Chapter 1

Peru: Financial Transactions Tax within the Scope of the OECD Model Convention?

Esteban Montenegro Guillinta and Mirna Solange Screpante

1.1. Introduction

The Peruvian Tax Court[1] (PTC) addressed whether the Financial Transactions Tax (FTT),[2] in accordance with Peruvian domestic law, constitutes a property tax and, therefore, is within the scope of the Chile-Peru Tax Treaty (2003).[3]

In February 2019, the Peruvian Tax Court decided against a taxpayer seeking reimbursement of FTT paid in Peru because it considered that taxes on property or capital apply to wealth or assets owned and not to wealth intake or expenditure. Basically, the Court stated that the nature of the FTT does not take into account the ownership of the funds. Moreover, the court indicated that it is important to notice that the mere presence of an asset in a taxable operation does not mean that the tax applied qualifies as a tax on assets. In fact, the FTT subjects certain operations to tax that are (or should have been) carried out in national or foreign currency through the financial banking system, but not the money that is passed through the banking system.

1. PU: Tax Court, 20 Feb. 2019, Ruling N° 01633-2-2019. There are two other recent decisions from the same tribunal that arrived at the same conclusion with essentially the same arguments. In this regard, *see* PU: Tax Court, 14 Feb. 2019, Ruling N° 01390-9-2019; and PU: Tax Court, 27 Sept. 2018, Ruling N° 07433-9-2018.
2. PU: Law 28.194, *Ley para la Lucha contra la Evasión y para la Formalización de la Economía* [Financial Transactions Tax] [hereinafter FTT] was enacted in 2004 as part of the Peruvian government's measures to promote the use of the banking system and combat the informal economy. It applies to both commercial and non-commercial transactions. Initially, it was supposed to be a temporary tax (originally applicable up until 2006), but it was renewed until 2011 when the tax rate was significantly lowered, and ultimately, the tax became permanent. Since 2011, the FTT rate has remained just 0.005% over taxable transactions (at its highest, for a few months in 2004, the rate was 0.10%).
3. *Convention between the Republic of Peru and the Republic of Chile for the Avoidance of Double Taxation and Prevention of Tax Evasion* [unofficial translation] (13 Nov. 2003), Treaties & Models IBFD [hereinafter *Chile-Peru Tax Treaty* (2003)].

The importance of this case goes beyond Peru, as it had a transnational impact in the region,[4] given the widespread use of this kind of tax. Governments have found an easy way to collect additional tax revenue in the FTT; however, it has raised a lot of controversy regarding its actual effects on the economy. In this sense, those who criticize the FTT have basically pointed out that it has a regressive effect on levels of bank penetration and, to the same extent, on the informal economy. It is argued that it is economically inefficient to tax the same activity multiple times along the different phases of the commercial cycle, generating a cascading effect and distorting prices related to financial intermediation in relation to the productive part of the economy.[5]

1.2. Facts of the case

The taxpayer filed an appeal before the Peruvian Tax Court against the resolution of the tax administration declaring the requests for reimbursement of undue and/or excess FTT payments for the period of 2009-2012 inadmissible.

The dispute was based on the fact that the taxpayer was a permanent establishment of a Chilean company, Lan Cargo, and was subject to FTT. In the taxpayer's view, FTT constituted a property tax or tax on capital and, therefore, was within the scope of article 2 of the Chile-Peru Tax Treaty (2003).

The taxpayer argued that the FTT did not tax income or consumption, but rather the money used in the transactions. Therefore, what was subject to tax were assets in bank accounts. Considering that taxes on capital or property are covered by the Chile-Peru Tax Treaty (2003), the taxpayer argued that the FTT fell within the scope of article 2 of the treaty and, therefore, that Peru had no taxing rights on capital under article 22 (either 22(2) or 22(4)).

In addition, the taxpayer stated that the Peruvian Constitutional Court already established that the FTT was a tax on capital or assets, and it further

4. The FTT in South America was preceded by the tax on bank and financial debits. It was implemented in (i) Argentina in 1983 and amended in 1988 and 2001; (ii) Chile in 1984; (iii) Brazil in 1994 and amended in 1997; Venezuela in 1994 and amended in 1998 and 2002; (iv) Colombia in 1998; and (v) Ecuador in 1999.

5. G. Lazo Saponara, *Reflexiones en Torno a los Principios Tributarios de Capacidad Contributiva y no Confiscación: A Propósito del Impuesto a las Transacciones Financieras*, 48 Instituto Peruano de Derecho Tributario, p. 83 (2009).

argues that if the FTT did not tax income or consumption, it must be considered a tax on capital or assets.

Regarding the jurisdiction to tax, the taxpayer argued that money is not movable property, in accordance with the legislation on the Peruvian General Sales Tax.[6] Thus, article 22(4) of the Chile-Peru Tax Treaty (2003), which attributes the power to tax only to the country of residence (in this case, Chile), would be applicable.

Additionally, the taxpayer affirmed that the tax administration misinterpreted the prerequisite of double taxation for the application of the treaty as a prerequisite of the same tax in both contracting states and the double taxation of income or assets.

Conversely, the tax administration sustained that the FTT did not qualify as a tax on capital or assets per se. In fact, it qualified it as a different tax that subjected the circulation of money to tax, which, despite having equity content, did not necessarily imply that the FTT constituted a tax on capital or assets.

Furthermore, the tax administration argued that, even if the FTT were treated as a tax on assets, the application of the Chile-Peru Tax Treaty (2003) required the subject to be taxed in both contracting states, since its objective was to eliminate double taxation. Moreover, it argued that money is a movable asset according to the Peruvian Civil Code[7] and, therefore, that article 22(2) of the Chile-Peru Tax Treaty (2003) (on the attribution of profits to permanent establishments) was applicable, not article 22(3) or (4). Therefore, Peru had the right to tax.

Finally, the tax administration asserted that the Constitutional Court did not affirm that the FTT constituted a tax on either capital or assets (*see* section 1.4.2.).[8]

The case was brought before the Peruvian Tax Court.

6. PU: *Decreto Supremo* N° 055-99-EF [General Sales Tax Law].
7. PU: *Código Civil* [Civil Code], art. 886, para. 10: (The other goods not included in Article 885o). Art. 886 exhaustively defines what falls under the definition of "movable assets". Money is not listed; however, it can be interpreted that it is considered movable property, as it is also not included in art. 885o, which defines immovable assets.
8. PU: Constitutional Court, 21 Sept. 2004, Ruling EXPS. N.° 0004-2004-AI/TC.

1.3. The Court's decision

The Tax Court ruled in favour of the tax administration. Basically, the Court asserted that the FTT was not a tax levied on assets or property and, therefore, that the Chile-Peru Tax Treaty (2003) was not applicable. The Court's main reason for this was the nature of the FTT and the type of wealth manifestation that the FTT intended to tax.[9]

The Tax Court argued that in order to analyse the nature of the FTT, it should be considered that taxes are based on the principle of the ability to pay,[10] which can be verified in certain manifestations of wealth: (i) wealth or assets acquired (wealth intake); (ii) wealth or assets owned (amassed wealth); or (iii) consumption (wealth expenditure).It added that income taxes, like direct taxes, most accurately reflect the ability-to-pay principle. The ability-to-pay principle holds that those who have a greater ability to pay taxes, measured by income and wealth, should pay more. It is due to this intrinsic relationship with the ability to pay that FTT is classified as a direct tax, since it directly affects the wealth of a taxpayer.

In relation to taxes on wealth or assets, which were the subject of the case at hand, it should be noted that these taxes apply to accumulated equity and not the inflows or outflows of equity, unlike income tax or consumption tax do, respectively. Therefore, taxes on assets are applied to subjects who hold the ownership of a good or an economically quantifiable right at a given time, as is the case with real estate, vehicles, jewels and works of art, among others. As a matter of fact, these taxes are also considered direct taxes, since they directly affect the wealth of the individual who owns such assets.

Conversely, in the case of consumption taxes, wealth is affected indirectly through the taxation of equity outflow. Therefore, the ownership of goods or services at a given time is not a relevant criterion.

9. Taxable transactions are the following banking operations: (i) transfers, deposits and withdrawals from or to a bank account; (ii) any payment to a financial institution; (iii) the acquisition of any financial instrument; (iv) money transfers that do not use bank accounts; (v) payments made by an individual or business that represent over 15% of its payment obligations in the tax year and were made without using money or banking operations; (vi) operations performed by financial institutions without using bank accounts for the acquisition of assets, donations or other expenses or costs that are deductible for income tax purposes; and (vii) payments or funds put at the disposal of the clients of financial institutions or third parties designated by them without using bank accounts.

10. The Peruvian Constitutional Court stated that "whenever a tax is established, this must have a close relation with the ability-to-pay from taxpayers, since this is the only way that the ability of the taxpayer to contribute with the taxes can be respected, or in other words, taxes will not exceed the ability-to-pay limits".

Moreover, the Court argued that, in the case of indirect taxes, the theory of tax incidence does not directly affect the ability to pay of the taxpayer, since two taxpayers with different abilities to pay will be taxed the same for similar transactions.[11] Therefore, the ability to pay of the taxpayer is only considered in the long run,[12] i.e. to the extent that the amount of consumption in one period is greater or less than that in another.[13] Contrary to that, some believe that FTT is a direct tax, since it taxes the actual inflow and outflow of money into and out of the bank account.[14]

With respect to the FTT, the Court argued that the tax basically taxed inflows and outflows of money in the national banking system, in which the theory of the taxable event does not cover the ownership of assets (tax on capital or assets), but rather the flow of money, which is a characteristic of consumption taxes (indirect taxation).[15] The fact that the FTT takes into account a disposal of assets does not mean that those assets themselves are subject to tax.

Based on that, the Court concluded that the FTT was not a tax on assets and, therefore, was not covered under article 2 of the Chile-Peru Tax Treaty (2003).

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11. It must be noted in particular who the final consumer is in respect of the "economic" or "de facto" taxpayer.

12. Taxes are direct when the incidence and impact of taxation on income or wealth fall on the same entity and the burden cannot be shifted by the taxpayer onto someone else.
They are indirect when they tax an expression of consumption or the transfer of wealth as an indicator of the ability to pay. –Accordingly, direct taxes tax an immediate externalization of wealth, while indirect taxes tax a later externalization of wealth. *See* B. Griziotti, *Principios de Ciencia de las Finanzas* p. 161 (Depalma 1959); H. Villegas, *Curso de Finanzas, Derecho Financiero y Tributario* pp. 162-163 (Astrea 2005); G.J. Ruetti, *Impuesto sobre las Transacciones Financieras*, in *Regimen Tributario Argentino* p. 370 (G.J. Naveira de Casanova et al. eds., Abeledo Perrot 2010).

13. It is logical to think that the greater the expense (especially for luxury and superfluous goods and services), the higher the level of wealth and ability to pay. *See* H.B. Villegas, *Curso de Finanzas, Derecho Financiero y Tributario* p. 78 (Astrea 2001).

14. C. Garcia Vizcaino, *Tratado de Derecho Tributario* p. 318 (Abeledo Perrot 2014).

15. P. Pistone, *Impuestos a las transacciones financieras: perspectivas y problemáticas*, Ámbito Jurídico (14 Nov. 2012), available at https://www.ambitojuridico.com/noticias/analisis/financiero-cambiario-y-seguros/impuestos-las-transacciones-financieras (accessed 11 Feb. 2021).

1.4. Comments on the Court's reasoning

1.4.1. Nature of the FTT

In accordance with Peruvian law, the FTT is levied on most banking operations and on certain transactions performed through the banking system. As such, the taxable events of the FTT are bank account transfers, deposits and withdrawals, in addition to other similar transactions, e.g., money transfers that do not use bank accounts.

Shortly after its inception, the FTT was subject to constitutional challenges due to a series of alleged failures that, in the plaintiffs' view, invalidated the tax.[16]

In the case under discussion, the taxpayers alleged that the FTT was a tax on capital or assets and, therefore, should be covered by the Chile-Peru Tax Treaty (2003) and reimbursed.

In analysing the nature of the FTT, the Peruvian Tax Court discussed the taxable wealth manifestations. The ruling identified the classic manifestations as (i) wealth or assets acquired (wealth intake); (ii) wealth or assets owned (amassed wealth); and (iii) consumption (wealth expenditure). Based on its configuration in Peruvian law, it is clear that the FTT does not target income (intake) or consumption (expenditure). As such, the discussion before the Tax Court focused on determining whether the FTT affects the wealth amassed by the taxpayers. Not surprisingly, the Peruvian Tax Court sustained that the FTT did not tax amassed wealth, since the ownership of money is irrelevant for FTT purposes.

The taxpayer argued, on the one hand, that the Peruvian Constitutional Court already established that the FTT is a tax on capital or assets and, on the other hand, that if the FTT does not tax income or consumption, it must be considered a tax on capital or assets.

However, both arguments were debunked by the very Peruvian Constitutional Court ruling that was mentioned by the taxpayer. That ruling never discussed whether the FTT taxes capital or assets; the Court dealt mainly with the alleged confiscatory effects and technical problems with the configuration of the FTT, which will be discussed in detail in section 1.4.2.

16. PU: Constitutional Court, 21 Sept. 2004, Ruling EXPS. N.° 0004-2004-AI/TC.

Regarding the alleged technical problems with the configuration of the FTT, the main problem – although not specifically discussed in the Constitutional Court's ruling – seems to be that the FTT does not appear to tax any manifestation of wealth (neither income, consumption nor assets owned) and could, therefore, be considered confiscatory. This argument was disregarded by the Peruvian Constitutional Court, which established that mere problems with the technical configuration of a tax cannot render a tax unconstitutional.[17] Furthermore, the Court did not indicate at any point that the FTT is a tax on capital or assets, but instead indicated that all taxes have an effect on the targeted taxpayers' assets.

In addition to that, when discussing the alleged confiscatory effect of the FTT, the Peruvian Constitutional Court focused the analysis on the tax rate, concluding that it was way too low to qualify as confiscatory.[18] Notwithstanding that, new challenges could arise based on case-by-case analyses.

In the authors' view, as regards treaty interpretation, although there is not exactly a conflict of qualification with respect to the application of the FTT, similar reasoning should be applied. In accordance with Peruvian law and case law, the FTT does not qualify as a tax on assets or capital and, therefore, for the purposes of the treaty, should not be considered as such.

1.4.2. Ruling by the Peruvian Constitutional Court on the nature of the FTT

In 2004, the FTT was subject to several challenges before the Peruvian Constitutional Court, the highest court in the country. These challenges were based on different aspects of the FTT, e.g., the alleged infringement of the right to own property, the alleged infringement of the freedom to enter into contracts and the alleged violation of bank secrecy.

For the purposes of this chapter, the authors focus on the challenges of the alleged confiscatory nature and anti-technical[19] configuration of the FTT. The reason for this lies in the fact that it is in regard to these aspects that

17. Id., at sec. §2.4.
18. Id., at sec. §5.21.
19. The court distinguishes between taxes that do not meet technical requirements (characteristics generally accepted in academia) and those that do not meet the requirements specifically established by the Peruvian Constitution. The first type is "anti-technical" (*antitécnico*), and the second is "unconstitutional".

the Court investigated, however briefly, the arguments brought about by the taxpayer to support its position that the FTT is covered by the Chile-Peru Tax Treaty (2003).

Regarding the purported anti-technical configuration of the FTT, the Court's ruling did not even mention the arguments of the plaintiffs and dismissed the claim *in limine*. This conclusion is paramount, since the Court expressly indicated that considering a tax anti-technical or inefficient is not something that can be challenged before the Court. Such characterizations are not sufficient for a tax to be deemed unconstitutional.

As regards the alleged confiscatory nature of the FTT, the argument is based on the fact that the FTT is levied without considering the ability to pay of taxpayers (individuals or business entities). The idea is that the ability to pay is not present in many cases, and therefore, the FTT would disproportionally and unreasonably encroach on the assets of the taxpayers affected by the tax.

The Court concluded, in line with previous case law,[20] that the confiscatory effect of a given tax is a matter that must be analysed on a case-by-case basis. Moreover, the Court explicitly indicated that, considering that the FTT rate is minuscule or negligible, any abstract declaration of confiscatory effects is out of the question.

With this ruling, the Constitutional Court sealed the constitutionality and validity of the FTT. Even though the Court left the door open for challenges in individual cases in which the FTT may unreasonably and disproportionally affect a taxpayer's assets, this scenario is highly unlikely, given that the Constitutional Court already qualified the tax rate as minuscule or negligible when it was a lot higher than the current rate.

1.4.3. Could a MAP be a viable solution?

Article 25 of the Chile-Peru Tax Treaty (2003) substantially follows the OECD Model Tax Convention (OECD Model)[21] (and, accordingly, the OECD Commentary on Article 25). Based on that, it is important to

20. For example, PU: Constitutional Court, 19 Dec. 2003, Ruling EXPS. N.° 2727-2002-AA/TC.
21. *OECD Model Tax Convention on Income and on Capital* (28 Jan. 2003), Treaties & Models IBFD.

determine whether the mutual agreement procedure (MAP) could have been a viable alternative for the taxpayer to try to solve the issue at stake.

From a Peruvian perspective, if the taxpayer would have opted for the MAP, the Peruvian tax administration could not have made effective use of it. The reason for that is a previous ruling of the Peruvian Constitutional Court,[22] which analysed the constitutionality of the FTT and dealt indirectly with the nature of the tax, although that case was not related to the application of the Chile-Peru Tax Treaty (2003). As the Constitutional Court briefly analysed the nature of the FTT but did not go so far as to establish that the FTT was a tax on capital or assets, a MAP in which the tax authority affirmed such nature could have been seen as either a criticism of the Constitutional Court ruling or a statement that goes further than what was intended by the Court. Therefore, the existence of this previous court ruling prevents, in effect, any real application of the MAP.

Having said that, there is no rule that remedies the double taxation created by situations in which the discussion deals with the inclusion or exclusion of a specific tax in or from the scope of a treaty.

These kinds of cases are similar to conflicts of qualification, as the different treatment arises from the application of domestic law. The solution provided by the Commentary on the OECD Model (2014)[23] for conflicts of qualification is that when the transaction is treated by the source state in accordance with its domestic law, such treatment must be considered to be in accordance with the double tax convention, and the state of residence must provide relief. In the case under analysis, the discussion is not of which provision of the double tax convention applies, but whether or not the convention itself applies. However, the root of the conflict is the same (i.e. the application of domestic law in the source state, in accordance with local law). Therefore, in the authors' opinion, it would be advisable that the Commentary include a specific provision that establishes consequences that are similar to those relevant to conflicts of qualification for cases in which the inclusion of a tax within the scope of a treaty is at issue.

22. PU: Constitutional Court, 21 Sept. 2004, Ruling EXPS. N.° 0004-2004-AI/TC.
23. *OECD Model Tax Convention on Income and on Capital: Condensed Version* (26 July 2014), Treaties & Models IBFD.

1.4.4. Relevance of the Court's decision in the international context

To put the importance that this ruling may have internationally into context, it is important to keep in mind that at least 13 additional countries in the Latin American region have taxes that can be considered similar to the Peruvian FTT.[24]

In recent years, there have also been proposals to establish similar taxes in the United States[25] (2019) and Spain[26] (2020).

The main focus of the analysis of each of these taxes for the purpose of the application of tax treaties based on the OECD Model would be to determine whether they qualify as taxes on capital or property, which would depend on the specific legal configuration of each tax.

However, when the local legislation establishes the taxable events as specific banking or financial operations, it could be argued that the logic behind the Peruvian case law should be applied.

It is also important to note that a detailed analysis of the case law of each country will be necessary, since – as is the case in Peru – there could already be rulings that establish criteria to determine when a specific tax constitutes taxation on capital or property.

1.4.5. Differences between the FTT in the United States and Europe

As described in section 1.4.4., in order to determine whether an FTT is covered under a tax convention based on the OECD Model, it is necessary to review the domestic and case law of the contracting states, since domestic concepts can vary greatly.

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24. OECD et al., *Revenue Statistics in Latin America and the Caribbean 2020* (OECD 2020), available at https://doi.org/10.1787/68739b9b-en-es (accessed 11 Feb. 2021). For example, Argentina, Bolivia, Brazil, Colombia, Ecuador, Peru and Venezuela.
25. US: S.1587 - Inclusive Prosperity Act (22 May 2019), available at https://www.congress.gov/bill/116th-congress/senate-bill/1587/text (accessed 16 Feb. 2021).
26. *See* http://www.congreso.es/portal/page/portal/Congreso/PopUpCGI?CMD=VERLST&BASE=pu14&DOCS=1-1&DOCORDER=LIFO&QUERY=%28BOCG-14-A-2-1.CODI.%29#(Página1) (accessed 22 Mar. 2021).