Chile issues instructions on modifications included in Law 20.630 on international taxation

On 11 March 2014, the Chilean Internal Revenue service (IRS) issued Circular N° 14 (Circular), which contains instructions on the modifications included in Law 20.630 (Law) on international taxation.

Law 20.630 modified several tax provisions, including a permanent increase of the Chilean First Category Tax, a new tax on indirect transfers of Chilean underlying assets, worldwide-source taxation for branches and permanent establishments of foreigners operating in Chile and a withholding tax exemption for payments abroad related to standard software.

Tax on indirect transfer of Chilean underlying assets

The Circular repeats the provisions included in the Law regarding taxable events, value determination of assets and capital gain calculation options to determine the tax.

In relation to the tax exemption for certain indirect transfers established in the last paragraph of new Article 10 of the Chilean Income Tax Law (ITL), the Circular mentions that two requirements should be met for the exemption to apply. First, the transfer of shares abroad must be verified within entities of the same economic group. Second, no gain or greater value should be realized by the transferor in the transaction under one of the options to calculate the capital gain included in Article 58 N°3 of the ITL. This is in line with what was already interpreted by the IRS in Ruling 2.158/2013.

The Circular mentions that the general rule is for the foreign transferor to declare and pay the tax in April of the year following the transaction. If the foreign transferor does not have a Chile Tax ID, it must obtain one. The Circular also confirms that the foreign transferor may choose to consider the income as sporadic and, thus, may declare and pay the tax within the month following the transaction.
In relation to applicable taxation regimes, the Circular references the possibility of treating the indirect transfer as if the Chilean assets were directly transferred, in order to benefit from the applicability of the First Category Tax as a sole income tax, or treat the respective income as exempt or not subject to tax. However, the Circular clarifies that the transfer would have to meet the requirements of the special tax regime for that regime to apply. For example, a requirement that shares must be sold in a Chilean stock exchange market would not be met, even if the indirect transfer is treated as if the assets were directly transferred. Accordingly, it is reasonable to conclude that an exemption, such as the one contained in Article 107 of the ITL for publicly traded stock, will not apply to an indirect transfer.

The Circular does not provide instructions on the sworn statement that the Chilean IRS may request from the foreign transferor, its agent in Chile, the Chilean entity treated as the Chilean underlying asset or the acquirer, in relation to the transfer value, the value of the Chilean underlying assets or any other information regarding the transaction.

Finally, the Circular contains provisions on the applicability of tax treaties to the Chilean indirect transfer tax regulated in new Articles 10 and 58N°3 of the ITL. The Chilean indirect transfer tax is a capital gains tax. In the Circular, however, the IRS stated that, for tax treaty purposes, the income generated should be regarded as "capital gain" (Article 13 of the tax treaties) or "other income" (Article 21 of the tax treaties) depending on whether the transferor (or acquirer) chooses to be taxed as if the Chilean assets would have been directly sold, or not.

As the treaties signed by Chile clearly indicate that “other income” only applies to income not specifically regulated in the treaty, it is unclear why the IRS would treat a capital gain as “other income” and not under the specific provision contained in the tax treaties for capital gain. Further clarification is expected on this point in future guidance.

Other regulations
The Circular contains regulations on other matters, which - in general terms - basically repeat the wording of Law 20.630.

Notwithstanding the above, the following aspects should be noted:

**New taxation of branches and other forms of permanent establishments of foreigners operating in Chile**
The Circular mentions that the income of permanent establishments (PE) operating in Chile shall be determined by their activities in Chile and abroad (i.e., taxed on a worldwide-source basis).
The Circular does not include a definition of PE, but defines what income should be taxed and how the tax should be calculated.

**Reimbursement of First Category Tax offset with taxes paid in a foreign jurisdiction**
The Circular confirms that the First Category Tax paid with a foreign tax credit (FTC) is not eligible for a refund request.

The Circular establishes that taxpayers obligated to determine their effective income under complete accounting should record in their Retained Taxable Profits registry (FUT) the part of the First Category Tax that does not give right to an eventual refund, because it was originally offset with an FTC.

**Withholding tax exemption to payments abroad in relation to standard software**
The Circular does not cover the tax treatment of a payment for standard software (that is otherwise exempt from withholding tax) when the beneficiary of the payment is a related party or an entity with residence/domicile in a tax haven jurisdiction. It appears that even if paid to a related party or an entity with residence/domicile in a tax haven jurisdiction, the payment for such software should be exempt from withholding tax.

**Modification to the VAT exemption applicable to certain payments abroad**
The Circular retains the VAT provisions provided in the Law, and confirms that a software license paid to a foreigner should always be exempt from VAT, because it is considered a service rendered abroad (and not in Chile) (Ruling 2,515/2013).
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