



Newsletter

## **Law 526:**

The new tax framework for foreign source passive income

**BDO**

## Background


The Ministry of Economy and Finance of the National Government of Panama (MEF) filed on April 30, 2026, before the National Assembly of Deputies, Bill No. 641 of 2026, "Which modifies and adds provisions to the Fiscal Code regarding income tax, establishes economic substance requirements for certain categories of passive foreign-source income, and provides other provisions" (hereinafter "Bill 641").

The proposed reform was subject to multiple exchanges, debates, and contributions at the level of the Public Finance Committee of the National Assembly of Deputies during its first debate and represents a significant structural change to the traditional principle of territoriality, considering that such income has historically not been subject to taxation in Panama. It introduces a differentiated regime based on the demonstration of adequate economic substance in the country.

Likewise, Bill 641 was discussed, analyzed, amended, and approved in its second debate, where, primarily, various economic sectors were included as excluded from the special regime applicable to passive income, considering that, in theory, they are subject to prudential supervision by other governmental regulatory entities, such as the Superintendency of Banks, the Superintendency of Insurance and Reinsurance, and the Superintendency of the Securities Market. Similarly, an exclusion was established for the Panamanian merchant marine, which is subject to supervision by the Panama Maritime Authority. In the same vein, approval was granted in the third debate before the Plenary of the National Assembly of Deputies on May 27, 2026.

Finally, Bill 641 was sanctioned by the Executive Branch on May 28, 2026, resulting in its enactment in the Official Gazette of the Republic of Panama as Law No. 526 of May 28, 2026, "Which modifies and adds provisions to the Fiscal Code related to income tax and economic substance for certain passive foreign-source income" (hereinafter "Law 526").





## What income is subject to the new tax regime established under Law 526?

The following categories of passive income are subject to this tax: “dividends, interest, royalties, capital gains, real estate capital income, and other movable capital income, provided that such income is derived from assets located or rights economically used outside the national territory”, that is, what has historically been referred to as extraterritorial or offshore activities. Law 526 defines the principal activities of these entities as “the generation, administration, control, acquisition, preservation, exploitation or disposition of passive foreign-source income, the execution, direction or effective control of which must be carried out in the Republic of Panama by the entity itself or through outsourcing,” in accordance with the conditions provided therein.

Failure to demonstrate economic substance shall result in the classification of the entity as a “non-qualified entity.” Consequently, such income shall be subject to the exceptional tax regime provided in Law 526.

## What does the exceptional tax regime on passive foreign-source income consist of?

Law 526 introduces an exceptional tax regime applicable to certain categories of passive foreign-source income when such income is received by entities (corporations, limited liability companies, or private interest foundations) incorporated under Panamanian law, which are members of multinational groups and which fail to demonstrate that they possess adequate economic substance in the Republic of Panama. It provides for the application of a 15% rate on the net taxable income for the relevant fiscal period, without giving rise to any additional tax, without prejudice to the provisions contained in Article 733 of the Fiscal Code.

For purposes of determining net taxable income for the relevant fiscal period, costs and expenses necessary for the generation, preservation, and maintenance of income—duly documented and directly related to the generation of passive foreign-source income—shall be deductible from gross income, in accordance with general rules.



## What are the special rules applicable to income derived from intangible assets?

With respect to income derived from the transfer or exploitation of intangible assets—such as patents, trademarks, copyrights, or similar rights—registered in accordance with Panamanian law but economically exploited outside the national territory, the reform introduces a technical mechanism allowing a portion of the net income to be classified as non-taxable or extraterritorial. Such partial exclusion shall be subject to compliance with specific registration, documentation, and proper accounting traceability requirements allowing for the reasonable substantiation of the determination made.

Failure to comply with these obligations shall result in the automatic classification of the entity as non-qualified, triggering the application of the exceptional tax regime to the entirety of the relevant passive income.

## What is the definition of a multinational group adopted for purposes of Law 526?

For purposes of this new regulation, qualified or non-qualified entities, depending on whether they demonstrate the economic substance requirements set forth in Law 526, must belong to multinational groups, defined as a group of two or more entities, related through ownership or control (understood as distinct concepts), which are tax residents in different jurisdictions. This definition includes the parent company, its subsidiaries, and permanent establishments.

Certain specific rules are established for this determination: (i) the entity is included in the consolidated financial statements of the group for reporting purposes under the accounting principles applied by its parent company; (ii) it would have been included had the parent company been required to prepare such financial statements; or (iii) it would be included in consolidated accounts if its participations were traded on a public securities market. If the Panamanian entity is excluded from such consolidation due to size or materiality, it shall still be considered part of the multinational group for purposes of this regulation.

## Is it possible to demonstrate economic substance through outsourcing of certain functions and services?

Certainly, Law 526 allows the outsourcing of relevant functions for demonstrating economic substance, meaning that Panamanian entities may subcontract functions and activities to comply with this requirement.

However, this possibility is limited and subject to specific rules: (i) activities related to maintaining adequate human resources, and (ii) operational costs and expenses necessary for the development of the entity's activities may be carried out by third parties, provided that such services are rendered within the territory of the Republic of Panama (i.e., resources or means located outside the national territory shall not qualify).

For these purposes, the resources used by the provider to demonstrate adequate substance for an entity may not result in overlapping hours of such resources where services are provided to multiple recipients. The contracting entity must maintain effective supervision and control over the outsourced activities, duly supported by sufficient contractual, operational, and accounting documentation, and outsourcing outside the territory of Panama is expressly prohibited.

Non-compliance with this prohibition shall result, by operation of law, in the loss of qualified entity status and the application of the exceptional tax regime to the relevant passive income.

## What method to eliminate or mitigate double taxation does Law 526 provide with respect to taxes paid abroad?

Panamanian entities within a multinational group that obtain passive foreign-source income may credit income tax or similar taxes paid abroad against the tax payable in Panama arising from the application of this special regime. Such foreign tax credit is limited to the maximum amount that would have been payable in Panama upon applying the 15% rate established in Law 526. This credit shall not be subject to refund, assignment, or transfer under any title whatsoever.



## Which entities are excluded from the application of this special regime applicable to passive income?

A rule is introduced excluding from the application of this regime entities within a multinational group that are financial entities subject to supervision by: (i) the Superintendency of Banks of Panama; (ii) the Superintendency of the Securities Market of Panama; (iii) the Superintendency of Insurance and Reinsurance of Panama; and (iv) any other competent financial supervisory authority in the Republic of Panama.

Likewise, entities engaged in the commercial operation of ships or vessels under Panamanian registry governed by the special merchant marine legislation, including ship owners, operators, and administrators, are also excluded. Such entities must demonstrate economic substance by complying with the following 3 conditions: (i) being registered before the competent authority or authorized by the Panama Maritime Authority (AMP); (ii) carrying out activities supervised by the AMP; and (iii) Foreign-source passive income subject to this exclusion must be directly and effectively linked to the regulated maritime activity, including returns derived from the placement of surplus cash, reserves, or guarantees associated with the operation of vessels or ships.

Certainly, the regulation contemplates the possibility that the Ministry of Economy and Finance, in coordination with these supervisory authorities, may verify, at any time, compliance with the economic substance requirements applicable to these entities.

These exclusions are based on the premise that the aforementioned regulatory authorities have access to information regarding economic substance, personnel, assets, risks, resources, and expenses incurred by their regulated entities. However, it is clear that the supervisory approach of each sector differs, and in no way resembles the tax information upon which taxable net income is determined in accordance with the provisions of the Tax Code.

Therefore, it is highly likely that this exception rule may be challenged when Panama's status as a non-cooperative jurisdiction is reassessed at the European Union level. This is a specific technical tax matter, either the Panamanian Tax Administration has access to the information necessary to conduct an adequate audit of the taxation of such passive income, or it does not. To avoid this outcome, all exempt entities must comply with the same standard of inclusion and annual reporting of information, and such information must be made available in a uniform manner across each regulated sector.

## What are the new rules applicable to companies operating under special regimes and legal stability in Panama?

Entities and companies incorporated under Panamanian law, which are members of multinational groups and are covered by preferential tax regimes, and which are required to file annual economic substance returns, must also report to the General Directorate of Revenue (Dirección General de Ingresos - DGI), within their sworn income tax return, all income derived from foreign-source passive income and evidence their status as qualified entities.

Such substantiation shall require demonstrating adequate economic substance with respect to each asset generating foreign-source passive income, as an indispensable condition for such income not to be subject to taxation in Panama. Failing this, such income shall be subject to income tax as provided under Law 526.

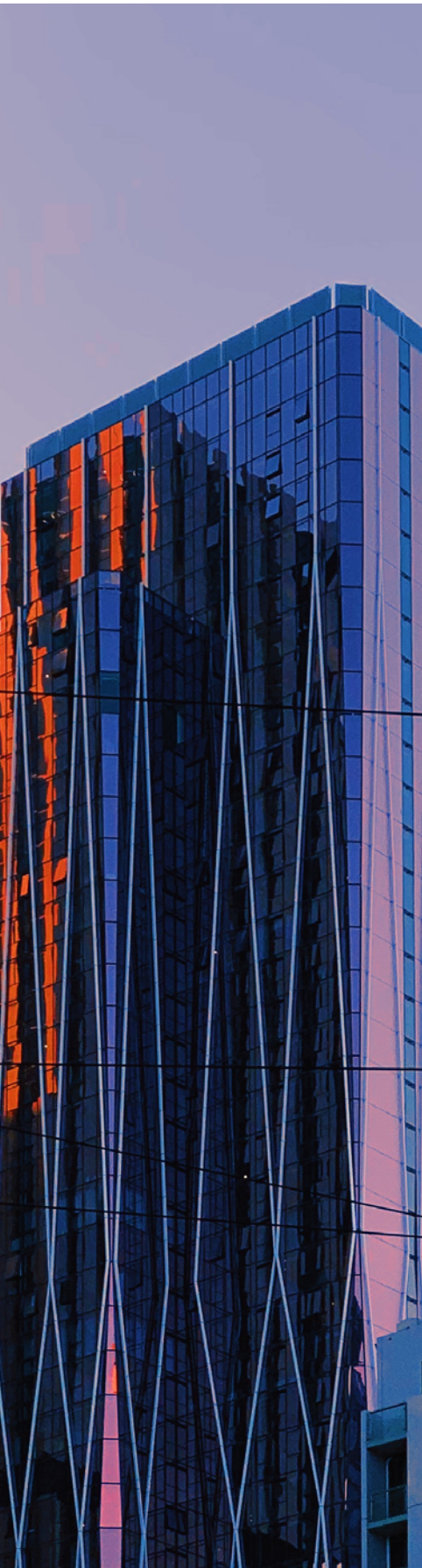
### Why is an anti-abuse clause included in Law 526?

A general anti-abuse clause is introduced, granting the Ministry of Economy and Finance the authority to disregard, through a duly reasoned resolution, any structure, arrangement, or legal form whose principal purpose, or one of its principal purposes, is to obtain a tax advantage that is contrary to the object and purpose of the regime applicable to foreign-source passive income.

In such cases, foreign-source passive income shall be subject to the 15% tax rate applicable to the fiscal period in which it was generated, without prejudice to the application of penalties, surcharges, and interest in accordance with the provisions of the Tax Code.

### Why are the rules applicable to intermediaries and the permanent establishment regime in the Tax Code being modified?

In line with the most recent amendments to the OECD Model Tax Convention, certain activities—such as the provision of services, the execution of works, the exploitation of resources, the use of equipment, or the performance of professional activities—may constitute a permanent establishment when carried out in Panama through an agent or representative authorized to contract in the name or on behalf of a foreign entity. Likewise, situations that previously did not constitute a permanent establishment due to the contractual status of an “independent agent” may now give rise to such status where such agent plays the principal role in the conclusion of contracts, provided that the economic substance and operational elements—such as assets, functions, and risks—indicate that these are effectively assumed by a contracting entity domiciled abroad.



## What does the new obligation to file a foreign-source passive income return consist of?

To strengthen audit and traceability mechanisms, entities or companies that are members of multinational groups, as defined under the new regulations, and that earn foreign-source passive income will be required to file an annual sworn return including such income. This obligation applies regardless of whether such income is deemed to be sourced within Panamanian territory, that is, even where no tax payment obligation arises, the obligation to report such income to the General Directorate of Revenue (DGI) remains.

Additionally, such entities must submit the necessary information to evidence compliance with the conditions demonstrating adequate economic substance for the relevant entity or company.

## Final Considerations

In general terms, Law 526 entails a profound modification of the regime applicable to passive foreign-source income in Panama by introducing a substantial departure from the traditional principle of territoriality. These new rules shall become effective as of fiscal year 2027.

This new scenario effectively signals the end of the incorporation of shell entities with no real economic activity or role and will require companies with international corporate structures to comprehensively review their structures, outsourcing schemes, models for holding and exploiting intangible assets, as well as their compliance and documentation systems, in an environment characterized by a higher level of tax scrutiny and exchange of information.

In this context, preventive tax planning technically supported and aligned with these new legislative provisions, which respond to international standards on tax cooperation and exchange of information, will be essential.

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