

# The 13th Annual Americas School of Mines Latin America Taxation - Peru

Rudolf M. Röeder  
Tax Partner  
Lima, Perú

[rudolf.roeder@pe.pwc.com](mailto:rudolf.roeder@pe.pwc.com)

# Agenda

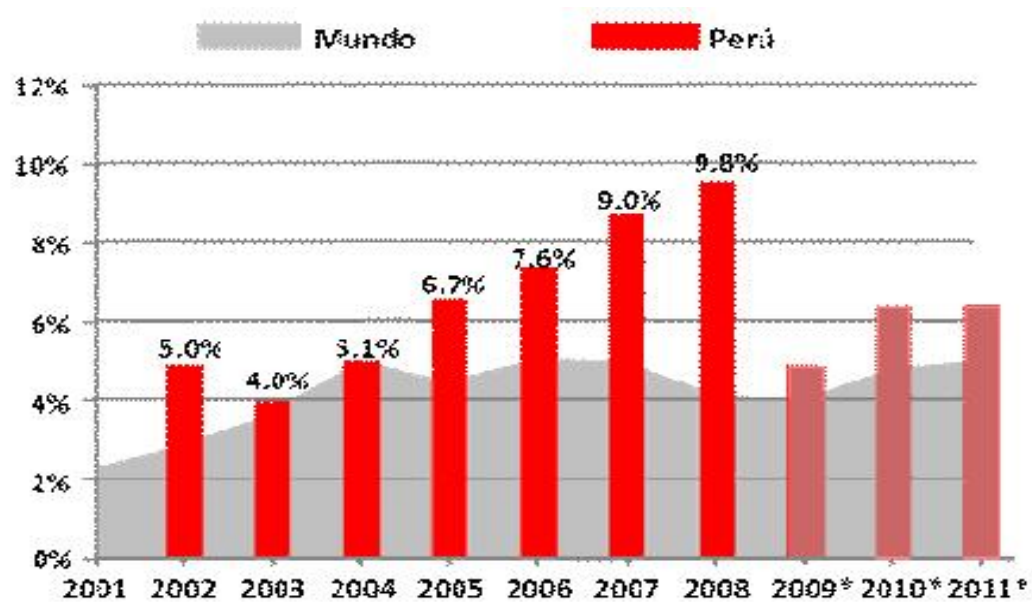
1. Overview of Tax Regime
  - a) Country Overview
  - b) Tax Regime for the Resource Sector
  - c) Other Taxes: royalties, social taxes, VAT.
2. Inbound Structuring
  - a) Cash Repatriation
  - b) Financing Structures
  - c) Holding Company Structures
  - d) Foreign Exchange Restrictions
  - e) Cost Sharing Arrangements

# Overview Of Tax Regime

## A) Country Overview

# The Peruvian Economic Environment

- a) Peru has experienced an excellent economic performance, as from 2002.
- b) In 2008, the GDP increased by 9.8%, a rate among the highest in the world.
- c) Despite the international crisis, positive economic expectations for Peru in the coming years are based mainly on the public and private investments announcements, and on the increase in confidence of foreign and domestic investors.



## The Investment Grade

In April 2008, the credit risk agency Fitch Ratings granted investment grade to Peru by raising the long-term Peruvian foreign currency debt to “BBB”.

This improvement in the classification of the Peruvian debt responds to its strong economic growth, reduction of the degree of internal use of the dollar, improved fiscal accounts and reduction of the debt burden, as well as the accumulation of reserves as a result of a marked trade surplus.

Country	S&P	Fitch	Moody's
Chile	A+	A	A2
Mexico	BBB+	BBB+	Baa1
Peru	BBB-	BBB-	Ba1
Brazil	BBB-	BBB-	Ba1
Colombia	BB+	BB+	Ba1
Venezuela	BB-	B+	B2
Argentina	B-	RD	B3
Bolivia	B-	B-	B3
Ecuador	SD	RD	Ca

## Most Important Taxes

- |                               |               |
|-------------------------------|---------------|
| 1) Income Tax:                | 30%           |
| 2) Value Added Tax:           | 19%           |
| 3) Profit Sharing:            | 8% (mining)   |
| 4) Mining Royalty:            | 1% - 3%       |
| 5) Excise Tax:                | Variable      |
| 6) Custom Duties:             | Variable      |
| 7) Financial Transaction Tax: | 0.6%          |
| 8) Real Estate Tax:           | 0.2% - 1%     |
| 9) Real Estate Transfer Tax:  | 3%            |
| 10) Payroll Taxes:            | 8% (employer) |

## The Peruvian Tax Administration/Tax Court

- a) The Peruvian Tax Administration (SUNAT) has substantially increased its technical abilities over the last 10 years.
- b) However, lack of resources has determined that the number of taxpayers which are regularly audited by SUNAT remains rather small.
- c) The largest taxpayers (“PRICOs”) (many of which are mining companies) are audited by SUNAT on a yearly basis.
- d) There is certain amount of turmoil inside the Tax Administration nowadays, as employees are demanding salary increases after an 8 year freeze.
- e) Important officers are leaving their jobs to pursue private practices.
- f) The Peruvian Tax Court is relied upon in most cases due to its technical capabilities.
- g) Tax Court Resolutions usually follow well known tax precedents.

# Foreign Investment

- a) Foreign investment coming into Peru must not be discriminated. It receives equal treatment save for some procedures it is subject to when acquiring property near the frontiers.
- b) Legal Stability and Tax Stability Agreements are a common practice and many foreign investors resort to them.
- c) There are no exchange controls. However, the Central Bank has a policy of “dirty floating”, aimed at reducing volatility of the Peruvian currency
- d) There are no barriers for the repatriation of funds.
- e) Double Taxation Treaties Network is still limited: Canada, Chile, Brazil and Spain (pending formalization). Treaties are being negotiated with Switzerland, France, Sweden, United Kingdom, Thailand and Italy. These treaties are being negotiated considering both the OECD Model and United Nations Model.
- f) Decision 578 of the Andean Community sets rules to reduce the impact of double taxation between Bolivia, Colombia, Ecuador and Peru. This rules follow the source principle, but still carry uncertainties.

## Overview Of Tax Regime

### B) Tax Regime For The Resource Sector

## Income Tax – Corporate Income

It is an annual tax levied on all income earned by taxpayers resident in the Peru, irrespective of nationality, companies' place of incorporation, or location of the income source. Non-resident taxpayers are subject to income tax only with respect to their Peruvian-source income.

A foreign tax credit is given with respect to foreign-source income taxes paid to the extent that the foreign country's tax rate is not higher than the Peruvian corporate tax rate.

Residents	
Corporate Tax Rate	30%
Dividends	4.1%

## Income Tax – Withholdings

Non - Residents	
Interest from external credits	4.99% (provided that certain requirements are met)
Interests paid abroad by multiple operation companies established in country, resulting from the local use of their foreign lines of credit	1%
Dividends	4.1%
Royalties	30%
Technical Assistance	15% (provided that certain requirements are met)
Other income including interest derived from external credits that does not fulfilled the requirements for a 4.99% rate; as well as interest paid abroad by local companies for credits granted by an external related company	30%

# Income Tax – Tax Treatment Of Major Items

## General Deduction Rule



An expense is deductible against gross income if it was necessary to produce said income or to maintain the source of income. If the company is not yet producing any operating revenues, it is not allowed to deduct any operating expenses. Additionally, there are certain non-operating gains and losses, which are reflected in the income statement whether there has been revenue, or not (i.e. exchange rate gains and losses).

## Start Up Costs



As a general rule, organization expenses, pre-operating expenses - including initial operations and further expansion of operations-, and interest accrued during the pre-operating period may be expensed in the first period of operation or amortized using the straight-line method over a maximum period of 10 years.

Once the company has elected the amortization period, it may only be varied subject to approval by the tax authorities. The total period may not exceed 10 years.

# Income Tax – Tax Treatment Of Major Items

## Acquisition of Mining Rights



- Amortization of the acquisition costs of mining rights starts after the period granted to the owner of the mining right to comply with the minimum production.
- The amortization period must be established based on the probable life of the ore, calculated by taking into account the proved and probable reserves and legal minimum production.

## Exploration Expenses



- Exploration costs accumulated up to the year when minimum production has to be achieved must be added to the acquisition cost and amortized as part of it. Mining companies may choose to expense said costs when incurred,
- The exploration costs incurred after minimum production is achieved, may be deducted in the fiscal period or amortized during the probable life of the mine.

Acquisition and explorations costs may be written-off prior to achieving minimum production if the mining right is abandoned or revoked.

# Income Tax – Tax Treatment Of Major Items

## Development Expenses



- Development expenses may be deducted in the year.
- The mining company may choose to amortize these costs over a maximum period of three years, provided the development allows a production period comprising at least two fiscal periods.
- The development cost may be written off if the mine is depleted or the mine right is abandoned or revoked.

## Infrastructure Expenses



- Mining companies may deduct investment in infrastructure that qualifies as a "public service" (ie, roads, electricity, water supply, etc.), provided the corresponding administrative authority approves the investment project.
- Rulings have not clarified whether the above deduction is also applicable for other statutory investments in infrastructure, like housing, health services, schooling, social assistance parks, which are also subject to approval by the administrative authority.

## Income Tax – Loss Carryovers

- A) By offsetting them against net income obtained within the next 4 fiscal years as from the year in which the loss was generated. The amount that is not offset within such period cannot be offset later; or,
- B) By offsetting them against 50% of the net income obtained in the following fiscal years. Under this system there is no time limit to offset the losses.

After choosing one of the aforementioned systems, the taxpayers can not change it until the accumulated tax losses from prior fiscal years are exhausted.

## Value Added Tax (VAT)

VAT levies the added value in each transaction carried out at different stages of the economic cycle, based on a debit/credit system, whereby input VAT may be offset with output VAT, provided that certain substantial and formal requirements are met.

### Levied Transactions

1. Local sale of goods.
2. The rendering or use of services in country
3. Construction contracts.
4. The first sale of real estate carried out by its constructors.
5. The import of goods.

**VAT Rate = 19%**

## Value Added Tax (VAT)

### Balance In Favor of The Exporter

Exporters of minerals are given a tax credit for VAT paid on their purchases. Such tax may be credited against other Peruvian taxes or fines and penalties derived from tax obligations. A tax refund by means of negotiable credit notes or cash checks is available for any non-utilized tax credit.

### Early Recovery of VAT (Mining Companies In Exploration Stage)

Holder of mining concessions have the right to be reimbursed VAT paid in connection to their activities during the exploration stage. For this purposes, concession holders need to enter into an Exploration Investment Contract with the Government.

The reimbursement may be requested on a monthly basis as from the month following the registration of the mentioned transactions in the purchase ledger of the concession holders.

## Other Mining Taxes And Retributions

### Mining Right Fee

Companies holding mining rights have to pay US\$3.00 per hectare, annually. For minor mining producers, the cost of hectare concession is US\$1.00 annually.

In case the mining company does not comply with the minimum annual production, it is subject to a penalty

### Profit Sharing

Statutory profit sharing of 8% of the employer's taxable income, which is deductible by the employer for tax purposes (a minimum of 20 employees is necessary).

Maximum limit of 18 salaries per employee. The difference is destined to a special training fund.

Profit sharing payments are considered as an expense to the extent that they are paid to their beneficiaries within the term for filing the annual IT return to the Tax Administration.

# Other Mining Taxes And Retributions

## Mining Royalty

Administrative retribution that mining holders shall pay to the Peruvian State for extracting metallic and non metallic mineral resources from its mining concessions.

It is calculated on the basis of the value of the mineral concentrates produced, according to their international market value and it should be monthly calculated and paid in respect the concentrates effectively sold. The law allows the deduction of certain costs and expenses such as indirect taxes, insurance, freight, among others.

Net Assets	Rates
Under US\$ 60 million of annual sales	1%
For the excess of US\$ 60 million and up to US\$ 120 million of annual sales	2%
For the excess of US\$ 120 million of annual sales	3%

## Other Mining Taxes and Retributions

### Payroll

- Employers make monthly payments equal to 9% of the total compensation paid to the employee.
- Employees must choose affiliation with either the National Health System (“EsSalud”) or the Private Health System (“EPS” or “Entidades Prestadoras de Salud”). 25% of the amount paid to the EPS may be used as a credit against EsSalud contributions.
- Employers must apply monthly with holdings for pension fund contributions equal to 13% of the compensation received by the employee, in case he/she is affiliated to National Pension System, or about 12.7%, in case he/she is affiliated to the Private Pension System (in this case, 10% corresponds to his/her personal pension account and almost 3%, to insurance and commissions for managing the fund).

## Juridical Stability Agreements

The investors must make cash contributions, through the national financial system, to the capital of a company or to make risk investments, formalized with third parties.

### Minimum investment: US\$ 10 millions

Guarantees to Foreign Investors	Guarantees to Peruvian Companies Receiving Investment
Income tax stability regime under which the 4.1% dividends tax rate cannot be modified.	Corporate income tax stability, with the income tax rate of 30%. The stabilized income tax rate will be the one in force upon the approval date of the JSA.
Hard currency availability for payments of liabilities and remittances of profits.	Stability of the labor regime applicable for hiring employees.
Exchange rate stability.	
Non discrimination with national investors.	

# Legal Stability Agreement – Mining Companies

## 10-year Stability Contracts

(Operations from 350MT/day up to 5,000MT/day or investment programs of US\$ 2million)

Tax Stability: (i) IT (the rate in force plus 2 additional percentage points); (ii) Export regimes; (iii) Consumption taxes with regard to their transferable nature (VAT); (iv) Special regimes for the return of taxes, temporary admission and similar; and (v) tax exemptions, incentives and benefits with reference to the taxes stabilized

Free disposition of currency generated by their exports

Non-discrimination with regard to exchange rate

Free commercialization of mineral products.

Stability of the special regimes, when granted, for return of taxes, temporary admission and other similar.

Administrative stability

# Legal Stability Agreement – Mining Companies

## 15-year Stability Contracts

(Initial capacity no less than 5,000MT/day or investment programs of US\$ 20 million (in case of new mining companies) or US\$ 50 million (in case of established mining companies))

Same benefits guaranteed in a 10-year stability agreement

Accelerated annual depreciation for machinery, industrial equipment, other fixed assets and buildings and construction

Opportunity of maintaining their accounting in foreign currency.

## Double Taxation Treaties

- Canada
  - Chile
  - Brazil (in force as from January 1st, 2010)
  - Spain (ratification is still pending)
- } Entered into according to OECD / UN Model
- Andean Community (Peru, Bolivia, Colombia and Ecuador)
- } Decision 578

# Roll-over of exploration expenditures

## Alternative 1:

### Funds expensed directly by XCo.

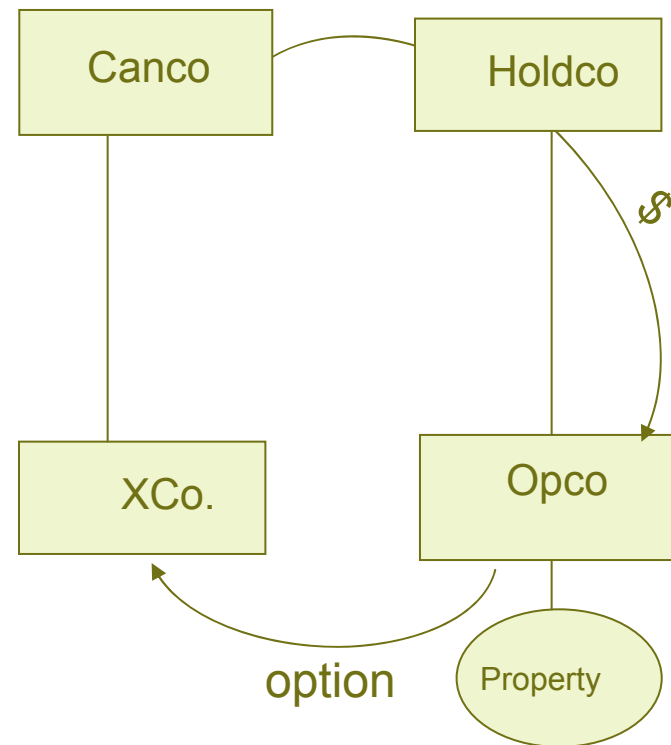
- Input VAT accumulates
- VAT credit is debatable
- Is there an asset?
- If treated as service, income recognition
- Transfer pricing

Alternative 2: Funds contributed to Opco and Opco explores.

- VAT may or may not be recovered, depending
- otherwise, loss of NOL and input VAT

Alternative 3: XCo. Explores and then merger.

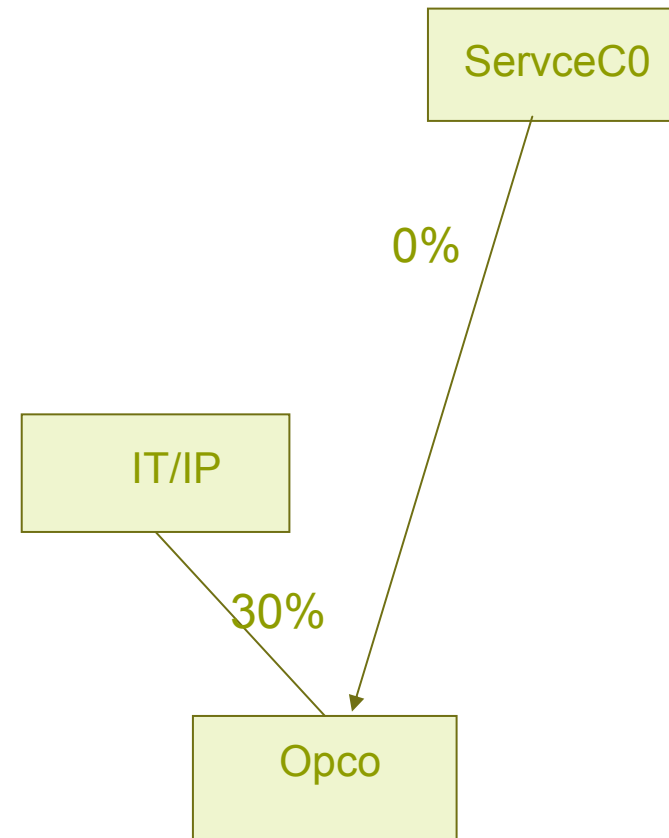
- VAT recovery is debatable, as merger is no taxable transfer



# Cash repatriation

- No payment of dividends possible if no accounting profit.
- Loans out of surplus cash-flow (no profit), subject to deemed interest (TP)
- Royalties, Digital services, 30%
- Technical assistance: 15%
- Other services rendered from abroad: 0%
- Capital reduction: 0%
  - Relatively easy procedure
  - Capital can be earmarked

Compare to 35,6%

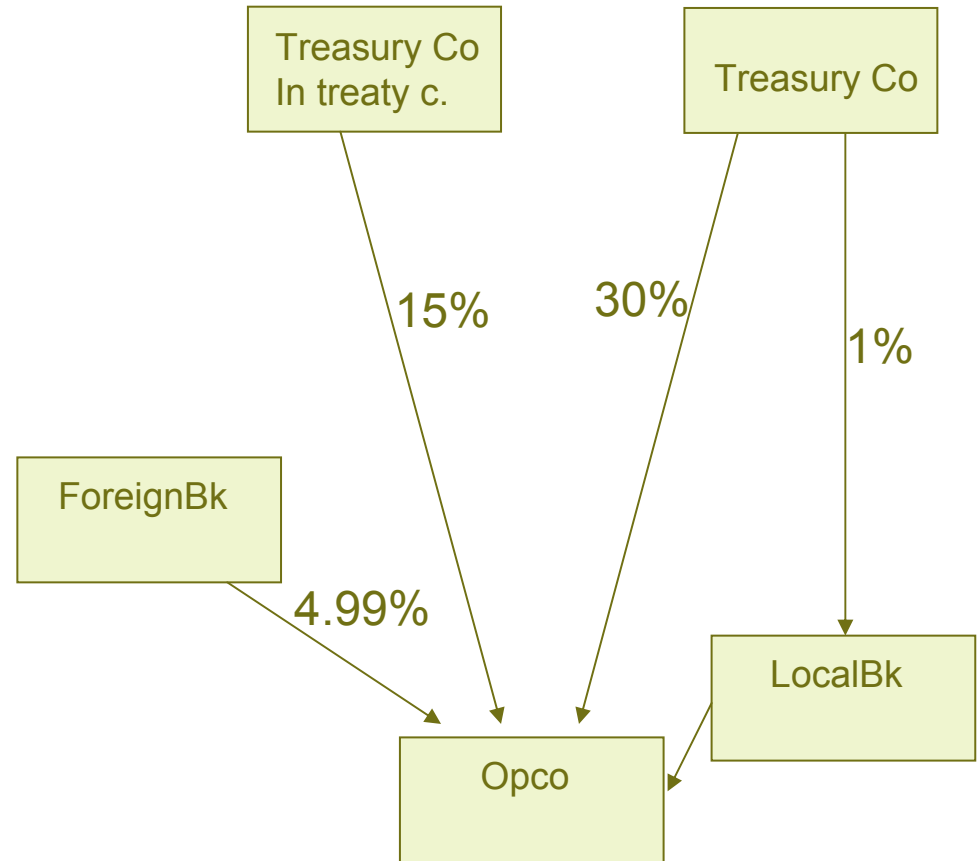


# Financing structure 1

## Loans:

- Corporate: 30%
  - Bank: 4.99
  - B2B: 30%
  - Local B2B: none, and then 1%
  - Treaty countries: 15%
- 
- VAT on interest if none financial institution

Compare to 35,6%



# Financing structure 2

## Silent partnership:

- 30%
- No thin cap
- No interest accrual
- Deductible
- No profit sharing

Compare to 35,6%



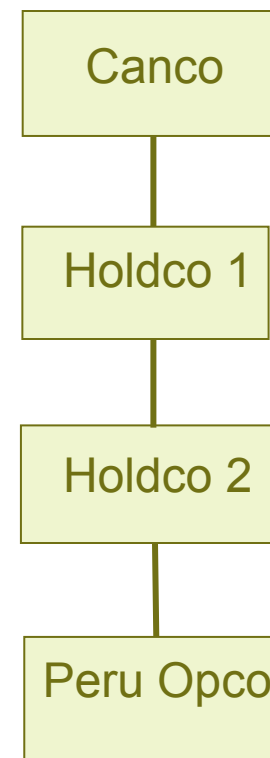
# Holding company structure

Only treaty with residence state as the rule, but

- Does the gain derive mainly from real property
- Does the “carry-on” exception apply to (i) exploration property; (ii) mine

Double tier structures work, but

- Law proposal to tax indirect transfers



# Thank you!