

Chilean Congress approves Modernization Tax Bill

January 29, 2020

On January 29, Chilean Congress approved a revised draft of the so called “Modernization Tax Bill”, after a year and a half of discussion. The original bill went through substantial amendments both in the Chamber of Deputies and in the Senate, incorporating the amendments agreed back in the December “Tax Agreement” between the Senate’s Finance Commission and the Government, to finance the new social agenda.

The revised draft of the tax bill was sent to Constitutional review and it is expected to be enacted in March 2020.

Below you will find a brief summary of the main amendments to be introduced:

I. Income Tax Amendments

1) Integration of Corporate-level tax and Final Taxes

The Attribution regime of taxation is repealed.

A full integration regime is introduced for Small and Medium Enterprises (SMEs) – i.e., with sales not exceeding USD \$2,8 million annually app.- so that the corporate level tax should be fully creditable against final taxes.

For large enterprises the current Partially Integrated Regime of taxation (“PIS”) should be applied going forward – i.e., 27% Corporate level tax (CIT) rate and shareholder’s taxation on a cash basis with full or partial CIT credit depending on whether the non-resident shareholders is resident or not in countries with which Chile has a double tax treaty in force.

Accordingly, in a PIS non-tax treaty scenario, the overall taxation in Chile should be 44.45%. For non-resident shareholder who are resident in a tax treaty jurisdiction and beneficiaries of dividend income under the respective tax treaty, the overall taxation under the PIS regime should be capped to 35%.

Entry into force: January 1, 2020.

2) SME clause and repeal of Article 14 ter.

Article 14 ter is repealed and replaced by a new SMEs regime of taxation (set forth in Article 14 d), which provides for a preferential tax regime for taxpayers with annual earnings up to USD \$2,8 million appx.

Main features are as follows:

a) 25% Corporate income tax rate.

b) New benefit applies by virtue of law.

c) New relation criteria set forth in Article 8, No. 17 of the Chilean Tax Code should be considered to qualify for the SME clause.

d) Taxpayers may elect to apply a fiscal transparency, i.e., to pay final taxes only, where the shareholders are subject to Chilean Complementary Global Tax (final tax for Chilean residents).

e) Profit reinvestment incentive is improved, allowing for a 50% of the reinvested profit tax deduction with a cap of USD\$ 188,000 appx. (5,000 UF).

f) Instant depreciation.

g) SMEs with annual sales not exceeding USD \$1,8 million appx. (50,000 UF), can reduce to 0,2% its provisional monthly payment (“PPM” by its acronym in Spanish) rate.

h) SMEs are not subject to the new Real Estate contribution surcharges.

3) Capital gains

- a) Financial instruments short sale – i.e., transfer within a repurchase agreement - is not considered as an alienation.
- b) Stock options regulated in employment agreement and collective agreements will not be considered as income neither when granted nor when the option is exercised. In the scenario where there is no agreement in place, only the option's delivery will not be deemed as income, however the exercise will be considered as remuneration.
- c) A residual rule is established for the alienation of any other unregulated goods.

Entry into force: January 1, 2020.

4) Anti-Avoidance Rule for non-pro-rata distributions

The Chilean IRS is granted with the authority to apply a 40% penalty tax to non-pro-rata distributions deemed as “unreasonable withdrawals”, where direct or indirect owners are deemed as related parties. This penalty tax should apply, prior summon of the respective taxpayers, where the non-pro-rata distribution deemed as “unreasonable withdrawal” with no economic or commercial reasonability. The penalty tax will be applied to the company that performed the distribution, over the portion exceeding the respective equity ownership interest (non-pro-rata distribution).

In addition, a transitory rule is incorporated to apply a similar penalty tax rule to unreasonable withdrawals performed by the company under the former 2014 Tax Reform – FUT substitute tax regime - which allowed to

pay a tax over the accumulated FUT and then perform distributions without being subject to distribution's ordering rules.

In this case, a 25% penalty tax would apply to “unreasonable withdrawals”, over the portion exceeding the respective equity ownership interest (non-pro-rata distribution).

5) Accumulated Credit Balance computation

Amendments to the formula of computation for the Corporate-level-tax credit average are introduced. New rules exclude from the computation the difference between the accelerated and straight-line depreciation and grant as a credit the corporate tax rate in force.

Entry into force: January 1, 2020.

6) Expenses

- a) The concept of tax deductible expense is redefined, establishing that these will be those *"that have the ability to generate income, in the same or future commercial years and in the same or future years and are associated with the interest, development or maintenance of the business ..."*
- b) The deduction of specific goods donated to non-profit institutions is allowed.
- c) Unrelated party bad debts deduction is allowed where unpaid credits last for more than 365 days, or a percentage thereof, following the criteria defined by the Chilean IRS.
- d) Tax deduction of shareholder's remuneration who actually works for the company is allowed, to the extent reasonable. In addition,

remunerations paid to shareholder's spouse or civil partner or his children, will be accepted as a tax expense under the same terms and conditions.

- e) Tax deduction of voluntary environmental expenses is allowed, provided they are established by the competent authority and with certain limits. The excess is not accepted as tax expense.
- f) Disbursements or discounts imposed by the authority to compensate damage to customers or users, in a strict liability scenario, will be considered as expenses. Disbursements in judicial or extrajudicial transactions will also be deductible, in an unrelated party scenario. This would include penalty clauses.

Entry into force: January 1, 2020.

7) Provisional Monthly Payments (“PPM”)

An important amendment is made to the calculation of the PPM rate. If the company has a relevant decrease (30% of its income, expenses, costs or taxable income), the PPM rate may be recalculated within the year.

Entry into force: January 1, 2020.

8) Progressive repeal of Payments per Absorbed Profits (PPUA)

The PPUA is repealed from the commercial year 2024 onwards. That is, the tax refunds received by companies whose losses have absorbed the profits received from their subsidiaries, which in turn have been subject to corporate income tax, regarding withdrawals and dividends received as of that year.

The repeal would not affect the allocation of losses to the companies' own present or future profits, nor the use of the corporate income tax credit against final taxes, which will be controlled in the tax credit balance ledger (SAC by its acronym in Spanish) of the receiving entity.

Between years 2020 and 2023 the PPUA return will be reduced gradually as follows: commercial year 2020 (90%), commercial year 2021 (80%), commercial year 2022 (70%) and commercial year 2023 (50%).

9) New tranche of final taxes and employment tax

A new bracket of 40% is established for final taxes and employment tax, applicable to income greater than 310 UTA (USD \$235k annually app.) and greater than 310 UTM (USD \$19k monthly), respectively.

This new bracket will be applicable as of commercial year 2020, and employment tax reliquidation regulations are contemplated in case of a lower rate has been applied previous to the Law publication.

The maximum tax burden **will not exceed 44.45%**, for which in the case of the Final Tax 40% bracket, a 5% credit will be granted over the taxable part of the withdrawals or dividends that exceed the sum of 310 UTA, keeping the 35% restitution tax debit for all tranches.

10) Instant depreciation

An immediate depreciation (one year) is established for 50% of the assets acquired for investment projects in the country **as of October 1, 2019 until December 31, 2021**, with the possibility to subject the

remaining 50% to the accelerated depreciation rules.

11) Private Investment Funds (FIP) and Investment Funds.

Article 92 from Law 20,712 is amended by introducing new incorporation requirements for FIPs (e.g., 8 non-related parties not being able to hold a 20% ownership interest in the fund each. The 20% ownership limitation considers any related party's interest).

In addition, the amendment states that if after a year since this Law enters into force, the FIPs do not meet the requirements stated in the proposed provision, the fund would be considered as a Corporation for tax purposes during the commercial year in which the FIP failed to comply with the new requirements.

However, the amendment states that if the FIP subsequently complies with the new requirements, it shall be considered again as a Fund for tax purposes, for the income obtained from January 1 of the following commercial year to the one that meets the requirements.

Entry into force: after a year since this Law enters into force.

12) Actively traded securities

The amendment states that in case the "actively traded" status is exclusively provided by a "Market Maker" contract (i.e., a contract which ensures the existence of daily buying/selling operations), capital gain derived from the sale of securities would not be subject to tax, only for

one year from the first public offering.

II. International rules

a) The definition of Permanent Establishment is incorporated in the Income Tax Law, which was previously regulated only through jurisprudence issued by the Chilean IRS.

b) Foreign Tax Credit ("FTC") rules are reformulated. FTC Credit limit for countries without a Double Tax Treaty raises from the current 32% to 35%.

c) When a Chilean entity holds shares in another Chilean entity through a foreign company, the withholding tax paid by the Chilean entity will be creditable.

d) Royalties derived from research and development projects under Law 20.241 will no longer be considered as passive income for CFC purposes.

e) Limitation for the 4% WHT rate in case of back-to-back structures.

New requirements are established for the application of the 4% rate. Among these, it is stated that the loan should not be granted through certain types of "structured agreement". This rule will apply to the interest paid, transferred into account, or made available to taxpayers not domiciled in Chile, for credits granted as of the effective date of the Law, as well as those granted prior to that date, whenever they have been novated, assigned or the amount of the credit or interest rate is modified later.

In addition, a new concept and requirements to qualify as a foreign or international financial institution (FFI) is established.

f) The deadline for the non-application of the restitution of the 35% of the CIT credit applicable to the PIS regime for countries with which Chile has signed, prior to January 1, 2019, a Double Tax Treaty that is in force (currently the United States) is extended until December 31, 2026.

III. VAT amendments

1) Special credit for construction

The current limit of 65% VAT tax credit for the construction of houses whose value does not exceed 2,000 UF (USD \$72,000 app.) is maintained.

2) Recurrent presumption for real estate transfers

The presumption of “recurrent status” for sale of real estate prior to one year since its acquisition is repealed.

3) 27 bis VAT refund

The rules for the anticipated refund of fixed assets VAT fiscal credit are modified by reducing the minimum term from 6 to 2 months to accumulate the VAT input and term to resolve from 60 to 20 days.

Entry into force: First day of the month following the publication of the law and 3 months from the entry into force of this Law (in case of deadline to resolve).

4) VAT on Digital services

A new taxable event is incorporated in Article 8 letter

n) of the VAT Law (D.L. 825), in order to tax with VAT the services provided by digital platforms, as follows:

- The intermediation of services provided in Chile, whatever its nature, or sales made in Chile or abroad, provided that they give rise to an import.
- The supply or delivery of digital entertainment content, such as videos, music, games or other similar, through downloads, streaming or other technology, including for this purpose, texts, magazines, newspapers and books;
- The provision of software, storage, platforms or IT infrastructure; and
- Advertising, regardless of the medium through which it is delivered, materialized or executed.

For the above, territoriality of services and reverse charge VAT rules are modified.

Regarding the services provided to individuals that are not VAT taxpayers (B2C), companies will be subject to the registration and simplified regime of taxpayers not domiciled or resident in Chile, which is created for this purpose, and VAT must be declared and paid in a tax period that can go from 1 to 3 months, at the taxpayer’s choice.

Regarding digital services provided to VAT taxpayers (B2B), a reverse charge mechanism will apply with the beneficiaries of the service retaining the corresponding tax, granting them the right to VAT fiscal credit for it.

Entry into force: 3 months since this Law enters into force.

IV. Tax Code amendments

a) An administrative complaint is created, in case of violation of the taxpayers' rights.

b) The concept of “resident” is modified and the concept of “business group” and “related” is incorporated; these last two reproduce the concepts of the Securities Market Law.

c) The Extrajudicial agreement between the Chilean IRS and the taxpayer, and its procedure is incorporated (Article 132 ter of the Chilean Tax Code).

d) The general anti-avoidance rules in force since September 2015 are maintained. The amendments proposed in the Modernization Tax Bill are repealed.

V. Other amendments

1) Taxpayer Advocate Service (DEDECÓN)

The bill establishes a **Taxpayer Advocate Service** in charge of acting as a counterpart of the tax authorities to ensure respect and effectiveness of taxpayer’s rights before the Chilean IRS.

Among its main duties would be: to guide taxpayers regarding any act or omission of the Chilean IRS that violates their rights; the resolution of complaints filed by taxpayers when their rights are violated; act as a mediator; propose changes to the content of Circular Letters and Resolutions, etc.

Entry into force: no later than 2 years after the Law’s publication date.

2) Substitute Tax for Historical Taxable Profits Fund Ledger balance (FUT)

A substitute tax regime is established with the purpose of raise funds with a 30% rate.

This mechanism is very similar to the one in the previous tax reform:

- 1) On all or part of the FUT generated until December 31, 2016, that the corporate income taxpayers register at the end of the commercial years 2019, 2020 and 2021.
- 2) The corresponding corporate income tax credit is applied to said tax.
- 3) Amounts already taxed would be preferred for withdrawal.

3) Tax equity regularization

The computation differences or others that are recorded in the tax equity, may be rectified in the annual income tax return of the tax years 2020 and 2021, both of the company, its shareholders or partners.

In case of not being able to rectify the declarations, there is the option to declare and pay a substitute sole tax of 20% over the determined differences.

4) Regional Development Contribution

(i) A special contribution is incorporated to investment projects for corporate taxpayers with full accounting records, when the projects meet the following copulative requirements:

(a) That involve an investment equal to or greater than USD \$10 million in tangible fixed assets and (b) That must pass through the Environmental Impact Assessment System (SEIA).

(ii) 1% will accrue once the project has been approved by the SEIA, its municipal reception has been received and begins to generate operational income (depreciation deducted).

(iii) Projects destined to health development activities, educational, scientific, research or technological development activities, and construction of houses and offices, so declared by the Ministry of Finance, shall be exempt from this contribution.

(iv) 1% will be applied to the acquisition value of all physical assets of the fixed assets, but only in the part that exceeds the amount of USD \$10 million. It can be paid in up to 5 annual and successive installments.

(v) 1% will be incorporated into the nation's general income, in which one part will be destined to the National Regional Development Fund and two thirds to the "Regional Contribution Fund".

(vi) It is understood that the contribution should be accepted as an expense according to the general rules of the Income Tax Law, although the Tax Bill does not specifically mention it.

Entry into force: It will apply to new investment projects and existing projects' extensions; whose Environmental Impact Assessment process starts counting from the Law's publication date.

5) Municipal license for investment companies

The Municipal Income Law is amended, establishing that will be subject to municipal license

investment companies that acquire or maintain assets or instruments, of any nature, from which they can obtain income derived from ownership, possession or possession as a precarious title as also of its alienation.

With this amendment, not only passive investment companies would be taxed, but any company that obtains such income.

The Law also includes a transitory provision which indicates that this amendment of the taxable event has as its sole objective, to provide legal certainty regarding the former provisions in force until June 30th, 2020. It also specifies that currently in-force provisions would apply regarding municipal patent accrued in periods prior to the entry into force of this amendment. **Therefore, neither refunds nor collection of municipal licenses will apply respect to periods prior to the entry into force of this amendment**, nor it will affect administrative or judicial procedures in progress or subsequently initiated respect to such periods.

6) DFL 2 – Real Estate

Properties received by inheritance are to be included within the current limit of two properties owned by a same individual for applying to the benefits of Law-ranked Decree No. 2 (DFL for its Spanish acronym). This modifies what was stated in Law No. 20.455

7) Real Estate Surcharge per taxpayer

A new surcharge of the current Real Estate Contribution is

applied through the incorporation of the new Article 7 bis to Law No. 17.235. This surcharge would be progressively applicable to the immovable properties that a taxpayer has, whose total fiscal value exceeds USD \$530,000 app.

The amount of real estate whose fiscal value is worth between USD \$530,000 to USD \$930,000 app., should be subject to a 0,075%. From USD \$930.000 app. to USD \$1.200.000 app. it should be subject to a 0,15% rate. From USD 1.200.000 onwards, the taxpayer should be subject to an additional 0,275% rate.

This amendment does not include relate party provisions regarding common-controlled entities, but it is based upon the sum of real estate property held by a single taxpayer in accordance to the real estate registry.

As an exception, SMEs would not be subject to this surcharge whenever the real estate is used for its business activity. In addition, real estate in which Pensions Funds are investing in, would also be exempted from this tax.

For the determination of the total fiscal value, it should be considered agricultural real estate, and non-agricultural real estate used for residential purposes.

The surcharge would have the same tax treatment as the Real Estate Contributions (i.e., it could be used as a credit or as an expense, as applicable).

Entry into force: As of the Law's publication date.

8) Other amendments

- Rules for audits of derivative instruments are modified (Law No. 20.544), and a new procedure to regularize undeclared, incomplete or erroneous transactions is included.

- Green tax is modified by changing its taxable event, and the corresponding means to challenge the payable amount determined by the Chilean IRS.

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