

PANAMANIAN CORPORATIONS: Their Usefulness, Advantages and Benefits

Practical Guidelines

INTRODUCTION

The law on Panamanian corporations, adopted in 1927, is a version of the corporation law of the State of Delaware, United States, and since its enactment, has been widely used by the international financial community due to the multiple advantages and benefits that these corporations offer in the achievement of offshore operations, among other purposes, as well as for the freedom, flexibility and ease in their handling.

Panamanian corporations are chartered mainly to operate and carry out commercial and industrial activities; acquire properties; limit the personal liability in the performance of business transactions that imply risks, or to structure the payment of taxes in foreign jurisdictions on profits from commercial transactions. Thus, Panamanian corporations buy yachts in Mediterranean and oil tankers in Asia, own bank accounts in Switzerland and Miami, buy merchandise in the Far East and set up trusts over properties located in Egypt or London. With these examples we want to emphasize the multiple uses given to Panamanian corporations and their acceptance by banks, investors and governments in all parts of the world despite the political situation in Panama at any given moment, as was demonstrated during the 80's, when Panamanian corporations were still being registered and, the already existing never ceased to receive the tax benefits that Panamanian law offers, nor were they at risk of ceasing to exist or operate by government decree.

Such success was demonstrated by the fact that more than 350,000 corporations are currently registered and active, and their owners and beneficiaries are, for their great part, non-resident, foreign citizens, that do not conduct any commercial transactions in Panama.

Our experience indicates that to properly use Panamanian corporations and conduct transactions and operations with them the users or owners thereof must know the practical aspects of their incorporation and management, which are not easily understood from simply reading our corporation law. Considering the foregoing, we have prepared this explanatory booklet to give the reader a practical and simple guide

that, apart from any legal explanation, provides basic information on the operation and use of Panamanian corporations, stating that this booklet does not pretend to substitute or refrain the reader from the guidance and advice of a Panamanian attorney, whose assistance is always necessary and recommended.

ADVANTAGES OF THE PANAMANIAN CORPORATIONS

A) Tax Benefits

The Panamanian taxation system is based on the territorial source of income. As such, the income earned from commercial transactions conducted outside of Panama is not subject to taxation in this country. Neither is subject to taxation, income from:

- 1) Re invoicing, from an office established in Panama, the sale of goods or services for an amount greater than that for which those goods or services have been invoiced to the office in Panama, as long as such goods or services remain abroad. This practice is known as "double invoicing";
- 2) Managing, from an office established in Panama, transactions that are executed, take place or have effects abroad; and
- 3) Distributing earnings or dividends or shares, when such dividends or earnings are produced from income generated or earned by the company outside of Panama, including the income from activities mentioned in 1) and 2) above.
4. Granting of loans or opening of lines of credit, in the way of interests, commissions or income of similar nature earned by individuals or corporations, regardless of their domicile or country of incorporation, or the place of disbursement of funds, provided that the debtors are domiciled abroad and the use of such financing is not used in Panama.
5. It is also exempted from the payment of taxes in Panama the income earned from the international maritime commerce and trade by owners of vessels registered in Panama, regardless of the place where the contract is executed.
6. Interests paid by banks located in Panama to any depositor for deposits located in Panama.

7. Panamanian corporations that operate abroad can distribute all or part of their assets among their shareholders without them or the corporation having to pay taxes in Panama.

B) Absence of Government Controls

Other than for the carrying out of specific types of business activities within Panama, such as banking, insurance or the providing of public utility services, there is no government entity or agency that has to authorize, approve or supervise the formation of a corporation, the amendment of its articles of incorporation or the beginning of its operations. Nor the issuing or transfer of shares, or the modification of the authorized capital of the corporation, the distribution of dividends, the dissolution, winding up or sale of the assets of the corporation is subject to government notice or approval.

There is no obligation of filing any kind of statements or financial reports before the fiscal authorities of Panama by corporations that do not carry out businesses within Panama. Transactions conducted abroad or the income earned from the same are not subject to report.

Also, it is not necessary to register or provide before any government authority, private or confidential information of the corporation, such as names of the shareholders, financial statements, and names of trustees or resolutions adopted by the Board of Directors or the Shareholders. Notwithstanding the foregoing, it will only be necessary to provide specific information to government authorities when required by them through the courts of justice as a result of a criminal investigation or legal process.

Once a corporation is chartered, it can conduct all the activities, objectives and businesses that its shareholders or directors wish, as long as they do not infringe any legal provision.

C) Capitalization

The law does not require a minimum corporate capital for the chartering of a corporation, or for its further operation or carrying out of its objectives. Neither it is required that the corporate capital be totally paid up when shares are registered in a shareholder's name. Actually, the corporate capital is only important for inscription purposes, since it serves as the basis for the calculation and payment of the registration fees of the articles of incorporation with the Public Registry. For all practical effects the corporate capital determines the amount of investment that the corporation can raise through the primary issuing and sale of its shares. Based on the foregoing, the setting out of the corporate capital becomes irrelevant for

corporations chartered for personal purposes such as acting as holding company of personal wealth. Therefore, the amount of corporate capital set out for this type of corporations is that which pays the lowest inscription fee to the Public Registry.

i. Par or Non Par Value Shares

The capital of a corporation can be stated in any type of currency, represented, in shares with par or non par value. In the former case, the par value is set out in the articles of incorporation. In the latter, the value or price of the shares is determined by the Board of Directors at the moment of issuing. The issuing of the shares can be paid by the shareholders either in cash or by providing works, services or goods of any kind to the company.

ii. Bearer Shares

The law allows that the shares be issued in bearer form, in which case the subscriber or shareholder will have to pay the company for the full value thereof.

Bearer shares are transferred through their delivery by the shareholder to the person who acquires them for any consideration, without requiring any endorsement or any report of such transfer to the company.

As we can see, bearer shares are a guarantee to the shareholder who wishes to remain anonymous. Additionally, bearer shares simplify the transfer of ownership in the company, absent of any bureaucratic procedures. The risk of this type of shares is that the holder thereof will be considered as its owner. Therefore, in case of loss of a bearer share the true owner can not claim title thereof.

D) Inapplicability of the Alter Ego or Responsibility Principle

The shareholder is not liable for the obligations of the corporation. He only responds to the creditors of the company for the amounts owed to the corporation for the issuing of the shares in case they have not been fully paid. Also, the corporation is not responsible for the personal liabilities of the shareholder.

E) Personal Corporations

The corporation can belong to only one person. There is no prohibition against the company having one shareholder. One individual or corporation can be the owner of all shares, or have the majority control of the corporation.

Additionally, a corporation can be shareholder of another corporation.

F) Shareholders' and Board of Directors' meetings

The meetings of the shareholders or directors can take place anywhere in the world. It is not necessary that the meetings be held in Panama. The law also allows that the resolutions of shareholders and directors be adopted by consent, through electronic means, either by telephone or fax, provided that all the shareholders and directors have participated in the meeting or were in contact among themselves and express by majority their consent or approval of the corresponding resolution.

The shareholders can be represented by proxy in a shareholders meeting. The articles of incorporation can provide that the members of the board of directors be represented by proxy as well.

In order for a shareholders or a board of directors meeting to be valid it is necessary that it has been previously served according to the procedure and prior to the compliance of the requirements set out in the articles of incorporation, unless the shareholders or directors waive their right to previous notice.

G) Management of the businesses of the company

Despite the fact that by law the supreme power and authority is vested in the general shareholders' meeting, the management of the businesses and the carrying out of the objectives of the company correspond to the Board of Directors, which must be composed of at least three members, either individuals or corporations, who do not need to be Panamanians, nor domiciled in Panama.

By law, the Board of Directors have the following powers and authority, in addition to any other that may be set out in the articles of incorporation:

- 1) Appoint and replace the officers of the company, to wit, at least a President, a Secretary and a Treasurer.
- 2) File law suits and defend the company from legal proceedings.
- 3) Adopt and use a corporate seal. This is not required by law.
- 4) Acquire, purchase, own and use all kind of goods and assets; mortgage assets of the company to secure debts or obligations of the company. It is important to point out that, by law, to sell, exchange or in any other way transfer assets of the company or giving them in mortgage to secure debts or obligations of any third party it is mandatory to have the previous approval of the shareholders, given at a shareholders meeting, unless the articles of incorporation specifically grant those authorities to the

board of directors.

- 5) Enter into of and execute contracts of any kind which do not imply the disposal, transfer or compromise of assets of the company.
- 6) Adopt by-laws.
- 7) Contract or enter into loan agreements, the opening of bank accounts.

The law does not set out a minimum number of meetings that the board of directors must hold within a year. Therefore, unless the articles of incorporation does not provide for such minimum, the directors will meet the times and at the places that the board so approves.

It is convenient to mention that in order to simplify the execution of the businesses and objectives of the company it is possible that the shareholders grant a general power of attorney to an individual to undertake the duties of the Board or the shareholders, and carry out the businesses of the company, so there will be no need for resolutions approved by the shareholders or the board of directors.

As to the liability of the members of the board of directors, our legislation exempts them from legal responsibility or any liability for the obligations of the company during its normal course of business, provided they were not taken or approved in violation or breach of the law or the articles of incorporation of the company. The directors are jointly liable to their corporation, to the shareholders and to third parties for the inadequate and deceptive management of corporate assets, or for the fraudulent issued of shares for a value inferior to the face value of those shares, or for distributing unjustified dividends.

H) Shareholders

The shareholders, gathered in a shareholders' meeting, are the supreme authority of the corporation. They don't need to be Panamanians or be domiciled in Panama.

The law does not set out a minimum number of meetings that the shareholders must hold within a year. Not even requires that the shareholders meet at least once a year. Therefore, unless the articles of incorporation does not provide for such minimum, the shareholders will meet the times and at the places that the board so approves, or at the request of shareholders who represent at least twenty percent of the authorized capital of the corporation. It is customary, however, to set out in the articles of incorporation that the shareholders will meet at least once a year, to receive from the board of directors a report on the management of the company; to appoint directors and to approve the payment of dividends.

For all legal purposes, a shareholder of a Panamanian corporation is the person who appears registered in the record book of shares of the company, if the shares are registered, that is, when the shares are issued in the name of an individual. If the shares are issued in bearer form, the holder of the stock certificate will be considered as the shareholder of the company for all legal purposes. In fact, when a bearer share is issued, the Record Book of Shares does not indicate the name of the shareholder. In this case, to prove the ownership to a share and be able to participate in a shareholders' meeting, the shareholder will have to show the stock certificate.

As indicated before, bearer shares are transferred by the simple delivery of the stock certificate to the new owner, without further notice or report to the company, whereas in case of nominative or registered shares, the transfer of the shares must be reported to the company in order for the latter to take note of such transfer in the Record Book of Shares, otherwise for all legal purposes the company the shareholder will remain to be who appears on record.

Every shareholder has a right to complain against and challenge the decisions or the resolutions approved at a Shareholders' meeting when they are adopted in violation of the law or the articles of incorporation, as well as to demand from the Board of Directors the rendering of accounts of their duties and the handling of the corporate affairs.

Unfortunately, our legislation does not grant the minority shareholders any particular or specific protection against decisions adopted and approved by majority shareholders when they are consistent with the law and the articles of incorporation. Therefore, minority shareholders are subject to the majority decision.

The transfer and sale of shares is no subject to regulation or approval by, or registration with, any government entity or authority. However, special of preferred rights, as well as limitations and restrictions, can be established in the articles of incorporation as a condition for the transfer of shares by a shareholder.

The shareholders, by law, are who have the power to decide at a general meeting, the amendment of the articles of incorporation; the appointment and replacement of directors; the winding up and dissolution or merger of the corporation; the sale, transfer or exchange or mortgage of corporate assets or grant them as collateral to secure obligations of third parties (even of related companies or

subsidiaries), among other powers and authorities that may be set out in the articles of incorporation.

As well as the directors, the shareholders can waive the right of previous notice to shareholders' meeting and vote by means of a proxy. Also, shareholders' meetings can be held anywhere in the world.

I) Free movement of funds and absent of bilateral agreements to provide information to other government authorities regarding taxation.

There are no currency restrictions in Panama, or limitations with respect to the transfer, assignment of moneys goods or assets abroad. Panamanian corporations can undertake and enter into any kind of financial transactions without being subject to government approvals or authorizations. Such operations do not need to be reported. However, in case the corporation had deposits with banks located in Panama any movement of funds for amount up to US\$10,000.00 has to be reported as a means to avoid and control money laundering.

Panama has not entered into, nor sign with any foreign government double taxation treaty or treaties related to the exchange of financial information. Therefore, any investigation by a foreign government dealing with tax matters would not prevail in Panama.

J) Panamanian Public Registry

Panamanian corporations shall be registered in the Public Registry for its incorporation, as well as any amendment to articles of incorporation. Likewise, the appointment and replacement of directors, officers and a Resident Agent must be recorded with the Public Registry. This is what gives security and certainty about the legal existence of the corporation and the persons in charge of its management and legal representation. This is not a mechanism of governmental control or regulation over the corporation. The inscription is a form of notice to third parties.

According to the general law on commercial contracts, it is an option, but not an obligation, to register general powers of attorney with the Public Registry.

FORMATION OF THE CORPORATION

Panama's law on corporation is very liberal and flexible. It does not have complex requirements or formalities for the organization of corporations. The formation procedure for a corporation is very swift

and simply. Two individuals, of any nationality and not having to be domiciled in Panama, can subscribe in any language the articles of incorporation, which should be acknowledged by public deed before a Notary Public in Panama. These persons need the essential assistance of an attorney, by legal requirement. Such articles of incorporation shall be registered in the Public Registry for effects of public notice to third parties, without that meaning that this government agency acts as supervisor of corporations. From that moment on, the corporation comes into life and acquires a legal existence; different from that of its shareholders.

The articles of incorporation shall contain the following basic information:

A) Name and domicile of the subscribers of the articles of incorporation. These persons can be either individuals or corporations and do not need to be Panamanians, nor domiciled in this country. The subscribers do not become shareholders for the fact of just executing the articles of incorporation. Shareholders will be those who subscribe the shares of the company and in whose favor the shares are issued. For practical reasons of convenience and with the purpose of maintaining the confidentiality of the person of the investor, attorneys member of the Resident Agent for the company act as subscribers of the articles of incorporation.

B) Name of the corporation. This can be expressed in any language, and shall be different from that of any existing corporation. The name of the corporation shall clearly indicate, by a word, phrase or abbreviation, that it is a corporation, i.e. Corp., Inc., or S.A.

C) Purpose or objective of the corporation. Our legislation does not require the listing of a long inventory of activities that the corporation will perform or carry out. It is enough with expressing that the corporation shall be able to conduct any lawful activity not prohibited by law. However, it is a practice to set out a long list of generic corporate purposes and objectives with the aim of complying with the legal requirements of other countries where the corporation is going to operate, which do require stating its corporate purposes in the articles of incorporation.

D) Corporate Capital. The articles of incorporation shall indicate the amount of the corporate capital in currency from any country, which can be represented in par value shares, in which case the articles of incorporation will have to indicate such value; in non par value shares, or a combination of both.

As we expressed in previous paragraphs, it is not required that the corporate capital be paid up prior to the incorporation of the company or thereafter for a corporation to operate, as required in other jurisdictions. Corporations are organized generally with an authorized capital of U.S. \$10,000.00 because it is the maximum capital which pays less registration fees to the Public Registry.

Shares with or without voting rights or shares with preferred rights, privileges, voting faculties, or restrictions, can be issued, as long as those rights or limitations are established in the articles of incorporation, which shall be stated in the respective stock certificate.

The corporation law allows the corporation to acquire its own shares. In addition, it authorizes modifying the corporate capital, altering the nominal value of the shares or changing shares of one class for another.

F) Domicile. The legal domicile of the corporation is Panama. However, the articles of incorporation can indicate that the corporation can have offices and even establish its commercial domicile abroad, where the board of directors so determines.

G) Duration of the corporation. It can be incorporated for a defined or an undefined period, or for the achievement of a determined operation. In any case, it can be dissolved at any moment. In practice, it is set out in the articles of incorporation that the company is incorporated for indefinite period of time.

H) Name and address of the directors. By law, the members of the board must be, at least three, either individuals or corporations. While they are designated by the client when requests the incorporation of the corporation, for confidentiality or practical reasons, the attorney can offer the service of providing nominee directors, who will act conforming to the strict instructions of the client. The directors do not need to be Panamanians, nor domiciled in this country. The articles of incorporation can allow the directors be represented by proxy and also that deputy directors be appointed.

The directors, as individuals and acting individually, can not bind the company or undertake obligations on its behalf for the single fact of being a director. The Directors act as a corporate body and therefore their decisions must be approved by majority to bind the company. Individual directors can bind the company if they have been empowered or authorized by the board of directors or by the shareholders, depending on who has the power and authority to approve a transaction due to the nature of the business.

I) Name of the officers. By law, Panamanian corporations must have at least three officers, to wit, a President, a Secretary and a Treasurer. They are appointed by the directors, usually among themselves. However, the law allows that the officers be different from the directors. One person can hold more than one office. As occurs with the directors, the attorney also can provide them.

Our legislation does not grant powers or authorities to the officers. Therefore, it is convenient to set out them in the articles of incorporation. Consequently, absent of any powers, these offices become symbolic because an officer can not represent, nor undertake obligations on behalf of the company if he does not have the corresponding authority.

The law on civil procedures indicates that the President is the Legal Representative of the company. This does not mean that he has power and authority to enter into agreements or bind the company without approval or authorization. By being the Legal Representative, the President has the authority to take notices and to grant powers of attorney. Additionally, the President chairs the shareholders' and directors' meetings; signs the minutes together with the Secretary.

The Secretary takes the minutes and signs them together with the President. Additionally, he keeps the records of the minutes and delivers secretarial certifications regarding the resolutions adopted by the shareholders or the directors at their respective meetings; updates the registry of shares and gives notice of the meetings.

J) Resident Agent. The law requires that a corporation name an attorney or a law firm as Resident. His only duty is to act as agent to collect from the company and pay to the government annual tax that all corporations must have to be in good standing. The Resident Agent has no power or authority to bind the corporation or to enter into any kind of agreements. Nor does he acts as service agent. The Resident Agent is a de facto liaison between the company and third parties for communication purposes.

ACQUISITION

To acquire a corporation it is not necessary to come over to Panama. It is enough to provide by mail, telex or fax the information mentioned above and indicate the name and address of the person to whom the respective correspondence has to be addressed to. Incorporation of a corporation takes about one week.

For reasons of convenience, it is feasible to acquire off-the-shelf corporations; which have been previously incorporated to have in stock, but that have never operated. These corporations do not have shareholders at the moment.

OPERATION OF A CORPORATION

Once the corporation is incorporated, it can engage in any lawful activity, through its Board of Directors, which is in charge of the management of corporate affairs and the execution of the mandate of the shareholders. The corporate directors meet as many times as they find convenient, unless the articles of incorporation indicates otherwise, with the purpose of adopting the resolutions or decisions necessary for handling the affairs of the corporation.

Actually, it is frequent for attorneys to offer, at a yearly cost, the service of corporation management for clients who wish to preserve the privacy of their acts. In these cases, the law firms provide the services of “nominee” directors who serve as “nominal” members of the Board, which would meet and adopt resolutions under written instructions of the client.

RECORDS THAT EVERY CORPORATION SHOULD HAVE

According to the requirements of the Code of Commerce, every corporation should have a Record of Minutes where all the minutes and resolutions adopted by the shareholders and the board of directors must be kept. Additionally, the corporation must have a Record Book of Shares where title or ownership of shares and the transfer thereof must be recorded.

Also, accounting records must be kept. There are no formalities as to the information that they must have. The requirement by law is that the company must comply with the regulations of the jurisdiction where it operates.

The foregoing are, in our opinion, the basic and most relevant aspects to be known by the owner or user of a Panamanian corporation. We reiterate that this information does not go into the particular details or requirements of legislations regulating or dealing with specific business activities carried out within the Republic of Panama. Therefore, legal advised must be required in each individual case or circumstance.

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