I. INTRODUCTION

Peru agrees with the idea that double tax treaties are not only useful, but invaluable tools in promoting understanding, stability and confidence among the participants in international commerce. The tangible benefits of the mechanisms provided by double-tax treaties include: the lowering of costs to the investor, the attraction of capital, and a shared understanding on the part of tax administrations of how the limited tax revenues from productive enterprises will be apportioned.

Peru's network of double-tax treaties is as yet underdeveloped. At the moment, Peru has treaties only with Sweden and the members of the Andean Pact. No negotiations are pending although some interest exists on the part of France, Germany, Japan and the United Kingdom and others. Nevertheless, the Peruvian delegation can offer its experience to this forum as a case study in the importance of double-tax treaties to a country that is undergoing the transformation from a centrally-controlled to a market economy. To further this objective, we will illustrate the role that double-tax treaties will play in the development of Peruvian market economy and in the process of Peru's reinsertion into the world economy. We hope that you will agree that Peru's experience illustrates that the making of double-tax treaties is an important ingredient in economic development, improving relations with foreign investors, attracting more of them, and improving understanding and cooperation in international relations.

II. WHY DOESN'T PERU HAVE DOUBLE-TAX TREATIES WITH THE MAJOR CAPITAL-EXPORTING NATIONS?

At a time when double tax treaties are becoming a key piece in the structure of trading and economic relations between countries, it is a curious fact indeed that Peru does not have double tax treaties with any of the major capital-exporting countries. There are many reasons, most of which are related in part to Peru's recent history as a heavily controlled

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The late 1980's saw Peru experiencing the worst of times from an economic, social, and political standpoint. Hyperinflation and economic stagnation crippled the economy and repelled foreign investment. Terrorism was rampant, and corruption blossomed. The national currency was worthless. To be brief, very little was going right before the tide turned in the 1990's.

The picture of the tax administration before 1990 illustrates the lack of imaginative direction that characterized Peruvian public institutions. Before 1990, the tax administration was incapable of dealing with the external organizations and institutions. It was a bloated bureaucracy under the supervision of the Ministry of Economy and Finance and it lacked the financial resources and decision-making authority to pursue its own agenda.

Likewise, the Peruvian tax system was complex, overwhelmed by ineffective taxes and lacked a clear policy direction. Many taxes were difficult to collect and some even yielded negative revenue. Compliance costs were high and the rate of compliance was low.

III. WHAT DOES THE FACT THAT PERU DOES NOT HAVE DOUBLE-TAX TREATIES IMPLY?

It means that Peru does not make full use of an important tool in structuring its international economic relations. For example, no mechanisms exist currently for the structured solution of important differences of opinion between the competent authorities of Peru and those of some of Peru's most important trading partners. It also means that Peru does not use one of the now common methods to attract foreign investment. Nevertheless, there are also important implications which are related to the state of the internal development process of the people and the economic structure of the country.

Peru was incapable of appreciating the value of and the need to establish double tax treaties. The years of poor economic and political management led to a lack of focus on the national interest and an attrition in institutional capacity. Peru's public institutions were unable to analyze Peru's position in relation to the rest of the world and to develop mechanisms to adjust to changing times. This means that many changes that should have been made were not and that Peru suffered for it. In addition, there were serious questions about the capacity of the country to monitor such instruments and to enforce them effectively, even if it were willing to sign double-tax treaties.
The relationship between Peruvians and their tax administration has not been a harmonious one. For example, the tax administration never saw the quality of service that it gave to the taxpaying public as an important component in getting the tax system to work. Likewise, and probably related, there has been a long-standing belief that the tax net catches only those who are artless enough to avoid it. There are at least two consequences. First, the tax administration has not been able to develop a process by which it could concentrate on the things it needed to do to get the tax system working well. Second, low rates of compliance have contributed to poor tax yields which led to an adversarial relationship between taxpayers and the tax administration. This adversarial relationship stimulated efforts on the part of the government and the tax administration to support additional and, in many cases, inconsistent taxes in the vain effort to pursue a non-complying public. This was hardly an environment conducive to the efficient use of the country’s energies and resources. The way public institutions and private companies behaved in Peru had to change.

The restrictions that were imposed on the free market in Peru in the past created a culture of doing business that eschewed free market principles. Transparency is one of the key ingredients in the development of a well-working free market and a sophisticated market culture. But during the 1980’s, the impetus for transparency was absent and the concept did not become part of the national consciousness. Thus, the kind of relationship between private companies and public institutions that would bring important issues to light did not occur because of the distrust that private companies and government institutions had for each other.

Peru’s lack of integration with the world economy in the pre-1990 era not only prevented goods and services from entering the country, but it also obstructed the free-flow of ideas that would have helped develop the country’s political, economic and social life. Peru now possesses the tools necessary to pull itself out of the morass into which it has slipped. I am happy to tell you that all this is now behind us.

IV. WHAT EVENTS HAVE TRIGGERED THE NEED TO HAVE DOUBLE-TAX TREATIES?

President Fujimori’s election in 1990 has been the catalyst for fundamental change in Peru. The series of reforms promulgated by the administration have been extensive and impressive in their results. Among the many reforms are: (1) a new foreign investment law emphasizing tax stability and the uncontrolled remittance of profits and capital gains; (2) a new free-trade law that mandates the free-flow of goods, labor and capital;
(3) a broad tax reform that has simplified the tax system, improved the efficiency of the tax administration and reduced the compliance costs to taxpayers. These reforms, and others, jump-started the economy, increased the country’s institutional capacity and competence, and have revolutionized the way that Peruvians see themselves and the way they do business.

It is important to understand just how far-reaching the 1991 tax reform was. First and foremost, the tax reform created an autonomous tax administration. The following statistics are enlightening. In just three years, the tax administration has made a 180-degree turnaround, and is now considered by the public to be the most efficient institution (public or private) in the nation. Of course, relations between the tax administration and the public have improved. Over sixty taxes were repealed. The present tax structure has four major components: a value-added tax, an income tax, customs duties and a selective sales tax. Naturally, rates of compliance have increased dramatically; collections rose from 4% of GDP (Gross Domestic Product) to 14% between 1990 and 1994.

In addition, the economic reforms have also led to other factors that have triggered the need for and the appreciation of double tax treaties. The opening of Peru’s economy to world markets has led to better economic performance, making the country an attractive venue for foreign investment. Also, Peru is restructuring its public and private debt with a Brady Plan. Therefore, Peru's reintegration into the world's economic and capital markets required that we begin the process of refining our relations with our external partners. The making of double-tax treaties is an integral part of this new ordering of Peru's international and economic relations.

V. WHAT DOES IT MEAN THAT PERU IS NOW AWARE OF THE IMPORTANCE OF HAVING DOUBLE-TAX TREATIES AND THAT FOREIGN INSTITUTIONS ARE INTERESTED IN MAKING SUCH AGREEMENTS WITH PERU?

The fact that Peru is aware of the need to have double-tax treaties indicates that a transformation at the most fundamental level has taken place in all parts of the society. What is even more stunning is that this process took place in a matter of four years. To be sure, all of Peru has not adjusted at once to these changes. However, the government is determined to press ahead with the process of change. The government no longer sustains the privileges that the business community became accustomed to in the past. In addition, all members of Peruvian society will be held to the letter of the law. This is an important message if the reforms are to become self-sustaining.
VI. WHAT ARE THE ISSUES THAT PERU WILL CONCENTRATE ON IN THE NEGOTIATION OF DOUBLE TAX TREATIES?

In closing, I would like to list some of the issues that Peru feels are very important in negotiating double-tax treaties: (1) Taxable income should be shared with the country of the investor; (2) Taxes should not discriminate against foreign investors; (3) Taxable income should take into consideration the deduction of expenses related to the activity.

Thank You.