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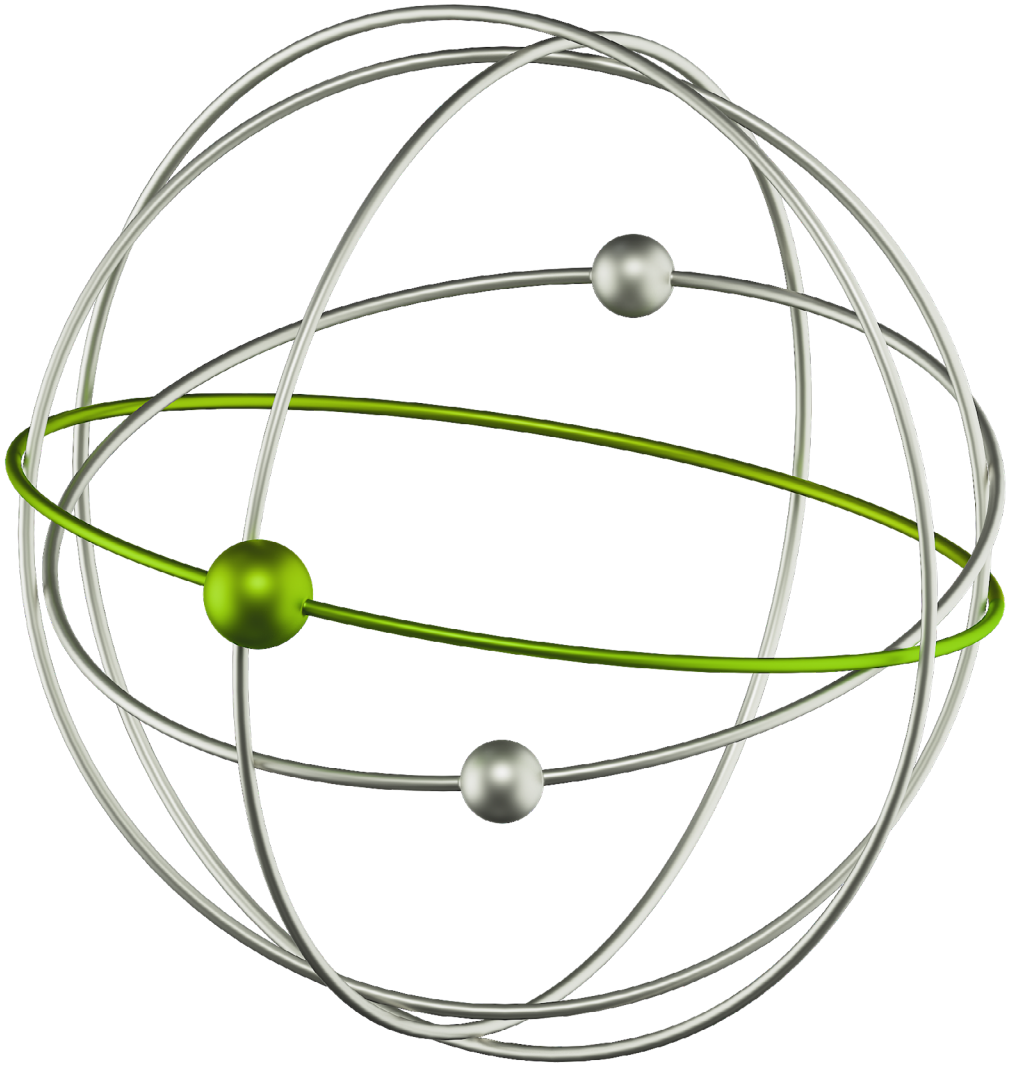

Panama Fiscal News

Tax Administrative Court classifies the carryforward of losses as a tax credit and consequently approves its transfer to another entity.

The **Tax Administrative Court** (TAT, for its acronym in Spanish), through Resolution No. TAT-RF-011 of February 26, 2024, approved the recognition of assignment of tax credit for carryforward losses generated by a company during the fiscal years 2016, 2017, 2018, 2019 and 2020.

To give context to its operative part, the Court pointed out that the carryforward of losses refers to tax losses that may be generated in more than one business year and in which case taxpayers would not have the obligation to settle Income Tax, since there is a "patrimonial detriment as a result of their operations".

Taxpayer Request

The TAT resolution indicates that the taxpayer based its request on the fact that during the aforementioned years it accumulated losses and was therefore subject to the application of Article 698-A of the Tax Code, which provides "that the losses generated by the taxpayer in a tax period will be deductible in the following five (5) tax periods at the rate of twenty percent (20%) of the aforementioned loss per year...".

On the other hand, the taxpayer argued that Article 83 of the Code of Tax Procedure, which refers specifically to the assignment of tax credits, does not establish any impediment for it to take place in this case, that is, with the carryforward of losses.

With these arguments, the taxpayer requested recognition from the Panama Tax Administration (DGI, for its acronym in Spanish), but this entity through an administrative act denied the request. In view of this, the taxpayer filed an Appeal for Reconsideration and subsequently filed an Appeal before the TAT for administrative silence.

DGI Opposition

The DGI assured that the request made by the taxpayer cannot be considered as a tax credit because it does not comply with the provisions of Article 82 of the Code of Tax Procedure, which cites that "those sums that the taxpayer has effectively paid to the treasury or that arise as a result of a tax benefit or incentive" will be recognized as tax credits.

For the DGI, in its operations, the taxpayer only generated losses and therefore there were no credits through tax benefits or incentives. In sum, the tax authority cited Article 698-A of the Tax Code to the effect that the "right to deduct losses is non-transferable, even in cases of consolidations or mergers."

Along these lines, the tax authority ruled out the application of the Code of Tax Procedure in the present case, considering the provisions of Articles 9, 10, and 14 of the Civil Code, and

pointing out that "in accordance with such rules, the provision of the code or special law is preferred, if it is found in various codes."

Reasoning of the TAT

Firstly, it should be noted that the TAT in the Resolution referred to the compensation of losses based on the study of Article 698-A of the Tax Code and Article 78 of Executive Decree 170 of 1993, which it subjected to an analysis from the doctrinal point of view to indicate that it could be a type of tax credit, but with some considerations:

"*Regardless of their denomination, the losses accrued in strict law correspond to a type of tax credit; that is, they can be used to offset future taxes, without this meaning the possibility of requesting the monetary refund of them, given the limitation of the law, in addition to the apparent impossibility of assigning them*".

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In addition to the above, this administrative authority indicated that the entry into force of Articles 82, 83 and 84 of the Code of Tax Procedure established new parameters for the assignment of tax credits:

"*Thus, we see that the existence of tax credits and the possibility of their assignment is subject in our current legislation to the existence of liquid and enforceable credits that have effectively entered the treasury or arise as a result of a tax benefit or incentive*".

In this way, the Court proceeded to develop the concepts, starting with the issue of tax benefits for which, after establishing that there is no definition for the term in Panamanian legislation it concluded this:

"*We have then that the broad term of tax benefits can include deductions, the origin and nature of which is not delimited in the law. The case of carryforward losses leads to the deduction of such loss in the following periods, so it can be understood as a benefit for the taxpayer, as expressed by the tax representative in his pleadings*".

Regarding liquid and enforceable credits, the court said that they are not developed in the tax system, so they equated the concept with what the tax administration describes about the current account and validated the opinion of experts who contributed their knowledge on the subject.

Based on these mechanisms, the court determined that, in the case of tax credits, the condition of "liquid and payable" will be subject to verification by the tax authority, but in the present case, as the tax authority did not request such validation, its conformity was implied.

"*In the case at hand, we see that in the first instance the illegitimacy of the alleged losses was not determined in any way, so it must be understood that the amounts declared were not in dispute,*" the ruling reads.

Dissenting opinion

It is worth noting that Resolution No. TAT-RF-011 of February 26, 2024, includes a dissenting vote of Judge Anel Jesús Miranda Batista, in which he sets out his position against classifying the loss carryforward as a tax credit.

Judge Miranda mentioned Article 698-A to argue that "the portion not deducted in one year may not be deducted in subsequent years, that is, if it is not deducted in the corresponding period, then it can no longer be used or deductible in the next fiscal period, that is, in simple words, the benefit of using loss carryforward is lost".

"*To interpret that once a benefit has been discarded, it can be revived without the existence of that condition in the law, in itself makes the act illegal, especially if that revival is with the sole objective of granting a credit...*

Consequently, I am of the opinion that the loss carry-forward regime is not a tax credit, firstly because it does not correspond to the payment of a tax made to the Treasury, secondly that its effective application requires the existence of taxable income (which is not the case in the present dispute), and that if there were, then it is limited to 50% of it. It is not possible to think of a tax credit that can be assigned when the preceding condition that grants a benefit to the taxpayer who lost is not given".

In another sense, the magistrate relied on Comparative Law to support his position; referring to the Tax Code of the Dominican Republic and Peruvian legislation to conclude:

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"As we can see in the Dominican legislation, the tax treatment of losses establishes that they will be deductible from the profits obtained in subsequent years without this being extended beyond five (5) years, in the same way a minimum deductible percentage of 20% is established, such portion not deducted in a tax period may not be deducted in subsequent periods nor will it cause any refund by the State. In the same way, Peruvian legislation also establishes that losses will be compensated by imputing them year by year until their amount is exhausted in the following five (5) periods and the balance that is not compensated in the elapsed period may not be computed in the following periods, as we can see nowhere in the rules in comparative law does it establish that losses are considered as tax credits".

Regarding the requirement for tax credits to be "liquid and enforceable", he maintained that, since the carryover of losses cannot be considered as a tax credit, it could not be evaluated whether the liquidity and enforceability requirements are met.

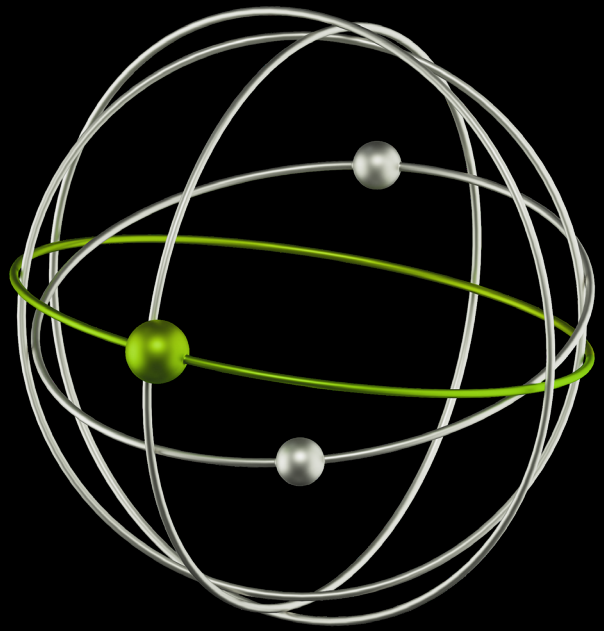
"In our opinion, a rule is being applied that is not compatible with this type of situation; since, in addition to the fact that the carryforward of loss maintains its own tax treatment within Article 698-A, we are also of the opinion that the definition of tax credits stipulated within Article 82 of the Code of Tax Procedure, the carryforward of loss could not be considered as a tax credit".

The Resolution issued by the TAT sets a precedent regarding the classification or nature of the carryforward of losses as a tax credit, by assimilating concepts such as "tax benefit" with that of "tax credit".

Author's Criteria

There is no doubt that a rational system of income taxation must recognize the losses suffered by taxpayers and thus ensure that relief mechanisms are granted. However, the intention of the legislator to include a mechanism for the recognition of these losses with certain limitations (in the Tax Code), cannot be interpreted as recognizing the transfer or assignment of this relief mechanism that depends exclusively on the operation of the business itself, to third parties or taxpayers so that they can allocate it as a decrease to their taxable net income, despite the fact that there is no link.

On the contrary, the Tax Code recognizes the carryforward of loss as a benefit (not a tax credit) in the determination of the Income Tax with express limitations, which under a literal interpretation such as that provided for in the Civil Code and the Tax Procedure Code itself, must be applied by any legal operator of the rule (understood as administrative authority or taxpayer). There are no gaps or collisions with other legal regulations in our tax legal system regarding the treatment of tax losses, which allow the application of provisions other than those established in the Tax Code and its regulations.



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