Peru deemed dividend rule for "credit" granted to shareholders modified

Peru's government issued regulations on 18 April 2015 that further amend the deemed dividend rules contained in the 2014 tax reform that made changes to the rules governing certain "credit" granted by Peruvian corporate taxpayers to resident individual shareholders and (corporate and individual) nonresident shareholders. Under the reform, credit granted to shareholders (other than resident legal entities), to the extent such credit does not exceed the total of profits and freely distributable reserves, may be characterized by the Peruvian tax authorities as deemed dividends subject to the tax rate in effect at the time the tax charge arises (which is at the time of the payment, unless otherwise stated).

Background

Dividends and any other form of profit distributions (collectively, "dividends") paid by resident corporate taxpayers are subject to tax in Peru, unless distributed to another resident corporate taxpayer.

Under the rules in effect until 31 December 2014, any credit granted by resident corporate taxpayers to their partners, associates, titleholders or participants (collectively, "shareholders"), in cash or in kind (whether to an individual shareholder or to all shareholders) and regardless of the legal form used, was recharacterized as a deemed dividend subject to a 4.1% withholding tax in any of the following circumstances:

- The credit was not granted by a company authorized to operate in the financial system (e.g. banks, financial institutions) or a leasing company;
- The recipient was not obligated to repay the amount;
- The due date for repaying the amount exceeded 12 months; or
- The actual repayment was not made within 12 months.

The previous regulations for the deemed dividend rules provided that the amount to be considered a dividend was required to be proportional to the profits and freely distributable reserves that were attributable to the shareholder based on its participation rights. Any excess amount constituted a loan and was subject to the deemed interest rule in other sections of the Income Tax Law, including the transfer pricing rules.

The recharacterization as a dividend applied from the time the credit was granted. The resident corporate taxpayer was required to pay the tax authorities the amount of tax that should have been withheld within the month after the occurrence of any of the situations requiring the application of the deemed dividend rule. If the shareholder had partially repaid the original credit by the time the deemed dividend rule was applied, only the balance remaining unpaid was considered as a deemed dividend. Credits granted in situations triggering the application of the deemed dividend rules had to be supported by written agreements.

Tax reform

According to the government, resident corporate taxpayers were able to circumvent the provisions triggering the deemed dividend rules. The reform eliminates the specific conditions required to trigger the rules. As from 1 January 2015, *any* credit granted by resident corporate taxpayers (except for "multiple operations" companies or leasing companies) to shareholders will be recharacterized as a deemed dividend subject to tax to the extent the credit does not exceed the total of profits and freely distributable reserves. This applies whether the credit is in cash or in kind, whether it is granted to an individual shareholder or to all shareholders and regardless of the legal form used. (The law does not include a "grandfathering" rule for outstanding credits that were granted for years ended on or before 31 December 2014.)

The dividend tax rates increased with effect from 1 January 2015 are as follows: 6.8% for 2015-2016; 8% for 2017-2018; and 9.3% for 2019 and thereafter. There is a special grandfathering rule, under which a payment made in or after 2015 that is linked to accumulated results or other deemed

dividend-triggering factors derived on or before 31 December 2014 will be subject to the 4.1% dividend tax rate.

The government has not indicated how the new deemed dividend rule will interact with other tax rules applicable to loan transactions, and the applicable regulations have not yet been updated in this regard. Thus, the new rules could be interpreted to mean that only the amount paid that is proportional to the profits and freely distributable reserves attributable to the shareholder should qualify as a deemed dividend subject to the tax rates above, and that any excess should be treated as a loan subject to the deemed interest rules, including the relevant transfer pricing provisions. Interest income recognized from loan transactions is subject to the corporate tax rate in effect at the time of the payment (28% in 2015-2016; 27% in 2017-2018; and 26% in 2019 and thereafter).

April regulations

The April regulations amend the deemed dividend rules to conform to the tax treatment provided under the new law. Similar to the former rules, the April regulations provide that the recharacterization as a dividend applies from the time the credit is granted; however, there no longer is a need to verify whether of any of the situations have occurred that previously were required to apply the deeming provision. Therefore, the provision that excluded amounts partially repaid before the occurrence of those situations from the amount of the deemed dividend has been abolished. Resident legal entities now must pay the tax authorities the amount of the tax that should have been withheld within the month following the grant of the credit, at the new tax rates effective as from 1 January 2015. The requirement that credits granted must be supported by a written agreement remains in place.

The April regulations do not address the tax treatment of outstanding credits that were granted for years ended on or before 31 December 2014.

The regulations also do not expressly provide the tax treatment that would apply to future distributions of profits and freely distributable reserves reflected in the accounting records of resident corporate taxpayers if these distributions include amounts that already were taxed under the deemed dividend rule.

Comments

It is unclear how the tax authorities will interpret the new regulations. Potentially affected investors should review intragroup financing terms implemented before 2015 to identify any potential tax exposure, and evaluate the costs associated with borrowing money from Peru that accrues interest on arm's length terms (as required under the Peruvian transfer pricing rules).

Additionally, since it is unclear how the tax authorities will treat distributions of amounts previously taxed under the deemed dividend rule, taxpayers should implement appropriate controls in the interim (e.g. by using auxiliary records and supporting their tax positions with solid legal grounds) to avoid taxing the same amounts twice. Double taxation could occur, for example, in situations in which a credit is treated as a deemed dividend for tax purposes and a profit distribution for the same amount is declared in the future and reflected in the financial statements, or where a credit is treated as a deemed dividend for tax purposes but it is accruing interest income in the financial statements.

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