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Peru

Tax Regime for Small Taxpayers and Special Economic Zones

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Technical Report

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ABBREVIATIONS

BEPS	Base Erosion and Profit Shifting
CCS	<i>Contribuciones a la Seguridad Social</i> (social security contributions)
CETICOS	<i>Centros de Exportación, Transformación, Industria, Comercialización y Servicios</i> (Centers for Export, Transformation, Industry, Commercialization, and Services)
CIEN	<i>Centro de Investigación de Economía y Negocios Globales</i> (Center for Economic Research and Global Business)
ENAHO	<i>Encuesta Nacional de Hogares</i> (National Household Survey)
FDI	Foreign direct investment
FHTP	Forum on Harmful Tax Practices
FTZ	Free trade zone
GDP	Gross domestic product
IGV	<i>Impuesto General a las Ventas</i> (general sales tax)
ILO	International Labour Organization
IPM	<i>Impuesto de Promoción Municipal</i> (municipal tax)
IR	<i>Impuesto a la Renta</i> (income tax)
IRC	<i>Impuesto a la Renta Corporativa</i> (corporate income tax)
ISC	<i>Impuesto Selectivo al Consumo</i> (selective consumption tax)
LP	Legal person
MEF	<i>Ministerio de Economía y Finanzas</i> (Ministry of Economy and Finance)
MINCETUR	<i>Ministerio de Comercio Exterior y Turismo</i> (Ministry of Foreign Trade and Tourism)
MSE	Micro and small enterprise
NP	Natural person
NRUS	<i>Nuevo Régimen Único Simplificado</i> (New Single Simplified Regime)
OECD	Organisation for Economic Co-operation and Development
RER	<i>Régimen Especial de Renta</i> (Special Income Tax Regime)
RG	<i>Régimen General</i> (general regime)
RI	<i>Régimen Intermedio</i> (intermediate regime)
RMT	<i>Régimen MYPE Tributario</i> (MSE Tax Regime)
RS	<i>Regímenes Simplificados</i> (simplified regime)
RUC	<i>Registro Único de Contribuyentes</i> (Unique Taxpayer Registry)
SDZ	Special development zone
SEZ	Special economic zone
SIS	<i>Seguro Integral de Salud</i> (Comprehensive Health Insurance)
SME	Small and medium-sized enterprise
SUNAT	<i>Superintendencia Nacional de Aduanas y Administración Tributaria</i> (National Superintendency of Customs and Tax Administration)
UIT	<i>Unidad Impositiva Tributaria</i> (unit of taxation)
VAT	Value-added tax
WTO	World Trade Organization
ZOFRATACNA	Tacna Free Trade Zone

PREFACE

In response to a request by the Ministry of Economy and Finance (MEF) of Peru, a technical assistance mission from the Fiscal Affairs Department (FAD) of the International Monetary Fund (IMF) visited Lima from August 12 to 26, 2019, to analyze certain aspects of the country's tax regime. The mission comprised Roberto Schatan (FAD and head of mission), Juan Carlos Benítez (FAD), and Isaias Coelho and José Madariaga (both external advisers).

The mission met with Deputy Minister of Economy Michel Canta and held a number of meetings with MEF technical teams headed by Marco Camacho, Director General of Government Revenue Policy, Miryam Yepes, Director of Economic Intelligence and Tax Optimization, Nelly Arce, Director of International Tax Affairs, Irene González, Director of Consumption and Taxation on Foreign Trade, and Eduardo Sotelo, MEF Advisor. Meetings were also held with Liliana Casafranca, Director General of Financial Markets and Private Pensions, Pedro Herrera, Director General of International Economic Affairs, Competition, and Productivity, José la Rosa, Director of the Directorate of International Economic Affairs, together with legal advisors Marely Huatuco and Brayan Palomino from the Ministry of Foreign Trade and Tourism, with officials from the Ministry of Production, led by Juan Carlos Zecenarro, Advisor to the Office of the Deputy Minister of the Ministry, and José Salazar, Director General of Policy and Regulatory Analysis, and with Strategy Manager José Antonio Peña and his technical teams, as well as other officials from various departments of the National Superintendency of Customs and Tax Administration (*Superintendencia Nacional de Aduanas y de Administración Tributaria* –SUNAT). The mission also met with private-sector representatives, managers from the Sociedad Nacional de Industrias, independent consultant Elmer Cuba (Macroconsult), and tax specialists from firms EY, PwC, and Damma.

The mission is grateful to the authorities for their hospitality and extensive cooperation. A particular expression of acknowledgment and thanks is extended to Miryam Yepes for her crucial collaboration in providing information and organizing meetings.

EXECUTIVE SUMMARY

The topics discussed in this report are tax regimes for small taxpayers (Chapter II) and the tax treatment of special economic zones (Chapter III). Although these aspects of the tax system have little direct effect on public finances, they affect many people and how those people make decisions or impact the positioning of certain regions relative to the rest of the country. Both are of social and political scope that is disproportionate to their magnitude of tax revenue collection, which is why their design must remain focused in its most strategic sense.

The special tax regime for small enterprises in Peru currently covers approximately 1.2 million active taxpayers, or 92 percent of the total, that bring in tax revenue amounting to barely 0.3 percent of GDP, that is, 8 percent of total corporate income tax. The regime is not designed to bring in considerable sums, but rather to have large segments of the population participate in the social contract, as they play an important role in the country's development and for which the alternative is to turn to informality, with the usual consequences of low productivity and precariousness.

The main source of strain in the small taxpayer regime is between the intention to simplify and reduce the tax burden for businesses with lower resources, thus minimizing the tax obstacle to formalization, and the intention to prevent the regime from being used by larger taxpayers to avoid taxes. An additional source of tension is that taxes are just one aspect of informality; other regulations and benefits, such as those applicable to employment and health, can weigh much more heavily in the decisions of small businesses. Although the tax system has to do its part, it is not solely responsible for decreasing the tremendous level of informality in Peru of between 60 and 70 percent, depending on how it is measured (ILO, see Box 2).

There are a number of good studies on Peru's small taxpayer regime, well known to the MEF and SUNAT. Although a consensus does largely exist on the regime's assessment, there are differences in the suggestions as to what should be done. There are currently three simplified regimes for small businesses, all optional to the general corporate income tax regime and each with its own categories that change the tax burden based on the size (mainly sales) of the enterprise. The tax bases and rates also change, creating ample opportunities for arbitrage, the artificial subdivision of businesses, and tax evasion. At the end of the day, all this makes the system far from simple. Worse still, a large portion of these taxpayers are outside the effective scope of SUNAT's scrutiny (no electronic invoices are issued).

The smallest, and only natural persons, have access to the New Single Simplified Regime (*Nuevo Régimen Único Simplificado* – NRUS) with which they fulfill all their tax obligations (except social security contributions) by paying a very small fixed monthly fee. The threshold is also used to determine the level for registration and payment of the general sales tax (*Impuesto General a las Ventas* – IGV) and the corresponding obligation to issue an invoice. This is the hiding place for

salaried employees as self-employed workers, professional service providers, and related persons (families) who subdivide their businesses among family members to pay an almost symbolic tax. Some analysts propose reducing the threshold for this regime and stripping it as much as possible by removing taxpayers' activities that may qualify for it. Others propose increasing the IGV threshold at the same time to reduce the number of taxpayers to whom this tax applies and may credit input VAT. The latter proposal would separate the NRUS threshold from the IGV threshold.

The mission, in turn, favors leaving the regime for the smallest taxpayers unchanged, with the exception of updating the fees, which were established in soles in 2003. The reality is that there are no strict boundaries for these types of regimes while the tax administration has no verification capacity. Even if the threshold were to be lowered, participants could subdivide further, conceal more income, and pretend they carry out activities that are not exactly the ones in which they are involved. SUNAT has made considerable progress with electronic invoicing, and its coverage will soon reach the NRUS threshold, which is 23 units of taxation (*Unidades Impositivas Tributarias* – UIT). For this reason, raising the threshold is not recommended at this time, especially if taxpayers above but close to this amount do not cost the treasury (*fisco*) either, since the IGV credit in Peru is refunded only to exporters. Besides, the NRUS threshold is close to the average of IGV thresholds in a broad sample of countries.

A greater reform effort must focus on the other two simplified regimes, the Special Income Tax Regime (*Régimen Especial de Renta* – RER) and the Micro and Small Enterprise Tax Regime (*Régimen MYPE Tributario* – RMT), both open to natural and legal persons. The RMT can be accessed by taxpayers with annual sales of up to 1,700 UIT (US\$2.1 million) and has approximately 700,000 active taxpayers. Under the RER, whose own ceiling is 125 UIT (approximately US\$155,000 annually), a rate of 1.5 percent is paid on gross income,¹ such that every taxpayer with a relatively high profit margin, that is, more than 5 percent of sales, is taxed under this regime instead of opting for the general regime or the RMT, under which a much higher rate is applied to profits. The incentive to subdivide businesses and benefit from the RER is particularly strong. This regime also inhibits efforts to formalize the economy because business costs and expenses, including payroll, are not deducted. Although most analysts note this problem, not all recommend eliminating this regime. The mission considers this to be necessary and that it should be replaced by a regime that taxes the taxpayer's net income base, but calculated based on cash flow, which has other advantages.

The RMT is simply a rate concession granted to those who were already under the general regime, allowing them a marginal rate of 10 percent for the first 15 UIT of net income. This moved taxpayers from the general regime to a less expensive regime, without managing to attract people from the informal sector or the RER owing to the supposed advantage of the

¹ This term is used loosely to mean income before deductions. Under the legal rule, "net income" is gross income less refunds, bonuses, and discounts.

gradual nature of the tax. Therefore, the suggestion is to eliminate this regime and create an “intermediate” one between the NRUS and the general regime comprising all those taxpayers that are currently under the RER and most of those under the RMT. The threshold of this intermediate regime could be 150 UIT, where cash flow would be taxed at the general regime rate of 29.5 percent. The simplicity would lie in the calculation of the base, with the financial advantages being that investments could be immediately deducted and a smaller number of accounting books would have to be kept. The system would be progressive owing to the three regimes (NRUS, intermediate, and general), without the need to introduce a fee for additional increasing marginal rates in the intermediate regime, as proposed by some specialists. The proposal would aim to provide a realistic solution to some of the main problems in the small taxpayer regime: excessive arbitrage, ad hoc regime that is inexpensive for high-profit businesses, unnecessary benefits, and lack of incentive to request an invoice for purchases.

Special economic zones (SEZs) also offer a set of tax benefits whose economic advantage is not very clear. There are currently four such zones in operation, including the Tacna Free Trade Zone (FTZ). SEZ users have the benefit of the suspension of indirect taxes on imports as long as such imports do not enter the rest of the country, as is common in the operation of such zones internationally. The idea is to facilitate exports without having to recover taxes paid for imported inputs. In Peru, however, the zones also benefit from a full exemption from income tax and from the tax on distributed dividends. This is unusual (although not unheard of), especially in countries in the region.

Nevertheless, SEZs have managed to attract only a handful of relevant enterprises and create few jobs (the number of which is not known with any certainty, given the poor quality of official data in that regard). This has also led to studies, proposals, and pressures to reform the current rules in order to make SEZs more successful. The most popular assessment is that SEZs have failed because they are located in disadvantaged regions, under government administration, without infrastructure, far from markets, and without skilled labor, among other similar factors. While there is little doubt that this is true, analysts’ subsequent logic is more daring: SEZs should be allowed where private investors decide to locate, since they will know better how to choose favorable locations, retaining all the tax benefits. The idea is for SEZs to be an instrument for promoting investment in general, separate from regional development. This poses a potential problem of eroding the country’s tax base.

Although the MEF proposes substantially decreasing the income tax benefit in SEZs, leaving it at a reduced rate of 20 percent, it also allows SEZs to lose their connection to regional development; they could be set up and proliferate where investors decide, with the necessary safeguards so as not to break the rules on harmful tax practices, in accordance with the rules adopted by the Organisation for Economic Co-operation and Development (OECD) within the framework of base erosion and profit shifting (BEPS).

However, this poses a serious risk to Peru's tax base, as it offers a tax advantage to national enterprises and foreign subsidiaries competing in the national market, meaning that the income tax benefit cannot be put solely towards promoting exports since it would violate World Trade Organization (WTO) standards. Large taxpayers could therefore relocate their operations to SEZs, supply the domestic market, and be free of income tax. The regime would attract considerable investments, which would be made anyway, as found by the vast literature on investment tax incentives (and as is currently the case in the zones in operation).

Peru has difficulty collecting taxes on par with other countries in the region, and it is clear that it is not in a position to give up tax revenue. However, it ranks high for foreign direct investment (FDI), private corporate investment as a proportion of GDP, and even export diversification. From a strategic standpoint, sacrificing tax collection to improve indexes that are less of a concern than tax revenue levels is not justified.

In summary, if the income tax benefit for SEZs were to be completely eliminated (including the dividend distribution exemption), there could be more flexibility as to their location. Otherwise, even if the benefit is moderate, the connection to the development of poorer regions would have to be maintained. Even in this case, however, the regulations governing them would have to be improved considerably.

At present, the legal framework applicable to SEZs is a regulatory tangle, with different characteristics and terms in each case that are not justified. In this respect, there is consensus between the various ministerial entities. The problem is that some would like to standardize the regime by granting the tax exemption to all present and future SEZs, while others would not extend such an exemption into the future and would create a new legal framework only for future zones, leaving the current regulation as is.

The mission instead recommends consolidating the regulatory framework for present and future SEZs, for all intents and purposes, with the exception of the income tax regime. The regime under which users made their investments prior to the law change should be respected, for the period of validity of their contracts with the zone. All subsequent investments, by either the same or new users, should fall under the new legal framework, which, in the mission's opinion, should not include the income tax benefit if the location becomes flexible.

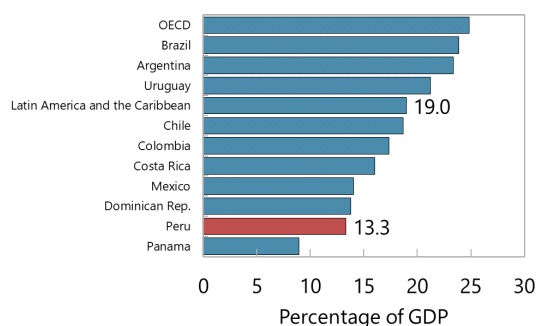
In any case, the benefits granted, including those referring to indirect taxes, should be conditional on specific investment and employment targets for the user. The production and transparency of corresponding information will therefore have to be improved significantly not only at the SEZ level, but also in respect of the ministerial entity that regulates those zones.

I. INTRODUCTION

1. **Peru has successfully dealt with the economic volatility of recent years, standing out among its Latin American peers.** Governments implemented prudent “countercyclical” macroeconomic policies that have fostered relatively high and stable growth rates compared to those of the region, reducing poverty as the country maintained low levels of public debt and high international reserve margins.²

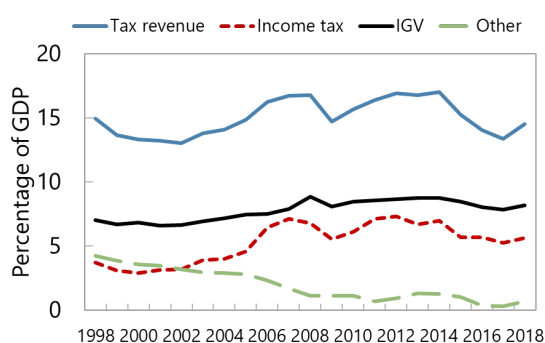
2. **However, the tax policy has been less successful.** Tax revenue collection is comparatively low for the region (Figure 1) and has lost even more ground in recent years (Figure 2), representing a constraint to reducing public infrastructure and social development program deficits faster. This is partly a reflection of a somewhat erratic tax policy. In 2014–2015, priority was given to reforms to facilitate growth (for example, low corporate income tax (*impuesto a la renta corporativo* – IRC) rates and a reduction in withholding schemes), followed in 2016–2017 by measures focused on improving progressiveness and formality (the lowering of IRC rates was reversed, a reduction in value-added tax (VAT) rates was proposed, and a system with better benefits for small taxpayers was introduced).

Figure 1. Tax Revenue of the General Government of Selected Countries (2017)



Source: OECD (2019), *Revenue Statistics in Latin America and the Caribbean 1990-2017*.

Figure 2. Changes in Tax Revenue and Primary Taxes (1998–2018)



Source: Prepared by the mission based on data from the Central Bank of Peru.

3. **The task of increasing collection was entrusted to the tax administration for improvement.** A significant effort was made to achieve this,³ especially through the adoption of an electronic invoicing system.⁴ In terms of the tax policy, changes were recently made to some

² IMF, *Peru: Staff Report for the 2018 Article IV Consultation*, June 19, 2018.

³ E. Rojas et al., *Peru – TADAT Performance Assessment*, FAD, IMF, June 2017; E. Rojas et al., *Perú – La Administración Aduanera de la SUNAT: Retos para un Funcionamiento Coordinado y Eficiente*, FAD, IMF, August 2017. More inspection powers were also given to SUNAT, such as the general anti-avoidance rule.

⁴ Matthieu Bellou et al., *Digitalization to Improve Tax Compliance: Evidence from VAT e-Invoicing in Peru*, IMF Working Paper (June 2019).

selective consumption taxes (*Impuestos Selectivos al Consumo* – ISC).⁵ However, total collection levels are still at a record low.

4. The general design of the tax regime has been fundamentally maintained. Its complexity, the many privileges it contains, and its coexistence with a very extensive informal sector⁶ did not undergo changes for the most part. Pressures on the tax system have been mounting as a result. The biggest of them all is that collection is insufficient, but the large majority of tax benefits it contains create their own dynamic that tends to put even more pressure on the remaining tax base because it increases the number of groups and sectors seeking special treatment.⁷ In the absence of a comprehensive review of the regime, the government is forced, from time to time, to address complaints or problems generated by the special regimes.

5. Tax regimes specifically intended for small taxpayers and for SEZs have warranted special attention lately.⁸ These regimes were adopted to support a decrease in the informal economy and the development of disadvantaged regions. Both purposes are argued not to have been fulfilled: informality continues to be high (while the regime resulted in an unplanned tax sacrifice) and investment and economic activity has not been significantly promoted in areas where tax privileges defining them as special had been granted. The net social benefit of these measures for Peru is questionable. There is also a limit on the tax advantages that can be granted in SEZs, as the community of countries has become stricter in tolerating tax treatments that can give rise to unfair tax competition. Years ago, only WTO restrictions existed. Today, however, efforts must also be made not to contravene the OECD's BEPS minimum standards.⁹

6. Formality and regional development, both entirely valid economic policy goals, are in principle pursued through a broad strategy based on various instruments beyond taxation. Regional development depends on a large number of factors, including public investment in infrastructure, abundance of skilled labor, availability of public services, business chains, and logistical efficiency, among many others. Tax incentives are an additional one, on which the failure or success of a project does not necessarily hinge. Similarly, the phenomenon of

⁵ In 2019, some tobacco products were added and used car rates were raised. In 2018, the rates applicable to some fuels, cigarettes, vehicles, and alcoholic and non-alcoholic beverages were raised.

⁶ Ricardo Fenochietto, Roberto Schatan, and Isaias Coelho, *Perú – Revisión del Régimen Tributario*, IMF, FAD, May 2014.

⁷ The exception are border clinics, which serve residents abroad, and VAT rebates for tourists.

⁸ SEZs in Peru receive different treatments and are formally classified under various names, as explained in Chapter III of this report. The term SEZ is used here as the generic name of the concept.

⁹ OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

informality is a function of a large number of variables, such as labor regulation, access to financial services, contributions, and social security benefits.

7. An analysis of the comprehensive strategy for achieving both goals in Peru is beyond the scope of this report. Instead, the report discusses whether the tax measures that have been adopted and those proposed to those ends are consistent with the broader national tax policy objectives, that is, whether they could be considered best practices or whether they could be improved based on the country's tax environment. Chapter II of this report analyzes the regime for small taxpayers. Chapter III discusses the tax treatment in SEZs and the draft reforms proposed by the private sector and by various instrumentalities. The report concludes with recommendations for improving these tax regimes, being mindful of the tax cost and international standards to avoid unfair tax competition.

II. TAX REGIME FOR SMALL ENTERPRISES

8. This chapter analyzes the current taxation design applicable to micro and small businesses in Peru. Its strengths and weaknesses are identified, and recommendations are made to improve efficiency and neutrality, thus facilitating labor and business formalization in this segment of economic activity. The mission analyzed various reform ideas being considered by the MEF and SUNAT, as well as studies produced by the World Bank Group and consulting firm Macroconsult.

A. The Rationale Behind Special Regimes

9. Running a small business is usually an entrepreneur's gateway to the business world. Generally speaking, such a business has little capital and technology and has very limited access to bank credit and export markets. Tax and labor obligations are another major obstacle, not only because of the direct financial burden they represent, but also because they pose an administrative burden entailing many associated secondary obligations. These costs also tend to be relatively higher for a small business, which makes the system potentially regressive.¹⁰ In some countries, the cost of an accountant typically by far exceeds what a small enterprise pays in taxes.

10. The obstacles mentioned play a significant role in a small entrepreneur's decision to opt for full or partial informality. Informality results in a lack of protection for the worker, evasion that hinders public finances needed to sustain the provision of social goods, and predatory competition against formalized companies. At the same time, remaining informal

¹⁰ The costs of compliance with tax rules and the regulations of general regimes in developing countries are estimated to be 5 percent of the gross income of a small business (International Tax Dialogue, *Key Issues and Debates in VAT, SME Taxation and the Tax Treatment of the Financial Sector*. Paris: ITD, 2013, p. 62). There is also strong evidence that tax compliance costs are regressive in relation to businesses' gross sales (World Bank Group, *Perú: Recomendaciones de reforma de los regímenes tributarios para las MIPYMES*, p. 25. Lima, 2018).

deprives the entrepreneur of the opportunity to access lines of credit, innovate, and integrate into productive chains; in short, it prevents that entrepreneur from prospering. In failing to penetrate the modern economy, small businesses end up suffering a high mortality rate.

11. Modern tax systems take this reality into account and seek to establish differentiated regimes to allow small businesses to grow within the legal framework. By educating entrepreneurs about tax obligations and gradually increasing the tax pressure in line with compliance capacity, the differentiated regime provides access to the general tax regime. The idea is to encourage entrepreneurship and innovation with a view to achieving a more productive economy.

12. The cost and complexity of the tax regime are not the biggest obstacle to formality for small businesses in Peru. Private-sector representatives state that pension and health system costs¹¹ are as high as or higher than taxation-related costs.¹² Worse still is labor legislation, which is apparently the main obstacle to the formalization of businesses.¹³ However, a simplified tax system for small taxpayers must do its part.

13. Peru has different special tax regimes for micro and small enterprises. Each of these regimes has its problems and, as a whole, they do not result in a simplified system, especially given that each one is optional and that the beneficiaries of these regimes can also opt for a general tax regime. For this reason, there is broad consensus on the need to reform the tax framework for small businesses.

B. Simplified Regimes for Small Taxpayers in Latin America

14. Simplified regimes aimed at micro and small enterprises are very common tax policy instruments in Latin America. With the exception of El Salvador, Panama, and Venezuela, all of the region's countries have some type of regime that offers a differentiated treatment to smaller taxpayers with smaller productive and managerial capacity. This type of practice is not exclusive to Latin America or to emerging or developing economies; it is also used in many advanced countries.

15. Given the diversity of small and medium-sized enterprises (SMEs), there is no single tax regime applicable to all cases. International experience with simplified regimes therefore differs remarkably. Generally speaking, international experience has shown that simplified regimes have segmented taxpayers based on their income, their legal constitution, the

¹¹ Initially, taxpayers paying the NRUS accessed Comprehensive Health Insurance (*Seguro Integral de Salud – SIS*) benefits. Expanding the no-cost SIS to the entire low-income population (universal coverage) eliminates the incentive for those registered in the taxation NRUS to continue contributing.

¹² See World Bank Group, *Perú: Recomendaciones de reforma de los regímenes tributarios para las MIPYMES*, pp. 8 and 14. Lima, 2018.

¹³ Macroconsult, *Propuestas para la reducción de la informalidad laboral*, p. 8. Lima, July 2019.

economic sector in which they operate, and other observable SME characteristics (such as the number of employees, their asset value, and the surface area their operations cover) to then offer a simpler tax treatment than general regimes.

16. In Latin America, efforts to reduce compliance costs have been taken through tax policy (substitution of various taxes, presumptive taxes, reduced rates) and administrative policy (simplified accounting, reduced number of payments). Simplified regimes segment taxpayers based on their size and often replace the payment of various taxes (usually income tax and VAT) through two mechanisms: (a) a fixed fee (Argentina, Brazil, Bolivia, Chile, Colombia, Ecuador, Peru, and Uruguay) or (b) a rate lower than that of the general regime, usually on the gross income of the SME (Table 1). Both tax policy instruments are supplemented with administrative measures that reduce the accounting requirements, the frequency of tax returns, and payments and that simplify the calculation of the tax burden. The thresholds for accessing the regime by the smallest taxpayers differ considerably between countries, although on average in Latin America the threshold is similar to that applicable in Peru (4.2 times per capita GDP, see Table 1). The thresholds also tend to decrease as the country's per capita income increases (see Appendix I).

17. Despite the variety of regimes in effect, there is a perceived tendency to replace presumptive taxes based on gross income with others based on the taxpayer's net margin. The purpose is to use the oversight opportunities afforded by new IT systems to arrive at a more precise approximation of the profit earned from the business activity. One example is the regime adopted by Chile, summarized in Box 1.

Table 1. Common Characteristics of SME Regimes in Latin America (2019)

Type of regime	Characteristics	Thresholds		Annual payment	Taxpayer type
		USD	Times per capita GDP		
One-time fee	Determined based on a portion of gross income or asset value or other business characteristics.	31,618	4.2	Fee average: from US\$373 to US\$1,340	Natural persons, sole proprietorships, and micro businesses
Presumptive	Applied based on gross income or, sometimes, on presumptive or simplified profit margins.	542,909	54.5	Rates range from 0.3% to 33%.	Small and medium-sized enterprises

Source: Prepared by the mission based on country legislation and information from Appendix I.

Box 1. Tax Regime for Small and Medium-Sized Taxpayers in Chile

Chile has a regime based on net profits for micro, small, and medium-sized enterprises. Its taxpayers are taxed on the difference between earned income (that which has materially entered the person's assets) and the expenses effectively paid during the fiscal year. They are also released from the obligation to keep certain accounting records and are entitled to immediate depreciation and other simplified administrative benefits for paying their taxes.

The regime sets income and effective capital limits in order to be accessed: (a) an average annual income not greater than 50,000 tax units (*Unidades Fiscales* – UF) (approximately US\$2,000,000) in the last three fiscal years, without exceeding 60,000 UF (close to US\$2,400,000) in any of those periods, under any circumstances. To calculate the limit, the taxpayer must add to own income that which was earned by related entities; and (b) for taxpayers starting up, effective capital of less than or equal to 60,000 UF.

Exclusion conditions include: (a) situations in which the taxpayer's income exceeds 35 percent of the total gross income earned during the year through the following activities: (a) possession or exploitation of non-agricultural real estate; (b) movable assets; or (c) participation in partnership contracts or joint ventures as either a manager or a participant; and (b) possession, in any capacity, of shareholder rights, company stocks, or investment fund shares exceeding 20 percent of the total gross income for the year.

Taxpayers subject to the regime may annually opt to exempt themselves from the payment of the first category tax (*Impuesto de Primera Categoría*), which is applied to business income at a rate of 25 percent. To do so, the enterprise must consist exclusively of owners, partners, or shareholders paying the global complementary tax (*Impuesto Global Complementario*) who are subject to progressive personal tax (from 0 to 35 percent).

C. Definition of Small Enterprise and Thresholds for Accessing Special Regimes

18. A differentiated tax treatment for small enterprises requires that a clarification be provided as to what constitutes a small enterprise and whether a distinction must be made between micro and small enterprises. There is no internationally agreed concept in that respect. On the contrary, countries have adopted a variety of definitions, typically based on parameters such as annual sales, number of employees, and asset value. For example, prior to 2013 in Peru, an enterprise was classified as micro if it had between 1 and 10 employees and its annual sales did not exceed 150 UIT, whereas a small enterprise was one that employed 1 to 100 workers and had annual sales of not more than 1,700 UIT (Supreme Decree 007-2008-TR). Since 2013, the classification has been based solely on sales (Law 30,056).

19. The legal definition of a micro and small enterprise (MSE) is not automatically transposed to the tax system. For tax purposes, thresholds for special regimes in line with a taxpayer's compliance capacity must be defined. In principle, if the taxpayer has the administrative and financial ability to comply with the general regime, access to a preferential tax regime should not be granted. The regime for MSEs, which entails a lower tax burden and

simplified procedures, must be harmoniously combined with the general tax regime instead of competing with it.

20. Access to tax formality should be easy. This means that compliance costs should be moderate and that progression toward the general regime should not experience significant discontinuity. As a result, more than one threshold must be defined to achieve this differentiated treatment as the business grows and approaches conditions that apply to a general regime taxpayer.

21. In summary, practicality guides the determination of thresholds for MSE regimes. Although based on general principles and economic policy objectives, at the end of the day, selecting a threshold requires a heuristic decision (accepted in law): it seeks to reconcile what is reasonable to request from MSEs (tax, documentation on transactions, books and records, provision of information, etc.) with the capacity and interest (cost-benefit ratio) of the tax administration to control such a large population with a low contributory capacity.¹⁴

D. Tax Regime for Micro and Small Enterprises in Peru

22. Peru has three special tax regimes for MSEs (see Table 2): New Single Simplified Regime (*Nuevo Régimen Único Simplificado* – NRUS), Special Income Tax Regime (*Régimen Especial de Renta* – RER), and Micro and Small Enterprise Tax Regime (*Régimen MYPE Tributario* – RMT). The regimes are accessible to persons with business income (third income tax category)¹⁵ below the respective threshold, whether they are individuals or corporations that meet certain specific conditions under each regime. Special regimes are applicable only to business income and some independent services. The tax paid by some MSEs under any of these regimes has a discharging effect and exempts the enterprise from any other income tax. However, distributed dividends are taxed at a final income tax rate of 5 percent.

¹⁴ The literature on the optimal VAT threshold considers the following variables: the additional tax collection generated by lowering the threshold (including to zero); the administrative (for the treasury) and compliance (for taxpayers) costs of lowering the threshold; the cost of distortions that the threshold creates by dealing with enterprises in different ways (those above and those below the threshold); and the support provided by expanded VAT control in controlling and collecting income tax. See Keen, Michael & Mintz, Jack (2004), "The optimal threshold for a value-added tax," *Journal of Public Economics*, Elsevier, vol. 88(3–4), pp. 559–76, March; and Wei, Feng and Jean-François Wen (2019), *The Optimal Turnover Threshold and Tax Rate for SMEs*, IMF Working Paper WP/19/98.

¹⁵ In Peru, income tax falls under five categories (real estate income, capital income, business income, self-employed work, and dependent work), each with its own rules and rates.

Table 2. Tax Regimes for Business Income (2018)

Regime	Thresholds	Payment of annual fee or rate (%)		Persons covered	Taxpayers		Accounting obligations	
		Soles	USD		Number	%	Documents	Books
NRUS	1) Up to S/. 60,000 (gross income or purchases)	S/. 240	71	Natural person selling merchandise or services to end consumers.	573,755	44	Issues payment slips only. Does not issue invoices for IGV purposes.	None. Keeps only proofs of payment.
	2) Over S/. 60,000 and up to S/. 72,000 (gross income or purchases)	S/. 600	177	Persons practicing a trade can also join.	35,917	3		
RER	Up to S/. 525,000 annually in sales	1.5% of annual net income		Natural or legal person dedicated to extractive, industrial, trade, service, or agricultural activities.	269,462	21	Issues all proofs of payment. Can issue invoices and debit and credit notes.	Purchase and sales records.
RMT	1) Net income under 15 UIT	10% on profits		Natural and legal persons whose net income does not exceed 1,700 UIT.	309,672	24	Issues all proofs of payment	<i>In higher cases:</i> Sales record
	2) Net income over 15 UIT	29.5% (for marginal) on profits			7,069	1		Purchase record General ledger Daily ledger Inventory book and balance sheets
General regime	All	29.5% on profits		All	106,357	8	Issues all proofs of payment	All books

Source: Prepared by the mission based on data from Macroconsult (2019) and SUNAT.

NRUS Regime

23. Natural persons with smaller business income in Peru can fulfill their tax obligations under the NRUS regime. Natural persons and undivided estates carrying out merchandise sales or providing services to end consumers as well as natural non-professional persons in any trade (independent service providers) can take advantage of this regime. They can pay a fixed monthly tax amount of S/. 20 if their annual sales do not exceed S/. 60,000 (close to 14 UIT) (Category 1) or S/. 50 if their annual sales exceed S/. 60,000, but remain below S/. 96,000 (close to 23 UIT) (Category 2). This payment replaces the income tax, general sales tax (*Impuesto General a las Ventas* – IGV), and municipal tax (*Impuesto de Promoción Municipal* – IPM).¹⁶ The NRUS also has a special category that exempts from tax sales of up to S/. 60,000 per year of agricultural products in their natural state made either by the producer or in food and produce markets (*mercados de abasto*).

24. NRUS taxpayers can issue proof of payment, but not invoices. In other words, they do not transfer an IGV credit to other taxpayers. They are also not required to keep accounting books, but must keep the proofs of payment issued and documents supporting their purchases. The reporting obligation is considered fulfilled when the monthly fee is paid, although SUNAT reserves the right to request any information it deems necessary.

25. In Peru, the upper NRUS threshold implicitly acts as the lower IGV threshold. This means that businesses with sales below this threshold do not have to pay IGV. The difference with OECD developed countries lies in the fact that they set an explicit limit in VAT legislation to prevent very small taxpayers, generally difficult to oversee, from issuing invoices and potentially eroding the tax base. In practice, these countries tend to have higher compliance and control levels, which is why they can set a relatively low threshold (1.2 times per capita GDP).

26. Up to 6 percent of purchases made by a taxpayer under the general income tax regime can be deducted based on payment slips (without an invoice). The purpose of the limit is to make room for microentrepreneurs to do business with larger enterprises, which could open the door to their expansion. However, deducting payment slips issued by NRUS taxpayers poses a serious risk to tax collection because information cross-referencing mechanisms are not yet developed at this level in order to detect the fraudulent issuance of slips.¹⁷ A study is

¹⁶ The IGV rate is 16 percent. An IPM of 2 percentage points is added for a total rate of 18 percent.

¹⁷ Taxpayers are not required to identify the deductions they make on invoices compared to those they make on payment slips, which is why SUNAT is unable to calculate the percentage that slips represent of taxpayers' total deductions under the RMT and general regime. In any case, total sales recorded by taxpayers under the NRUS account for just 2 percent of total costs and expenses deducted under those two regimes.

recommended to determine whether the facility in question is not a tax base loophole and whether the cap on such a blind deduction is still appropriate.¹⁸

27. The NRUS covers 607,000 active taxpayers, or 47 percent of taxpayers with third category income. However, the NRUS segment participates with just 0.69 percent of the tax revenue contributed by the third category. This segment has the highest number of taxpayers, 94 percent of whom fall under Category 1 (up to 14 UIT in sales).

28. Generally, analysts agree that it would be advisable to keep the NRUS without major changes, allowing very small taxpayers to pay a fixed fee. One big reason for this is that, otherwise, there would be a large influx of new taxpayers under the IGV with little tax collection interest, but with risks for the tax. Such taxpayers would be authorized to issue invoices that would generate a tax credit for enterprises currently paying the tax. This would require considerable administrative work in a situation that is difficult to control. Although it already covers taxpayers with higher sales volumes, electronic invoicing is a long way from reaching the enormous NRUS taxpayer population. Mass access to the Internet and electronic wallets is a long-term objective, just like the country's full access to banking services.

29. To bring back the NRUS amount to its initial design, the fixed monthly amount that has remained at S/. 20 and S/. 50 for a long time could be updated.¹⁹ Moreover, to facilitate compliance and eliminate the need for periodic payments, potentially attractive to taxpayers living in remote locations, the option of making 6 or 12 monthly payments in advance could be offered, with a small discount for the advance payment. The advance payment would not produce the right to remain in the NRUS if sales levels exceed the threshold during the fiscal year.

RER Regime

30. The RER is applied to gross income, which is an approximation of the taxpayer's (presumed) net income. The tax, paid monthly, corresponds to 1.5 percent of gross income, which must not exceed S/. 525,000 for the year. Enterprises with more than 10 workers or with fixed assets (except real estate and vehicles) totaling more than S/. 196,000 do not qualify for the RER, nor do societies of academics. The tax is certainly simpler to calculate and, according to various analysts, results in a very light tax burden compared to the general regime.²⁰ In any case, since unlike the general regime (which taxes net income), this regime is optional, anyone with a relatively low profit margin on sales will opt for the general regime and will avoid the more

¹⁸ At present, enterprises under the general regime do not discriminate between invoices and slips. It is therefore difficult for SUNAT to calculate the purchase deductions for NRUS taxpayers. A study could shed light on the impact of the deduction with a view to its potential revision in the future if frequent abuses are found.

¹⁹ Adjusted for inflation, the amounts of S/. 20 and S/. 50 would now be S/. 31 and S/. 78, respectively.

²⁰ Macroconsult, *Propuestas para la reducción de la informalidad laboral*, p. 57. Lima, July 2019.

burdensome 1.5 percent rate. For any business with profit margins above 5 percent, the RER offers a tax benefit compared to the general regime.²¹

31. The simplicity and reduced tax burden under the RER help with formalization, but the calculation of tax on the basis of sales removes the incentive of requesting purchase invoices. Nor does it encourage labor formality, since the payment of salaries does not affect the tax determination. Moreover, since only the sales value is taken into account to calculate the tax, there is a strong incentive to omit sales, which also compromises income tax and IGTV compliance. By not creating an incentive to require purchase invoices for income tax purposes, the RER weakens control of the IGTV, the basis of which is the contrast of interests between buyers and sellers with regard to the issuance of invoices.

32. The 1.5 percent RER rate may be low, but it represents a highly variable effective burden. The RER applies to a variety of business activities with sales below the respective threshold, which most likely have very different operating profit margins. This creates distortions between sectors and resistance to migration to the general regime. By the same token, a sort of “glass ceiling” is created for the activity, inhibiting expansion and rewarding entrepreneurial dwarfism or even the artificial subdivision of businesses.

33. RER taxpayers are also IGTV taxpayers. Unlike in other countries (especially OECD countries, see Table 3), Peru’s IGTV does not establish a minimum sales threshold for registration as a taxpayer. However, the NRUS threshold (S/. 96,000) serves as an implied IGTV threshold: NRUS taxpayers cannot issue invoices and do not pay the IGTV separately. The RER regime ends up being the gateway to the IGTV network. The RER is a risky combination for the IGTV, RMT, and general regime because its taxpayers are taxed on a presumed basis, but can issue deductible invoices to those who pay taxes on a net basis under the RMT and the general regime. Therefore, a RER taxpayer could, for example, issue an invoice for S/. 1,000 without commercial substance (on which S/. 15 of RER would be paid) and give it to the RMT or general regime taxpayer, who would use it to reduce its income tax by S/. 295.²² Table 3 shows that the IGTV threshold in Peru, expressed as a multiple of per capita GDP, is 2.8 times the average threshold of OECD countries.

²¹ Businesses with net profit margins below 5 percent have a low tax incentive under the general regime.

²² By issuing the S/. 1,000 invoice, the RER taxpayer would have to pay S/. 180 in IGTV, but the “buyer” would take a S/. 180 credit, meaning that the combined IGTV taxation would be zero.

Table 3. VAT Thresholds and Their Characteristics in OECD Countries

Country	Threshold in local currency	Threshold in USD	Times per capita GDP	Type of threshold 1/	Voluntary registration	Minimum duration
Germany	17,500	20,675	0.4	Collection	Yes	5 years
Australia	75,000	56,111	1.0	Registration	Yes	1 year
Austria	30,000	35,443	0.7	Registration	Yes	5 years
Belgium	25,000	29,536	0.6	Collection	Yes	None
Canada	30,000	23,153	0.5	Registration	Yes	1 year
Korea	24,000,000	21,807	0.7	Collection	No	None
Denmark	50,000	7,918	0.1	Registration	Yes	2 years
Slovakia	49,790	58,825	3.0	Registration	Yes	1 year
Slovenia	50,000	59,073	2.3	Registration	Yes	5 years
Estonia	40,000	47,257	2.1	Registration	Yes	None
Finland	10,000	11,814	0.2	Registration	Yes	None
France	82,800	97,824	2.3	Registration	Yes	2 years
Greece	10,000	11,814	0.6	Collection	Yes	2 years
Netherlands	1,345	1,589	0.0	Collection	No	None
Hungary	8,000,000	29,606	1.9	Collection	Yes	1 year
Ireland	75,000	88,609	1.2	Registration	Yes	None
Iceland	2,000,000	18,467	0.2	Registration	Yes	None
Israel	99,003	27,573	0.7	Collection	No	None
Italy	65,000	76,794	2.2	Collection	Yes	None
Japan	10,000,000	90,561	2.3	Registration	Yes	1 year
Latvia	40,000	47,258	2.6	Registration	Yes	None
Lithuania	45,000	53,165	2.8	Registration	Yes	None
Luxembourg	30,000	35,444	0.3	Collection	Yes	None
Norway	50,000	6,148	0.1	Registration	Yes	2 years
New Zealand	60,000	41,577	1.0	Registration	Yes	None
Poland	200,000	55,379	3.6	Registration	Yes	None
Portugal	10,000	11,814	0.5	Collection	Yes	None
United Kingdom	85,000	113,535	2.7	Registration	Yes	None
Czech Rep.	1,000,000	46,020	2.0	Registration	Yes	1 year
Sweden	30,000	3,451	0.1	Registration	Yes	3 years
Switzerland	100,000	102,262	1.2	Registration	Yes	1 year
Average		42,919	1.2			
Peru		28,296	4.0	Collection	Yes	

1/ The registration/collection **thresholds** are sales levels below which national providers are exempt from the requirement to register for and/or collect VAT, until such time as they exceed those thresholds. **Registration** means countries where a registration threshold is applied, that is, where providers with a business volume below the threshold do not have to register for VAT and are exempt from any VAT obligations. **Collection** means countries where a collection threshold is applied, that is, where all providers must register for VAT, but are not required to collect and transfer it until they exceed the collection threshold. The thresholds shown in this table apply to enterprises established in the country.

Source: OECD (2018), Consumption Tax Trends 2018.

34. The RER is a remnant of a time when tax controls were too weak to allow for adequate oversight of the income and expenses of small taxpayers. Although electronic invoicing in Peru is not yet universal, it is sufficiently disseminated among RER system members. At the same time, all RER taxpayers are obliged to comply with the IGV, which requires them to keep sales and purchase records for tax purposes. As a result, the RER can be completely replaced with a better quality regime based on a calculation (albeit a simplified one) of net income.

Tax Regime for Micro and Small Enterprises (RMT)²³

35. Until 2016, the NRUS and RER special regimes offered benefits to enterprises with sales of up to 125 UIT. As of 2017, the RMT introduced preferential treatment for enterprises with annual sales of up to 1,700 UIT. The RMT²⁴ base is calculated in a manner similar to that of the general regime, but applies the 10 percent rate to the first 15 UIT in profit. For profits exceeding 15 UIT, the general regime rate of 29.5 percent is paid. Another advantage for taxpayers relative to the general regime is that the requirements to keep accounting books are lower.²⁵ The argument is that this progressiveness would open another gradual path toward formalization, preventing the shock of a 29.5 percent rate for the first sol of profit.

36. In reality, the introduction of the RMT caused a migration of enterprises (processed automatically) out of the general regime. Consequently, the general regime currently has the lowest number of active taxpayers (8 percent of the total). The expectation that the RMT would attract enterprises from the other special regimes (especially from the RER), particularly from the informal sector of the economy (Figure 3), did not materialize.²⁶ New RMT taxpayers would request invoices, which would help offset the loss of tax collection due to the adoption of the 10 percent rate on the first tier of profits. It is noteworthy, however, that 76 percent of taxpayers registered under the RMT report annual sales below 50 UIT, which indicates that the gradualism in the tax burden is not effective either in encouraging taxpayers to move to higher tax burden tiers.

37. The RMT has therefore added another layer to the already complex architecture of the tax system for small taxpayers. This is one more option—now the fourth including the general regime—that taxpayers must explore to minimize their tax burden, that is, to achieve the most profitable arbitrage. It also means that there are two additional thresholds (10 and

²³ Also referred to as the “MSE tax regime.”

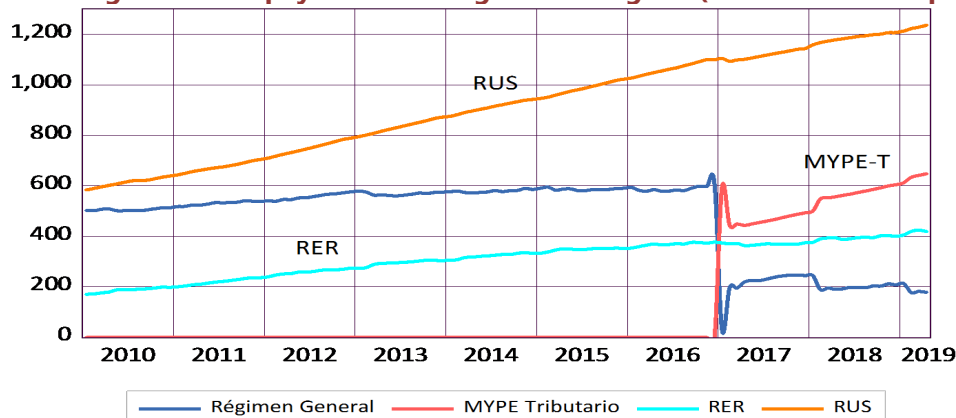
²⁴ The RMT is aimed at natural and legal persons, undivided estates and conjugal partnerships, de facto associations of professionals, and the like earning third category income and domiciled in the country with net income below 1,700 UIT for the year (S/. 7,140,000). Unlike other regimes, the RMT does not include any restrictions on the activities that can be carried out, on the value of fixed assets, or on the number of workers.

²⁵ With annual income of up to 300 UIT, only the sales records, purchase records, and simplified daily ledger must be kept. Above that, the books set out in Article 65 of the Income Tax Law must be kept.

²⁶ Source Figure 3: Jorge Baca Campodónico, “La informalidad laboral y los regímenes tributarios RER y RUS,” *Expreso* (Lima), August 18, 2019 (www.expreso.com.pe).

1,700 UIT) that encourage the subdivision of businesses. The result is greater complexity and more tax distortions. Meanwhile, informality in Peru continues to be very high, even compared to other countries in the region (see Box 2 and Appendix II).

Figure 3. Registered Taxpayers According to Tax Regime (thousands of taxpayers)



[Figure 3 key: Régimen General = General regime; MYPE Tributario = MSE tax]

Box 2. Simplified Tax Regimes and Informality

Informality is a prevalent problem in developing economies. The International Labour Organization (ILO) measures it in two different ways. The first, informal employment, corresponds to the proportion of workers who are not protected by labor legislation and by social security, which is generally measured by the absence of coverage under the public social security program. The second, the informal sector, refers to enterprises excluded from legislation or outside of its regulatory and tax scope, which is generally measured by the absence of records or accounting or the size of the enterprise.

Peru has a comparatively high percentage of informality, much higher than the rest of South America, although lower than Central America. Compared to other emerging and developing economies, the levels of informality in Peru, in terms of both informal employment and the informal sector, are also high.

The Government of Peru has introduced simplified tax regimes with the intent of promoting formality. However, informality is caused by multiple factors. The literature finds that other factors, such as income, education, labor policy, the institutional framework, productivity levels, and trust in governments, are also determinative and explain informality. Responses to informality should therefore not be approached exclusively from the perspective of tax design, but rather holistically, and should include labor, administrative, and institutional aspects.

Informality in Latin America and Other Emerging Countries (2017)

Country	Informal employment (%)	Informal sector (%)
Peru	68.9	59.8
Bolivia	84.0	74.7
Guatemala	80.9	72.6
Honduras	79.3	77.1
Ecuador	72.7	52.4
Paraguay	70.3	50.6
El Salvador	70.2	68.2
Colombia	61.5	58.3
Dominican Republic	57.2	50.9
Argentina	47.9	43.8
Brazil	45.0	36.0
Costa Rica	37.9	35.5
Chile	29.3	22.2
Uruguay	24.0	26.7
Average for Latin America	59.2	52.1
Bangladesh	94.7	81.8
Indonesia	84.2	84.3
Pakistan	81.7	80.0
Vietnam	73.3	62.1
Egypt	63.8	62.9
Albania	61.0	63.5
Armenia	47.9	47.1
South Africa	35.3	45.2
Bosnia and Herzegovina	29.5	26.3
Serbia	19.8	10.7
Average for other emerging countries	59.1	52.9

Source: International Labour Organization.

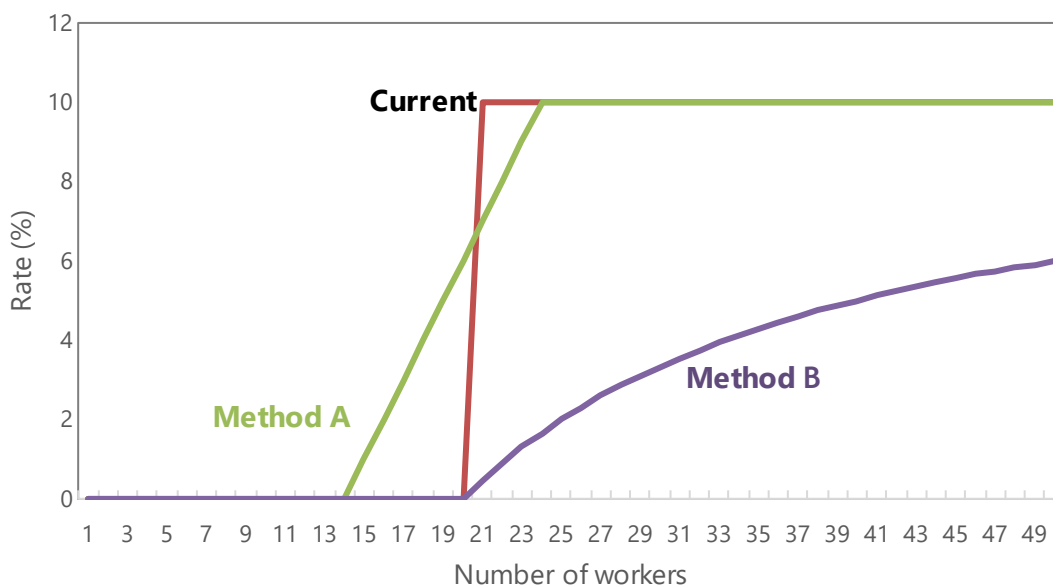
Profit Sharing

38. The Peruvian law guarantees annual profit sharing to company employees.

Although profit sharing is not a strictly tax-related but rather a labor-related issue, it has an effect similar to that of a tax on profits and consequently represents a cost relevant to the issue of informality. The rates are not low: 5, 8, or 10 percent depending on the sector of activity. Enterprises with fewer than 20 employees are exempt. Hiring the twenty-first worker triggers profit sharing for all employees. Therefore, surpassing the 20-employee mark entails a particularly high marginal cost. This provides a strong incentive for entrepreneurial dwarfism and discourages growth.

39. One way of mitigating the impact would be for profit sharing to start at low rates that increase with the number of employees (Method A). Profit sharing could be triggered with employee number 21, as is currently the case, or a lower number, 15 for example, but be set at 1 percent for an enterprise with 15 employees, 2 percent for an enterprise with 16 employees, and so on until the maximum rate is reached (5, 8, or 10 percent).²⁷ Gradual rate growth would soften the migration to profit sharing and would mitigate the negative impact on formal employment.

Figure 4. Enterprise Profit Sharing Rates



Source: Prepared by the mission.

40. Another way of eliminating the discontinuity involved in hiring employee number 21 is to provide the enterprise with an exemption for the equivalent of 20 employees (Method B). In such case, the profit sharing rate (currently 5, 8, or 10 percent)

²⁷ This solution was proposed by consulting firm Macroconsult (2019).

would be multiplied by a positive coefficient $(N-20)/N$, where N represents the number of employees.²⁸ Figure 4 shows how the rate changes under each method.

Informality and the Importance of Simplified Regimes

41. The tremendous size of the informal economy in Peru is noteworthy. Estimates based on national accounts and the household survey show that there were 6,878,000 informal productive units in 2017 that generated 18.4 percent of Peru's GDP.²⁹ That year, informal employment accounted for 72 percent of the economically active population (EAP), of which about three-quarters worked for informal enterprises and close to one-quarter held informal occupations in formalized enterprises, that is, in enterprises that only reported a fraction of the labor force in their records.

42. The tax system and its administration are not among the main causes of informality in Peru. When the National Household Survey (*Encuesta Nacional de Hogares – ENAHO*) asked non-agricultural productive units about their main reason for not registering with the tax administration (and not having a tax identification number), the responses were surprising: "A question that was added to the ENAHO in 2014 refers to the reasons for which the operator did not register the productive unit (business or establishment) with the tax administration. The responses provided in 2016 indicate that the largest percentage of informal productive units do not consider it necessary (44.5 percent). The second reason is that their business is small (36.2 percent), while the third and fourth reasons are that the work is casual (11.4 percent) and that the respondent cannot bear the tax burden (2.2 percent). The response with the lowest percentage was that the paperwork is very complicated (1.1 percent)."³⁰

43. It also highlights the multiplicity and high thresholds of regimes for small businesses (Table 4). The NRUS has two thresholds, 2.5 and 4.0 times per capita GDP, while the RER and RMT establish thresholds that are 21.7, 121.3, and 294.7 times per capita GDP, indicative of the high amount of income permitted for small taxpayers to belong to these regimes. The configuration of the various thresholds of the current regimes also resembles a progressive scale in which the tax burden increases with income, which creates various arbitrage opportunities for enterprises.

44. The largest tax collection contribution comes from general regime taxpayers. Despite representing the smallest proportion of taxpayers, the general regime contributes

²⁸ The adjusted rate applicable to the enterprise would be $t^* = k t$, where t is the sector rate (5, 8, or 10 percent), $k = \max [0, (N-20)/N]$, and N is the number of employees.

²⁹ National Institute of Statistics and Informatics (*Instituto Nacional de Estadística e Informática – INEI*), *Producción y Empleo Informal en el Perú: Cuenta Satélite de la Economía Informal 2007-2016*. Lima, December 2017. The numbers shown here may not match ILO figures given the different definitions and ways of calculating them.

³⁰ National Institute of Statistics and Informatics (INEI), *Producción y Empleo Informal en el Perú: Cuenta Satélite de la Economía Informal 2007-2016*, p. 91. Lima, December 2017.

3.23 percent of GDP to Peru's tax collection, or 91 percent of collection from business income. The RMT, RER, and NRUS bring in only 0.25, 0.06, and 0.02 percent of GDP, respectively, despite representing 92 percent of all taxpayers earning business income.

Table 4. Thresholds and Tax Collection by Regime Type

Regime	UIT	Soles	USD	Times per capita GDP	Collection (2018)		
					Millions of soles	% GDP	% of total
RUS	14	60,000	17,685	2.5	112	0.02	0.59
	23	96,000	28,296	4.0	20	0.00	0.10
	Total NRUS					132	0.02
RER	125	525,000	154,745	21.7	344	0.06	1.80
RMT ¹	700	2,940,000	866,574	121.3	803	0.15	4.22
	1,700	7,140,000	2,104,536	294.7	526	0.10	2.76
	Total RMT					1,329	0.25
RG ²	-	-	-	-	17,268	3.23	90.61
Total					19,058	3.56	100.00

Source: Prepared by the mission with data provided by the MEF and SUNAT.

1/ The threshold refers to the income level below which the first 15 UIT in net profits fall.

2/ The general regime has no thresholds.

E. Proposed Reforms

Macroconsult

45. Consulting firm Macroconsult proposed consolidating the RER and RMT into a single regime, based on cash flow, and maintaining the NRUS, but for a much smaller set of taxpayers. The NRUS regime would be applied only to winery businesses and food and produce markets. The regime for small enterprises above the RUS threshold and below the general regime threshold (*intermediate regime*)³¹ would pay a progressive tax based on net business income at marginal rates of 1, 5, 10, 15, 20, and 30 percent. The general regime rate would also be increased to 30 percent to bring it in line with the income of natural persons. Every month, the taxpayer would submit a final tax return that would make the annual return unnecessary.

46. It is unclear whether the time has come to eliminate or radically reduce the NRUS. Maintaining the NRUS does not prevent us from recognizing its many problems, such as

³¹ The study authors do not refer to it as such because they believe that this regime would apply to most taxpayers and would become the real general regime. Although they do not suggest a specific value for the border threshold between the intermediate regime and the general regime, they indicate that it should be set between 125 UIT (RER threshold) and 300 UIT (simplified accounting threshold under the RMT).

employees who are registered as entrepreneurs, the issuance of apocryphal payment receipts, sales without proofs of payment issued, and informal employees, among others. As progress is made with electronic invoicing, electronic payment slips, and the links between tax controls and payment systems, the NRUS regime could be revised and tax intelligence and risk analysis services could identify and penalize the most abusive practices.

47. The main motive for the proposal, in addition to simplifying the system to consolidate the regimes, is to promote labor formalization. Initially small marginal rates that grow with business expansion would encourage the formalization of small enterprises and would increase their contribution as their business grows. Very small initial taxation is considered to be an effective instrument for attracting and educating new small entrepreneurs. The regime would apply to all business income earned by either a natural person with a business or a corporation.

48. The proposal breaks with the basic principle of simplification based on taxing the gross income of small businesses. This is a proposal that the mission picks from this study, as well as the consolidation of the RER and RMT into a single regime. However, the argument in favor of the progressiveness of the regime is less clear. The progressiveness of the RMT did not attract informal businesses to taxation and created an incentive for many enterprises to declare just 15 UIT of net income. The argument is not very convincing: moderate marginal rates do not appear to be attractive enough to offset the high costs of formalizing labor relations and requiring invoices for purchases.

49. The application of different rates to different entrepreneurs also creates opportunities for arbitrage and abuse of the system through the artificial transfer of income (from high rates to low ones) or costs (in the opposite direction). The monthly submission of an income tax return by all NRUS taxpayers that would migrate to the intermediate regime would increase the amount of information that micro taxpayers would have to provide, thereby increasing compliance costs for taxpayers and processing costs for the tax administration. Integrating the majority of the NRUS population into the general (or intermediate) system, as proposed by Macroconsult, would be even more burdensome because it would imply lowering the threshold for the IGV.³² The inability, at the present time, to electronically oversee this enormous number of micro taxpayers attracts new risks, as discussed above.

³² Therefore, if the NRUS regime were to be hypothetically eliminated, all the former NRUS taxpayers would become IGV taxpayers.

World Bank

50. The World Bank conducted a comprehensive study on the taxation of small businesses in Peru and proposed streamlining the system.³³ The study finds that the current thresholds are very high and suggests that the system be restructured into three segments:

1. **Micro business** run by a natural person (artisans, basic service providers) with annual sales of up to 7 UIT (S/. 28,350) corresponding to the tier exempt from personal income tax. These taxpayers would pay a fixed amount instead of income tax, the IGV, and the health contribution.
2. **Small business** run by a natural person with annual sales of up to 38.5 UIT (S/. 156,000). The contribution of these taxpayers would replace the income tax and the IGV and would be calculated as a percentage of sales: 0.2 percent for manufacturing, 3.5 percent for trade, and 8 percent for services.
3. **Medium-sized enterprise**, which could consist of a person or a corporation, with annual sales not exceeding 1,700 UIT (S/. 6,885,000). These taxpayers would initially be subject to the general income tax regime, with limited administrative simplification advantages (reporting and payment facilities). In the medium term, natural persons under this regime would migrate to the progressive personal income tax, while legal persons would move on to the third category general regime. Medium-sized and large enterprises would be IGV taxpayers.

51. The World Bank's proposal has the benefit of pursuing greater consistency in corporate income taxation and strengthening collection capacity. This would notably be achieved by reducing the thresholds of preferential regimes. It also seeks to establish greater harmony between business and labor income taxation. The micro business regime is similar to Argentina's monotax and Brazil's individual micro entrepreneur regime, with a link to the health pension system, which could be an additional attraction for formalization. However, this micro business regime could be overstepped in 2021 when Peru provides universal access to the SIS without the need to pay taxes under the NRUS.

52. The proposed regime would nevertheless have significant weaknesses. In particular, it would maintain the presumed income system of the RER, which, as discussed earlier, rewards tax arbitrage and avoidance. As for the IGV, increasing the entry threshold to 38.5 UIT, as proposed, would remove enterprises with sales in that interval from the IGV, which would be a move in the opposite direction of the trend to expand the IGV scope as the mass implementation of electronic invoicing advances.³⁴

³³ World Bank Group, *Perú: Recomendaciones de reforma de los regímenes tributarios para las MIPYMES*. Lima, 2018.

³⁴ The argument is that the VAT threshold is being increased from 24 UIT to 38.5 UIT because the taxpayers in this interval pay virtually nothing since their credits for purchases typically exceed their debits for sales. The argument must be weighed against the fact that this group of taxpayers does not cost the treasury anything because the small amounts of credit accumulated do not need to be repaid. Moreover, it is only a matter of time before electronic invoicing significantly improves oversight of taxpayers in the lower band of the IGV.

53. The two proposals examined recommend decreasing the NRUS threshold or restricting who can benefit from the regime, but what is most likely is that abuses in this regime will still continue without major changes. Tax abuses, such as wage relationships disguised as self-employment and business division among family members, will continue to happen with a smaller threshold. There will be more subdivisions, more income will be hidden, employees will continue to pass themselves off as self-employed workers, and taxpayers will pretend to carry out permitted activities. All of these practices are reflective of SUNAT's weak control. Under the current circumstances, there would be no noticeable difference in leaving things as they are. In any case, the NRUS grouping represents a very small proportion of tax collection.

F. Bases for a New Tax Regime for Small Enterprises

54. Like in many advanced economies, Peru's public finances are sustained mainly by two primary sources: the IGV and income tax. The IGV is applied uniformly, whereas income tax has a schedular structure according to income type. In particular, business or third category income comprises simplified regimes for small taxpayers. There is a consensus among specialists that this business income tax structure is ineffective and is not conducive for taxpayers, the treasury, or the Peruvian economy due to the distortions it creates.

55. The mission suggests three regimes for business income, the general regime, and only two simplified regimes for small taxpayers: the NRUS and one intermediate regime to replace the RER and RMT. With this proposal, the number of general regime taxpayers, who account for just 8 percent of the total and contribute 92 percent of third category tax, would increase slightly. The NRUS would remain unchanged in the medium term,³⁵ except for an update to the fee amounts, and would allow semi-annual or annual prepayment, possibly at a discount. This pertains to close to half of taxpayers and entails tax collection of less than 1 percent of income under this category.³⁶ The biggest innovation to the current regime, which picks up various aspects from the proposals made in the previously cited studies, introduces an "intermediate" regime that replaces the RER and RMT, merging and restructuring them considerably.

56. The proposed restructuring is largely feasible due to the progress that Peru has made in automating and digitalizing its tax services. Electronic invoicing is already mandatory

³⁵ Maintaining the NRUS without major changes for the time being does not mean that this regime is satisfactory. However, its reform should be postponed in order to (i) move forward undistractedly with higher priority issues (RER and RMT) and (ii) allow electronic invoicing to make headway in the micro business segment. At a later stage, consideration could also be given to eliminating the NRUS special category (full exemption) so that beneficiaries pay the same fee as the rest of the taxpayers currently do under this regime.

³⁶ The existence of a very simple regime for micro enterprises contributes to tax education. Contributing, even a little, is a form of civic participation and a connection with civic rights and obligations. See Corbacho, A., Fretes Cibils, V. and Lora, E. (eds.), *Recaudar no basta: Los impuestos como instrumento de desarrollo*. Washington, DC: Inter-American Development Bank, 2013.

for enterprises with sales above 150 UIT, and the plan is to extend it in December 2020 to enterprises with sales above 23 UIT, meaning that it would include all those currently registered under the RER. Electronic payroll is already a reality.

57. The lower threshold of the intermediate regime could be established along the border of the current NRUS. This way, the persons currently taxed under this regime would not be affected. The proposed limit for qualifying for the intermediate regime (upper threshold) is 150 UIT (as per the MEF/SUNAT proposal), which is slightly above the threshold that existed for simplified regimes prior to the reform that introduced the RMT. Enterprises with sales above 150 UIT would migrate to the general regime, which entails the obligation to keep full accounting records. However, this should not be a major problem for such enterprises because they were already taxed under the general regime and subject to this obligation before 2017. Irrespective of the thresholds described, the general regime option should remain open for any taxpayer.

58. The main difference between the *intermediate* regime and the general regime is that the tax base would be the profit determined based on cash flow.³⁷ Moreover, there would be monthly and final tax returns and simplified accounting would be kept. There would be no need to keep comprehensive records, inventory books, and balance sheets on a regular basis for tax purposes. Only purchase and sales records would be required, which are crucial for VAT, and a simplified daily ledger, like the one already kept by RMT enterprises with annual sales below 300 UIT. Losses one month would be treated as costs the following month. An annual tax return would not be necessary. The determination of profit based on cash flow is common in the Macroconsult, World Bank, and MEF/SUNAT proposals.

59. The cash flow basis would reward the immediate deduction of investments, as if though it were a current expenditure (with the exception of land, which would be deducted upon sale). In addition to accounting simplicity, this is a significant incentive for capital investment and would eliminate the need to maintain asset depreciation schemes. To protect the system against improper migration from the general regime in order to benefit from this regime, a capital limit beyond which the enterprise would be unable to join the intermediate regime could be considered.³⁸

60. The tax rate under the new intermediate regime should be the same as the income tax paid under the general regime (29.5 percent). This would create an incentive to purchase with invoices so that they are recorded as a cost and, above all, to formalize employees (the main

³⁷ Under a simplified monthly cash flow system, sales and purchases are computed when they must be invoiced, the payroll is recorded when it is paid, the procurement of capital goods (except land) is immediately deducted (depreciation does not have to be computed), potential losses one month are considered expenditures the following month, financial investments are not deducted, loans do not constitute income, interest paid is deducted, and financial income constitutes current income.

³⁸ Macroconsult, in turn, proposes limiting the deduction to 50 percent of sales for the month.

cost for many enterprises) in order to reduce the tax burden. Another advantage of a uniform rate is that it would significantly reduce opportunities for arbitrage between regimes, as can currently happen between the RER, RMT, and general regime. Rate progressiveness is not desirable in this context for two reasons. The first, from a practical standpoint, is the risk that related enterprises paying different tax rates will collude and transact with one another to reduce the average effective rate. The second, one more of principle, is that the partners of enterprises with large or small profits may have very different personal incomes and wealth; rate progressiveness is a concept that makes sense for personal income, but does not apply to legal persons.

61. The IGV is not currently viewed as a problem to the same extent as income tax. That is why it would make sense for the corporate income tax reform to affect IGV design and application as little as possible. Maintaining the NRUS, as proposed, keeps the VAT threshold at 23 UIT. Lowering the IGV threshold by reducing the NRUS threshold introduces risks in the issuance of invoices (which are credits against the public treasury) by entities over which adequate supervision is not yet in place. By contrast, raising the IGV threshold, even when it leaves taxpayers with an IGV credit in their favor outside the tax, improves neither control nor collection, as analyzed above.

62. The introduction of the intermediate regime could increase tax revenue slightly. Mission estimates indicate that the proposed reform could reasonably represent an overall increase in tax revenue of 0.14 percent of GDP (Table 5). Taxpayers currently under the NRUS and general regime will see no change in their situation. Most of the increase in collection would come from taxpayers currently under the RMT who would move to the general regime. Updating the NRUS fees would increase tax collection by only S/. 74 million.

63. The incorporation of RER taxpayers into the intermediate regime could amount to close to S/. 200 million (0.04 percent of GDP). Taxpayers who choose to be taxed under the RER when they are able to be taxed under the general regime (including the RMT) reveal that they likely have margins above 5 percent. Therefore, their taxation on a net basis (29.5 percent) should result in a heavier burden than on a gross basis (1.5 percent of sales). In any case, if all RER taxpayers were to raise their costs to make them equal to their income and thus empty the intermediate regime base, S/. 344 million in tax collection would be lost (Table 5).

Table 5. Tax Collection Impact of Proposed Regime¹

Current				Proposed				Collection impact	
Regime	Taxpayers (thousands) ²	Collection		Regime	Taxpayers (thousands) ²	Collection		Soles (millions)	% GDP
		Soles (millions)	% GDP			Soles (millions)	% GDP		
NRUS	610	132	0.02	NRUS	610	206	0.04	74	0.01
RER	268	344	0.06	RI ³		542	0.10	199	0.04
RMT	317	1,329	0.25	[23 - 150 UIT]	535	510	0.10	238	0.04
[<150 UIT]	267	272	0.05			1,052	0.20	437	0.08
RMT [> 150 UIT]	50	1,057	0.20	General regime	156	1,312	0.25	255	0.05
General regime	106	17,268	3.23			17,268	3.23	-	-
Total	1,301	19,072	3.56		1,301	19,838	3.71	766	0.14

Source: Mission estimates with data provided by the MEF and SUNAT.

1/ The estimates assume that, in the case of the RER, the profit margin of the enterprises under this regime is equivalent to that of their peers under the general regime, that is, the same income levels. The intermediate regime rate (29.5 percent) is applied to this margin. The tax collection effect of eliminating the RMT results from applying estimated effective tax rates to the profit recorded by taxpayers in the tier above and below 150 UIT. The rates are (a) 20 percent, equal to the average of enterprises under the general regime in this income range, and (b) 16 percent, which corresponds to the rate of the first quartile of the distribution of effective rates observed in the general regime. This measurement, lower than the average for the tier, is used as a reference to take into account the fact that the base in the intermediate regime is lower than in the general regime. This is only an approximation.

2/Refers to active taxpayers that made payments under the regime in which they were registered.

3/ Tax collection under the RER is determined by multiplying the reported gross income by the profit margin (tax base / gross income) under the general regime. The intermediate regime rate is applied to this product.

64. The reconfiguration of the RMT would also have a positive tax collection impact.

The proposal would split the current number of active RMT taxpayers into two groups, those below and those above 150 UIT in gross income. The group consisting of income below 150 UIT (84 percent of active taxpayers) would become part of the intermediate regime, meaning that taxpayers would pay the general regime rate like they did prior to the 2016 reform. Tax collection would consequently increase approximately S/. 238 million (0.04 percent of GDP). The second group, consisting of income above 150 UIT, would become part of the general regime, increasing tax collection by S/. 255 million (0.05 percent of GDP) (Table 5). In other words, eliminating and restructuring the RMT would yield an estimated increase of S/. 493 million.

65. The administrative cost of transitioning from the RER and RMT to the proposed intermediate regime is not high.

The simplified cash flow system is not very different from the IGV mechanism, to which the taxpayers under these regimes are already accustomed. The use of electronic invoicing, which already encompasses the RMT realm and is making inroads into RER territory, and the progress that has been made with electronic payroll are a very important backbone of the new architecture. There will therefore not be significant increases in compliance costs. The thresholds established to define the NRUS, intermediate regime, and general regime should be the only references for determining enterprise size for tax purposes. Definitions on enterprise size contained in other rules should therefore be removed from tax legislation.

66. The new regime has advantages, including the following:

1. The number of special regimes is reduced from three (NRUS, RER, and RMT) to two (NRUS and the intermediate regime).
2. Presumptive taxation gives way to a more realistic measurement of profits, in line with the variation in profitability between enterprises.
3. Disconnecting the regimes reduces opportunities for arbitrage and evasion (for example, an RER enterprise fraudulently invoicing a general regime enterprise).
4. There is less of an incentive for RER and RMT enterprises that split in order to continue to benefit from these regimes when their sales grow.
5. The tendency toward dwarfism (keeping an enterprise small so as not to reach higher tax brackets) is eliminated once there are no more tax discontinuities (differences in treatment) as the enterprise grows.
6. The control capacity of electronic invoicing is strengthened (through information cross-referencing).
7. Income tax and IGTV monitoring is mutually enhanced once the respective bases converge (except for labor costs).
8. The incentive to invest is extended to small enterprises through accelerated deduction (immediate depreciation of fixed assets).

Recommendations

- Replace the RER and RMT used to tax MSE profits with an intermediate regime involving monthly cash flow-based determination with a base equal to income less costs.
- For the new regime, adopt the rate applicable to the general business income regime and the 150 UIT annual net income threshold.
- Refrain from making changes to the NRUS regime for the time being, but consider doing so when technological control conditions permit, except for updates to the tax amount, and allow semi-annual or annual prepayment potentially at a discount.
- Examine the use made of the allowance to have up to 6 percent of purchases with payment slips (without invoices) to determine whether there is a loophole and whether that limit should be revised.

III. TAX REGIME OF SPECIAL ECONOMIC ZONES

A. Background

67. Special economic zones (SEZs) have gained popularity around the world as an instrument for economic promotion.³⁹ SEZs are delimited geographic areas with a special regulatory framework for operators and users applicable to both customs and taxes that also provide infrastructure and services specifically designed to attract private investment.⁴⁰ In terms of customs, SEZs are an extraterritorial space where merchandise can be deposited (for a defined period or indefinitely, depending on the country) without being considered admitted into the national territory for customs purposes. As long as goods are maintained in SEZs, they are not subject to the taxes typically imposed on imports, namely tariffs, customs duties, the IGTV, and the ISC, as applicable.

68. SEZs are typically designed to promote the export of manufactured goods or services or the reshipment of merchandise. This way, the advantages of suspending indirect taxes on imports become a financial benefit for the exporter, as the latter would be entitled to a refund of the said taxes in that capacity. It involves introducing a special regime equivalent to temporary imports, which also represents an important administrative facility, because the beneficiary is not only exempt from tax on imports, but also (and for the same reason) does not have to then have the refund processed when exporting the good or service.

69. Some countries offer supplementary tax benefits in addition to indirect tax exemption for temporary imports. Sometimes a full or partial exemption of the income tax is granted, which is a different tax policy approach with other types of challenges. This class of tax benefits risks violating WTO rules against export subsidies⁴¹ or OECD minimum standards on harmful tax practices,⁴² in addition to representing a tax sacrifice for the domestic economy that is much more difficult to justify.

³⁹ There are currently approximately 5,400 SEZs in 147 countries. UNCTAD (2019), *World Investment Report 2019: Special Economic Zones*, United Nations, NY.

⁴⁰ Farole, Thomas (2011), *Special Economic Zones in Africa. Comparing Performance and Learning from Experience*, Washington, DC: World Bank.

⁴¹ WTO Agreement on Subsidies and Countervailing Measures (see section H).

⁴² OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

B. SEZs in Peru

70. In Peru, there are currently four SEZs in operation: three that have been formally called special development zones (SDZs) since 2016, located in Ilo, Paita, and Matarani, and the Tacna Free Trade Zone (FTZ). There are also two SDZs not in operation, Loreto and Tumbes, and an SEZ in Puno (so legally named), which is not in operation either (see Box 3). Enterprises that settle in SEZs enjoy a special customs and tax regime for a set period of time: until 2042 in the case of SDZs and until 2032 or 2049 in the case of the Tacna FTZ, depending on how the law is interpreted.⁴³

71. The SEZs in Peru date back to 1989 and have undergone a series of regulatory changes since then. The main purpose of Peru's SEZs is regional development to create jobs in disadvantages areas and contribute to the modernization of the ports where they are located.⁴⁴

Box 3. Special Economic Zones in Peru

Location	Name	Year created	Status	Decree or law
Tacna	FTZ	1990/2002	In operation	Law 27,688
Paita	SDZ	1996	In operation	DL No. 864
Ilo	SDZ	1996	In operation	DL No. 842
Matarani	SDZ	1996	In operation	DL No. 842
Puno	SEZ	2006	No operations	Law 28,864
Tumbes	SDZ	2011	No operations	Law 29,704
Loreto	SDZ	2013	No operations	Law 26,953

C. Persons and Activities that Can Benefit from SEZs

72. Both the procedures and the persons who can access the SEZ regime are similar across the various regimes, whether in an SDZ or an FTZ. National or foreign natural or legal persons that enter into an onerous use assignment contract for the lots of land in SEZs or that exercise the purchase option for land located in SEZs are eligible for the regime. In both cases, a public bid process is required prior to the user's qualification.⁴⁵ SEZs are administered by a

⁴³ The validity period of the Tacna FTZ has been changed multiple times. Law 27,688 (March 28, 2002) established a 20-year term from the date of the Regulation (December 18, 2002). Law 29,739 (July 6, 2011) extends the term for 30 years from the date of its publication. Law 30,976 (July 3, 2019) establishes that the exemptions under the law are valid for 30 years from the date of its publication. For the MEF, the regime is valid until 2032, whereas for Tacna FTZ management, the last law would involve a validity until 2049. The Puno SEZ is valid until 2027.

⁴⁴ The original Tacna FTZ began with Supreme Decree 089-89PCM15. Until 2016, the current SDZs were called Centers for Export, Transformation, Industry, Commercialization, and Services (*Centros de Exportación, Transformación, Industria, Comercialización y Servicios – CETICOS*). Law No. 30,446 (May 12, 2016) changed their name to SDZs without introducing substantial differences to the previous regime, aside from extending their validity until 2042.

⁴⁵ Appendix III describes the requirements and procedure for accessing the regime of an SEZ.

committee or management board attached to the regional government, with administrative, economic, and financial autonomy. Private administration of SEZs was recently allowed.⁴⁶

73. Both SDZs and FTZs can host virtually any type of business; there is no selective industrial policy intent in SEZ design. Any manufacturing activities can be carried out, including maquila and assembly, services, logistics, and trade, except those which are prohibited, such as the sale of weapons and narcotics, and those on a short negative list in connection with the manufacture of oil and flour.⁴⁷ As of 2011, the repair and/or refurbishment of used vehicles is prohibited as well (Law No. 29,303 of December 31, 2010).⁴⁸

74. There is no minimum investment requirement to be an SEZ user in Peru. Unlike other countries, Peru does not require a minimum investment to access SEZ benefits. There is also no minimum requirement for hiring staff like in Colombia's and Costa Rica's FTZs, for example. There is a plan within the MEF to introduce a minimum investment amount, which would be positive.

D. Tax Benefits

75. Enterprises established in Peru's SEZs enjoy a practically full tax exemption, except for social security contributions. The main tax benefits for users are, first of all, an exemption from the IGV, IPM, and ISC on procured goods that are eventually destined for export as well as tariffs and customs duties on imports with the same destination. Second, enterprises that have been established in SEZs for some years enjoy a full income tax exemption.⁴⁹ They are also exempt from withholding tax on dividends distributed to the shareholders of those enterprises.

76. The legal framework of SEZs also includes a broad exemption for all "taxes created and to be created."⁵⁰ The intent of this provision is to guarantee stability, protecting users and operators from any changes in tax legislation within the established period of validity. This protection would apply for not only central government, but also regional and municipal

⁴⁶ Supreme Decree No. 005-2019 of August 2, 2019.

⁴⁷ Supreme Decree 010-2013 – 12 08 90: Other oleaginous fruit or seed flour, except mustard flour. - 1515 21: Corn oil, crude - 1515 29: Corn oil, except crude - 1516 20: Vegetable oils and fats. See Appendix IV.

⁴⁸ SDZs may use, in extension zones, up to 30 percent of the land that has been assigned to set up enterprises that carry out different activities from those permitted in such zones, which will not enjoy any tax benefit granted to SDZs by law.

⁴⁹ Initially, a conditioning factor of a minimum of 92 percent of annual operations was established for exports (Law No. 26,831). This was eliminated in 2005 (Law No. 28,569, clause thirteen, Complementary, Repealing, and Final Provision).

⁵⁰ Article 7, Law No. 27,688.

government taxes.⁵¹ These benefits apply indiscriminately to SEZs, without prejudice to their name.⁵²

77. The rule has been amended in terms of the scope of the income tax exemption for SDZ users. The tax benefits in an SEZ normally expire when the product or service originating in it is sold in the national territory (separate from another SEZ). The underlying logic is that these are indirect taxes that are suspended at the time of admission into the SEZ whose subsequent destination is export. Following that pattern, Article 16 of the CETICOS Regulation (Supreme Decree No. 23-96-ITINCI) points out that enterprises would lose the benefit of exemptions (including from income tax) upon making the first sale of goods or services to consumers in the rest of the country. This effect on the income tax was contrary to the WTO rules on export subsidies. Now, the law expressly states that the commercialization of merchandise to the rest of the national territory is subject to tariff duties, the IGV, the ISC, the IPM, and all the other corresponding import taxes.⁵³ This provision does not include income tax, however. Therefore, the income obtained from the admission of merchandise from the SDZ into the national territory is income tax-deductible. This rule complies with WTO rules.⁵⁴

78. A similar income tax exemption situation arises from the law regulating the Tacna FTZ. Article 7 of the Tacna FTZ Law provides that users that carry out permitted activities are exempt from income tax, the IGV, the ISC, the IPM, and “any other tax created or to be created.” Article 8 of that same law stipulates that operations with the rest of the national territory are subject to taxes on sales, imports, and service delivery. The provision omits any reference to taxes on income from such operations. It therefore stands to reason that the rule does not impose income tax on domestic operations.

79. The full income tax exemption is especially generous. Other countries with developed SEZs do not offer it (Box 4). This is a difficult advantage to justify for national enterprises outside the SEZ that also serve the domestic market. Granting the benefit only to exporting enterprises, however, poses a risk of unfair competition in global markets, penalized by the WTO (see section H).

⁵¹ In the opinion of the MEF and some independent analysts, the said guarantee of invariability is actually a dead letter because it does not generate rights acquired before a change in law. This is discussed in greater detail in section F.

⁵² Appendix V provides a detailed list of the tax benefits for users in SDZs and the Tacna FTZ. A peculiarity of the Tacna FTZ is that it coexists with a Trade Zone that enjoys its own tax benefits.

⁵³ Article 2 of Law 30,777 amending Article 4 of the Unique Ordered Text regarding CETICOS. Excluded is the admission of goods from the Tacna FTZ into the Tacna Trade Zone.

⁵⁴ Peru’s most recent review by the WTO was in 2017, and the organization did not observe an income tax exemption in SEZs. See WTO (2013), *Peru: Trade Policy Review, Report by the Secretariat*.

Box 4. Income Tax Treatment in the Region's SEZs

Chile – Corporate income tax (first category tax) is exempted, but not the personal income tax of shareholders. Given that income tax in Chile is integrated, the corporate income tax exemption is officially a tax deferral.

Colombia – Income tax is not exempted, but a significant rate reduction is granted (20 percent compared to 33 percent under the general regime). SEZs in Colombia also offer benefits in the deductibility of certain types of expenses; for example, enterprises dedicated to science and technology have a deduction of 175 percent of the value of the investment made in research, development, and innovation, provided that it does not exceed 40 percent of the net income.

Dominican Republic – Corporate income tax is exempted, but FTZ enterprises are required to pay a 3.5-percent tax on gross sales (Law 139-11 of June 24, 2011). The regular income tax rate is 27 percent on net taxable income.

Costa Rica – For a given period of time, some types of enterprises in SEZs are fully exempt from income tax, while others receive a rate reduction. In the Expanded Greater Metropolitan Area, there is a 100-percent income tax exemption for eight years for some types of enterprises (services, export trade, and processing companies that are “megaprojects”). The rest of the enterprises pay a rate of 6 percent. Outside this area, the exemption is 100 percent for 12 years for first category enterprises. The conditions are somewhat less favorable for those that do not qualify as megaprojects. In addition, payments abroad are exempt from tax.

80. Another major benefit is that sales from the national territory to the SEZ are considered a virtual export. This means that they are subject to an IGV rate of zero and refunded accordingly. This increases the administrative burden for SUNAT because it widens the network of taxpayers subject to the zero rate and because it must oversee more complex operations (for example, sales to SEZs that are later partially reintroduced into the national territory). This also increases the recovery of tariff duties through drawback that, regardless of control, results in a questionable benefit (for the WTO) due to the fact that the drawback amount can be much higher than the tariff amount paid.⁵⁵

E. SEZs in Peru Have Not Worked

81. The consensus among analysts in Peru is that SEZs have been unsuccessful. The central argument is that they have attracted very little economic activity. In 2018, the four SEZs in operation generated US\$47 million in exports and created over 1,400 direct jobs, according to the data available (see Table 6).⁵⁶ This is a very small fraction of Peru's economic activity. Nevertheless, there is no consensus on the causes behind these disappointing results. Some

⁵⁵ The drawback refers to the recovery by exporters of the tariffs paid on the importation of inputs used to produce exported products. In Peru, however, the drawback amount is a fixed percentage of the export value, regardless of the tariffs paid for imported goods incorporated into the exported good. Effective January 1, 2019, this rate is 3 percent.

⁵⁶ Although this employment figure comes from the Ministry of Foreign Trade and Tourism (*Ministerio de Comercio Exterior y Turismo* – MINCETUR), the number is uncertain. ZOFRATACNA reported 605 direct jobs in 2018 directly to the mission, which seems more reasonable given the number of users in the zone.

attribute it to poor tax management,⁵⁷ while others blame broader management failure by the State in administering the zones.⁵⁸ Others still emphasize the lack of business readiness in the places where SEZs are located, such as little infrastructure and distant connection to major foreign markets.⁵⁹

Table 6. SEZ Investment, Exports, and Imports (2018)

SEZ	Number of users	Investment committed	Investment made	Exports	Imports	Direct employment
Tacna	507	N.A.	N.A.	5.6	N.A.	605
Paita	18	117.3	N.A.	38.9	N.A.	1,097
Matarani	20	15.7	N.A.	2.2	N.A.	176
Ilo	14	0.3	N.A.	0.1	N.A.	110
Total	559	133.4		46.8		1,429

Source: Prepared by the mission with data provided by the MEF/MINCETUR.

N.A.: Not available

* It is unclear whether it refers to the operator's employees or users.

F. Proposed Reforms

82. Given the limited success that SEZs have had in Peru, various voices have been raised suggesting reforms to the regime. The Center for Economic Research and Global Business (*Centro de Investigación de Economía y Negocios Globales – CIEN*) recently published a detailed analysis of the Peruvian SEZ situation, comparing the zones to others more developed in Costa Rica and the Dominican Republic, for example.⁶⁰ The main conclusion of the study is that the tax privileges granted to SEZs are not attractive for investment because the zones lack other factors essential to business success. The central message is that tax benefits do not make up for this failure and cannot alone generate a successful investment dynamic.

83. The location of SEZs in Peru's disadvantaged areas is presumably the main obstacle to their takeoff. According to the CIEN study, the geographic location of SEZs has major drawbacks because these zones are in cities with little urban and social development and without infrastructure, skilled labor, and networks of providers that are far from major markets, conditions crucial for the development of business activities.⁶¹

⁵⁷ Jorge Medicina Di Paolo, *El Peruano*, 6/6/2018 "...the conclusion that can be drawn is that the failure of SEZs in Peru is due to a failure in tax policy management."

⁵⁸ CIEN, p. 40.

⁵⁹ CIEN, p. 53.

⁶⁰ CIEN, *Propuesta para un Nuevo Régimen de Zonas Económicas Especiales en el Perú*, Asociación de Exportadores (ADEX), Lima - Peru (December 2018).

⁶¹ CIEN (2018), pp. 40–1.

84. The argument invalidates the very purpose of SEZs in Peru. SEZs are established with the aim of promoting regional development in disadvantaged areas, and it is precisely this that would prevent them from thriving. In a way, the argument is that SEZs in Peru are inane. The solution would therefore be to change the rationale for SEZs: instead of promoting regional development, they should be an instrument for increasing investment and employment in the country, with no geographic preference.

85. The key recommendation is for the private sector to have the freedom to decide the location of the SEZ. However, it seems that making SEZs a success was an objective in itself that took priority over other economic policy considerations. From a national tax policy standpoint, this is concerning. Placing SEZs in localities with high urban development, with advanced infrastructure, involves a policy that provides a tax subsidy to those who are more advantaged and benefit more intensely from public investment. This would weaken consideration of the national tax policy, which is already struggling to collect on par with other countries in the region (see Figure 1).

86. The proposal distinguishes between tax privileges according to the type of activity carried out in the SEZ. The income tax rate would be reduced according to the level of technology and innovation contributed by the activity in question, the lowest being 10 percent. Regardless of the difficulties in objectively defining and distinguishing one sector from another and ensuring, in practice, that enterprises do not pretend to belong to the most beneficial category, the advance selection of winning sectors has largely been questioned as an arbitrary exercise. Using tax policy to this end is a high-risk move.

Proposed Reform of the MINCETUR Law

87. The mission reviewed a proposed law prepared by MINCETUR that would replace the current legal framework applicable to SEZs. The proposal compiles and organizes the legal framework for SEZs in a single document, replacing a set of rules scattered throughout numerous provisions that are not always consistent.⁶² Both SDZs and FTZs would have a single legal framework and would all be called SEZs (Article 6).

88. However, the proposal changes the intent of SEZs at the root, completely erasing their role as a development instrument in disadvantaged regions. The purpose of the law (Article 2) includes, among other objectives, the promotion of private investment, job creation, and export diversification, but excludes any mention of regional development. This opens the door for SEZs to be located anywhere in the country, as suggested by the CIEN proposal (2018).

⁶² There are differences between the activities permitted in SDZs and the Tacna FTZ. For example, SDZs are authorized to provide telecommunications services as well as technical support, repair, refurbishment, servicing, and recycling services for merchandise, whereas the Tacna FTZ is not. In contrast, Tacna FTZ users are authorized to carry out activities for infrastructure development, which is not included as an activity permitted in SDZs.

89. The tax regime set out in the proposed law reproduces the current benefits, in addition to the tax invariability clause, with all of the faults and potential loopholes this entails. SEZ users would be exempt (Article 40(a)) from income tax, the IGV, the ISC, the IMP, and any other central, regional, or municipal government tax created or to be created.

90. An innovative aspect of the provision is that the income tax exemption would be scaled down over time to the point of disappearing. Full exemption would be limited to a period of 15 years. From there onward, the exemption would be 75 percent for the next 10 years and 50 percent for the 5 years after that (Article 40(a)). The benefit as it stands now (a 100-percent income tax exemption) is programmed until the end of the validity of the SEZ in particular. However, the draft law provides that, if at the end of the period, the user has reinvested amounts that represent a certain percentage of the initial investment, that user will receive exemptions for an additional time.⁶³

91. The draft law also incorporates SEZ users into the Single Window for Foreign Trade (*Ventanilla Única de Comercio Exterior*) regime. Private operators and users can therefore use electronic means to manage the administrative and customs procedures, services, or information requirements necessary to carry out their activities. For the rest, the SEZ customs regime is maintained.

92. The draft law does not make the tax benefit conditional on an obligation to export the good or service. This means that the provision is in compliance with WTO rules on export subsidies (see section H), but is also the most generous version of an SEZ. Apparently, nothing in the proposed draft law would impede the establishment of a new SEZ in a high development zone to which existing national enterprises (and multinational subsidiaries) move to operate in the domestic market with a full income tax exemption, competing advantageously with other domestic enterprises.

93. In principle, the new SEZs will be existing SDZs and FTZs, but new SEZs could be created by supreme decree. The authority responsible is MINCETUR, on the prior favorable opinion of a standing multisector commission (Article 11).⁶⁴ This is in contrast with today's process, whereby each SEZ must be constituted by means of law. Given the strong (and generous) tax input of SEZs, in addition to the fact that they can be created without limitations in terms of number and region (at least according to this draft law), the initiative considerably reduces the MEF's governance over tax policy. As a matter of fact, it transfers considerable power over taxes to business promotion agencies, which is not a best practice in tax policy implementation. Under the draft law, the MEF would only monitor and control the tax regime

⁶³ The draft is not clear as to whether the period refers to the first 15 years and the extension of the benefit to the 100-percent income tax exemption or to the 30 years and the 50-percent exemption benefit.

⁶⁴ The draft law does not specify who comprises this multisector commission or what its procedure would be for authorizing new SEZs (for example, whether it would be by majority or unanimity of its members).

applicable to SEZs, but would have no authority to decide the tax expenditure limit that the proliferation of new SEZs might entail (Article 19.2).⁶⁵

94. In summary, the proposal changes the intent of SEZs, leaving regional development aside. Employment and economic diversification at the national level would now be an instrument for boosting investment (although there are no specific investment, employment, or business type requirements). This is a matter that falls to Peru's general tax regime because SEZs would no longer be a means of achieving a specific and focused objective.

SEZ Draft Law Prepared by the MEF

95. The mission examined the proposed law developed by the MEF to regulate SEZs: "Framework Law on Special Economic Zones." The MEF's proposed law does not provide for an income tax exemption like the one that SEZs currently enjoy (but does leave benefits related to indirect taxes). Instead, it would grant a reduction in the income tax rate (to 20 percent). This would decrease distortions and the tax advantage with which SEZ enterprises would compete in the domestic market (which also has an impact on tax collection). Moreover, taxing income generated in SEZs would require active control by the tax authority of those taxpayers that today are of little interest to the treasury, which would reduce the incentive to carry out aggressive tax planning through them (see section H). The MEF draft law would also restrict SEZ beneficiaries to legal persons, excluding natural persons who currently obtain the benefit.

96. In addition to changes to tax incentives, the MEF proposes a simplification in SEZ customs procedures in its draft law. The entry of merchandise from the rest of the national territory would no longer require an export declaration but would instead be subject to a simple registration process. The IGTV benefits would be maintained as if though it were an export, but the drawback benefit would be lost. However, the problem with the drawback (explained above) is widespread, as it benefits all exporters. Removing it for only those from SEZs would give an advantage to the imported product and would be contrary to the aim of SEZs of promoting value chains in the domestic economy. The draft law would, however, allow the application of the "Single Window for Foreign Trade" procedure to SEZ sales (similar to the MINCETUR proposal).

Permitted Activities

97. The MEF draft law also ensures that SEZs are not the seat of front companies used as instruments to unduly attract profits from related companies. It therefore restricts permitted activities to productive processes that generate value-added or transform tangible products, expressly excluding the exploitation of intellectual property, financial services, and

⁶⁵ SEZs also pose a customs control problem. The Tacna FTZ, which is peculiar in that it is adjacent to a trade zone, accounts for close to 20 percent of the country's total contraband. MEFR, Report No. 143-2019- EF / 62.01.

holding companies. Based on a similar logic, excluded from tax benefits are also logistics activities, whose registration in the SEZ could be strictly formal, by providing their service primarily outside the SEZ. These exclusions are aligned with the OECD's new minimum standards on harmful tax practices (see section H). Another activity that would fall outside income tax benefits is the resale of merchandise abroad under the reshipment regime.⁶⁶

98. The MEF also proposes limiting benefits to the procurement of goods from the Tacna Trade Zone. More specifically, resident natural persons in the rest of the national territory who buy goods from businesses established in the Trade Zone through e-commerce would be subject to the payment of taxes.⁶⁷ This restriction is in step with what is being done by many countries, which intend to tax activities carried out through e-commerce that, because of their characteristics, easily evade the condition of having a physical presence in a territory to be subject to taxation.⁶⁸ The measure also generates an advantage for Tacna merchants beyond the charter established for visitors to the zone. The charter promotes tourism and additional economic revenue in the zone that would justify the said charter. E-commerce loses this connection with regional development. Like MINCETUR, the MEF proposes maintaining the exclusion of auxiliary services (for example, food outlets, coffee shops, banks, freight agencies, customs agencies, and business support services) from tax beneficiaries.⁶⁹

Determinants and Restrictions

99. Another positive aspect of the draft law is that it requires a minimum investment in the zone (US\$5 million) for the tax benefit to be obtained.⁷⁰ In other words, the benefit depends directly on the fulfillment of the special regime objective, although it does not specify a period within which to do so. The draft law would grant an additional tax benefit, accelerated depreciation⁷¹ for the procurement of new assets. This benefit is also directly connected to the completion of the investment. However, this requires controls by the authority administering the

⁶⁶ This is because the reshipment of merchandise is formally classified in the draft law as a logistics activity (Article 21(5)). It is unclear whether the underlying logic for excluding it is that it is a business with little value-added and not so much that it was an activity carried out mainly outside the zone.

⁶⁷ Congress recently agreed (Law 30,976 of July 3, 2019) to allow e-commerce from the Trade Zone to the rest of the country. The MEF's interpretation is that these operations are taxed.

⁶⁸ OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

⁶⁹ Article 9 of Supreme Decree 005/-2019. MINCETUR

⁷⁰ The US\$5 million is the minimum established for entering into a Legal Stability Agreement with the State of Peru (excluding the mining and hydrocarbon sectors, from which a minimum of US\$10 million is required).

⁷¹ The draft law would permit an annual depreciation rate of 20 percent (Article 24.1), which is higher than the majority of rates under the general income tax regime.

SEZ, controls that are currently non-existent or very weak.⁷² Moreover, the requirement must refer to a new investment, which to define precisely is no trivial matter.

100. The draft law denies benefits under the regime when a user carries out activities with related parties (Article 24(7)). This is in response to a reasonable concern that the profits from enterprises transacting with SEZs would be transferred from the national territory. However, the same concern does not apply to transactions between SEZ users and related parties abroad. The diversion of profits from abroad to a Peruvian SEZ should be of concern, first of all, to the authority of the other country. For situations where diversion of profits from the SEZ to other countries is feared, no regulation is required other than the one already applied under the general income tax regime in Peru for related operations (transfer prices). This limitation is contrary to the objective of promoting international business chains that typically exist between related enterprises. In the same vein, assumptions of relationship should be the same as those set forth in the income tax law.

101. The draft law joins the other proposals in freeing SEZs from their connection with the development of disadvantaged areas. The draft law indicates that the factors for creating new SEZs are the zone's potential for new investment attraction, export diversification, technology transfer, job creation, and productive chains. There is a vague and tangential mention of regional development when it states that SEZs can also be created for the "harmonization of domestic economic activity." SEZs could obviously be created for many different reasons (and more attractive for private investment) other than the economic development of the poorest regions. Like MINCETUR, it proposes that the private sector should be the one to define the location of SEZs, with the restriction to require a law authorizing it, as will be discussed later.

Treatment of Existing SEZs

102. The MEF draft law does not subject existing SEZs to the new regime it proposes. These would maintain their tax privilege, which would expire in accordance with the established timeframes. Upon expiry, such zones could be replaced by new SEZs established under the proposed rules. The difference with MINCETUR here is important because the other ministry's draft law provides for a standardized regime for all current and future SEZs. The argument is that one of the serious problems with the current regime is the wide range of rules and administrative, customs, and tax treatments, which leads to complex management and confusion between investors, at the very least. Improving the current regime means making it uniform for all current SEZs and those that will follow. The MEF's proposal would not do this and would add one more system to the various ones that exist today. This could be perceived as a weakness in that proposal.

103. However, standardizing the regime for SEZs entails a different aspect from administrative complexity that is no less important. Current tax benefits in SEZs include, in

⁷² Discussion between the mission and the general administrator of the Tacna FTZ.

addition to the express exemptions, an exemption from any tax “created or to be created” during the SEZs’ period of validity. The aim of the law is to protect SEZ users through tax stability. Regardless of how valid or sustainable this purported protection is,⁷³ standardizing the tax regime for future SEZs with that of existing ones should consider whether the said protection must be respected. Doing so necessarily involves maintaining a full income tax exemption in the new regime. The MEF instead proposes not standardizing the regime so that income tax can be collected in the new SEZs while respecting the intent of the law in effect.

Approval of New SEZs

104. Aside from a framework law that would govern SEZs, the MEF proposes that each new SEZ be established by a specific law (Article 5.1). This is because Article 79 of Peru’s Political Constitution provides that tax exemptions must be approved by law, with a qualified majority in Congress. The initiative would rest with the executive, on the prior evaluation of convenience and opportunity contained in the joint favorable opinion of the Ministries of Production, Foreign Trade and Tourism, and Economy and Finance. This procedure seems necessary to respect the constitutional mandate, at least according to MEF legal analysts. It would also serve as a control mechanism against the mass and indiscriminate expansion of SEZs, which could violate tax equity and jeopardize tax collection. The other proposals are based on the law that establishes the legal framework of SEZs as sufficient for fulfilling the constitutional mandate, leaving the authorization of individual SEZs to the administrative sphere. This scheme would be more flexible than that of the MEF and also riskier for tax revenue and a potential systematic tipping of the balance in tax equity, driven by an industrial promotion policy without major counterweights.

G. Best Practices in Tax Incentives

105. Extensive literature on tax incentives for investment reveals that such incentives are generally used with little effectiveness and efficiency in developing countries.⁷⁴ Economists have traditionally been skeptical about the net benefits that an aggressive, sustained tax

⁷³ There is a difference of opinion as to the guarantee that the law affords with respect to its own invariability. The MEF understands that the period of validity of any law is that which is decided by Congress, and its will would not be limited by periods pre-established by Congress. In other words, any pretense of the law’s invariability would be futile due to the principle of “immediate application of the law.” Some independent specialists are of the opinion that this is litigable because they understand there to be rights acquired by a law aimed at protecting the taxpayer’s interest for a given and explicit period in the law itself, without detriment to the law amending the conditions for new actors. In any case, it is uncommon in Peru for the treasury to eliminate benefits before the pre-established period. For example, when the rules on applying carryover losses were amended in 2004, those who had losses pending amortization at the time of the reform were allowed to follow the previous rules. Losses generated as of 2004 fell under the new rules (Legislative Decree 945 of 2004).

⁷⁴ UNCTAD (2019), p. xiii: “In fact, the performance of many zones remains below expectations. SEZs are neither a precondition nor a guarantee for higher FDI inflows...Where they lift economic growth, the stimulus tends to be temporary: after the build-up period, most zones grow at the same rate as the national economy. And too many zones operate as enclaves with limited impact beyond their confines.”

incentive policy might lead to,⁷⁵ especially one based on an exemption, plain and simple, from corporate income tax, as is the case in Peru's SEZs. Schemes that reduce the cost of investment, such as accelerated depreciation, are better rated than tax holidays that affect only the net profit earned by enterprises.

106. The argument that tax benefits boost investment might be exaggerated. The tax burden, within certain reasonable parameters, is just one variable in the decision to invest, and frequently a minor one. Many times, what is more important is for the tax system to be stable and simple to comply with, a situation against which a couple of factors conspire in Peru, namely the changes to the rule on SEZs and the interpretation problems resulting from the complex regulatory framework developed accordingly over the years.

107. The tax resource cost of the incentives might be underestimated. The distortion caused by the alteration of relative prices, the increasing marginal cost of replacing lost tax collection with other sources, and the avenues to tax avoidance in the rest of the economy that open up with SEZs represent costs that are likely substantial, but very difficult to measure. Even worse, the tax collection loss can, in some cases, represent just a shift in tax burden to the country of residence of a foreign investor, depending on the tax regime on dividend distribution prevailing in that country.⁷⁶

108. Tax holidays are of little use to business start-ups, which would have losses in their first years of operation anyway. Such businesses might also carry the losses accumulated during this period for a few more years. Profitable enterprises are the ones that benefit most from a tax holiday and the ones that—for the same reason—would likely invest anyway. This investment boosting instrument is redundant in those cases and attracts rather opportunistic investment, which moves out as soon as the benefit ends.

109. Evidence shows that, for each successful SEZ implemented in a given country (for example, China or South Korea), failed projects abound. This is especially true in low-income countries.⁷⁷ The success of some SEZs has been accompanied by comprehensive policies that offer investors competitive infrastructure and good access to major markets, in addition to abundant and trainable (cheap) labor and a relatively dependable institutional framework,

⁷⁵ An early reference on the subject. See, for example: Dale Chua (1995), "Tax Incentives," in P. Shome (ed.), *Tax Policy Handbook*, FAD, IMF. For a more recent detailed discussion, see IMF, WB, UN, and OECD, *Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment, A Report for the G-20 Developing Group* (Oct. 15, 2015).

⁷⁶ There are still countries that tax the worldwide income of their residents, generally allowing deferral until such time as the dividends of active businesses are distributed. The global profits of passive businesses are typically taxed in the country of residence when they are earned. This is the case for most middle-income countries in Latin America, including Peru.

⁷⁷ See Douglas Zhihua Zeng (2015), *Global Experiences with Special Economic Zones*, World Bank Research Working Paper 7240.

among other aspects. The absence of any of these cannot be offset with tax incentives. The experience in Peru would seem to confirm this conclusion.

110. It is therefore important to analyze investment incentives as part of broader tax policy, aligning its consistency with the country's tax architecture. The transparency with which tax benefits are administered is crucial for this, which requires producing complete and reliable public information on the resulting benefits and costs of SEZs. Otherwise, it is impossible to assess the instrument's effectiveness and difficult to ensure that it is used properly. Peru has much room to improve in that respect. MINCETUR does not publish basic statistics on SEZs, and SEZs do not provide systematized information either.⁷⁸

H. International Considerations

111. The international community's concern for curbing unfair tax competition has risen dramatically in recent years. In fact, the OECD has adopted minimum standards to prevent countries from promoting unfair tax practices.⁷⁹ The Forum on Harmful Tax Practices (FHTP) is carrying out various review and monitoring processes on potentially harmful tax regime around the world. Peru has subscribed to these minimum standards by joining the Inclusive Framework promoted by the OECD and has been subject to review⁸⁰ and will be again, especially if it adopts a new SEZ regime. Also of concern—longer-standing at that—are special tax regimes that provide export subsidies, a situation that the WTO is monitoring and penalizing.

BEPS and Unfair Tax Competition

112. The OECD's new minimum standards on harmful tax competition define certain criteria for a special regime to be designated low-risk.⁸¹ The main criteria are as follows:

- Preferential treatment is only granted to a small portion in terms of surface area or population relative to the country as a whole and is provided given the zone's low level of economic development;
- The regime is designed primarily to create jobs and attract tangible investment, rather than passive income (for example, the export of intangible intellectual property assets);

⁷⁸ See section I.

⁷⁹ See OECD (2016), *BEPS Project Explanatory Statement: 2015 Final Reports*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

⁸⁰ The conclusions of the OECD review on Peruvian SEZs are outlined in OECD (2019), *Peer Review Results Inclusive Framework on BEPS: Action 5 - Update (July 2019)*. The report concludes that the SDZ regime was outside the scope of the FHTP review because the regime does not apply to mobile income involving a BEPS risk. The Tacna FTZ was considered to be within the scope of the review, but it was found not to be harmful, without further explanation. The truth is that problematic activity is small (is not material) and, according to the MEF, the procedure for a user to pay a royalty abroad deduction-free is so complex that it would not be a benefit. This last point would have led to the OECD's conclusion.

⁸¹ OECD (2015), *op cit*, p. 65.

- Beneficiary entities must have economic substance to access benefits (demonstrate job creation, minimum investment amounts, and ownership of fixed assets);
- The country agrees to have access to regime information (for example, information on investment amounts, numbers of beneficiary entities, and income tax-exempt amounts) and share them with the FHTP.

113. The OECD has also identified factors that indicate when a special tax regime is harmful. This is when:⁸²

- the regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities;
- the regime is ring-fenced from the domestic economy;⁸³
- the regime lacks transparency;
- there is no effective exchange of information with respect to the regime;
- the regime fails to require the development of activities with economic substance.

The WTO and the Agreement on Subsidies and Countervailing Measures (ASCM)

114. The ASCM was signed in 1994 to eliminate export incentives. In general terms, improper incentives under the ASCM are direct export and import substitution subsidies.⁸⁴ In particular, the WTO prohibits government subsidies for SEZs when, for example, tax deductions or direct tax exemptions are granted, including deferrals, conditional on an export, without extending the benefit to the commercialization of products in the local market. This discrimination initially existed in the regulation of SDZs and the Tacna FTZ, but was eliminated in 2005. The current regimes have not been considered contrary to WTO regulations.⁸⁵ This means that enterprises in SEZs compete advantageously with domestic enterprises.

Other Unfair Tax Competition Practices Through SEZs

115. The reshipment of merchandise imported from third countries is one of the key activities permitted in SEZs. This activity is also income tax-exempt and is therefore covered by the CIEN and MINCETUR draft laws. However, this exemption means that the tax authority has no interest in verifying that third country invoicing is correct because this does not affect any tax base in the country where the SEZ enterprise resides. The reshipper can then underinvoice the

⁸² OECD (2019), *Harmful Tax Practices - 2018 Progress Report on Preferential Regimes. Inclusive Framework on BEPS: Action 5*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

⁸³ Refers to preferential tax treatments partially or fully isolated from the local economy of the jurisdiction granting the benefit.

⁸⁴ Article 3 of the ASMC.

⁸⁵ WTO (2013), *Trade Policy Review Report by the Secretariat on Peru*, Oct. 2013.

sale to an importer from a third country and thus avoid partial payment of tariffs, VAT, and, where applicable, the ISC in this country.⁸⁶ In some cases, the reshipper could correct the export value with a debit note, but this would be a separate document from the invoice and unknown to the authority of the importing country. An SEZ whose reshipping users are income tax-exempt is a risk for international tax competition in a manner not intended by the SEZ's host country. This harmful practice becomes more difficult if that exemption is eliminated.

International Tax Competition Beyond Harmful Practices

116. Competition between countries in attracting capital is not limited to the harmful practices identified by the OECD in connection with BEPS. Competition also entails reductions for the tax burden, such as direct subsidies and transfers, and FDI, which is a real and substantial activity. The widespread reduction in corporate income tax rates in many countries is a compelling example.⁸⁷ In this sense, SEZs play a significant role. This dynamic, characteristic of the international tax architecture that favors the source for granting the jurisdictional right to collect income tax, is a global problem that encourages a race to the bottom as far as taxes are concerned, where all (medium and large) countries come out on the losing end in the long run. Some countries have a greater ability to resist this competition owing to their comparative advantages, the profitability of investment projects, and an attractive business climate beyond tax. For now, Peru has a corporate income tax rate close to the average of comparable economies in the region⁸⁸ and has managed to attract FDI competitively without having to rely on SEZs (see section J).

I. Transparency on SEZ Activity

117. The statistical information that the government of Peru produces on SEZs is scarce and of poor quality. The SEZ regulatory body is MINCETUR, but this ministry does not have sufficient data to assess the zones' behavior. The information obtained differs for each zone, in addition to being incomplete. For example, there is only data on the investment committed by zone users, but not on the investment made. No information is also collected on wages and salaries paid. Information on imports from SEZs (although Customs has the records) or on sales inside the country is not collected systematically. Information on employment is not reliable: 46 jobs have been reported for the Tacna FTZ, when more than 500 enterprises are established there (Table 6). SUNAT does not regularly control VAT refund generated by sales (virtual exports) in SEZs by national residents.

⁸⁶ SUNAT has noted this practice in the importation into Peru of products from the Iquique FTZ in Chile.

⁸⁷ IMF (2014), *Spillovers in International Corporate Taxation*, IMF Policy Paper (Washington); IMF (2019), *Corporate Taxation in the Global Economy*, IMF Policy Paper (Washington).

⁸⁸ The corporate income tax rates in 2019 were as follows: 27 percent in Chile, 34 percent in Brazil, 30 percent in Argentina, 33 percent in Colombia, 25 percent in Ecuador, and 25 percent in Bolivia.

118. The SEZs themselves do not produce sufficient information. SEZ web pages contain very few details on their activity level. For example, the Paita SDZ (visited during the mission) contains a section (tab) on transparency called *Transparencia*, which in turn contains another on performance indicators called *Indicadores de desempeño*. This section contains various *Institutional Operational Plan Evaluation* reports, the most recent being from the fourth quarter of 2015. However, attempts to open these files lead to the following system message: “The page you are looking for does not exist.” The Matarani web page simply does not have information. With the exception of the Ilo SDZ, whose page contains slightly more information,⁸⁹ SEZs could do much more to contribute to accountability.

119. MINCETUR plans to improve the collection of data on SEZs. In 2019, SEZs will have to provide MINCETUR with information in a standardized format designed by the ministry. However, failure to do so is not penalized, nor does MINCETUR have the authority to enforce this. The gaps in this regard are still very wide and will have to be remedied before consideration is given to increasing the number of authorized SEZs.

J. SEZs and Investment in Latin America

120. Promoting private investment is one of the main reasons behind the proposal to create new SEZs in Peru.⁹⁰ While SEZs in Peru have not had greater success in that respect, investment in the country is not an obvious disadvantage relative to the other countries in the region, including those that stand out with economic activity in their SEZs.

121. Private investment in Peru’s corporate sector has been considerably higher than in countries with highly developed SEZs. Figure 5 shows how such investment in Peru has been higher over the past decade as a percentage of GDP than in Colombia, Costa Rica, and the Dominican Republic, sometimes referred to as model countries in terms of SEZs.⁹¹ Peru also appears at the top as an FDI destination compared to the region (above 4 percent of GDP, see Figure 6). Although outperformed by Costa Rica (a small economy) in that segment, it is more interesting that Peru has managed to attract more investment than Colombia, despite the strong role that SEZs have played in that country as a destination for FDI.⁹² Chile, meanwhile,

⁸⁹ In its transparency section, the Ilo SDZ web page contains information on its users, including a description of their activities, the employment created, the taxes applied on auxiliary services, and the fulfillment of institutional goals (*Informe Anual de Impacto de ZED Ilo en el Desarrollo Regional*, 2018), but has information on exports, imports, or transactions inside the national territory.

⁹⁰ Farole, T. and G. Akinci (2011), *Special Economic Zones. Progress, Emerging Challenges and Future Directions*, World Bank. Washington, DC.

⁹¹ CIEN (2018), *Propuesta para un Nuevo Régimen de Zonas Económicas Especiales en el Perú*, DT No. 2018-01.

⁹² SEZs account for close to 40 percent of FDI in Colombia; source: Asociación de Zonas Francas de las Américas. 2016.

systematically outperforms Peru when it comes to investment, despite the fact that its SEZs are of little significance relative to the size of its economy.⁹³

Figure 5. Private-Sector Gross Fixed Capital Formation¹ (2012–2018 average)

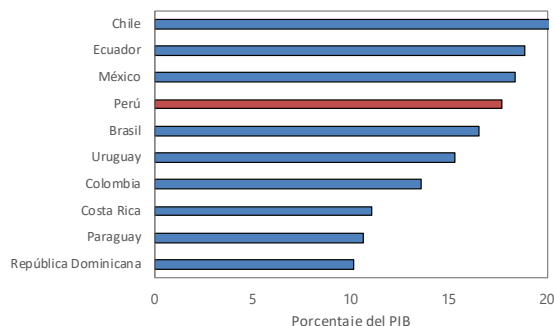
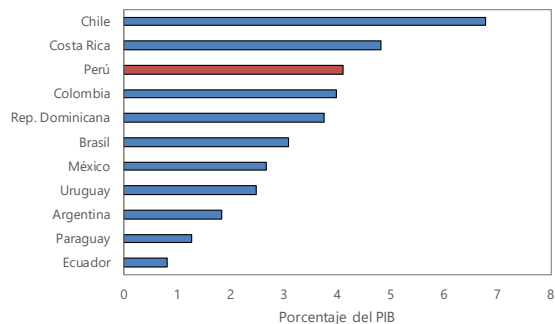


Figure 6. Net Foreign Direct Investment Flows (2010–2018 average)



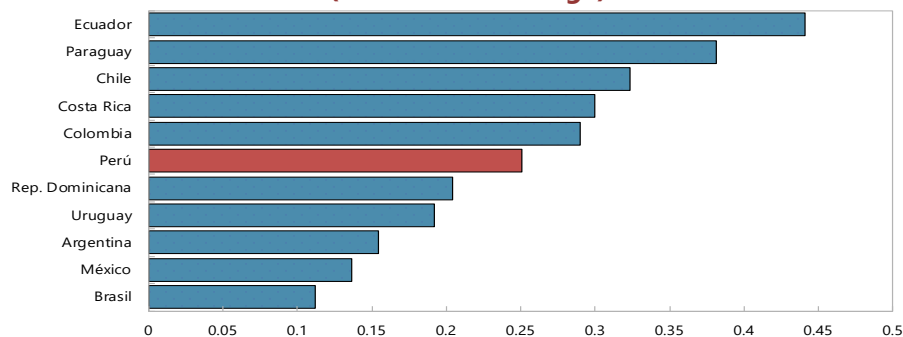
Source: Prepared by the mission with data from UNCTAD (2019), the WEO (2019), the World Bank (2019), and country national accounts.

1/ Private-sector gross fixed capital formation pertains to corporations and does not include households.

Using SEZs as an instrument to promote Peruvian export diversification is also encouraged.

Nevertheless, Peru already diversifies its exports more than most Latin American countries (Figure 7), including some with very large SEZs, such as Costa Rica and Colombia.⁹⁴

Figure 7. Export Concentration Index¹ (1995–2018 average)



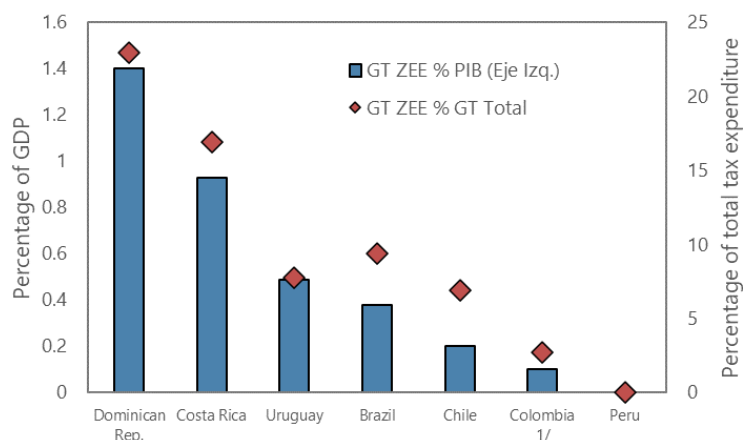
Source: Prepared by the mission with UNCTAD data (2019).

1/ Herfindahl-Hirschman Index: a coefficient closer to 1 denotes higher levels of concentration in exported products.

⁹³ Total investment in Peru, including public investment, between 2010 and 2018 accounted for around 24 percent of GDP on average, which is higher than most countries in the region and on par with the Dominican Republic. Source: WEO (World Economic Outlook Database, 2019).

⁹⁴ In Colombia, SEZs are responsible for 13 percent of the country's total exports. UNCTAD (2019), *World Investment Report 2019. Special Economic Zones*.

Figure 8. SEZ Tax Expenditure in Selected Countries (2017)



Source: Prepared by the mission with data from country tax expenditure reports, CIAT (2016) in Paraguay, the World Bank (2011) in Colombia, and the World Bank (2017) in Chile.

1/ Data for Colombia are for 2010.

122. Peru is one of the countries with the lowest tax collection in the region, and SEZs, where they are successful, generally represent a significant tax expenditure. In the Dominican Republic and Costa Rica, they account for around 1 and 1.5 percent of GDP (Figure 8). In addition, the tax expenditure of SEZs is sometimes underestimated because the concept is often measured based on the tax return prepared by SEZ users, which many times simply operate as a cost center. In other words, they reflect the minimum profits necessary to finance their operations, transferring the rest (through transfer prices, for example) to their parent companies or the group's subsidiary where treasury functions are concentrated (likely located in a jurisdiction with low taxation as well). Thus, the reported profits, the basis for measuring tax expenditure, could very much be artificially reduced. Given all of the above, expanding the use of SEZs to increase investment in Peru does not seem very intuitive,⁹⁵ as it poses the risk of having no greater effect in achieving their objective (because they would possibly capture a high proportion of investments that would be made anyway) and, at the same time, jeopardizing the scarce tax collection.

K. Discussion Summary

123. We must not lose sight of the fact that regional development is the main reason for authorizing SEZs. This is essential to the extent that SEZs mean an income tax exemption. Maintaining that purpose is prudent not only to comply with the OECD's minimum standards on harmful tax practices, but also to avoid the risk of disrupting the national tax policy, ceding the tax base, and generating unjustified tax advantages and distortions. As long as income tax

⁹⁵ Tax incentives have not been an effective policy tool in promoting gross fixed capital formation in Latin America; they have had better luck in attracting FDI flows. Klemm, A. and Van Parys, S. (2012), "Empirical Evidence on the Effects of Tax Incentives," *International Tax and Public Finance*, 19(3), pp. 393–423.

benefits are granted, even if they are partial, the requirement for SEZs to be located in disadvantaged areas according to an established and objective criterion must be maintained.

124. There can be greater flexibility with SEZs as long as the tax advantages are relative to indirect taxes on temporary imports only. Insofar as SEZs offer indirect tax benefits only as a facility for (genuinely) temporary imports, the conditions for the location and number of SEZs can be made more flexible because the problem of distorting tax advantages is essentially eliminated.

125. Full income tax exemption is excessive in any context. The likelihood of favoring investments that would be made anyway is very high. The advantage granted to the competition by the domestic market is difficult to justify, which is why it is not common practice.

126. It is also advisable to link the continuity of the tax benefit to the fulfillment of specific employment and investment targets. Oversight of beneficiaries must therefore be strengthened, for which the generation of (public) information on the performance of SEZ users must be significantly enhanced.

127. Consolidating and simplifying current regulations should not be sacrificed. For this reason, the new SEZ law must cover the current ones and standardize the criteria, except as concerns income tax. All progress and clarity on other issues, including the effective date of the regime, must be applicable to current SEZs.

128. The (partial or total) elimination of the income tax benefit must respect the investments made under previous legal conditions. Although the concept of acquired right in the event of a law change does not exist in Peru, in practice, the tradition in the country has been to respect the concept when the tax regime is substantially modified. Consequently, SEZ users in operation should maintain their current tax regime until their contract expires. New investments, as well as new users of current SEZs, will have to operate under the tax conditions of the new law.

129. Although the legal flexibility proposed by the MINCETUR draft law for creating new SEZs is understandable, the constitutional impediment seems clear. The legislator protected Congress, with a qualified majority no less, in its authority to regulate the imposition of taxes and, where applicable, exemption from them. The constitutional mandate also protects the treasury against the possible proliferation of tax exemptions that the executive might approve without major counterweights. Therefore, a framework law that entrusts the executive with deciding who is entitled to a tax exemption would not appear to be consistent with Peru's constitution. For this reason, the mission is inclined to think that any new SEZ should be authorized by its own law, although the risk is that this will end up creating a messy legal situation again because these individual laws could go beyond or deviate from the framework law. If the income tax benefit is completely eliminated for SEZs, it is no longer clear whether the constitutional restriction for approving a new SEZ applies.

130. The promotion of investment and employment, regardless of the country's region, is typical of a national tax policy rather than of a focused instrument such as SEZs. Instead of using instruments such as SEZs, which sporadically affect groups of enterprises that succeeded in obtaining the benefit, coexisting (and competing) with the rest of those subject to the general tax regime, this general regime should be reviewed and efforts should be made to find ways to make it more investment friendly, rather than having it promote one investment at a time based on decisions that are not entirely transparent, which introduces distortions and potentially harmful advantages.

Recommendations

- Eliminate the income tax exemption as a benefit for being located in an SEZ.
- If a partial income tax benefit is maintained in SEZs, ensure that its main purpose is the regional development of disadvantaged areas.
- If the tax benefits granted to SEZs are relative to indirect taxes on temporary imports, consideration could be given to authorizing SEZs with greater flexibility, while at all times addressing tax and customs control problems.
- Grant the tax benefit on the condition that specific investment and employment targets are met by the SEZ user.
- Consolidate the current regulations of the various existing SEZs, including the period of validity, as well as any new SEZs that are created into a single legal framework, considering the Single Window for Foreign Trade, except for the income tax treatment.
- Establish in a transitory article of the new law that current users will be able to maintain the treatment under the current law until their contracts with the SEZ expire.
- Consider the excessive benefit of the drawback for exporters as a widespread issue and resolve it in those terms;
- Create new SEZs by means of a law, in accordance with constitutional restrictions, irrespective of the law establishing the corresponding legal framework;
- Comply with WTO and BEPS Action 5 restrictions for SEZ purposes, that is, do not include highly mobile activities or logistics operating outside the SEZ;
- Allow reshipment, but without an income tax benefit;
- Subject users in SEZs to requirements on transfer prices established in the general income tax regime.

Appendix I. Simplified Regimes in Latin America

1. In Latin America, simplified tax regimes for small taxpayers are very widely used.

Their purpose is to reduce the compliance costs faced by this group. The tax policy avenue most used to this end is the substitution of taxes with (a) fixed fees and (b) reduced rates applied on a presumptive basis. The most common in administrative terms are the simplification of accounting and a reduction in the number of payments.

Simplified Fixed Fee Regimes

2. In Latin America, simplified fixed fee regimes have been aimed mainly at natural persons with business income and, in very few cases, at legal persons. Generally speaking, these types of simplified regimes are not aimed at tax collection and seek to promote the tax culture among this group of taxpayers. They are the simplest regimes, with voluntary participation and self-categorization, that substitute one or more taxes (in Argentina, Brazil, and Uruguay, they also substitute the payment of social contributions). Continued adherence to the simplified regime depends primarily on not exceeding a certain level of gross income, gross sales, capital, or asset value, or any combination of these (in the case of Argentina and Ecuador, wage income could also be included), supplemented by other micro enterprise characteristics (Table 7). The fixed fees also vary based on these criteria, as the aim is to make them progressive.

3. Peru's NRUS, a simplified fixed fee regime, does not have a significant gap between its threshold and the region average, but it does relative to its fixed fees. In Latin America, the average thresholds are 4.2 times per capita income, 0.2 percentage points above the threshold established by the NRUS. Average annual payments in the region range from US\$373 to US\$1,340, although they vary widely (for example, Ecuador and Nicaragua charge annual fees that do not exceed US\$25 for the smallest taxpayers) (Table 7). In Peru, these payments range from US\$71 to US\$177, respectively, with a fairly wide gap relative to the fees required by other countries with per capita income similar to Peru's.

Table 1. Simplified Fixed Fee Tax Regimes in Latin America

Country	Regime	Taxes replaced	Gross income threshold		Annual fixed fee (USD)		Taxpayer
			USD	times per capita GDP	From	Up to	
Peru	New Single Simplified Regime (NRUS)	ISR, VAT, and IPM	28,296	4.0	71	177	Natural persons
Argentina	Monotax 1/	ISR, VAT, and employee CSS	40,855 (trade) 27,257 (services)	3.9 2.6	368	2,767	Natural persons with micro or small enterprises
Bolivia	Simplified tax regime 2/	IU, RC-IVA (ISR), VAT, and IT	26,822	7.0	41	306	Natural persons: retailers, artisans
Brazil	Regime for the Individual Microentrepreneur (MEI) 3/	All federal taxes and CSS	16,265	1.7	162	182	Individual entrepreneurs
Chile	ISR regime for small taxpayers 4/	Category 1 ISR	8,653	0.5	433	1,731	Natural persons with artisan workshops, micro enterprises, and fishermen
Ecuador	Ecuadorian Simplified Tax Regime (RISE) 5/	ISR and VAT	60,000	9.7	17	3,125	Natural persons with small businesses
Nicaragua	Special Administrative Estimation Regime for Fixed Fee Taxpayers 6/	ISR and VAT	14,488	7.3	22	54	Natural persons
Uruguay	Monotax 7/	All national taxes, except on imports	22,028	1.3	623	1,214	Natural persons with reduced business activities, de facto partnerships (maximum 3 partners)
	Small Enterprise Tax (IPE)	IRAE, VAT, and IP	36,714	2.1	1,320		Enterprises with commercial or industrial activities
Average (excludes Peru)				4.2	373	1,340	

Source: Prepared by the mission with data from country legislation. The exchange rates used come from the IMF/WEO (2019).

Notes: Simplified regimes are based on SME characteristics and indicators (gross income, capital amount, number of employees, surface area used, electricity consumed, and activity carried out).

1/ In Argentina, the monotax category is determined based on gross income, the surface area used to carry out the economic activity, the electricity consumed, the leases paid, and the activity carried out.

2/ In Bolivia, the capital must be below Bs 60,000.

3/ In Brazil, having no more than one employee, who is also paid at least a minimum wage.

4/ In Chile, the threshold for benefiting from the special tax regime changes based on activity. The one presented corresponds to cash equity for artisans and family-run micro enterprises. To qualify as artisanal, fishermen must not operate more than two vessels and cannot exceed 15 gross tons.

5/ In Colombia, establishments must have an area smaller than 50square meters.

6/ Ecuador requires fewer than 10 employees. If it is under a dependency relationship, the income for this item cannot exceed the basic fraction of income tax with a rate of 0 percent for each year.

7/ In Uruguay, in addition to income, there are limitations on economic activities, and there have to be fewer than three partners.

Presumptive Simplified Regimes

4. The second type of simplified regime is aimed primarily at small and medium-sized enterprises. It is presumptive and usually taxes gross income. These taxpayers are larger and have a bigger managerial capacity, which is why determining tax is usually slightly more complex than for fixed fee regimes because minimum accounting standards must be observed to quantify gross income, but not net profit. Some other characteristics of these regimes are that they are voluntary, although minimum periods of adherence to the regime are established in many cases.

5. Experience in Latin America shows that gross income is the most widely used basis for determining tax. However, there are exceptions: the Dominican Republic, where profit margins are established according to the activity or economic sector in which the SME operates; Chile, where the tax amount varies in proportion to asset value for agricultural and transportation SMEs or the price of copper for mining SMEs; and Paraguay, where tax is determined based on the lower of either 10 percent on net income or 30 percent on annual sales (Table 8).

6. The thresholds vary widely. The average for the region, excluding Peru, is 54.5 times per capita GDP. Paraguay has the lowest threshold at 2.8 times per capita GDP, whereas Peru stands out with the highest for the SME Tax Regime (294.7 times).

7. There is no clear majority among the countries between those that opt for a fixed rate and those that opt for progressive rates. Peru has opted for both: a reduced fixed rate on gross income for smaller SMEs and progressive rates for those with greater capacity, equating the maximum rate with the general regime rate. Some countries, such as Brazil and Chile, also establish differentiated progressive rates based on the economic activity carried out by taxpayers.

Table 2. Simplified SME Tax Regimes

Country	Regime	Taxes replaced	Threshold		Base	RS rate (%)	Taxpayer	General regime rate (%)
			USD	Times per capita GDP				
Peru	Special Income Tax Regime (RER)	ISR	154,745	21.7	Net income	1.5%	Natural or legal persons	29.5
	SME Tax Regime (RMT)	ISR	2,104,536	294.7	Net income	10–29.5%	Natural or legal persons	
Brazil	Integrated Tax and Contribution Payment System (SIMPLES)	Federal taxes and CCS	1,301,211	139.3	Gross income	Trade 4 - 19% Industry: 4.5 - 30% Services: 6% - 33%	SMEs	34.0
Chile	Presumptive Income Regime	Category 1 ISR	369,953	23.4	Land appraisal	10%	Agricultural SMEs	25.0
			205,529	13.0	Truck value	10%	Transportation SMEs	
Colombia	SIMPLE regime 1/	Category 1 ISR	698,800	44.3	Copper value	4-20%	Mining SMEs	33.0
			2,055,324	130.3	Gross income	0.25%	Natural and some legal persons	
Costa Rica	RTS	VAT, ISR, specific ISR and sales tax	846,427	126.7	Gross income	1.8–11.6%	Natural and legal persons	30.0
Guatemala	RTS for small taxpayers	ISR and VAT	109,261	9.2	Annual purchases	2–7.5% / 2	Natural persons and small enterprises	30.0
Honduras	RTS for small taxpayers	ISR and VAT	19,243	4.1	Gross income	5 percent	Natural and legal persons	25.0
Honduras	Simplified Sales Tax Regime	Sales tax	9,985	3.9	Gross income	N/A 3/	Natural and legal persons	25.0
Mexico	Tax Incorporation Regime (RIF)	ISR, VAT, and IEPS	100,313	10.2	Tax profits	Profit ratio 4/	Micro and small enterprises	30.0
Paraguay	Income Tax for Small Taxpayers (IRPC)	ISR	16,631	2.8	Real net or presumptive income 5/	10%	Sole proprietorships	10.0
Dominican Republic	Simplified Tax Procedure (PST)	ISR and ITBIS (VAT)	798,796	97.7	Net income determined	27% 6/	Natural and legal persons	27.0
			171,906	21.0	Net income determined	15–25%	Natural persons or sole proprietorships	
Average excluding Peru			542,910	54.5				

8. Simplified regimes in Latina America have opened arbitrage opportunities for SMEs and other enterprises. Two factors have contributed to this. First, the low capacity of tax administrations to perform effective control over a large number of taxpayers in this sector. Second, because they are voluntary and offer generous incentives for adherence to them, simplified regimes have widened the tax burden gap between them and the general regime, encouraging many SMEs to keep themselves artificially small (through underreporting or atomization) to continue to belong to the simplified regime. In particular, many simplified regimes that substitute VAT have introduced implicit thresholds for VAT (most Latin American countries do not have an explicit VAT registration threshold, see Table 9), which have not always been created bearing in mind VAT optimality criteria, affecting competitiveness and distorting the behavior of enterprises with income close to the threshold.

Table 3. VAT General Regime and Simplified Regimes in Latin America

Country	Explicit thresholds in general regime		VAT rate (%)	Implicit thresholds under simplified regimes		Record type
	USD	times per capita GDP		USD	times per capita GDP	
Peru 1/	No threshold		18.	28,296	4.0	Voluntary
Argentina 2/	No threshold		21	42,279	4.0	Voluntary
Bolivia	No threshold		13	63,418	6.0	Voluntary
Chile	No threshold		19	19,825	5.2	Voluntary
Colombia	1,006,096	150.6	19	38,275	2.4	Voluntary
Costa Rica	No threshold		13	69,900	5.9	Voluntary
Dominican Rep. 3/	No threshold		18	823,976	100.8	Voluntary
			18	177,325	21.7	
Guatemala	No threshold		12	19,243	4.1	Voluntary
Honduras	No threshold		15	10,386	4.0	Voluntary
Mexico	No threshold		16	105,672	10.7	Voluntary
Nicaragua	No threshold		15	39,933	20.1	Voluntary
Paraguay	No threshold		10	4,273	0.7	Voluntary
Uruguay	No threshold		22	36,714	2.1	Voluntary

Source: Prepared by the mission in accordance with the legislation of each country and data from the International Bureau of Fiscal Documentation.

1/ Peru: The VAT rate presented includes a 2 percent IPM.

2/ Argentina has two thresholds depending on activity: services and trade.

3/ The Dominican Republic has two thresholds depending on size: small and medium-sized enterprises and micro enterprises.

Appendix II. Simplified Tax Regimes and Informality

- 1. Responses to informality should not be approached exclusively from the perspective of tax design, but rather holistically, and should include labor, administrative, and institutional aspects.** Extensive literature analyzes the relationship between taxes and the formalization of economic activity, a complex relationship in which informality is recognized as having many causes. In addition to taxes, other factors, such as income, labor regulations, education, the institutional framework, productivity levels, and trust in governments, are also determinative in explaining informality.
- 2. Taxes and their relationship with labor informality: in principle, labor informality depends on the elasticities of labor supply and demand.** If labor demand (from employers) or supply are perfectly inelastic, a change in labor taxes will not affect the employment level or formalization (and the greater the elasticities, the greater the impact). Kugler and Kugler (2009), for example, find that 20 percent of the increase in labor taxes in Colombia after the 1993 reform was passed on to workers in the form of lower wages. Heckman and Pagés (2003) draw a similar conclusion, finding that a third of labor taxes are passed on to wages in Latin America.
- 3. When the expected benefits are lower than the contribution made, labor taxes change the relative cost of the factors (work and capital).** This makes one factor (labor) more expensive relative to another (capital) and creates an incentive to invest through the latter and not the former. A clear example of this was the contribution reduction in Colombia (which reduced the cost of labor), funded with an increase in the corporate income tax rate (which increased the cost of capital), creating an incentive to formalize workers whose salaries qualify for a deduction of that tax.
- 4. Most studies conclude that labor regulations also have a negative impact on employment and formality.** They contribute to an increase in informal labor, unemployment (particularly in the margin), and inequality, in both developing and developed countries. Greater labor market rigidity is associated with lower employment and informality levels, in both African and Latin American countries. With the hiring and/or dismissal of workers becoming more expensive, employers opt not to employ the individual or to employ that individual informally.¹
- 5. Many micro enterprises decide to operate in the informal economy for subsistence reasons.** Evidence shows that, in developing economies, informal micro enterprises remain informal given the few benefits that becoming formal affords them. These types of establishments interact with similar informal establishments, hire informal workers, and are

¹ See Kumar, Nataraj, and Perez-Arce, 2014; Lustig and McLeod, 1997; Heckman and Pages, 2000; Botero et al., 2004; Caballero et al., 2004; Djankov and Ramalho, 2009; Fallon and Lucas, 1991; Gindling and Terrell, 2009; Kugler, 1999 and 2004; Mondino and Montoya, 2004; Saavedra and Torero, 2004; and Kaplan, 2009.

extremely unproductive, which is why increasing costs could force them to disappear, leading to more poverty among individuals who depend on them (La Porta and Schelifer, 2014).

6. Formality also increases with enterprise size. Large enterprises are generally managed by more educated professionals with more intensive capital, which requires a more skilled workforce (La Porta and Shleifer, 2008). Large enterprises usually require staff with more training not only in handling machinery, but also in conducting procedures. They invest in training and therefore seek a more extensive, secure, and formal relationship. Productivity goes up significantly when comparing small enterprises with formal ones and quickly increases with the size of the enterprise.

7. Education and labor productivity are also closely tied to informality. Busso, Fazio, & Levy (2012) find that productivity in the informal sector in Mexico is approximately 50 percent lower than in the formal sector. Workers with high productivity (which is associated with higher education according to what the labor market demands) have access to higher wages. These wages become more expensive with taxes (due mainly to social contributions and income tax) and regulations (severance pay, notice, minimum wage, etc.), meaning that employers are only willing or able to pay high salaries (including taxes and regulations) to workers whose productivity (derived largely from their education level) offsets them. To workers with productivity lower than that salary (including taxes and regulations), they can only offer (and the workers can only accept) work "outside" the regulations (for example, with below minimum salaries or salaries without deductions and contributions).

8. There is no evidence that tax benefits focused on small enterprises increase aggregate employment more than a benefit that extends to all enterprises (International Tax Dialogue, 2007). On the contrary, benefits focused on small enterprises can have a negative effect on growth, creating a "small business trap" that motivates them not to grow in order to maintain the preferential treatment (IMF, 2012).

9. The main objective of simplified regimes should be simplification, both in the private and in the public sector, and not the creation of opportunities for tax arbitrage, facilitating tax compliance by small taxpayers (with little administrative capacity) and tax administration (with the aim of focusing on supervising larger taxpayers, which account for the largest share of tax collection). The objective should not be to reduce the tax burden because, if this reduction is significant, the simplified regimes end up being highly distortive, encouraging the division of enterprises or underreporting for the purpose of continued eligibility under the regime.

10. In short, informality is a problem with multiple causes and contributing factors beyond taxes and regulations. Variables such as education, development, trust in institutions, enterprise size, and productivity can also help reduce it, which is why tackling it from a purely tax perspective might not yield the expected results if other equally important factors are ignored.

Appendix III. Procedure for Qualifying for an SEZ

SDZ	<p>Information to provide when applying for pre-qualification as a user: Name or business name, taxpayer identification number (<i>Registro Único del Contribuyente</i> – RUC), activity or activities to be carried out in the SDZ, including documents supporting the project, land and infrastructure required, other details that may be required by the SDZ administration.¹</p> <p>Bid process: Provide a three-month guarantee for the assignment for use of the respective lot, which may be in the form of a bond letter, a cashier's check, or cash. The enterprise that offers the highest amount for the assignment for use of the land and the highest investment will be the successful bidder.</p> <p>Signing of contract: Provide a two-month guarantee for the assignment for use, valid for 12 months, renewable until the end of the contract, in an amount equivalent to 15 percent of the committed investment amount. Once the assignment for use contract has been signed, the three-month guarantee provided to participate in the bid process will be returned. In the event that the contract is not awarded for reasons not attributable to the debtor, the guarantee will be returned at the end of the bid process.</p>
Tacna FTZ	<p>Procedure for consideration as a user: Submit an application containing identifying details for the applicant and the powers with which the latter acts. Indicate the economic activity to be carried out, specifying national subdivisions, the investment amount, the volume and value of inputs and products, the level of employment to be generated, the surface area required, and any other information depending on the format. The rules for participation in the public bid process must be met. The applicant will be required to deposit a guarantee corresponding to one month of the assignment for use. Once the lot subject to the assignment for use has been awarded, the successful bidder has 10 calendar days to sign the contract, for which the latter will be required to deposit a two-month guarantee for the assignment for use, plus the first month's installment, and any other documents set forth in the bidding rules.</p>

¹ Each zone has additional requirements, as stated on the corresponding web pages, such as: Forms based on the economic activity to be carried out, the investment schedule form, a sworn declaration of the absence of any debts as a user or former user of the SDZ, and the payment of a processing fee.

Appendix IV. Activities Permitted in SEZs

ACTIVITIES PERMITTED IN THE SDZ

Industrial activities – Maquila and assembly – Storage, transport, distribution, and commercialization of merchandise within SDZs, abroad, and in the rest of the national territory – Packing, unpacking, labeling, fractioning, picking, packaging, bottling, placarding, freeze-drying, or preparing or conserving merchandise for transport. -Telecommunication activities – Information technology activities. -Technical support, repair, refurbishment, remanufacture, repowering, servicing, and recycling of merchandise. Science and technology research and development activities.

ACTIVITIES PERMITTED IN THE TACNA FTZ

Industrial activities – Agroindustrial activities – Assembly activities – Maquila activities – Logistics services – Information technology services – Science and technology research and development services – Human health research services – Infrastructure development services.¹

¹ Article 7, Law 30,976 of July 2019.

Appendix V. Tax Benefits of Peruvian SEZs

Scenario 1: Operations between SDZ / Tacna FTZ users	Users exempt from all taxes for the development of authorized activities, the transfer of goods, and service delivery.
Scenario 2: Operations from SDZs / Tacna FTZ to foreign countries	SDZ / Tacna FTZ users exempt from all taxes.
Scenario 3: Operations from the national territory to SDZs / Tacna FTZ	<p>Income from goods to SDZs / Tacna FTZ is exempt from tariff duties imposed on their importation.</p> <p>National enterprises that transfer goods from the country to SDZs / Tacna FTZ are considered to be exporting and may request a refund of the tariff duties and an IGV rebate.</p> <p>To maintain the benefits, goods entering for maquila cannot be renationalized, but will have to be transformed, used, or exported.</p>
Scenario 4: Operations from foreign countries to SDZs / Tacna FTZ	Income from goods from foreign countries to SDZs / Tacna FTZ is exempt from tariff duties imposed on their importation.
Scenario 5: Operations from SDZs / Tacna FTZ to the national territory	<p>These operations are subject to regular taxes on sales, imports, and service delivery. However, manufactured products pay the lowest tariff rate, in accordance with trade agreements signed with Peru.</p> <p>Exception: Users are exempt from tariff duties when the goods are obtained from maquila, repair, and other processes that generate value-added for the goods.</p>
From Tacna FTZ to Trade Zone	<p>The Tacna Trade Zone is the geographic area comprising the district of Tacna and the trade centers of the Alto de la Alianza district. Merchandise that enters that zone from free warehouses in the Tacna FTZ is exempt from the IGV, the IPM, and the ISC, the only payment being a special tariff of 6 percent on the Cost, Insurance, and Freight value or the acquisition value, whichever is greater. (Law No. 27,688, Law on the Tacna Free Trade Zone and Trade Zone, approved by Supreme Decree No. 142-2008-EF, published on 12/4/2008).</p>

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