Setting up your Business in Peru
Issues to consider

As of the end of 2016, Peru's GDP increased by 3.9% and reached a value of US $ 186,838 million approx.; thus, Peruvian economy completed 15 years of continuous growth. The GDP over 2017 is expected to increase 4.2%. Our strategic location on the South Pacific, modern legal and stable framework and vast natural resources makes Peru an excellent country where investors are welcome and can develop their business.

However there are a number of issues which you must consider when you are looking to set up your business in Peru. This document takes you through some of the common questions we come across and gives you practical information about the issues you need to consider.

What type of Business Structure should we use?

There are advantages and disadvantages to all of them, and there is no one correct answer, it's all dependent on your specific business circumstances and needs. A brief overview of the main structures is below:

Establishment (a branch of your overseas business)

- Not a separate legal entity but an extension of the overseas parent company
- No limited liability or ring-fencing of the Peru operations
- If have a permanent establishment in Peru then profits from this PE are liable to Peruvian Corporation tax
- Must file **parent company accounts**, prepared under Peru Company Law, at Companies House for public inspection, even if these are not made publically available overseas

Limited Company:

- Provides limited liability and ring-fencing to Peruvian operations
- Gives a perception of a local business, with longevity
- Corporation tax to be paid on company profits
- Must prepare financial statements and file its own tax returns

Limited Liability Partnership:

- Partners have limited liability
- Profits are allocated to partners who then pay Income Tax on these profits personally
- The tax residence of the member, and where the profits in the LLP originated will determine in what jurisdiction and how these profits are taxed

How much Corporation Tax will the business pay?

As of December 31st 2016 (and 2015) the Corporation Tax rate is 28% and applies over resident companies on their worldwide taxable income. Resident companies are those incorporated in Peru. Branches and permanent establishments of foreign companies that are located in Peru and nonresident entities are taxed on income from Peruvian sources only.

The taxable income of business enterprises is generally computed by reducing gross revenue by the cost of goods sold and all necessary expenses to produce the income or to maintain its source. Since fiscal year 2017 the corporate rate will be 29.5%.

Monthly prepayments must be done during the fiscal year, applying over the net incomes of each month a rate of 1.5% or a coefficient calculated using the resulting tax and net incomes from preceding year, which ever result is higher.

Additionally, the government has created a special regime for companies with yearly net incomes lower to 1,500 ATU (US $ 1,900,000 approx.) stating a progressive accumulative rate: the first 15 ATU of taxable basis are levied at 10%, and the excess with 29.5%. The companies affiliated to this regime will apply a 1% rate over their monthly net incomes to calculate the monthly prepayments only if their yearly net incomes do not exceed than 300 ATU (US $ 380,000 approx.), otherwise must follow the rules of the previous paragraph.

Mining Tax: effective from October 2011, mining companies are subject to an additional Special Mining Tax based on a sliding scale, with progressive marginal rates ranging from 2% to 8.4%. The tax is imposed on operating profits derived from sales of metallic mineral resources, regardless of whether the mineral producer owns or leases the concession.

In addition, mining companies that have signed stability agreements with the Government are subject to "voluntary" payments, which are calculated based on a sliding scale with progressive marginal rates ranging from 4% to 13.12%. These rates are applied to operating profits derived from sales of metallic mineral resources, regardless of whether the mineral producer owns or leases the mining concession. Higher tax rates apply to higher amounts of operating profits.

Temporary Net Assets Tax: it is imposed on resident companies, and on agencies, branches and permanent establishments of foreign entities. Its base equals the value of the net assets of the taxpayer as of December 31st of the preceding year that exceeds PEN 1,000,000 (US $ 312,000 approx.). The payments may offset the advance payments required under the general Income Tax regime or may be claimed as a credit against the Income Tax payable for the tax year. A refund may be requested for any balance of tax payment that is not used in the current year.

What if we use Peru to set up our holding company?

In Peru holding companies are subject to the ordinary tax regime.

A Dividend Tax at a rate of 6.8% during fiscal years 2015 and 2016, and 5% since 2017, is imposed on distributions of profits to nonresidents and individuals by resident companies and by branches, permanent establishments and agencies of foreign companies. This tax is generally withheld at source. However, in certain circumstances, the company must pay the tax directly.

For permanent establishments, branches and agencies of foreign companies, a distribution of profits is deemed to occur on the deadline for filing their annual corporate income tax return (usually at the end of March of the year following the tax year).

Only if a Peruvian company earns profits from another Peruvian company, it must not consider them within its taxable incomes. Otherwise this rule does not apply to foreign profits, being taxed at a rate of 28% during 2015 and 2016, and 29.5% since 2017.

What if we make cross-border transactions between group companies?

Transfer Pricing Rules
Peru follows internationally recognized Transfer Pricing (TP) rules where cross-border trading and financial transactions between affiliated entities have to be conducted on an arm's length basis. The price and terms should be the same as if the transactions had been between completely independent parties.

Our transfer-pricing rules provide for advance price agreements between taxpayers and the Peruvian tax authorities.

Resident taxpayers must file prepare a transfer pricing report which must include a functional and risk analysis, analysis of the adopted pricing model and benchmarking of the arm's length basis. Since 2017 taxpayers subject to TP rules must fill and submit 3 reports describing their transactions with related parties and/or tax heavens: Local Report, Master File and Country by Country Reporting, in order to follow the OECD's BEPS program recommendations.

Typical transactions between affiliated entities that are covered by TP rules are:

- Sale and purchase of goods
- Provision of management services
- Property rental charges
- Transfer of intangible assets e.g. trademarks, patents
- Sharing of knowledge, expertise, business contacts etc.
- Provision of financial support e.g. inter-group loans and charging a "market" interest on loans

Controlled Foreign Corporations Rules
Since 2013 we have an International Fiscal Transparency System, which applies to Peruvian residents who own a controlled foreign corporation (CFC). These rules established the requirements for a foreign company to be qualified as a CFC. For these purposes, the ownership threshold is set at more than 50% of the equity, economic value or voting rights of a nonresident entity.

In addition, to be considered a CFC, a nonresident entity must be resident of either of the following: (i) a tax-haven jurisdiction; (ii) a country in which passive income is either not subject to income tax or subject to an income tax that is equal to or less than 75% of the income tax that would have applied in Peru.

The amendments also provide a list of the types of passive income that must be recognized by the Peruvian resident (such as dividends, interest, royalties and capital gains). The revenues are allocated based on the participation that the Peruvian entity owns in a CFC as of December 31st.

What Employment Taxes and Social Security will need to be paid?

If an individual is resident in Peru then they are subject to Peruvian tax laws on their worldwide taxable income. Nonresidents are taxed on their Peruvian source income only.

Residency of foreign citizens is established on January 1st of the calendar year subsequent to the foreign citizen's continuous presence in Peru for more than 183 days in any 12-month period. Peruvian citizens who leave Peru regain residency status on the first day of the first calendar year after their return to Peru, unless they return temporarily and live in Peru no more than 183 days in any 12-month period.

For resident employees, the tax rates are applied on a progressive accumulative scale expressed in ATU, as set forth in the table below. ATU is an official referential value established by the government at the beginning of each year. For 2017, 1 ATU equals PEN 4,050 (approx. US $ 1,200). The current Personal Income Tax rates in Peru are:

Taxable Income		Rate on excess
Exceeding	Not exceeding	
ATU	ATU	%
0	5	8
5	20	14
20	35	17
35	45	20
45	--	30

Only for resident employees and independent professionals the first 7 ATU (US $ 8,800 approx.) are tax exempt, and can deduct 3 additional ATU from certain services (interests from mortgages, lawyers, medical, architects, etc.) if they have the supporting invoices issued by the providers.

Salaries and remunerations received by nonresident employees for services provided in Peru are taxed at a rate of 30% over the gross income.

Employers have to pay Peruvian Social Security, which is called Health Care Fund (ESSALUD) at a fixed rate of 9% over the salaries.

Employees must contribute 13% of their salaries and wages to the government-sponsored pension fund (OFICINA DE NORMALIZACIÓN PREVISIONAL – ONP). Under an alternative system, employees must contribute an average rate of 12.86% of their salaries and wages, or balance of their pension funds accounts, or a combination of both items to the Private Pension Funds Trustee (ADMINISTRADORA DE FONDO DE PENSIONES – AFP). These amounts must be withheld by employers under both the ONP and AFP systems.

It is the employers' legal responsibility to pay over employee and independent professional's taxes and social security deductions to Peruvian tax authorities. Employers must withhold Income Tax monthly from salaries of employees. An 8% tax must also be withheld on fees paid for independent professional services that are provided to legal entities as payment toward the professional's annual income tax.

What is Value Added Tax (VAT) and should the business be registered?

VAT is a "goods and services tax" on supplies made, the standard rate of which is 18%. There are 4 types of supply:

- Taxable – must charge VAT on supplies, can reclaim input VAT
- Zero rate – can reclaim a special input VAT.
- Exempt – cannot charge VAT nor reclaim input VAT
- Outside the scope – not in the Peruvian VAT system

The supply of most types of goods and services in Peru would be classed as Taxable supplies. VAT applies to the following transactions:

- The sale of personal property in Peru.
- The provision or use of services in Peru.
- Construction contracts.
- The first sale of real property by the builder.
- The importation of goods from outside Peru, regardless of the status of the importer.

However, when these supplies are made to companies which are outside of Peru, advice needs to be sought as to what rate of VAT, if any, to use.

For the aforementioned transactions, VAT payable is determined on a monthly basis by deducting from the gross tax (*output VAT*) the corresponding VAT credit (*input VAT*). As a result of this calculation, an excess credit may arise instead of a financial cost for the tax period.

The gross tax corresponding to each taxable operation is determined by applying the VAT rate of 18% to the tax base (for example, the price of goods and services, or the value of construction contracts). The VAT credit consists of the VAT separately itemized in the payment voucher (or corresponding document) relating to any of the levied activities. Tax returns must be submitted monthly.

Companies with yearly sales lower than 1,700 ATU (US $ 2'150,000 approx.) can defer their VAT payable for 3 months if they meet some requirements.

In general, Peruvian VAT is levied at a rate of 0% on the exportation of goods and services.

For a service to qualify as an export, it must be included in Article 33 or Appendix V of the Peruvian VAT Law. Appendix V can be modified by a Supreme Decree countersigned by the

Ministries of Economy and Foreign Trade. In addition, on the request of a party, new services can be included in Appendix V. For exports of goods, customs documents must provide evidence that the goods have left the country.

Exporters may recover VAT paid on the acquisition of goods and services. Exporters may apply to be reimbursed for VAT paid through credit notes. Credit notes may be used to offset either output VAT or income tax liabilities

Additionally, Peru has Selective Tax on Consumption (ISC) which is an excise tax levied on the sale in the country and import of the goods listed in Appendixes III and IV of VAT Law, such as alcohol drinks, oil, sodas, mineral waters, vehicles and cigarettes.

The ISC tax base consists on the sales value, and CIF customs value. The rates are established in Appendixes III and IV. This tax is included within the cost of goods.

Has Peru signed Double Taxation Conventions with another countries?

Since 2001, Peruvian Government has been making its best efforts to sign Double Taxation Conventions (DTC) to avoid the double taxation over incomes obtained by resident and nonresident subjects which is a limitation to international business and economic growth.

As of January 1st 2015 the DTC with Chile, Canada, Brazil, Mexico, Portugal, Switzerland and South Korea are effective; all of them follow the OECD Model.

Can we provide Share Option Plans to our staff?

Many companies see *Share Option Plans* as being an important way of attracting, motivating and retaining key staff.

Peruvian Income Tax Law has not established specific rules regarding taxation of equity awards or *stock options plans*. Under the general taxation rules, the benefit obtained from a stock option plan equals the spread between the purchase price and the fair market value of the shares. Such spread must be recognized as compensation income because it is provided as part of an employment relationship. However, on the sale of the shares, the individual derives a capital gain equal to the difference between the sale price and the purchase price. Because no specific rule allows the purchase price to include the spread previously taxed as compensation income, a double taxation issue may arise.

However this is a very technically complex area and careful planning needs to be undertaken as soon as share option plans are being considered for implementation in Peru.

How else can we compensate our employees?

Peru has a very comprehensive range of compensation and benefit options available for companies to offer their employees. Pensions, private medical insurance, life and disability cover are now commonplace benefits provided by many Peruvian businesses to their workforce.

Flexible benefit packages are also gaining in popularity, giving employees options on how they wish to “spend” their benefits allowance; which can range from “purchasing” additional holiday entitlement to obtaining full family medical cover.

Like we mentioned previously, the Income Tax is imposed on all remuneration received by an employee in the form of salaries, bonuses, living and housing allowances, tax reimbursements, benefits in kind and any other fringe benefits, so any compensation received by employees because of their job is taxed.

To discuss your requirements please contact the International Office on +44 (0) 1245 449266 or email us directly.

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