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# Panama

## International Estate Planning Guide

Individual Tax and Private Client Committee

Contact:

Alvaro Javier Aguilar-Alfu

Lombardi Aguilar Group  
*Panama City, Panama*

aguilara\_5389@yahoo.fr

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## I. Wills and Disability Planning Documents

### A. Will Formalities and Enforceability of Foreign Wills

The granting of a will is subject to ritualistic formalities, omission of which can result in its annulment. Depending on the circumstances under which they are granted, wills may be common (including holographic, open and closed wills), or special (including maritime wills, military wills and wills granted abroad).

#### 1. Common: Holographic, Open and Closed wills.

Witnesses of the will must be economically independent from the grantor, the heirs and the Notary, as well as being mentally capable to serve as such. The Notary must ascertain the identity of the grantor and the two (2) witnesses required by law at the time of granting.

A holographic will is a will that is written by hand by the grantor on normal paper and is dated. The holographic will remains as a private document until the death of the grantor, at which time it must be submitted to a Notary for transcribing as a public document and filed before a Circuit Judge within four (4) years of the death of the decedent.

An open will is read and granted before a Notary and three (3) witnesses in the presence of the grantor. The law permits an open will to be granted before five (5) witnesses if no Notary exists in the location or in case of imminent death of the grantor. The omission of any of the legal formalities of an open will results in its annulment, with the Notary being liable for any damages.

A closed will is a written will that is delivered to the Notary inside a sealed envelope. The Notary then drafts an instrument under the other formalities of the open will attesting to the reception of the document from the grantor. After the formalities, the will may be stored by the grantor, a trusted person or the Notary. Once subject to probate, a closed will that is found void due to the omission of one of the legal formalities may still be followed as a holographic will. Due to the possibility that a holographic will may be challenged through graphological experts, open wills are more common.

#### 2. Special: Maritime, Military and Granted Abroad.

A military will can be granted by draftees and other employees of the armed forces or police before an officer or commander, either as a closed or open will. If the grantor is ill, the will may be granted before a doctor and two (2) witnesses.

A maritime will can be granted by anybody in a sea voyage in the presence of 2 witnesses before the Captain of a merchant ship or the Commander of a military ship, either as a closed or open will. A copy of the maritime will must be delivered to the Consul of Panama at the next port of call.

Wills granted by foreigners on board a Panama-flag ship are later forwarded by the Ministry of Foreign Relations to the authorities of the country of the grantor. Maritime wills granted on board a foreign-flag ship are deemed valid when granted according to the formalities of the relevant country, when later delivered to the Panama Consul.

Wills granted abroad must be granted according to the formalities of the relevant country and must be delivered to the nearest Panama Consul. Joint wills are not valid in Panama even when allowed in the country of granting.

### B. Will Substitutes (Revocable Trusts or Entities)

Trusts and private foundations may serve as will substitutes for post-mortem disposition of assets. The trust is a contractual relationship allowed in Civil-Law Panama pursuant to Law 1 of 1984. The private foundation is an entity that has assets gifted by a grantor for the benefit of beneficiaries.

The trust and revocable foundation have the following features:

- Simplicity of execution. Inter-vivos trust deeds may be granted by the Settlor by private document before a Notary Public anywhere in the world. In the case of post-mortem trusts, they must be granted under the formalities of a will. Only when the trustee is licensed by the Superintendent of Banks may a post-mortem trust be granted through a private notarized instrument without the formalities of a will. Private foundations may be formed by proxy but require registration of their charter.
- Contractual freedom. A grantor can execute a trust deed or foundation charter with any clauses or distribution plans as long as they are not contrary to law, morality or public interest. This rule allows the possibility of post-mortem distributions different from those of the grantor's estate laws or forced heirship rules.
- Duration. The duration of both entities can be indefinite, which excludes them from any rule against perpetuities.
- Confidentiality. Trust deeds and foundation regulations do not need to be made public by their registration (except for trusts when real estate in Panama is being settled). The trustee, foundation council member and their employees are subject to a duty of confidentiality. Breaches of this duty are subject to imprisonment or monetary fines.
- No citizenship requirements. Individuals or entities of any country can serve as grantor, trustee, foundation council member or beneficiary. None of the parties need to be Panamanian, except for the attorney who serves as resident agent.
- No licensing requirements. Any capable person or entity may serve as trustee or foundation council member and does not need to be authorized by a government authority, unless they market themselves as such on a regular basis. Trustees serving as commercial custodians may apply for a trustee license from the Superintendent of Banks, in which case the trustee is subject to quarterly reporting, capital adequacy ratios and know-your-customer rules similar to those of banks.
- Charitable or for-profit purpose. Trust and foundation charter provisions may designate a general class of beneficiaries or unborn beneficiaries. Alternatively, trust and foundation charter provisions may also authorize commercial transactions, such as securitization of receivables or other assets.
- Revocability option. Trusts and private foundations are irrevocable by default, unless the parties decide otherwise.
- Separate patrimony. Trust and private foundations assets are deemed as separate from assets of the grantor and trustee or foundation council member.
- Low local taxation. Income earned from assets located abroad or funds held in any bank in Panama are exempt from local Panama taxes. However, legislation from the country of residence or citizenship of the grantor, trustee or foundation council member may impose additional tax obligations.

- Minimum reporting requirements. Will substitutes that do not hold assets in Panama or are not earning income in Panama are exempt from having to file tax returns or financial statements. Trustees are required to render account of their performance to the beneficiaries and maintain a duty of care under the *bonus pater familiae* standard.

### C. Powers of Attorney, Directives, and Similar Disability Documents

Powers of attorney and all mandates become extinguished upon death of the grantor, which makes them inefficient for estate planning. Directives that do not follow the formalities of a will cannot prevail over testamentary provisions or intestacy rules.

## II. Estate Administration

### A. Overview of Administration Procedures

Post-mortem estate administration procedures are carried out under succession, which is defined as the assignment of active and passive rights that comprise the inheritance of a dead person to the surviving person, which the law or the testator call to receive. Both testate and intestate succession require that a probate proceeding be opened, which takes place upon death of the decedent or in the case of presumption of death.

A testamentary succession starts by filing the original death certificate and copy of the will in court. Once the judge evaluates the documents necessary to open a probate procedure, resolution is issued naming the persons appointed as heirs in the will for publication in a newspaper, after which the court will proceed to the adjudication of the property. During this period any person having an interest in the property may contest the resolution, requiring the judge to render a decision.

Intestate succession may be started by any person who has an interest in the estate of a decedent, accompanying the petition with the following documentation:

- Proof of death of the decedent;
- Affidavits from notaries in the domicile of the decedent stating that no will has been filed with them. The affidavit is not necessary when the decedent is not domiciled in Panama and has died abroad, and
- Full proof of kinship on which the plaintiff bases his or her right.

In either case, the executor will have to conduct an inventory of the assets and liabilities of the decedent. Creditors may appear in order to submit any liabilities for consideration. The probate judge decides on the challenges submitted and approves the inventory in order for assets to be adjudicated to the heirs and legatees.

Any individual or entity has the right to receive assets upon succession, unless excluded by law, such as aborted creatures and person unable to succeed due to indignity pursuant to the specific situations under article 641 of the Civil Code. The acceptance or repudiation of the inheritance are acts which the law deems entirely voluntary. Co-heirs may ask at any time for the partition of the inheritance either through the courts or extrajudicially.

### B. Intestate Succession and Forced Heirship

Intestate succession is carried out upon the full or partial absence of a will. Under Panama intestate succession rules, children of the decedent and their descendants – whether illegitimate or adopted – receive their inheritance in equal parts. In the absence of descendants, ancestors will inherit, excluding

siblings, who inherit as collaterals in the absence of ascendants of the decedent. The surviving spouse who is not legally separated or divorced from the decedent inherits equally with each of the above-mentioned classes. In the absence of all of these heirs, the Municipality where the decedent had domicile inherits all assets.

Testamentary succession laws allow substantial freedom to dispose of assets, as long as a pension is provided for children up to the age of 25 and for parents, spouse and handicapped children for the time they may need support which allows them to maintain their standard of living as of the time of death.<sup>1</sup>

### C. Marital Property

Marriages before 1995 are subject to the Civil Code rules while those after that date are subject to the Family Code. This is important because Civil Code marriages are subject by default to the rules of separation of assets, while Family Code marriages are deemed by default to be under a regime of participation in gains (*participacion de ganancias*). The following regimes for marital property currently exist:

1. Joint property (*sociedad de gananciales*). Assets obtained during marriage by either of the spouses are owned jointly. Assets may not be disposed of without consent of the other party.
2. Separation of assets. Each spouse owns his or her assets but both spouses are obligated to contribute to common marriage expenses according to their individual income.
3. Participation in gains. Unlike the other two (2) regimes which require a pre-nuptial or post-nuptial agreement, this is the current marital property regime by default. Each spouse has a right to participation in gains earned by the other one, but each one retains private ownership of his or her assets.

### D. Tenancies, Survivorship Accounts, and Payable on Death Accounts

1. Tenancies. All rights and duties of the decedent become assets and liabilities of the estate. This means that rights held by the decedent under tenancies and survivorship accounts also become assets of the estate.
2. Survivorship Accounts. Accounts owned jointly (i.e. an Account of A and B) are subject to having the shares of the decedent account holder turned over to the estate for inventory. The balance of accounts owned severally (i.e. an Account of A or B) may be disposed of by the surviving account holder without regards to the existence of a probate procedure.
3. Payable on Death Accounts. Banks are required to disclose information regarding accounts held by the decedent if they receive a request from a probate judge. Post-mortem instructions to banks for performance upon death of the account holder have been deemed as valid by the Supreme Court even if they do not have the formalities of a will.

## III. Trusts, Foundations, and Other Planning Structures

### A. Common Techniques

The most common alternative technique has been to place assets under the name of corporations. The corporations' bearer shares are placed under safekeeping and hopefully passed on to the heir by delivery of the certificates. A will is still executed for purposes of dealing with guardianship issues. This method can result in litigation when a large number of descendants exist or share certificates are lost.

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<sup>1</sup> Panama Civil Code Article 778.

Trusts and private foundations are exempt from forced heirship and succession rules, as the only legal requirement is that rules of accumulation, distributions or disposition of the assets not be contrary to morality, the laws or public order.

An inter vivos trust may be granted through a notarized private instrument or a public deed. In the case of post-mortem trusts, they must be granted under the formalities of a will. Only when the trustee is licensed by the Superintendent of Banks may a post-mortem trust be granted through a private notarized instrument without the formalities of a will.

#### B. Fiduciary Duties (Trustees, Board Members, Directors, etc.)

Panama is a Civil Law country, so fiduciary duties exist solely in virtue of a written trust deed and may not be construed. However, attorneys-in-fact and other representatives are subject to fiduciary-like duties under the Civil Code mandate provisions and the specific law applicable to the entity they represent.

The Civil Code provides that the representative (*mandatario*) must comply with the mandate and is liable for the damages caused to the grantor (*mandante*) for not carrying out the mandate. The representative must act according to the instructions of the grantor and "in their absence, will carry out everything that, according to the nature of the business, a good father of family (*bonus pater familiae*, in Spanish, *buen padre de familia*) would do."

Trustees and foundation council members are required to render account of their performance to the beneficiaries and maintain a duty of care under the *bonus pater familiae* standard under the trust and private foundation law respectively.

The duty of directors is more limited in scope, being more applicable to the accuracy of corporate accounts. Directors are not personally liable for the liabilities of the corporation, but will be personally or severally liable, as the case may be, to it or to third parties, for (i) the effectiveness of payments which appear to have been made by the shareholders; (ii) the true existence of agreed dividends; (iii) the proper management of the accounting, and (iv) in general, for the proper or improper execution or performance of the agency or for the violation of the laws, the articles of incorporation, the by-laws or resolutions of the General Meeting. Directors who were absent with cause or who protested in due time against a resolution of the majority shall be exempted from liability. The liability of Directors may only be demanded by virtue of a resolution of the General Shareholders Meeting.

#### C. Treatment of Foreign Trusts and Foundations

Panama trusts may be redomiciled to another country when the trust deed permits. Foreign trusts may be subject to Panama law if the trustee alone or jointly with the settlor so directs. Panama is not a member of The Hague 1985 Convention on the Law Applicable to Trusts and on their Recognition. Foreign trusts are subject to Panama law, when enforcing their rights in court.

### IV. Taxation

#### A. Domicile and Residency

For contractual purposes, the legal domicile of a person is in the place where he is normally employed, or has his or her main place of business. Mere residence serves as civil domicile for persons that do not have a formal domicile elsewhere.

For tax purposes, individuals who remain in Panama for more than 180 days during the fiscal year and earn any taxable income are subject to income tax at normal rates, despite their immigration status. Income taxes owed by a deceased individual at the time of death are payable by the heirs as a debt deducted from the estate assets.

Foreigners may source their income in Panama by several methods, such as establishing residence, invoicing from Panama, or acting through Panamanian vehicles. Individuals and legal entities that do not have a registered domicile, place of incorporation, or registered branch in Panama may be subject to taxation. As a general rule, taxpayers are considered to be individuals or entities that earn income considered taxable by law (i.e. non-exempt local-source income), regardless of their nationality, domicile, or residence.

#### B. Gift, Estate, and Inheritance Taxes

Estate or mortis causa taxes, as well as gift or inter vivos taxes, were abolished in 1985 and 2002, respectively.

#### C. Taxes on Income and Capital

Panama follows a territorial system which taxes only income from local sources, excluding from taxation income earned from activities whose effects occur outside of the Republic.

Income tax is payable in Panama only by individuals and entities that have Panama-source income from transactions with Panamanian taxpayers on a regular basis, minus the deductions for office expenses and those allowed by law. Taxpayers with income sourced from Panama must file an annual income tax return. Individuals and entities whose sole income has been subject to income tax with-holding (such as salaries, dividends from local companies, or social security funds) or whose income is tax-exempt (such as interest from bank accounts), or individuals whose net taxable yearly income is less than US \$9,500 are not required to file a tax return.

Merchants with operations with effects in Panama and which are not exempt by special law are subject to a 2% tax on capital, defined as assets in Panama minus liabilities.

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### **ALVARO JAVIER AGUILAR-ALFU.**

Partner

#### **Lombardi Aguilar Group**

[aguilara\\_5389@yahoo.fr](mailto:aguilara_5389@yahoo.fr)

Telephone number: +507 340-6444

Graduated in 1991 from the University Santa Maria La Antigua as Licentiate in Law and Political Science, Mr. Aguilar earned in 1992 a masters degree (LL.M.) in International Legal Studies with concentration in International Trade and Banking, at the Washington College of Law, The American University. In addition, he attended courses in International Corporate Law at Widener University / Université de Geneve, Switzerland.

After working as legal assistant with Panama business law firm, Mr. Aguilar served as administrative intern of the Administrative Tribunal of the Organization of American States in Washington, D.C. He later worked as attorney with a Panama commercial law firm.



As attorney, Mr. Aguilar has worked in the drafting of commercial, mortgage and banking contracts; negotiation and drafting of joint venture and real estate agreements; conducting of due diligence research for transactions; provided legal advice for privatisations and international business and corporate law matters in general.

He has served as member of the Board of Directors of the Panama Bar Association, American Chamber of Commerce (AMCHAM), Panamanian Association of Law and New Technologies (APANDETEC), several non-profit institutions and as President of the Association of Chinese-Panamanian Professionals (APROCHIPA). He has been selected for the Corporate Tax section of Who's Who Legal and by the Central American business publication *CAPITAL FINANCIERO* as one of the "40 under 40" for his achievements as a young legal professional.

Mr. Aguilar delivered a presentation of the "Securitization: An Increasing and Safe Financing Technique in Emerging Markets" at the New York State Bar Association meeting in Santiago de Chile, as well as participated in panels on Trusts & Estates at the meetings in Lima, Singapore, and Panama. He is the author of the Panama chapter of "International Taxation of Low-Tax Transactions" and reports for Trusts & Trustees Journal and other international publications.