Chile-US Tax Treaty and Chilean Tax Reform Bill

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Overview of Chilean Taxation

- **OECD compliance:** Chile is an OECD member country that follows almost all guidelines (BEPS, transfer pricing rules, exchange of information, CFC, GAAR, etc.).
- **Outbound regimes:** A simple CFC regime, only for passive income. No PFIC nor GILTI.
- **Unique tax regime for entities:** No matter the type of entities, they are taxed as opaque. There is no flow-through tax regime except for CFC and some SME's.
- **Expansive Treaty Network:** Chile has signed 37 Tax Treaties, including the main economies around the world, and most of Latin American Countries.
- **No wealth tax:** Chile has no wealth tax. However, there are: inheritance and gift tax, municipal license taxes, and real estate taxes.
- **VAT:** Sales and services are generally levied with a 19% VAT flat rate. Exemptions are available.
- **Corporate Income Tax (CIT):** Levied with a 27% flat rate. Small and medium companies have a lower CIT rate (12.5% on 2024).
- **Personal Income Tax:** Levied with a progressive rate ranging from 0% to 40%. In the case of local dividends, CIT can be fully or partially credited against Personal Income Tax depending on the tax regime of the payor.
- **Withholding Tax (WHT):** Non-residents are taxed with a general 35% WHT rate. Several special rates are applicable to different incomes. Dividends are taxed with the general 35% WHT rate on the grossed-up dividend but being able to use 65% of the CIT as credit, resulting in a 44.45% overall taxation (CIT + WHT).
- **Tax treaty countries:** non-resident shareholders resident of a treaty country can credit 100% of the CIT against WHT applicable on dividends, lowering the overall taxation to 35%.

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U.S – Chile New Tax Treaty

Tax Treaty Network

No.	Europe
1	**Austria**
2	**Belgium**
3	**Croatia**
4	**Denmark**
5	**Spain**
6	**France**
7	Ireland
8	**Italy**
9	**Norway**
10	Netherlands
11	**Poland**
12	**Portugal**
13	**UK**
14	**Czech Republic**
15	Russia
16	**Sweden**
17	**Switzerland**

No.	Asia
1	**China**
2	**Korea**
3	The United Arab Emirates
4	India
5	Japan
6	**Malaysia**
7	Thailand

No.	America
1	**Argentina**
2	Brazil
3	Canada
4	Colombia
5	**Ecuador**
6	United States
7	Mexico
8	**Paraguay**
9	Peru
10	**Uruguay**

No.	Oceania
1	**Australia**
2	New Zealand

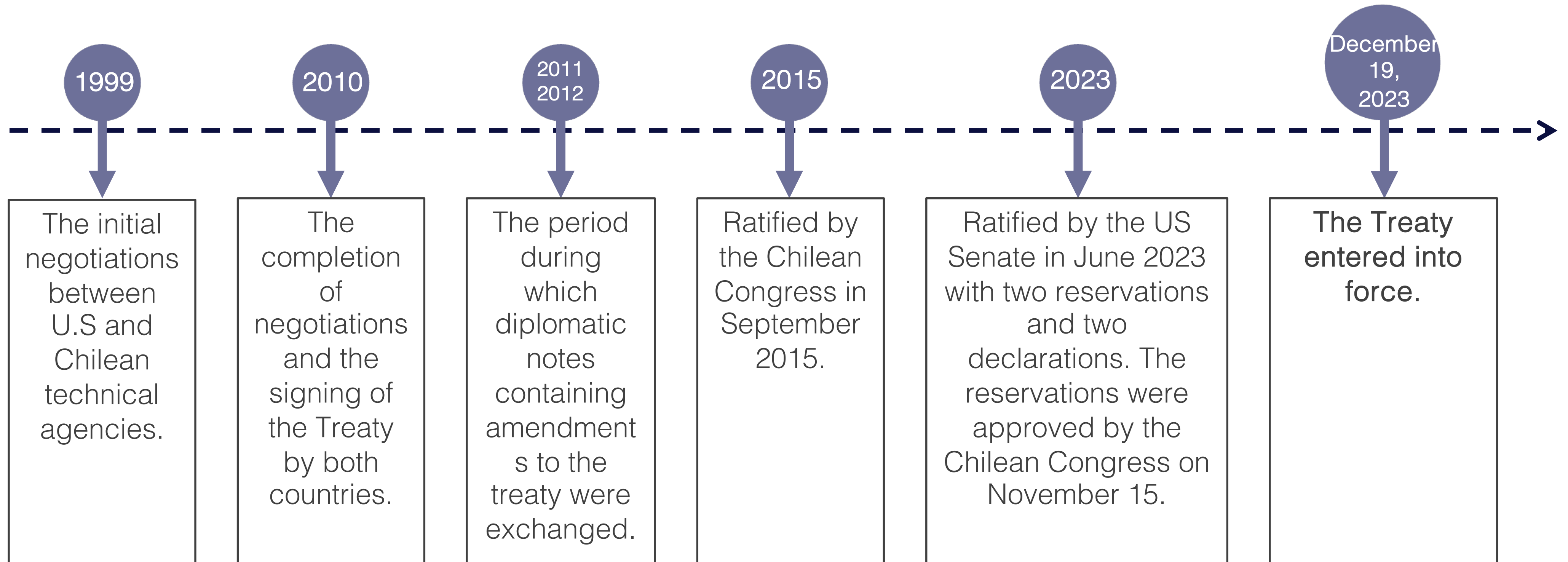
No.	Africa
1	South Africa

(*) Database of ICSID Worl Bank Group and Chilean Tax Authority

Chile-US Tax Treaty

U.S – Chile New Tax Treaty

Background



U.S – Chile New Tax Treaty

Efective dates

Entry into Force: The U.S. and Chile informed each other through diplomatic channels that their respective constitutional and statutory procedures had been fulfilled. The Treaty officially entered into force on December 19, 2023. It's crucial to highlight that the entry-into-force date does not necessarily coincide with the date when the Treaty's provisions become effective.

- Taxes withheld at source: The Treaty takes effect for amounts paid or credited on or after the first day of the second month following the entry into force, which is February 1, 2024.
- Other taxes: The Treaty is applicable for tax periods starting on or after January 1 of the calendar year immediately following the effective date, which is January 1, 2024.
- Exchange of information: Apply from the date of entry into force of the Treaty.

Initially, this rule aimed to facilitate the prompt effectiveness of withholding tax reductions, bypassing the need to wait for the following year (referred to as the "rule for other taxes"). However, due to the entry-into-force date of the treaty, it was recognized that this rule would become effective later than the other provisions outlined in the treaty.

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U.S – Chile New Tax Treaty

General aspects

- It is one of three treaties currently in force between the U.S. and a Latin American country, representing the first to be approved by the U.S, Senate in over a decade.
- The primary objective of this treaty is to promote trade and investment between the two nations by reducing or eliminating double taxation on income. This holds particular significance for U.S. taxpayers after the last tax reform, as it facilitates their ability to claim tax credits for taxes paid in Chile.
- Prior to the treaty, IRS officials had to evaluate Chilean taxes to determine eligibility for the U.S. tax credit. However, with the treaty now in effect, Chilean taxes considered as income taxes should be acknowledged as creditable for U.S. tax purposes.

Taxes covered

- The Treaty applies to income and wealth taxes between the U.S. and Chile but excludes state and local taxes.
- It does not cover social security and unemployment taxes, as these are regulated by a distinct bilateral agreement.

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U.S – Chile New Tax Treaty

Residence

- The Treaty establishes rules for determining the residence of individuals and other categories of taxpayers.
- This encompasses tie-breaker rules designed to determine a single country of residence when an individual is regarded as a tax resident under the domestic laws of both the U.S. and Chile.
- Chile will not consider a U.S. citizen or green card holder as a resident of the U.S. unless that individual has a substantial presence, permanent home, or habitual residence in the U.S., and that person is not a resident of a third country.
- In order to have access to the treaty, a resident has to be also a “qualified” resident under the LOB clause.

Tie-breaker rules

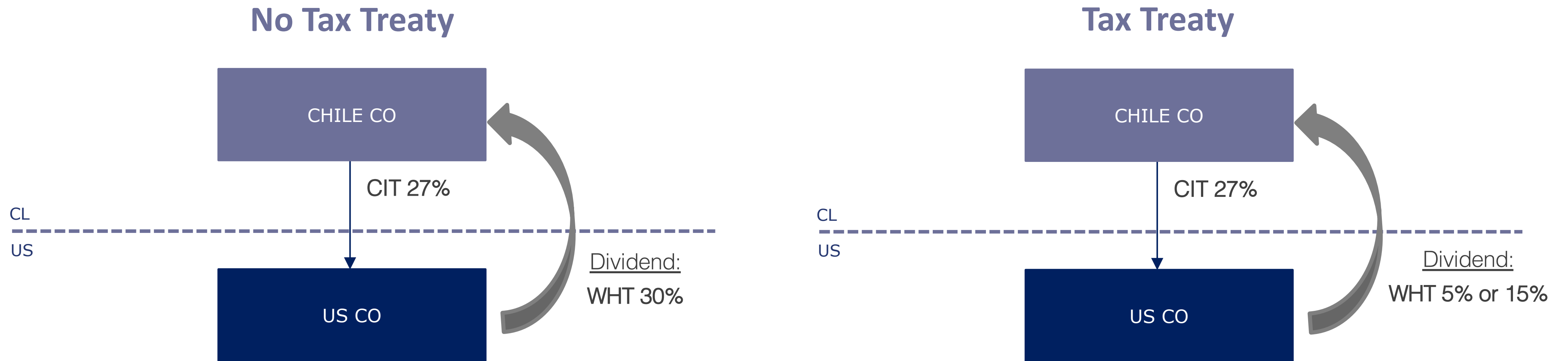
1. The country where the person has permanent housing available to them;
2. The country with which the individual has the closest personal and economic ties (the center of their vital interests);
3. The state where the person habitually resides; and
4. The country of which the person is a national.

If none of the aforementioned rules establish residency, the determination will be made through a mutual agreement procedure.

U.S – Chile New Tax Treaty

Dividends from the U.S. to Chile

Dividends arising in the US and paid to Chilean resident would be reduced from 30% to **15%** (or **5%** if the BO is a company that owns directly at least 10% of the voting stock of the payor) :



U.S – Chile New Tax Treaty

Tax Treaty v/s No Tax Treaty simulation

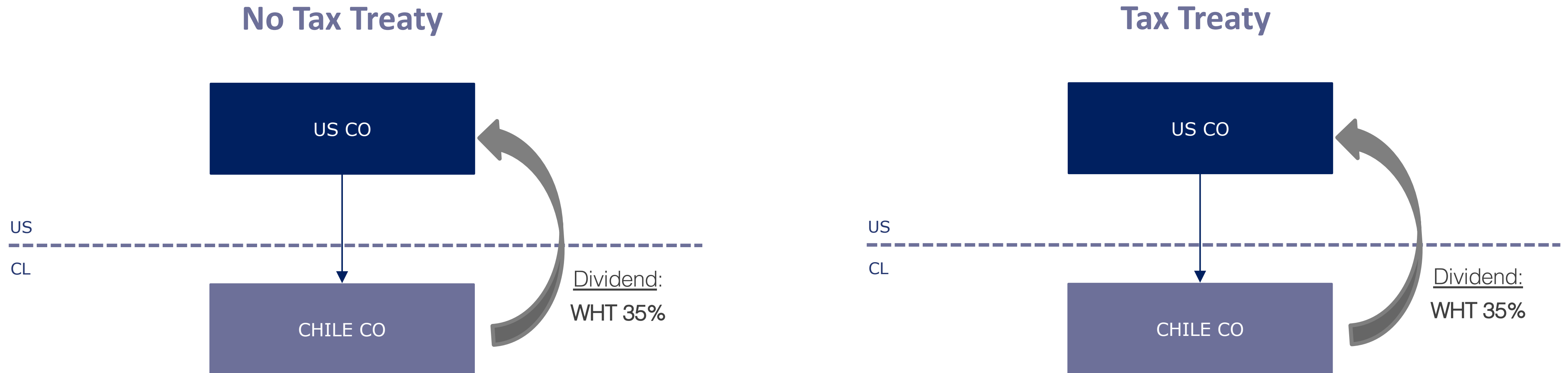
WHT No Tax Treaty		
Instant 1		
	Annual Income	100
	Corporate U.S Tax 21%	21
	Cash for dividen distribution	**79**
Instant 2		
	WHT tax basis	79
	WHT 30%	23.70
	Net dividend	**55.30**
Instant 2		
	Net dividend	55.30
	Gross up	35.00
	Tax basis	90.30
	Chilean corporate Tax 27%	24.38
	Tax credit	24.38
	Tax payable	0
	Total dividend received abroad	**55.30**
Total Tax Burden		**44.70**

WHT Tax Treaty			
		Tax 5%	**Tax 15%**
Instant 1			
	Annual Income	100	100
	Corporate U.S Tax 21%	21	21
	Cash for dividen distribution	79	79
Instant 2			
	WHT tax basis	79	79
	WHT	3.95	11,85
	Net dividend	75.05	67.15
Instant 2			
	Net dividend	75.05	67.15
	Gross up	24.95	32.85
	Tax basis	100	100
	Chilean corporate Tax 27%	27	27
	Tax credit	24.95	27
	Tax payable	2.05	0
	Renta (3)	73.00	67.15
Total Tax Burden		27,00	32.85

U.S – Chile New Tax Treaty

Dividends from Chile to U.S

As a result of the inclusion of the 'Chile Clause' in the Tax Treaty, Article 10° will not have practical application for dividends distributed from Chile to the US. That is illustrated as follows:



Only 65% of the CIT can be used as a credit against the 35% WHT. Nevertheless, the US already had a 100% credit under domestic law.

CIT is fully creditable against the 35% WHT.

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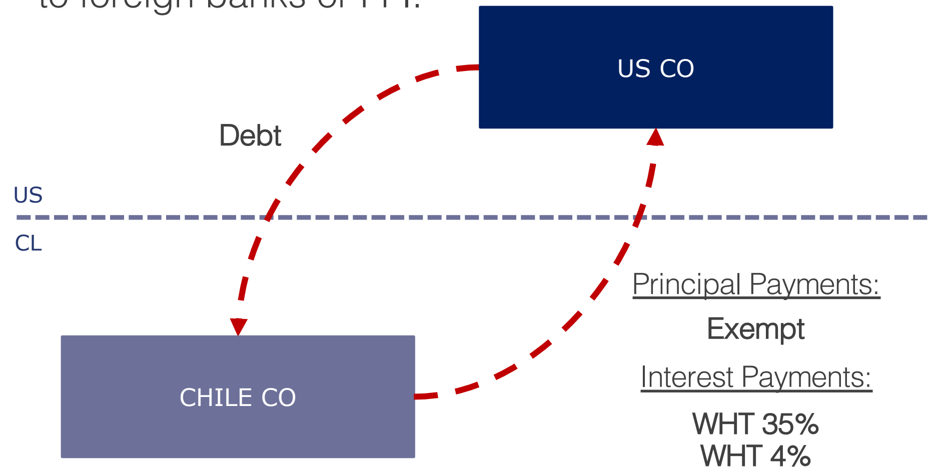
U.S – Chile New Tax Treaty

Interest from Chile to U.S

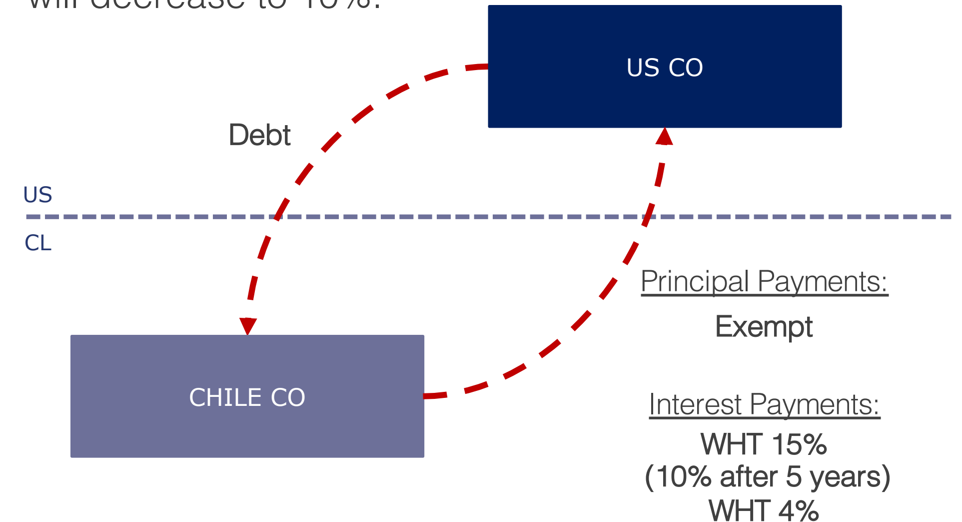
No Tax Treaty

The interest paid by a debtor resident of Chile to a creditor residing in the United States is generally subject to a withholding tax rate of 35%. 4% applies to foreign banks or FFI.



Tax Treaty

The maximum tax rate applicable to interest paid to residents of the other country is restricted. For the initial 5 years, this maximum rate will be 15%, after which it will decrease to 10%.



A preferential rate of 4% is applicable if the recipient of the interest is a bank, insurance company, financial institution, etc.

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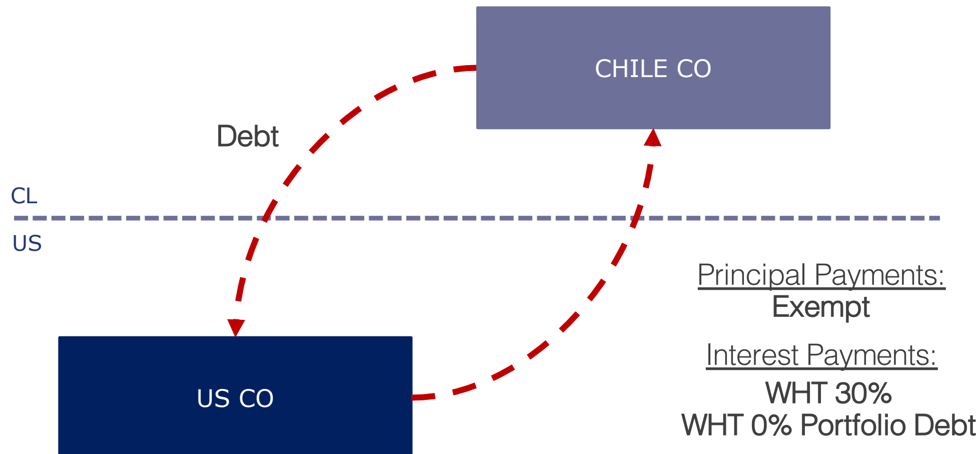
U.S – Chile New Tax Treaty

Interest from the U.S to Chile

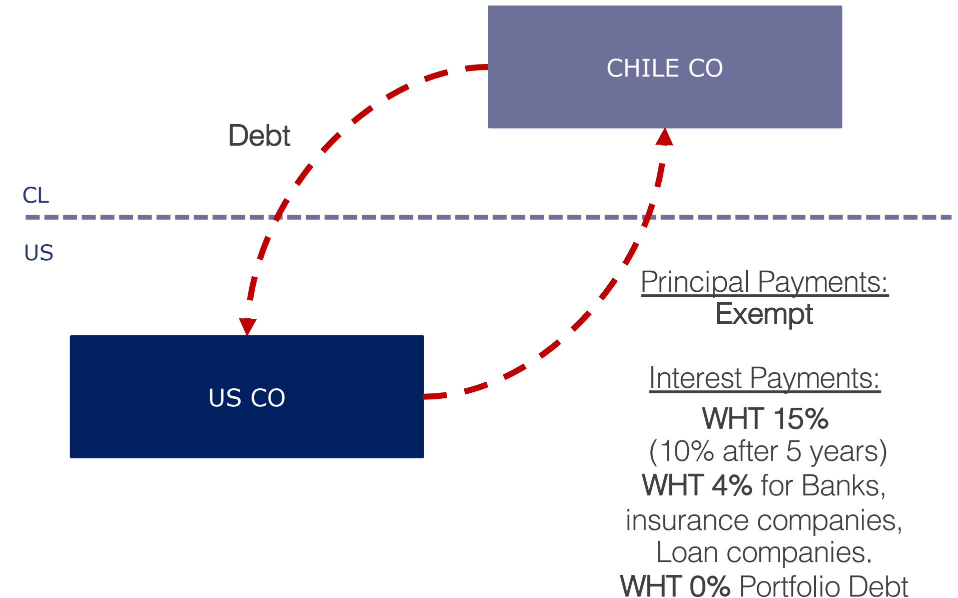
No Tax Treaty

The interest paid by a debtor who is a US resident to a creditor residing in Chile is generally subject to a withholding tax rate of 30%. However, if the loan meets the Portfolio Debt regulations, it goes to 0%



Tax Treaty

The maximum tax rate applicable to interest paid to residents of the other country is restricted. For the initial 5 years, this maximum rate will be 15%, after which it will decrease to 10%. 4% for certain companies. 0% Portfolio Debt.

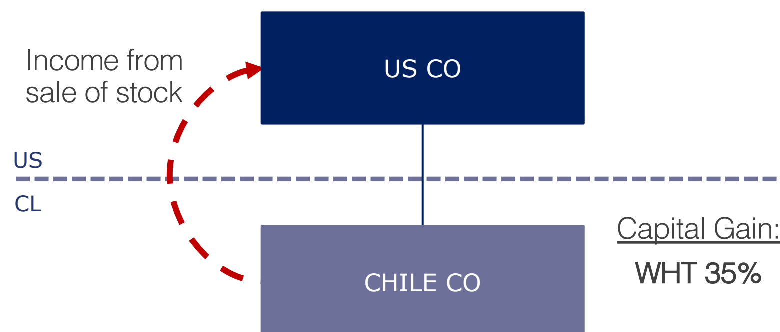


U.S – Chile New Tax Treaty

Capital Gains

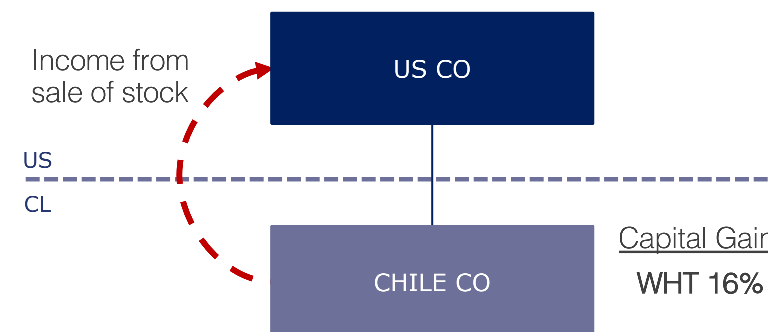
No Tax Treaty

- **Non-resident sellers:** Subject to a 35% WHT upon capital gains.
- **Indirect disposal of Chilean assets:** Subject to a 35% WHT on capital gains derived from the disposal of shares, equity rights or securities on a foreign entity, provided some thresholds are met.



Tax Treaty

- **Sale of real estate:** No limitation to WHT taxation. In the case of Chile, this includes stock deriving its value in more than 50% from Chilean real estate.
- **Sale of company shares:** WHT reduced to 16% (max ownership threshold of 50% in the case of shares and less than 20% in other rights).
- **Indirect disposal of Chilean assets:** Tax Treaty does not expressly limit the application of long arm capital gains rule, though we are of the opinion that it does.



- Tax exemption in the case of pension funds, and substantially and regularly traded stock when the seller is a mutual fund or other institutional investor or a US qualified resident, provided certain requirements are met.

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U.S – Chile New Tax Treaty

Insurance Premiums

No Tax Treaty

The rates applicable to insurance policies for each country are as follows

1. In Chile, taxes on insurance premiums paid to foreign insurance companies are imposed at the following rates: a) 22% for all types of policies on individuals residing in Chile or property situated in the country; and b) 2% for reinsurance.

Tax Treaty

In the absence of a permanent establishment, the U.S. and Chile may impose its excise tax on insurance premiums paid to foreign insurers of the other jurisdiction, but the tax so charged shall not exceed:

1. 2% of the gross amount of the premiums in the case of policies or reinsurance; and
2. 5% of the gross amount of the premiums in the case of all other policies of insurance.

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U.S – Chile New Tax Treaty

Limitation on Benefits (LOB)

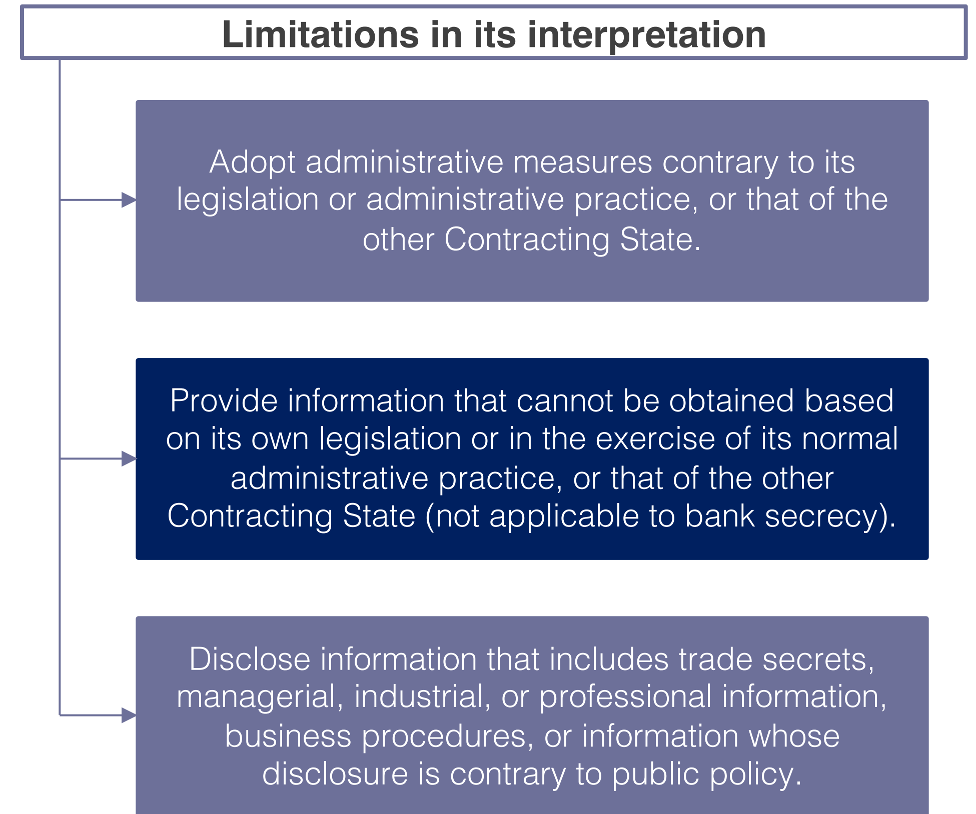
- LOB article: The treaty incorporates anti-treaty-shopping provisions aimed at preventing residents of third countries from receiving undue benefits. These provisions generally rely on objective tests rather than determining purpose or intention. A resident of a Contracting State meeting one of these tests will qualify for the specified benefits.
- Qualified persons: includes individuals, publicly traded companies, companies 50% owned by a publicly traded company, parent companies (with certain requirements), charitable religious educational entities, pension funds, and companies actively carrying on a trade or business and whose income is derived in connection with such trade or business.

Reservations made by the U.S Senate

- BEAT: The treaty does not prevent the U.S. from applying the Base Erosion Anti-Abuse Tax (BEAT) to a resident company or a permanent establishment in the country. This provision emphasizes that the treaty does not hinder the application of domestic anti-abuse measures such as BEAT by the U.S.
- Language update: Due to legal changes in the U.S. subsequent to the signing of the agreement, the language referring to exemptions is 'updated' without altering the general principles within the treaty. Specifically, Article 23 (Relief from Double Taxation) is modified to accommodate the repeal of the foreign indirect tax credit.

Exchange of information

- The competent authorities of the Contracting States are obligated to exchange information that is pertinent to the application of the treaty or domestic tax laws, encompassing any taxes imposed by a Contracting State, in accordance with the provisions of the treaty.
- This exchange covers aspects related to the assessment, collection, and enforcement of taxes, as well as the prosecution of non-compliance and appeals. Importantly, this extends beyond taxes covered by the treaty.
- The received information must be handled with confidentiality and is only allowed to be disclosed to individuals or authorities involved in tax-related functions.
- A Contracting State cannot refuse to provide information solely on the grounds that it is in the possession of banks, other financial institutions, or any person acting in a representative or fiduciary capacity, or because that information relates to ownership participation.
- No limitation on date, except for Chilean bank accounts which have limitations for information before January 1, 2010.



Chilean Tax Reform Bill

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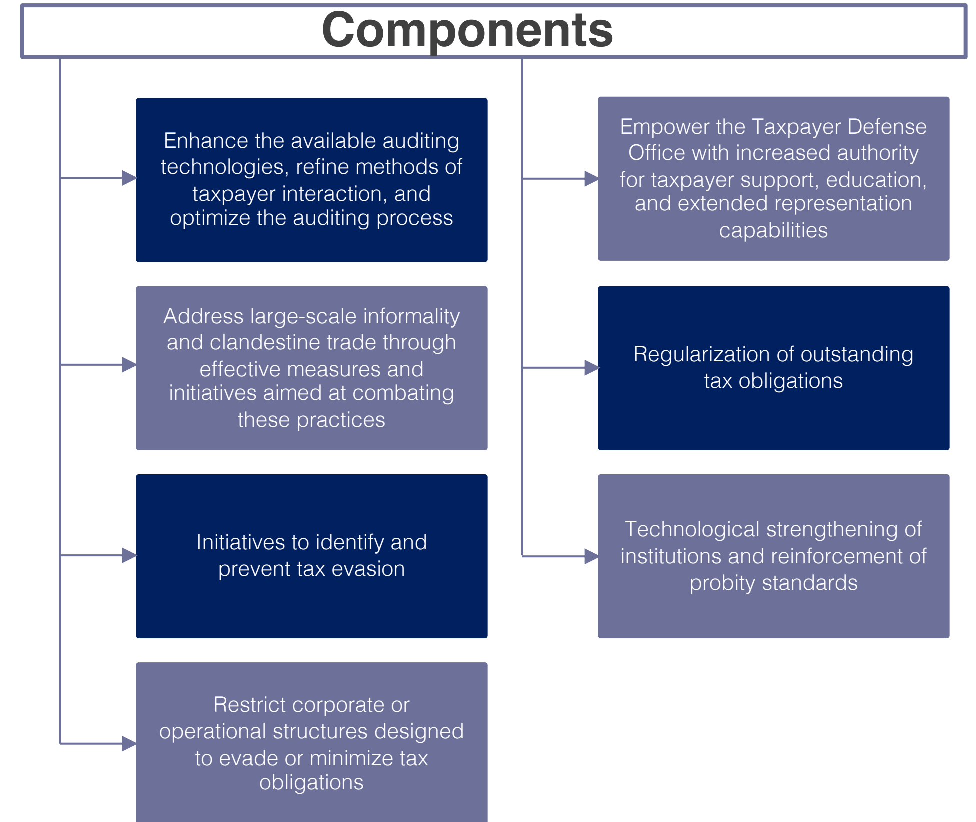
Chile Tax Reform Bill

Tax agreement

- On August 1, 2023, the Government introduced the Tax Agreement for Development proposal. This pact comprises various components and initiatives aimed at fostering economic development, ensuring fiscal responsibility, and enhancing controls for increased tax compliance.
- As part of this agreement, several bills have been presented, including one that aims to establish a Registry of Final Beneficiaries.
- The recently introduced tax reform bill, presented to Congress on January 29th of this year, aims to enhance oversight of tax obligations compliance and implement anti-abuse measures to counter aggressive tax planning.
- One could anticipate that in the upcoming months, the government will introduce new bills to complement the one currently being processed, addressing other matters not included in it.



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Chile Tax Reform Bill

Corporate group

- The definition of corporate group is incorporated, expanding beyond ownership and administrative relationships to include debt relations.
- Each business group is now required to appoint an attorney-in-fact, a designated individual responsible for communication and coordination with the tax authority.
- A new auditing procedure is introduced, enabling the tax authority to conduct unified audits to business groups.

Bank secrecy

- The bill introduces changes to the bank secrecy procedure, transferring the responsibility of initiating the procedure to the taxpayer if they wish to contest the lifting of secrecy.
- Additionally, a new measure is established to compel banks and financial institutions to report instances when an individual receives multiple transfers from various sources within specified timeframes.

International corporate restructuring

- They will be tax-neutral to the extent that they produce effects on assets, shares, or rights located in Chile, and insofar as: there is a legitimate business reason; they have been carried out within the same business group; in the case of contributions, no cash flows are generated for the contributor; and the tax basis of the assets being transferred, allocated, or contributed is maintained. Additionally, the legal requirements of the relevant country must be complied with, and the tax rights of Chile are not compromised or affected.

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Chile Tax Reform Bill

Estate and Gift taxes

- Modifications are introduced with the aim of updating the asset valuation rules for estate and gift tax purposes, providing guidelines for different specific cases. This is to achieve greater certainty in the applicable rules, particularly in cases involving social rights, shares, or participations in Chilean or foreign companies that do not have stock market presence and portfolio investments.
- It is specified that the gift tax will apply to those donations where the donee has domicile or residence in Chile or in cases where the donated assets are located or registered in Chile or have been acquired with resources from the country.
- Revocable donations (currently exempt from gift tax but subject to estate tax) will be subject to gift tax.
- "Normal market value" is defined.

Luxury tax

- The bill introduces modifications with the goal of enhancing certainty and simplifying the application of the tax. Additionally, it expands the entities obligated to furnish information to the tax authority.
- The legislation also addresses the exemption on sailboats, specifically for instances where they have been utilized by high-performance athletes.
- In cases of a taxed asset under co-ownership, the bill establishes that the co-owners will share joint responsibility for the tax. This allows the billing for the entire amount to be issued to any of the co-owners.

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Chile Tax Reform Bill

CFC Rules

- The concept of relationship rules is expanded, impacting several existing provisions, including those related to controlled foreign companies (CFCs) and modifying the control rules. Under this provision, spouses, civil partners, ascendants, descendants, and relatives up to the second degree of consanguinity or affinity will now be considered as related parties.
- For the computation of the 2,400 UF (roughly USD 100,000) profit limit, the passive income of all related parties will be considered. If a related party exceeds the limit, it contaminates all the rest.

Transfer pricing

- In alignment with OECD international standards, the arm's length principle is explicitly incorporated into Article 41 E of the Income Tax Law. This involves conducting transactions at standard market prices, values, or returns.
- The relationship rule for individuals is eliminated.
- There is a proposal to modify how the tax authority determines transfer pricing adjustments, introduce anticipated agreements, and incorporate a new concept of self-adjustment for transfer prices made by the taxpayer.

Tax Haven

- The term 'tax haven' is replaced by 'territory or jurisdiction with a preferential tax regime.' This refers to locations with which Chile lacks an agreement for effective information exchange and that do not meet the conditions for compliance, as per the standards set by the Global Forum on Transparency and Exchange of Information for Tax Purposes or another international organization of which Chile is a member.

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Chile Tax Reform Bill

GAAR modifications

- Modification of the general anti-avoidance rule on two levels. On one hand, substantive modifications are proposed to establish a clear framework for the application range of this rule, regulating when and how it applies, in addition to specifying the form of interaction with the special anti-avoidance rules.
- On the other hand, the application of the general rule to operations consisting of a set of acts in which, despite one or more of them being subject to a special rule, the application of the general rule is allowed.
- The qualification of abuse or simulation is moved from the Tax Courts to the Chilean IRS, which must request the prior intervention of an Advisory Consultative Council composed of 7 members, external to the administration, which must rule on the economic and legal reasonableness of the operations submitted to its analysis. Their opinion is non-mandatory.
- The taxpayer keeps the right to contest the decision of the tax administration before the Tax and Customs Courts.

Whistle blower

- A whistle blower regulation is introduced, with a reward of a percentage of the penalties imposed to the denounced taxpayer.
- Penalties are imposed to fake information.

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Chile Tax Reform Bill

Transitional measures for tax compliance

A procedure is established to acknowledge undeclared capital held abroad and not declared in Chile through the payment of a substitute tax at a **rate of 12%.** This tax will fulfill all outstanding tax obligations.

1. Eligible taxpayers are those domiciled, resident, or incorporated in Chile before January 1, 2023, with respect to their assets and income located abroad;
2. These assets must have been acquired before January 1, 2023, and the income derived from them must extend until December 31, 2023;
3. There is no obligation to repatriate the declared assets or income, but individuals who opt to repatriate must utilize banking institutions as directed by the Central Bank (when applicable); and
4. All kinds of assets (stocks, social rights, rights over a trust or fiduciary, financial instruments, real estate, etc.), currencies, and income derived from the declared assets may be subject to declaration.

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Chile Tax Reform Bill

Topics not included in the Chile Tax Reform Bill

1. Restructuring of the integrated corporate tax system;
2. Reduction of the corporate tax rate from 27% to 25%;
3. Wealth tax;
4. Deferred tax on final taxes and increased rates and brackets for individual income tax;
5. Increased rate on capital gains from stock market instruments; and
6. No modifications to the regulation of insurance.

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