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Recent Developments in International Taxation

Chile

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Year 2018 was marked by a public debate over what is the most efficient and fairest tax system for Chile. In August, the government submitted to Congress a tax bill (the "**Tax Bill**") for the "Modernization of the Chilean Tax System", which, along with other measures, repeals the "income attribution" and "partially integrated" income-tax-regimes introduced by the past administration, going back to the totally integrated tax system that applied in Chile for more than 30 years, from 1984 until 2016.

This report analyzes the most significant tax developments proposed in the Tax Bill from an international tax perspective, and other important tax developments in Chile of years 2018-2019.

I. TAX BILL

1. *Rules on International Taxation*

a) ***Return to a fully integrated tax regime:*** The tax reform passed in year 2014 (the "**2014 Tax Reform**") replaced the historic Chilean integrated income-tax-regime for two new alternative regimes, i.e., the "income attribution" and the "partially integrated". Under the income attribution tax regime, companies are subject to a 25% Corporate Tax and taxable profits are immediately allocated to the company's owners/shareholders. Shareholders not domiciled in Chile ("**Foreign Shareholders**") are subject to a 35% Withholding Tax on the income attributed to them on the same tax period, with the full corresponding tax credit, preventing any chance of deferring the Withholding Tax. The partially integrated regime, on the other hand, operates on a cash basis. Under this regime, the Corporate Tax is applied with a tax rate of 27%, providing the possibility of deferring the payment of the Withholding Tax until profits are actually distributed to Foreign Shareholders, but restricting the applicable Corporate Tax credit to 65%. This translates into an effective tax burden of 44.45%. The restriction on the Corporate Tax credit does not apply to Foreign Shareholders with residence in a tax treaty country, remaining subject to a 35% total tax burden on profits distributions as under the past regime[1].

The Tax Bill repeals both the "income attribution" and the "partially integrated" tax regimes and reintroduces a sole fully integrated tax regime, with the following main features:

- The Corporate Tax applies with a 27% rate to all companies[2],
- The Corporate Tax serves as a credit against the Withholding tax in full. For this purpose, the amount of the credit is equal to the average of the credits registered by the company, with a cap of 27%,

[1] The same rule applies, until December 31 of year 2021, to countries that signed a tax treaty with Chile on or before December 31 of year 2018, but that not have entered into force yet.

[2] Exceptionally, small and medium companies are subject to a 25% Corporate Tax rate.

- The Withholding Tax applies on a cash basis, on profits actually distributed to Foreign Shareholders.

b) ***The end of back-to-back loans*****:** Under current legislation, interest paid by Chilean borrowers on loans granted by certain foreign lenders, including, banks, international financial institutions, insurance companies and certain pension funds, qualify for a reduced 4% Withholding Tax rate, instead of the 35% standard rate. Back-to-back loans are eligible for the reduced 4% rate, provided they satisfy the thin-capitalization rules applicable to related-party debt.

The Tax Bill disqualifies back-to-back loans from the reduced 4% rate altogether. Foreign banks, financial institutions, insurance companies and pension funds would need to be the final beneficiaries of the interest payments to qualify for the 4% rate.

c) ***Taxation on e-commerce:*** the Tax Bill introduces a 10% sole income tax on online-services rendered by non-Chilean residents. These online services include intermediation, entertaining, marketing, cloud storage, among others. This tax has to be withheld by the issuer of the electronic payment method utilized to pay for the services (i.e. the issuer of the credit card).

2. ***New broaden approach on tax expenses deductibility:*** Currently, expenses can be deducted for tax purposes provided they are "necessary" for the production of taxable income. This "necessity test" has been narrowly interpreted by the tax administration, requiring each expense to be inevitable and strictly mandatory.

The Tax Bill proposes a new test for the deductibility of expenses. This test requires expenses to be directly or indirectly associated with the business activities, including ordinary, extraordinary, regular, exceptional, voluntary or mandatory expenses, provided they are reasonable given the circumstances.

3. ***Instant depreciation for new investment projects*****:** The Tax Bill incorporates a transitory rule, under which companies will have the ability to deduct as a tax expense 50% of any new or imported fixed assets acquired as part of a new investment project (broadly defined), provided such new investment is carried out within the 24-month period following the enactment of the Tax Bill. The remaining 50% may be depreciated pursuant to the general rules (normal or accelerated depreciation).

4. ***Restrictions on the application of the General Anti-avoidance Rules ("GAAR"):*** The Chilean GAAR were first introduced by the 2014 Tax Reform. The broadness and vagueness of their text have generated legal uncertainty regarding their practical application among taxpayers.

The Tax Bill pursues to restrict the GAAR's scope of application, by incorporating additional conditions that must be proven by the IRS in order to challenge an operation under these rules. In this sense, while under current legislation GAAR apply to acts and contracts that do not produce "significant" economic effects other than those purely tax-related, under the new proposed text, any economic effect would prevent the application of the GAAR. Additionally, the new text requires acts and contracts to be "notoriously artificial".

5. ***New tax-amnesty program:*** The Tax Bill proposes a new transitory amnesty program (the 2014 Tax Reform also included one), which would be in force for a 1-year period after the enactment of the law. Under this program, taxpayers domiciled, resident, established or organized in Chile prior to January 1, 2018, may voluntarily declare to the IRS their assets and income maintained abroad that, even though having been taxable in Chile in past periods, where not duly declared and levied with taxation. The assets and income declared under this program would be subject to a sole 10% tax (instead of the 35% tax rate normally applicable to Chilean individual residents and the 27% Corporate Tax rate applicable to companies).

II. TAX TREATIES AND MULTILATERAL CONVENTION

1. ***Tax Treaty with Uruguay:*** In year 2018, the Tax Treaty for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion ("**Tax Treaty**") between Chile and Uruguay entered into force. The Tax Treaty with Uruguay, as well as the other 32 Tax Treaties signed by Chile, follows the OECD Model Tax Convention.

2. ***Reduction in the tax rate applicable on interests:*** According to article 11 of the Tax Treaty between Chile and Japan, as of January 1, 2019, the tax rate applicable on interest by the source country was reduced from 15% to 10% (except in the case of interest paid to banks, insurance companies and other financial institution, in which case a 4% tax limit applies). Pursuant to the Most Favorite Nation (MFN) clause established in most of the Tax Treaties signed by Chile, from January 1, 2019, this new 10% tax limit on interest applies with most of Chile Tax-Treaty-partners.

3. ***Automatic Exchange of Information:*** In year 2018, Chile commenced the automatic exchange of financial information, in accordance with the commitment made in the context of the OECD Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information. In this first year, Chile exchanged information with 47 countries.