

# *Highlights of Chile* 2010-2011



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## 2010-2011

## ***Synopsis***

- The economy had a positive growth of 5.2%, after the negative growth of 2009.
- As a result of the earthquake of February 27, 2010, Law N° 20,444 published on May 28<sup>th</sup> 2010 established a National Reconstruction Fund and tax incentives for donations made in case of a catastrophe.
- On July 31<sup>st</sup> 2010 Law N° 20,455 was published which established a financing plan for the reconstruction of the country after the February 2010 earthquake.
- On September 8<sup>th</sup> 2010, the Bill of Law that regulates the tax treatment of financial derivatives entered the Congress.
- Law N° 20,469 published on October 21<sup>st</sup>, 2010 modified mining taxation.

## ***Political environment***

The President, Mr. Sebastian Piñera, took office on March 11, 2010, during the reconstruction process that took place after the earthquake.

According to the statistics of a local think tank (the Centro de Estudios Públicos or CEP) Mr. Sebastian Piñera's government has an approval rating of 44%.

The Lower Chamber currently has 54 representatives from the center left coalition (Concertación), 57 from the governing center right coalition (Alianza), 2 from the Regionalist Party (Partido Regionalista de los Independientes), 3 from the Communist Party, and 4 that are independent.

The Senate is made up of 14 senators from the center right coalition, 19 from the center left coalition, 2 independents, and 1 from the Broad Social Movement (Movimiento Amplio Social, MAS).

Thus, the Government does not have a clear majority in either Chamber.

# ***Economic Performance, Tax And Labor Legislation***

## **1. GDP**

During 2010, the Chilean economy had a positive growth of 5.2%, mainly due to the growth of all productive activities except for the fishing sector and industrial activity, which came down mainly to the effects of the earthquake. Retail stands out for its contribution to GDP growth.

Internal demand grew 16.4% as a result of private consumption and the investment in machinery and equipment.

Chile's per capita income (PPP US\$) is approximately US\$ 14,780, according to the 2010 Human Development Report issued by the United Nations Development Programme.

## **2. Trade Balance and Balance of Payments**

The trade balance for 2010 showed a surplus of US\$ 15,000 million, with exports of US\$ 69,000 million and US\$ 54,000 million of imports. The previous year this surplus reached approximately US\$ 14,000 million. This is the twelfth consecutive year of surplus.

At the end of 2010, the copper price quoted in the London Metal Exchange reached an average of US\$ 341.978 per pound, figure that is 46% higher with regard to the average for 2009, being the highest ever annual nominal average.

In 2010, the positive evolution of the copper price started at US\$ 338.561 per pound at the beginning of January and ended at an annual maximum of US\$ 441.781 per pound on December 31<sup>st</sup> 2010. This is explained by the rising demand from China and the devaluation of the dollar.

The estimate for 2011 is that the annual average price of copper will be around US\$ 417 per pound.

Foreign exchange reserves were US\$ 27,864 million at the end of the 2010, compared with US\$ 25,372 in 2009, US\$ 23,162 million in 2008, US\$ 16,910 million in 2008, US\$ 19,429 million in 2006, and US\$ 16,963 million in 2005.

## **3. Double Taxation Agreements**

Chile has twenty four agreements for the avoidance of double taxation and the prevention of fiscal evasion in force with Argentina, Belgium, Brazil, Canada, Colombia, South Korea, Croatia, Denmark, Ecuador, Spain, France, Ireland, Malaysia, Mexico, Norway, New Zealand, Paraguay, Peru, Poland, Portugal, Sweden, Thailand, Switzerland and the United Kingdom.

Agreements with Australia, Russia and the United States of America have been already signed and are currently pending ratification by Congress.

Negotiations with South Africa have concluded and the treaty is awaiting signature by both countries.

## **4. Trade agreements**

At present, there are Free Trade Agreements (FTAs) in force with the United States of America, China, Canada, Colombia, Mexico, South Korea, Turkey, E.F.T.A. (Iceland, Liechtenstein, Norway and Switzerland), Costa Rica, El Salvador, Guatemala, Honduras, Australia, Panama and Peru. The latest agreement, with Guatemala, came into force in March 2010.

Agreements of Economic Association with Japan, members of the EU and of the P4 (formed by New Zealand, Singapore, Brunei Darussalam, and Chile) and limited FTAs with India and Cuba are in force. On the other hand, Economic Complementation Agreements exist with Bolivia, Ecuador, Mercosur and Venezuela.

At present, negotiations for an FTA with Nicaragua have concluded. Also, Chile is negotiating FTAs with Malaysia and Vietnam.

## 5. Foreign debt

Foreign debt has been steadily increasing, and reached a gross amount of approximately US\$ 83,607 million in September 2010. This rise has been mainly caused by an increase in short term banking liabilities, long-term debt owed by companies and individuals and an increase in government long term debt.

Notwithstanding the above, foreign debt maintains stable as a percentage of GDP and exports.

During the third quarter of 2010 the gross influx of capital was US\$ 10,900 million. This is explained, mainly, by direct foreign investments flows and portfolio investments of US\$ 5,500 and US\$ 4,000 million, respectively.

## 6. Foreign investment

During 2010, total authorized foreign direct investment (FDI) channelled through DL 600 reached an historic record of US\$ 13,257 million, which is the highest annual amount for this kind of investment and represents an increase of 201% with regard to the same period of last year.

The main sectors receiving DL 600 FDI were mining (82.9%), services (9.1%), electricity, gas & water (4.1%). Foreign investors came from Canada (60.8%), Japan (20.8%), Spain (4.7%) and Mexico (3.7%).





## 7. Outbound investment

Outbound investment was US\$ 6,126 million in 2010, increasing 31% compared with 2009. During the last quarter of 2010, the Retail sector was the protagonist, with 92% of the investment.

The accumulated amount during 2010 was not only the highest in the decade, but also corresponds to the second highest in the country's history.

Of these outbound investments, 97% went to Latin American countries. The countries that received the largest shares were Brazil (45%), Peru (32%) and Colombia (16%). On the other hand, the preferred sectors for these investments were retail (45%), transport (19%), industry (16%), services (8%), and forestry (7%), among others.

## 8. Sector performance

During 2010 the fishing sector registered a 13.7% contraction. This result reflected the contraction of the fish farming centres and smaller extractive fishing catches. Also, industrial activity decreased 1%, specially "Fuel elaboration", "Paper manufacture" and "Fishing industry", which were highly affected by the earthquake damage to their productive infrastructure.

On the contrary, electricity, gas and water grew 13.7% due to a more efficient performance by gas and electricity through the development of the liquified natural gas (LNG) regasification industry.

Construction grew 3.6% due to new building and expenditure on repairs and demolitions. Communications grew 10.5% thanks to mobile phones results. Mining grew 1.2% due to copper production.

Commerce, restaurant and hotel activity grew 13.3%. Commerce expansion was due to sales in the retail sector, the wholesale sector and automotive sales.

## 9. Country risk

Chile's credit risk rating in long term foreign currency is "A+", according to Standard & Poor's. The credit risk rating in local currency and its transfer and convertibility evaluation was kept at "AA". This consolidates Chile's leading position in Latin America as the country with the best credit risk rating, which has also been reflected in Chile's position in the J.P. Morgan Emerging Markets Bond Index (EMBI Global). The JP Morgan EMBI Global Chile Stripped Spread as of February 2011 was 111.

These classifications reflect Chile's low level of public and external net indebtedness, its fiscal flexibility and the sustained strength of its economy.

## 10. Labor

In 2010, the annual average unemployment rate reached 8.2%.

## 11. Inflation

Annual inflation in 2010 was 2.7%.

Inflation was -1.4% in 2009, 7.1% in 2008, 7.8% in 2007, 2.6% in 2006, 3.7% in 2005, 2.4% in 2004, and 1.1% in 2003.

## 12. Exchange rates

The “observed” exchange rate, which is the average of buying and selling rates for transactions in the Formal Market, closed the year at Ch\$ 468.37 per US dollar, compared with Ch\$ 507.1 at the beginning of the calendar year.

The exchange rate reached its highest value for the year in May at Ch\$ 549.17 and its lowest value in December at Ch\$ 468.37.

## 13. Interest rates

The Central Bank increased the interest rate 8 times during 2010, due to the inflation scenario. The benchmark lending rate was at 0.5% at the beginning of the year and reached 3.25% at year end, which has been increased during February 2011 to 3.5%.

## 14. Foreign exchange regulations

Since 2002, foreign exchange operations fall into 3 categories: (i) operations that must be performed through the formal exchange market (i.e. a commercial bank) and reported to the Central Bank; (ii) operations that must be performed through the formal exchange market; or (iii) operations that need only be reported to the Central Bank. Thus, there are no transactions that require prior approval by the Central Bank.

## 15. Tax legislation

**Law N° 20,444** was published on May 28<sup>th</sup> 2010. It creates the National Reconstruction Fund (The “Fund”) which is destined to finance the construction and reconstruction of public and private infrastructure affected by earthquakes and other catastrophes that may occur in the national territory.

The Fund will be made up of all money contributions received through inheritance, wills and donations made under this Law and all contributions received through international cooperation. Also all donations received by the Ministry of Interior for these catastrophes and which are made within the period established by law will be part of the Fund.

In order to be subject to Law N° 20,444 all contributions to the Fund must be made within a period of two years from the date of the Supreme Decree issued establishing the zones affected by the above mentioned catastrophes.

This Law also creates a tax benefit regime to promote all donations made to the Fund, which allows taxpayers of First Category Tax, Global Complementary Tax, Employee Tax and Additional Income Tax to use these benefits. In addition, this regime introduces an innovation allowing donations made to this Fund to be considered as an advance payment of Inheritance and Donations Tax.

As a general rule, all donations eligible to use the benefits associated to First Category Tax and Inheritance Tax must be made in money. Nevertheless, First Category Taxpayers are allowed to make donations in kind and use the Income Tax benefit. In addition, the system allows all taxpayers considered in this Law to make donations to the Fund to finance specific works, previously identified by the Finance Ministry, and even allows that these works be executed directly by the donor.

All donations subject to this Law are exempt from the court notice procedure and will be exempt from the Inheritance and Donations Tax of Law N° 16,271.

In contrast, these donations cannot use other tax benefits present in other laws. However, donations made under Law N° 20,444 are not subject to the limits established in article 10 of Law N° 19,885 which regulates tax benefits for other donations.

**Law N° 20,455** was published on July 31<sup>st</sup> 2010. This Law modified several laws in order to obtain funds for the reconstruction of the country after the earthquake.

The corporate income tax rate went from 17% in 2010 to 20% for income received or accrued during calendar year 2011. The referred rate will be of 18.5% for income received or accrued during calendar year 2012. Finally, income received or accrued during calendar year 2013 and subsequent years will be subject to a 17% tax. The monthly income tax prepayments must be adjusted accordingly.

A 0.275% annual surtax for 2011 and 2012 will be applied in connection with real estate whose fiscal value amounts to approximately US\$ 182,000 or more (5% of the most expensive real estate in Chile), with some exceptions. Such surtax may not be used as a credit against income taxes.

### **Bill of Law that regulates the tax treatment of financial derivatives**

On September 8<sup>th</sup> 2010, the Bill of Law that regulates the tax treatment of financial derivatives entered the Congress. This project considers as derivatives, and specifically regulates forwards, futures, swaps, options, and the combination of these. It also defines the concept of financial derivatives and considers as such, contracts that fulfil certain requirements at inception.

The project regulates, among other subjects:

- Determination of the income source.
- Income recognition and the expense deduction.
- Option regulation.
- Contracts between related parties.
- The Internal Revenue Service powers regarding control rules, audit investigations and valuation.
- The situation of the monthly provisional payments.

At this date the project is still in Congress with maximum urgency.

**Law N° 20,469** was published on October 21<sup>st</sup> 2010. This Law replace article 64 bis of the Income Tax Law which established the specific tax for the operational mining income obtained by a mining exploiter, added new article 64 ter of the Income Tax Law that established the determination of operational mining taxable income, modified article 11 ter of Decree Law N° 600 and established temporary and optional rules for investors and companies subject to article 7, 11 bis and 11 ter of Decree Law N° 600, temporary article N° 5 of Law N° 20,026 and companies that are considered in temporary article 4 of this new Law. This Law established a new specific tax on mining activity. The new regime raises the tax rate currently paid by mining companies from 4% to 9% of taxable mining operating income for a period of three years (2010, 2011 and 2012), calculated according to a company's mining operating margin. As from 2013, the regime stipulated in the company's original contract will apply until this expires when a further six years of tax stability will be added with a rate of between 5% and 14%.

The Foreign Investment Committee (FIC) has received 18 applications from mining companies interested in adhering to the optimal terms of this Law.



## 16. Labor legislation

This year amendments to the Labor Code were passed such as Law N° 20,416 published in the Official Gazette on February 3<sup>rd</sup> 2010, which sets forth new standards for labor fines regarding small businesses; also, Law N° 20,425, published on February 13<sup>th</sup> 2010, forbids employers from deducting the amounts owed by the employee for goods bought from the employer.

Law N° 20,455 was published on July 31<sup>st</sup> 2010; it regulates and procures funds for the reconstruction of the country after the earthquake. In that Law, a cap is set on the amount to be considered as non taxable income in Agreed Deposits. Agreed Deposits are pension funds added by the employer to improve the employee's retirement fund. Law N° 20,455 sets a cap of approximately US\$ 40,900 to be considered as non taxable income per year, starting in 2011.

In this sense, several laws regarding flexibility for the employers to comply with their obligations because of February's earthquake were passed, among them a special period was granted to pay employees' social security contributions pursuant to Law N° 20,446, published in the Official Gazette on July 3<sup>rd</sup>; or a flexibilization in the requirements to obtain unemployment social insurance was granted by Law N° 20,440, published in April 8<sup>th</sup>, 2011.

Law N° 20,449 published on July 3<sup>rd</sup> 2010, set the Minimum Monthly Wage at CLP 172,000 (US\$ 360 approximately).

Finally, Law N° 20,454 published on July 31<sup>st</sup> 2010, sets incentives for the employer to execute pre employment agreements, a sort of trainee contracts.

## 17. Prospects for 2011

The Central Bank of Chile estimates that GDP growth will be in a range from 5.5% to 6.5% during 2011.

The expectations for inflation are 3% in the mid term. However, for the coming months the Central Bank estimates that inflation will increase.

## 18. PwC in Chile

PricewaterhouseCoopers ([www.pwc.cl](http://www.pwc.cl)) has been present in Chile since 1914. During these 97 years we have served the most prestigious local and foreign entities operating in Chile. We are the leading firm in the auditing business, with a staff of approximately 1,000 distributed in the cities of Antofagasta, Santiago, Viña del Mar, Concepción, and Puerto Montt.

Our services include auditing, management consulting, executive recruitment, fixed asset valuation, due diligences, technology and software selection, performance improvement, enterprise risk management, tax and legal services, foreign investment registration and structuring, bookkeeping, confidential payroll and corporate finance services. In general, we provide information and advice on how to operate in Chile.

Our main objective is to help our clients be successful and we welcome any questions you may have related to either our services in general or to the information above.

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Desert Bloom and Copiapoa Cactus - Chile's region III, Atacama.







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Front cover image: Torres del Paine and Lago Grey - Chile's region XII, Magallanes.  
Inner image N°1: Torres del Paine and Guanaco - Chile's region XII, Magallanes.  
Inner image N°2: Desert Bloom and Copiapo Cactus - Chile's region II, Antofagasta.

Photographer: Eduardo Lira V.

