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International Tax

Chile Tax Alert

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Amended tax reform bill approved by Senate

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On 9 August 2014, the Chilean government presented to Congress a 235-page document containing modifications to the 2014 tax reform bill initially presented in April of this year (for prior coverage, see the alert dated 17 April 2014). On 19 August, the Senate approved the modified reform bill, which now will be voted on by the House of Representatives, with a view to obtaining legislative approval before the end of September.

The modifications to the reform bill are intended to implement a compromise reached on 8 July between the governing coalition and the opposition parties, under which the government agreed to submit certain changes to the bill to achieve full political support and obtain legislative approval before the end of September 2014. However, the revised bill contains some measures that were not included in the original bill or in the July compromise. The modifications are in line with the reform bill's original purpose of collecting an additional 3% of GDP, establishing a more equitable tax system and new incentives for investment and savings and reducing tax evasion and avoidance.

Dual tax system

According to the revised bill, Chile would have a dual tax system starting from 2017.

Under the existing rules, business income derived by an enterprise in Chile is subject to a 20% First Category Income Tax (FCIT), but such income also is subject to income tax on a cash basis when distributed to the shareholders/partners of the enterprise, at rates that vary depending on whether the shareholder/partner is resident or nonresident. Nonresident shareholders are subject to a 35% withholding tax on dividends. The tax paid by the enterprise may be used as a credit against the liability of the shareholders/partners, resulting in an overall income tax rate of 35% on distributed profits for nonresident shareholders.

Under the revised bill, shareholders would be able to opt to be subject to one of the following systems:

- **Attributed income system:** Shareholders would be taxed on an accrual basis, with a FCIT rate of 25% imposed at the level of the operating entity, plus global complementary tax at progressive rates for resident individuals or an additional withholding income tax (AWIT) of 35% for

nonresident shareholders (the FCIT being 100% creditable), resulting in an overall income tax charge of 35% for nonresidents. Under this system, profits would be required to be attributed to the owners or shareholders, irrespective of whether a distribution actually is made.

- **Semi-integrated system:** Shareholders would be taxed on a cash basis (when profits are distributed), but at a FCIT rate of 25.5% for 2017 (and 27% as from 2018). The FCIT still would be creditable against the 35% AWIT under that system, but 35% of the credit would have to be paid to the Treasury, so, in practice, only 65% of the FCIT would be creditable. Thus, taxpayers would pay for the ability to defer shareholder taxation until profits actually are distributed with a higher overall income tax rate than under the attributed income system.

The way in which a decision on the election between the two systems would be made would depend on the type of entity. A unanimous decision of the owners would be required for limited liability companies and companies divided by shares. For stock corporations, the determination would be made in an extraordinary shareholder meeting, by approval of owners of a majority of at least two-thirds of the issued voting stock.

New entities would be required to notify the Chilean tax authorities of their election at the time the entities register to commence activities. Existing taxpayers wishing to make or change an election would be required to give notice during the last three months of the year preceding the year in which the taxpayer intends to operate under the new system.

Once an election is made to use a particular system, the taxpayer would be required to remain under that system for at least five years; at the end of this time, the taxpayer would be free to opt into another system. If a taxpayer opts into another system, any item pending taxation at that time would be subject to tax.

By virtue of a provision known as the “Chile clause,” Chilean tax treaties do not limit the application of Chilean AWIT on dividends paid by Chilean companies, provided the FCIT is creditable against the AWIT. Depending on the treaty, the semi-integrated system (under which only 65% of the FCIT would be creditable) could trigger application of treaty caps. To prevent this result, the amended bill proposes that investors from countries with treaties containing the Chile clause would be entitled to 100% of the FCIT credit, even if they have opted into the semi-integrated system. Thus, investors from such treaty countries would enjoy the advantage of deferring shareholder taxation until profits are distributed, and yet retain the benefit of the overall 35% income tax charge. This could lead to a shift in the jurisdictions commonly used to make investments into Chile.

Gradual increase of FCIT

The current FCIT rate of 20% would be increased gradually to 25% under the attributed income system, as described below. In the case of the semi-integrated system, the rate would increase to 27%.

Year	Rate
2014	21%
2015	22.5%
2016	24%
2017	25%/25.5% (semi-integrated system)
2018	25%/27% (semi-integrated system)

Anti-avoidance rules

The revised bill contains several measures related to preventing the avoidance of tax.

Deductibility of financing expenses: The revised bill specifically allows for the deductibility of interest incurred to finance the acquisition of shares and rights in companies, as long as the general requirements for an expense deduction are satisfied. The provision in the original bill that would have precluded the deduction of interest in relation to these assets has been eliminated from the revised bill.

Thin capitalization rules: New rules would apply as from 1 January 2015 that would impose a special tax on interest on debt that exceeds a debt-to-equity ratio of 3:1, which would be calculated annually. The new provision would affect interest and any other expenses relevant to financing, such as commissions, services and expense reimbursements. Although any type of loan would be considered for purposes of the calculation of the total indebtedness, only interest paid on financing deemed related and subject to the reduced AWIT rate of 4%, or not subject to AWIT, actually would be subject to the special tax. (The 4% reduced AWIT rate is available for loans granted from abroad by foreign banks or financial institutions and under some other circumstances). Thus, while the thin capitalization rules would be tightened, the second test included in the original bill (50% of the taxpayer's net taxable income for the period) is not contained in the revised bill.

Loans granted before 1 January 2015 would be grandfathered and not subject to the new rules, unless they are modified or assigned after that date.

Controlled foreign company (CFC) rules: CFC rules would be introduced to prevent the deferral of tax on foreign-source income. The rules would require Chilean resident taxpayers to include currently the income of nonresident entities that are deemed to be CFCs.

The bill defines "control" in terms of participation in the capital, profits, voting rights or rights to appoint directors or administrators for an entity. However, a foreign entity would be deemed to be a controlled entity (irrespective of the participation or rights involved) if it is resident in a country with low taxation or an otherwise preferential tax regime (the modifications would reduce the scope of a "preferential tax regime" and exclude OECD member countries from that definition). Passive income, for purposes of the CFC rules, would comprise dividends, withdrawals of profits, interest, capital gains and royalties, among other types of income. Under the revised bill, the application of the CFC rules would be postponed to 1 January 2016.

General anti-avoidance rule (GAAR): The Chilean tax authorities would be authorized to challenge agreements, structures or activities of companies that are carried out for the main or sole purpose of avoiding the payment of tax. However, the revisions to the bill establish that the tax authorities would be required to request the tax court to rule on whether a taxpayer's actions constitute tax avoidance or evasion. "Abusive transactions" are defined as transactions that, individually considered or as a whole, have no relevant legal or economic effects apart from the following tax effects:

- Avoiding a taxable event in whole or in part;
- Reducing the taxable base or tax liability; or

- Postponing or deferring the triggering of tax.

Taxpayers would be able to request an advance ruling on whether a transaction or series of transactions is susceptible to being considered tax avoidance or evasion. The new rules would apply starting one year after the enacted law is published.

The modifications to the bill include a specific provision according to which investment companies and, in general, businesses that derive passive income, may not be used to abusively defer or reduce the tax liabilities of their owners; when this is the case, the pertinent investments would be subject to the penalty tax on hidden distributions.

Limits on payments to foreign related parties: As from 1 January 2015, certain expenses incurred in transactions with nonresident parties that are directly or indirectly related to a Chilean taxpayer would be deductible only in the calendar year in which the expenses are paid, credited to an account or made available. In addition, to claim a deduction, the Chilean taxpayer would be required to have paid and declared the corresponding withholding tax (except for payments that are exempt from withholding under domestic law or an applicable tax treaty).

Voluntary disclosure of foreign assets and income

The amended bill includes a proposal to introduce a voluntary disclosure opportunity for taxpayers to report previously untaxed assets and income abroad. The disclosure period would be available for calendar year 2015. Taxpayers resident/domiciled/established in Chile before 1 January 2014 would be able to declare assets and income subject to Chilean tax that have not been timely declared and taxed. “Assets” for these purposes also would include assets in Chile held by residents through entities, trusts and foreign representatives.

Taxpayers making the declaration would be required to waive bank secrecy regarding income or assets included in the disclosure statement. The tax authorities and other government agencies would be permitted to request information from banks regarding the items disclosed by the taxpayer. A taxpayer making a disclosure would be able to bring the disclosed assets or income to Chile, but would not be required to do so.

The assets and income disclosed would be subject to tax at a flat rate of 8%. The valuation of the asset would be the taxpayer’s basis for all tax purposes (e.g. in case of a subsequent disposal of the assets). The 8% tax would replace any other taxes otherwise due on the disclosed income. The tax authorities would issue an assessment for the tax due within five business days from the date the disclosure statement is filed, and payment would need to be made within 10 business days from the date of the assessment.

The revised bill includes provisions aimed at safeguarding against the use of the measure for money laundering or financing of terrorism.

Indirect taxes

Value added tax (VAT): In the case of real estate, starting 1 January 2016, the scope of VAT would be extended beyond construction activities to include the sale of real estate by habitual sellers.

Stamp tax: The tax on loans would be increased from 0.033% and 0.4% rates to 0.066% for each month or fraction thereof, capped at 0.8%. For credits collectable on demand or without a maturity date, the applicable rate would be increased from 0.166% to 0.332%. The rate on extensions or renewals also would increase.

Measures relating to small and medium-sized enterprises (SMEs)

Provisions of the revised bill that are relevant for SMEs include the following:

- Medium-sized companies with sales of up to approximately USD 4,178,100 would be able to deduct 20% (under the attributed income system) or 50% (under the semi-integrated system) of the undistributed profits reinvested in the company from their tax base. In both cases, the deduction would be capped at approximately USD 166,000. To be eligible for this regime, a taxpayer's income derived from participations in other companies, from fixed interest securities and from certain other sources could not exceed 20% of its gross revenue.
- Small businesses with sales up to approximately USD 2,090,000 would be able to opt into a special tax system, under which they would be exempt from carrying full accounting books and would pay tax only on their cash flow, i.e. earnings received and expenses actually paid. In addition, businesses that are owned exclusively by individuals would be able to opt to be exempt from corporate income tax (FCIT) and to be subject only to individual income tax on the amounts withdrawn from the business or entity. Restrictions would apply as to the percentage of income that candidates for this regime could derive from investments in real estate, in other companies, in the capital market and from some other sources. Some special rules would apply during transition years 2015 and 2016.
- Subject to certain requirements, compensation paid by SMEs to nonresidents for advertising or for a subscription to, or for use of, technical platforms would be exempt from withholding tax.
- As from 1 January 2015, qualifying SMEs would be allowed to defer the payment of VAT for up to two months after the normal due date.
- Existing SME regimes would be repealed and the maximum sales thresholds for the presumed income regimes would be drastically reduced to approximately USD 200,000 for transport business, USD 375,000 for agriculture and USD 710,000 for mining. The limits would be defined by an inflation-cleared currency unit called a "*Unidad de Fomento*" or "UF," and the USD equivalents would vary with inflation and with the exchange rate.

Other measures

Withdrawals in excess of taxable profits and reinvestment benefit: The reinvestment benefit consisting of deferral of shareholder taxation on profits withdrawn from a Chilean entity with a view to reinvesting them in another Chilean business within 20 days would be repealed. The ability to withdraw amounts in excess of taxable profits with deferral of shareholder taxation until the time when taxable profits are generated also would no longer be available.

One-year opportunity to withdraw historic accumulated profits (historic FUT), subject to a reduced tax rate: The modifications introduced to the bill include an incentive to withdraw historic FUT. During the year 2015, taxpayers that have initiated their activities before 1 January 2013 and that record a balance

of undistributed taxable profits by 31 December 2014 would be able to choose to withdraw part of the historic FUT and pay a final tax rate of 32% (the normal AWIT rate is 35% for nonresident shareholders), against which the FCIT paid would be creditable. The option would be available for the part of the accumulated balance that exceeds the average annual amount withdrawn or distributed during the years 2011–2014. Some specific components of the historic FUT would not be eligible for the 32% rate.

New reporting requirements for certain investments: Additional annual reporting requirements regarding investments abroad would be introduced, as well as requirements for settlors, beneficiaries and trustees in relation to trusts and similar arrangements. Substantial penalties would apply for failure to comply.

Tax goodwill benefit: The tax goodwill benefit that allows taxpayers to amortize over a period of 10 years a tax goodwill balance available after stepping up nonmonetary assets to fair market value following an upstream merger would be repealed starting 1 January 2015 for mergers carried out after that date. However mergers initiated before that date and completed before 1 January 2016 would be grandfathered and the related goodwill would remain amortizable. To be grandfathered, a taxpayer would be required to file a sworn declaration on initiated mergers before 31 December 2014.

Immediate depreciation: The proposal from the original bill that would have allowed taxpayers of all sizes to use instant depreciation for fixed assets during the year following the enactment of the reform bill is eliminated from the revised bill.

"Sin" taxes: The reform bill would increase taxes on tobacco, alcohol and beverages with high sugar content, although some changes have been made to the original proposals contained in the bill.

Green taxes: The reform would introduce taxes on emissions from stationary sources and on certain vehicles considered a source of pollution. The revised bill modifies the proposals included in the original reform bill. In the case of emissions from fixed sources, the tax would apply on the emission of particulate matter, nitrogen oxide, sulfur dioxide and carbon dioxide produced by establishments with boilers or turbines with a thermal generation capacity, individually or in the aggregate, of at least 50 megawatts.

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