



Mergers & Acquisitions

in 60 jurisdictions worldwide

Contributing editor: Casey Cogut

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Panama

Julianne Canavaggio

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1 Types of transaction

How may businesses combine?

In Panama, business combinations are usually structured as stock or asset purchases, tender offers or mergers, but other techniques are also used, such as the capitalisation of stock of two operating companies to a holding company specifically incorporated for that purpose and the joint participation in the holding company.

In the case of publicly traded companies, combinations usually take place through a two-step process that starts with a tender offer (either for stock or cash or a combination of both) followed by an actual merger.

2 Statutes and regulations

What are the main laws and regulations governing business combinations?

The relevant Panamanian laws and regulations governing business combinations include Law No. 32 of 1927 (the Corporations Law), Law No. 4 of 2009 (the Limited Liability Company Law) and the Commercial Code, which is supplemented by the Civil Code. In Panama there is no mandatory merger control approval process; however, the antitrust and competition regime established by Law No. 45 of 2007 (the Competition Law) regulates economic concentrations created by the mergers and other business combinations.

As combinations generally cause taxable events, the Tax Code and its regulations (specifically Executive-Decree No. 18 of 1994 which establishes a special regime regarding stock-for-stock mergers) and Law No. 18 of 2006, which created a special capital gains regime, are also relevant.

In the case of publicly traded companies, Decree-Law No. 1 of 1998 and its regulations (the Securities Law) govern tender offers, proxy statements and rules of disclosure, among other matters.

3 Governing law

What law typically governs the transaction agreements?

Domestic business combinations are typically governed by Panama law.

4 Filings and fees

Which government or stock exchange filings are necessary in connection with a business combination? Are there stamp taxes or other government fees in connection with completing a business combination?

Most if not all business combinations require some kind of filing with a governmental entity depending on the industry involved or the type of transaction.

Share acquisitions of privately held companies do not require filing with any governmental entity. Asset acquisitions that include real estate require filings with the Public Registry Office, which

engender notarial and registration fees that vary depending mainly on the value of the real estate. In the case of share and asset acquisitions (as well as mergers), stamp taxes are necessary (at the rate of US\$1 per US\$1,000 of the face value of the transaction).

Tender offers must be filed with the National Securities Commission (the NSC) (which requires the payment of a US\$10,000 filing fee). The target company and the stock exchange in which the target securities are traded must also be promptly notified.

In the case of mergers, the agreement must be filed with the Public Registry Office (which requires a recordation fee that varies pursuant to a progressive table based on the authorised capital of the surviving or resulting entity) and the General Directorate of Revenue of the Ministry of Economy and Finance must be notified of the merger within 30 days.

Although not required, business combinations may apply for a favourable opinion from the Authority of Consumer Protection and Defence of Competition under the Competition Law, which would exempt the combination from challenges under said law. No fee is payable for the request of this opinion.

5 Information to be disclosed

What information needs to be made public in a business combination? Does this depend on what type of structure is used?

The Securities Law requires public companies to disclose all material (that is, information that would probably be of value to an investor), non-public facts or information that could have a material effect on the market price of its securities registered with the NSC. Since most business combinations meet that standard, public companies must disclose to the public the nature of the transaction and its main terms and conditions.

The basic terms and conditions (price, terms of payment, hold-backs and material conditions) as well as the reasons, strategies or purposes of the combination should be included in disclosure statements made by public companies involved in business combinations.

6 Disclosure of substantial shareholdings

What are the disclosure requirements for owners of large shareholdings in a company? Are the requirements affected if the company is a party to a business combination?

The Securities Law does not establish special disclosure requirements for large shareholders and the NSC has not yet adopted regulations establishing such rules of disclosure. Note, however, that public companies are obliged to disclose the names of controlling shareholders at the time of their initial registration and must update that information at least quarterly.

7 Duties of directors and controlling shareholders

What duties do the directors or managers of a company owe to the company's shareholders, creditors and other stakeholders in connection with a business combination? Do controlling shareholders have similar duties?

Panama law entrusts the control and direction of the affairs of a corporation to its board of directors. As a general rule, the board exercises all powers of a corporation, except for those that by operation of law, or by the articles of incorporation or by-laws of the corporation, are reserved to shareholders. Under Panama law, the relationship between directors, on the one hand, and the corporation and its shareholders, on the other hand, is best characterised as that of agent and principal. Directors are generally considered to have received a 'mandate' to manage the affairs and assets of the corporation. As such, directors are responsible for discharging their mandate with the duty of care owed by agents and may become personally liable for negligence in the discharge of these duties.

In addition to liability attaching for a breach of the general duty of care, under Panama law directors of a corporation may also become personally liable in the event of:

- (i) false capitalisation: if the books of the corporation reflect capital contributions not made by shareholders;
- (ii) lack of funds to pay declared dividends: if the corporation does not have sufficient funds to pay dividends that have been declared by the board of directors;
- (iii) improper accounting: if the accounting books of the corporation are improperly kept. There is no definition as to what constitutes improper book-keeping; however, material violations of the accounting standards adopted by the corporation may reasonably be expected to constitute improper bookkeeping; or
- (iv) violations of corporate documents or the law: if they authorise actions that violate the law, the articles of incorporation or the by-laws of the corporation, or any resolutions adopted by shareholders.

The standard of care to which directors are generally subject is that which 'ordinarily prudent men would usually exercise in the discharge of their own affairs'. This means that although as a general rule directors are not personally liable for the obligations of the corporation, they may become jointly and severally liable if they are found not to have discharged their duties as directors with the degree of care that ordinarily prudent men would usually exercise in the discharge of their own affairs.

Directors who vote against a resolution or an act of the board of directors that gives rise to personal liability, as well as directors who are not present with reasonable cause at the meeting where such resolution or act is adopted, are exculpated from personal liability.

If directors are found liable for breaching their general duty of care or for breaching any of their duties mentioned in (i) to (iv) above, they may be held jointly and severally liable for damages arising from such breach. Claims may be filed by the corporation itself or, derivatively, by any other person who has suffered damages, including shareholders and corporate creditors.

Notwithstanding the foregoing, no director of a Panama corporation may be held personally liable either to the corporation, its shareholders or any other person by breach of duty of care (either for a breach of their general duty of care or the specific duties mentioned in (i) to (iv) above), unless a resolution authorising such action is adopted by the shareholders of the corporation. In the absence of such shareholders' resolution, only the corporation would be liable to third persons for damages resulting from the acts of its directors.

Directors of public companies may also become personally liable for breach of their duty of loyalty and self-dealing. Under Panama law, all agreements and arrangements between a corporation and any of its directors or officers, or any transaction in which any such director or officer has directly or indirectly an interest, must be approved

by the board of directors and disclosed to shareholders at the next meeting of shareholders. If shareholders disapprove the agreement, arrangement or transaction, they may decide to bring personal action against the directors who voted in favour of such agreement, arrangement or transaction, if there are basis for such an action. In such circumstances, directors may become personally liable for damages if they are found to have acted not in the corporation's best interest.

In the case of business combinations, the duty of the directors generally is to look after the interests of the company and its shareholders as a whole, bearing in mind the objective of maximising shareholder value.

Panama law does not impose similar duties on controlling shareholders.

8 Approval and appraisal rights

What approval rights do shareholders have over business combinations? Do shareholders have appraisal or similar rights in business combinations?

Mergers

Panama law allows a company to be absorbed by another company, regardless of the jurisdiction of incorporation of the companies (merger by way of absorption), and also allows two companies to merge forming a new consolidated entity. Under Panama law, upon a merger becoming effective, the absorbed company ceases to exist as a legal entity by operation of law, and the surviving company assumes all the assets, rights, licences, capital, liabilities and obligations of the absorbed company by universal succession.

Unless the articles of incorporation state otherwise, for a merger to become effective in Panama, a merger agreement must be executed by at least a majority of the directors of each company and approved by the holders of at least a majority of issued and outstanding shares of each company. The merger agreement must then be registered with the Registry of Companies in Panama, whereupon the merger becomes effective, unless a later effective date is defined in the merger agreement.

Stock and asset purchases

Unless the articles of incorporation state otherwise, the acquisition of a company, regardless of whether it is structured as a stock or an asset purchase, generally requires approval from a majority of the directors of the acquiring company. On the other hand, the sale of a company, if it represents all or substantially all of the assets of the seller, generally requires approvals from both a majority of the directors and from the holders of at least a majority of all the issued and outstanding shares with the right to vote of the selling company.

Shareholders do not have appraisal or similar rights in business combinations.

9 Hostile transactions

What are the special considerations for unsolicited transactions?

Hostile or competitive bids are expressly permitted in tender offers. Such competitive bids must comply with certain special provisions of the Securities Law and its regulations, including the filing of an offering memorandum.

There is no statutory obligation imposed on the board of directors or the officers of a Panama corporation to evaluate or transmit to its shareholders hostile bids for a business combination. In general, the board of directors and officers must exercise the duty of care described in question 7.

10 Break-up fees – frustration of additional bidders

Which types of break-up and reverse break-up fees are allowed?
What are the limitations on a company's ability to protect deals from third-party bidders?

There is no legal statute that prohibits or limits the use of break-up fees or other mechanisms to prevent third-party bids, therefore, on the basis of general principles of freedom of contract, the parties to a business combination may agree and be bound by break-up fees designed to frustrate additional bidders. Additionally, commercial trusts are sometimes utilised to ensure that all shareholders commit for a limited time frame to a particular business combination, thus frustrating third-party bidders.

11 Government influence

Other than through relevant competition regulations, or in specific industries in which business combinations are regulated, may government agencies influence or restrict the completion of business combinations, including for reasons of national security?

In general, governmental agencies do not influence business combinations, unless their approval is expressly required, as in the case of mandatory approvals in regulated industries, such as banks, insurance companies, etc. Under the Securities Law, the NSC may suspend tender offers that include false statements or omit material facts that under the law must be disclosed so that the statements made are not misleading in light of the circumstances. Reasons of national security should not influence or restrict the completion of business combinations.

12 Conditional offers

What conditions to a tender offer, exchange offer or other form of business combination are allowed? In a cash acquisition, may the financing be conditional?

In Panama, parties to a contract are at liberty to agree to such terms and conditions, as deemed to be in their best interests, provided that such terms or conditions are not contrary to the law, morals or public policy. Particularly, in cash acquisitions, the availability of sufficient financing may be a condition.

Tender offers may be revocable or irrevocable and must be made to all holders of shares, under the same terms and conditions, and must provide a term of at least 30 days for acceptance. Any shareholder may revoke its acceptance at any time before the expiration of the offer. Once a tender offer is launched, offerors are prohibited from acquiring shares in the target in a manner other than as provided in its terms.

13 Financing

If a buyer needs to obtain financing for a transaction, how is this dealt with in the transaction documents? What are the typical obligations of the seller to assist in the buyer's financing?

If a buyer needs to obtain financing for a transaction, it is generally disclosed in the preliminary agreements such as letters of intent or memorandums of understanding, and the obtaining of such financing is included as a condition precedent to closing in the main transaction agreement. The seller typically has obligations to cause the target company to provide information and cooperate with the buyer's financing efforts.

14 Minority squeeze-out

May minority stockholders be squeezed out? If so, what steps must be taken and what is the time frame for the process?

Squeeze-out procedures are not contemplated under Panama law. However, the most familiar squeeze-out may be accomplished by

way of the dissolution of the corporation and the subsequent acquisition by the majority shareholders of the assets of the corporation, while minority shareholders receive cash as a distribution in liquidation. Majority shareholders may also use other more sophisticated techniques, such as reverse stock splits. Under the Corporation Law, the articles of incorporation of Panama corporations may include provisions that in effect permit the squeeze-out of minority shareholders. Even if such provisions are not included in the articles of incorporation, such result may be achieved through, for example, the addition of a clause providing that no fractional shares will be issued after a reverse stock split and establishing a monetary payment for such shares.

In the case of tender offers for the acquisition of public companies followed by a merger to squeeze out minorities, it is possible to offer greater consideration in the tender offer than in the merger. In these cases, offerors must bear in mind the disclosure obligations provided in the Securities Law (see question 5) as liability may arise for violations thereof.

15 Cross-border transactions

How are cross-border transactions structured? Do specific laws and regulations apply to cross-border transactions?

Panamanian legislation is, in general, territorial in its application. There are no special statutes in effect that establish additional requirements for cross-border transactions. See question 18 for a description of purchase price allocation considerations in a cross-border transaction.

16 Waiting or notification periods

Other than as set forth in the competition laws, what are the relevant waiting or notification periods for completing business combinations?

A business combination that involves a tender offer must include a statutory minimum waiting period of 30 days before the acceptance is effective (see question 12).

In transactions that involve the acquisition of all or substantially all the assets of a commercial establishment, a three-day public notice must be made before payment of the purchase price is effected to enable the creditors to claim against the purchase price or to question the adequacy of the purchase price in anticipation of seller having the right to receive payment free of claims from creditors.

17 Sector-specific rules

Are companies in specific industries subject to additional regulations and statutes?

Governmental approvals, consents, filings and/or notices are required in connection with the merger or acquisition of companies that operate in certain regulated industries. For instance, the merger or acquisition of the stock or assets of a bank or trust company licensed to operate in Panama must obtain prior approval by the Superintendency of Banks. Similar prior approval is required from the National Securities Commission for the acquisition of companies licensed to operate as broker-dealers in Panama. Other similar approvals or notices are required for companies in the insurance, public utilities, and radio and TV industries, among others. Bank mergers and acquisitions may also generate additional potential regulatory issues, as the acquiring company must meet post-merger capitalisation and lending limit requirements.

18 Tax issues

What are the basic tax issues involved in business combinations?

One of the main drivers of any sell-side deal structuring is taxes. The structure of an acquisition is usually influenced to a large extent by a need to make the transaction tax effective for the seller, without

causing adverse tax consequences to the buyer. As Panama generally follows a territorial system of taxation, only Panama-source income (ie, generally income and capital gains realised in connection with a trade, business or real estate transaction in Panama) is taxable in Panama. Thus, mergers or acquisitions of companies organised in Panama that do not carry on any trade or business or own assets within Panama are generally not taxable.

In Panama, mergers or acquisitions are generally structured as either stock-for-stock transactions, stock-for-cash transactions or a combination of both. Acquisitions can also be fashioned as a straight purchase of shares or a purchase of assets. A brief description of the tax treatment of each follows.

Stock-for-stock and stock-for cash mergers

In Panama, stock-for-stock mergers are tax-free transactions, provided that no cash is paid out (except up to 1 per cent of the value of the transaction for adjustments of fractional shares) and certain other accounting parameters are followed. In a stock-for-stock merger, the shareholders of the merged company keep a tax basis on the shares of the surviving company that they receive equal to their average pre-merger tax basis of the surrendered shares.

Stock-for-cash mergers are not tax-free transactions. Gains realised by selling shareholders in these transactions, which are deemed to be gains from Panama-source income, are subject to a 10 per cent capital gains tax. The capital gain is the difference between the selling price allocated to Panamanian sources and the tax basis of the shares owned by the selling shareholder. Notwithstanding the foregoing, the law requires buyers to withhold 5 per cent of the total purchase price allocated to Panamanian sources, as an advance of the capital gains tax and directly pay this amount to the tax authorities within 10 days of the transfer of the shares. It is important to note that the buyers, as well as the target company whose shares are being acquired, are jointly and severally liable with the buyer for the payment of the 5 per cent advance capital gains withholding. If the 10 per cent capital gains tax on the realised capital gain is less than the 5 per cent advance withholding, sellers can request a tax credit for the difference. This credit must be used the same fiscal year than the capital gain is realised. Alternatively, sellers can choose to treat the 5 per cent advance capital gains withholding as the final and definitive capital gains tax payable in connection with the sale of the shares. In practice, most sellers pay the 5 per cent purchase price capital gains withholding, as it is difficult for most sellers to request and use the tax credit on the same year that the transaction took place. Notably, although the capital gains tax only applies to gains from Panamanian sources, to this date no rules regarding purchase price and/or income allocation have been enacted.

Stock purchases

Stock purchases are subject to a 10 per cent capital gains tax on Panama-source gains in the same manner that stock-for-cash mergers are taxed, including the 5 per cent advance withholding obligation. It is worth mentioning that the Department of Revenue of the Ministry of Economy and Finance has repeatedly taken the position that the capital gains tax applies to the sale of the shares of not only Panamanian corporations, but to the sale of any upstream company, regardless of its jurisdiction of incorporation, as long as this company, directly or through one or more subsidiaries, has Panama-source income.

Asset purchases

Asset purchases are generally taxable events in Panama. Gains realised on the sale or disposition of assets located in Panama are generally subject to a 10 per cent capital gains tax. In addition, the transfer of chattel property, such as inventory or equipment, is subject to a value-added tax equal to 7 per cent, and the transfer of real estate is subject to a 2 per cent transfer tax and a 3 per cent capital gains tax. In addition, buyers of an ongoing business concern must be aware that under current tax laws, they will become liable for past taxes

of the business, even if they are buying the assets of the business and not the stock of the company.

Taxation of Dividends for Companies with Operations in Panama

Frequently, M&A transactions involve either a pre-closing dividend to exclude assets from the transaction or a post-closing dividend to distribute gains to shareholder. In this regard, as a general rule, corporations in Panama are subject to a 10 per cent dividend tax (20 per cent if the shares are issued to bearer), on Panama-source income. Thus, income that is not Panama-source income is generally not subject to dividend tax in Panama. However, due to a recent tax reform, if the company paying the dividend engages in commercial or business activities in Panama that requires the company to obtain a business licence (*aviso de operación*), then in addition to paying a 10 per cent dividend tax on Panama-source income, the company is also subject to a 5 per cent dividend tax on non-Panama-source income.

Goodwill

Goodwill is another frequent point of conflict between buyers and sellers. Buyers generally want to be able to claim a tax deduction for the amortisation of any goodwill paid in the acquisition. However, amortisation of goodwill is only deductible in Panama if the seller recognises the goodwill as income on its annual tax return.

Purchase price allocation

Companies with both Panama-source income and non-Panama-source income present a unique tax issue. Since Panama taxes only apply to Panama-source income, any gain realised on the sale or disposition of stock or assets of these companies should be allocated between the two kinds of income, Panama-source and non-Panama-source. In the case of an asset sale, such an allocation is relatively easy to do, based upon the location of the asset. However, Panama has yet to adopt rules of income allocation for stock purchases. As such, in cross-border stock purchases or mergers, transactions are often structured so that the sale of Panamanian-based assets or operations are segregated and sold separately from the operations in other jurisdictions.

19 Labour and employee benefits

What is the basic regulatory framework governing labour and employee benefits in a business combination?

The basic law governing employers and employees is the Labour Code. Also relevant is the Social Security Law, which establishes contributory retirement and pension funds, among other things. In general, the law protects employees of entities involved in a business combination as employees' rights remain unaffected thereby. In a merger scenario, the surviving company assumes the labour relations and liabilities of the absorbed company. Similarly, in stock acquisitions the target company retains responsibility for labour relations and liabilities. However, asset acquisitions present a special case. If the sale comprises all, or substantially all, of the assets so that the business operation is transferred, both the buyer of the assets (as the new employer), and the seller of the assets are, for a one-year period following the acquisition, jointly and severally liable for all labour liabilities arising prior to the acquisition of the assets or business. Furthermore, employees retain all their rights and benefits and no adverse changes can be made to their terms of employment. Thus, in many asset acquisitions and in so far as may be legally feasible, buyers require sellers to terminate all or certain labour relations as a condition precedent to closing, in order to be able to rehire some employees on more favourable terms to the extent permitted by law.

Update and trends

The Panamanian legal system is a civil legal system and therefore, historically, in transactions and other commercial dealings the contract parties relied heavily on statutory law. That is, the parties would contractually address the main obligations, and Panamanian law would fill out the gaps on other issues, which resulted in five to 10-page (or fewer) purchase and sale agreements or even financing agreements. Notwithstanding the foregoing, as the Panamanian economy grew and attracted foreign investment, Panamanian M&A was taken over by common law-style concepts. Now, in traditional deals regarding a Panamanian target company, one will encounter preliminary agreements such as letters of intent or memorandums of understanding, as well as confidentiality/non-disclosure and/or exclusivity agreements. These preliminary agreements are typically followed by a due diligence process dealing with both the legal, operational, financial and technical aspects of the target. The main transaction agreement – whether a stock purchase agreement,

asset purchase agreement or merger agreement – will address all relevant aspects of the transaction in detail. It will contain exhaustive representations and warranties, detailed conditions precedent, mechanisms for purchase price adjustments, escrows, remedies for breach, non-competition, termination, confidentiality, etc. It is unusual to leave an aspect largely unregulated and leave it to the general laws to settle such issues should a dispute arise.

As Panama continues to attract significant regional economic groups, foreign and multinational corporations seeking to take advantage of its unique geographical position, its free markets and its investor-friendly climate, cross-border mergers and acquisitions in Panama, and across the Central American region, are likely to increase. Undoubtedly, the body of legislation affecting mergers and acquisitions in Panama will continue to evolve as transactions involve more international parties and they become more and more complex.

20 Restructuring, bankruptcy or receivership

What are the special considerations for business combinations involving a target company that is in bankruptcy or receivership or engaged in a similar restructuring?

The Commercial Code deals only with bankruptcy liquidation, other forms of bankruptcy reorganisations are not contemplated. A business combination with a target company that is in bankruptcy or receivership may expose the assets of the acquiring company to the creditors of the bankrupt and thus must be carefully negotiated and agreed with the bankruptcy curator and the bankruptcy judge.

Banking institutions subject to intervention by the Superintendent of Banks may be reorganised as determined by the superintendent, who has ample powers to order the sale, merger or consolidation of the bank.

21 Anti-corruption and sanctions

What are the anti-corruption and economic sanctions considerations in connection with business combinations?

There are no anti-corruption or economic sanctions specific to business combinations. Under the Criminal Code of Panama, certain activities constitute criminal offences punishable by imprisonment,

such as those related to market manipulation (unlawfully buying or selling securities or manipulating the price or trading volume of securities for purposes of securing a benefit) and money-laundering (the taking, depositing, trading, transferring or exchanging moneys, securities, properties or other financial assets, for the purpose of hiding or concealing their unlawful origin or for the purpose of using them in political campaigns, if one knew, or should have reasonably known, that such money, securities, properties or other financial assets originated from crimes against humanity, drug-trafficking, arms-trafficking, human-trafficking, kidnapping, terrorism and financing of terrorist activities, child pornography and corruption, paid-for homicides, financial crimes, international bribes and corruption of public officers, intellectual property rights, trafficking with stolen vehicles and other related crimes). Any person who, knowing the unlawful origin of such moneys, securities, properties or other financial assets, uses his employment, office or position to authorise or permit any of the money-laundering activities described above, or hides or obstructs any investigation relating to any such moneys, securities, properties or other financial assets, will also be subject to criminal liability.



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