



GUIDELINES ON PANAMA'S SUBSTANTIVE LAW ON TRUSTS

Juan Pablo Fabrega
Partner

INTRODUCTION

The Republic of Panama is considered one of the oldest and safest tax havens in the world, located in Central America, between Colombia and Costa Rica. Since its independence from Colombia in 1903, Panama has had convenient and attractive legislation for offshore operations, based exclusively on the territorial principle of not taxing foreign source income.

Due to its structure, geographical position, political stability and characteristics of its economy, Panama has become one of the most important tax havens of the Western Hemisphere. It has excellent international transportation and communication systems; the United States Dollar has been a currency of legal tender for more than ninety years in Panama; there are neither exchange controls nor government regulations and there is a complete freedom in the movement of funds. Also, confidentiality and banking secrecy are recognized by law.

Panama's success as a tax haven is primarily based on its tax structure. According to article 694 of the Fiscal Code, the income earned by any person, either an individual or a corporation, from sources outside of Panama, is exempt from taxes. Our legislation expressly provides that the following transactions are not subject to income tax in Panama:

- a) Invoicing to a company abroad, from an office located in Panama, the sale of goods for an amount greater than that at which said goods were invoiced to the office located in Panama, provided those goods are handled exclusively abroad.
- b) Directing or managing, from an office located in Panama, operations and transactions that are executed, completed or take effect abroad.
- c) Distributing dividends from income earned by a company when that income is produced or earned abroad.

Also, the Fiscal Code exempts from income tax:

- a) The interest paid by banks located in Panama to their customers for savings accounts and time deposits kept in Panama and
- b) The salary or fees earned by Directors, Officers and Executives of Panamanian corporations located abroad.

These benefits have made of Panama the tax haven that it is today and the reason why others from the region have tried to imitate us.

THE TRUST IN PANAMA

The first trust law in Panama was adopted in the 1940's, based on the common law trust. However, in 1984 new provisions on trusts were enacted by means of Law No. 1 of January 5th, to complement other legal instruments and benefits provided by Panama as a tax haven to the international financial community.

This legislation introduced new and modern concepts to update the former law on trusts in order to make them more flexible and convenient to foreigners who were searching for a place to execute a trust overseas.

The most important features of the Panamanian trust are:

- a) **LIBERTY OF BARGAINING:** The trust can contain any lawful clause as the needs of the settlor may require. According to articles 5 and 9 of Law No. 1, the trust may be created for any purpose provided it is not contrary to the law or public policy.

The basic provisions that a trust agreement must contain in order to be binding are the following:

1. The appointment of the settler, the trustee and the beneficiary and the appointment of deputy trustee and beneficiaries, if any.

2. The description of the goods and properties to be assigned by the settler to the trustee as part the assets of the trust.
3. The express declaration of the settlor to create the trust and the indication of whether it will be revocable or not.. If nothing is said in the trust agreement, it shall be considered as irrevocable.
4. The rights and duties of the trustee and the restrictions or limitations imposed to him.
6. The way the trustee shall dispose of, administer, manage and distribute the assets of the trust and its income.
7. The appointment of a Resident Agent who must be a lawyer or law firm, who shall sign the trust agreement.
8. The domicile of the trust
9. An express declaration that the trust is executed according to the Panamanian law on trust and that it is subject to the jurisdiction of Panama.
 - b) PRIVATE DOCUMENT ANDSIMPLE EXECUTION: The trust is a private agreement entered into by the settler and the trustee, with the only formality that the signature of settlor and trustee must be authenticated by a Notary Public and signed by the Resident Agent, so confidentiality is guaranteed. It is not necessary that the trust be executed in a public deed or be registered in any public register unless real property located in Panama is given in trust.
 - c) DURATION: The trust is not perpetual unless so is stated by the settlor in the trust. The trust should have its duration expressly stated. Also, it may be revocable or terminated before its expiration if it is so provided by the settlor in the trust agreement.
 - d) CONFIDENTIALITY: Article 37 of Law No.1 expressly guarantees the confidentiality for the execution of the trust. It provides that the trustee and his representative or employees or any other person involved in the execution of the trust must uphold the secrecy of the operation. The violation of this provision is penalized with imprisonment of up to six (6) months and a fine of up

to US\$50,000.

- e) CORPORATIONS MAY BE USED AS SETTLORS, TRUSTEE AND BENEFICIARIES. The settler, the trustee and/or beneficiary may be a corporation. They do not need to be individuals.

- f) SPECIAL TAX BENEFITS: To be consistent with the tax principles already mentioned, Law No.1 expressly states that the acts of executing, modifying and terminating a trust as well as the transfer, conveyance or encumbrance of trust funds and the income or interest produced by the assets and properties given in trust are exempt from all taxes, contributions, assessments or encumbrances, provided the trust involves the following assets:
 - 1. Properties or assets located abroad;
 - 2. Funds that are not from Panamanian source or subject to taxes in Panama;
 - 3. Shares of stocks or securities of any kind, issued by corporations whose income is not produced in Panama, even though those shares or securities may be deposited in Panama;
 - 4. Time deposits or savings accounts kept in banks located in Panama.

The previous tax limitation will not be applicable when the trust funds are invested in housing projects or the development of industrial parks in Panama, in which cases the income earned in those commercial operations will be tax free.

- g) SEPARATE ESTATE: The assets of the trust shall constitute an estate separate from the assets of the trustee. Therefore, they can not be attached, seized or subject to any lien as a result of obligations of the trustee. The assets of the trust only answer for liabilities of the trust itself.

- h) ASSETS SUBJECT TO TRUST: The trust fund may consist of properties or assets of any kind, present or future. The settlor may increase or add other assets to the trust fund after the execution of the trust.

- i) APPLICABILITY OF FOREIGN LAW AND JURISDICTION: Although the trust shall be regulated by Panamanian law, the settlor and the trustee may agree that foreign law will be applicable. Also, the trust and the trust fund may be transferred to another jurisdiction or country.

- j) TRUST OF OTHER JURISDICTIONS: Trusts created pursuant to foreign law may be governed

by Panamanian law provided they are subject to the formalities of the law on trusts.

- k) TRUSTEE: The trustee can be any person, either an individual or a corporation duly authorized by law. Also, the settlor may replace the trustee if so provided in the trust agreement.

- l) RESIDENT AGENT. All trust executed according to and regulated by the Panamanian law on trust must have a Resident Agent who must be a lawyer or a law firm. The only duty of the Resident Agent by law is to sign the trust agreement in order to be effective. The Resident Agent can not receive notices on behalf of or by the parties to the Trust Agreement, nor can he bind the Trust. In practice, the Resident Agent acts more like a acts as a non-binding “reference intermediary” among any third party and the settlor, the trustee and/or the beneficiary, since most of the time the identity of the settler and the beneficiary is not disclosed.

These are the most relevant features that have made the Panamanian trust one of the most secured and useful trusts of any tax haven in the Western Hemisphere.