INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/129

PANAMA

SELECTED ISSUES

March 2023

This paper on Panama was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on February 8, 2023

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

PANAMA

SELECTED ISSUES

February 8, 2023

Approved By
Western Hemisphere Department

Prepared by Sebastian Beer, Dora Benedek, Ricardo Fenochietto, Alexander Klemm, and Carolina Osorio Buitron (FAD); Nicolas Fernandez-Arias, Olga Bespalova, Julian Chow, and Marina Rousset (WHD); and Alberto Soler (ICD).

CONTENTS

Acronyms

B2C	Business to Consumer
BEPS	Base Erosion and Profit Shifting
CAIR	Alternative Calculation of Income tax (Cálculo alterno del impuesto sobre la renta)
CFC	Control Foreign Company
CIT	Corporate Income Tax
DGI	Revenue Directorate General
EMMA	Multinational Enterprises Providing Services Incentive Related to Manufacturing (Empresas Multinacionales para la prestación de servicios relacionados con la manufactura)
ESL	Education Security Levy
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GloBE	Global Anti-Base Erosion
IBFD	International Bureau of Fiscal Documentation
IIR	Income Inclusion Rule
ITBMS	Tax on Transfer of Tangible, Mobile Goods and Service Rendering
LAC	Latin and Central American countries
LVIGs	Low Value Imported Goods
MNCs	Multinational Companies
OECD	Organization for Economic Cooperation and Development
PIT	Personal Income Tax
QDMTT	Qualified Domestic Minimum Tax
SEM	Multinational Regional Headquarters Incentive
SSC	Social security contribution(s)
STTR	Subject to Tax Rule
VAT	Value-Added Tax
WEO	World Economic Outlook
WoRLD	IMF Internal World Revenue Longitudinal Database

TOWARD A MODERN TAX SYSTEM

A. Introduction

1. **Panama's tax collection has been historically low, reflecting the authorities' overarching strategy to promote an investment-friendly environment with low taxation**. The level of revenue is a result of relatively low tax rates, as well as ample use of base-eroding policy measures, such as tax incentives and exemptions across all taxes, that also affect fairness and efficiency. Although low taxation could help the country achieve the policy objective of attracting investments, it leads to chronical fiscal deficits (Figure 1.1) and limits fiscal space for social inclusion policies. Even if national preferences and public choice in Panama are in favor of a small government and public sector, there is ample space to modernize the Panamanian tax regime by increasing its progressivity and transparency, reducing distortions, and aligning it with international best practices trough revenue neutral reforms. This paper presents the main features and weaknesses of the current Panamanian tax system and provides an international comparison of its performance.

2. **This paper is structured as follows**. Section II describes the performance of the Panamanian tax system in international comparison. Sections III to V analyze the different taxes in Panama and Section VI summarizes and concludes.

B. Growth and Tax Revenues

3. **Panama's macroeconomic performance has been notably robust** (Figure 1.2). A significant increase in investment led to a rapid accumulation of capital that boosted economic growth to impressive and comparatively high levels. Over the last three decades real Gross Domestic Product (GDP) multiplied fivefold (Figure 1.3). Foreign and domestic investments have been supported by several factors: Panama's geographic location, trade openness, world-class ports, airport, and logistics operations, financial system depth, and the doubling of the Canal's capacity to accommodate much wider ships.[1] The country's policy to attract investment was also reflected in historically low tax collections.

4. **Government revenues have fallen during the period following the Global Financial Crisis (GFC), reflecting cyclical and structural forces (Figure 1.5).** Tax and non-tax receipts contribute equally to Panama's central government revenues, both accounting for about 10 percent of GDP. Non-tax collections include social security contributions (SSC) (about 6.0 percent of GDP) and contributions from the Panama Canal Authority (about 3.5 percent of GDP). These receipts fell steadily until 2016 despite the expansion of the canal, due to the slowdown in global trade (Figure 1.4); and revenue from most taxes also declined (Figure 1.6). After the GFC, tax buoyancy—a measure of responsiveness of revenue mobilization to economic activity—has on average remained below unity, as tax collection has failed to keep-up with growth (Figure 1.7)[2]

[1] https://www.imf.org/en/News/Articles/2021/11/17/na111821-panamas-story-of-convergence.

[2] The only exception was 2012 due to a tax reform that, among other measures, increased the rate of some excises and the ITBMS (the Panamanian VAT) rate by 2 percentage points.