Panama: Changes introduced to transfer pricing legislation

January 9, 2017

In brief
Executive Decree No. 390 of October 24, 2016 (Decree No. 390) was published by the Tax Administration of Panama for the purpose of regulating the arm’s-length principle outlined in Chapter IX, Title I, Book Four of the Tax Code, and amending articles of Executive Decree No. 958 as of August 7, 2013.

In particular, based on this Decree the information required, at the Group and taxpayer level, has been expanded and is more specific. As a consequence, taxpayers will need to analyze and provide more information and data for transfer pricing documentation purposes.

In detail
Decree No. 390, published in the Official Gazette 28.146 as of October 24, 2016, aims to update the applicable transfer pricing rules to thwart instances of tax avoidance as perceived by the Tax Administration of Panama. Below is a summary of the content of Decree No. 390:

Transactional analysis
- All intragroup transactions (income, costs, and expenses) executed by the taxpayer with foreign-related entities should be analyzed on a transactional basis, except in those cases in which two or more transactions are jointly integrated from an economic point of view or are considered as a continuation of one another and therefore cannot be properly valued separately.

Comparability analysis and adjustments
- Decree No. 390 establishes that the information over several fiscal periods can only be used when doing so adds value to the transfer pricing analysis.
- For the application of adjustments, it is necessary to take into account certain provisions (e.g., quality of the information subject to the adjustment, purpose of the adjustment, reliability of the criteria for performing the adjustment, among others) to be considered in the analysis performed.
- In order to determine if two or more transactions are considered comparable, it is necessary to take into account the characteristics, functions, contractual clauses, economic circumstances, and commercial strategies.
- Internal comparables shall prevail over external comparables.
- External comparables located within the Republic of Panama (i.e., local external comparables) shall prevail over international comparables.
Transfer pricing method and arm’s-length range

No significant changes were introduced by Decree No. 390 regarding the transfer pricing methods; however emphasis is made to the determination of the arm’s-length range which consists of: “...values found between the first and the third quartile”. When the price or margin established for intragroup transactions falls within the arm’s-length range (established as the interquartile range), the Tax Authorities will consider that the price/margin complies with the arm’s-length principle. Otherwise, the taxpayer must perform adjustments to the median of the arm’s-length range.

Content of the transfer pricing report

Decree No. 390 introduced changes regarding the content of the Transfer Pricing Report by expanding the information to be included as follows:

- General information required regarding taxpayer:
  - Information regarding intragroup transactions performed, specifying amounts and the related parties for each type of transaction.
  - Tax information of the taxpayer and the foreign-related parties with which intragroup transactions were performed (name, legal address, and tax number identification).
  - Organizational chart of the taxpayer and of the multinational group to which it belongs.
  - Type of relationship with its related parties (direct or indirect).

- Analysis of the industry in which the taxpayer operates.

- Analysis of the economic sector in which the taxpayer operates.

- Key competitors of the industry in which the taxpayer operates.

- Detailed description of the functions or activities performed by the taxpayer and its foreign related parties, to the extent that these affect or are affected by the intragroup transactions subject to analysis, including a description of the assets employed and risks assumed by each of these parties.

- Detailed description of the transactions carried out with foreign-related parties, including the context in which these transactions were performed.

- Information used to determine the arm’s-length value of intercompany transactions indicating the transfer pricing method or methods used.

- Detailed analysis of comparability in accordance with the provisions of Article 762-E of the Tax Code and Article 4 of Decree No. 390, including any change in the analysis regarding previous fiscal year.

- Reasons for the selection of the transfer pricing method for each type of transaction and detailed explanation of the reasons for rejection of the methods described in Article 762-F of the Tax Code.

- Summary of the facts or circumstances taken into consideration in the application of the transfer pricing methodology for each transaction carried out with foreign-related parties.

- Financial and fiscal information used in the application of the transfer pricing method selected for the analysis of the intragroup transactions.

- Details of search strategy performed in selecting comparables, including quantitative and qualitative criteria and matrix of acceptance and rejection.

- List and description of external and/or internal independent transactions selected as comparables.

- Public information or audited financial information of the comparables including the business description.

- Audited financial statements of the taxpayer corresponding to the fiscal year during which the taxpayer performed intragroup transactions subject to analysis.

- Demonstration that that financial data used in the application of the selected transfer pricing method is consistent with the annual financial statements.

- Segmentation criteria of the financial data of the comparables used in the transfer pricing analysis, as well as the sources and the dates on which the information was obtained.

- Detailed explanation of the reasons for the use of information corresponding to more than one single year, for each intragroup transaction.
- Detailed explanation and justification for the use of comparability adjustments indicating whether the adjustments were performed only to the tested party, only to comparables, or both. The aforementioned is required for every intragroup transaction executed and subject to analysis.
- Explanation of the reasons for the selection of the profit level indicator; depending on the selected transfer pricing method.
- Detailed calculation of the arm's-length range.
- Explanation of the reasons which lead to the conclusion that intragroup transactions subject to analysis were performed in accordance with the arm's-length principle, as a result of the transfer pricing method selected for the analysis.

**Information and documentation relating the Group:**

In order to promote the adequacy of the transfer pricing analysis, taxpayers should provide, upon request of the Tax Authorities, the following information and documentation, to the extent the information and documentation is economically relevant regarding the intragroup transactions performed:

- Description of the aspects that produce benefits to the Group.
- General description of the value chain of the five major products and/or services offered by the multinational Group, as well as the description of the geographical markets in which it operates.
- The financial statements, or equivalent report of the group.

- List and brief description of the service agreements in force between entities of the Group that affect the intragroup transactions performed by the taxpayer subject to analysis, including description of the methodology for the attribution of costs as well as transfer pricing policy applied.
- List of intangibles of the multinational Group that affect the intragroup transactions performed by the taxpayer, including information regarding the legal ownership.
- General description of the transfer pricing policies applied within the Group regarding financial transactions that affect the intragroup transactions performed by the taxpayer.
- A list of Advance Pricing Agreements in force within the Group that affect the intragroup transactions performed by the taxpayer.
- Detailed information on whether the taxpayer has been part of a business restructuring process or whether it has been affected by a business restructuring process performed within the Group and description of how the restructuring process affects the taxpayer.
- Detailed information on whether the taxpayer has participated in the transfer of intangibles and explanation of how the aspects of these transactions affect the taxpayer.
- A description of the functions, assets, and risks assumed by the related entities, to the extent they affect the related transactions performed by the taxpayer.

**Validity**

Decree No. 390 entered into force January 1, 2017, subrogating Articles 1, 2, 3, 4, 5, 6, 7, and 8 of Executive Decree No.958 of August 7, 2013.

**The takeaway**

Executive Decree No. 390 implements changes to the analysis of intragroup transactions and to the content of the Transfer Pricing Report. The information required, particularly at the Group level, has been expanded and is more specific. As a consequence, taxpayers will need to analyze and provide more information and data for transfer pricing documentation purposes.
Let’s talk
For a deeper discussion of how this issue might affect your business, please contact:

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