Chile's new President promises substantial tax reform package by March 31, 2014

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In brief

Re-elected Chilean president Michelle Bachelet, whose new term commenced on March 11, 2014, has announced that she will submit a significant tax reform package to the Chilean Congress by March 31, 2014.

The package's details are not yet public except for a general description of the reform's main provisions. This reform is expected to be the most significant in the last 30 years. Two proposed reforms are expected to attract particular attention: an increase in the corporate income tax rate to 25% and a gradual elimination of the deferral mechanism of final taxation (commonly known as FUT).

Several of the proposed changes could have significant impact on US multinational corporations (US MNCs) with Chilean subsidiaries.

In detail

Although the details of President Bachelet's economic program are not yet available, the tax bill's main features are expected to be as follows:

Changes to Chilean tax system structure

- The corporate income tax rate would increase from 20% to 25%, phased in over a four-year period.
- Shareholders' taxation would be imposed on an accrual basis instead of the current cash basis mechanism. This would eliminate the Taxable Profits Fund Ledger (known as FUT for its Spanish acronym). Although we do not yet have details about the implementation of the FUT elimination, the main concept is that profits would be taxed at the shareholder level when generated, regardless of whether they are distributed. The underlying corporate tax paid at the entity level would remain creditable against the final shareholder tax, such that the total income tax payable in Chile would remain at 35%. This measure is expected to take effect four years after the enactment of tax reform.
- Taxable profits generated before this reform would remain subject to the current tax treatment, i.e., the cash-basis mechanism.
- Within four years of enactment, the top marginal individual income tax rate would be reduced gradually from 40% to 35%.

Anti-tax-avoidance measures

- General anti-avoidance rules (GAAR) would target tax-motivated transactions. These rules are expected to include provisions penalizing tax advisers engaged or collaborating in aggressive tax planning structures.
- Additional government resources would strengthen the Chilean tax authority's tax audit activity and would conduct a review of its current audit procedures.
- Changes to the rules applicable to Chilean private investment funds (FIPs for its Spanish acronym) would help prevent abusive structures. There is no indication of the specific changes other than harmonizing the FIP's tax regime with the proposals to eliminate FUT.

Investment and savings tax incentives

- A one-time full depreciation deduction would be allowed for expenses incurred in asset acquisitions. There is no guidance as to the type of assets that may be eligible for this benefit.
- Special taxation exemptions would be available for individuals' investments in certain financial instruments.

Other amendments

- All transfers of new real estate property executed before the sale to a final customer would be subject to VAT.
- We expect an increase in the stamp tax rate from 0.4% to 0.8%, phased in over a two-year period.

The takeaway

Although few details of the proposed Chilean tax system changes have been released, US MNCs with Chilean subsidiaries should be aware of them and evaluate potential scenarios. Taxpayers may find particularly relevant the elimination of the FUT mechanism and the increase in the Chilean corporate tax rate. More information should be available on all the proposed reforms upon release of the draft tax reform bill.

Let's talk

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

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