



## Chile's new rules on taxation of foreign passive income

One of the changes introduced by Chile's 2014 tax reform is the adoption of certain standards proposed by the OECD base erosion and profit shifting (BEPS) project aimed at combating international tax evasion. To this end, a controlled foreign company (CFC) regime has been introduced to regulate passive income earned by Chilean companies abroad. The regime aims to prevent the deferral of tax on foreign-source income by requiring Chilean resident taxpayers to include in their current taxable income certain types of passive income earned by nonresident foreign entities that are deemed to be CFCs.

Although the CFC regime will come into effect on 1 January 2016, certain reporting requirements on investments abroad must be fulfilled by 30 June 2015.

### Application of regime

A foreign entity will be considered a CFC if a Chilean taxpayer holds, directly or indirectly, 50% or more of the capital, profits or voting rights; can elect the majority of the directors; or has unilateral powers to amend the foreign company's bylaws. A foreign entity generally will be deemed to be controlled (irrespective of the participation or rights involved) if it is established, headquartered or resident in a low or no-tax country or territory (although companies established in OECD member jurisdictions will be excluded from this presumption).

In addition, for the CFC regime to apply, the foreign entity will have to earn income defined as "passive," which includes interest (unless the foreign entity is a bank or financial entity regulated in the relevant country), capital gains and royalties. Any form of distribution or accrual of profits derived from the CFC's participation in other entities also will be considered passive income. However, it is important to note that an exception will be provided if the distribution or accrual comes from another company controlled, directly or indirectly, by the CFC that is not headquartered or resident in Chile and earning passive income is not the company's main line of business or activity. For example, if a Chilean taxpayer holds an indirect participation in a nonresident operating entity, the income from that operating entity will not be recognized as received or earned by the Chilean taxpayer and will not be subject to taxation in Chile in accordance with the CFC provisions.

### Determination of income

Passive income received or earned by the CFC will be considered to be received or earned by the Chilean taxpayer at the close of the relevant fiscal year, in proportion to the taxpayer's participation in the CFC.

Expenses incurred to generate the passive income will be deductible, and the income will be determined in the currency of the country in which the CFC is located and then converted into Chilean pesos using the exchange rate at the end of the fiscal year in Chile. If the passive income accounts for 80% or more of the CFC's income, its total income will be deemed passive. If the passive income accounts for 10% or less of the CFC's income or does not exceed UF 2,400 (the UF is an inflation-adjusted monetary unit, and the threshold currently is equivalent to about USD 96,000), it will not be taxed in Chile under the CFC rules.

### Information required

New obligations will be imposed on Chilean taxpayers under the CFC regime. These include keeping detailed and up-to-date records of the passive income calculated in the country of the CFC, the dividends or earnings from the CFC and the taxes paid or owed on this income abroad. The Chilean tax authorities will issue a resolution specifying the precise information that must be maintained in

these records and may request formal clarification of information from taxpayers to oversee and enforce compliance with the rules.

In guidance issued on 16 March 2015, the tax authorities require Chilean taxpayers that have certain investments abroad, such as equity interests, stock, shares or other forms of participation in the ownership or profits of a foreign company in which the investor directly or indirectly holds any percentage, to file an affidavit when the direct or indirect amount of such investments exceeds USD 1 million at any time during the relevant business year. The affidavit must be filed annually by 19 March for transactions that took place during the preceding business year. By way of exception, taxpayers that are required to file in tax year 2015 with respect to transactions undertaken in 2014 will have until 30 June 2015.

The affidavit will need to contain information on the entity that received the investment; the amount(s) invested; dividends; withdrawals; interest, commissions and other benefits obtained; the profit or loss on the sale or redemption of the relevant stock or equity interest; the dissolution and liquidation of the companies or entities that received the investments; and the taxes paid abroad and any tax credit limits associated with those taxes. Failure to file the affidavit will be subject to a penalty of up to one annual tax unit (currently approximately USD 850).

## Comments

The introduction of the new CFC regime means that investments made in other countries will need to be reviewed closely because Chilean investors that have decided to invest abroad without necessarily seeking a deferred tax benefit will be subject to the new rules on passive income if, for example, they keep cash surpluses (from dividends) abroad that generate passive income from investments made in those countries.

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