

# Highlights of Chile

## 2009-2010

Chile's most significant economic, tax and labor events of 2009

# Synopsis

- The economic trend generated by the global recession in 2008 continued throughout most of 2009 and Chile's economy had negative growth of 1.5%.
- On December 15, 2009, Chile was invited to join the OECD, and became a member on January 11, 2010.
- Mr. Sebastian Piñera won the presidential elections with 51.90% of the votes in the second ballot that took place on January 17, 2010.
- Agreements for the avoidance of double taxation and the prevention of tax evasion were signed with Australia and the United States of America. Chile is the second South American country that has signed a Double Taxation Treaty with the United States of America.
- On February 27, 2010 a massive 8.8 earthquake affected the central region of the country, causing widespread destruction and the loss of many lives.

# Political environment

The newly elected president, Mr. Sebastian Piñera, a moderate liberal in economic matters from the center right coalition Alianza por Chile, took office on March 11, 2010, putting an end to 20 years of 4 consecutive governments of the center left coalition, Concertación de Partidos por la Democracia.

According to the statistics of a local think tank (the Centro de Estudios Públicos or CEP) Mrs. Michelle Bachelet's government started its fourth and final year with an approval rating of 43% and ended the year with a rating of 78%. The cause of this significant rise in the polls was mainly associated with a positive popular perception of the economic measures implemented by the Government to confront the global international crisis.

The Lower Chamber currently has 53 representatives from the center left coalition (Concertación), 55 from the governing center right coalition (Alianza), 2 from the Regionalist Party (Partido Regionalista de los Independientes), 3 from the Communist Party, and 7 that are independent.

The Senate is made up of 16 senators from the center right coalition, 19 from the center left coalition, and 3 independents.

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



# Economic Performance, Tax and Labor Legislation

## 1 GDP

During 2009, the Chilean economy had negative growth of 1.5%, mainly due to the downturn observed in the fishing industry, as well as in industrial and construction activities. Also, transport, commerce, financial services and mining activities were affected by the recession. Following the trend registered in the last quarter of 2008, in the first, second and third quarters of 2009 the economy shrank by -2.1%, -4.5% and -1.4%, respectively. In the last quarter, the Chilean economy registered 2.1% growth.

Chile's per capita income (PPP US\$) is approximately US\$ 13,880, according to the 2009 Human Development Report issued by the United Nations Development Programme.

## 2 Trade Balance and Balance of Payments

The trade balance for 2009 showed a surplus of approximately US\$ 14,000 million, with exports of US\$ 54,000 million and US\$ 40,000 million of imports. The previous year this surplus reached approximately US\$ 9,000 million. This is the eleventh consecutive year of surplus.

The average copper price reached approximately US\$ 2.34 per pound, which is nevertheless 26% lower than the 2008 average of US\$ 3.15 per pound. The 2009 average reflects the variation from US\$ 1.39 to US\$ 3.33 per pound at the beginning and end of 2009, respectively, largely explained by the rising demand from China.

Foreign exchange reserves were US\$ 25,372 million at the end of the 2009, compared to US\$ 23,162 in 2008, US\$ 16,910 million in 2007, US\$ 19,429 million in 2006, US\$ 16,963 million in 2005, and US\$ 16,016 million in 2004.

## 3 Double Taxation Agreements

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

Agreements with Australia, Belgium, Russia, Switzerland, Thailand 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.

Agreements are being negotiated with Austria, China, Cuba, Czech Republic, Finland, Hungary, India, Italy, Kuwait, The Netherlands, Uruguay, and Venezuela.

## 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, E.F.T.A. (Iceland, Liechtenstein, Norway and Switzerland), Central America (Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua), Australia, Panama and Peru. The latest agreement, with Colombia, came into force in May 2009.

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, an FTA with Turkey is pending ratification by Congress. Also, Chile is negotiating FTAs with Malaysia, Thailand (preliminary studies concluded) and Vietnam.



## 5 Foreign debt

Foreign debt has been steadily increasing, and reached a gross amount of approximately US\$ 68,873 million in September 2009. This rise has been mainly caused by an increase in short term banking liabilities and long-term debt owed by companies and individuals.

A large share of the foreign debt is long-term, of which approximately 80% corresponds to loans to private companies.

The improvement in financial conditions in international markets allowed Chilean banks and companies to maintain access to new foreign loans. Furthermore, short term financing spreads diminished for banks and private companies.

## 6 Foreign investment

During 2009, total authorized foreign direct investment (FDI) channelled through DL 600 amounted to US\$ 6,280 million, which is the second highest annual amount for this kind of investment in the past 10 years.

The main sectors receiving DL 600 FDI were services (61.9%), electricity, gas & water (12.2%), and industry (9.3%). Foreign investors came from the United States of America (59.4%), Australia (8.9%) and Peru (6.4%), the latter mainly relating to the acquisition of a local cement company from another foreign investor.

On the other hand, DL 600 FDI effectively entering Chile was US\$ 5,082 million, mainly from the United States of America, the United Kingdom and Peru, in services, mining, and industry.

Figures and data about FDI informed under Chapter XIV of the Compendium of Foreign Exchange Regulations are not yet available

## 7 Outbound investment

Outbound investment was US\$ 4,217 million in 2009, increasing 46% compared with 2008. During the first semester outbound investment reached US\$ 835 million and US\$ 3,381 million in the second half of the year, which represents the highest amount registered for a single semester in the past 12 years. The latter is directly related to the acquisition of a Brazilian forestry company, which by itself represents a third of the total amount invested during the second semester.

Of these outbound investments, 96% went to Latin American countries. The countries that received the largest shares were Brazil (41%), Peru (33%) and Colombia (12%). On the other hand, the preferred sectors for these investments were forestry (43%), services and retail (22%), energy (22%), industry (7%), among others.

## 8 Sector performance

During 2009, the fishing industry was the worst hit by the downturn, registering a 12.2% contraction. This was largely due to a fall in salmon exports, caused by a sanitary crisis suffered by the sector, and smaller extractive fishing catches. Also, the manufacturing industry decreased by 7%, construction by 5.2%, transport by 3.4%, and services by 2.7%.

Mining decreased by 1.4%, mainly in the first half of the year, attributable to lower production of iron and other minerals. Copper production remained stable and although coal, oil and gas production grew, this was insufficient to change the results for this sector, due to their small share of overall production.

On the contrary, electricity, gas and water grew 15.7%, due to a more efficient utilization of resources in energy generation, and communications grew 6.9% thanks to mobile phone results.

## 9 Country risk

Since December 17, 2008, 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 also 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 2010 was 137.

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

Furthermore, the Central Bank estimated that the Economic and Social Stabilization Fund, created in 2007, would have a balance of US\$11,274 million at the end of 2009, after a reduction of approximately US\$ 9,000 million (5.4% of the GDP) drawn during the year to finance the Fiscal Stimulus Plan and the fiscal deficit.

## 10 Labor

In 2009, the annual average unemployment rate reached 9.7%.

## 11 Inflation

Annual inflation in 2009 was -1.4%. After 74 years, this is the first time Chile registered deflation. During the year, there were 8 months in which this index varied negatively. The latter is explained by the drop in prices of clothing, food and transport, even though prices of hotels, electricity, gas and water, education and fuels registered some increases.

Inflation was 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\$ 507.10 per US dollar, compared with Ch\$ 640.91 at the beginning of the calendar year.

The exchange rate reached its highest value for the year in January at Ch\$ 643.87 and its lowest value in November at Ch\$ 491.09.

## 13 Interest rates

The Central Bank reduced the interest rate 7 times during 2009, due to the deflation scenario. The benchmark lending rate was at 7.49% at the beginning of the year and reached 0.50% at year end, which has been maintained during the first quarter of 2010.

## 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°. 20,322** was passed on January 13, 2009 and published on January 27, 2009 in the Official Gazette. This law established new Tax and Customs Courts in order to replace a system in which the Chilean Internal Revenue Service and the Chilean Customs Service acted as Courts of First Instance in any trial regarding tax and customs legislation, respectively.

The new Tax and Customs Courts will be rolled out gradually in the different regions of the country, starting with those located in the northernmost part of Chile. The Metropolitan Region, where Santiago is located, will be the last one to receive these new courts in February 2013, 4 years after the publication of this law in the Official Gazette.

**Law N°. 20,406** was passed on November 25, 2009 and published on December 5, 2009.

This new bill introduced changes to the Tax Code with the purpose of broadening the cases in which the Chilean IRS may have access to the information on banking operations subject to bank secrecy or confidentiality.

Previously, article 62 of the Tax Code only allowed Ordinary Courts to order the examination of bank current accounts in the context of procedures for crimes related to compliance with tax obligations. Likewise, the Director of the Chilean IRS was allowed to order the examination of current accounts, issuing a well founded decision while investigating breaches to tax laws that are sanctioned with imprisonment or other restrictions on freedom of movement.

This new bill replaced article 62 of the Tax Code. In its new wording, this article allows not only Ordinary Courts to authorize the examination of the information on banking operations of certain persons, in the context of procedures for crimes related to compliance with tax obligations. Nowadays, the same faculty was granted to Tax and Customs Courts in procedures for the application of penalties that are not imprisonment or restriction on freedom of movement.

Furthermore, article 62 now grants the Chilean IRS, in the context of its fiscal supervision faculties, the possibility to request information on the banking operations of certain persons that is indispensable to verify the truthfulness and completeness of their tax returns. The Chilean IRS may request this information in

the following three cases:

- (i) While exercising fiscal supervision related faculties;
- (ii) Upon request from a foreign tax administration, if there is an agreement for the exchange of information executed by Chile with the respective state which has been ratified by the National Congress, and
- (iii) In the context of a procedure for the exchange of information with the competent authorities under the agreements contained in a double taxation agreement executed by Chile that is in force.

Information requests made by the Chilean IRS are subject to a regulated procedure under article 62, which begins with a notice sent to the bank by the National Directorate of the Chilean IRS asking for the delivery of the information required. The bank in turn must notify the owner of the information of the existence of this request and of its scope, asking for the authorization to release the information. If the owner of the information does not authorize the bank to fulfill the request from the Chilean IRS, the bank will not be able to deliver this information. In this situation, the Chilean IRS is allowed to file a request for authorization before the corresponding Tax and Customs Court. An enforceable court decision allows the Chilean IRS to demand the information from the bank, which shall have 10 days to deliver it, counted as from the date of the notice given by the Chilean IRS with a copy of the Court's decision.

# 16 Labor legislation

During 2009 several legal amendments were introduced to the Labor Code. The first amendment extended the right to maternity leave to adoptive parents (Law 20,399). The second amendment gave the right to claim nursery benefits to adoptive parents (Law 20,367). The third, contained in Law 20,348, established the right to equal pay between genders, regarding individuals that perform the same tasks. This amendment is applicable to employees from the private and public sectors. The fourth, introduced by Law No. 20,425, forbids employers from deducting the amounts owed by the employee for goods bought from the employer.

Furthermore, the roll out of the reform introduced by Law No. 20,087 of January 6, 2006 which replaced the old labor procedure with a new oral procedure, concluded in 2009 and reached Santiago.

Regarding Social Security legislation, Law 20.382 modified some articles of the Unemployment Insurance Law, aimed at broadening the type of employees covered, the employment termination causes that trigger the benefit and the number of months covered by this insurance.

## 17 Prospects for 2010

In December 2009, in the scenario before the earthquake of February 2010, the Central Bank of Chile had forecast a GDP growth of 4.5% to 5.5% for 2010. Furthermore, despite the deflation scenario, the Central Bank had considered that during the first half of 2010 inflation indicators would be positive and would gradually reach 3% during the last quarter of 2011. Local experts forecast that 2010 inflation would range from 2.2% to 3.1%.

During January and early February 2010, local think tanks expected unemployment to remain at a 9% rate, while the Government expected a lower range of between 8% and 9%.

In the new scenario created by the earthquake that affected the central area of Chile, which produces almost 80% of the country's economic output, these forecasts have been modified. Thus, GDP projections have been adjusted to a range from 3.5% to 4.5%, inflation to a range from 2.9% to 4%, and unemployment rate projections could also be higher too, due to the numerous dismissals (almost 8,000) implemented on force majeure grounds by some companies heavily hit by the earthquake.

The Government, on the other hand, has announced reconstruction measures that will certainly impact these figures. Such measures will be financed with funds obtained from the Economic and Social Stabilization Fund, through donations with tax benefits, public debt, further privatizations of state owned companies, and tax increases, among others.

## 18 PricewaterhouseCoopers in Chile

PricewaterhouseCoopers ([www.pwc.cl](http://www.pwc.cl)) has been present in Chile since 1914. During these 96 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 850 persons 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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Front cover image: Agostini Fjord, Chilean Patagonia - Chile's Región XII, Magallanes and Chilean Antarctica



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