengthen the capacity of supervision and control of insurance and reinsurance companies, trusts, cooperatives, savings and credit companies, in short term.

3. Exchange of Information:

a. Panama should adhere—with the correspondent reserves—to the Treaty of Exchange of Multilateral Information and define bilaterally those countries that will do it automatically, immediately.

b. Security and confidentiality of the information: In a very short term, it must be established the legal framework from which Panama will provide information to third countries. The same must establish the minimum parameters that must have the requiring country to maintain the confidentiality of the information provided and protect it, and the penalties for possible violations to such confidentiality—especially in the case that mechanism of exchange of information automatically are established^{5}.

c. Institutional Framework: Professionalize the department in charge of the exchange of information in the General Directorate of Revenues (DGI for its

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^{4} In general, it is unquestionable, the immediate necessity that all regulatory institutions that in a way or another are involved in the process of making effective the Exchange of information are independent, have suitable professions and have an adequate budget. We recommend that the road map to achieve it in the medium term is prepared and presented to the international community immediately. In this framework we consider important that the Superintendence of the Stock Market avails immediately to IOSCO.

^{5} The existing legislation protects the management of the information in Panama only.
acronym in Spanish) of the Ministry of Finance and Economy, and provide the funds required for that, in an immediate manner. At the same time, the legal regulations must be adapted so that there is no doubt that the DGI is the entity through which the Republic of Panama exchanges information with third countries (in the understanding that the same is obtained through the regulations properly established).

In medium term, the DGI should count with a technical team, of which its only missions the continuous evaluation of the international standards and the adaptation of the country to the same, without undermining our economy of services.

d. In short term, it must be installed and become operational the technological tools that are necessary to measure the efficiency and compliance with the request of information of third countries.

4. Base Erosion and Profit Shifting (BEPS) 

a. Although this is an issue of which the countries of G-20 have not reached defined settlements, and since it is of national interest to continue attracting foreign investment in the way through the establishment of international companies in our country, we recommend that all applicable regulations is guided to having what has been defined as substance, in other words those that attract capitals, generate jobs or better quality, provide new technologies and methods of production to the country, open new international markets, consume nationals supplies in a significate way—energy, raw materials, supplies, support services—and generate systematic capacities that without their investment will not be given in the country.

b. In this line, we recommend that in an immediate manner it is studied the convenience, or lack of it, of eliminating the possibility of booking transactions offshore as the legal regulations allows, applicable to free economic zones (merchandise that does not circulate through national territory, in any way) and the law of stock. This type of operation does not create job opportunities and does not pay taxes in our country, which does not add value.

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6 BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity. Although some of the schemes used are illegal, most are not. This undermines the fairness and integrity of tax systems because businesses that operate across borders can use BEPS to gain a competitive advantage over enterprises that operate at a domestic level. Moreover, when taxpayers see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.

7 Hong Kong and Singapore – countries particularly analyzed by similarities with the economy of Panamanian services—have accepted to implement the basic package of BEPS. The importance of the early decision making, and no reactive, is that it allows to do the required adjustments with time.
5. Strengthen the capacity of the institutions of higher education to form professionals in legal, accounting and audit affairs and the consistent compliance with the necessities of supervision and control established by the changes recommended in previous articles.

IV. PRELIMINARY CONCLUSIONS OF THE COMMITTEE

The vocation of services and the advantages that Panama offers to position itself as a regional leader in the provision of all types of services, is a subject not discussed, moreover the possibility of maintaining itself as a regional leader is a subject poorly understood. The situation is in reality pretty simple: Performing international operations requires security, certainty and speed, and the doubts about the transparency and weakness of the system affect the decision making of the investor.

The road that the country has to follow about the situation faced and the present recommendations are a decision that must be taken by national authorities. Given the impact that it could have the doing or not doing, it must be treated as a subject of the State and not as stepping out, like it has been done for the last 15 years.

Panama must maintain, in all moment, its sovereign right to exonerate activities that develop in national territory, as long as they meet the rules of substance that we have referred, as well as the reporting standards and accounting records that will be established for its appropriate control. On the other hand, the sophistication of the tributary offer for no residents is a critical component of the global quality of the offer to thirds, and given the options and alternatives that the OECD and its members allow, should be consider carefully all international treaty in the subject.

This Commission considers that Panama should not enter in the debate of the qualification of the fiscal evasion as a crime to satisfy the demand of third countries, because as a subscriber of the United Nations Convention against Corruptions, the obligation of exchange of information because of tax motives exists already, if that constitutes a crime in the requiring country8.

It will be fundamental to create as well the legal, institutional, programmatic, of infrastructure and technology conditions and instances, as well as of formation of human capital that supports the regulatory framework that will be put into effect, because the worst situation would be to create instances and expectations in a documental level that then the country will not have the capacity of supporting in practice. In this sense it is recommended to be pragmatic and program some changes and compromises in the time, giving the necessary time so that the different instances can adapt to the new demands.

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8It is important to narrow that Panama has been marked for non-compliance with this obligation, which has become relevant by reason of the so-called “Panama Papers