



Executive Decree No. 390 of October 24, 2016 which regulates the arm's length principle of Chapter IX of Title I of Book IV of the Tax Code and replaces articles to Executive Decree No. 958 of August 7, 2013

Executive Order No. 390 of October 24, 2016 (hereinafter "Decree") was published in Official Gazette No. 28146-B dated October 25, 2016, which regulates the arm's length principle of Chapter IX of Title I of Book Four of the Tax Code concerning adequacy standards to the Treaties or Conventions for the Avoidance of Double International Taxation.

This Decree repeals certain articles to Executive Order 958, dated August 7, 2013.

Legal basis

Law 33 of June 30, 2010; Article 20 of Decree No. 109 of May 7, 1970.

Main amendments

- It was confirmed that transactions with related parties should be analyzed one by one and according to valuation methods set forth in Article 762-F. Two or more transactions can be grouped, for the purposes of its analysis, when they are integrated **from the economic point of view** or follow one after the other without separating at all.
- It was emphasized that the use of financial information from various periods can only be used when it adds value to the transfer pricing analysis. Likewise, it states that multiannual information data of **relevant economic cycles** and life cycle of **comparable products** may be used when these facts and circumstances improve reliability.
- Adjustments were added to increase the country risk comparability and differences in geographic market.
- The provisions in Article 762-E of the Tax Code are confirmed in relation to the 5 elements to make a comparability analysis, thus remaining as follows:
 - 1) Below are the characteristics of the goods or services in order to determine the degree of similarity of related and unrelated party transactions:
 - ✓ In case of a tangible property transfer, its physical characteristics, qualities and reliability, as well as availability and volume of supply.
 - ✓ In case of provision of services, the nature and scope of the services.
 - ✓ In case of intangible assets, the manner of the transaction (licensing or sale), type of asset (patent, trademark or practical know-how or knowledge), duration, degree of protection and foreseen benefits from their use.
 - 2) The duties exercised, considering the assets used and risks assumed by each of the parties involved.

“This Executive Order repeals sections 1, 2, 3, 4, 5, 6, 7 and 8 of Executive Decree No. 958 of August 7, 2013.”

- 3) The contractual clauses of the transactions, whether **expressed or implied.**
 - 4) The economic circumstances which may be relevant to determine comparability of markets, such as **its geographical location; its size; degree of competition and relative competitive position of buyers and sellers; availability (the risk) of substitute goods and services; levels of supply and demand in the market as a whole and in certain areas if relevant; the purchasing power of consumers, nature and scope of market regulations; production costs; transportation costs; market level (e.g., retail and wholesale); date and time of the transaction, etc.**
 - 5) Business strategies that can be: **innovation and development of new products, degree of diversification, aversion to risk, assessment of political changes, impact of current labor laws and drafts in progress, duration of agreements and any other factors that influence the daily management of the taxpayer.**
- The definition is modified of "external comparable" such as those transactions carried out between independent parties in comparable circumstances. Similarly, the taxpayer may identify market operations or **companies with open capital** not only on the basis of reliable data, but also may use **recognized publications or official sources of information.**
 - It was emphasized that Panamanian comparables will have priority over international comparables.
 - New definitions for the application of the comparable uncontrolled price method, cost plus method, resale price method and the net margin method of the transaction, set forth in Article 762-F of the Tax Code.
 - A definition of full range competition was added consisting of prices or margins of unrelated transactions and compared to the margin price of the related transaction, thus in this manner, it will be comprised as of the first quartile (lower limit) up to the third quartile (upper limit), the median being the value of the second quartile.
 - Reporting requirements and documentation of transfer pricing study are prolonged to the extent they are **economically relevant with regard to facts and circumstances of the transactions:**
 1. General information of the taxpayer:

Detail of intra-group transactions: amounts and related parties per each type of transaction.

 - a) Fiscal information of taxpayer and its related parties living abroad (name, legal address and tax identification number). (Point 1. Article 7 of Executive Decree No. 958 of August 7, 2013).

- b) Flowchart of the taxpayer and the multinational group to which it belongs. (Point 2. Article 7 in Executive Decree No. 958 of August 7, 2013).
 - c) Type of relationship with related parties (directly or indirectly). (Point 1. Article 7 in Executive Decree No. 958 of August 7, 2013).
 - d) General description of the multinational group (background, products, services, etc.).
 - e) Analysis of the industry in which the taxpayer operates.
 - f) Study of the economic sector in which the taxpayer operates.
 - g) Key competitors of the industry in which the taxpayer operates.
2. Detailed description of the functions or activities of the taxpayer and related parties living abroad, to the extent they affect or are affected by related party transactions made by the taxpayer, including the description of assets and risks assumed by each of these parties.
 3. Detailed description of the transactions carried out with related parties residing abroad, including the context in which transactions were made.
 4. Information used to determine the valuation of transactions between related parties, including a detailed description of the nature, characteristics and amount of its transactions with related parties stating the valuation method or methods used.
 5. Detailed analysis of comparability in accordance with Article 762-E of the Tax Code and Article 4 of this Executive Decree, **including any changes in the analysis compared to the previous year.**
 6. Reasons for acceptance of the related method for each type of operation and detailed explanation of the reasons for rejecting the methods described in Article 762-F of the Tax Code.
 7. Selection of the method for each type of transaction to determine the price or profit margins in the transactions held with their related parties residing abroad, including the criteria and other objective factors to consider that the method is applicable to the operation.
 8. Summary of facts or circumstances taken into consideration for the application of the transfer pricing methodology for each transaction with related parties residing abroad.
 9. **Financial and Tax** information used for the analysis of the selected method in the valuation of transactions made with related parties.
 10. Details of the search strategy for comparables, including quantitative and qualitative criteria for each transaction and also the acceptance and rejection matrix.

11. List and description of selected independent transactions such as comparable, internal and external transactions.
 12. Public information or audited financial information of the comparables, including the business description.
 13. **Audited** financial statements of the taxpayer for the fiscal period for which transactions with related parties residing abroad are conducted.
 14. Segmentation criteria that demonstrate how the financial data used for the application of the transfer pricing method are related to the annual financial statements.
 15. Segmentation criteria of financial data used for the comparables, in the transfer pricing analysis as well as the sources and dates of obtained information.
 16. Detailed explanation of the reasons for the use of information from various periods for each transaction carried out with related parties residing abroad.
 17. Justification for the use of comparability adjustments and explanation of the application thereof, detailing if they were applied to the information of the testing party, or to the results of the comparables or both, for each transaction with related parties residing abroad.
 18. Justification for the choice of the profitability indicator, depending on the selected method.
 19. Detail of the calculation of the free competition range.
 20. Explanation of reasons for concluding that transactions with related parties residing abroad were agreed according to the principle of free competition under the selection of the transfer pricing method applied.
- It is confirmed that the transfer pricing study and any additional information requested by the General Directorate of Revenue (DGI), must be presented in the Spanish language.
 - Additional related requirements of Article 762-K of the Tax Code is incorporated on the information and documents related to the business group, **in order to promote the adequacy of its analysis, to the extent that they are economically relevant.**
 1. Description of aspects generating benefits of the multinational group.
 2. General description of the value chain of the five main products and/or services offered by the multinational group, as well as description of the geographical markets where it operates.
 3. The financial statements of the group or equivalent report on the last fiscal year.

4. List and brief description of the agreements for services among multinational group members that have an impact on the transactions with the taxpayer's related parties, including the transfer pricing policy for the attribution of costs and fixed pricing policy for intra-group services.
5. List of intangibles or group of intangibles of the multinational group that have an impact on the taxpayer's transactions and as their related parties, hold legal ownership of them.
6. Overview of transfer pricing policies of multinational group related to financing arrangements and/or leverage between related parties that have an impact on the taxpayer's transactions with related parties.
7. A list of previous agreements on transfer prices concluded by the members of the group related to transactions in which the taxpayer participates (APA Advance Pricing Agreements).
8. Detail information on whether the taxpayer has been part of a corporate restructuring, if it has been affected by a corporate restructuring process and how the aspects of these transactions affect the taxpayer.
9. Itemize if the taxpayer has participated in the transfer of intangibles and include an explanation of how aspects of these transactions affect the taxpayer.
10. A general description of the nature and value of related transactions in which the taxpayer participates.
11. A description of the functions, assets and risks of the group companies, to the extent they are affecting the related transactions made by the taxpayer.

Scope of application and effect

This Decree shall apply to those taxpayers who have a normal and special fiscal period, as of January 1, 2017.

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