Digital Taxation in Peru and Tax Treaties

By:

Lisset López Miranda

December 8, 2020

Reinforced by the COVID crisis, the worldwide expansion of the digital economy is a phenomenon that does not only worries and affects developed countries. Certainly, any State where the Internet access is conceived by its citizens as a basic need to carry out their economic transactions either within or outside the country, should have to pay attention to the tax issues derived from the performance of digitalized business, an unstoppable reality which goes far beyond a simple discussion about the advantages and disadvantages of creating digital services taxes.

As highlighted by Pascal Saint-Amans during an interview in September 2020, the Director of the Center for Tax Policy and Administration at the OECD has affirmed that the current work of the OECD regarding the topic is not targeted to taxing digital services, but renovating the international system in order to address the tax challenges of the digitalization of the economy. Based on a global solution specially before the digitalized businesses of multinational

enterprises (MNEs), the OECD aims to allow countries to levy with corporate income tax those businesses whose growth relies on the digital age in which we find ourselves.

With respect to this complex issue, the digital economy has not been a topic left aside by Peruvian tax policies makers. On the contrary, a widely tax reform was enacted in Peru in 2003 through Legislative Decree No. 945 regarding international tax matters based on the fact that conventional tax sources rules for services (services execution location's nexus) were not enough to levy non-residents on new type of transactions derived from technological development principally fueled by Internet globalization which not depend on physical presence.

Further justifications are described in the Written Report of the above-mentioned decree. In earlies 2000's, the market use nexus was not generally applied to trigger source income with respect to services since the digitalization and remote services were not as widespread in the Peruvian territory as today. In this respect, the Written Report refers the market use as the "new nexus" which does not require a permanent establishment (PE) for guarantee taxing rights to the payer residence's State. Precisely, this criterion is said as the one developed for Internet based transactions.

Congruently, the 2003 tax reform with non-material later amendments, establishes that digital services rendered by non-residents corporations, performed within Peru or abroad, are levied with a 30% withholding tax, provided that the services are used for economic purposes in Peru, or used or consumed in Peru. For income tax purposes, "digital services" are defined as services provided through the Internet or any of its adaptation, protocol application or platform, or through the technology used by the Internet or by any equivalent network performed, which are characterized as being essentially automated and not feasible in the absence of information technology. The regulation presents an enunciative list of digital services examples as software maintenance, data warehousing, application service provider, banner ads, among others.

However, identified as one of the problems of the electronic commerce for

income tax purposes since 2003, the categorization of this type of business income is still a problem today because of the way in which technology affects digital products and services. The limits between license use of software and digital services are not cleared taking into account Peruvian Administration Notices (No. 110-2019-SUNAT and Notice No. 42-2014-SUNAT, for example).

The different tax treatment applied regards on the characterization of complex benefits received by the user linked to a software. For example, the software as a services, in which a third-party provides applications and makes them available to users over the Internet, have been defined as a type of cloud computing services and as an automated digital service (ADS) by Pillar 1 Blueprints, the last document published by the OECD with respect to the new nexus and profit allocation in a digital economy.

As noted by Aleksandra Bal (Bal, 2014) a tax challenge for cloud-based services will arise in assigning the compensation between the software's license use and the involved digital services. Clearly, this matter is beyond the purpose of this article, but it should be pointed out that this is a trendy topic in Peruvian tax consultancy nowadays.

Regarding the use or consumption in Peru nexus rule for digital services, the referred nexus to Peruvian jurisdiction exists when the services are intended to Peruvians resident users' activities included governmental authorities' activities. It is assumed that a business income recipient uses or consumes a digital service in Peru when the user accounts the compensation as an expense or cost for income tax purposes.

Based on the general rule that only business income recipients are demanded to keep accounting books, cross-border business-to-business (B2B) supplies of services are effectively levied in Peru with income tax. Nevertheless, the increasing business to consumer market (B2C) in Peru, whose annual growth is projected to be the largest of the South America region in 2020, is not reached by any tax, neither income tax nor VAT (under the reverse charge mechanism).

Under an international perspective, with only nine Double Tax Treaties (DTT) signed by Peru, with the Andean Community, Brazil, Canada, Chile, Japan (not

in force yet), Korea, Mexico, Portugal and Switzerland, digitalized business taxation is not directly addressed by most of the aforementioned DTTs, except with Brazil and Switzerland ones which treat digital services as royalties. With the exception of the Andean Community DTT, all the others follow the OECD Model Convention with certain specific amendments which recognizes Peru's mainly condition as the source State.

As it is mostly accepted, the principal purpose of DTTs is prevent international double taxation to promote the exchanges of goods and services, as well as the movement of capital and people. That purpose is tried to be reached first with a distribution of taxing rights between the residence State and the source State. Then, in the case both countries have taxing rights, the credit method in the residence State of the income recipient offers relief against double taxation. With regards to taxing right's allocation, the current nexus rule contained in Article 7 of DTT under the OECD model does not allow the source State to levy with income tax any business income under this article scope, unless the supplier has a PE in the source State. Therefore, without a PE definition that includes digitalized business services, these will remain out of taxation of the source State.

Thus, according to Peruvians DTT's except the one with the Andean Community, royalties arising in a contracting State and paid to a resident of the other contracting State may be taxed in both States. Consequently, that characterization of digital services' compensations as royalties allows taxing rights to source State with limits, provided royalties beneficial ownership's requirements are fulfilled. Notwithstanding, neither of the mentioned DTT's brings any treaty definition of digital services. Peru-Brazil DTT royalties' treatment goes far beyond any other DTT signed by Peru because it leaves business income of Article 7 without effective content. In fact, for this DTT the term royalties not only means the standard definition of royalties as payments of any kind received as a consideration for the use of, or the right to use, any intellectual property, or for the use or right to use, industrial or commercial or scientific equipment's, or for information concerning industrial, commercial or scientific experience.

Conversely to the traditional definition, for Peru-Brazil DTT purposes, royalties

also mean any kind of payment received for technical services, technical assistance services, digital services, and business services (consultancy included), which entitles Brazil and Peru's income tax levy on these services' compensation. As a result, digital services rendered by Brazilian corporations to Peruvian users for their consumption in Peru will be subject to a withholding tax rate of 15% on gross income (instead of the 30% general rate). For its part, Peru-Switzerland DTT establishes that in addition to the standard royalties' definition, this term includes payments for technical assistance services and digital services. Subsequently, Peru will levy digital services supplied by Swiss corporations which trigger Peruvian source income (digital services used or consumed in Peru) with a 10% on gross income withholding tax rate (instead of 30%).

In respect to the Andean Community tax treaty, entirely based on the exclusive taxation in the source income State, it applies to transactions between residents in Colombia, Ecuador, Bolivia and Peru. This tax treaty establishes that business income from professional, technical, technical assistance and consultancy services are only levied in the member State in which the benefit of the services occurs. It is presumed that the place where the benefit occurs is the one where the corresponding expense is charged and recorded. Other type of business services profits will be levied only by the member State in which the business activity has been performed.

The Andean Community Court of Justice has stated that in a globalized and interconnected world with sophisticated information networks, the focus is on levy the income where the benefit occurs in the case of business income from professional, technical, technical assistance and consultancy services. Furthermore, the significance granted by the Court to these activities will consider digital services as part of either technical or technical assistance services. Therefore, digital services will be levied in a State member no matter their performance is carry out abroad that country.

Returning to a global vision of the analyzed matter, it should be noticed that in its long path to becoming an OECD member, Peru closely follows the discussion progress towards a global solution to tax challenges arising from digitalization. Nevertheless, Peru has not stablished yet unilateral tax measures to levy high

digitalized services especially in the context of B2C services, but the intention is present according to a later comment.

Undeniably, the need to increase tax collection as one of the resources to face the COVID crisis, the sense of tax justice and the difficulties to reach a global consensus especially from the United States of North America, has led to the recent proliferation of unilateral tax measures in response to the digitization of the economy. The unilateral tax measures to face this phenomenon, as digital services taxes on gross income (applied or ready to be applied by Brazil, Italy, France, Spain Italy, Great Britain, and others) and VAT as permanent tax policies are not recommended by the OECD. The negative impacts are principally the risk of double or multiple taxation, the negative consequences on commercial relationships between the countries of residence of the principal MNEs and the user countries, and the price elevation effect on digital services' consumers, especially individuals.

Thinking about the future in a post-Covid era, the Peruvian Multiannual Macroeconomic Framework 2021-2024 - highlighting the average tax-to-GDP ratios in Peru of 16.9% which is low compared to Latin America and OECD countries average (23.2% and 34%, respectively) - aims to increase the permanent tax revenues. This purpose is intended to be reached through the adjustment of previously levied sources as municipal taxes (as an OECD recommendation in 2020), the assessment of current tax exemptions and tax regimes for small and medium-sized enterprises, and digitalized businesses have a special room for new tax measures through the VAT.

In fact, Peruvian tax policy makers are planning to apply VAT (general tax rate of 18%) on enterprises suppliers of services through digital platforms. Similar tax measures have been recently taken by other Latin America countries in which VAT collection is focus on B2C operations by means of financial intermediaries (like credit card issuers) or non-residents registration and compliance.

Nevertheless, up to early October 2020, no detail of the VAT on digital services for B2C transactions with influence in the Peruvian market has been disclosure by the Peruvian Government (parliament neither executive level), but it seems

that we will take some of the experience and rules of our neighbors. Still, seventeen years after the first tax reform on the matter, what is secure is that Peruvian second wave on challenges and policies regarding digital economy taxation has just begun.

---

*LL.M in International Taxation, University of Florida Levin College of Law, Florida, United States. Second Major in Taxation, Pontificia Universidad Católica del Perú, Lima Perú. Lawyer, J.D. from Pontificia Universidad Católica del Perú, Lima Perú.

View online: Digital Taxation in Peru and Tax Treaties

Provided by Afronomicslaw