

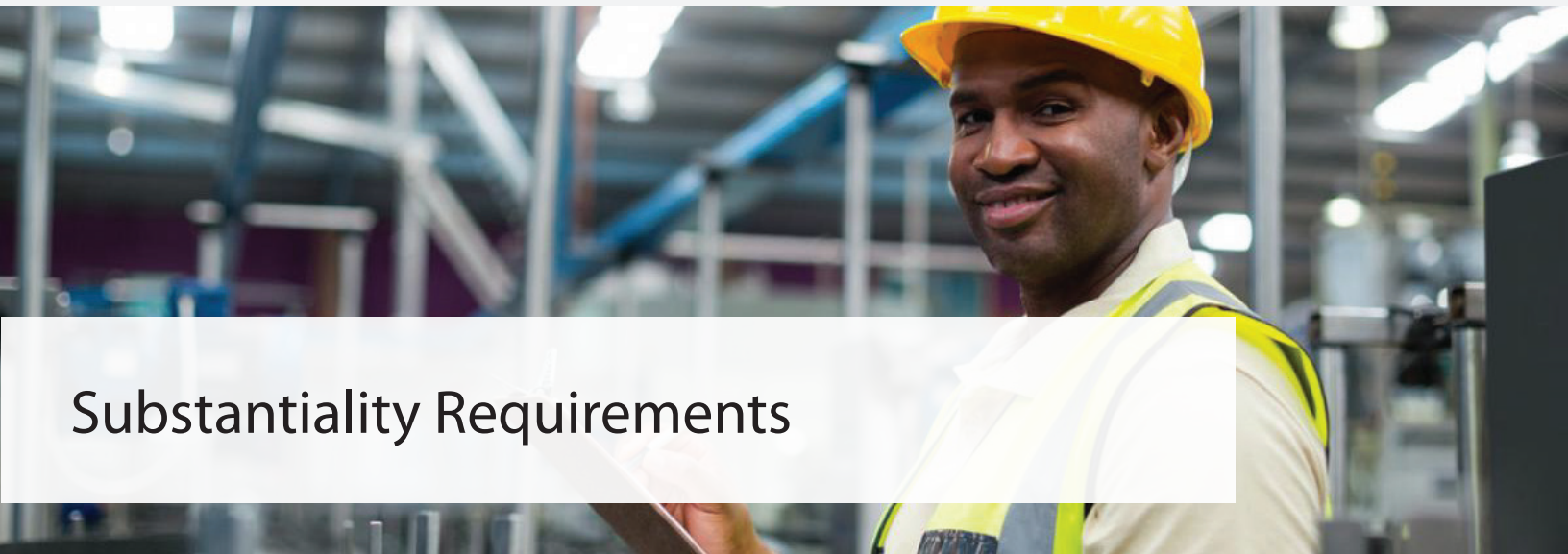
On September 16, 2020, new regulations were introduced for Law 41 of 2007, the law that establishes and regulates the Multinational Headquarters (“MHQ”) Regime in Panama.

In addition, on September 17, 2020, the MHQ Secretariat issued *“Guidelines for the Application of Substantiality Requirements”* in line with the Organization for Economic Cooperation and Development’s (“OECD”) Inclusive Framework on Base Erosion and Profit Shifting.

The following is a summary of the most relevant changes under the new regulations and guidelines.



**Recent amendments to the Regulations governing
Multinational Headquarters Companies**



Substantiality Requirements

In order to determine compliance with the OECD's substantiality requirements, the new regulations introduce the concept of "Principal" and "Secondary" activities.

Principal Activities refers to the activities directly associated with the generation of income for the MHQ company, which must be one or more of the activities approved under Law 41. **Secondary Activities** refers to the activities that are not directly associated with the generation of income for the MHQ company.

To benefit from the tax incentives offered by Law 41, MHQ companies must be able to demonstrate that the Principal Activities are carried out in Panama. Furthermore, the MHQ company must maintain an adequate number of employees and incur an adequate amount of operational expenses for the execution of the Principal Activities. "Adequate" is defined as *"what is suitable, appropriate and sufficient for the execution of the Principal Activity, according to the particularities of each company and the nature of the business"*. As such, the precise number of employees and amount of operational expenses will vary in each case.

All or part of the Principal Activities may be outsourced to a third-party provider, which provider must be located in Panama, and must also hold an MHQ license; however, the MHQ company must maintain sufficient control and oversight of such outsourced activities in order for the income generated by those activities to be subject to the tax benefits of Law 41. In the case of outsourcing, the employees and expenses of the third-party provider will be considered in the determination of "adequate" employees and expenses as described in the paragraph above. Any outsourced Principal Activities that are carried out outside of Panama, or without sufficient control and oversight by the MHQ company, will be subject to regular taxes. Secondary Activities may be outsourced either within or outside Panama.

Finally, in order to meet the substantiality requirements, MHQ companies must provide regular, detailed annual reports as described below.



Annual Reporting Requirements

Since it was first introduced, Law 41 has required MHQ companies to file an annual report. Previously, this report was filed within the first five business days of the month in which the MHQ license was granted, and required only basic information regarding the company's operations in Panama, including a summary of operations and a report of any changes in the immigration status of MHQ employees. The new regulations establish more robust reporting requirements that are applicable to all companies with an MHQ license, including more detailed information and supporting documentation.

These reports must be filed with the MHQ Commission within six months of the close of the MHQ company's fiscal year and must include:

1. Sworn Declaration signed by company's legal representative and a certified public accountant that includes the following information:
 - a) Name and personal data of the legal representative and the authorized public accountant who signs the sworn statement, who in turn must sign the respective statement.
 - b) Detailed description of the activities carried out, specifying which of these were the Principal Activities and which were Secondary Activities.
 - c) Description of the resources, personnel, facilities, equipment or goods used in the execution of the activities.
 - d) Income generated by the activities carried out, including gross income, direct and indirect costs, and net income.

e) If applicable, any of the company's principal or secondary activities that were outsourced to third parties must be described and the related operating expenses detailed, including the name and address of each service provider, detailed information on the mechanisms used by the MHQ company to monitor and control such outsourced activities, and information of the employees working with the service provider.

f) Description of total of operating expenses, detailing those directly related to the Principal Activity.

g) Name and job title of full-time qualified employees who are in charge of carrying out the company's Principal Activities.

h) Identification of the parent company or affiliates or subsidiaries to which services have been provided under the MHQ license.

i) Investments made in Panama during the respective fiscal period.

j) Names, general information and job title of all foreign personnel employed by the MHQ company during the respective fiscal period, who hold a MHQ visa, and the total amount of the payroll corresponding to such personnel.

k) Names, general information and job title of all Panamanian personnel employed by the MHQ company during the respective fiscal period, and the total amount of the payroll corresponding to such personnel.

l) Description of technology transfer and / or education activities carried out during the respective fiscal period.

*Information must be provided for each activity included in the company's MHQ license. If there are activities that are included in the MHQ license which are no longer applicable, the MHQ company should request a modification of their MHQ license to eliminate any extra activities listed.

2. Copy of MHQ company's audited financial statements.SEM.

3. Any other information and documents required by the MHQ Commission.



Report Filing Deadlines

MHQ companies whose MHQ licenses were issued prior to October 17, 2017 must present their first report under the new format for the period between January 1, 2020 and December 31, 2020 by no later than June 30, 2021. Thereafter, reports must be filed for each calendar or fiscal year by June 30 or six months after the close of the fiscal year, as the case may be.

MHQ companies whose MHQ licenses were issued on or after October 17, 2017 must present their first report under the new format for the 2019 fiscal year by December 31, 2020. Thereafter, reports must be filed for each calendar or fiscal year by June 30 or six months after the close of the fiscal year, as the case may be.

If an MHQ company fails to submit the report or supporting documentation as required, the MHQ Commission will have a period of 30 days to issue a resolution declaring the company's failure to comply with the reporting requirements for the previous fiscal year.

Once received, the MHQ Commission will have a period of six months to issue a resolution declaring whether or not the company has complied with the reporting requirements, which period may be extended an additional six months, if required. If the information and documentation provided is incomplete, the MHQ Commission may issue a resolution declaring the company's failure to comply the reporting requirements for the previous fiscal year.

Resolutions issued by the MHQ Commission will be issued to the MHQ company, who may present a request for reconsideration with additional information, in two instances. Resolutions will be shared directly by the MHQ Commission to the Tax Authority so that the tax benefits offered by Law 41 can be applied.



Penalties for Noncompliance

The MHQ Commission may issue written warnings for any failure to comply with the MHQ Law and Regulations which is not considered a “Minor” or “Major” infraction.

“Minor” infractions include failing to present the annual report within six months of the end of fiscal year, filing incomplete information or documentation, or failing to provide additional information and documents requested by the MHQ Commission. These minor infractions will result in fines of between US\$5,000.00 and US\$50,000.00.

“Major” infractions include receiving three written warnings or repeated minor infractions, having employees on the payroll without proper work visas, and reporting foreign employees on the MHQ company’s payroll who do not actually work in the MHQ company.

Repeated major infractions may result in the cancellation of the MHQ company’s license.

We hope that you will find this information useful and we look forward to assisting you should additional questions arise.



ARIAS, FABREGA & FABREGA