Superintendencia de Bancos de Panamá

Criteria for interpreting the FECI:
Responses to Inquiries on Withholding

1. To apply the withholding, it is the purpose of the loan and not the nature of the beneficiary that must be considered.

2. A loan transaction is considered executed when the funds are delivered or made available to the borrower.

3. The classification of a loan with regard to withholding is not modified by refinancing, extension or payment arrangement.

4. Each Bank and Finance Entity is entitled to classify loans as personal, commercial or as loans allocated to other sectors mentioned in paragraph d of Article 28 of Executive Decree 29 of 1996, following the usual classification criteria applied by the Bank or Finance Entity.

5. Withholding calculation is the same as interest rate calculation, so it does not permit calculations based on fractions of a day.

6. Personal and commercial loans granted before the enactment of Law 4 of 1994, i.e. before 19 May 1994, will continue to be subject to a 0.5% withholding until the contracted due date of the loan.

   All domestic personal and commercial loans granted between 19 May 1994 and 22 June 1995 (the promulgation date of Law 28 of 1995), regardless of the amount, will be subject to the 1% withholding until the loan is satisfied.

   Loans granted after 22 June 1995, **for an amount equal or less than B/.5,000.00** will be exempt from withholding, even though they are classified as domestic personal or commercial loans.

7. Pursuant to the provisions in Article 9 of Executive Decree 29 of 1996 regulating Law 4 of 1994, the amount that is the basis for the interest rate calculation is understood to be the amount of the loan. As a result, those loans whose amount is over B/.5,000.00 will be subject to withholding.

8. The guarantee of personal and/or commercial loans with bonds, securities or shares does not change the withholding status of the loan.

9. Interbank allocations or interbank deposits are not subject to withholding. Nevertheless, if a bank has interbank transactions through loans classified as domestic commercial loans, these loans will be subject to the application of withholding.

10. The balance for the partial use of a line of credit of indefinite or definite term, as well as the daily average balance on overdraft demand deposits, domestic personal and commercial loans originated after 22 June 1995 (the date on which Law 28 of 1995 was promulgated), for an amount of or less than B/.5,000.00, will not be subject to the withholding in Law 4 of 1994.

11. The balance for the partial use of lines of credit of indefinite or definite term, as well as the daily average balance on overdraft demand deposits, domestic personal and commercial loans originated before the enactment of Law 28 of 1995, regardless of the amount, will continue to be subject to the application of 1% withholding until the loan is satisfied.

12. Loans granted for engaging in industrial activities will be exempt from withholding. Industrial activities are those that involve the transformation of raw material into a finished product. Related activities such as distribution and commercialization are not included.

13. Loans for the construction of facilities or expanding those places already built, housing the workforce and capital assets (machinery and equipment) are exempt from withholding beginning 15 May 1997. (Executive Decree 21 dated 12 May 1997).

14. Tourism is classified as an industrial activity and, consequently, the domestic loans destined to that activity are exempt from withholding pursuant to Executive Decree 79 of 2003.

15. Extraction activities are not classified as industrial activities. Extraction, mining and quarrying are not excluded from the definition of personal and commercial loans.

16. Construction loans granted pursuant to Law 4 of 1994 are not exempt from interest rate withholding.

17. Traditional fishing is that carried out near the shore, with small boats generally having outboard motors and weighing less than 10 gross tons, by simple or rudimentary fishing methods and on journeys of no longer than five days. Fishing that does not meet these conditions will be not considered traditional fishing. Thus, loans destined for purchasing, operating and maintaining tuna or shrimping vessels are not exempt from withholding.

18. For a loan to be qualified as a home mortgage loan, the finance entity must verify the following: 1- The loan is destined for the acquisition (purchase or construction) of the beneficiary's main residence; 2- The loan actually pays for the acquisition or construction of the residence, i.e. the contractor, developer, or seller will receive the amount of the loan; 3- The loan will substitute for or cancel any other temporary ("interim") loan previously existing.

19. Only the loan for the acquisition of a main home, understood as the one in which the borrower actually lives, is exempt from withholding. The home exemption may be used for only one loan meeting such conditions. The existence of two or more loans exempt from withholding based on the argument that they have been classified as home mortgage loans, is not viable.

20. For loans granted to a legal entity for the purchase of a house or apartment, there is a de facto presumption against its being considered a home mortgage loan, since natural persons are the ones living or residing in a facility, making it their home. Nevertheless, lender and borrower can

obviate the de facto presumption with evidence showing that in fact the real beneficiary is an individual who is responsible for the credit liability.

21. Loans granted to an individual to remodel his home can be classified as home loans. However, it is up to each Bank or Finance Entity to qualify loans according to the classification referred to in Art. 28, paragraph d of Executive Decree 29 of 1996.

22. If under the criteria of the previous paragraph (number 21), loans granted to refinance loans for the acquisition of homes are classified by the Bank or Finance Entity as home loans, they will not be subject to the withholding in Law 4 of 1994. If, on the other hand, the Bank or Finance Entity classifies these loans as personal or commercial, the loans will be subject to withholding.

23. If a loan has several components, some destined for exempt purposes and others for non-exempt purposes (e.g. acquisition of a building with homes and business locales), the exemption in favor of one of them does not devolve to the others. It is necessary for the borrower to identify the amount utilized for exempt purposes; otherwise, withholding will be applied to the entire loan.

24. The right to benefits granted by Law 9 of 1997 (Casco Antiguo Revitalization) does not by itself authorize the exemption of withholding. The loan can avail itself of the incentives in Decree Law 9 of 1997 and the exemption from withholding in Law 4 of 1994 only to the extent that the loan complies with the requirements of Decree Law 9 of 1997 and Law 4 of 1994.

25. Acquisition or construction of a country house (second home) is not exempt from withholding.

26. Loans granted by banks in favor of Savings and Loan Associations, authorized by the Banco Hipotecario Nacional (National Mortgage Bank) in accordance with Law 39 dated 8 November 1984, are not exempt from withholding.

27. Not all loans secured with mortgages qualify as home mortgages. The mortgage created as collateral for domestic personal and commercial loans does not permit the classification of those loans as home mortgages and, therefore, they are subject to withholding.

28. As of the enactment of Law 49 of 2009 (i.e., as of 18 September 2009) new loans granted in international free trade zones owned or managed by the Colon Free Zone or any other Zone or free trade area established or that will be established in the future, will be considered domestic commercial or personal loans and, therefore, will be subject to the 1% FECI regime withholding.

    All new loans greater than B/.5,000.00 granted to businesses located in the Colon Free Zone or any other Zone or free trade area established or that will be established in the future, will be considered domestic loans, and therefore will be subject to the referenced FECI regime withholding, except those secured with savings or time deposits.

29. A borrower's activities must be classified based on the overall tenor of his business and not on each separate transaction.

30. A domestic loan is one granted to individuals residing in Panama or legal entities established pursuant to Panamanian law and obtaining taxable income in Panama, or to foreign legal

entities having branches authorized to operate in Panama and the Panamanian branch is responsible for the loan.

31. Domestic personal and commercial loans guaranteed with bank deposits, *i.e.* savings or time deposits, will be ***exempt from the 1% withholding***, according to Law 4 of 1994, as provided for in the amendments introduced by Article 31 of Law 69 of 2009. This Law governs the loans guaranteed with bank deposits that were generated after the enactment of Law 49 of 2009, and banking institutions are ordered to refund the FECI withholding that has been withheld since 18 September 2009 on loans guaranteed with bank deposits.

    As of 3 May 2004, the 1% surcharge calculation is made exclusively based on the amount exceeding the guarantee, stated above; i.e. the withholding will be applied on the portion that is not guaranteed with a time deposit.

32. Pursuant to the considerations issued by the Office of the Administrator General with regard to the application of banking benefits granted to retirees and pensioners by Law 6 of 1987, as amended by Laws 18 of 1989 and 37 of 2001, this regulation is not restrictive and does not exclude any person retired under any system other than the Panamanian Social Security System. In this sense, loans granted to persons benefiting from retirement or pensioner programs other than the Panamanian Social Security System, whether public or private, domestic or foreign, such as those offered by Pension Fund Administrators or by the Former Panama Canal Commission, **are entitled to an exemption to the one percent (1%) withholding.**

33. Law 14 dated 22 January 2003, published in O.G. 24,728 dated 28 January 2003, defines a Senior Citizen as a woman who has reached 55 years of age and a man who is 60 years old, regardless of whether or not they are pensioned or retired.

34. Loans granted to companies engaged in Leasing are not exempt from withholding. However, there will be no withholding on the leasing contracts entered into with their clients.

35. Loans granted to companies engaged in “factoring” are not exempt from withholding. However, withholding is not required in the case of “pure factoring” operations – i.e. when the transaction is an unsecured purchase of invoices. These operations will be exempt from the FECI payment.

    Nevertheless, when the factoring agreement is similar to a loan agreement, providing the client’s invoices as collateral, the operation will be subject to the 1% FECI withholding requirement.

36. The credits granted by a commercial establishment through credit cards will be subject to withholding, as long as they are over the B/.5,000.00 limit. The above is applied to the entire balance and not exclusively to the portion exceeding B/.5,000.00

37. The exception to the application of withholding in Article 2 of Law 4 of 1994 is in favor of loans granted **to** credit unions, not loans granted **by** credit unions.

38. For the purposes of the exemption of withholding referred to in Paragraph 9 of Article 13 of Executive Decree 29 of 1996, it is not enough that the loan be destined to finance the execution of contracts resulting from public tenders such as Pricing Applications (formalized by Purchase

Orders), Public Bids, Work Contracts, Service Rendering Contracts, Supply Contracts or even Direct Contract Agreements. The borrower that will execute such contracts must also be a *concessionaire* of the State.

39. The loans granted by financial organizations to individuals and legal entities for financing through bonds or securities are not exempt from withholding. For the exemption to be applied, the finance entity must directly fund the issuance of bonds and securities duly registered with the National Securities Commission.

40. A Decision of the Third Chamber for Contentious Administrative Matters of the Supreme Court of Justice dated 1 February 2006 determined that a fifteen (15) year period must be taken into account in the case of FECI claims, as the period of one hundred and eighty (180) days provided for in articles 16, 20, and 21 of Executive Decree 29 of 1996 is not applicable for the restitution or reimbursement of amounts paid improperly.

41. Any loan granted for the acquisition of property in certain domestic business locales, qualifying as a domestic personal and commercial loan and whose amount is greater than B/.5,000.00 will be subject to the application of the 1% annual FECI withholding pursuant to the provisions of Article 796 of the Commercial Code, which establishes that commercial loans will always be repayable.

42. In cases where the purchase or construction of the main home for the final beneficiary of a loan is made prior to the granting of the loan, the loan may be considered a "home loan" exempt from the 1% FECI withholding as long as it meets the following conditions:

    - That the loan applicant has not entered into any prior loan contract, already paid off, for the purpose of funding the purchase or construction of the same principal home that he now wants to fund with the new loan, regardless of whether or not said home was given as collateral,
    - That the loan requested is not intended to recoup the monies used to make improvements to the main home, and
    - That the Bank has procedures and policies that allow it to request its customer provide any documentation necessary to determine clearly the intent to use the loan for the direct purchase or construction of the loan beneficiary's main home.

43. Factoring is a financial activity that basically consists of a bilateral agreement or contract in which a person (the factor) acquires the commercial invoices, payable on demand or short-term, from another person (the customer) who is a supplier of goods and/or services that needs to obtain liquidity before such credits come due.

    There any various legal constructs that could be similar to the factoring agreement. However, the transfer of credits seems to follow the main purpose of a contract as inferred in Law 4 of 1994. As a result, the factor acquires the right to the invoices and, theoretically, the customer is not liable for the debtor's solvency, with the factor lacking any right of return or action against its customer.

That contract in which the factor includes clauses in the contract delineating the recourse that can be applied against its customer if the credit in the invoices cannot be recouped from the debtor, the law (Article 2 of Law 4 of 1994) calls "financial factoring with recourse."

The 1% withholding is applicable to contracts of the financial factoring modality, and will accrue on the total amount of the invoices transferred by the grantor to the finance entity. The Commission bases its decision on the fact that the price of the factoring operation is the value of the credits less the fees, interest, and any other charge, if applicable, due to the risk of default.

The Commission considers that factoring with or without recourse **is not a loan** that can be contracted and later paid or satisfied in advance. As provided for in Law 4 of 1994, Factoring is the transfer of credits. In that sense, the factor (the bank or finance entity) acquires from its customer (the grantor) the rights stated in the invoices and the customer is no longer liable for the debtor's solvency on those invoices. That being the case, the grantor does not owe anything to the factor, and the factor will have to take all necessary action to manage and collect the credits. Thus the grantor could hardly pay, in advance, a debt to which he and the factor have not agreed.

The Commission considers a loan secured with invoices an entirely different matter. In that case, we would be facing a pledge loan in which the finance entity grants credits for an amount less than the pledge amount, among other things, assuming that the debt can be increased because of interest, judicial expenses, if applicable, and the possible devaluation of the goods at auction.

If so, banks and finance entities may calculate interest and the 1% that corresponds to FECI, using as a base the amount of the loan and can, as of now, claim reimbursement in cases of an advance payment. But it is important and obligatory to stop calling loan operations Financial Factoring. This is mainly due to the fact that the FECI Commission must pay attention to the fact that factoring companies might be engaged in habitually granting loans without being authorized, regulated, or overseen by any authority competent to do so.

Furthermore, the Superintendency of Banks requires that all loans granted by its regulated entities be verified in accordance with credit risk management and other applicable provisions included in the banking regime.

44. Domestic personal and commercial loans greater than B/.5,000.00 granted for the purchase of shares in a Corporation are subject to the 1% FECI withholding, regardless of the property owned by the corporation, due to the fact that these loans are not exempt under any provision of Law 4 of 1994. This means, this activity is not exempt from the FECI regime.

45. Solely for the purpose of applying the FECI Regime, foreign loans are considered those loans that are: (i) granted to a nonresident individual or legal entity, which although still domiciled or registered in Panama, does not have operations in the country and (ii) whose money obtained from this loan is used exclusively abroad, not in Panama, and cannot in any way be considered to serve a domestic purpose.

    At the same time, there could be a case in which a loan has a portion that can be classified as a foreign loan, to be used abroad and therefore exempt from the 1% withholding required by the

FECI Regime, and another portion, classified as a domestic loan, which will be used domestically and is subject to the 1% withholding of the FECI Regime.

It is also feasible for the bank granting the loan classified as a foreign loan to permit the borrower to request the disbursement of all or part of these funds to an account in the same bank, exclusively destined for transferring these funds abroad or for receiving payments inherent in that financing, but this account must not generate interest.

Criteria for interpreting the FECI:
Responses to inquiries on the Interest Rate Discount

1. The favorable classification of a loan for receiving the interest rate discount is not lost because of its refinancing. However, in order to determine the applicability of the discount, the Bank is responsible for checking that the original loan received a favorable classification for the Interest Rate Discount, because the cancellation of a previous obligation is not considered a qualification for receiving the Interest Rate Discount. This is a necessary condition to recognize the continuity of the Interest Rate Discount for the new loan.

2. The favorable classification of a loan for receiving the interest rate benefit is not lost due to the debtor's delinquency, as long as the delinquency is due to reasons beyond his control, but the application of the discount and recognition of the benefit are suspended as long as the delinquency lasts.

3. The loan delinquency does not cancel the right of the bank or finance company to receive payment for the discount granted. However, the bank or finance company will be compensated only in relation to the amount of the debtor's payments. This is the case because compensation is directly linked to the discount received by the debtor, a discount which he received only when he makes payments on the loan.

4. Law 28 dated 20 June 1995, in force as of 22 June 1995, amended Article 1 of Law 4 of 1994 by adding five (5) conditions or requirements that must be present in loans to be allowed the discount. A maximum amount of B/.200,000.00 per item per production cycle was established among these requirements.

   Therefore, loans granted after the enactment of Law 4 of 1994, that is, after 19 May 1994, but before the promulgation of Law 28 of 1995, i.e. before 22 June 1995, qualify for the interest rate discount under the conditions of Law 4 of 1994. On the other hand, loans granted after the enactment of Law 28 of 1995 exceeding B/.200,000.00 per item per production cycle, are disqualified **in their entirety** from receiving the interest rate discount.

5. For lines of credit contracts to qualified sectors, the loan amount will be the amount used by the borrower, regardless of the maximum amount authorized by the contract. So, in cases of lines of credit for amounts greater than B/.200,000.00, the first B/.200,000.00 may receive the discount regardless of whether it is used all at once or in increments, or whether it is an overdraft on a current account. The modality under which the loan is granted is not relevant for the effects of the interest discount.

6. As of 1 February 2002, the discount percentage applicable for loans previously granted as well as for new loans granted to qualified members of the agriculture sector and to exporters of non-traditional products from the agro-industrial sector, is **three and a half percent (3.5%)**.

   Domestic loans to qualified members of the agriculture sector and to exporters of non-traditional products from the agro-industrial sector that were current as of 22 June 1995 (the enactment date of Law 28 of 1995), shall maintain the 4% discount until the obligation is satisfied.

Loans to qualified members of the agriculture sector granted after entry into force of Law 28 of 1995, but provided before the new discount percentage was fixed, that is, made between 22 June 1995 and 30 June 1995, inclusive, are entitled to a discount of four percentage points (4%) on their interest rate for the interest owed through 30 June 1995. As of 1 July 1995, the applicable discount percentage is reduced to 3.50%.

7. An agriculture producer is any individual or legal entity engaged in agricultural activities, whether he/it depends of that activity or those activities are the source of his/its income (Law 2 of 1986).

8. For an individual or legal entity to have access to the Interest Rate Discount, he must meet the requirements of an agriculture manufacturer pursuant to the provisions stated above. This discount cannot be accessed by those persons acting only as promoters or intermediaries in agricultural activities.

9. Only one (1) loan for one (1) item, for one (1) production cycle is permitted. When the production cycle ends, a new loan may be granted. In those cases that, due to the very nature of the activity to be developed, it is understood that the production cycle is one year, only one operation per year will be feasible.

10. The concept "item" involves both the product and the purpose of the loan. So different combinations of products and purposes to be funded can be envisioned. For example:

    Item 1: red kidney beans (product)/sowing (purpose)
    Item 2: red kidney beans (product)/raw material (purpose)
    Item 3: potatoes (product)/sowing (purpose)

11. The limits on transactions, amount and production cycles are applied according to the line items. So, loans destined to each line item are subject to those limits for the purposes of the requirements considered in Paragraph III.1 of Article 6 of Executive Decree 29 of 1996.

12. The agreed term of loans granted in each production cycle will depend precisely on the item's components, and such limitations in time are exclusively established for the purpose of restricting qualified credit operations to just one (1) per line item and production cycle.

13. The funding for acquiring land destined for qualified activities and for land use planning for performing such activities qualifies for receiving interest rate discounts. Article 6 of Law 4 of 1994 does not envision the recognition of discounts on loans granted for land leasing.

14. A loan granted originally for the acquisition of land destined for engaging in a benefited activity qualifies for a discount. Refinancing of this loan does not affect its classification.

15. Logging, by itself, is not within the activities and purposes approved for an interest rate discount.

16. The acquisition of land already reforested is not approved for an Interest Rate Discount because, in this case, the loan was not destined to a new agricultural investment, but to substitute for an investment that was already made.

17. Drying and milling of rice and other grains (sorghum, corn, and coffee) qualify as industrial activities. The utilization of agricultural raw material to develop this activity is not enough by itself to be classified as an agriculture activity. In this sense, the loans destined for this activity will not receive the interest rate discount.

18. The payment of taxes, rates or levies of any nature does not qualify for the interest rate discount.

19. Horse breeding is not within the activities qualified for the interest rate discount. Regardless of its consideration as an Agriculture Sector activity, horse breeding does not benefit from the interest rate discount.

20. For reasons of technical or financial convenience, some corporations organize their activities into several production farms belonging to one company while others have as many companies as production farms. In the case of several borrowing companies, it is feasible for each of them to have access to the interest rate discount on a qualified loan transaction up to B/.200,000.00 per item per production cycle. In the case of a sole borrowing company, the limit will be applied and capped as soon as a transaction for the amount established by Law per item per production cycle is completed.

21. Only agro-industry that exports non-traditional products is qualified to receive the interest rate discount. Article 2 of Law 108 of 1974, whereby production benefits are created, identifies the following exports as traditional items: sugar cane; banana (fruit) and banana puree; cane syrup and molasses; cocoa beans; coffee beans; fresh, chilled or frozen shrimp; fresh, chilled or frozen beef; untanned cattle hides; cattle, pigs, sheep, and horses, on the hoof; fishmeal, other oils from fish and marine animals; scrap metal; unprocessed tortoise shell; fruit extracts (citric); petroleum and its derivatives; sales under bilateral free trade or preferential treatment agreements; foreign sales from the Colon Free Zone; minerals, metals and their derivatives, cut wood; fresh, chilled or frozen lobster and shark fins. Consequently, products that are not listed in Article 2 are treated as non-traditional.

22. A loan for the acquisition of a truck, combine harvester or a vehicle could qualify as a capital asset and as such, acquire an interest rate discount as long as that good is destined to a qualified activity.

23. Plant and flower production is included within the agriculture sector.

24. Restitution is a mean to settling obligations contemplated in the Civil Code. Finance companies are not allowed to unilaterally resolve the reimbursement applications submitted to the Superintendency, nor discount directly from the withholding made from domestic personal or commercial loans greater than B/.5,000.00 that were already granted. The obligation to remit the total amount withheld as withholding cannot be compensated with possible reimbursements that the Superintendency of Banks must make to the same financial entity for discounts made on the interest rates.

25. Sworn Affidavits and evidence of destination of the investment. Article 5 of the Law and Article 24 of the Regulation require any person receiving a loan with an interest rate discount to provide a sworn affidavit on the destination (activity and purpose) of the loan in the format and manner required by the Superintendency. In this sense, sworn affidavits made generically or not

responding specifically to the activity to which the loan is destined shall not be admissible. In any case, this Sworn Affidavit is not definitive proof authorizing the utilization of funds from a loan. In order to prove definitively that the credit granted an interest rate discount is destined to the sectors benefited with a discount, banks and finance entities must require their borrowers to provide evidence of the destination of the funds through invoices, purchase orders and other documents by which the use of the credit in qualified activities and purposes is verified.

26. "Minor species" refers to the production and raising of animal species smaller than cattle or horses. These species refer to those that must be technically improved to facilitate their handling and production in order to obtain, on the one hand, animals that can be easily commercialized and, on the other, economic benefits for the producer.

    For the purposes of the FECI system, the following items are considered "minor species": quail, partridges, pigeons, rabbits, peccaries, guinea pigs, agoutis, pacas, frogs, iguana, bees, sheep, and goats.

27. "Compensation," understood for the purposes of the FECI Regime as a process by means of which an agriculture producer obtains a subsidized loan to compensate for an investment previously made in its production cycle, is not contemplated in the purposes defined in Article 6 of Law 4 of 1994 for the development of the activities listed in the above regulation. Consequently, Compensation cannot be used as a reason in obtaining a subsidized agriculture loan.

    Regarding recent inquiries and doubts on that topic, and without prejudice to the clarification above, the FECI Commission provides the following Criteria:

    1. The Commission would accept the viability of the following scenario: For example, an agriculture producer arranges a Bank loan for one of the purposes prescribed in the law, to conduct any of the subsidized activities. During the period between the formalization of the loan and its effective disbursement, the producer uses his own funds or funds from any other determined origin for the activity. After having been granted the loan, he covers the alternate resources, whether his own or another party's, with the proceeds of the loan. The loan is granted, in principle, for the **purpose** provided by law.

    2. The Commission would also consider it feasible if, contrary to the scenario in paragraph 1, the investment of his own or any other resources and the subsidized loan application within the FECI Program are made concurrently or within a period not greater than sixty (60) calendar days after the investment is made, and the reason for applying for the loan *a posteriori* is adequately justified to the bank. In that case, the loan would be classified as a loan to pay for a **purpose** previously acquired.

    3. In either of the cases provided in paragraphs 1 and 2, the Bank would be required to make the relevant verifications, including the determination of the origin of funds, before the relevant approvals, and it would be subject to auditing by the Program conducted by the Superintendency of Banks.

    The criteria in paragraphs 1, 2, and 3 will be taken into consideration by the Superintendency of Banks as of its communication through a Circular it will issue.