

Chile enacts substantial tax reform

October 3, 2014

In brief

After six months of debate in the Chilean Congress, the country's significant tax reform legislation was published on September 29, 2014 in the Chilean Official Gazette.

The tax reform introduces substantial changes to the Chilean tax system, including two alternative methods for computing shareholder-level income taxation, additional corporate tax rate increases, limits for goodwill amortization, important amendments to the thin capitalization rules, deductibility of related-party payments, general anti-avoidance rules (GAAR), and other substantial modifications.

In detail

The most important provisions of the Chilean tax reform legislation are summarized below.

Amendments to the Chilean tax system

FUT elimination

The tax reform creates two alternative mechanisms of shareholder-level income taxation.

Attribution-basis shareholder taxation. Under this mechanism, Chilean companies will continue to be subject to corporate-level income taxation at the rates outlined in the table below. Shareholders would be taxed on income attributed to them as of the end of the tax year in which the income is generated, eliminating the taxable profits fund ledger (FUT for its Spanish

acronym). These profits would be taxed at the shareholder level whether or not they are distributed (the so-called 'attribution method'). The underlying corporate income tax paid at the entity level remains creditable for all taxpayers against the final shareholder tax, so the combined total Chilean income tax burden remains 35%. This regime will be available on January 1, 2017.

Cash-basis shareholder taxation. Under an alternative mechanism, a 27% corporate-level income tax (CIT) applies, along with a 35% shareholder-level tax that is imposed on cash distributions. 65% of the CIT is creditable against the 35% shareholder-level tax (as opposed to 100% under the current FUT regime). However, for shareholders resident in jurisdictions that

have a tax treaty in force with Chile, the underlying CIT is fully creditable against the 35% additional tax. This regime will be available on January 1, 2017, with a phase-in of the 27% rate as outlined in the schedule below.

The default mechanism for foreign shareholders generally will be the cash-basis mechanism, unless the distributing entity makes an election to apply the attribution method. Once the election is made, it will apply for five years. There are rules coordinating the application of both regimes in the context of a corporate reorganization.

For profits generated from January 1, 2015 through December 31, 2016, the current (pre-reform) cash-basis/FUT tax system will apply, subject to certain limitations.

Corporate income tax rate increase

The corporate-level income tax rate will increase gradually from the current 20%, as follows:

- for 2014, 21%
- for 2015, 22.5%
- for 2016, 24%
- for 2017, 25% for shareholders on the attribution method, and 25.5% for shareholders on the cash-basis method
- for 2018 and future years, 25% for shareholders on the attribution method and 27% for shareholders on the cash-basis method

Capital gains on the sale or other transfer of shares

In general, foreign shareholders will be subject to 35% tax on capital gains that are recognized in connection with the sale or other transfer of Chilean shares on or after January 1, 2017. Under the current rules, such capital gains are subject to tax at a rate of 20% or 35%, depending on certain specific requirements. Under the new rules, the rate will be 35% on net gain in all cases.

Sourcing rules for privately/publicly traded bonds

Effective October 1, 2014, bonds issued in Chile by Chilean companies will be deemed located in Chile.

Deductibility of interest payments

New provisions expressly allow the deductibility, for Chilean income tax purposes, of interest and other expenses derived in connection with the acquisition of shares, bonds, and similar instruments. The original version of the tax reform bill did not allow the deductibility of such interest expense. This provision will take effect on October 1, 2014.

Deductibility of related-party payments

Payments to foreign related parties will remain deductible, but only in the year in which they were effectively paid, and to the extent that any applicable Chilean withholding tax was paid. This provision will become effective on January 1, 2015.

Thin capitalization rules

A 3:1 debt-to-equity ratio will continue to apply, but now will be applied to total indebtedness, both foreign and local. The tax reform legislation includes additional guidance as to how to compute the amount of equity and the total amount of debt. The legislation also includes a grandfathering provision covering loans entered into before the new rules become effective on January 1, 2015.

Goodwill

The tax reform legislation limits the amortization of goodwill, which will be considered a non-deductible intangible for Chilean income tax purposes on the amount exceeding the fair market value of the assets received. This provision will become effective on January 1, 2015.

Controlled foreign corporation (CFC) rules

The tax reform introduces anti-deferral rules for passive income earned by a Chilean entity's CFCs. Generally, passive income includes dividends, interest, and royalties, with some exceptions. A foreign tax credit is available, subject to Chilean domestic law provisions. The legislation also includes specific rules with respect to income taxes paid in jurisdictions in the chain below the CFC when there is a tax treaty or an exchange of information agreement in force with Chile.

The CFC regime will become effective on January 1, 2016.

Note: The legislation includes specific provisions and thresholds for determining what constitutes a 'preferential tax regime' for CFC purposes. OECD countries are expressly excluded.

General anti-tax-avoidance rules (GAARs)

The tax reform introduces GAARs targeting tax-motivated transactions. The GAARs will allow the Chilean IRS to disallow tax benefits obtained from abusive or aggressive tax planning.

The GAAR provisions will become effective on September 29, 2015 and will apply only to transactions executed or concluded after that date.

Under a new consultation procedure, taxpayers may ask the Chilean IRS to determine whether a transaction may fall under the GAAR provisions.

The takeaway

US multinational companies with Chilean subsidiaries should determine how the changes to the Chilean tax system may affect their operations or investments in Chile, and how some of these changes will be treated for US tax purposes (e.g., creditability).

Note: The reform gives the Chilean IRS the authority to issue regulations and instructions on how to implement the changes. Affected companies should monitor the guidance issued by the Chilean IRS.

For prior coverage of the Chilean tax reform, see PwC Insights, "[Chile submits tax reform amendments to Congress](#)," August 22, 2014; "[Chile announces amendments to the tax reform bill](#)," July 22, 2014; and "[Chile's new president sends substantial tax reform package to Congress](#)" April 3, 2014.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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