Latin American Tax Newsalert

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Chilean tax reform bill approved by Congress

In brief

Chile's Senate and a Chamber of Deputies has approved a tax reform bill that has been submitted for the President's signature. After almost two months of discussions in Congress and with different political parties and business organizations, the Executive Branch withdrew the first draft of the tax reform bill and submitted a second draft, which has now been approved by Chile's National Congress. The revised draft issued September 4, 2012, included several key changes, but also retained important provisions from the earlier draft.

This Newsalert summarizes key aspects of the new version of the tax reform bill that may interest international investors. (For discussion of the first draft of the tax reform bill, see PwC's *Latin American Tax Newsalert* dated May 9, 2012).

Eliminated provisions

- **Changes to the thin capitalization rules:** The bill eliminates the proposal to change the thin capitalization testing period from annual to monthly.

- **New rules for cross-border reorganizations:** The bill eliminates the proposed changes to the Chilean tax-free reorganization provisions. However, the bill adds reference to intragroup reorganization in the context of indirect transfers of Chilean companies (see below).

- **Reduction of custom duties to zero percent:** The current custom duties rate applicable in the absence of a Free Trade Agreement would not change.

Modified provisions

- **Taxation of indirect transfers of Chilean shares:** The first draft of the tax reform introduced capital gains taxation on the indirect transfer of at least a ten percent interest in a Chilean entity (Sociedad Anonima (SA) or Limitada), regardless of the transferee's residence.

  The second draft would still subject to tax the indirect transfer of at least a ten percent interest in a Chilean company, but introduces several tests for measuring the Chilean subsidiary's materiality relative to the non-Chilean entity being directly transferred. Subject to certain requirements, the proposal also would tax transfers in which the transferor is a resident of a jurisdiction included on Chile's tax haven list.

  The second draft exempts from indirect tax a transfer of a Chilean company that is part of an intragroup cross-border reorganization, provided the transfer itself does not generate gain for the transferor.

  This indirect transfer tax would apply beginning on the day the law is published in the Official Gazette, which could occur as soon as September 2012.

- **Penalty tax on loans to shareholders or interest holders:** The first draft of the tax reform proposal included a provision imposing a 35% penalty tax on certain loans made by a Limitada to its quotaholder, or by an SA to its shareholders. Under the new draft, the amount of the share or quotaholder loan may be considered a deemed dividend distribution subject to the regular tax rate (up to 40% if the beneficiary is a Chilean individual or a total of 35% of beneficiary is a foreign resident) plus a 10% penalty.

- **Stamp tax reduction:** The first draft proposed to reduce the stamp tax rate from 0.6% to 0.2%. The second draft would reduce the rate to 0.4%.

Retained provisions

- **Subject Limitada distributions in excess of the Chilean previously taxed income account (FUT) to immediate taxation:** The rule applicable to *Sociedads de Responsabilidad Limitad* (SRLs or Limitadas) that allows a tax deferral on distributions until the SRL generates taxable earnings remains unchanged in the second draft.

- **Increase the 'First Category' corporate-level income tax rate to 20%:** This change would apply from January 1, 2012, as proposed in the first draft.

- **Modification of the capital gains tax rules relating to transfers of Chilean Limitada interest:** The second draft, like the first, would subject the sale or other transfer of an ownership interest in a Limitada to the same income tax treatment that currently applies to the transfer of shares in a Chilean SA.

- **Allowance of goodwill amortization:** Purchase price would be allocated to non-monetary assets of the target up to fair market value. The difference (if any) can be amortized as goodwill over a ten-year period, as provided in the first draft of the tax reform bill.

- **Taxation of Chilean branches of foreign companies on a worldwide income basis:** The current law subjects Chilean branches to tax only on a territorial basis.

- **Introduction of OECD-based transfer pricing rules:** The new rules also include Advanced Pricing Agreements.

- **Imposition of a penalty tax on disallowed expenses incurred by Limitadas:** Current law applies a similar tax treatment to disallowed expenses incurred by stock corporations.

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