

Economic Analysis: Ah, Panama

by Martin A. Sullivan

"Panama, Panama. Ain't nothing like it . . ."

-- Van Halen, 1984

It's shaped like an "S" fallen headfirst, with Costa Rica to the west, Colombia to the east, the Atlantic Ocean to the north, the Pacific to the south, and a big canal in the middle. Promoters call it "the new Switzerland." Of course, you can't trust self-interested parties who have everything to gain. But it's not all just hype about Panama. If you want to find a place to stash your cash, Panama has to be high on your list. Maybe even higher than Switzerland. The Swiss are yielding bit by bit to the EU. Nobody is pressuring the Panamanians.

Panama is the complete package. It's got everything you want in a tax haven.

Check out these features:

Stability. When investing in a small foreign country, you want to know first and foremost that its government and financial institutions -- and all the money you're leaving in their care -- will still be around five years from now. You want to be shrewd, like Michael Corleone, who held off investing \$2 million in cash in Cuba in 1957. You'll recall the soon-to-be-deposed Cuban president waved off concerns about rebel activity by joking that "we will tolerate no guerrillas in the casinos or the swimming pools," but the don didn't fall for it.

General Manuel Antonio Noriega, now in a Miami jail on charges of cocaine trafficking and money laundering, was Panama's dictator until the U.S. military ousted him in December 1989. Noriega for Panama and Castro for Cuba are events you as an investor wish to avoid. Fortunately, there is little to indicate that unpleasantness like dictatorship or revolution is in Panama's future. Since the U.S. invasion, four democratically elected presidents have served as leaders of the constitutional government. Panama's current president, Martín Torrijos, whose father, Omar, ruled Panama as a populist military dictator from 1968 to 1981, campaigned on a platform of less corruption, more jobs, and improved security and was elected in

2004 with 47 percent of the vote -- 17 percentage points above his nearest rival.

Panama's economy as a whole is strong. National income is rising at a brisk pace. Per capita income is the highest in Central America. Inflation is lower than in the U.S.

The Panama Canal provides a steady source of revenue that helps keep taxes low for the country's three million residents. Under the terms of the 1977 Panama Canal Treaty, the U.S. has primary responsibility for protection of the waterway. In an October 2006 referendum, 78 percent of voters approved a third set of locks for the canal that will enable passage of larger modern cargo vessels. The estimated cost of \$5.25 billion will be financed by future tolls, and the estimated number of jobs created during the long construction phase of the project is 40,000.

What about the banks? The IMF does not comment on individual banks, but in a recent report ("Panama: Assessment of Financial Sector Supervision and Regulation," Feb. 15, 2007, pp. 7-8), it stated:

Panama's banking system over several decades has achieved regional and global status as an important international financial center. The well-developed banking system comprises established domestic and foreign-owned banks that offer integrated domestic and international financial services.

. . . .

A key strength to the financial sector has been the stable banking system, which has benefited from Panama's continuing favorable economic and business climate.

As of March 2006, assets in Panama owned by Panama banks totaled approximately \$40 billion.

The strong economy and expansion of the canal have fueled a real estate boom in Panama City. Two projects are particularly notable. The Trump Ocean Club Panama is a 65-story, \$220 million building with 300 hotel units, 500 condominiums, a marina, a private beach, and a casino. The project is scheduled for completion in 2009. The proposed Ice Tower, scheduled to open in 2010, will soar 104 stories in the already crowded Panama City skyline and will be the tallest concrete structure in the world.

Finally, Panama's economic and political stability are enhanced by its close historical ties to the U.S. Although the U.S. no longer has military bases in Panama, there is a community of 25,000 U.S. expatriates there. And Panama's elite often educate their children in the U.S. President Torrijos, for example, studied political science and economics at Texas A&M after graduating from St. John's Military Academy in Wisconsin.

Secrecy. Besides stability -- and, of course, zero taxation of your investment income -- what you need most from a tax haven are layers on layers of secrecy. The U.S. government seeks to invade your privacy. You must build a financial fortress with several lines of defense. Your best bet is dealing directly with Panamanian lawyers who can assure you of confidentiality through the attorney-client privilege and who in any case are needed to establish a Panamanian offshore corporation. Avoid any middlemen, especially those working from the U.S. who will surely give up your identity to the U.S. government to save their own necks.

Your lawyers in Panama will supply directors and nominal owners whose names -- not yours -- will appear on the official documents of the public registry of Panama. They will also arrange a bank account for the corporation on which only the corporation's name appears. Panama's banks and their employees are prohibited from revealing any information about depositors to anybody but the Panamanian government. That last disclosure occurs only in the rarest circumstances.

For an extra layer of protection, the shares of your Panama corporation could be owned by a Panama foundation or Panama trust under your control. Or perhaps you would prefer a Nevada shell corporation between you and your corporation. To further secure your privacy, be sure that all bank statements and other information are never mailed to your home address, but instead go to a mail forwarding service in another country.

The U.S. Treasury needs access to information from other countries to enforce its own tax laws. Information exchange provisions are included in tax treaties, but when treaties are not feasible, Treasury tries to obtain bilateral exchange through a tax information exchange agreement. In 2001 Treasury secured TIEAs with the Bahamas and with Antigua and Barbuda. In 2001 then-Treasury Secretary Paul O'Neill made a commitment to expand the U.S. TIEA network to help enforce U.S. tax laws. As a result of those efforts, the U.S. secured agreements with the Cayman Islands (November 2001), the British

Virgin Islands (April 2002), the Netherlands Antilles (April 2002), Guernsey (September 2002), the Isle of Man (October 2002), Jersey (November 2002), and Aruba (November 2003).

In January 2002 Treasury announced that representatives of the Panamanian and U.S. governments had begun discussions of a TIEA (*Doc 2002-666 [PDF], 2002 WTD 6-28*). But in the five years since, no agreement has surfaced. The Panamanians' intransigence on this point is a big reason for Panama's rising popularity with offshore investors, and the lack of a TIEA has done no apparent damage to the Panama-U.S. relationship.

After a year of difficult negotiations, Panama finally agreed to enter into a mutual legal assistance treaty (MLAT) with the U.S. in 1991. The MLAT is used primarily to fight narcotics trafficking, related money laundering, and other serious crimes. "Pure tax" matters are not covered by the MLAT. So unless you are a really bad criminal or you have really bad lawyers, you should have little to fear from the government of Panama.

Reputation. Maintaining reputation is critical to any offshore haven. Any mix with criminal activity like drug trafficking or money laundering drives away legitimate investors who don't want their reputations damaged by association. Loss of investor confidence can snowball into a full-fledged banking crisis. And a bad reputation could spell the imposition of international pressures in the form of restrictions on trade, travel, or financial transactions.

In 2000 the OECD included Panama among the 35 jurisdictions engaged in harmful tax practices. Also in 2000, Panama was identified by the Financial Action Task Force (FATF) as 1 of 15 jurisdictions placed on an FATF blacklist for noncooperation in the global fight against money laundering. After much internal and external haggling, Panama took some small steps toward increased transparency and information exchange, and it was removed from the FATF blacklist in 2001 and from the OECD list in 2002. The FATF praised Panama for its substantial efforts to conform to 40 recommendations set out in a code of good practice governing money laundering.

And what about Panama's standing with the U.S. government? The dark days of the Noriega regime have long

been forgotten, as reflected by the remarks of Secretary of State Condoleezza Rice on a recent visit to Panama City: "The United States and Panama enjoy an excellent bilateral relationship. Perhaps it is exemplified best by the fact that we continue to improve our relations and we do look forward to Congress's ratification of the free trade agreement, which would put our economic relations on an even more sound footing." (State Department press release, 2007/T10-3, June 4, 2007.)

Considering that less than two decades have passed since a major political upheaval and considering its extensive border with the world's leading producer of cocaine, Panama has done a remarkable job of gaining the acceptance of foreign governments and foreign money.

Convenience. Panama is located in the Eastern Standard time zone. Spanish is the official language, but English is spoken by almost all members of the financial community. Although the balboa is the official currency (with its value fixed at US \$1), the economy is fully "dollarized"; U.S. dollars are accepted everywhere. And unlike most other Caribbean offshore centers, Panama does not lie in the usual path of hurricanes (which is one reason why the Panama Canal was built there in the first place). In the grand scale of things, these matters should be relatively minor, but they round out the package nicely.

The Flip Side

The features described so far are what make Panama a prime location for going offshore. Not mentioned in the investment and tourism brochures, however, are Panama's poverty and inequality. In fairness to the promoters, investors and tourists are well insulated from the grimy side Panama's economy. Those unfortunate aspects need not be of any concern in your decision to make use of the country's world-class financial services. On the contrary, you may take some satisfaction from the notion -- consistent with the government's strategy of mitigating the plight of the poor through economic growth - - that your offshore asset protection strategy is boosting an economy where a lot of people can use a helping hand.

According to the World Bank, Panama is a nation of "stark contrasts" and "extreme inequality." The World Bank reports that 40 percent of Panamanians live in poverty and one-sixth are destitute. It goes on to say that Panama's "public administration systems remain underdeveloped, its civil service weak, and a portion of the economy remains sheltered, serving only the domestic market and lacking the dynamism to generate adequate jobs and growth." ("International Bank for Reconstruction and Development Interim Strategy Note for the Republic of Panama, FY2006-2007" (Report No. 32887-PA), Aug. 30, 2005, p. 1, *available at* <http://web.worldbank.org>.)

According to UNICEF ("At a Glance: Panama," *available at* <http://www.unicef.org/infobycountry/panama.html>), the wealthiest 20 percent of the population has an annual family income 32 times that of the poorest 20 percent. That places Panama among the countries with the highest levels of economic inequality in the world. Malnutrition affects about 19 percent of the population.

The agency also notes that more than 50 percent of children under the age of five live in conditions of poverty, and nearly 30 percent in conditions of extreme poverty. Also, Panama is one of the two Central American countries that have experienced a rise in chronic malnutrition of young children in the last six years.

Doing your financial business in Panama can help the overall economy, but, as indicated in the World Bank's 2005 report on Panama (pp. 6-7), that stuff before about helping the poor by investing in Panama may just be wishful thinking:

Despite averaging 3.5 percent annual real GDP growth between 1997 and 2003, ambitious poverty reduction programs adopted by successive administrations and some progress in reducing extreme poverty, moderate poverty rates in Panama remained practically unchanged. This suggests that the country's high levels of income inequality and structural issues in economic and social policy are preventing growth from effectively reducing poverty.

*Martin A. Sullivan is a contributing editor to
Tax Notes International.*

E-mail: martysullivan@comcast.net