

IN THE MIDST OF THE COVID-19 CRISIS, I PROPOSE THE PANAMANIAN GOVERNMENT TO ELIMINATE THE ALTERNATIVE CALCULATION OF INCOME TAX AND SPEED-UP THE ELECTRONIC INVOICE

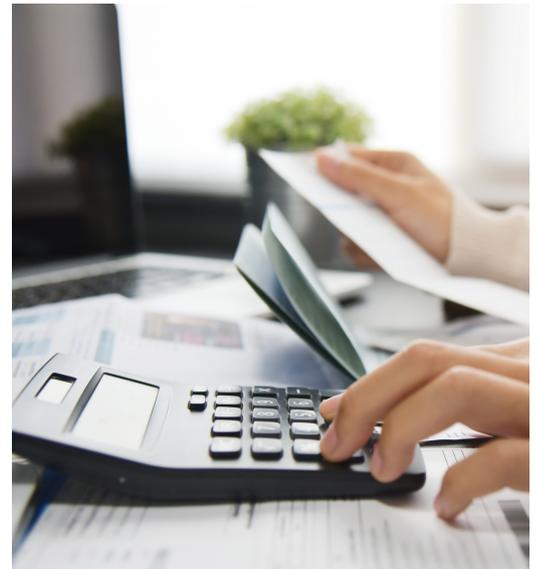
BY PUBLIO CORTÉS

The “CAIR” (which is an acronym in Spanish) is an Income Tax (IT) Alternative Calculation that applies in Panama to corporations with taxable income superiors to 1.5M dollars. On this alternative calculation there is an “alleged income” in which the Government assumes a minimal profit range for the businesses that fit in them regardless of their market or business type. The amount due is compared to the traditional calculation of the IT and the highest would be paid.

The Law establishes two causes by which you can avoid the CAIR, after an administrative procedure of authorization from the Tax Administration (DGI). The exclusion causes are: That the CAIR payment leads to loses or if the effective tax rate exceeds the general rate of 25% because of the CAIR.



When the CAIR was established in 2005, 15 years ago, the substantial hypothesis for its creation was that several businesses declared losses before the Tax Authorities for years, nonetheless ahead of banks and market plazas they showed financial solvency. It was argued that the taxpayers applied an important quantity of deductions that were not necessarily correct, which in return, caused the contribution to the raise of IT not to be the expected one.



It was also argued that the Tax Administration, regardless of their legal faculties, lacked the administrative and technological capacities to verify and oversee enough. Which is why the CAIR was presented as a formula capable of collection, at least in a general form, what would raise the contribution of IT to the Government's taxation income.

I do believe that several of the premises invoked back in 2005 were reasonable but they are not anymore. Let us see.

The CAIR does not help to collect more taxes

Maybe in the initial years, because of its innovation and the manner it was applied, the CAIR had some changes in the collection of taxes. Though in those years it was likely the increase in control perception what helped the most due to the movements of the DGI on deductions and incentives control and the inclusion of annexes to the IT Returns and other measures.

In any case, in recent years and today, it is not true that the CAIR helps to increase the collection.

The person who is writing this article was the General Director of Revenue in Panama, which is the Tax Administration top official, from October 2014 to April 2018 and I can say that, according to my loyal understanding and knowledge, the CAIRS' collection of taxes impact was not relevant during those fiscal years.

In my humble opinion, the current reality is due to several accumulated factors across time, from which we could mention:

- From the start the CAIR system was applied to a big amount of corporations. It was even applied initially to certain individuals. Nonetheless, through the years, the issue was being limited further: the CAIR for individuals was quickly eliminated and after the application to corporations was reduced only to those businesses that had taxable incomes above 1.5 Million Dollars.



- Though it has not been equal through the years, because there have been highs and downs, the reality today is that corporations that are authorized the Non-application of CAIR are granted this right for periods that are becoming increasingly larger. The Law allows it to be within 1 to 3 fiscal years subsequent and the dominant tendency is to grant the highest one possible.
- For different reasons, the petitions of Non-application of the CAIR in the last fiscal years were accepted in an 80% and even up to a 90% by the Tax Administration.
- In the cases of the Taxpayer businesses whose petitions were refused, several engage in administrative disputes before the DGI and later in the Administrative Taxation Court, that could, optimistically speaking,

last 3 years in which they would still not pay according to CAIR. Which means that the collection impact would be diluted and that would be if the Tax Authorities win, which do not occur always.

- The factors mentioned before have decreased the amount of corporations that actually pay CAIR. It would be worse from the fiscal year of 2020 because, clearly, due to the COVID-19 world crisis, the capacity to earn profit for several businesses will be affected and there is no need to be an expert in public finances to understand that the CAIR exclusion petitions due to losses will rain like a storm in the Chagres River Woodlands and it would be justified in its entirety.



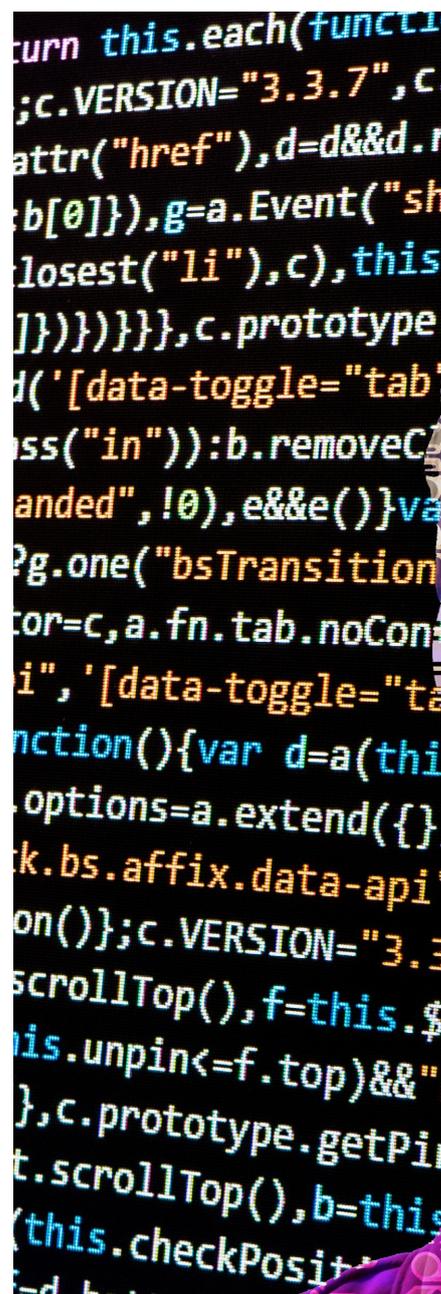
With the current technology, the CAIR is no longer necessary

The factors mentioned above are enough to support the lack of usefulness of the CAIR in the last years, which will only increase with the economic crisis that we are already experimenting.

Nonetheless, there is an additional element that it is essential: the premise that originated the CAIR establishment, that is to say, the lack of administrative capacities from the DGI to apply control measures on businesses regarding IT, is not as valid anymore.

And it is essentially because of the following:

- Due to a joint effort from different administrations, the DGI counts today with several more technological tools of intel exchange and control, compared to the ones that they had back in 2005. Whether they are used a lot or not-so-much is another issue, but there are more tools. There is a lot of room for further improvement but there has been some already.
- During my management as General Director of Revenue and due to the advises of experts in the Inter-american Centre of Taxation Administrations (CIAT), the support from the Chamber of Commerce, Industries and Agriculture of Panama and the backup from Fernando Barraza, Director of the Internal Revenue Service (SII) of Chile and his team, the Panamanian State started the implementation of an electronic invoice system. Said project is being worked upon with huge advancements from there and has been continued by the present administration which had added their own scope.



With the Electronic Invoice the DGI will have under their disposal, by digital means, the sufficient intel for the CAIR to be obsolete.

The Electronic Invoice is useful for everyone^[1]

In the Electronic Invoice the issuer, the buyer and the Tax Administration, share the same electronic document, endorsed by an electronic signature which backups the operation and is the actual invoice for every commercial, financial, taxation and juridical ends. Said document contains every information about the operation.

[1] With information from: ICT as a Strategic Tool to Leapfrog the Efficiency of Tax Administrations. Bill & Melinda Gates Foundation, Seattle, WA. USA/ Inter-American Centre of Tax Administrations – CIAT, Panama City, Panama, 2020.

For the society in general, the electronic invoice provides the following advantages:

- Less paper consumption. From an ecological point of view, this has an important value though from the monetary perspective for businesses it is far from being the most relevant saving.
- By having standard electronic invoice technology, the electronic commerce of any type is increased, not limiting itself to the one related with digital assets.
- The possibility of using the registered information in standard invoices eases the compliance with fiscal and non-fiscal norms.
- When the same document is used in both the relations between companies like those within companies and the DGI, it is cheaper to comply than to not.
- The local technological capacity is boosted because the need for the development of software in Panama is increased.
- Big buyers and sellers do not impose their standards in technological relations because there is only a sole national standard.
- By increasing the electronic interaction in the market, the social distancing is favoured proper for this pandemic time of the COVID-19 because the invoice is sent through email along with an electronic signature that IS the ORIGINAL invoice.



For the Taxation Administration, the electronic invoice provides the following advantages:

- Greater reliability and greater opportunities in relation to the intel that is received from the taxpayers.
- The information gathered is wider and it allows further economic and fiscal analyses beyond the mere tax control.
- The fact of counting on so many information that just so happens to be precise too, forces the Tax Administration to present their drafts of Income Tax Returns to the Taxpayers, which is the route where the world is drifting towards and a destiny that is already present in several countries.
- The evasion is decreased and the collection of taxes is increased because a formalization of commercial operations is carried naturally due to tax authorities use the same digital documents that merchants use in their mutual relations for fiscal controls.
- Clearly with these advancements, transparency and intel administration on the hands of the DGI, the outdated control system that CAIR represents would turn out unnecessary, which would consequently decrease the risk of corruption.
- The litigiousness is mitigated. Nowadays and, from past administrations, the DGI was overwhelmed in its Juridical Section thanks to Motions for Reconsideration, a big amount of them due to CAIR issues and by cost and expenses objections in IT, along with VAT issues (called as "ITBMS" in Panama). Along with the technological administration of intel, the amount of conflictive cases should decrease, which would optimize the DGI's efficiency and that of the Administrative Tax Court, which would receive too the impact of said litigiousness due to Motions for Appellative Review.

For the taxpayer, the Electronic Invoice provides the following advantages:

From the point of view of the invoice issuer:

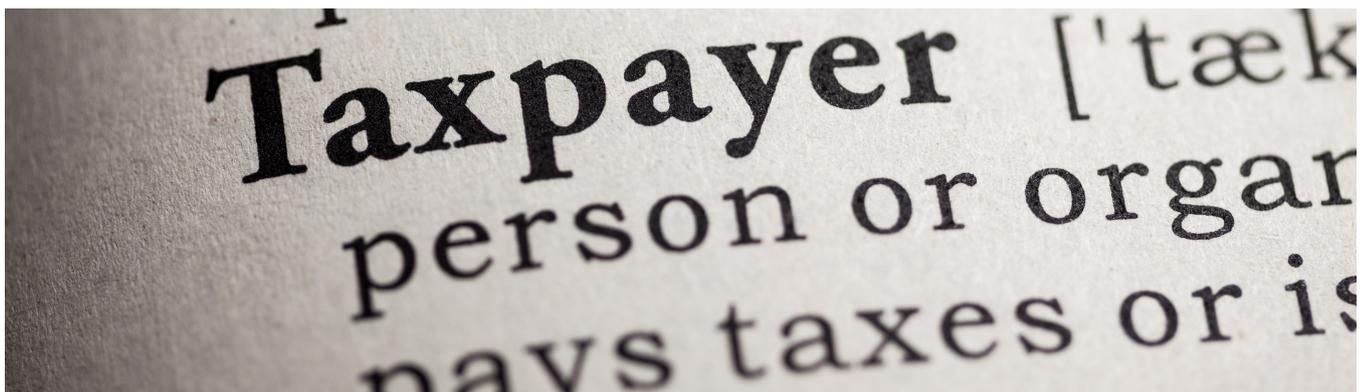
- Cost reduction in paper and printing devices purchases.
- It eases the shipping procedures.
- It causes a re-engineering of sale procedures which leads to an optimization of time and resources.

From the point of view of the buyer who receives the invoice:

- The information provided by an invoice will be received electronically and structured.
- The point mentioned before allows the previous planification of the logistic of reception of physical assets.
- Same thing allows the elimination of error and transcription costs.
- It eases the accounting automatization.

From the point of view of both of them:

- Storage of fiscal documentation costs will be decreased or eliminated.
- Further fiscal obligations are simplified.
- Costs of Fiscal Reports Preparation would be decreased or eliminated. For example: Why would the DGI want the “purchases report...” (Form 43) or the Annexe 72 to the Income Tax Returns with the details of who is receiving the payment of the costs and deductible expenses if the DGI has every invoice?
- The electronic relation between companies is impulse.





Final reflection

In his first administrative year speech, the President of Panama said that he communicated some instructions to the DGI: "... Every request that be presented and supported shall count with a period of authorization to not pay IT according to CAIR up to 3 years."

In our judgement the above does not mean that every request of non-application of the CAIR will be approved. That could not be done, because its approval, according to the Law, require of a probatory labour, case by case. This means that every taxpayer should credit their particular situation and that cannot be considered as "approved" beforehand, assuming that the support for any petition would be valid. Now, the reality of the economic crisis points towards, as stated before, an increase in requests well supported based in losses for the fiscal year of 2020.

In our interpretation what the President did say was that in case that they are presented on time and that the DGI estimates that certain requests of non-application of CAIR are well supported, those who are approved, would be granted 3 years.

Regardless, I am sure that the President gave this instruction with good intention. Nonetheless, if I would be in the position of granting him a recommendation, I would suggest to go further than that and promote the derogation of CAIR because it is unnecessary, since it no longer represents a major collection of taxes for the DGI and it is a cost of compliance for businesses according to the reasons already explained in this article.

The economic crisis derived from the COVID-19 Pandemic has already demonstrated the importance of technology. In fact, in the DGI this crisis has already produced an increase in the management of Tax Administration-Taxpayer relations online.

Instead of following through with the barren erosion of the CAIR, we should speed up the project of Electronic Invoice in Panama that has been already adopted by the current administration according to their own scope.

This cost reduction and the development of a more sincere relation between the Tax Administration and the Taxpayer, applying technology, will be a factor worth being thankful for, by the businesses in front of the hard stage of economic recovery that we have to deal with.



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