

DOING BUSINESS IN PERU

INTRODUCTION

PERU: BUSINESS OPPORTUNITY FOR FOREIGN INVESTORS

Due to their continued macroeconomic stability, Peru is as a natural destination for foreign investors in the mining, oil, agribusiness, fishing, construction, electrical, financial, chemical - pharmaceutical, tourism, among others economic sectors.

Indeed, in late 2013, Peru's GDP rose by 6%, reflecting the country's optimum economic growth. Thus, following this positive economic trend, it is expected that the GDP of Peru in 2014 reaches 4,1% despite the global economic crisis. The Central Bank of Reserve calculates GDP in \$ 176.7 billion. Thus, the Peruvian economy completed 10 years of continuous growth at rates above the Latin American average. The level of international reserves amounts to US\$ 57.7 billion, equivalent to more than one year of imports and 2 times the foreign public debt stock. This is one of the highest liquidity levels both of the region and worldwide, and represents a support for the international obligations that Peru would need to fulfill in the event of possible contingent scenarios including a damaged foreign environment and international financing restrictions.

Our legislation has a proper legal framework for foreign investment as non-discriminatory treatment, absence of exchange controls, convertibility of currencies, stable tax regime and free remittance of profits abroad (upon payment of withholding tax on dividends of 4.1%). In this regard, we invite you to explore investment opportunities in our country.

Our professional team will advise you throughout the process to establish a subsidiary, branch or permanent establishment in the country, obtain the appropriate permits and comply with tax, labor and administrative obligations in order to conduct your business properly, obtaining the maximum benefit.

LEGAL FRAMEWORK

I. Corporations issues

1. Incorporation

Peruvian Corporations Law mainly recognizes the following types of companies:

- Sociedad Anónima - S.A. (Joint-Stock Company).
- Sociedad Comercial de Responsabilidad Limitada - S.R.L. (Limited Liability Commercial Partnership).

Both types of companies are required to have a minimum of two (2) stockholders, who may be individuals or legal entities domiciled (resident) in Peru or not.

No minimum capital amount is required (except for certain activities such as banking, finance and insurance). In order to incorporate a company, capital must be paid in no less than twenty five percent (25%) of the face value of every share or participation. For cash contribution, capital amount must be deposited in a bank or financial institution of the local financial system, in the name of the company.

Peruvian Corporation Law establishes three types of *Sociedad Anónima* (Joint- Stock Company), with different features and characteristics:

a) Closed Joint-Stock Company (*Sociedad Anónima Cerrada - S.A.C.*)

This type of company is appropriate for few partners and small or medium size capitals. It may not have more than twenty (20) stockholders; its shares are not freely transferable in the Stock Market. These companies can operate without a Board of Directors.

b) Open Joint-Stock Company (*Sociedad Anónima Abierta – S.A.A.*)

This type of company is appropriate for large capitals. It is open to contributions by any person or entity through the Stock Market.

These companies are required to comply with the following conditions: A primary public offering of shares or obligations convertible into shares must be made; there must be more than seven-hundred fifty (750) stockholders; more than thirty-five percent (35%) of the company's capital must belong to one-hundred seventy-five (175) or more stockholders. A joint-stock company is also considered "open" when all the voting stockholders approve unanimously to adopt said regime.

Its shares are freely transferable and must be listed in the Stock Market. Any stipulations contained in the stockholders' agreement or the by-laws establishing limitations on the free transferability of shares, any manner of restriction on the trading of the shares, or any preferential right of the stockholders or the company to acquire shares in case of their transference, are not valid.

c) Ordinary Joint-Stock Company (*Sociedad Anónima – S.A.*)

This type of company is appropriate for middle-size companies. Its shares usually are not listed in the Stock Market. These companies operate with a Board of Directors.

d) Limited Liability Commercial Partnership (*Sociedad Comercial de Responsabilidad Limitada – S.R.L.*)

This company represents an alternative to the Closed Joint-Stock Company. It must have a maximum of twenty (20) partners who may be individuals or legal entities. As in the case of Joint-Stock companies, the responsibility of the partners is limited to their participation in the Company's capital.

The capital is divided into equal and indivisible participations, which may not be incorporated into securities.



These companies has not Board of Directors. Its administration is conducted by the Partners' Meeting and the Management.

2. Branch establishment

Another way to doing business in Peru, without having a company, is through the incorporation of a permanent establishment such a Branch.

In accordance with Peruvian Corporations Law, branches are secondary establishments through which companies develop their activities, in places other than their legal domicile.

These entities lack legal identity independent from their parent companies (except for tax purposes). In fact, although the establishment of a branch requires registration, it does not grant legal personality to the branch. The branch has no rights and obligations different from the parent company.

Branches must have permanent legal representation in Peru and be granted management autonomy in the scope of their activities assigned by the parent company.

3. Taxation - differences between subsidiaries and branches

Subsidiaries and branches levied with the same Income Tax Rate: thirty percent (30%) on net income. Even though, branches established by non-domiciled pay Income Tax only over their Peruvian-source income, while companies pay taxes over their worldwide income.



An additional four point one percent (4.1%) rate as a withholding tax levies profits distributions by companies and branches established in Peru. In the case of companies it is understood that there is distribution of profits when the companies distribute dividends. Said distribution takes place when the agreement is adopted by the shareholders meeting or the profits are made available to the partners or stockholders, whichever occurs first.

In the case of branches of companies or entities of whatever nature constituted abroad, it is understood that there is distribution of profits when the branches show profits at closing of the fiscal year. Thus, it is in that moment that the obligation to pay the additional rate would originate. This payment shall take place within the period established for the filing of annual tax returns (that is, within the first three months of the next year).

Therefore, if the profits to be obtained by the entity to be constituted in Peru were to be indefectibly distributed to the foreign stockholders, the difference between incorporating a company or a branch would lay, basically, on the date of payment of the additional rate referred to above. In the case of a branch, as we have indicated, the obligation of payment will originate beforehand (when profits are shown at fiscal year closing, even if there were no distribution agreement nor had any distribution taken place), while in the case of companies said obligation will arise when the distribution agreement is adopted or profits are distributed, whichever occurs first.

On the contrary, should the profits to be obtained in Peru were not to be distributed, but reinvested in our country, it seems advisable to constitute a company, since in this manner there would not arise the obligation to pay the additional rate.

In the **Exhibit A** we compare the main rules applicable to branches and subsidiaries.

TAXATION IN PERU

II. Tax Issues

1. Income Tax

a) Domiciled (Resident) entities - main rules

- A company is considered domiciled in Peru for tax purposes if is incorporated in Peru or it has a permanent establishment, branch or agency in Peru of a non-domiciled entity. In this case, the condition of domiciled includes the branch, agency or other permanent establishment, as regards their Peruvian-source income.
- Domiciled companies are subject to taxation on their worldwide income.
- Non-domiciled branches, agencies or other permanent establishment in Peru are taxed only on their Peruvian-source taxable income.
- The general corporate income tax rate is thirty percent (30%).
- The distribution of dividends and any other manner of distribution of profits to individuals and to non-domiciled legal entities is subject to a four point one percent (4.1%) rate, payable by the beneficiary of said distribution.
- Losses may be offset under one of the following systems:

- i) Losses incurred in one fiscal year may be offset with taxable income obtained in the four immediately subsequent fiscal years computed as from the year following to the generation of losses. The balance non-offset after this period may not be offset in the next years ; or,
 - ii) Losses incurred in one fiscal year may be offset by imputing them on a year basis, until using their entire amount, to the fifty percent (50%) percent of the taxable income obtained in the immediately subsequent fiscal years (without any time limitation).
- Corporate Income Tax Returns for the income obtained during the fiscal year must be filed between the end of March and the beginning of April of the next year.
 - Twelve monthly advance tax payments are made based either on the previous year's tax revenue ratio or two percent (1,5%) of monthly gross revenue.
 - Thin capitalization rules have been incorporated into Peruvian Income Tax Law. These rules establishes that the maximum amount of indebtedness with related individuals or companies will be determined by applying the factor of three (3) to the taxpayer's equity at closing of the previous fiscal year. Should at any moment during the fiscal year the indebtedness with related individuals or companies exceed the maximum amount referred to above, only those interests proportionally corresponding to said maximum amount of indebtedness will be deductible.

b) Non-domiciled (non residents) withholding tax - main rules

Taxpayers domiciled that pay taxable income to beneficiaries not domiciled in Peru (foreign companies or individuals that do not have a company or a permanent establishment incorporated in Peru), must withhold and pay to the Tax Administration the withholding tax corresponding to the non-domiciled beneficiaries, as indicated below.

- Four point ninety-nine (4.99%): rate applicable to interests on loans or credits from abroad, granted by companies non-domiciled in Peru, if the requirements established in the Income Tax Law are fulfilled (not to exceed the maximum rates allowed by Law and in the case of cash loans, the entry of the foreign currency into the country is to be evidenced).

This rate will not apply to interests paid abroad by Peruvian private companies for loans granted by a non-domiciled company with which it is economically related; nor to interests paid abroad by Peruvian private companies for loans granted by a creditor whose intervention has the purpose of concealing a credit operation between related parties. In these cases the applicable Income Tax withholding rate is 30%.

- Thirty percent (30%): rate applicable to royalties.
- Four point one percent (4.1%): rate applicable to the distribution of profits from domiciled legal entities.
- Ten percent (10%): rate applicable to the chartering of vessels and aircraft.
- Thirty percent (30%): rate applicable to other income.

In activities performed partially in Peru and abroad, the Withholding Tax applicable is as follows:

Activity	Effective Withholding Tax Rate (%)
Air transport	0.3
Lease of vessels	8
Lease of aircrafts	6
Supply of shipping containers	4.5
Transport containers demurrage	24
Insurance	2.1
International news agencies	3
Maritime transport	0.6
Motion picture distribution	6
Transfer of television broadcasting rights	6
Telecommunications services	1.5

Benefits obtained by non-domiciled entities for performing technical assistance and digital services to domiciled companies or entities are taxable in Peru.

- i) **Technical assistance:** Technical assistance is defined by tax regulations as every service -wherever it is performed- through which the provider undertakes to provide specialized technical knowledge, applied through the exercise of an art or technique, intended for the manufacturing of goods or rendering of services or the performance of other operations the purpose of which is to generate income. According to this, technical assistance may include, inter alia, engineering services such as the execution and supervision of assembling, installation and startup of machinery, equipment, and production plants; calibration, inspection, repair and maintenance of machinery and equipment; performance of tests and trials, quality control, project research and

development, execution of pilot programs, laboratory research and experiments.

The rate applicable to technical assistance is fifteen percent (15%) - withholding tax. In this case the provider has to send a statement declaring that he will perform technical assistance services and the fees obtained for such services will be registered in its accountant books. Additionally, Peruvian Tax Administration will require a report made by a worldwide auditor firm, certifying that the technical assistance was rendered.

ii) Digital services: Digital services are understood as all services made available to the user through Internet (or any network), through accesses on-line, which are essentially automatic and not viable in the absence of information technology. Regulations consider as digital services, inter alia, the following:

- Software maintenance
- Technical support to the client in the network
- Data warehousing
- Application hosting
- Application Service Provider - ASP
- Web site hosting
- Electronic access to consulting services (professional services - consultants, lawyers, physicians, etc.- through electronic mail, video conference or other remote communication medium)
- Banners
- "On line" auctions
- Information distribution
- Access to an interactive Internet page

- Interactive training
- On-line portals for purchase-sale

The rate applicable to digital services is thirty percent (30%) - withholding tax.

c) Transfer pricing rules

For Income Tax purposes, the determination of transfer prices (market value) for transactions with related companies, must be made using the arm's length principle and be supported with documentation and information (a report) on the valuation methods used to determine transfer pricing, indicating the criteria and objective elements considered for said determination. Should the value assigned differ, either by overstatement or understatement, the Tax Administration will adjust it.

The arm's length principle adopted establishes that prices agreed in transactions between related companies must correspond to the prices which would have been agreed in transactions between non-related subjects, in independent transactions in equal or similar conditions.

Two or more individuals, companies or entities are considered as related parties when one of them participates, directly or indirectly, in the management, control or capital of the other; or when the same individual or group of persons participate directly or indirectly in the direction, control or capital of several persons, companies or entities. The condition of related party also occurs when the transaction is conducted using persons, whose purpose is to conceal a transaction between related parties, and in case of sale of more than fifty percent (50%) of total sales to a non-related company.

The following, among others, are some of the assumptions causing the relationship:

- When an individual or legal entity owns (directly or indirectly) over thirty percent (30%) of another company's capital.
- When the capital of two or more companies belong, in over thirty percent (30%), to common partners.
- When the companies have directors, managers or administrators, or other common officers, who have power of decision on the financial and commercial agreements adopted.
- When a non-domiciled company has one or more permanent establishments in Peru, in which case there will be a relationship between the non-domiciled company and each one of its permanent establishments, and the permanent establishments between themselves.

d) Agreements to avoid double taxation signed by Peru with other States

Peru has signed agreements to avoid double taxation and fiscal evasion in relation to Income Tax with Chile, Canada, Brazil and countries of the Andean Pact (these countries are Colombia, Ecuador and Bolivia).

Peru has signed Agreements with Portugal, Mexico, and South Korea, which will enter in force on 1 January 2015.

2. Value Added Tax

Value Added Tax (VAT) is a consumption tax on added value, levied on the sale in Peru of goods and chattels, the import of goods, rendering of services, use in the country of services provided by non-domiciled, construction contracts executed in Peru, and the first sale of real property by those persons defined by the Law as "builders".

VAT is an immediate realization tax, but settled monthly with an eighteen percent (18%) rate. Because of its structure of taxation on added value, the gross VAT of operations for the period is determined every month (fiscal debit) and the VAT transferred to the taxpayer in acquisitions is deducted (fiscal credit)¹; insofar as the material and formal requisites contemplated in the VAT rules are met.

The substantial or constitutive requirements for the fiscal credit, are basically two: i) the acquisition should constitute cost or expense for Income Tax purposes; and ii) it is intended to operations for which VAT will be paid. The formal requisites are: i) the VAT should appear differentiated or separate on the payment documents issued by the supplier; ii) the payment document (invoice or debit note) should meet the requisites and characteristics established in the Payment Document Regulations; and iii) payment documents are entered into the Purchase Register, within the established period (twelve -12- months).

VAT Law contains listings (appendixes) of operations exempt from said tax.

There is a special regime for the exports of goods in general as well as for certain services, operations not subject to VAT, which also cause the refund of the VAT paid by the exporter on its related acquisitions, which is known as Balance in Favor of the Exporter, subject to fulfilling the requisites established by regulations.

Actually there are special regimes of VAT withholding, recipients and deductions, which should be considered in the financial planning of operations.

1. Exceptionally, in the case of use in the country of services provided by non-domiciled, and the import of goods, the VAT payable is the gross VAT (i.e., in this case the application of VAT fiscal credit is not possible). VAT paid to the Tax Administration for these concepts may be subsequently applied as fiscal credit.

- Through the withholding system, certain taxpayers designated as withholding agents by the Tax Administration, retain a percentage (six percent 6%) of the amount indicated on their suppliers' invoices, issuing a withholding certificate that will be used against the VAT payment said supplier should make in the corresponding month.
- Under the recipient regime, certain taxpayers designated as recipient agents should charge their customers an additional percentage (two percent 2%) over the sales price, issuing a recipient certificate that will be used against the VAT payment said customers should make in the corresponding month.
- Under the deductions system, those taxpayers acquiring certain products shall deduct a percentage from the purchase value to be deposited in a special account with *Banco de la Nacion* (government-owned bank), in the name of the suppliers. The suppliers may only withdraw the funds on said accounts for the payment of their tax obligations.

3. Selective Consumption Tax (ISC)

ISC is levied on the consumption of certain goods specifically indicated by supreme decree. Are subject to ISC the sale in Peru at producer level, the import and sale in the country by the importer of gasoline, gasoil, liquefied oil gas, kerosene, certain automobiles, ethyl alcohol, certain alcoholic beverages, cigarettes, beer, among other goods.

ISC is a tax applied only in the producer or importer stage. ISC rates or fixed amounts vary according to the type of goods involved.

4. Customs Duties

In general, the import of goods is subject to customs duties and VAT.

Ad-valorem customs duties are determined based on Value at Customs, which is established according to the rules of the World Trade Organization Agreement on Valuation at Customs.

These duties have variable rates depending on the customs tariff involved. Additionally, it should be kept in mind that Peru has commercial agreements with several countries, which imply the granting of preferential customs treatment that could reach up to the total exemption from payment of customs duties. Therefore, this aspect must be reviewed depending on the goods to be imported.

VAT levied on imports is determined by applying the eighteen percent (18%) rate on the basis of the customs CIF value plus the duties and taxes applicable to imports. VAT paid on imports may be used as fiscal credit in the same month, subject to fulfillment of the substantial and formal requirements established by VAT Law.

Certain imports are subject to additional variable duties and customs duties rebates, the ISC, the additional customs duties surtax and anti-dumping and compensatory duties (according to product and country of origin).

5. Other taxes

Beside those mentioned above, there are some local taxes. The main ones are the Property Tax (levied on the ownership of real property), Excise Tax (levied on the transfer of real property), and the Vehicle Tax (levied on the ownership of certain vehicles).

On their turn, municipal services such as street cleaning, parks and security are subject to the payment of rates to the Municipal Councils in the jurisdiction of which the property is located.

TAXATION ON SALARIES

III. Hiring of personnel

It will correspond to the branch or subsidiary to open the payrolls and withholding books, and assume the costs required (the tax costs derived from the hiring of personnel are summarized in the Exhibit II).

In the case of hiring foreign employees by an employer domiciled in Peru, the remuneration paid to said employees would constitute Peruvian-source income for them, since it would be remuneration for the rendering of services in Peru. Therefore, said income would be subject to Income Tax payment (withholding) at a 30% rate, as established by Income Tax Law, so long as the foreign employee maintains the tax status of non-domiciled in Peru.

With regard to the filing of annual Income Tax returns by the foreign employees, it should be taken into account, that under Income Tax Law, taxpayers who received



only fifth-category income (income from personal work performed as employees, that is in a relationship of dependence) are not required to file tax returns.

Foreign employees may opt for the Income Tax treatment applicable to individuals domiciled in Peru, after remaining in the country during one hundred eighty-three percent (183) days in any period of twelve (12) months. The change in tax status from non-domiciled to domiciled will become effective as from January 1 of the year following that situation.

Those employees with tax status of domiciled (Peruvians or foreigners) are subject to Income Tax under a progressive scale rate of fifteen percent (15%), twenty-one percent (21%) and thirty percent (30%), and are entitled to a yearly free deduction of seven (7) UIT (*Unidad Impositiva Tributaria* -Tax Unit-, is a tax reference unit established annually. For 2014 this deduction is S/. 26,600 *Nuevos Soles*, it means, around US\$ 9,672).

In the case of hiring non-domiciled individuals as independent professionals (not included in the payroll), they would be subject to Income Tax payment (withholding) at a twenty-four (24%) rate on gross income.

We remain at your orders for any clarification or additional information that you could require on the contents of this report. So feel free to contact us by phone or e-mail.

Lima - Peru, 2014

EXHIBIT A

Branches and Subsidiaries

Comparison of main aspects

Aspect	Branch	Subsidiary (affiliate)
1. Territorial relationship of income	Taxes levied on Peruvian-source income only.	Taxes levied on worldwide income, with the possibility of applying the income taxes paid abroad as credit.
2. Imputing of expenses and costs incurred abroad	Difficulty in supporting expenses and costs transferred by the parent company by means of contracts, and difficulty in billing between parent company and branch.	Imputing of expenses and costs transparent and clear, without tax contingencies.
3. Remittance of profits	Unrestricted remittance of profits abroad.	Unrestricted distribution of dividends and

		remittance of same abroad.
<p>4. Tax treatment of net annual income and distribution of profits or dividends</p>	<p>The net annual Peruvian-source income obtained by the branch would be subject to Peruvian Income Tax, at a 30% rate.</p> <p>It is understood that there is distribution of profits when the branches show profits at closing of the fiscal year. Thus, it is in that moment that the obligation to pay the additional rate (4.1%) would originate. This payment shall take place within the period established for the filing of annual tax returns (that is, within the first three months of the next year).</p>	<p>The net annual worldwide income of the subsidiary would be subject to Peruvian Income Tax (IT) at a 30% rate.</p> <p>When dividends are distributed to the parent company, they would be subject to Income Tax withholding at a 4.1% rate.</p>

<p>5. Responsibility before third parties for activities in Peru</p>	<p>The parent company answers with 100% of its equity for all the branch's obligations.</p>	<p>The subsidiary answers with its own equity for its obligations, unless parent company joint and several liabilities are agreed, according to customers' demands.</p>
<p>6. Mergers</p>	<p>It is not possible to merge a branch in Peru with a company.</p>	<p>Joint-Stock Companies and Limited Liability Commercial Partnerships can merge with another companies.</p>
<p>7. Legal Personality</p>	<p>Branches lack legal identity independent from their parent companies (except for tax purposes). The branch has no legal personality different from the parent company.</p>	<p>The constitution of a company causes the creation of a legal entity, which has legal personality different from its partners.</p>



ABOGADOS®

8. Company Organization	The administration is conducted by the Board of Directors (when corresponding) and Management.	It has a permanent legal representation and management autonomy within the scope of the activities assigned to it by the parent company.
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EXHIBIT II

Hiring of Personnel

Mainly costs

PAYROLL CONTRIBUTIONS					
	DEFINITION	RATE	TAXABLE BASE	BENEFICIARY	CREDITOR
HEALTH CARE REGIME	Provides the employee with medical services, hospitalization, surgery and medicines and the payment of his remuneration during the time the illness lasts. For female employees, there is also the payment of an amount equivalent to 45 daily remunerations before and after delivery, when pregnant, among other economic benefits.	9% paid by the employer	The employees' remuneration	Employees	Seguro Social de Salud (ESSALUD)

<p>ADDITIONAL WORK RISK INSURANCE</p>	<p>Covers contingencies of work accidents and professional illnesses, disability or death resulting from work accidents or professional illnesses, for working in jobs involving high-risk activities.</p>	<p>0.9% to 7%, according to the risk of the activities of each work centre, paid by the employer</p>	<p>The total employees' remuneration (hourly-rated and salaried) exposed to the risk</p>	<p>Employees exposed to the risk</p>	<p>Seguro Social de Salud (ESSALUD) or Entidades Prestadoras de Salud (EPS)</p>
<p>NATIONAL PENSION SYSTEM</p>	<p>Guarantees the employees the payment of retirement pensions. The right to receive a retirement pension is acquired at 65 years of age, if contributions have been paid for at least 20 years.</p>	<p>13% paid by the employee</p>	<p>The employee's remuneration</p>	<p>Employees</p>	<p>Oficina de Normalización Previsional (ONP)</p>
	<p>Guarantees the affiliated employees the payment of retirement, disability, or dependent's pensions, and</p>	<p>Around 12% (Contribution plus a percentage for commission and another for insurance, established by</p>	<p>The employee's cash remuneration</p>	<p>Employees</p>	<p>Administradoras de Fondos de Pensiones (AFP)</p>

<p>PRIVATE PENSION SYSTEM</p>	<p>funeral expenses. The right to receive a retirement pension is acquired upon reaching 65 years of age. The employee chooses between this system or the National Pension System.</p>	<p>each AFP). Paid by the employee</p>			
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