



Chilean Tax Reform main changes

February 2020

Please find below a summary of the main changes included in the tax reform approved by the Chilean Congress on January 29, 2020. The government expects to promulgate the Reform in March 2020.

Tax Reform bill approved by the Congress

As a general rule the Tax Reform provisions will apply as from the first day of the month following the publication of the law in the Official Gazette; however, the law contains several transitional articles under which some provisions apply retroactively or after the date above mentioned.

A. Single Partially Integrated Tax Regime

The tax reform considers a single partially integrated tax regime, applicable to companies whose annual sales exceed 75,000 UF (USD 2.8 million approximately). Under this single regime, the corporate income tax rate ("FCIT") is 27%, which is partially creditable against final taxation of partners/shareholders; unless they reside in a tax treaty country, in which case the FCIT is fully creditable.

Upon distribution of profits to non-resident partners/shareholders, a 35% Additional Withholding Income Tax (WHT) applies, and only 65% of the corporate tax is creditable, with the remaining 35% being paid back to the Chilean Treasury as WHT. Thus, the combined tax rate on profits earned in Chile amounts to 44.45%. However, if the partner/shareholder resides in a country with which Chile has a Tax Treaty in force, the full 27% FCIT is creditable, resulting in combined tax rate of 35%.

In addition, the tax reform considers a transitional provision, according to which partners/shareholders of companies subject to the partially integrated tax regime are entitled to the full FCIT credit until December 31st of year 2026 when a Tax Treaty has been signed prior to January 1st, 2020, but such treaty is not yet in force. As a result, the total tax burden applied to profits is 35%.

Entry into force: January 1st, 2020.

B. Simplification and release of records

Carrying of the tax control ledgers that show taxable and non-taxable profits (RAI, DDAN and REX) would not be mandatory provided the company does not have exempt income. Only an annual tax credit control ledger would be required.

Entry into force: January 1st, 2020.

C. Integrated tax regime for Small and Medium-Sized Enterprises (SMEs)

The tax reform introduces a fully integrated tax regime, with a 25% corporate tax rate for small and medium-sized companies whose annual sales do not exceed 75,000 UF (USD 2.8 million approximately).

Upon distribution of profits, the full corporate tax paid will be available as a credit against taxes applicable to the final partners/shareholders.

This regime introduces an option for determining effective income through full or simplified accounting records. In addition, it considers an instantaneous and automatic depreciation for capital goods acquired for the execution of its commercial activities, among others measures.

Entry into force: January 1st, 2020.

D. VAT tax on digital services (19%)

The 19% VAT will apply on the fees of the following digital services provided by non-residents:

- Intermediation of services to be provided in Chile,
- Intermediation of sales undertaken in Chile or abroad provided in this last case that they give rise to an import;
- Provision or delivery of digital entertainment content, such as videos, music, games or other through download, streaming or other technology, including texts, magazines, newspapers and books;
- Provision of software, storage, platforms or IT infrastructure;
- Advertising, regardless of the medium through which it is delivered.

Foreign service providers will be responsible for declaring and paying the VAT, unless the beneficiary of the service is a taxpayer subject to VAT, in which case this latter will have to withhold the VAT. The reform provides a simplified web based mechanism for non-residents to declare and pay the VAT on services provided to Chilean resident individuals that are not VAT taxpayers. Digital services provided to these individuals will be WHT exempted.

However, the Chilean IRS may instruct that payment card issuers, such as debit, credit or other payment systems, withhold all or part of the VAT applicable to non-resident digital service providers that do not abide to the simplified compliance mechanism.

Services subject to VAT rendered by non-residents to VAT taxpayers in Chile, including the abovementioned digital services, are exempt from VAT provided they are subject to WHT, i.e. not exempt under domestic law or under a treaty.

Entry into force: 3 months from the entry into force of the law.

E. International Taxation

i. Domestic concept of permanent establishment (PE)

The tax reform introduces a legal definition of the concept of permanent establishment in line with the OECD and the Chilean IRS guidelines. The new legal definition considers:

- A place used for the permanent or habitual operation of all or part of the business or activity of a person or entity without domicile or residence in Chile, whether or not used exclusively for this purpose, such as offices, facilities, construction projects and branches.
- The carrying out of activities in the country through an agent that habitually concludes contracts of the foreign company, plays a leading role that leads to the conclusion of such contracts, or negotiates its essential elements.
- Economically and legally independent agents who carry out activities in their ordinary course of business and agents with powers to execute acts or contracts with specific purposes, for a fixed term or for a specific project, are excluded.
- If the person or entity without domicile or residence in Chile performs exclusively organization and start-up activities in the country, no PE will be triggered.

Entry into force: January 1st, 2020.

ii. Foreign Tax Credit

The rules on foreign tax credit are consolidated into a single article and the applicable ceilings are harmonized. The accreditation of taxes paid abroad is simplified. The tax credit benefit is extended to investments of companies resident in Chile that invest in foreign companies that have investments in Chile. For this purpose, the withholding tax applied in Chile will give rise to credit when the income to be recognized in Chile corresponds in its origin to Chilean source income obtained by taxpayers or entities without domicile or residence in the country.

The credit will be the lower of: (a) the tax actually paid abroad and (b) 35% on the gross income taxed abroad, irrespective of whether the income proceeds from treaty countries or from countries with which no tax treaty is in place. In addition, foreign tax credit would be subject to a global ceiling of 35% of the amount resulting from adding the available credits to the Net Foreign Source Income of each year. As previously, absent a tax treaty, not all types of income give rise to foreign tax credit.

Entry into force: January 1st, 2020.

iii. Withholding tax on profit distributions (WHT)

The WHT applicable on withdrawals, remittances or distributions abroad must be determined considering an interim FCIT credit, based on the corporate tax rate in force in the year of the remittance or distribution. Therefore, the withdrawal, remittance or distribution shall define its taxation at the year-end.

Any withholding tax difference determined at year-end must: a) be paid in the annual tax return to be declared by the Chilean company in April of the following year or b) be requested as a refund by the foreign partner/shareholder through an administrative procedure or through the annual tax return to be filed in April of the following year.

Entry into force: January 1st, 2020.

iv. VAT on Services Rendered from Abroad

- Vatable services rendered abroad and utilized in Chile are subject to a 19% VAT, unless they are effectively subject to the withholding tax of article 59 of the Chilean Income Tax Law ("CITL").

Entry into force: January 1st, 2020.

v. Recognition of royalties as active income in the context of R&D projects

- Royalties will not be considered passive income under Chilean controlled foreign company rules when such royalties relate to research and development projects that Chilean companies undertake through subsidiaries abroad. The projects must be approved by Corfo (government agency that fosters productivity and industrialization) through a procedure to be set jointly by Corfo and the Chilean IRS.

Entry into force: January 1st, 2020.

vi. Modifications regarding taxation of financing with foreign loans.

- The sub-capitalization rule is modified to eliminate those hypotheses that affect transactions between a creditor and a debtor that are neither directly nor indirectly related (credits with third-party guarantees). Such financing will be understood to be related only to the extent that there are guarantees granted by third parties related to the debtor, provided that such third parties are domiciled or resident abroad and are the final beneficiaries of the loan interest.

- Additionally, the exception for large-scale projects known as "Project Finance" is defined more broadly, expanding the concept so as not to increase financing costs for these projects.

Entry into force: As from the first day of the month following the publication in the Official Gazette.

vii. Restriction of the use of the 4% preferential WHT rate / definition of Foreign Financial Institution (FFI)

- Restriction to benefit from the 4% reduced WHT rate on back-to-back financing or structured agreements that allowed transferring interest from taxpayers that are not eligible to the reduced rate, had they been the creditor of the loans.
- Definition of Foreign Financial Institution (FFI): The required minimum of capital and reserves is increased from USD 8 million to USD 16 million approx. and it is required that their financing operations be carried out periodically (among other characteristics).

Entry into force: Credits granted before the entry in force of this law will remain subject to the rules currently in force, provided that they are not substantially modified (mainly in terms of their amount and interest rate).



F. Tax Expenses

The Tax Reform includes a broader definition of tax expenses. They are defined as those expenses able to generate income in the same or future financial years and relate to the interest, development or maintenance of the business line.

In addition, the Tax Reform introduced and modified certain special expenses. Some of the main changes are the following:

- The cost of food, hygiene products and personal hygiene, books and school supplies, clothes, toys, among other, are tax deductible as long as they are delivered free of charge to non-for-profit institutions.
- Write-off of receivables against unrelated third parties that remain unpaid for more than 365 days from their due date will be deductible.
- Accelerated depreciation equivalent to 1/10 of the useful life of fixed assets is established for taxpayers whose sales do not exceed 100,000 UF per year (approximately USD 4 million).
- Compensations of members of partnerships or "employer's salary" will be tax deductible as long as they are reasonable considering the importance of the company.
- The deduction of expenses incurred in environmental measures is expressly allowed for the execution of projects or activities, in benefit of groups, sectors or interests of the respective locality.
- Legal damages payable to clients or users are tax deductible when imposed by the relevant regulator. Disbursements paid due to a settlement reached between unrelated, whether judicial or extrajudicial, or as a result of a contractual penalty clause
- Losses deriving from derivative agreements that failed to fulfill reporting obligations or the information reported was erroneous or incomplete are not deductible, unless the obligations is fulfilled late or rectified within the deadlines established by the Chilean IRS.

Transitory window for the regularization of derivative agreements entered as of 2014: Taxpayers engaged in derivative agreements contracted during the period 2014 - 2019 may submit, amend, or complete the pertinent affidavits within a 6 months term following the entrance into force of the tax bill, in which case they may deduct the expenses related to the derivatives.

Entry into force: January 1st, 2020.

G. Substitute Tax – Temporary window for profit extractions under reduced rates

A transitory measure incorporated in the reform establishes the possibility to pay a tax in substitution of final taxes to be applied to (part or all) profits accumulated until December 31, 2016 (former FUT ledger), with a fixed and single rate of 30%. The Corporate Income Tax paid on such profits will be creditable against the substitute tax.

In addition, profits that have been subject to substitute tax may be withdrawn or distributed at any time without further taxes and without considering income allocation rules.

Window Period: Option may be exercised until last banking day of 2021 or until April 2022 when submitting annual income tax return.

H. Temporary window for cleaning-up net tax equity differences

- Possibility to rectify Tax Equity differences reported to Chilean IRS.
- 20% substitutive tax on positive differences

Window Period: Taxpayers may rectify said differences in the income tax return for fiscal year 2020 or 2021.

I. New tax on investment projects

The reform introduces a one-time 1% tax for investment projects executed in Chile that exceed USD 10 million.

- The tax rate would amount to 1%, to be applied on the acquisition value of fixed assets comprised in a same investment project, **but only on the part exceeding USD 10 million.**
- 1% tax shall be declared and paid in April of the following year in which the project generates income together with the income tax return.
- Possibility to pay this contribution in **5 annual and successive instalments**, payable together with the annual income tax return.
- Suspension of works & force majeure: possibility of suspending payment of instalments or extinguishing payment obligation, respectively. Payments already made will not be refunded.

Entry into force: New tax will be applied to new investment projects whose environmental impact assessment process begins as of the date of publication of this law in the Official Gazette.

J. Investment Incentives

i. Fixed asset VAT refund

Among the pro-growth measures included in the Tax Reform is the modernization of VAT refund procedures. The above, seeks to generate better conditions for the acquisition of fixed assets by companies and, in this way, support the process of recovery of investment in progress. Thus, article 27 bis of the VAT law is modified, reducing the period during which the taxpayer must maintain an input VAT credit balance before he can request the refund from a minimum of six to a minimum of two months. The response time of the Chilean IRS is reduced from 60 to 20 days, subject to subsequent audit.

Entry into force: 3 months from the entry into force of the law.

ii. VAT exemption

- The reform extends the VAT exemption applicable to the import of fixed assets, allowing Chilean residents and not only investors to request the benefit.
- Indeed, according to the new text, **Chilean residents** (not only investors) may request an exemption from this tax for the capital goods imported and used for the development, exploration or exploitation in Chile of **mining**, manufacturing, forestry, energy, infrastructure, telecommunications and research or technological, medical or scientific development projects, among others, that imply investments for an amount of at least USD 5 million.
- Additionally, the Tax Reform reduces the period in which the project must generate revenue to proceed with this exemption from 12 months to **2 months** from the date of importation into the country of the goods.

Entry into force: 1st day of the month following to the publication of the Tax Reform in the Official Gazette.

iii. Instantaneous Tax Depreciation

Until December 31, 2021 taxpayers will be entitled to instantaneous depreciation equivalent to 50% of the investment made in new or imported fixed assets (including investments in civil works and constructions) as from October 1, 2019. Companies will be able to depreciate instantly 50% of the investment made in new projects that begin during said period, and accelerate the remaining 50% of the investment.

The Araucania Region in the South of Chile will benefit from instantaneous depreciation for the total investment in new or imported fixed assets made in said region until December 31, 2021.

iv. Extreme Zones

Another pro-investment measure incorporated in the tax reform is the extension of the tax incentives applicable to Extreme Zones in the extreme North and South of Chile, extending the benefits to 2035.

Entry into force: 1st day of the month following to the publication of the Tax Reform in the Official Gazette.

K. Closing down of business for tax purposes

Profits pending of taxation will be deemed reinvested if the owners are taxpayers that determine income based on full accounting records.

In all other cases, including if the owners are non-residents, a single 35% closing down tax will apply which can be offset with the accumulated corporate income tax credits.

Entry into force: January 1st, 2020.

L. Green Taxes

- i. Greater precision in the definition of the taxable event.

The initial bill already contemplated the extension of the scope of application by eliminating the reference to boilers and turbines and replacing it by an annual pollution emission threshold. The parliamentary discussion made it possible to introduce definitions of related concepts, such as "establishment", "emission source", and "combustion". In this way, all emissions will be taxed on particulate matter PM, NOx, SO2 and CO2 produced by establishments whose emitting sources, individually or in aggregate, issue 100 tons or more of particulate matter per annum, or 25,000 or more tons of CO2. The parliamentary discussion also changed the definition of the taxpayer, insofar as the tax will affect the owners of the emitting establishments rather than the users.

- ii. Possibility of offsetting taxed emissions by emission reduction projects of the same contaminant.

The approved reform establishes a mechanism by which taxpayers subject to the tax may compensate all or part of their taxed emissions, and thus reduce the amount of tax payable, through the implementation of emission reduction projects of the same pollutant. The reduction must be incremental, measurable, verifiable and permanent. In any case, the reductions must be additional to the obligations imposed by prevention or decontamination plans, emission standards, environmental qualification resolutions or any other legal obligations.

- iii. Means of challenging the tax assessments.

The approved text specifies the mechanisms for notification of the tax assessment, means of challenge available to the taxpayer and the effects that the modifications ordered by the environmental authority will have on the issuance of a new assessment of taxes by the IRS.

M. Gradual elimination of the tax refund of the First Category Income Tax (known as PPUA)

If a holding company is in a tax loss position and receives a dividend from a lower tier Chilean company, the loss will offset the dividend in whole or in part and the holding company will be entitled to a cash refund of the corporate tax paid by the distributing company on the profits out of which the dividend is paid. This refund is known as “PPUA” in Chile. This mechanism will be gradually eliminated as shown below:

Elimination of the tax refund triggered as a consequence of a company in tax loss position receiving dividends from a lower tier-company.

Gradual reduction - Percentage of refund available:

Year 2020: 90%

Year 2021: 80%

Year 2022: 70%

Year 2023: 50%

Year 2024 and over: No refund.

Notwithstanding the above, the reform will not affect the availability of the tax loss to offset profits generated by the taxpayer’s own operations in subsequent fiscal years, nor the ability to use the FCIT credit attached to dividends received from lower tiers to offset final taxes.



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