

The 13th Annual Americas School of Mines Latin America Taxation - Chile

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Agenda

1. Overview of Chilean Tax Regime
 - a) Income Tax. General
 - b) Business income tax. General
 - c) Determining the Net Taxable Income (Mining activities)
 - d) Non deductible expenses
 - e) Dividend distributions
 - f) Dividends & DTCs
 - g) Imputation system example
 - h) WHT to other outbound payments
2. Specific Mining Tax
3. How to invest? Foreign investors regimes.
4. Vehicles of investment / Holding companies
5. Financing Structures. The back to back structure.
6. Cash Repatriation

1. Overview of Chilean Tax Regime

a) Income Tax. General

- Chilean residents are subject to tax on **world-wide income** // non Chilean residents are subject to tax on their **Chilean source income**.
- Corporate residence is determined by **incorporation**.
- Profits earned from business activities are subject to business income tax (First Category Tax / BIT) at a corporate level.
- At the time of distribution or remittance, those profits are subject to surtax (local individual investors) or withholding tax (foreign investors).
- Domestic inter-company dividends are not subject to income tax.
- Chile has an **imputation system** i.e. the BIT paid is creditable against the withholding tax (WHT).
- WHT is levied at proportional rates (generally at 35%). There are several special rates.

1. Overview of Chilean Tax Regime

b) Business income Tax. General

- **Business income tax** is levied at company level on net accrued income.
- **Net taxable income (NTI)**. The **NTI** (BIT taxable basis) is equal to the gross income less the direct costs and “**necessary expenses**”.
- The computation of NTI includes the adjustments for inflation.
- **BIT rate**. The current rate of BIT is 17%.

c) Determining the NTI (Mining activities)

- Notwithstanding the importance of mining activities, the Chilean Income Tax Law (CITL) does not provide a specific regime for the sector.
- Accordingly, income from mining is, in principle, subject to the general provisions of the CITL, notwithstanding the Special Mining Tax.
- Under the next headings I will cover the following issues: (i) Amortization of mine acquisition cost; (ii) Organization and start-up expenses; (iii) Net operating losses; and (iv) depreciation of fixed assets.

1. Overview of Chilean Tax Regime

c) Determining the NTI (Mining activities)

1. Amortization of mine acquisition cost

The acquisition cost of mines is deductible in the computation of taxable income which is added to the direct cost of the extracted mineral, in the ratio of the mineral to the total reserves of the mining deposit.

2. Organization and start-up expenses

They are deductible from the gross income up to 6 consecutive fiscal years as from the year in which the expenses were incurred, or from the year in which income production from the company's main activity begins, whichever is latter.

In other words, a company may either write off the organization and start-up expenses against income arising in one fiscal year or amortize them on up to 6 consecutive fiscal years.

The disbursements made in the stage prior to the production and sale of minerals (exploration stage), which are regarded part of the mine (i.e. routes of access; corridors; etc), constitute investments in fixed assets, and therefore, they receive the same tax treatment (depreciation rules)– Ruling N° -1559/91-3008/00 - 4262/06, Chilean IRS.

1. Overview of Chilean Tax Regime

c) Determining the NTI (Mining activities)

2. Organization and start-up expenses (cont).

The Chilean IRS states that the disbursements made prior to the production and sale of minerals, which cannot be regarded as investments in fixed assets, must be considered as organization and start-up expenses.

Rulings N° 279/84 -1739/86 - 1559/91- 3008/00 - 4262/06 – Chilean IRS.

As an example, the following disbursements are treated as organization and start-up expenses:

- Marketing surveys;
- Legal fees and expenses for the company's incorporation;
- Preliminary technical studies;
- Exploration disbursements.

1. Overview of Chilean Tax Regime

c) Determining the NTI (Mining activities)

2. Organization and start-up expenses (cont).

In the cases of loss or extinction of the mining property due to abandonment (usually on the ground of unpaid mining license), renunciation, or failure to comply with the formalities of inscription, the disbursement derived from the acquisition of such mining property is not considered as a necessary expense to produce taxable income – Ruling N° 3080/87, Chilean IRS.

3. Net operating losses

Carry back and tax refund. Net operating losses incurred by the taxpayer in a taxable year must be offset against its undistributed after-tax income. In this scenario the BIT already paid on such income is treated as an advance BIT payment and would be refunded.

Direct and indirect profits refund.

1. Overview of Chilean Tax Regime

c) Determining the NTI (Mining activities)

3. Net operating losses (Cont.)

- **Carry forward.** If the net operating losses exceed the taxpayer's undistributed after-tax income, the excess may be offset against the taxpayer's profits of the subsequent taxable years without limit.

4. Fixed Assets Depreciation

- **General rule.** Fixed assets are depreciated on the **straight-line basis**, according to the useful life tables published by the Chilean IRS.
- **Accelerated depreciation.** Eligible for this method are new fixed tangible assets (if acquired locally) or new or used fixed tangible assets (if imported), provided that their regular useful life is 3 years or more.
- Under the accelerated method, assets are depreciated over one-third of the normal useful life, eliminating fraction of months.
- Taxpayers may discontinue the use of the accelerated depreciation at any time, but may not return to it later.

1. Overview of Chilean Tax Regime

c) Determining the NTI (Mining activities)

4. Fixed Assets Depreciation (Cont.)

- This method may be opted by the taxpayer only for determining its BIT liability.
- That part of the depreciable base in excess of the deduction resulting from the straight-line method must be added back for determining the tax liability of shareholders.

1. Overview of Chilean Tax Regime

d) Non deductible expenses

- **Necessary expenses.** Among other requirements, expenses must be compulsory and indispensable to generate taxable income, as regards their nature and amount.
- **Non-deductible expenses.** Expenses that are not compulsory and indispensable as said above are non-deductible.
- Their treatment depends from the investment vehicle used:
 - a) **Stock Corporations and Permanent Establishments.** Non-deductible expenses are assessed with a 35% single tax that must be paid by the company.
 - b) **Limited Liability Companies (LLCs).** The non-deductible expenses of LLCs are considered as withdrawals of the partners, who are subject to WHT, regardless of the tax situation of the company (taxable profits or losses).

1. Overview of Chilean Tax Regime

e) Dividend distributions

WHT on dividends. Remittance of dividends to non resident investors is subject to 35% WHT.

WHT on withdrawals of financial profits in excess of taxable profits, in case of LLCs, is deferred until the generation of taxable profits. (Accelerated depreciation).

Imputation System. Chile has an imputation system i.e. paid BIT constitutes a credit against the WHT.

FUT (Taxable earnings register). In order to control the FCT creditable against the WHT, a specific register (FUT) shall be kept by the companies (offset losses).

Allocation rules apply to dividend distributions (FIFO).

1. Overview of Chilean Tax Regime

f) Dividend & DTCs

Under the Double Tax Conventions (DTC) concluded by Chile, the application of 35% WHT on dividends is **NOT** reduced (Protocol / Art. 10).

Example

DTC Canada / Chile Art. 10.2 “The provisions of this paragraph shall not affect the taxation of the company in respect to the profits out of which the dividends are paid. For the purposes of this paragraph, the term “**taxation of the company**” means, in the case of **Chile**, taxation under both, the first category tax and the additional tax as long as the first category tax is deductible in computing the additional tax”.

1. Overview of Chilean Tax Regime

g) Imputation system. Example.

Net Taxable Income		1000,00
FCT	17%	170,00
Net income available for distribution		830,00
Add back FCT		170,00
WHT Taxable basis		1000,00
WHT	35%	350,00
FCT Credit		170,00
WHT to be paid		180,00
Net amount received by investor		650,00
Total tax burden		35%
Total tax burden over net dividends		21,69%

1. Overview of Chilean Tax Regime

h) WHT to other outbound payments

a) Interest

- **General** tax rate on interest income is **35%**.
- On an **exceptional** basis, interest on loans granted abroad by foreign or international banks or foreign financial institutions is levied at a rate of **4% WHT**, provided that certain requirement and limits are met.
- There are **thin capitalization rules** (3:1) limiting debt **leverage** in certain circumstances, which include back-to-back loans.

b) Technical assistance and engineering work

- The tax rate is **15%** on the remuneration paid. A **20%** rate applies if the beneficiary is a related party with the payer.
- Under DTCs the services are considered as business profits i.e. there is no WHT.
- Special case of Brazil.

1. Overview of Chilean Tax Regime

h) WHT to other outbound payments

c) Remuneration for services rendered abroad

Generally subject to 35% WHT

However, the CITL states that the amounts paid abroad as remuneration for services of smelting Chilean products, refining or other special process, will be exempt from WHT.

d) Royalties

The WHT on royalties paid to non-residents depends on the nature of the intangible giving rise to the royalties (from 15% up to 80%).

DTC considerations.

2. Specific Mining Tax (SMT)

This tax is levied on operative income earned by mining enterprises, which are those who extract mineral substances and sell them in any states.

This tax is calculated according to two different computations, one intended to fixed the tax rate and the other to determine the tax basis.

I. Tax rate

It depends on the volume of sales, converted into metric tons of the fine copper:



2. Specific Mining Tax (SMT)

II. Taxable base

The tax base is the net operating income of the mining enterprise.

The net operating income is NTI, as corrected by specific additions and deductions in order to exclude the elements which are not linked with the mining activity.

a) Additions: (i) Net operating losses; (ii) Accelerated depreciation;

b) Deductions: Income not directly related to the sale of minerals (interest received)

The SMT is a deductible expense in calculating the BIT.

The SMT is not creditable against WHT.

3. How to invest? Foreign investors regimens.

a) Foreign Investment Statute - Decree Law 600

Under this system, a foreign investor signs a contract with the Government of Chile that authorizes the investor to transfer capital abroad and set down guaranties and rights.

Decree Law 600 grants certain rights to all investors such as:

1. Access to the foreign exchange market;
2. The right to repatriate capital invested in Chile without any taxation.
3. Income taxes can not be increased for 10 years. This period may be extended to 20 years for investments equal to, or exceeding, US\$ 50 millions.

In exchange of the guaranteed protection from future changes in the CITL, foreign investors are required to pay a combined corporate income tax and a tax on dividend or profit distributions at a rate of 42%, excluding the SMT.

3. How to invest? Foreign investors regimens.

The tax invariability can be waived one-time only, which usually happens when the investor decides to remit profits because the rate set in DL 600 is 42% while the general rate applicable on profits remittances is 35% (the general WHT).

The tax invariability represents a great guaranty to the investor and offers a fundamental fiscal stability in the period between consummation of the investment and the waiver of that invariability.

b) Chapter XIV of the Compendium of Foreign Exchange Regulations of the Central Bank of Chile

Under this mechanism, foreign investors must register with the Central Bank of Chile contributions to the capital of a Chilean company, a loan, etc., provided that the investment exceeds US\$ 10,000 or its equivalent in another foreign currency.

This chapter establishes reporting duties and does not offer significant rights to the foreign Investor as compared to those in the general tax regulations.

4. Investment vehicles / Holding companies

1. Stock Corporations (SC)
2. Limited Liability Company (LLC)
3. Permanent Establishments (PE)
4. Investment Platform / Offshore SC / 41 D

4. Investment vehicles / Holding companies

1. Stock Corporation. SC is a legal entity formed by the contribution of a common fund supplied by shareholders liable solely for their respective contribution, and managed by a board of directors comprised of members who can be removed”.

SC’s could be open or closed.

The shares (participation into the SC) can be freely transferred to third parties unless agreed otherwise.

There is no minimum capital requirement for SC’s nor are they subject to oversight by a regulatory agency, except for open SC’s or closed SC’s that submit voluntarily to the regime of an open SC.

2. Limited Liability Company. LLC is a contract in which two or more people stipulate that they will contribute something into an entity in order to distribute amongst themselves the benefits reaped from it. The partner's liability is limited to the amount of their contributions or to the sum they indicate in the partnership contract.

The LLC is managed by all partners or by one or more of their commonly appointed representatives and it constitutes a legal entity.

4. Investment vehicles / Holding companies

1. PE. There is not any definition of PE under Chilean legislation. However, branches have specific rules to be set up.

Under the Chilean IRS criteria a representative empowered to bind the foreign company constitutes a PE.

DTC special cases.

2. Investment Platform / Offshore SC / 41 D. It is a special holding regime.

The company is considered to be NON resident in Chile. Accordingly, it is not eligible for the benefits of DTCs.

The investment platform must always be an SC.

It has a specific “holding” business purpose.

It is a scarcely used regime due to its complexity, maintenance costs, exclusive business purpose and lack of residence in Chile.

There are probably 10 Companies subject to the mentioned regime and most of them set up for Argentinean purposes.

4. Investment vehicles / Holding companies

Considerations when choosing a SC or LLC

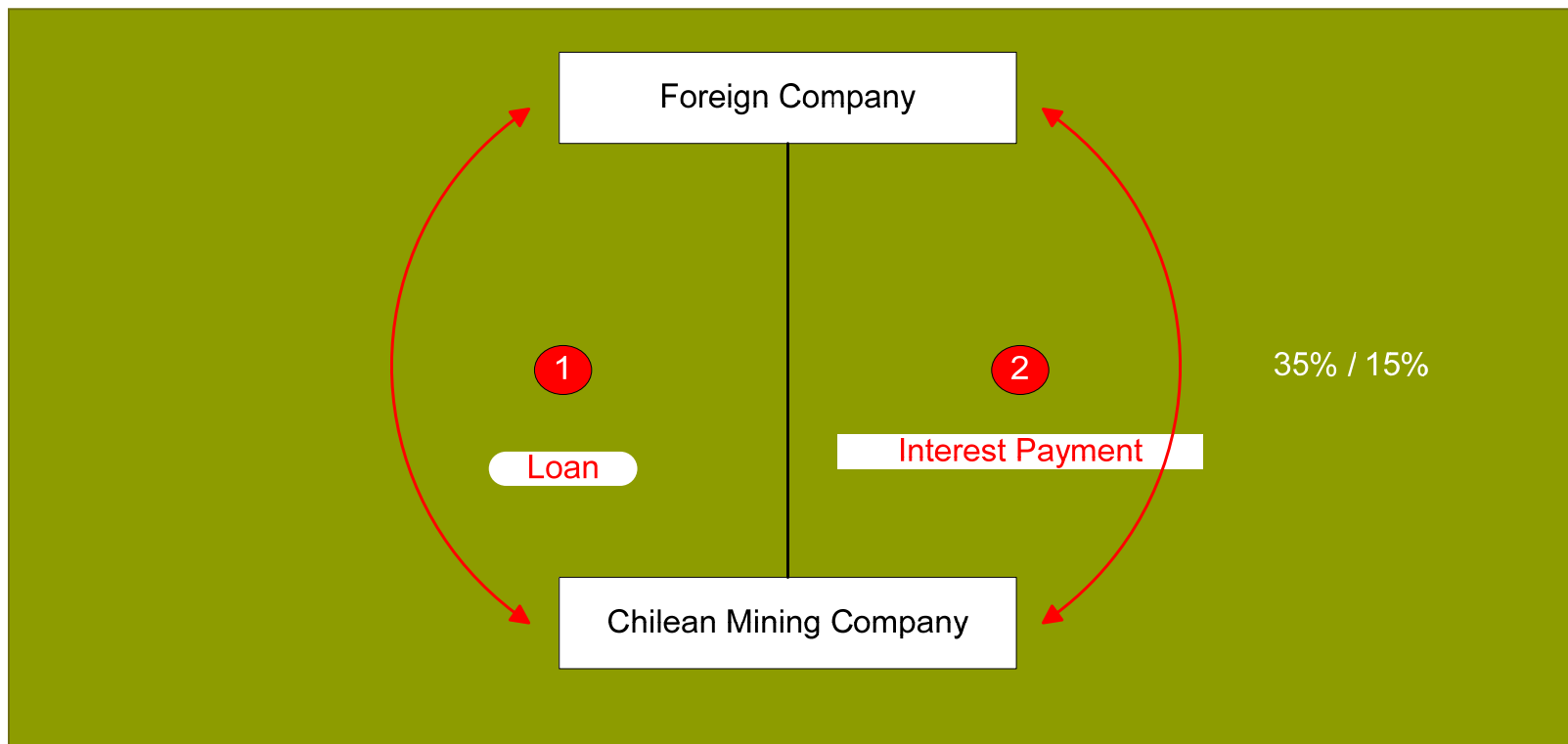
They must be analyzed at the time the legal vehicle is chosen, and consist basically in:

1. Amendment of the company bylaws;
2. Reinvestment of profits;
3. Potential deferral of WHT;
4. Sale of the shares & sale of quotas (tax cost basis // tax treatment);
5. Outbound loans to shareholders;
6. Deduction of expenses.

5. Financing Structures

Back-to-back loan transaction

Under Article 59 (1) of the Chilean Income Tax cross-border interest payments made by a Chilean resident to a non Chilean resident are generally subject to WHT at a 35% (DTC 15%).



5. Financing Structures

Back-to-back loan transaction

However, cross-border interest payments made by a Chilean resident to a non-Chilean resident bank or financial institution are subject to a reduced 4% WHT.

If any portion of the interest is attributed to “Excessive Indebtedness”, Chilean thin capitalization rules would tax that interest with a 31% entity-level income tax borne by the Chilean borrower, in addition to the mentioned 4% withholding tax.

Excessive Indebtedness is defined as which exceeds three times debtor’s adjusted tax equity in the year it was incurred (3:1 debt-to-equity ratio).

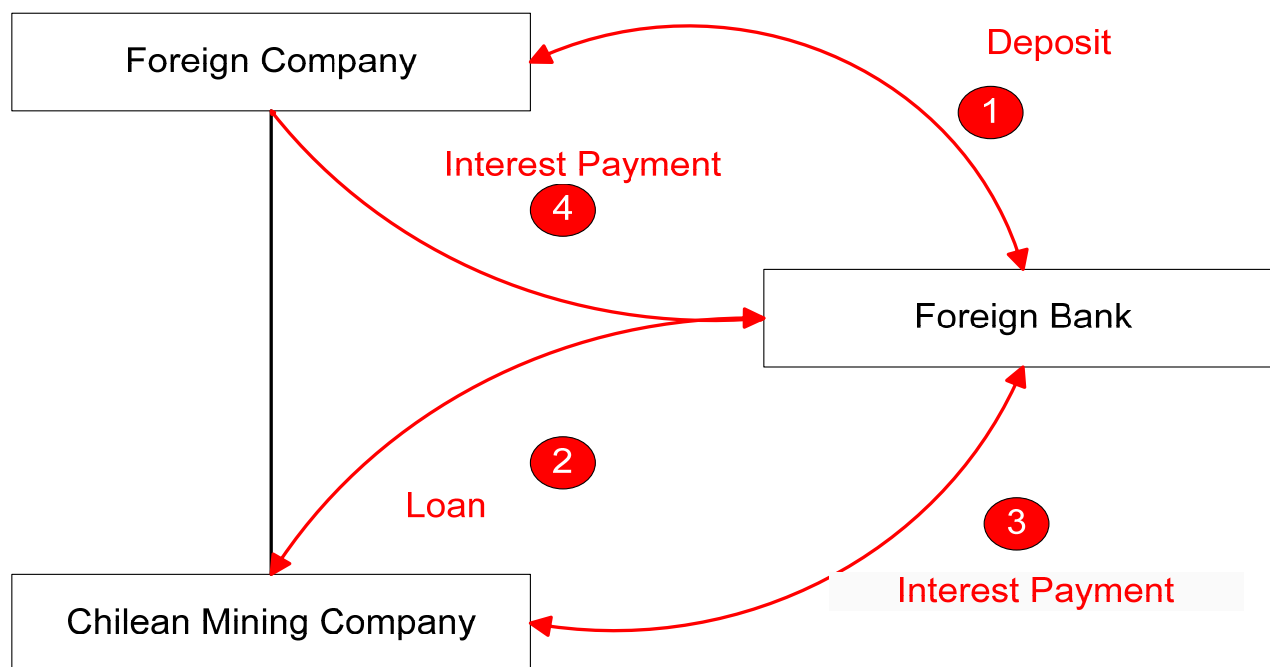
Only related-party loans are counted towards the Excessive Indebtedness computation.

When TCR are met, back to back loans allow the application of 4% WHT on interest.

5. Financing Structures

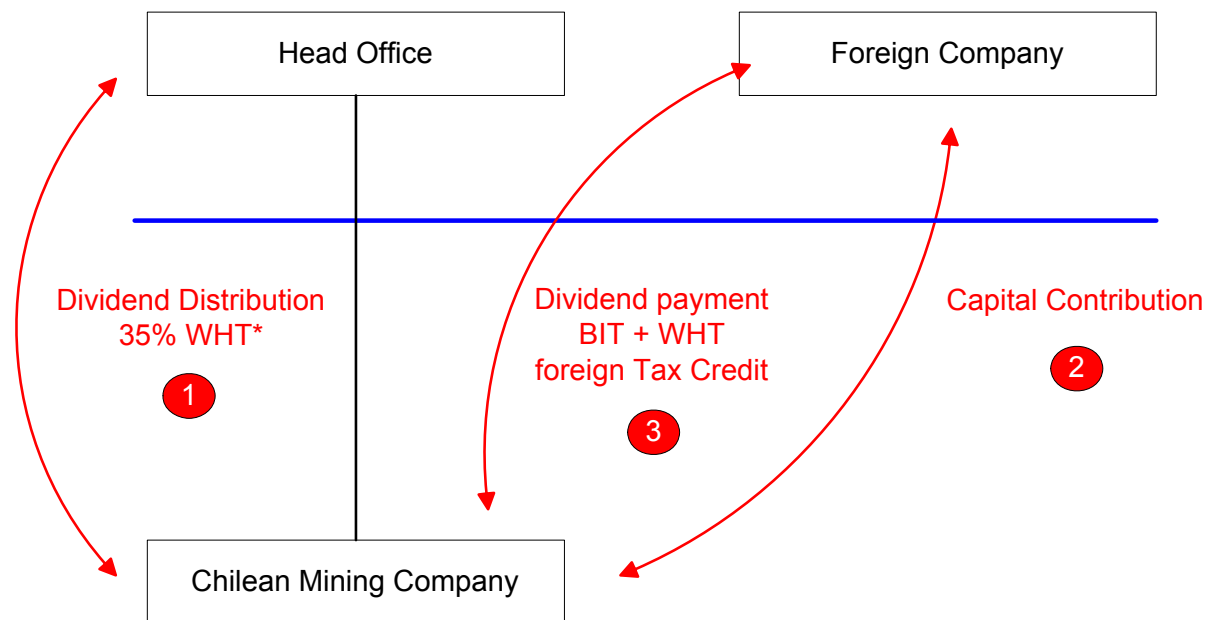
Back-to-back loan transaction

Indirect loan arrangement under which funds are lent through an intermediary which enters into a separate but symmetrical loan agreements with the lender on the one hand and the borrower on the other.



6. Cash Repatriation General Rule

- Outbound dividends are subject to 35% WHT (BIT paid is creditable against WHT)
- Companies resident in Chile are subject to world wide income taxation (foreign income tax credit).

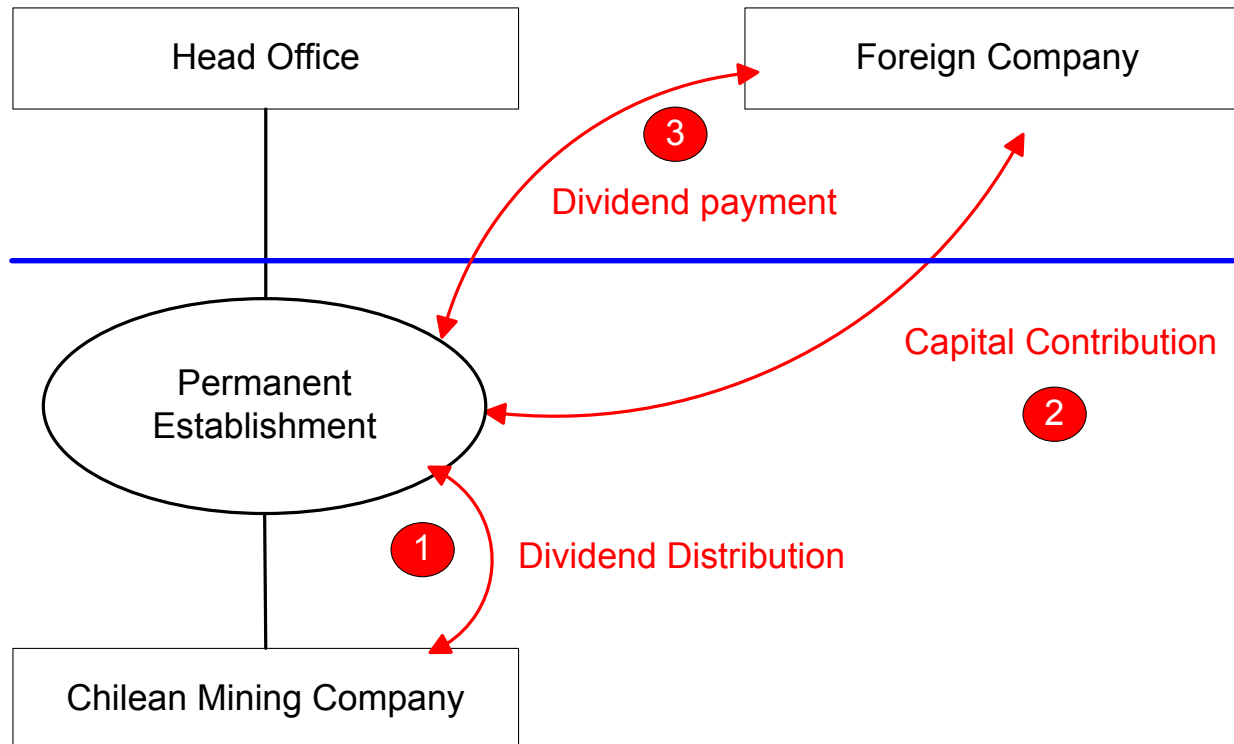


* BIT paid is creditable against WHT

6. Cash Repatriation PE Investments

- Domestic inter-company dividends are not subject to income tax;
- Under the Chilean Income Tax Law, PEs are subject to Income Tax in Chile only on their Chilean source income.
- Dividends distributed by a non-Chilean resident company & interest paid by a non-Chilean resident are considered as non-Chilean source income.
- Considerations:
 - a) Transfer pricing
 - b) Municipal license

6. Cash Repatriation PE Investments



Thank you!