
Panama

International Estate Planning Guide

Individual Tax and Private Client Committee

Contact:

Alvaro Javier Aguilar-Alfu

Lombardi Aguilar Group, *Panama City*

aaguilar@lalex.com

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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, whose omission can result in its annulment. Depending on the circumstances under which they are granted, wills may be:

- common: holographic, open and closed wills; and
- special: maritime, military and granted abroad.

Witnesses of the will must be economically independent from the grantor, the heirs or the notary, as well as being mentally capable to serve as such. The notary must ascertain the identity of the two witnesses required by law and the grantor at the time of granting. If the grantor does not completely understand Spanish, then two certified interpreters and three witnesses must be present at the granting.

A holographic will is one which 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, upon which it must be submitted to a notary for transcribing as a public document and filed before a circuit judge within four years of the death of the decedent.

The open will is read and granted before a notary and three witnesses in the presence of the grantor. In a situation where no notary exists in the location, or in the case of the imminent death of the grantor, the will is granted before five witnesses.

The omission of any of the legal formalities of an open will results in its annulment, with the notary being liable for any damages.

The closed will is that which is written on paper and 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 receipt 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, which 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 popular.

The military will is granted by draftees and other employees of the armed forces or police force 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 witnesses.

The maritime will is granted by anybody in a sea voyage in the presence of two 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 onboard a foreign-flag ship are deemed valid when granted according to the formalities of said country, when later delivered to the Panama Consul.

Wills granted abroad must be granted according to the formalities of said country, when later 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 under civil law in Panama pursuant to Law 1 of 1984. The private foundation is an entity which has assets gifted by a grantor for the benefit of beneficiaries.

The trust and revocable foundation have the following features.

1. SIMPLICITY OF EXECUTION

Inter vivos trust deeds may be granted by private document by the settlor before a public notary anywhere in the world. In the case of post-mortem trusts, they must be granted under the aforementioned will formalities. Only when the trustee is licensed by the Superintendent of Banks may a post-mortem trust be granted through a private notarised instrument without the formalities of a will. Private foundations may be formed by proxy, but require registration of their charter.

2. CONTRACTUAL FREEDOM

A grantor can execute a trust deed or foundation charter with any clauses or distribution plans provided they are not contrary to law, morality or public interest. This extends to allow the possibility of post-mortem distributions different from those of the grantor's estate laws or forced heirship rules.

3. DURATION

The duration of both entities can be indefinite, which excludes them from any rule against perpetuities.

4. 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 said duty are subject to imprisonment or monetary fines.

5. NO CITIZENSHIP REQUIREMENTS

Individuals or entities of any country can serve as grantor, trustees, foundation council members or beneficiaries. None of the parties need to be Panamanian, except for the attorney who serves as resident agent.

6. REDUCED LICENSING REQUIREMENTS

Any capable person or entity may serve as protector or foundation council member and does not need to be authorised by a government authority. However, only trustees with a license from the Superintendent of Banks may act as such,¹ in which case the trustee is subject to quarterly reporting, capital adequacy ratios and know-your-customer rules similar to those of banks.

7. CHARITABLE OR FOR-PROFIT PURPOSE

Trust and foundation charter provisions may appoint a general class of beneficiaries or unborn beneficiaries. Alternatively, they may also serve for commercial transactions, such as securitisation of receivables or other assets.

8. REVOCABILITY OPTION

Trusts and private foundations are irrevocable by default, unless parties decide otherwise.

9. SEPARATE PATRIMONY

Trust and private foundation assets are deemed as separate from assets of the grantor and trustee or foundation council member.

10. 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 countries of residence or citizenship of the grantor, trustee or foundation council member may impose additional tax obligations.

11. REPORTING REQUIREMENTS

Will substitutes without assets in Panama or not earning income in Panama are exempt from having to file tax returns. However, trustees are required to draft financial statements of the trusts they manage.² 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 which 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 which comprise the inheritance of a dead person, to the surviving person, which the law or the testator call to receive.

Both the testate and intestate succession require that probate proceedings be opened, which takes place upon death of the decedent or in the case of presumption of death.

A testamentary succession starts by filing in court the original death certificate and copy of the will. 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 it will proceed to the adjudication of the property. During this period, any person having an interest in the property may contest the decision, in which case it is left to a judge to render the decision.

Intestate successions may be started by any person who has an interest in the estate of a decedent, accompanying to the petition:

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

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 persons unable to succeed due to indignity³ 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 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. Upon lack of descendants, ancestors will inherit excluding siblings – who inherit as collaterals upon lack of ascendants of the decedent.

The surviving spouse, who is not legally separated or divorced from the decedent, inherits equally with each of the aforementioned classes.

The absence of all of the above results in the municipality, where the decedent had domicile, inheriting 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 support⁴ which allows them to maintain their standard of living as of the time of death.

C. Marital property

Marriages before 1995 are subject to Civil Code rules, while those marriages 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 the 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:

- *joint property (sociedad de gananciales)*: assets obtained during the marriage by any of the spouses are owned jointly; assets may not be disposed without consent of the other party;
- *separation of assets*: each member owns his or her assets, but the obligation subsists of contributing to common marriage expenses according to their individual income; and

- *participation in gains*: unlike the other two 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 spouse, but each spouse 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 (ie, Account of A and B) are subject to the shares of the decedent account holder being turned over to the estate for inventory. The balance of accounts owned severally (ie, 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 details on 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 though 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, which bearer shares are placed under safekeeping and hopefully passed on to the heir by delivery of the certificates. A will is still executed for the purpose of dealing with guardianship issues. This method can result in litigation when a large number of descendants exist or share certificates are lost.

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 may not be contrary to the morality, laws or public order.

An *inter vivos* trust may be granted through a notarised private instrument or a public deed. In the case of post-mortem trusts, they must be granted under the aforementioned 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 notarised 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 by 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 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 damages caused to the grantor (*mandante*) for not carrying it out. 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 subject to 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 they will be personally or severally liable, as the case may be, to it or to third parties, for the effectiveness of payments which appear as being made by the shareholders; for the true existence of agreed dividends; for the proper management of the accounting; and, in general, for the proper or improper execution or performance of the agency or for the violation of the laws, articles of incorporation, by-laws or resolutions of the General Meeting. Those directors, who were absent with cause or who protested in due time against the resolution of the majority, shall be exempt 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 allows so. Foreign trusts may be subject to Panama law, as long as the trustee alone, or jointly with the settlor, states so. Panama is a member of The Hague 1985 Convention on the Law Applicable to Trusts and on their Recognition from its ratification by Law 44 of 2012.

IV. Taxation

A. Domicile and residency

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

For tax purposes, an individual who remains more than 180 days during the fiscal year in Panama and earns any taxable income is subject to income tax at normal rates, despite his or her 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 or place of incorporation or registered branch in Panama may be subject to taxation. Generally, taxpayers are considered to be the individuals or entities, despite their nationality, domicile, or residence, that earn Panama income considered taxable by law (ie, non-exempt local-source income).

B. Gift, estate and inheritance taxes

Estate or *mortis causa*, 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 any income which is earned from activities the effects of which occur outside of the Republic of Panama.

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 withholding (eg, salaries, dividends from local companies or social security funds) or whose income is tax exempt (eg, 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.

The duty to file tax returns falls on the executor of an estate, the trustee of a trust or the legal representative of a private foundation. Special rules for estates, trusts or private foundations with international parties are stated in double taxation agreements and (in their absence) the Tax Code.

Merchants performing operations with effects in Panama, and which are not exempt by special law, are subject to two per cent tax on capital, defined as assets in Panama minus liabilities.

Notes

- 1 Art 4 of Law 21 of 2017. Art 22 of Law 21 of 2017 specifically prohibits acting as a trustee without a licence.
- 2 Art 29 of Law 21 of 2017.
- 3 'Indignity' here is defined under Article 641 of the Civil Code, which includes reasons as to why one would be deemed 'undignified'. These include '[p]arents who abandon their children and prostitute their daughters or reduce their modesty'.
- 4 Art 778 of the Panama Civil Code.