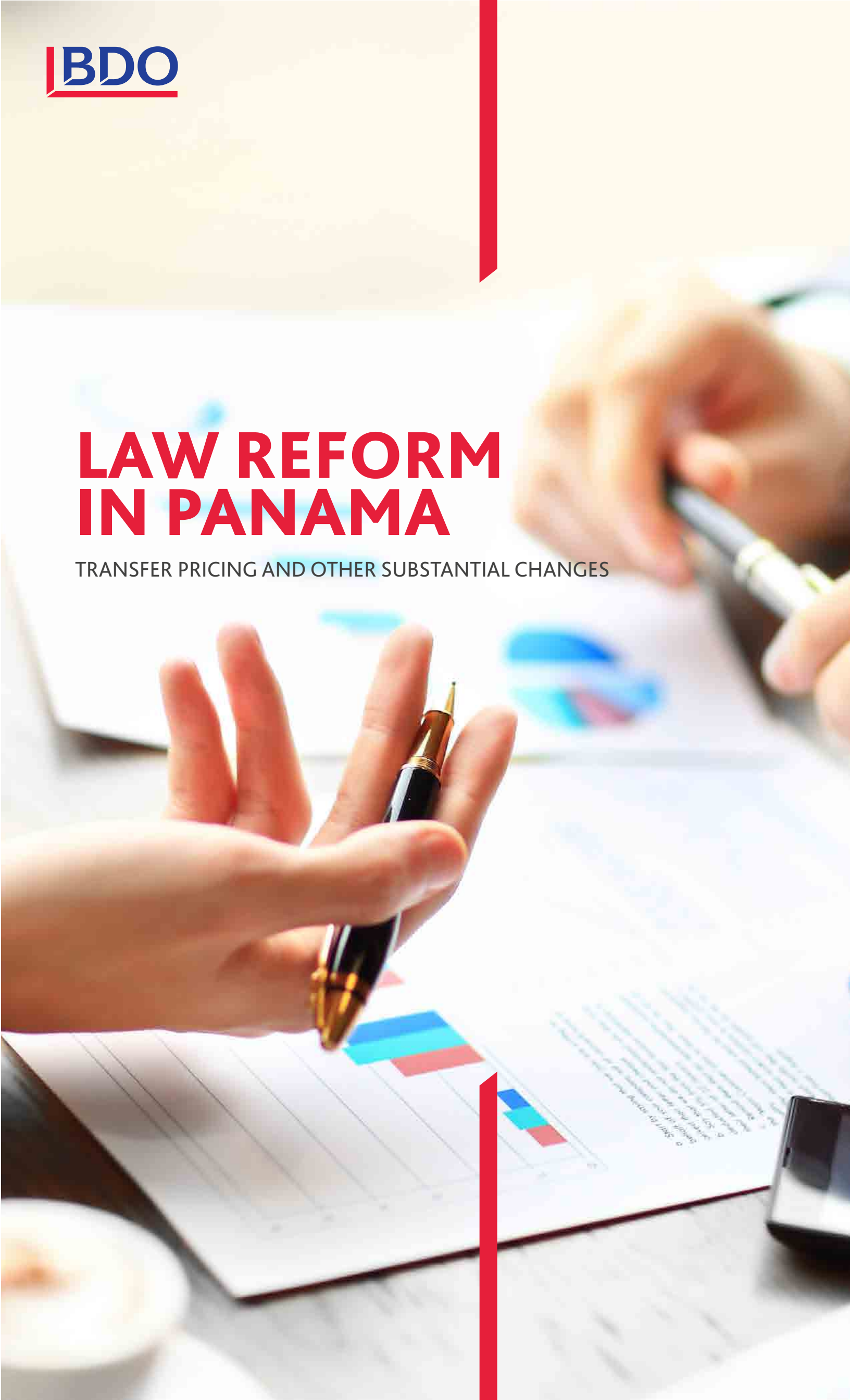


LAW REFORM IN PANAMA

TRANSFER PRICING AND OTHER SUBSTANTIAL CHANGES



On 24 October 2018, Law N° 57 introduced amendments on Law 41, 2007, which created the special regime on Multinational Companies Headquarters (MHQ or SEM, Sede de Empresa Multinacional).

Formerly exempt from Corporate Income Tax and Transfer Pricing Compliance, the new Law contains substantial changes on both fields for SEM Entities.

The most significant points of Law N° 57, 2018 are found mainly in the modification of the tax regime, and in the fulfilment of the documentation and analysis of the intercompany transactions under the local Transfer Pricing Provisions.

WHAT SERVICES ARE ESTABLISHED IN THE SCOPE OF THE SEM REGIME?

The main objective of this special regime is to set up the conditions for the creation of Regional Service Centers or Headquarters in Panama.

The SEM Regime includes technical, financial and/or administrative assistance, as well as other support services. The range of services is comprehensive and also includes, financial management services, credit and risk analysis, due diligence and a data processing centre.

WHO ARE THE RECIPIENTS OF THE SERVICES?

Under the SEM Regime Law, the main function of a Multinational Company recognised as SEM (MHQ) will be providing the above-mentioned services to related entities.

PARTIAL ELIMINATION OF TAX BENEFITS

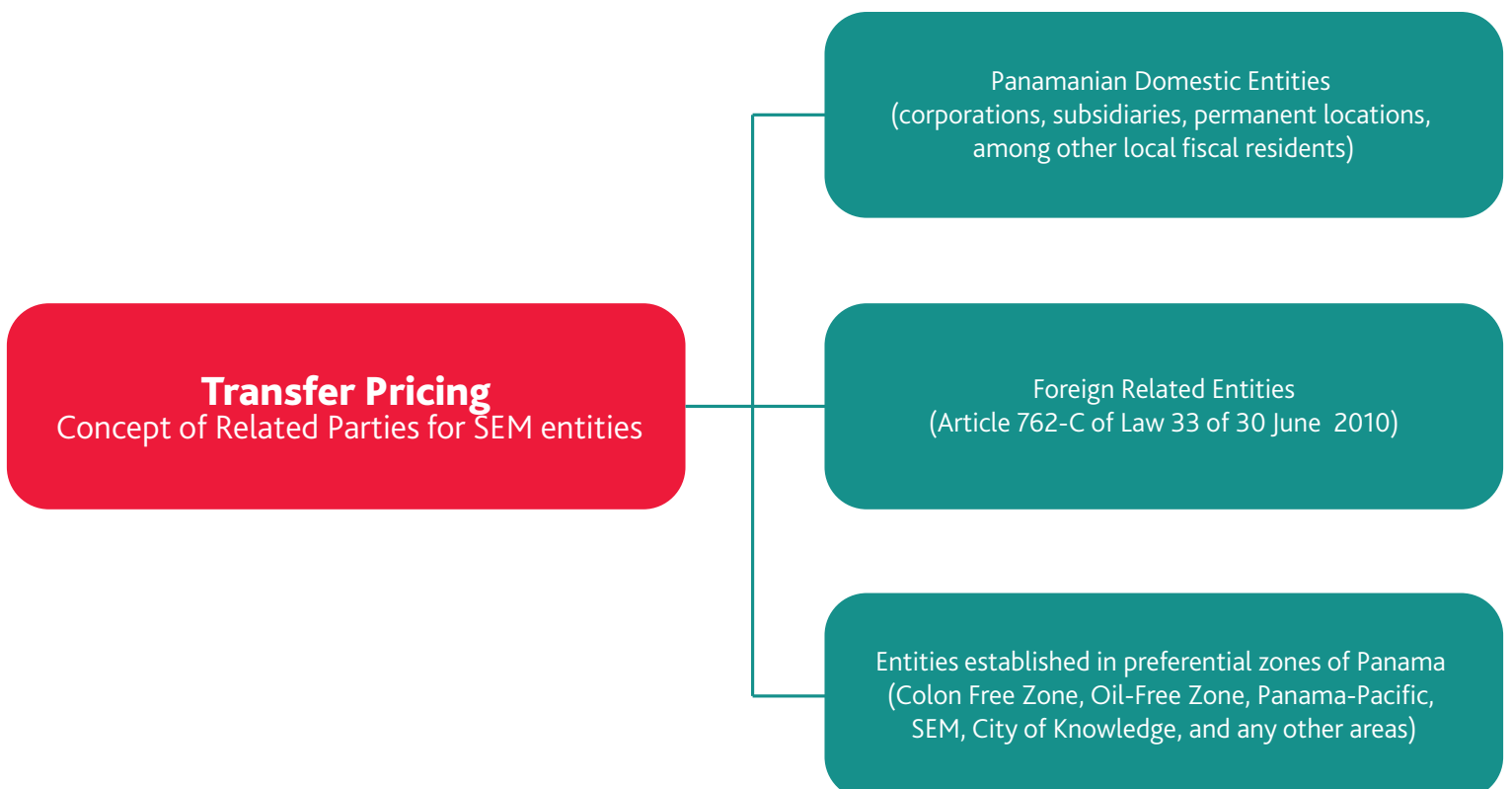
Among other amendments, as from fiscal year 2019, SEM entities will be subject to 5% Corporate Income Tax, as a result of the services provided. However, similar to the former Law 41, they will be exempt from dividend tax.

TRANSFER PRICING DOCUMENTATION

Because of the elimination of the said Corporate Tax Benefits, and following the OECD recommendations, the commercial and financial transactions carried out by the SEM entities and their related parties will be subject to the Transfer Pricing rules.

That is, they must be aligned to the Transfer Pricing provisions of the Republic of Panama: Law 33 of 31 December 2010, Law 52 of 28 August 2012, and Executive Decree 390 of October 2016.

The scope of the regulation will be significant as it is expected to cover transactions with foreign related parties, domestic affiliates, and those affiliates established in preferential or special areas (Colon Free Zone, Oil-Free Zone, Panama-Pacific, SEM, City of Knowledge, and any other areas).



Compliance for SEM entities will be similar to the rest of the entities that are currently obliged to prepare transfer pricing documentation:

1. Preparation of the transfer pricing report (local file), according to Regulation 390 of 24 October 2016,
2. Presentation of **Form 930** (TP Form), according to Resolution N° 201-1973 of 2 April 2018.

However, the obligation is expected to be burdensome due to the above-mentioned scope.

WHAT'S NEXT?

Within the scope of the Inclusive Framework promoted by the OECD, Panama continues to implement changes in its regulatory framework.

The changes are an integral part of the fight against BEPS, encouraged by this Organisation.

The BEPS Action Plan 5, "Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance", is expected to have a direct effect on all Panamanian free zones and special regimes as of the year 2019.

Law No. 69 of 26 December 2018, in its Article 9, increases the extent of the said Action Plan 5 aiming at increasing Transfer Pricing compliance:

1. The aforementioned article states that all "natural or legal persons that carry out transactions with related parties that are established in the Colon Free Zone, the Oil-Free Zone, the Panama Pacific Special Economic Area, SEM, the City of Knowledge [...] will be subject to the Transfer Pricing regime."
2. It will also cover all natural or legal persons established in preferential zones that deal with related parties in other special zones, within Panamanian territory or abroad.
3. Similarly, it will cover those companies exempt from Corporate Income Tax.

The transfer pricing obligation will be dual. That is, if a Panamanian fiscal resident entity carries out a commercial or financial transaction with an entity established in any Panamanian Special Zone, the obligation to submit Transfer Pricing documentation will fall on both entities.

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