



MERGERS AND ACQUISITIONS

Peru

Taxation of Cross-Border
Mergers and Acquisitions

2010 Edition

TAX

Peru

Introduction

In Peru there are no specific legal tax provisions regulating the tax treatment of cross-border mergers. There are only legal tax provisions for tax-neutral local mergers. Cross-border mergers will trigger tax effects according to general tax rules applicable to transfers of assets.

Recent Developments

Although, as noted, there are no legal provisions regulating the tax treatment of cross-border mergers, there are legal provisions regulating the tax treatment of income generated as a consequence of a transfer of shares issued by a Peruvian incorporated company, because such transfers may generate Peruvian-sourced income in the form of capital gains.

Until 31 December 2009 transfers of shares were generally tax exempt, but income tax was levied at 30 percent when the transfer took place out of a central negotiation mechanism (Stock Exchange Market or any central negotiation mechanism set in the Securities Market Law) under the following assumptions:

- from the eleventh transfer on, when the transferor was a non-domiciled individual; and
- when the transferor was a non-domiciled entity.

From 1 January 2010 onwards transfer of shares are subject to income tax. When the transfer is done within the country by a non-domiciled individual or entity it is subject income tax at a rate of 5 percent. All other transfers are subject to income tax levied at a rate of 30 percent.

Asset Purchase or Share Purchase

From the Peruvian tax perspective an asset purchase and a share purchase are not equivalent.

Purchase of Assets

An asset purchase will not trigger any taxable event for the acquirer apart from the input value-added tax (VAT) carried forward by the transferor of the asset. Since it will be not possible to use the input VAT as a tax credit, it will qualify as cost for the non-domiciled transferor.

The value of the asset will represent its stepped-up cost for when it is subsequently sold.

From the transferor's perspective it should be noted that the sale of assets located within the country could generate Peruvian-sourced income in the form of a capital gain that will be taxed a rate of 30 percent.

Purchase Price

For income tax purposes, both assets and shares must be transferred at fair market value.

The fair market value for assets is the value set when purchasing them in an active market. If they are not frequently traded, their fair market value will be set by a valuation. For transactions between related-parties the fair market value must be the value that would have been set by non-related parties (the arm's length principle).

The fair market value of shares will be the price set on the stock exchange.

For shares not negotiated in a central negotiation mechanism the fair market value cannot be below the equity value of the shares to be transferred. The equity value of the shares to be transferred must be calculated by dividing the total net equity of the company on last 31 December between the total number of shares issued by the company according to a balance not older than twelve months.

Goodwill

The difference between the net equity value of a corporation to be merged and the total value of the merged companies must be recognized as goodwill for accounting purposes only. This goodwill will not trigger any taxable event.

Depreciation

Once the assets of an entity are used to generate taxable income, they can be depreciated on a yearly straight-line method by applying the following percentages:

Assets	Rate (%)
Buildings and constructions	3
Livestock, fishing nets	25
Vehicles and other means of transportation (except trains), and ovens	20
Mining, petroleum and building machinery, and equipment (except office furniture and equipment)	20
Data processing equipment	25
Machinery and equipment acquired on and after January 1, 1991	10
Other fixed assets	10

The depreciation admitted for income tax purposes is the one entered in the accounting books, provided it does not exceed the maximum depreciation percentages mentioned earlier. Higher depreciation percentages than these are not permitted, and no adjustment of applied depreciation rates is possible once the taxable year is closed.

Tax Attributes

As already noted capital gains derived by a non-domiciled person or entity from the transfer of shares or assets will be subject to income tax, but the capital gain must be determined on a net basis by deducting from the purchase price at fair market value the cost incurred in acquiring the shares or the assets.

Before any payment of the consideration a request must be submitted to the tax authority for a Capital Investment Recovery Certificate (CIRC), including supporting documentation that demonstrates the cost of the shares and assets to be transferred. The CIRC must be issued within 30 days. At the end of that period it can be assumed that the CIRC has been granted. The CIRC will be valid for 45 calendar days.

Value-Added Tax (VAT)

Share sales and purchases operations are not subject to VAT.

Transfers of asset are subject to VAT at 19 percent. Input VAT generated when purchasing VAT-levied assets can be offset against the output VAT (VAT tax credit) generated by the purchaser at the time of a subsequent sale.

If the acquirer is non-domiciled it would not be possible to use the paid VAT as a tax credit. As a consequence, the paid VAT will be considered as part of the cost of the assets.

A transfer of assets located in Peru by a non-domiciled person or entity is subject to VAT. The acquirer and

vendor are jointly liable for paying VAT to the tax authority.

Transfer Taxes

There is no stamp duty when purchasing or selling assets.

Stamp duty land tax (SDLT) is payable by the purchaser on the transfer of land and buildings at a rate of 3 percent of the adjusted value of the land or buildings to be transferred. This adjustment is made on a wholesale price index basis. The taxable value cannot be less than the value calculated by the city hall, within whose jurisdiction the building or land is located. The first 10 taxable units of the taxable base are SDLT exempt.

Purchase of Shares

The transfer of shares issued by a Peruvian incorporated company may generate capital gains taxed as income on a net taxable capital gains basis.

For income tax purposes, shares must be transferred at fair market value. The fair market value of shares will be the one set on the stock exchange. For shares neither negotiated nor registered in a central negotiation mechanism the fair market value cannot be below the equity value calculated by dividing the total net equity of the company by the total number of the shares issued. The net equity value of the shares must be determined on a last balance sheet basis non being older than twelve months according to a balance not older than 12 months.

Tax Indemnities and Warranties

There are no rules governing the granting of tax indemnities and warranties on the sale or purchase of shares.

Tax Losses

Non-domiciled persons and entities are not entitled to carry forward losses. Only domiciled corporate tax payers are able to carry forward Peruvian-sourced tax losses.

Crystallization of Tax Charges

As long as the purchaser is a domiciled individual or entity, the crystallization of the tax charges will be executed by means of an income tax withholding mechanism at the above rates. Otherwise, income tax must be directly paid by the non-domiciled acquirer by using Form 1073, tax code 3061.

Pre-Sale Dividend

Dividends are income taxed at a rate of 4.1 percent when paid to non-domiciled entities or individuals. The obligation to withhold dividends will arise when the General Shareholder Meeting agrees to distribute the dividends. In the case of branches and other kinds of Permanent Establishments the dividends will be deemed as distributed when the by the dead-line for submission of the annual income tax return.

Transfer Taxes

There is no stamp duty on purchases of shares.

Tax Clearances

The Peruvian Tax Authority is not empowered to carry out audit procedures to determine whether non-domiciled tax payers have complied with tax statute provisions and been duly assessed. Nevertheless, tax authority is empowered to audit all domiciled withholding agents to check if non-domiciled income tax was duly withheld.

Choice of Acquisition Vehicle

There is no particularly favorable vehicle from the Peruvian tax perspective for acquiring shares or assets in Peru, but it is important note that Peru has signed double taxation treaties (DTTs) with Chile, Canada, and Brazil, the last of which became enforceable from 1 January 2010.

Choice of Acquisition Funding

The acquisition vehicle chosen may influence the decision of whether to fund the vehicle with debt or equity.

Debt

The principal advantage of debt is the potential tax-deductibility of interest (see Deductibility of Interest), because payment of a dividend does not give rise to a tax deduction. However, regulations regarding applicable withholdings of dividends and interest, and transfer pricing rules should be taken into account.

Deductibility of Interest

Peruvian income tax law imposes the following limits on interest deduction:

- Interest on debt and related expenses originated from their payments are deductible in the portion that does not exceed the amount of the income for exempted interests.

- Interest on loans granted by related parties can be deducted, provided such debts do not cause the borrower's debt/equity ratio to exceed 3:1.

Withholding Tax on Debt and Methods to Reduce or Eliminate

Interest paid by a domiciled company to non-domiciled companies for financing operations is subject to withholding tax (WHT). For loans between related parties the applicable rate is 30 percent.

However, this rule does not apply if the loan is granted by a non-related financial entity and meets certain requirements, such as:

- the loan does not cover a loan between related parties and is not back-to-back;
- the domiciled company files a statement from the financial entity with the Peruvian Tax Administration in which the lender confirms that no related parties are involved;
- in the case of cash credits it must be shown that money has entered into the country; and
- the loan's interest rate must exceed the predominant preferential rate by more than three points.

For loans obtained in the U.S. market, the predominant preferential rate is the prime rate. For loans obtained in Europe, the predominant preferential rate would be LIBOR. For other markets, the Peruvian Tax Administration will determinate the rate. If all the above requirements are met the WHT rate would be 4.99 percent.

Equity

If a purchaser contributes capital to acquire shares the share issue will not be subject to tax. The contribution will be deemed a cost. Capital gains earned by domiciled company on share disposals are subject to the income tax according to the treatment explained above.

Other Considerations

Company Law and Accounting

The General Corporations Act establishes how Peruvian companies may be form, operated, organized, re-organized, and dissolved. The Act establishes two basic forms of reorganization: mergers, and splits. Conceptually, a merger takes place when two or more corporations are brought together into one entity and it may adopt one of the following forms:

- a merger which creates a new entity and extinguishes the entities it incorporates; and
- the absorption of a company by another and the extinction of the absorbed entity.

In these instances the shareholders of the companies extinguished will receive shares from the new or surviving company. In the case of a split one or more portions of the equity of a company is transferred to a new or pre-existing company. The former company may or may not be extinguished.

The General Corporations Act requires financial statements to comply with legal norms and principles of IFRS approved in the country by the Peruvian Regulation Accounting Committee. Since the IFRS framework is conceptually wider than the General Corporations Act reorganization norms, it is probable that for accounting consolidated information will be required, while for legal corporate purposes individual financial statements will be required. In general terms the General Corporation Act and IFRS both determine the accounting treatment for M&A transactions.

Group Relief/Consolidation

In Peru it is not possible to consolidate profits and losses among related companies.

Transfer Pricing

Peruvian Transfer Pricing Rules apply to all transactions between related parties when one or more of the companies are subject to tax in a foreign jurisdiction and when and the transaction take place from, through or to a jurisdiction with favorable taxation as well. The Peruvian company will be obliged to support these transactions with a transfer pricing study and present a yearly Informative Sworn Statement before the tax authority.

Comparison of Asset and Share Purchases

From a tax perspective, an asset purchase differs from a share purchase. By means of the former you acquire the

ownership of an identifiable asset. By means of the latter you acquire a percentage participation in a corporation equity, and rights to partake in the results of the business through dividends.

Advantages of Asset Purchases

An asset purchase gives ownership of specific assets and triggers no taxable event for the acquirer who can deduct the purchase cost when subsequently selling the asset. The acquirer can also deduct the input VAT on the acquisition from the output VAT that will be generated by future sales, unless the acquirer is non-domiciled, in which case the input VAT adds to the cost of the acquisition.

Disadvantages of Asset Purchases

The transfer of an asset will trigger income tax on any capital gains – the difference between the fair market value of the asset and its cost – for the vendor, and the transfer could be subject to VAT in the vendor's hands if the tax authority deems that the vendor and the purchaser are jointly liable.

Advantages of Share Purchases

A share purchase triggers no taxable event for the acquirer, who can deduct the acquisition cost when subsequently selling the shares. Additionally, through a share acquisition the acquirer gains a participation in the corporate equity, and a right to receive dividends. The transfer of shares will also be VAT exempt.

Disadvantages of Share Purchases

As with an asset purchase the transfer of shares will trigger income tax on any capital gains – the difference between the fair market value of the shares and their cost.

Withholding Tax Rate Chart

Country	Dividends		Interest (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies (%)		
Bolivia ¹	_2	_2	_2	_2
Canada	15	10 ³	15	15
Chile	15	10 ⁴	15	15
Colombia ¹	_2	_2	_2	_2
Ecuador ¹	_2	_2	_2	_2

Notes

1. In application of Decision 578 of the Andean Community.
2. The domestic rate applies; there is no reduction under the treaty. The source state has the exclusive right to tax.
3. The rate generally applies with respect to participations of at least 10 percent of voting power.
4. This rate generally applies with respect to participations of at least 25 percent of voting power.

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