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Recent Developments in International Taxation

Chile

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In February 2020, a significant tax reform (the 'Tax Reform') was enacted in Chile.¹ The following report analyses the main aspects of the Tax Reform from an international tax perspective.

Corporate income tax

Return to a sole income tax regime

The Tax Reform eliminated the attributed income tax regime, which had been incorporated by the tax reform passed in Chile in 2014.² Therefore, the partially integrated income tax regime remains as the sole income tax regime available.³

Tax rate

The Tax Reform does not change the rate of income tax that affects Chilean companies ('corporate tax') or the rate of withholding tax borne by foreign shareholders on dividends ('dividend withholding tax'). The rate of both taxes remains at 27 per cent and 35 per cent, respectively.

In addition, the Tax Reform does not modify the aggregate tax rate that results from the integration of corporate tax and dividend withholding tax, nor does it significantly change its calculation and imputation formulas. In other words, corporate tax continues to be a credit (total or partial, as the case may be) against dividend withholding tax, starting with credits generated from 2017, with a 27 per cent rate, and following with credits accrued before 2017, with the average rate of such credits.⁴

The effective rate on net dividends is 23.9 per cent generally, and 10.9 per cent for foreign investors with residence in a jurisdiction with a double taxation agreement in force with Chile, the United States or the United Arab Emirates.

Tax basis

NEW TEST FOR EXPENSES DEDUCTION

Prior to the Tax Reform, expenses were deductible only if they were 'necessary' for the generation of taxable income. This was interpreted narrowly by the tax authority, limiting deductions to expenses that were essential and mandatory. With effect from 2020, the Tax Reform loosens this requirement, stating that expenses must be 'adequate' to generate taxable income.⁵

DEPRECIATION ALLOWANCES

The depreciation allowances are as follows:

- deduction of 50 per cent of the value of new or imported tangible fixed assets utilised in new investment projects, acquired between 1 October 2019 and 31 December 2021; the remaining 50 per cent can be amortised using normal or accelerated depreciation;

¹ Law No 21,210, enacted on 24 February 2020.

² Under this regime, income was subject to taxation both at the level of the company and the shareholders in the same year it was generated, on an attributed basis (even though no actual profit distribution had been paid to the shareholders over the year).

³ Besides the preferential income tax regime applicable to SMEs, as explained below.

⁴ The general rule remains that corporate tax credit is limited to 65 per cent of its amount, except in the case of foreign investors with residence in a jurisdiction with a double taxation agreement in force with Chile, in which case, no limitation applies. The full-credit imputation also benefits investors residing in the United States and United Arab Emirates, countries that have a tax treaty signed with Chile, but which are pending ratification, until 2026. Therefore, if the tax treaties signed with those countries are not ratified by December 2026, dividend distributions paid after that date will have a limited 65 per cent corporate tax credit.

⁵ In addition, the Tax Reform modernises the regulation of a series of specific expenses, including certain donations, bad loans, labour compensation and severance, and environmental mitigation expenses.

- deduction of 100 per cent of the value of tangible fixed assets, acquired between 1 October 2019 and 31 December 2021, and installed and used in the Araucanía Region; and
- super-accelerated depreciation: taxpayers with an average annual turnover of less than UF 100,000⁶ may depreciate investments in tangible fixed assets, new or used, in the tenth of their useful life. Prior to the Tax Reform, this super-accelerated depreciation was limited to taxpayers with an average annual turnover of less than UF 25,000.

GRADUAL ELIMINATION OF TAX REFUNDS

The Tax Reform gradually eliminates the use of tax losses to obtain corporate tax credit refunds attached to dividends received (generally referred to as Pago Provisional por Utilidades Absorbidas or PPUA). Specifically, the Tax Reform limits the tax loss or dividends received (whichever is lower) that can be attributed to the calculation of PPUA to a maximum of 90 per cent, 80 per cent, 70 per cent, 50 per cent and zero per cent in tax years 2021, 2022, 2023 and 2024, and from 2025, respectively.

This modification is relevant to foreign investors who have established holding companies in Chile. This is because expenses of holding companies (eg, interest) will not permit the recovery of corporate tax paid by the operating companies in which they invest.

SME REGIME

The Tax Reform significantly extends the range of companies that qualify as small and medium-sized enterprises (SMEs)⁷ and establishes for them a preferential regime that, in practice, probably results in an effective tax-rate close to zero on income that is not distributed to the owners.

The SME regime considers: (1) cash-basis income recognition; (2) 25 per cent corporate tax rate; (3) expensing of fixed assets; (4) expensing of inventory; (5) deduction of up to 50 per cent of the taxable income that is reinvested in the company, with a cap of UF 5,000; (6) credit against dividend withholding tax of 100 per cent of the amount paid as corporate tax (100 per cent integrated system); and (7) option to keep simplified accounting.

SMEs whose shareholders are individuals or foreign residents may opt to be transparent for tax purposes. In such a case, the SME will not be subject to taxes, and the tax base of the SME will be attributed to its owners in the same year it is generated. The transparency regime can be particularly attractive for small foreign investments in infrastructure or energy projects.

Foreign financing

Thin-capitalisation rules

The Tax Reform restricts the qualification of 'related debt'. Before the Tax Reform, any loan that was guaranteed by a related party was considered 'related debt'. The Tax Reform now requires, in addition to the related-party guarantee, that the guarantor is domiciled abroad and that it is the ultimate beneficiary of the interest of the debt in order for the debt to be treated as 'related-party' debt.

Additionally, the Tax Reform exempts from the thin-capitalisation rules any syndicated loans for the development, expansion or improvement of one or more projects in Chile when: (1) most creditors are not related to the borrower; and (2) the financing terms satisfy the arms' length principle.

⁶ UF (Unidad de Fomento) is a Chilean currency unit indexed to Chilean internal inflation. The value of the UF on 14 June 2020 was CLP 28,711.73 (approximately \$36.5 considering a USD/CLP FX rate of USD 1: CLP 784,65).

⁷ The SME regime only applies to companies whose effective capital, at the start up of activities, is less than UF 85,000 and their annual average gross income in the last three years does not exceed UF 75,000. To calculate the average, certain extraordinary items of income are excluded, and income from related companies is included. In addition, the SME's annual gross income from investments in real estate or from financial investments cannot exceed 35 per cent of its total gross income.

*Back-to-back loans*⁸

New requirements have been established to curtail the use of back-to-back loans. Now, to qualify for the preferential four per cent withholding tax rate on interest from loans granted by foreign or international banks or financial institutions: (1) the financial institution must be the ultimate beneficiary of the interest on the loan; and (2) the lender must provide a sworn statement to the debtor stating that it has not concluded a structured agreement that modifies the final beneficiary of the interest.

The Tax Reform also introduces stricter requirements to qualify as a foreign financial institution,⁹ including the following: (1) its main purpose must consist of granting financing; (2) most of its income must derive from such activity; (3) its financing activity must be carried out periodically; and (4) the entity's paid-in equity and reserves must be equal at least UF 400,000.

ADDITIONAL PROPERTY TAX

The Tax Reform increases property tax levied on a taxpayer's real estate valued,¹⁰ in total, over 670 annual tax units (*unidad tributaria anual* or UTA).¹¹ The increase in property tax will be applied by marginal tranches.¹²

VAT ON DIGITAL SERVICES

The Tax Reform taxes digital services with VAT (19 per cent), effective from 1 June 2020. The services taxed include brokerage, media, software, IT infrastructure and advertising, provided by persons domiciled or residing abroad.

VAT applies only to the extent that at least two of the following circumstances are verified: (1) the device's internet protocol (IP), or other geolocation mechanism, indicates that the user is physically in Chile; (2) the payment method is issued or registered in Chile; (3) the user identifies with an address in Chile for the issuance of payment vouchers; or (4) the subscriber identity module (SIM) of the device uses a Chile country code.

VOLUNTARY SUBSTITUTE TAX

The Tax Reform contemplates the possibility of applying a 30 per cent substitute tax, in lieu of dividend withholding tax, with respect to all or part of the retained taxable income generated before 31 December 2016. Taxpayers may opt for this benefit by December 2020, 2021 or the last business day of April 2022, with respect to the balances of such income determined as of 31 December 2019, 2020 and 2021, respectively.

This substitute tax implies a decrease in the tax to be paid on the remittance of dividends to foreign investors from 35 per cent to 30 per cent. Additionally, income taxed with the 30 per cent substitutive tax can be remitted abroad at any time, even before income generated from 2017 onwards (which represents an exception to the general imputation rules). In certain cases, it may be attractive.

TOTAL WAIVER OF INTERESTS AND PENALTIES

Taxpayers that, as of 1 March 2020, maintained pending judicial procedures against tax assessments may terminate said procedures and obtain a total remission of interest and fines, if they recognise the debt and meet certain requirements.

⁸ These modifications do not affect loans granted prior to the effectiveness of the Tax Reform, to the extent that they are not novated, assigned or modified in the amount or interest rate.

⁹ Registration in the tax authority's foreign financial institution (FFI) registry continues to be voluntary, although highly recommended to benefit from the reduced four per cent withholding tax.

¹⁰ The total tax appraisal (tax base) is made up of the sum of the tax appraisals of all real estate owned by the same taxpayer, including the part of real estate owned jointly with co-owners.

¹¹ The value of the UTA in June 2020 was CLP 604,464.

¹² Considering the amount of the total tax appraisals as follows: (1) 0.075 per cent between 670 UTA and 1,175 UTA; (2) 0.15 per cent between 1,175 UTA and 1,510 UTA; and (3) 0.275 per cent over 1,510 UTA.

PRIVATE INVESTMENT FUNDS

The Tax Reform increased from four to eight the minimum number of unrelated investors required to establish a tax-deferred private investment fund. It also established that no such investors, together with their related parties, may hold more than 20 per cent of the fund's quotas. Institutional investors remain exempt from these rules.