

VALUE ADDED SALES TAX (ITBM) IN PANAMA

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I. Legal background

The general system for taxation of sales was formally established in Panama with the passing of Act 65 of December 22, 1976, which provided for enforcement, from March 1, 1977, of what is known as the tax on transfer of movable property with tax credit, more commonly known as ITBM.

There are no similar precedents for general taxation of the volume of business in Panamanian tax history, where there had previously only been an extensive system for the application of a tax payable by means of revenue stamps which, under some of its manifestations, was applicable to personal and commercial transactions.

Act 75 mentioned above was regulated with the passing of Decree 59 of March 24, 1977, while several resolutions of a specific and general character issued by the General Directorate of Revenue exist today to complement the legal framework for the structure and enforcement of the tax.

II. ITBM structure

One of the major concerns borne in mind by the Government authorities at the time of passing of legislation on the new tax was endowing it with the greatest legal and structural simplicity, in order that the tax administration could manage it with the greatest efficacy to achieve the collection goals foreseen at the time of its establishment.

The following is a summary of the structural characteristics of the new tax:

1. It is applied at all the marketing stages on the basis of the value added at each stage, determined on the basis of the "tax by tax" system. On the basis of this system, it can be pointed out that the ITBM is, in essence, a general multiple-stage tax on sales, to

which the mechanism of "tax credit" has been introduced to avoid an accumulation of the tax pressure.

2. It is essentially levied on the transfer of movable property arising from commercial and industrial transactions. The tax is not levied on the rendering of services, although the tax on manufacturing contracts is levied (in other words the tax on the processing of raw materials when it occurs at the industrial level), as well as the tax on lease of movable property with certain limitations.
3. Although it is expressly provided that the tax is not considered a tax on imports, the latter are within the scope of the tax whenever made by businessmen or individuals and whenever destined to personal use of the importer, at which time the tax paid is considered the final tax.
4. The transfer of foodstuffs, medicines and pharmaceuticals, staple agricultural products, fishing, hunting and the transactions of small taxpayers are exempt from the tax. Although those engaging in these transfers are exempt, they must pay the tax on their purchases of taxable products and inputs.
5. The regime known as the "zero rate" has been established to apply to sales for exports, to re-exportation and to sales made by the Authorized Agencies of the United States Government in what is known as the Panama Canal Zone, according to which although the sale is exempt the seller can credit the tax that has been levied on his inputs.
6. According to the law, the taxpayers are classified into two categories: *Class 1* taxpayers with average monthly gross income in excess of B/.5,000 (equal to U.S. dollars), who *declare and pay on a monthly basis*, and the smaller taxpayers under *Class 2*, with an average monthly gross income below B/.5,000 but above the exemption limit, who *declare and pay on a quarterly basis*.
In all cases, a single return is filed which is of a definitive character.
7. The single rate of the tax is 5 percent.
8. As additional aspects to the originating legislation and closely related to the new tax, we must mention that the *Single Taxpayer File* was established with the passing of Act 76 of December 22, 1976, at the General Directorate of Revenue, at the same time obligating corporations and individuals to register, as well as partnerships, companies, associations, groups or entities which generate or must withhold taxes on account of the activities that they develop. Also, this same Act 76 *provides for the obligation of invoicing* all of the commercial transactions concerning transfers, sales, refunds and discounts and, in general, all types of transactions similar to the ones mentioned. It must be added that these two mechanisms have proved to represent an excellent support for the administration of all taxes and of ITBM in particular.

III. General aspects of ITBM administration

A. *Planning and work programs*

As indicated previously, between the time the legislation was passed and the time of effective enforcement of the tax, provision was made for a lapse of two months to set up the entire administration, to which effect it was necessary to formulate the overall planning, to formulate work programs and make intensive efforts.

The ITBM was placed under the administrative responsibility of the General Directorate of Revenue (DGI), which is the office responsible for administration of all national taxes, both of an internal and customs type. The DGI has an organizational structure of the "functional type", which was practically maintained in its integrity needing no structural

changes as a consequence of the ITBM enforcement. We must only refer to the establishment of the Single Taxpayer File Section within the Automated Data Processing Department.

The activities planned and carried out by the DGI in basically a period of two months, with a view to the implementation of the correct administration of the ITBM, can be summarized as follows:

- (a) national campaign for dissemination of information and publicity through the press, radio and television;
- (b) dissemination of information and lectures for all sectors of national entrepreneurial, industrial, commercial, agricultural and farming activities;
- (c) dissemination of information for professional associations, lawyers, public accountants;
- (d) entering into an agreement with the Association of Accountants of the Republic for mutual cooperation in the launching of the tax;
- (e) internal training of officials at all levels – the higher executive level, middle management, line-managers, in the capital city and five regional administrations;
- (f) participation of executives of all offices in the country in these efforts;
- (g) contracting of auditing personnel to be assigned to field audit of the tax;
- (h) intensive training of this personnel for their tasks at the time of enforcement of the tax;
- (i) promotion campaign, vis-à-vis national companies which supply cash register equipment, for adaptation of machines installed throughout the country to the new control requirements established by the Law. Detailed regulations concerning the control characteristics and requirements of the machines, on the basis of the agreement entered by the General Directorate of Revenue and Special Work Teams responsible for the development of tasks to:
 - design the form for filing and payment of ITBM;
 - design the form for registration in the Single Taxpayer File;
 - prepare the design of model invoices and sales vouchers for dissemination, publication, presentation through the press, television and radio-telephone;
 - prepare and formulate all of the instructions concerning the correct application of legal provisions on the part of taxpayers and officials, with regard to:
 - form for filing and payment = correction form;
 - the exporters' sector;
 - the internal flow of return processing;
 - the internal flow of registrations with the Single Taxpayer File.
 - internally adapt the Data Processing Department for the entire computer processing of ITBM returns;
 - prepare the respective programs;
 - incorporate a Single Taxpayer File Section into its structure;
 - adapt the administration to the entire new process. To this effect, the process was implemented, the officials were trained and qualified, and the development of functions inherent to the following was strengthened:
 - taxpayer assistance;
 - filing of returns;
 - collection of the tax;
 - mechanized processing;
 - output information process;
 - utilization of information for the managerial and operational level;

- preparing and training the internal levels for the control stage and for evaluation of the tax;
- making the systematic monthly evaluation of the tax;
- on the basis of the evaluation, preparing pilot plans or selective audit plans;
- implementation of the pilot plans.

B. *System for assessment and payment – Data processing*

It must be pointed out that the tax is assessed on a monthly or quarterly basis by the filing of a tax return. The return is filed, in triplicate, with the Reconnaissance Department of each Regional Administration, where the numerical and formal contents of the return are verified. The original of the return, when applicable together with the cash register record, is finally incorporated in the taxpayer's dossier. The duplicate is filed at the respective Regional Administration and the third copy is delivered to the taxpayer. When a balance in favor of the taxpayer (tax credit) is established, the Reconnaissance Department places a stamp on same to certify this fact on the section corresponding to the Collection Stamp. When a balance in favor of the Treasury (tax debit) is established, the taxpayer must go to the Collection Unit where he makes the payment in cash, or by means of a certified check, or by means of "Certificados con Poder Cancelatorio" (certificates for payment) or "Certificados de Abono Tributario" (certificates of tax payment). The return form contains instructions to facilitate the computation by the taxpayer. The Control and Verification Section verifies the forms received and sends them in batches of 50 to the Control and Registration Section of the ADP Department. The Collection and Filing Section receives both forms containing certification of payment and the forms with tax credit that are sent by the different Regional Administrations. All of the data concerning the declaration-assessment of sales are processed by mechanized means, for example:

1. The Single Taxpayer File (RUC).
 - 1.1 Corporations (Volume-Page-Entry) (Roll-Image-Card). Corresponding to the registration number on the books of the Corporation Section of the Public Property Registry.
 - 1.2 Individuals (Personal Identity Card). Identifies Panamanians and both nationalized and non-nationalized foreigners residing in the national territory. The Verifying Deigit (Module II) has been added to the RUC in order to avoid inconsistency in registration of this identifier.
2. Period of the declaration.
 - 2.1 Monthly.
 - 2.2 Quarterly.
3. Total transactions.
4. Non-taxable transactions.
5. Exempt transactions.
6. Total taxable transactions for the period.

The Data Processing Department determines the tax, applying 5 percent to the total taxable transactions for the period, which represents the debit (Dr.) to the taxpayer current account.
7. Deductible ITBM levied on local purchases.
8. Deductible ITBM levied on imports.

This data is matched against the date appearing under item 35 of the form to avoid inconsistency in the formation supplied by the taxpayer.
9. Total tax payable.

This data must harmonize with the total for daily collections by tax, by cashier and province, and represents the Credit (Cr.) to the taxpayer current account.

10. The amount requested through the presentation of the "Certificate con Poder Cancelatorio" (Certificate for Payment) is deducted from the balance of the tax credit for the following period.

All of the above is reflected on a listing of the current accounts by taxpayer and region, which is issued by this Department on a monthly basis and the balance of which is used for collection action due to evident errors.

C. Statistics

The following considerations are derived from a detailed review of ITBM collections from the date of enforcement up to March 31, 1979.

- In its first full year of enforcement (1978) the tax reached a total collection volume of more than 48 million balboas, which represents approximately 15 percent of the total tax revenues of the Central Government, a percentage which will presumably tend to increase in future due to the fact that collections for this tax follow a parallel with inflation, which is the contrary of many taxes in existence that only increase on the basis of actual growth. At present, the ITBM already ranks in third place in order of individual importance within the total tax revenues, slightly below the Import Customs Duties which represent approximately 17 percent of total collections, and Income Tax which is 37 percent of the total tax revenues of the Government.
- On the basis of the 31 months which have elapsed since its enforcement, the duties forecasted for customs represent approximately 58 percent of the total collections while the sales transactions represent 42 percent.

The most important economic sectors for this tax are, obviously, those of trade and industry.

Within the sector of trade, representing more than 70 percent of the taxable transactions, mention must be made of the predominant participation of large department stores, supermarkets and shops, in other words, establishments selling all kinds of goods (13 percent of the total taxable transactions), and establishments selling clothing in general (12 percent of the total).

In the industrial sector, which contributes more than 25 percent of the total, mention must be made of the importance of the sector of manufacture of beverages in general, which contributes slightly more than 4 percent, and the shoe and clothing manufacturing sectors representing slightly more than 3 percent of the total taxable transactions.

- Taking into account the data appearing in Table 1, it may be observed that a *total of 4,650 taxpayers file ITBM returns* of which 2,850 (in other words 61 percent) are of economic importance (Class 1) while one third are small taxpayers (Class 2). To the above we must add that of the 18 million balboas collected for value added tax in 1978, only approximately 600,000 balboas (in other words slightly more than 4 percent of collections) originated with Class 2 taxpayers, which ultimately means that there is an entire effort concerned with administrative services, paperwork and costs for practically one third of the taxpayers who scarcely represent 4 percent of collections.

To supplement the above, it must be said that of the total taxpayers filing a return (4,650), there are 2,900 (62 percent) who assess and *pay*, while approximately one third declare *tax credit* and, consequently, do not pay tax.

On the basis of analyses made we find that two large taxpayers accumulate most of

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the tax credit, and that one of them in particular is an exporter who in agreement with the legal provisions finds protection under the "zero rate regime" and accumulates credits on inputs which are recognized by means of "Certificados con Poder Cancelatorio" (certificates for payment).

With regard to this phenomenon it must be stated that the experience of this Administration with regard to these large taxpayers who almost exclusively dedicate themselves to exports, and who, consequently, are entitled to the above-mentioned certificates, has been that the accumulation due to this tax provision has become very important, of 5,000 dollars each time, and it has been believed more advisable to exempt these companies from making pre-payments on imports since such amounts or pre-payments distorted the collection figures and created a financial problem at the time of their reimbursement. Logically this experience is only valid for small countries having important exporting companies.

TABLE 1

Average number of taxpayers with declared and paid ITBM

Type of activity	Class 1	Class 2	Total
- Trade	1,400	900	2,300
- Industry	300	180	480
- Services	100	20	120
TOTALS	<u>1,800</u>	<u>1,100</u>	<u>2,900</u>

Average number of taxpayers having declared tax credit

Type of activity	Class 1	Class 2	Total
- Trade	900	500	1,400
- Industry	100	190	290
- Services	50	10	60
TOTALS	<u>1,050</u>	<u>600</u>	<u>1,750</u>

Finally, and in agreement with what may be specifically observed in Table 2, a great concentration of ITBM collections in a few taxpayers has been observed since; taking the month of February 1979 as a sample, 88 (*in other words, 7 percent of the total Class 1 filers*) contributed 44 percent of collections for the month, while 124 taxpayers (*9 percent of the total*) declared and paid 51 percent of collections.

TABLE 2

Concentration of the tax paid by means of returns filed

Month for the test:	February 1979.
Total taxpayers - Class 1:	2,850
Total taxpayers with debit balance:	1,855
Total collection unit:	1,472,734.00
1.7 percent taxpayers with a debit balance, or 27 percent of the total taxpayers, represented 37.2 percent of collections at the Collection Unit.	
51 percent of the total collected was from 103 taxpayers representing 5.5 percent of the total filers.	

IV. Specific problems and aspects of ITBM administration

1. Until now, auditing efforts were basically oriented to examination of the following aspects appearing on the taxpayer returns:
sales – taxable, non-taxable (exonerated) and exempt (taxable at the zero rate);
purchases – local and imported;
tax credit – including compliance with the legal requirements established for its admission.

At the time of the establishment of ITBM, a specialized team of auditors was set up. This group carried out its tasks for a period of more than one year, which offered positive results with regard to the additional assessments made and to the orientation provided to taxpayers with regard to the tax in particular. However, after this first experience and to avoid a proliferation of inspectors for each one of the taxes with its ensuing cumbersome requirements and annoyance for the taxpayer in the sense of having to receive visits from auditors of the General Directorate of Revenue on different occasions, and since most taxpayers had been covered to that date, it was considered more efficient to integrate this team of auditors with the general auditing teams in order that ITBM could be audited together with other taxes and in the course of a single audit.

The problems faced under this new structure are principally due to the fact that situations may arise in which the net time for the satisfactory auditing of an ITBM taxpayer is in excess of that required for the auditing of income tax since the number of ITBM returns is greater. Notwithstanding this fact, the General Directorate of Revenue considers that due to the close relationships existing between these two taxes, auditing and examinations must be carried out jointly; further, the auditors themselves have expressed their preference for this latter system.

2. Legislation authorizes taxpayers to utilize *cash registers* to replace invoicing in the manner of bills of sale or specific vouchers. It must be pointed out that the following anomalies have been found in this field:
 - a taxpayer transferring a cash register from one business establishment to another (branch or head office), without informing the General Directorate of Revenue;
 - the existence of taxpayers utilizing cash registers without due authorization and instructions;
 - some taxpayers utilizing cash registers with the drawers open; in other words, not registering the amount of the sales on the machine, and also pressing the key corresponding to exempt goods in the case of taxable goods;
 - on certain occasions it has been observed that taxpayers request companies supplying cash registers to leave them on a trial basis or for exhibition purposes for several days and, when the machines are returned, the tape for control is not removed, which indicates that the taxpayer does not, in principle, intend to declare the receipts accumulated through that cash register;
 - on occasion, taxpayers claim that the tapes of the cash register or the auditing tapes have been stolen from them or have been lost, which can also imply unreported sales;
 - when a cash settlement is made at the close of the day, on several occasions it has been observed that the total receipts issued for cash sales do not agree with the flow of receipts and funds in general;
 - a clear distortion in the figures corresponding to taxable and exempt sales has

also been observed, together with the logical tendency on the part of the taxpayer to increase the inputs of taxable goods and decrease sales of same.

3. A form called the Corrective Return is being used in order that the taxpayer may spontaneously correct the errors which he may have made in filing his regular returns. This form was created a short time after the enforcement of ITBM since many taxpayers were requesting that changes be made on their returns due to errors on their part. This decision was taken to expedite the administrative process.
4. The legislation provides for the existence of fraud whenever the taxpayer files his return after the 60-day term for this purpose has elapsed. The formula adopted has proved to be a source of problems and frictions with taxpayers because whenever the taxpayer spontaneously files a return after the 60 days, he claims that he is not guilty of fraud. Some more realistic procedure must be found as a penalty for this violation.
5. The controls exercised over the merchandise and inventory seem to represent one of the most adequate mechanisms for verification of the correctness of the amounts declared by the taxpayer. In this regard, the Auditing Department has programmed the development of *preventive audits* in those periods in which sales increase, taking into account the type of activity and taxpayer behavior (e.g. Father's and Mother's Day, Carnival, Christmas). Thus, 244 preventive audits were programmed for December 1978 through which sales for the month were taken day by day, and an important increase in collections of the tax for the month was observed. This has been combined with the review of inventories of different companies in the course of the first days of January, after the close of the fiscal year.
6. Among the irregularities most frequently detected by means of direct taxpayer audit in the field, we find the following:
 - invoices not complying with the requirements for admission of tax credit;
 - claims for tax credits based on invoices in the name of other firms (frequently found in groups of companies);
 - claiming of credits on the basis of invoices on which the ITBM was not included;
 - utilizing documents, such as debit notes and transfer notes, in lieu of invoices;
 - taxpayers selling without the issuance of invoices, with the inclusion of evasion "case by case" or "in chain" (case of a factory and intermediaries in the sector of underwear);
 - utilization of non-official invoices which are afterwards not recorded (sales to tourists or those in transit in the country).

V. Conclusions

1. ITBM has been peacefully incorporated into the Panamanian tax structure and currently represents an important percentage of the total revenue collections of the Government.
 2. There are aspects of the structure of the tax itself which are under review. The General Directorate of Revenue has the intention of following the evolution of the tax for a reasonable period, with a view to suggesting and promoting changes to the legal system. Aspects, such as exemptions, small taxpayers and the rendering of services, as well as the regime for violations and penalties, must be carefully reviewed with a view to eventual changes.
- From the administrative standpoint, the statistics and experiences available to date

show that small taxpayers (in our case those identified as Class 2 taxpayers, or in other words those with monthly sales below 1,500 balboas or dollars) represent a relatively heavy burden for the administration and do not generate very important tax revenues for which reason it seems advisable ultimately to utilize formulas to reduce the workload and the costs required by same.

3. Administration of the tax has given rise to different types of problems, principally in the areas of *auditing and collection*. In the area of auditing, taxpayer violations have been detected in the utilization of cash registers, in invoicing, and in distortion of the taxable and exempt sales. In the field of collection, discrepancies are observed in calculation of the tax and in the correct identification of the taxpayer registration. Also, problems have arisen with regard to determination of the "Class" of taxpayer. The *preventive audit* system, particularly in what concerns in situ audits and auditing of inventories, has proved to be very effective in detecting and preventing violations. The structure of a VAT-type tax, as is the case with the ITBM, permits the utilization of the cross-controls technique to verify the consistency of the returns of buyers and sellers with regard to the same tax, as well as to match the gross income amounts declared by the taxpayer for ITBM and for income tax purposes. Although the verification of the receipts or declared sales by the same taxpayer is a simple task which is easy to program, the matching of transaction figures among buyers and sellers would require the addition of annexes to the return form, which should contain figures on sales for each taxpayer, with the total for each buyer for periods of at least one year. This can obviously be very cumbersome for most taxpayers, for which reason the solution to simplify it would be to establish the obligation of declaring the sales made to a single taxpayer whenever the total reaches a minimum reasonable amount. Under such conditions, the matching would lose much of its effectiveness, although it can offer satisfactory results in the case of large taxpayers.