Income taxation of salaries paid by foreign parent companies under Law 41

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The issue of the taxability of salaries paid by a Foreign Parent Company ("FPC") to the employees of its Multinational Administrative Headquarter ("MAH") - established in Panama under Law 41 - deserves deeper analysis and debate than it has received so far in the professional forum. The territoriality of such labor income hence its subjection to Panamanian income tax versus the qualification of the same as non-taxable income deriving from a foreign source are – or are least should be – the poles of the discussion. Additionally, the citizenship of the MAH's employees is in the mere center of the matter since some are of the opinion that Panamanian employees of an MAH shall be taxed in Panama while foreigners would be exempted when holding a specific visa. Such opinion assumes the general territoriality and taxability of salaries of MAH's employees therefore the need for an exemption to neutralize the tax.

However, when the payor of the salary is not the FPC but the MAH established in Panama under the auspices of Law 41, and regardless of the citizenship of the employee, we have no doubt as to the territoriality of such income and its subjection to Panamanian income tax. Moreover, we agree that currently no exemptions stand to counteract taxation on such territorial income (see article 21 of Law 41). Therefore, we see no room for discussion in such a case.

Now, with respect to the object of the discussion - salaries paid by FPCs to the employees of their MAHs located in Panama - in our opinion, such income should be deemed by Panamanian tax authorities as non-taxable income deriving from a foreign source, provided that **(i)** the FPC acts as payor of the salary (see article 10b of Executive Decree # 170 of 1993); **(ii)** the employee's labor consists of leading and managing from Panama transactions that render its economic effects abroad; that is, the employee's labor is framed within the boundaries of article 4 of Law 41; and, therefore **(iii)** such labor does not participate in the production of Panamanian territorial income or the preservation of the same, and its value does not constitute a deductible expense in Panama for the entity that benefits from it abroad. Being present all these elements, we believe that salaries paid by FPCs to the employees of their MAHs located in Panama should be deemed as non-taxable in Panama regardless of the citizenship of the employees and their immigration status.

Accordingly, the salary of an MAH foreign employee shall be considered *prima facie* by Panamanian tax authorities as non-taxable income deriving from a foreign source, when **(i)** the FPC acts as payor of the salary and **(ii)** the employee holds an MAH Permanent Staff Visa to legally reside and work in Panama with the MAH. When such two conditions are met, Panamanians tax authorities shall *prima facie* assume that **(i)** the foreign employee's labor consists of leading and managing from Panama transactions that render its economic effects abroad; that is, the employee's labor is framed within the boundaries of article 4 of Law 41; and, therefore **(ii)** such labor does not participate in the production of Panamanian territorial income or the preservation of the same, and its value does not constitute a deductible expense in Panama for the entity that benefits from it abroad. It is important to note that a foreign employee of an MAH shall hold an MAH Permanent Staff Visa to legally reside and work in Panama with the MAH; in which case, his or her salary shall be *prima facie* and automatically afforded

the same foreign-source tax treatment as that of holders of Special Temporary Visitor Visas when the FPC acts as payor of the salary (see article 26 of Law 41 in conjunction with article 10b of Executive Decree # 170 of 1993).

Some have misinterpreted the income tax provisions of Law 41 and disregarded related Panamanian income tax provisions of general applicability, by affirming that Panamanian employees of an MAH are subject to Panamanian income tax while foreign employees of an MAH would not be taxed when they hold MAH Permanent Staff Visas. Such opinion wrongly assumes with extreme simplicity that salaries paid to MAH employees are of Panamanian source (territorial income) even when **i)** the FPC acts as payor of the salary; **(ii)** the foreign employee's labor consists of leading and managing from Panama transactions that render its economic effects abroad; that is, the employee's labor is framed within the boundaries of article 4 of Law 41; and, therefore **(iii)** such labor does not participate in the production of Panamanian territorial income or the preservation of the same, and its value does not constitute a deductible expense in Panama for the entity that benefits from it abroad. Furthermore, such opinion erroneously regards the MAH Permanent Staff Visa as a legal requisite for a tax exemption to apply in favor of foreign employees. We strongly disagree with this position as expressed above. There is no need for exemptions when dealing with non-taxable foreign source income. The MAH Permanent Staff Visa is merely a migratory requirement under Law 41 and *prima facie* evidence of the foreign source nature of salaries paid by the FPC to such visa holders.

Finally, in our opinion[1], it is pertinent to close by noting that dissimilar application of income taxation to employees of an MAH on the basis of their citizenship (Panamanian of foreign) would be discriminatory and outrageously unconstitutional. Panamanian law shall apply equally to all individuals according to the Panamanian Constitution regardless of the citizenship of the subjects at bar (see articles 19 and 20 of the Panamanian Constitution).

[1] The opinions expressed herein are personal to the author and do not constitute and shall not be construed as legal or professional advice of any kind.