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Corporate Tax

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Payet, Rey, Cauvi, Pérez Abogados

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Payet, Rey, Cauvi, Pérez Abogados has extensive experience in providing taxation and customs advice to investors in the telecommunications, banking and finance, education, electricity, mining, real estate, manufacturing and trade sectors. Services include consulting, support during tax audits, taxation litigation, tax planning, due diligence for acquisitions, tax compliance, financial restructuring and the review of tax returns, as well as consultancy on customs issues. The taxation practice group is mainly focused on tax consulting, special tax audit assignments and litigation. It has expertise in M&A transactions, and counsels clients on the most adequate and business-oriented tax schemes to structure and implement such transactions. The team also advises on the tax benefits that apply to domestic and foreign investors, and to the recipient companies of such investments, whether through tax stability agreements, special tax benefits, treaties to avoid double taxation or other mechanisms.

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1. Types of Business Entities Commonly Used, Their Residence and Their Basic Tax Treatment

1.1 Corporate Structures and Tax Treatment

In Peru, businesses generally adopt any of the following corporate forms set forth in the General Corporations Law:

- Stock Corporation (*Sociedad Anonima – S.A.*) Minimum two shareholders (no maximum). The Board of Directors is mandatory.
- Closely Held Stock Corporation (*Sociedad Anonima Cerrada – S.A.C.*) Minimum two and maximum twenty shareholders. The Board of Directors is optional.
- Publicly Traded Corporation (*Sociedad Anonima Abierta – S.A.A.*) Shares are to be issued through an initial public offering; and/or minimum of 750 shareholders; and/or over 35% of its share capital is distributed among 175 shareholders; among others. Supervised by the Peruvian Securities Exchange Authority.
- Limited Liability Company (*Sociedad Comercial de Responsabilidad Limitada – S.R.L.*) Minimum two and maximum twenty shareholders. There is no Board of Directors. The share capital is not represented in shares, but in equity stakes (*participaciones*).

Because of their simplicity and ease to transfer its shares, the most common corporate forms used in Peru are Stock Corporations and Closely Held Stock Corporations.

Under any of the abovementioned corporate forms, the shareholders or members will generally not be personally liable for the corporation's obligations and/or liabilities. This includes any tax liability, as the corporation or company will qualify as a separate and independent taxpayer from its shareholders or members.

1.2 Transparent Entities

In addition to the above, businesses may be carried in Peru through investment funds and trusts which, pursuant to Peruvian income tax provisions, qualify as "pass-through" or "transparent" vehicles. This status means that the investment fund or trust (which according to corporate provisions, do not qualify as corporations) will not qualify as a taxpayer itself, but its investors or members. Thus, all the income generated by the investment fund or trust will be allocated to the corresponding party and will be levied for such income

in accordance with its particular conditions and nature of the allocated income.

In these cases, the income shall be allocated to the investors or members and the corresponding tax liability will arise:

- Domiciled individuals: when a total or a partial redemption of their certificates of participation in the investment fund/trust occurs, or when the income is paid or credited; unless the allocated income qualifies as corporate income.
- Peruvian corporations and domiciled individuals obtaining corporate income: when a total or a partial redemption of their certificates of participation in the investment fund/trust occurs, or at the end of every fiscal year.
- Non-domiciled investors: when a total or a partial rescue of their certificates of participation in the investment fund/trust occurs, or when the income is paid or credited.

Recently, Peruvian provisions have created two types of investment funds and trusts for purposes of exclusively carrying real estate property business: Real Estate Income Investment Funds (*Fondos de Inversion en Renta de Bienes Inmuebles - FIRBI*), and Real Estate Income Trusts – REIT (*Fideicomiso de Titulización para Inversión en Renta de Bienes Raíces – FIBRA*)

These types of vehicles are subject to a special tax regime under which the following tax benefits apply:

- Deferral of capital gains from immovable property contributions. This deferral also applies to real estate transfer tax (*impuesto de alcabala*) in case of FIRBI.
- Reduced income tax rate of 5% (versus 29.5% or 30%) applicable to the income allocated in favor of individuals.
- Income tax exemption to capital gains from the sale of FIRBI and FIBRA certificates through the stock market provided certain conditions are met.

Real Estate Income, Private Equity and Private Debt funds and trusts are utilized for the avoidance of incorporating an independent or separate entity from the investors, and to continue applying the tax treatment corresponding to the investors. Thus, using these vehicles may result beneficiary for the investors, as they can apply preferential tax regimes and/or rates to the income derived from their investments.

In addition, guarantee or escrow trusts are commonly implemented for finance transactions in order to ensure the financing collateral and segregate the necessary cash flows for debt repayment.

Finally, local trusts are also used for purposes of structuring family assets and facilitate inheritance matters.

1.3 Determining Residence

According to Peruvian income tax provisions, corporations will be deemed as Peruvian tax residents (i.e. domiciled taxpayers) when incorporated in Peru and, thus, be subject to taxation on a worldwide basis. In the case of branches and other permanent establishments of non-Peruvian corporations, they will be deemed as Peruvian domiciled taxpayers, but only with respect to their Peruvian source income.

Investment funds and trusts created under Peruvian legislation will not be deemed as tax residents, as they do not qualify as taxpayers.

Currently, Double Taxation Treaties (DTT) are in force with the following countries: Brazil, Canada, Chile, Korea, Mexico, Portugal and Switzerland. These DTT follow the OECD Model Convention and define “resident” as any individual, trust, company, partnership or any other body of persons who, under the laws of a given contracting State, is liable to tax therein by reason of its domicile, residence, place of management or any other criterion of a similar nature.

In addition, Peru is part of the Andean Community together with Bolivia, Colombia and Ecuador (Member Countries) and, consequently, Decision 578 (treaty for the avoidance of double taxation) applies to transactions between these countries. In general terms, Decision 578 provides that individuals will be deemed as domiciled in the Member Country of their usual residence and, in case of corporations, in the Member Country of their incorporation.

1.4 Tax Rates

Peruvian domiciled corporations and individuals who generate business income under the general regime are generally subject to a flat rate of 29.5% on their corporate net income.

In addition to the above, dividends or any other kind of profits distribution by Peruvian corporations in favor of their shareholders will be subject to income tax at the following rates: 5% for profits generated as of 2017; 6.8% for profits generated between 2015 and 2016; and 4.1% for profits generated up to 2014. Note that this tax does not apply when the distribution is made in favor of another Peruvian corporation.

2. Key General Features of the Tax Regime Applicable to Incorporated Businesses

2.1 Calculation for Taxable Profits

Taxable business profits are computed on a yearly basis, in accordance with their accrual, and based on the net profits and losses of the corresponding taxpayer, with certain adjustments set forth in the tax provisions: deduction/addi-

tion of expenses and others, exclusion of non-taxable or exempted income, among others.

With respect to the expenses incurred, these will be allowed in order to determine the corporate net income when they are necessary to produce taxable income and maintain its source, as well as generating capital gains, provided they are not forbidden by the income tax provisions (Principle of Causality).

2.2 Special Incentives for Technology Investments

Under the general regime, expenses related to research and development (R&D) -specifically, scientific research, technology development and technology innovation projects (as defined in the corresponding income tax provisions) -are deductible for purposes of determining the corporate net taxable income, regardless of being related to the Peruvian corporation's core business or not.

Alternatively, Peruvian corporations making the abovementioned R&D expenses may apply to a special regime which allows the following deductions: 175% deductible expense: The project is directly developed by the taxpayer or through a Peruvian domiciled scientific research / technology development / technology innovation center. 150% deductible expense: The project is directly developed through a non-Peruvian scientific research / technology development / technology innovation center.

For purposes of being entitled to the additional 75% or 50% deduction, among others, the following shall be considered:

- The Peruvian corporation must not be deducting said R&D expenses under the general regime and must keep control accounts with respect to each project.
- The National Board of Science, Technology and Technological Innovation (*Consejo Nacional de Ciencia, Tecnología e Innovación Tecnologica - CONCYTEC*) shall (i) qualify the "scientific research", "technology development" and "technology innovation" projects as such; and (ii) authorize the development of the project (either directly by the taxpayer or through a scientific research / technology development / technology innovation center).
- The project result must be registered before the National Institute for the Defense of Free Competition and the Protection of Intellectual Property (*Instituto Nacional de Defensa de la Competencia y de la Protección de la Propiedad Intelectual - Indecopi*), when applicable.
- R&D expenses may be deducted as from the fiscal year in which the project's qualification is obtained. Expenses incurred before said qualification shall also be deducted as from the fiscal year when the qualification is obtained.
- The additional 75% and 50% deduction is yearly limited in each case up to 1,335 tax units (PEN 5,540,250 for 2018, which approximately amounts to USD 1,683,966).

Moreover, the total amount that may be deducted by a given taxpayer for this concept will be limited as follows:

- 2017: PEN 114,800,000 (approx. USD 35,323,077)
- 2018: PEN 155,200,000 (approx. USD 47,753,846)
- 2019: PEN 207,200,000 (approx. USD 63,753,846)

This special R&D expenses deduction will be valid until the fiscal year 2019.

2.3 Other Special Incentives

Within the special tax regimes or incentives for carrying investments in Peru, we may find the following:

Legal Stability Agreements

Peruvian and non-Peruvian investors, as well as Peruvian corporations receiving investments, may enter into legal stability agreements for a 10-year period. Under these agreements, foreign investors stabilize the income tax regime in force at the time when said agreement is entered into with respect to dividends and profit distribution; whereas Peruvian corporations stabilize the corporate income tax regime.

Tax Stability Agreements

Peruvian corporations holding mining or hydrocarbons concessions may enter into tax stability agreements which grants, among other benefits, the stability of the overall tax regime applicable to the Peruvian corporation (not only corporate income tax).

In general terms, the tax stability includes the following:

- Corporate income tax regime. In this case, the stabilized tax rate shall be increased by 2%.
- Value Added Tax (VAT), but only with respect to its offsetting system.
- Special regimes relating to tax refunds, temporary imports and export regimes.

In case of mining corporations, a specific tax stability agreement shall be entered into with respect of a specific mining project and, depending on the operation capacity and the investment amount, the tax stability may be granted for a 10, 12 or 15-year term.

On the other hand, with respect to hydrocarbons corporations, the tax stability is included in the license agreement, and will be subject to the license agreement's term:

- (i) exploration: up to 7 years;
- (ii) exploitation of crude oil: up to 30 years; and
- (iii) exploitation non-associated natural gas and condensates: up to 40 years.

These terms may be exceptionally extended.

VAT Special Recovery Regimes
These regimes apply to Peruvian corporations at pre-operative stage in order to allow them to recover the VAT paid in their acquisitions (input VAT) before starting operations.

The main requirements for applying these regimes are related to the pre-operative stage term and the amount to be invested.

Amazon Regime
Corporate taxpayers domiciled in the amazon region carrying certain activities (agriculture, aquiculture, fishing, tourism, manufacturing activities, and forestall transformation and extraction) within such region may be subject to a special income tax (10%, 5% or 0% rate) and VAT regime (tax exempted transactions and special input VAT credit).

Agriculture Regime
Corporate income obtained by Peruvian corporations or individuals developing agriculture (excluding forestall industry), agroindustry activities outside of Lima and Callao, or aquaculture activities, may be subject to a reduced 15% income tax rate. With respect to the aquaculture activities, this reduced tax rate will apply as of January 1st, 2019.

Financial Leasing Special Depreciation Regime
Peruvian corporations may acquire fixed assets through financial leasing. In such case, the lessee may choose to (i) depreciate the assets under the general regime or (ii) apply a special annual depreciation rate according to the term of the agreement ("accelerated depreciation"), provided certain requirements are met.

Among the requirements for applying the accelerate depreciation regime, the financial leasing agreement term must be for at least two years for movable property or five years for immovable property.

Infrastructure Projects for Taxes
Peruvian corporations may apply for this special regime which allows them to pay part of their tax liabilities through the execution and/or maintenance of certain infrastructure projects.

For such purposes, the interested corporations must comply with certain conditions, such as enter into an agreement with the local or regional government where the infrastructure project shall be executed and obtain the authorization from the Peruvian investment promotion agency (Proinversion) for listed or new infrastructure projects.

The amount invested by the corresponding corporation (represented in a certificate issued by the local/government) may be applied as a credit against its future income tax but limited up to 50% of its income tax of the previous fiscal year. Any remaining balance of this credit may be applied in the following years until it is fully applied.

2.4 Basic Rules on Loss Relief

Losses generated by Peruvian corporations within any given fiscal year may be carried forward and offset against taxable income of the following fiscal year. For such purpose, the taxpayer may choose any of the following offsetting systems which, once elected, cannot be modified until the losses are totally used or extinguished: System A: losses generated in a given year may be offset against the total net income of the following years with a time limit of four years; or System B: losses generated in a given year may be offset against up to 50% of the net income of the following years with no time limit.

No carry-back of losses is allowed under Peruvian tax provisions.

There is no distinction between ordinary losses and capital losses other than capital losses from the transfer of shares under certain conditions which are not deductible ("wash sales").

2.5 Imposed Limits on Deduction of Interest

As a general rule, interest from loans will be deductible as an expense provided that the loan was obtained to acquire goods or services necessary to produce taxable income or maintain the source of said income.

Notwithstanding, in case of loans between related parties, the deductibility of interest will be subject to thin capitalization rules. This means that the related party loans should not exceed three times the borrower's equity as of the closing of the prior fiscal year. Interest related to any excess will not be deductible for tax purposes.

As of January 1st, 2019, until December 31st, 2020, the deductibility of interest will be subject to thin capitalization rules, for all the taxpayers, except for the following:

- Banking companies;
- Taxpayers whose income is less than or equal to 2,500 UIT (PEN 10,375,000)
- Taxpayers who through Public Private Association develops projects with accordance to Legislative Decree 1224;
- Indebtedness for the development of projects under the Legislative Decree 1224; and,
- Indebtedness arising from the issuance of representative debt securities that meet certain conditions.

As of January 1st, 2021, the deductibility of interest will be subject to 30% of EBITDA from the prior fiscal year.

2.6 Basic Rules on Consolidated Tax Grouping

Consolidated tax grouping is not allowed under Peruvian tax provisions, regardless of the possibility of consolidating financial statements. Thus, it is not possible to offset tax losses of a given corporation against the taxable income of another corporation of the same corporate group.

2.7 Capital Gains Taxation

Capital gains may be generated from the sale, contribution or any kind of transfer of goods in exchange for a consideration. Said gain shall be determined from the difference between the transfer value of the good (which must meet market value standards) and the tax basis the seller has in such good (i.e. acquisition cost).

When a capital gain is obtained by a Peruvian corporation, it shall be included among its corporate income (business income) and, thus, be subject to the flat 29.5% tax rate.

In case of sale of shares, as of January 1, 2016 and up to December 31, 2019 (this term may be extended) a tax exemption (i.e. 0% tax rate) will apply when the sale is performed through the Lima Stock Exchange (LSE) and the following conditions are met: (i) within a 12-month period, the seller, together with its related parties, do not transfer 10% or more of shares issued by the Peruvian company, and (ii) the shares have market liquidity (*presencia bursátil*).

2.8 Other Taxes Payable by an Incorporated Business

Valued Added Tax ("VAT") is levied at an 18% rate on the following transactions:

- (i) sale of movable property in Peru;
- (ii) rendering and utilization of services in Peru;
- (iii) construction contracts;
- (iv) first sale of real estate property by the constructor; and,
- (v) import of goods.

Real Estate Transfer Tax ("Alcabala") applies on transfers of immovable property, regardless a consideration is agreed or not. The applicable tax rate is 3% on the transfer value, and the taxpayer will be the purchaser.

Financial Transactions Tax ("FTT") applies to debits and credits in Peruvian bank accounts, at a 0.005% rate on the transaction amount.

2.9 Incorporated Businesses and Notable Taxes

Temporary Net Assets Tax ("TNAT") applies to Peruvian corporations at operative stage, except when such corporation started its business as of January 1 of the fiscal year when the TNAT must be paid.

TNAT levies the value of the net assets set forth in the taxpayers' balance sheet as of December 31 of the prior fiscal year, adjusted by deductions and amortizations allowed by the Peruvian legal provisions (taxable basis).

The TNAT rate is 0.4% on the excess of PEN 1MM (approximately USD 300M) of the taxable basis. This tax may be applied as a credit against the taxpayer's corporate income tax liabilities and, in case is not totally offset, the remaining TNAT may be refunded by the Peruvian tax authorities.

Mining Taxes: New Mining Royalty, Special Mining Tax and Special Mining Contribution

As from the last quarter of 2011, not only the mining royalty was modified, but two new mining taxes were incorporated to the Peruvian system (special mining tax and special mining contribution).

In general terms, these three concepts are payments in favor of the Peruvian government (regional or central) for the exploitation of mineral resources. In case of the mining royalty, the payment shall be made for both metallic and non-metallic mineral resources, whereas the special mining tax and special mining contribution shall be only made for metallic mineral resources.

Another relevant difference in case of the special mining contribution is that it only applies to mining corporations with projects with tax stability agreements in force which voluntarily entered into agreements with the Peruvian Government in order to be levied with this contribution.

The calculation basis for these mining taxes is the operating profit of the quarter; i.e., income from the sale of mining resources, minus the corresponding cost of sales and operating expenses (which must meet market value standards).

Then, the effective rate to be finally applied on said basis shall be calculated based on the operating margin of each quarter (operating profit divided by the sales income) and the cumulative progressive scale established for each mining tax. In the case of mining royalty, the amount payable cannot be lower than 1% of the sales revenue generated in the respective quarter.

Finally, the amounts paid for the aforementioned mining taxes will be deductible as an expense for income tax purposes.

3. Division of Tax Base Between Corporations and Non-Corporate Businesses

3.1 Closely Held Local Businesses

Local businesses normally operate through a corporate structure. Nevertheless, businesses can also be carried through non-corporate forms, such as joint venture or consortium agreements, as well as through other associative or collaboration agreements, such as silent-partnerships (*asociación en participación*).

Joint Venture and Consortium Agreements

Pursuant to Peruvian income tax provisions, when these agreements keep independent accounting from their members, they are deemed as independent taxpayers. Thus, even though from a legal perspective these agreements are not deemed as a different legal person from their members, from a tax perspective they qualify as an independent taxpayer from them.

The general rule for this type of agreements obtaining corporate income is that they must keep independent accounting from their members, unless: (i) when, considering the transactions that are developed, it is not possible to keep an independent accounting; and (ii) the agreement's term is no longer than three years.

When the agreement has independent accounting, any income generated will be subject to the general regime and, thus, subject to corporate income tax rate on its net taxable income (e.g after deducting expenses which comply with the Principle of Causality and offsetting tax losses). Moreover, it will be obliged to comply with formal liabilities (e.g. obtaining a taxpayer's ID number (*RUC*), filing monthly and yearly tax returns, etc.)

In addition to the above, the further income allocation by the agreement to its members will be considered as a dividend distribution subject to withholding taxes, unless the allocation is made in favor of a Peruvian corporation.

Finally, these agreements also qualify as VAT taxpayers and, thus, when performing transactions levied with said tax, they shall be invoiced by the agreement as an independent taxpayer.

On the other hand, when the agreement has no independent accounting, the income or profits obtained shall be allocated to its members (individuals or entities) at the end of the fiscal year or at the termination of the agreement, whichever occurs first, in accordance with their corresponding participation or the percentages agreed by the members. Then, said members must incorporate such allocated income into their corresponding income.

Regarding VAT, these agreements do not qualify as an independent taxpayer. Hence, each member shall invoice their corresponding transactions and declare and pay the corresponding VAT, when applicable.

Considering the above, this structure is usually implemented for projects with special characteristics and short-term businesses.

Silent Partnership (Asociación en participación)

Under these agreements, one or more parties make a contribution as silent-partner (*asociado*) to participate in the results (profits or losses) of a business or investment developed or held by another party (*asociante*).

From a Peruvian tax perspective, silent partnership agreements do not give rise to a new and separate taxpayer, as the member acting as *asociante* would be the one deemed as the taxpayer for the taxable income generated from the respective business.

For purposes of calculating the corresponding income tax of the silent-partnership's members, the income or profits distributed to the *asociado* will be declared and paid by said member as a corporate income and, in turn, such amount will be deducted as an expense by the *asociante*.

Because of its nature, this structure is difficult to use (if not impossible) in businesses that are incompatible with the existence of silent partners (*asociados*); i.e. when the parties involved have to participate actively and openly in the business or in the management itself.

3.2 Individual Rates and Corporate Rates

Corporate income tax rate applicable to the general regime (i.e. 29.5%) is higher than the average tax rate applicable to individual independent professionals (ie progressive scale rate of 8% to 30%).

In this regard, Peruvian tax and legal provisions do not establish special rules with respect to the form individuals shall perform their professional activities. Therefore, they may freely choose to perform their activities through a corporate form or as independent professionals.

Note that, when performing these activities through a corporate form, income generated will be subject to the regime applicable to third category (corporate) income tax (i.e. 29.5% rate on net income at corporation level, plus withholding taxes to dividends distribution at the individual professional level) and the services will be levied with an 18% VAT.

On the other hand, professional activities directly performed by the individual will be subject to the regime applicable to fourth category (independent professional/labor) income

tax (ie only a progressive scale rate of 8%, 14%, 17%, 20% and 30% on net income) and no VAT applicable.

3.3 Accumulating Earnings for Investment Purposes

Currently, Peruvian tax provisions do not establish any disposition regarding accumulating earnings for investment purposes in case of closely-held corporations or any other type of corporate form.

3.4 Sales of Shares by Individuals in Closely Held Corporations

There is no special income tax treatment applicable to individuals for dividends distributed by closely held corporations, as well as for capital gains from the sale of shares issued by these corporations. In this sense, the general income tax treatment for dividends and capital gains previously explained will apply:

Dividends: subject to income tax at the following rates: 5% for profits generated as of 2017; 6.8% for profits generated between 2015 and 2016; and 4.1% for profits generated up to 2014.

Said tax must be withheld by the corporation distributing the dividends when the distribution agreement is approved by the shareholders general meeting, or when the dividends are effectively paid, whichever occurs first.

Capital gains: the difference between the transfer value of the shares (set at market value standards) and the tax basis the shareholder has in those shares will be subject to income tax at the following rates: Domiciled individuals: 5% effective rate (6.25% rate on 80% gross income); and Non-domiciled individuals: 30% rate, as the sale will be executed over the counter.

In order to be entitled to deduct the tax basis, it must be certified by Peruvian tax authorities through a *"certificación de capital invertido"* procedure before receiving any payment.

3.5 Sales of Shares by Individuals in Publicly Traded Corporations

As well as in the case of closely-held corporations, no special income tax treatment has been established for dividends distributed by publicly traded corporations in favor of individuals, neither for the capital gains obtained by individuals from the sale of shares issued by this type of corporations; unless the sale is performed by a non-domiciled individual through the LSE. Therefore, the income tax treatment will be as follows:

Dividends: subject to income tax at the following rates: 5% for profits generated as of 2017; 6.8% for profits generated between 2015 and 2016; and 4.1% for profits generated up to 2014.

Said tax must be withheld by the corporation distributing the dividends when the distribution agreement is approved by the shareholders general meeting, or when the dividends are effectively paid, whichever occurs first.

Capital gains: the difference between the transfer value of the shares (set at market value standards) and the tax basis the shareholder has in those shares will be subject to income tax at the following rates:

Domiciled individuals: 5% effective rate (6.25% rate on 80% gross income); and

Non-domiciled individuals: 5% if the shares are listed in the Peruvian Stock Market sale is executed through the LSE, or 30% rate if the sale is executed outside the LSE.

In order to be entitled to deduct the tax basis, it must be certified by Peruvian tax authorities through a *"certificación de capital invertido"* procedure before receiving any payment. This requirement does not apply when the sale is carried through the LSE.

Finally, as of January 1, 2016 and up to December 31, 2019 (this term may be extended) a tax exemption (ie 0% tax rate) will apply when the sale is performed through the LSE and the following conditions are met: (i) within a 12-month period, the seller, together with its related parties, do not transfer 10% or more of shares issued by the Peruvian company, and (ii) the shares have market liquidity (*presencia bursátil*).

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

In absence of income tax treaties, Peruvian source income obtained by non-domiciled beneficiaries would be subject to the following withholding taxes:

- Dividends: 5% (profits as from 2017); 6.8% (profits between 2015-2016); or 4.1% (profits up to 2014).
- Interest from loans: 4.99%, provided certain requirements are met; otherwise, 30%.
- Royalties: 30%.

Generally, third parties' income taxes assumed by Peruvian corporations are not deductible as an expense for the latter. However, as an exception, in case of interest from loans granted by non-domiciled lenders, the corresponding income tax may be assumed by the Peruvian borrower and be entitled to deduct such tax as an expense.

As a general rule, the withholding liability is triggered in the month when the income is paid or credited to the non-dom-

iciled beneficiary and should be paid to the tax authorities within the following month as of which the income was paid.

Notwithstanding, in case of dividends distribution, the withholding liability arises when said distribution is approved at the Shareholders General Meeting or when the dividends are paid, whichever occurs first.

On the other hand, until December 31st, 2018, if a Peruvian corporation records a service retribution (e.g. interest or royalties) in favor of a non-domiciled beneficiary as an expense in its accounting, an amount equivalent to the withholding tax must be paid to the tax authorities within the following month when said record is made, irrespectively of whether the income was actually paid to the non-domiciled beneficiary or not. As of January 1st, 2019, in these cases is applicable the general rule explained before.

4.2 Primary Tax Treaty Countries

As mentioned before, currently, Peru has DTT in force with the following countries: Brazil, Canada, Chile, Korea, Mexico, Portugal, Switzerland and the Andean Community (Bolivia, Colombia and Ecuador).

The primary DTT countries used by foreign investors to invest in Peru are Chile, Andean Community, Brazil and Canada.

4.3 Use of Treaty Country Entities by Non-Treaty Country Residents

Under Peruvian local tax provisions, no specific "treaty shopping" regulations have been enacted. Thus, Peruvian tax authorities may only challenge this type of transactions by means of DTT provisions, specifically, under the "beneficial owner" provisions.

Note that "treaty shopping" transactions could be also challenged under the general anti-elusive provision (Provision XVI of the Peruvian Tax Code). However, the application of said provision is currently not in force.

Notwithstanding the above, in practice, Peruvian tax authorities usually do not challenge transactions under the argument of a treaty shopping, although this may change in the future.

4.4 Transfer Pricing Issues

Currently, the main issues for investors regarding the application of transfer pricing rules are related to the intra-group services: management services and financing services.

In general terms, the retribution for every transaction must be set at market value standards; otherwise, Peruvian tax authorities may adjust such retribution for tax purposes. In case of transactions between related parties and with parties domiciled in tax havens, said market value is determined in accordance with transfer pricing rules.

As of fiscal year 2017, transfer pricing rules establish additional requirements for the deduction of expenses derived from services: (i) the service must comply with a "benefit test" (i.e. the service provides an economic or commercial value to the user, improving or maintaining its commercial position); and (ii) the service user must provide the tax authorities with documentation and information which support the effective rendering of the service, its nature, actual necessity of the service, costs and expenses incurred by the service renderer, as well as their reasonable allocation criteria.

The amount that may be deducted as an expense by the service user will be determined considering the total sum of costs and expenses incurred by the service renderer and the corresponding mark-up, which, in case of low value-added services cannot exceed 5%.

In this scenario, deductibility of expenses related to management services will be subject to the abovementioned requirements; otherwise, their deduction will be challenged by the tax authorities.

In case of financing services (loans), in addition to the above, it should be noted that the deduction of interest will be subject to thin capitalization rules and the withholding tax applicable to the interest will be 30% (versus a reduced 4.99% rate, provided certain conditions are met).

Note that, in case of free loans granted by non-domiciled lenders in favor of a related Peruvian corporation, transfer pricing rules will determine a deemed interest for Peruvian income tax purposes. Consequently, the Peruvian borrower shall determine and pay the 30% withholding tax previously mentioned on said deemed interest.

4.5 Related Party Limited Risks Distribution Arrangements

Considering that there are no special provisions to challenge this related party limited risk distribution arrangements, this type of agreements and the tax effects in Peru can be only challenged by Peruvian tax authorities under the general transfer pricing rules, just as any other transaction between related parties.

4.6 Comparing Local Transfer Pricing Rules and/ or Enforcement and OECD Standards

Even though Peru is not a member of the OECD, its transfer pricing rules follow the OECD transfer pricing guidelines. Moreover, the Peruvian Government is adapting its local legislation to the OECD regulations, which includes transfer pricing guidelines.

As consequence of the above, as from fiscal year 2017, not only the requirements for services expenses deduction were modified, but also the formal liabilities with respect to transactions subject to transfer pricing rules.

5. Key Features of Taxation of Non-Local Corporations

5.1 Taxing Differences

Even though local subsidiaries (corporations) and local branches of non-Peruvian corporations are deemed as "domiciled taxpayers", as previously explained, while the local subsidiaries are subject to taxation on their Peruvian and foreign source income, local branches are only taxed on their Peruvian source income.

Notwithstanding, in both cases, the income will qualify as a corporate income subject to a flat 29.5% rate on the net income.

On the other hand, with respect to dividends or other profits distribution, in case of local subsidiaries the corresponding income tax would apply upon the agreement or effective distribution; whereas local branches shall yearly assess an income tax on their net income of the corresponding fiscal year.

The applicable tax rates in both cases are 5% for profits generated as of 2017; 6.8% for profits generated between 2015 and 2016; and 4.1% for profits generated up to 2014.

Finally, another relevant difference between subsidiaries and branches is that a subsidiary is a different and independent entity from its shareholders for every purpose, whereas a branch is an "extension" of its head office and, consequently, the latter will be liable for its branch's liabilities, except for its tax liabilities.

5.2 Capital Gains of Non-Residents

Capital gains derived from the sale (direct and indirect) of shares issued by Peruvian corporations are subject to Peruvian income tax as follows:

Direct Sale

As previously explained, the capital gain shall be determined by the difference between the transfer value (set at market value) of the shares and the tax basis the non-Peruvian shareholder has in those shares, which must be certified by the Peruvian tax authorities through a *"certificación de capital invertido"* procedure before receiving any payment; otherwise, no tax basis will be deductible for determining the capital gain, and the total consideration will be subject to income tax.

Note that this certification is not required when the sale is executed through the LSE.

The tax rate for the abovementioned capital gain will be 5% when the shares are listed in the Peruvian Stock Market and the sale is carried through the LSE; otherwise, a 30% rate applies.

If the sale of shares is executed through the LSE, as previously mentioned, the capital gain may be tax exempt, provided that: (i) within a 12-month period, the seller, together with its related parties, do not transfer 10% or more of shares issued by the Peruvian company (ie no change of control), and (ii) the shares have market liquidity (*presencia bursátil*).

When the purchaser is a Peruvian domiciled taxpayer, the corresponding tax must be withheld; otherwise, said purchaser will be joint and severally liable for the corresponding tax liability.

In addition, the Peruvian corporation which issued the shares transferred may be also joint and severally liable for the non-Peruvian seller's tax liability under certain situations (e.g. when the seller owned 10% or more of the issued shares).

Indirect sale

A taxable indirect sale of Peruvian shares will be generated when the shares issued by a non-Peruvian corporation which, in turn, owns (directly or indirectly) Peruvian shares are transferred provided that: (i) more than 50% of the value of the non-Peruvian corporation derives from Peruvian shares, and (ii) 10% or more of the non-Peruvian corporation shares are transferred by the seller and his related parties within a twelve-month period (ie change of control).

In this case, unless the sale is executed through the LSE, the tax basis must be also certified by the Peruvian tax authorities in order to be deducted.

Likewise, the applicable tax rates will be 5% when the shares are listed in the Peruvian Stock Market, and the sale is carried through the LSE; or 30% in other cases.

In case of Peruvian domiciled purchasers, the aforementioned withholding liability will also apply. If no withholding is made, then the purchaser will be joint and severally liable for the non-Peruvian seller's tax liability.

When the purchaser is also a non-Peruvian domiciled taxpayer, no withholding liability will apply. However, the issuer Peruvian corporation may be joint and severally liable for the respective tax liability under certain situations (e.g. when the seller owned 10% or more of the issued shares). Likewise, as of January 1st, 2019, if the non-Peruvian corporation has a branch or other permanent establishments in Peru that

has an equity assigned, the latter will be jointly and severally liable for the non-Peruvian seller's tax liability.

Bear in mind that, when these sales are performed by a shareholder resident in a jurisdiction which has a tax treaty in force with Peru, the applicable tax treatment may vary (e.g. under the DTT with Canada, the capital gain from sale of shares may be only taxed in Canada).

5.3 Change of Control Provisions

Even though Peruvian tax provisions do not include specific provisions regarding "change of control", we may find it as a condition that triggers certain tax effects:

- One of the requirements to generate a taxable indirect sale of Peruvian shares is that 10% or more of the non-Peruvian corporation is transferred.
- The capital gains tax exemption does not apply when 10% or more of the Peruvian shares are transferred.
- An issuer Peruvian corporation may be joint and severally liable for the non-Peruvian seller's tax liability, among other situations, when the seller owned 10% or more of its shares.

Notwithstanding the above, it should be noted that Peruvian corporations shall communicate to the Peruvian tax authorities the direct transfer of their shares in every case, and the indirect transfer when the corresponding conditions to be taxable in Peru are met.

5.4 Formulas Used to Determine Income of Foreign-Owned Local Affiliates

For Peruvian income tax purposes, the consideration agreed in every transaction (i.e. sale of goods, rendering of services) must be set at market value. In the case of transactions between related parties, the market value will be the price or consideration that would have been agreed with or between independent parties in comparable transactions, in equal or similar conditions, in accordance with transfer pricing rules.

5.5 Deductions for Payments by Local Affiliates

As previously explained, expenses may be deducted by Peruvian domiciled taxpayers to determine their corporate net income, provided they comply with the Principle of Causality. In case of expenses derived from services rendered by related parties, transfer pricing rules establish the following additional requirements for their deduction: (i) the "benefit test"; and (ii) provide the tax authorities with documentation and information regarding the services.

In this regard, it should be noted that the amount that may be deducted as an expense by the Peruvian corporation (local service user) will be determined considering the total sum of costs and expenses incurred by the service renderer and the corresponding mark-up, which, in case of low value-added services cannot exceed 5%.

Therefore, the deductibility of expenses related to management, consulting and administrative services will be subject to the abovementioned conditions and limitations.

5.6 Constraints on Related Party Borrowing

Related parties financing services (loans), as previously mentioned, are subject to the general conditions and limitations applicable to transactions between related parties, as well as to thin capitalization rules.

Additionally, it should be noted that the corresponding interest will be subject to a 30% withholding tax (versus a reduced 4.99% rate, provided certain conditions are met).

Finally, an 18% VAT will apply to the interest (retribution for the loan), unless the lender is a financial or banking entity. In such case, the VAT shall be self-assessed, declared and paid by the Peruvian corporation (local service user).

Nevertheless, said VAT may be offset as a credit (input VAT) against future transactions levied with VAT (output VAT), provided certain conditions are met.

6. Key Features of Taxation of Foreign Income of Local Corporations

6.1 Foreign Income of Local Corporations

Peruvian corporations (domiciled taxpayers) are subject to taxation on a worldwide basis; i.e. not only their Peruvian source income, but their foreign source income will be levied in Peru.

For such purpose, each taxpayer shall sum and offset every foreign source income and loss accrued in a given fiscal year and, if a net income is determined, it shall be added to its Peruvian source corporate net income and be taxed at a 29.5% income tax rate.

As well as in the case of Peruvian source income, in order to determine the foreign source net income, expenses incurred abroad that comply with the Principle of Causality may be deducted.

If a foreign source loss is determined in any given year, it cannot be offset for purposes of determining the corresponding income tax. In addition, no carry-back or carry-forward of foreign source losses are allowed under Peruvian tax provisions.

Notwithstanding the above, it is important to mention that income taxes paid outside Peru may be applied as a credit against the foreign source income Peruvian tax liability, subject to certain limits and conditions.

Likewise, as of January 1st, 2019, in general, Peruvian corporations that obtain foreign source income from dividends distributed by non-domiciled companies could apply as a tax credit: (i) the income tax paid or withheld abroad for dividends or distributed profits; and, (ii) the income tax paid by the first-level and second-level non-domiciled company, subject to certain limits and conditions.

6.2 Taxation on Dividends from Foreign Subsidiaries

Dividends received by Peruvian corporations from their foreign subsidiaries qualify as foreign source income and, consequently, are taxed in accordance with the abovementioned treatment.

6.3 Use of Intangibles

It is possible that an intangible developed by a Peruvian corporation is used by its non-Peruvian subsidiary. In such case, the retribution paid by the non-Peruvian subsidiary (intangible user) will qualify as a royalty and it will be levied for the Peruvian corporation as a foreign source income, as the intangible would be utilised outside Peru.

Despite the fact that, from a commercial perspective, the aforementioned use assignment of intangibles may be agreed for a reduced retribution or for free; for Peruvian income tax purposes, the Peruvian corporation will be obliged to recognise a taxable income for a deemed market value consideration under transfer pricing rules.

In addition to the above, as the use assignment will qualify as a service rendering which is not included among the transactions that qualify as an "export of services", the royalty (retribution) will be subject to an 18% VAT, which shall be invoiced by the Peruvian corporation and charged to the non-Peruvian subsidiary.

6.4 Taxation of Income of Non-Local Subsidiaries Under CFC-Type Rules

As from fiscal year 2013, a special regime for the recognition of passive income obtained by non-Peruvian subsidiaries of Peruvian domiciled taxpayers entered in force in Peru. Note that this Peruvian regime resembles the CFC Rules of the United States of America (1962).

Under the Peruvian CFC regime, special rules apply regarding the opportunity when a Peruvian domiciled taxpayer must recognize and pay taxes for certain income derived from investments carried through foreign subsidiaries that qualify as "Controlled Foreign Corporation" (CFC), regardless of the regular regime (based on the moment when income is accrued or received), as follows:

A foreign subsidiary will qualify as a CFC when the following conditions are met:

- For Peruvian income tax purposes, it has a legal personality independent from its partners, associates, members or owners;
- It is incorporated in a country or jurisdiction which qualifies as a tax haven or where its passive income is not subject to any type of income tax, or the tax levied is equal or lower than 75% of the tax that would be payable on the same income in Peru; and
- A Peruvian domiciled taxpayer (individual or corporation), individually or together with its related parties, participates, directly or indirectly, in 50% or more of the foreign subsidiary's share capital, income or voting rights.

If a foreign subsidiary qualifies as a CFC, then the Peruvian CFC regime will apply to the passive income it generates (e.g. dividends, interest, capital gains, among others) and, consequently, such income shall be allocated to its Peruvian domiciled owner at the end of the given fiscal year, even though it has not been actually distributed to the latter.

As consequence of the attribution, the Peruvian domiciled taxpayer shall recognise a taxable foreign source income and determine and pay the corresponding income tax.

It should be noted that the income attribution previously mentioned does not include certain passive income, such as passive income that qualifies as Peruvian-sourced.

Considering that, as previously mentioned, branches are "extensions" of their head offices, they do not qualify as a different nor independent legal entity from their corresponding head office. In fact, branches are secondary establishments through which a corporation can develop its business in a different place than its usual domicile (in this case, a different jurisdiction from Peru).

In this context, the Peruvian CFC Regime does not apply to income generated through non-Peruvian branches of Peruvian corporations, and said income will be subject to Peruvian taxes as directly generated by the latter.

6.5 Rules Related to the Substance of Non-Local Affiliates

There are no specific rules regarding the substance of economically related non-local corporations for Peruvian tax purposes. However, the general anti-avoidance rule incorporated to the Peruvian Tax Code (Provision XVI) may apply (see below),

6.6 Taxation on Gain on the Sale of Shares in Non-Local Affiliates

Capital gains obtained by Peruvian corporations from the sale of shares issued by economically related non-local corporations are taxed as a foreign source income.

7. Anti-Avoidance

7.1 Overarching Anti-Avoidance Provisions

As from July 2012, a general anti-avoidance rule was incorporated to the Peruvian Tax Code (Provision XVI), under which Peruvian tax authorities were allowed to consider acts, situations and economic activities performed, established or desired by the taxpayers, in order to determine the real nature of the taxable event.

Provision XVI also established that, in case a tax elusion was detected, the Peruvian tax authority would be entitled to disregard the legal form or structure implemented and collect the taxes that would correspond to the transaction which it considers was really intended by the parties.

Notwithstanding the above, considering that the conditions that would allow the Peruvian tax authorities to disregard any given legal form or structure were not clearly established, which generated juridical insecurity, the application of Provision XVI (except for the "simulated acts" rules) is currently suspended until the Ministry of the Treasury issues the corresponding regulations (which are still pending to be enacted). It is important to mention that, under a recently tax reform, there has been given certain guarantees to the taxpayers for the application of such Provision, for instance the creation of an inspector committee who will issue an opinion if there is a case of tax elusion.

In addition to the above, other specific anti-avoidance rules have been included in Peruvian tax provisions, such as the following:

- Deemed dividends in case of capital reductions, loans granted in favor of shareholders, and indirect disposal of income.
- Restrictions to the transfer, cancellation and/or amortisation of shares issued as consequence of a spin-off and/or a simple reorganisation with no tax effects.
- Indirect transfer of Peruvian shares as a Peruvian source income.
- Non-deductibility of capital losses in case of "wash sales".
- Requirement of "price paid" for the amortisation of intangible assets.
- Peruvian CFC rules.

8. Other

8.1 Regular Routine Audit Cycle

There is no legal or tax provision establishing a routine audit cycle. Nevertheless, the statute of limitations for the Peruvian tax authorities to assess tax debts, require payment and impose fines is four years. This term will be six years for those taxpayers who did not file their tax returns as required by law. The statute of limitations to request or make any compensation and to request tax refunds is four years.

Notwithstanding the above, considering how the statute of limitations should be computed (eg as from January 1 of the following year from which the annual tax return should have been filed), it actually extends beyond the referred terms.

The abovementioned statute of limitations terms may be also extended in case they are interrupted (in which case, the computation re-starts as from the beginning) or suspended (in which case, the computation is only suspended during a period and then continues).

9. BEPS

9.1 Recommended Changes

Peru has the objective to be a member of the OECD. Following this purpose, the Peruvian Government has been adapting its local legislation to the OECD regulations, which includes also the implementation of some BEPs recommendations as follows:

- Action 3: Since January 1st, 2013, Peru included in its tax legislation the CFC Rules, by which it was established a special regime for the recognition of passive income obtained by non-Peruvian subsidiaries controlled by Peruvian domiciled taxpayers.
- Action 4: As a part of our last tax reform, it was included, as of January 1st, 2019 and until December 31st, 2020, the thin capitalisation rules not only for related parties' loans but also for independent parties' ones. In this sense, the loans should not exceed three times the borrower's equity as of the closing of the prior fiscal year. Interest related to any excess will not be deductible for tax purposes. As of January 1st, 2021, the limitation for the deduction of interest will be subject to 30% of the EBITDA from the prior fiscal year.

- Action 5: The Executive Power has been coordinating with Peruvian Congress in order to fix strategies for limiting the creation of new tax benefits and rationalise the ones currently in force.
- Action 7: As a part of our last tax reform, as of January 1st, 2019, it was included a definition of permanent establishment, recognising the temporal permanent establishment, the depending commissionaire, among others.
- Actions 8, 9, and 10: As of January 1st, 2017, the Peruvian Government adapted its local legislation to the OECD regulations, which includes transfer pricing guidelines. As consequence, the requirements for services expenses deduction and the comparable uncontrolled price method in the importation or exportation transactions were modified.

- Action 13: As of January 1st, 2017, the Peruvian Government adapted its local legislation to the OECD regulations, which includes the formal liabilities with respect to transactions subject to transfer pricing rules.
- Action 15: On May 2018, Peru joined into two major OECD Conventions, which are Anti-Bribery Convention and multilateral Convention on Mutual Administrative Assistance in Tax Matters.

9.2 Government Attitudes
As we mentioned, since Peru is seeking to be a member of OECD, Peruvian Government is committed in keep incorporating and adapting its legislation according to the BEPs. This commitment is expressly mentioned in our Multi-Annual Macroeconomic Framework 2019-2022, in which it's been established that to fight tax evasion and avoidance, Peru will be incorporating and adapting its legislation in accordance to OECD recommendations. Also, Peru will negotiate its new Double Taxation Treaties considering the BEPs recommendation to avoid the treaty shopping.

9.3 Profile of International Tax
As part of the globalization, Peru is part of the global business system, and, in that sense, Peruvian economy is impacted everyday by cross-boarding transactions. In this scenario, International tax law has an important role in the equation since it is necessary to give clear rules to the parties involved knowing the tax cost associated with their transactions.

Based on the above, Peru has as a priority the implementation of BEPs recommendations to update the international tax system, and to fight against an aggressive tax planning to secure Peruvian's tax base.

9.4 Competitive Tax Policy Objective
Although, it is important to have a competitive tax policy to attract investments in Peru, especially considering our equity gaps, it is also a necessity to incorporate the BEPs recommendations in order to avoid the erosion of Peruvian's tax base.

Based on the above, in our opinion, the objective of a competitive tax policy will balance properly in the long term, since it is a process that it is being implemented in different countries around the world, and it will lead to a standardisation of the global tax system.

However, we should recognise that, in the short term, adapting our legislation to BEPs recommendations represents a challenge for a developing country as Peru, and requires certain time for the adaptation of all the players involved: government, the Peruvian Tax Administration, and the parties in the transaction.

9.5 Features of the Competitive Tax System
As a developing country, our tax system includes various tax benefits and tax exemptions to attract investments in Peru. However, as part of incorporating BEPs recommendations, Peruvian Government will have to limit the creation of new tax benefits and rationalise the ones currently in force. This will make our competitive tax system less attractive for the investment.

9.6 Proposals for Dealing with Hybrid Instruments
Peru has not yet implemented BEPs recommendations regarding hybrid instruments (Action 2). Our legislation is dealing with such instruments through the CFC rules, the recent limitation to interest deductibility and the amendment to the DTC model.

9.7 Territorial Tax Regime
We do not have a territorial tax regime. However, as of January 1st, 2019, until December 31st, 2020, the deductibility of interest will be subject to thin capitalisation rules, for all the taxpayers, except for the following:

- Banking companies;
- Taxpayers whose income is less than or equal to 2,500 UIT (PEN 10,375,000)
- Taxpayers who through Public Private Association develop projects related to infrastructure, public services, services related to them, applied research and technology innovation under Legislative Decree 1224;
- Indebtedness for the development of the aforementioned projects under the Legislative Decree 1224; and,
- Indebtedness arising from the issuance of representative debt securities that meet certain conditions.

As of January 1st, 2021, the deductibility of interest will be subject to 30% of EBITDA from the prior fiscal year.

This modification in our legislation represents a radical change for the companies, since the thin capitalisation rule was only applicable for loans between related parties. In that scenario, we expect that the investment in Peru decreases.

9.8 CFC Proposals
Peru does not have a territorial tax regime, however, as we mentioned before, it has been implementing CFC rules since January 1st, 2013.

9.9 Anti-Avoidance Rules
Peru has DTC in force with the following countries: Brazil, Canada, Chile, Korea, Mexico, Portugal, Switzerland and the Andean Community (Bolivia, Colombia and Ecuador). These DTCs follow the OECD Model Convention, except for the Andean Community, so we can find the reference of "beneficial owner" in Articles 10, 11 and 12 (referred to passive income), but not in the Article 7.

According to the information provided by the Peruvian government, in order to prevent treaty abuse, it has been incorporated the minimum standards in the new models of DTC that Peru is currently negotiating.

In our opinion, these changes are likely to have impact in the investors in the future, since it will require a more complex analysis in order to apply the benefits from DTC. In fact, the person who claims the DTC benefits should meet certain objective test, which include an additional cost that should be considered to make an investing decision in Peru.

Also, as a developing country, our public institutions are still very fragile, so it will represent a challenge when a controversy case related to the application of the benefits arises. This will also mean an additional cost to be assessed by the investor when is deciding whether invest in Peru.

9.10 Transfer Pricing Changes

In our opinion, the change of the formal liabilities for transactions subject to transfer pricing rules will not represent a radical change, since the taxpayers already had to file a Technical Transfer Pricing Study when they have transactions with related parties. Likewise, since the multinational groups are not representative in our economy, we think that the application of country by country reporting will be minimum.

On the other hand, there has not been changes related to the taxation of intellectual property, therefore, we cannot give an opinion in this matter.

9.11 Transparency and Country-by-Country Reporting

Although, we recognise the complexity around the disclosure of certain information, and the problems with the confidentiality that could arise, in our opinion, these proposals are seeking a common benefit to avoid base erosion and profit shifting. Based on that, we are in favour for the transparency and country by country reporting.

However, we think that it would be important to have an open communication between the Peruvian tax administration and the other parties involved. In that sense, it will be necessary to provide a technical orientation about the application and the requirements, organise debates and have a public platform for inquiries related with how the information provided could be used, the nature of the information provided, among others.

9.12 Taxation of Digital Economy Businesses

Unlike other Latin American countries, Peru has not approved yet any tax regulations (and there is not any bill pending for approval) regarding digital economy businesses operating largely from outside Peru.

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