



BULLETIN

Law 526 of 2026: Economic Substance and the New Tax Order for Passive Income.

CONTEXT AND BASIS OF THE REFORM

On May 28, 2026, Panama's National Assembly enacted Law 526 of 2026, published in the Official Gazette No. 30534B. This tax reform, which will take effect from fiscal year 2027, represents a significant shift in the tax treatment of passive foreign-source income obtained by entities of multinational groups domiciled in Panama.

The creation of this law responds to an undeniable international reality: for decades, Panama was known as a jurisdiction that allowed entities

multinational companies to obtain passive income from abroad without any tax burden, regardless of whether they had real economic substance in the country. Although legal under prior regulations, this structure generated international scrutiny and eroded Panama's reputation for compliance with global tax standards. Law 526 acknowledges this challenge and addresses it through a fundamental principle: the conditioning of favorable tax treatment on the effective compliance with economic substance requirements. In other words, tax benefits are now linked to tangible operational reality in Panama.

WHO DOES THIS LAW APPLY TO

The law is directed specifically at entities that are members of multinational groups established or domiciled in Panama. A multinational group is defined as two or more entities linked by ownership or control, resident for tax purposes in different jurisdictions. It is not enough for an entity to be international; it must be part of a structure with presence in at least two countries.

Passive income covered by this law includes dividends, interest, royalties, capital gains, real estate income, and other foreign-source movable capital income. If your Panamanian company receives any of these income from abroad, this law applies to you.

THE PILLARS OF ECONOMIC SUBSTANCE

The law introduces three fundamental pillars that every entity must demonstrate annually to maintain preferential tax treatment of its passive income:

- **Qualified and remunerated personnel:** Your company must have competent executives or professionals, adequately remunerated, dedicated to managing the income-generating assets, with appropriate physical facilities in Panama.
- **Strategic decisions adopted locally:** Decisions regarding acquisition, preservation, exploitation, and disposition of assets must be made in Panama, with effective assumption of associated risks.

- Proportionate operational costs and expenses: Your company must incur costs directly linked to the management of these assets in Panama.

The evaluation is not mechanical. The law provides that the adequacy of these requirements will be judged considering the nature, scale, complexity, and amount of the passive income, as well as the operational structure of the group. A simple holding company does not face the same standards as a complex investment fund manager.

EXCEPTION FOR PURE HOLDINGS

The law provides a special regime for pure holdings, that is, entities whose principal activity is passive ownership of interests in other companies without conducting substantial commercial activity on them. For these entities, the requirement is reduced to only demonstrating qualified, remunerated personnel and adequate physical facilities in Panama. It will not be necessary to demonstrate local strategic decisions or proportionate operational costs. This flexibility recognizes the particular nature of these structures.

OUTSOURCING OF FUNCTIONS

A relevant aspect is that the law expressly allows compliance with economic substance requirements through contracting third-party service providers domiciled in Panama. However, the law does not specify the details of how this outsourcing should be carried out, leaving these aspects for the regulation that the Executive Branch will publish in the next 90 days. It will be crucial to closely follow these regulatory provisions, as they will define what type of control and supervision must be exercised over the providers.

THE FUNDAMENTAL DISTINCTION: QUALIFIED VS. NON-QUALIFIED ENTITIES

Law 526 introduces a distinction that determines your company's tax treatment. This classification is not automatic; it depends entirely on you demonstrating compliance with economic substance requirements.

Qualified Entity

A qualified entity is one that is part of a multinational group, obtains passive foreign-source income, and demonstrates to the tax authority that it fully complies with all economic substance conditions. For a qualified entity, passive foreign-source income remains untaxed in Panama, as has been the case historically. The benefit is continuous, year after year, as long as it maintains economic substance certification. However, this status is not permanent; it must be renewed annually by submitting detailed information demonstrating compliance with the requirements.

What must a qualified entity demonstrate? Each year, it must show that it has: qualified and remunerated personnel in Panama dedicated to managing the assets; strategic decisions made in Panamanian territory, assuming corresponding risks; and adequate operational costs incurred locally. The evaluation is made with respect to each type of passive income, which means that an entity could be qualified for dividends but not qualified for royalties, for example, if it lacks personnel dedicated to managing royalty-related assets.

Non-Qualified Entity

A non-qualified entity is one that, although it is part of a multinational group and obtains passive foreign-source income, fails to demonstrate compliance with economic substance requirements. This can be for several reasons: absence of qualified personnel in Panama, lack of local strategic decisions, insufficient related operational costs, or failure to submit required information.

The tax consequences are significant. A non-qualified entity will see its passive foreign-source income taxed in Panama at a rate of 15% on net taxable income. This contrasts sharply with the historically favorable treatment. Furthermore, this classification as non-qualified opens the door to additional sanctions, fines, surcharges, and interest according to the Tax Code.

An important clarification must be made. The 15% rate is lower than Panama's general corporate income tax rate (currently 25% for many entities). However, the decisive factor is that this rate applies only to non-substantiated passive income, allowing the rest of the entity's operations to follow applicable tax regimes. For an entity that only obtains passive income, the impact is total.

CONSEQUENCES OF NON-COMPLIANCE

Entities that fail to demonstrate economic substance will be considered "non-qualified entities" and their passive foreign-source income will be subject to a 15% rate on net taxable income. This rate applies after deducting properly documented costs and expenses. Furthermore, this applies without prejudice to fines, surcharges, and interest that may correspond under the Tax Code. It should be noted that the law expressly excludes regulated financial entities such as banks, insurance companies, securities brokers, fund managers supervised by their competent agencies in Panama, as well as maritime shipping companies registered in Panamanian registries, with respect to income linked to their ordinary regulated activity.

INFORMATION REPORTING OBLIGATION

The law introduces a clear obligation: multinational entities must annually report in their tax return the passive foreign-source income obtained and the information necessary to demonstrate compliance with economic substance requirements. This transparency is essential for regulatory compliance. Law 526 of 2026 marks the beginning of a new era in Panamanian taxation. The law takes effect in fiscal year 2027, and regulations will be published in the coming months. This is the right time to act. Every Panamanian multinational entity should review its corporate structure and determine whether it is exposed to passive foreign-source income under this new regulation.

We cordially invite you to schedule a consultation with our tax experts. At MGI Montúfar & Asociados, we have highly experienced professionals who can assist you in a detailed analysis of your legal structure, evaluate your exposure under Law 526, and define the necessary actions to ensure compliance before it takes effect. Anticipation, in tax matters, is the best strategy. Contact us today to protect the interests of your multinational group.

For more information contact:



Eduardo Montúfar Rojas
MGI Montúfar & Asociados
montufar@montufarcpa.com



About MGI Worldwide

MGI Worldwide is a leading top-20 international network and association of over 8,000 audit, accounting, tax and consulting professionals in some 400 locations around the world.

www.mgiworld.com

Power to
grow
With MGI Worldwide

Follow us on

