

Latin American Tax Newsalert

A Washington National Tax Services (WNTS)
Publication

October 15, 2012

Peru's expanding tax treaty network should benefit foreign investors

In brief

The Peruvian Finance Minister recently mentioned that Peru has been expanding its use of income tax treaties as instruments to boost investments with its principal trading partners. During 2011 and 2012, Peru expanded its income tax treaty network by signing treaties with Korea, Mexico and Switzerland. These will enter into force once the corresponding ratifications take place. Currently, Peru has tax treaties in effect with Brazil, Canada, Chile and the Andean Community members (Bolivia, Colombia and Ecuador).

A US multinational with investments or operations in Peru should find that the expanding treaty network reduces its cost of business for transactions with companies in the treaty partner countries.

This newsalert highlights the tax treatment of Peruvian transactions under the tax treaties with Korea, Mexico and Switzerland (collectively the 'tax treaties') with regard to (i) interest, (ii) royalties, (iii) dividends, (iv) real estate investments, and (v) capital gains on the sale of shares.

Interest

Domestic Peruvian tax law generally subjects interest payments on related-party loans to a beneficial owner who is a resident of Korea, Mexico or Switzerland to a



30% withholding tax rate. However, under the tax treaties, interest payments on such loans should be subject to maximum Peruvian withholding tax rate of 15%. Note that an even lower 4.99% rate may apply in some cases.

Additionally, certain other interest payment categories are potentially subject to lower or no withholding tax under the tax treaties:

- Interest payments on any type of loans granted by Swiss resident banks should be subject to Peruvian maximum withholding tax rate of 10%.
- Interest payments on financed acquisitions of industrial, commercial and scientific equipment, which are paid to a beneficial owner who is a resident of Switzerland, should be subject to Peruvian maximum withholding tax rate of 10%.

Royalties

Under the tax treaties royalties paid to a beneficial owner who is a resident of Korea, Mexico or Switzerland should be subject to Peruvian income tax withholding at a maximum rate of 15%. Note that under domestic Peruvian tax law royalties are subject to a higher Peruvian withholding tax (30%).

Note that in the tax treaties with Korea and Switzerland technical assistance service fees fall under the category of royalties; these treaties subject such fees to Peruvian withholding tax at a maximum rate of 10%, rather than the domestic income tax withholding rate of 15%.

Dividends

Under the tax treaties, dividends paid by a Peruvian resident company to a beneficial owner who is a resident of Korea, Mexico or Switzerland may be taxed in Peru at maximum rates of 10% or 15%.

Note, however, that domestic Peruvian tax law provides a lower rate; indeed, under the Peruvian income tax law dividends paid by a Peruvian-resident company to a non-Peruvian resident shareholder should be subject to withholding tax at rate of 4.1%.

Real estate investment

Under the tax treaties gain derived by a resident of Korea, Mexico or Switzerland from the alienation of immovable property situated in Peru may be taxed in Peru.

Similarly, gain derived by a resident of Korea, Mexico or Switzerland from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in Peru may be taxed in Peru.

Capital gains on the sale of shares

With regard to the direct sale of Peruvian shares, under the tax treaties the corresponding gain may be taxed in Peru as follows:

- Specifically under the tax treaties with Mexico and Korea the gain may be taxed in Peru provided that, at any time during the 12 months prior to the transfer, the transferor, along with its related parties, held an interest of at least 20% in the share capital of the Peruvian company. For ownership interests of 20% or more,

the Peruvian domestic capital gain rates listed below should apply. Qualifying sales of interests less than 20% should not be subject to tax in Peru.

- Specifically, under the tax treaty with Switzerland the Peruvian capital gains tax should not exceed:
 - a) 2.5% of the net gain from transactions undertaken in the Peruvian securities exchange in regard to shares listed on the public registry of the Peruvian securities exchange
 - b) 8% of the net gain from transactions undertaken within Peru. Note, however, that the tax treaty does not contain a definition of the phrase 'undertaken within Peru'
 - c) 15% of the net gain in all other cases.

With regard to the indirect sale of Peruvian shares, the tax treaty with Mexico does not reference this type of transaction, unlike the tax treaties with Korea and Switzerland which do so by providing that the corresponding gain may be taxed in Peru (as described in the bullet points above).

In assessing the relief under the tax treaties, foreign investors may recall that, in general under domestic Peruvian tax law, capital gains on the direct or indirect sale of Peruvian shares should be subject to Peruvian capital gains tax as follows:

- 5% for sales undertaken on the Peruvian securities exchange in regard to shares listed on the public registry of the Peruvian securities exchange
- 30% in all other cases.

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Solicitation.

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