CHILE

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INTERNATIONAL DEVELOPMENTS

1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

On 2014, a tax reform was enacted in Chile whose provisions have entered into force on 1 January 2017. Although the reform included several legislative changes, the most relevant one was the introduction of two distinct tax regimes between which individuals and foreign companies must choose, one in which income is taxed on an accrual basis with a maximum tax rate of 35%, and one in which it is taxed on a cash basis with a maximum tax rate of 44.45%. However, foreign investors shall always be subject to the 35% rate if they reside in a country where there is a tax treaty in force with Chile.

Among other important reforms that have entered into force are: i) hardened rules regarding thin capitalization; ii) carry-back of tax losses is no longer possible; iii) regarding mergers, the goodwill balance generated in excess of the assets' fair value cannot be used as a deferred tax expense as it used to; iv) capital gains on sales of shares are taxed as ordinary income, whereas before the reform they were subject to Corporate Tax as a sole tax under certain circumstances; v) VAT now applies to the sale of real estate in many cases; vi) the endowment of the IRS with several new powers, including a new anti-avoidance rule and powers to access taxpayers' accounting records; vii) the introduction of CFC rules and viii) the replacement of the Statute of Foreign Investment with a new rule that many view as less favourable.

2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

During the past decades, Chile has continually had an open attitude regarding globalization and has concluded several kinds of treaties with many different jurisdictions, regardless of the political parties that have held power. In this sense, as an OECD member Chile has actively undertaken actions to implement BEPS standards. The two most recent tax reforms (2012 and 2014) have introduced rules regarding the issues addressed by BEPS Actions, even before the Actions themselves have been issued.

Specifically, the 2012 tax reform included transfer pricing rules, which enable the Chilean IRS to challenge prices set forth in international transactions between related parties and also to conclude transfer pricing agreements with taxpayers. The transfer pricing rule placed the burden of proof on the taxpayer, as is set forth that it is the taxpayer's duty to demonstrate that transactions with related parties are carried out at fair value.

The 2014 tax reform further implemented BEPS Actions by introducing changes such as the following:

i) hardened thin capitalization rules which set forth a new way of calculating the borrowing company's equity for purposes of determining its debt-to-equity ratio, considering all of its debts, instead of just the debt payable to related parties, as was applicable until then;

ii) Controlled Foreign Corporation rules, which did not exist in Chile, and make it mandatory for taxpayers to recognize as their own taxable income the profits accrued by controlled offshore entities;

iii) IRS powers to require certain taxpayers to maintain digital accounting records, and even to access them at any time

iv) a new anti-tax avoidance rule that hinders taxpayers from using procedures that result in a lower tax burden and which are deemed to have no other significant purpose; and

v) introduction of several rules that deter transactions with entities domiciled in territories considered tax havens, such as the inability to use foreign taxes as credit when intermediate entities domiciled in such territories are used.

Regarding Action 6 (prevention of tax treaty abuse), the tax treaties entered into by Chile have consistently followed the OECD Model Tax Convention. The most recent tax conventions concluded by Chile, such as those concluded with Japan and Italy, have included provisions that prevent treaty abuse, by way of setting forth that a benefit derived from a treaty shall not apply if it is deemed that the main purpose of the creation of a structure or the conclusion of an agreement was to take advantage of such benefit. Also, during 2015 the IRS implemented a new affidavit which is to be completed by all taxpayers included within a list of “sizable taxpayers”, and which addresses BEPS-related issues, such as controlled offshore entities and operations with related parties.

Furthermore, Chile participated in the Ad Hoc group of jurisdictions in charge of developing the multilateral instrument set forth in BEPS Action 15.

Chile is also a signatory of the OECD Multilateral Competent Authority Agreement, and is scheduled to exchange information from September 2018.

Lastly, on 2009 a law was passed which considerably restricted the bank secrecy rule, enabling the IRS to request information from banks regarding tax audits in general; previously, this was possible only during investigations associated with tax felonies.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

Tax advantages:

From a seller’s perspective, the tax cost of the shares can be deducted from their sale price, which can lead to a lower tax burden. In addition, the transfer of shares is easy and calculating their tax cost is simple.

Also, in the case of publicly listed companies, the sale of shares may qualify for a capital gains tax exemption if certain conditions are met.

From a buyer’s perspective, the income generated by the acquired company is subject to corporate tax, but only at the level of the company itself and not at the level of the buyer. Such income can be offset with future tax losses generated by the company (and, in some cases, with past tax losses as well).

Tax disadvantages:

The target company’s tax liabilities are always inherited. On the other hand, tax losses are not always available. The acquisition cost of the shares cannot be depreciated.

B. Asset deal

Tax advantages:

From a buyer’s perspective, the seller’s tax liabilities (as well as other liabilities) are not inherited. Tangible assets acquired can be depreciated.

Tax disadvantages:

From a seller’s perspective, the depreciation of assets is deducted from their tax cost and, therefore, the capital gain obtained in the sale of assets (which is taxed as ordinary income) may be considerable.

From a buyer’s perspective, tax losses are not available. In addition, income generated by certain assets (for example, land or certain financial instruments) will have a direct tax impact on the buyer. Also, in many cases the sale of fixed assets will be subject to Value Added Tax, which is not always recoverable by the buyer.

BUY-SIDE

4. WHAT STRATEGIES ARE IN PLACE, IF ANY, TO STEP UP THE VALUE OF THE TANGIBLE AND INTANGIBLE ASSETS IN CASE OF SHARE DEALS?

As a general rule, in share deals it is not possible to step up the value of the target company's tangible and intangible assets. However, if the target company is absorbed via acquisition of all of its issued shares, a merger can take place. In this case, goodwill rules apply, and if the acquisition cost of the target company's shares is greater than its tax equity, the difference can be allocated to the target company's nonmonetary assets, increasing their tax bases.

If the tax basis of the assets is increased artificially –such as by selling and then reacquiring the assets- the IRS could challenge the operation and pursue it as tax avoidance under the new anti-tax avoidance rule mentioned in number 1 above.

5. WHAT ARE THE PARTICULAR RULES OF AMORTISATION OF GOODWILL IN YOUR COUNTRY?

When a Chilean company is absorbed by another Chilean company, and the acquisition cost of the absorbed company's shares is greater than its tax equity, a goodwill balance is generated which can be used by the buyer of the shares to step up the tax cost of the absorbed company's nonmonetary assets, on a pro rata basis, up to an amount equal to such assets' fair value. If there are no nonmonetary assets, or if after allocating the entire amount of goodwill generated a balance still remains, such balance will be considered an intangible asset that can only be amortised when the company is dissolved or ceases to operate for tax purposes.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

As a general rule, interest payments on borrowings can always be deducted from income from tax purposes, unless the amount lent is used directly or indirectly to generate income which is tax exempt. If that is not the case, the law expressly states that interest payment on amounts borrowed in order to acquire a company's shares or other kinds of participation in a company will always be deductible from income. However, under Chilean transfer pricing rules, the IRS may challenge the interest rate agreed upon if it is deemed not to meet arm's length conditions.

Such limitations only exist when the borrower is a company domiciled or resident in Chile and the lender is a related party based abroad. In such a case, interest can still be deducted from income; however, if the indebtedness of the Chilean debtor is greater than three times its equity, a 35% penalty tax is levied on interest payments made to related parties, which is to be paid by the Chilean debtor. In determining tax equity for these purposes, capital contributions which have been directly or indirectly financed by related parties are not considered. It must also be noted that the 35% penalty tax only applies if the interest payments benefit from a reduced tax rate (lower than 35%), which may happen if i) the lender is a foreign financial entity, or ii) the lender is a resident of a tax treaty country (where it will usually benefit from a Withholding Tax rate of 10% or 15%).

The current rules were set forth by the most recent tax reform (2014), which changed the way of determining the borrower's tax equity.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE DEBT ON ACQUISITIONS?

A procedure commonly used to push down debt is to incorporate a Chilean entity into which both capital and debt are contributed. Such company may then acquire the target company, make a capital contribution in it or merge with it. If the acquisition is made under market conditions, there would be no tax issues to consider.

As said above, interest payments will be deductible for the borrowing company, but they will always be subject to thin capitalization rules and transfer pricing rules if they are paid to a related party.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Currently there are no tax incentives of this kind in force in Chile.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

The general rule is that tax losses incurred by the target company are available for the acquiring company. However, they cannot be used in certain situations where it is deemed that the existence of tax losses was the main reason for the acquisition. Tax losses cease to be available when there is a change of control of a 50% or more of the target company's shares, be it directly or indirectly, provided that: i) at the time of the acquisition, the target company lacked assets that were either sufficient to continue carrying out its activities or valued in an amount that justifies the acquisition price, or ii) the target company changes its scope of activities, without continuing its former business, within the 12-month period prior to or following the acquisition.

In the case of a merger or spin-off, tax losses can be used only by the company that originally incurred them. Following a merger where a company absorbs another, the surviving company can still use its own tax losses, but not those of the absorbed company. If none of the companies survived the merger, tax losses cease to be available. The same applies for spin-offs: only the parent company that survives the spin-off can continue to use the tax losses it had incurred prior to the operation.

10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

Income tax returns and accounting records for the last 6 fiscal years should be carefully examined, as that is the maximum statute of limitations applicable to taxes. Failure to file tax returns or late payment result in taxes being subject to a substantial interest rate of 18%; additionally, severe penalties become applicable.

Regarding VAT returns, the maximum statute of limitations is 36 months. The Chilean IRS places considerable attention on VAT, because it is the highest-grossing tax in Chile. The target company's activities and records should be examined taking this into account.

11. IS THERE ANY INDIRECT TAX ON TRANSFER OF SHARES (STAMP DUTY, TRANSFER TAX, ETC.)?

There is a stamp duty in Chile, but it only applies to the issue of certain debt instruments. The transfer of shares, as well as the transfer of other kinds of assets, is not subject to any kind of transfer tax.

12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX DEDUCTIBILITY OF ACQUISITION COSTS?

The costs incurred on the acquisition of a Chilean company are deductible provided that the taxpayer can demonstrate those costs to the tax authority. In general terms, only direct costs may be deductible to determine the gross income of the taxpayer. In this sense, article 30 of the Chilean Income Tax Law provides that the direct cost of goods and services may be deducted. Regarding goods purchased in the country, the value or purchase price will be considered as direct cost, according to the respective invoice, contract or agreement; freight and insurance costs incurred until goods are delivered at the buyer's warehouses may also be included. On the other hand, regarding merchandise imported into the country, the CIF value, the admission rights, the customs clearance costs and, optionally, freight and insurance to the importer's warehouses will be considered as direct cost.

13. CAN VAT (IF APPLICABLE) BE RECOVERED ON ACQUISITION COSTS?

This depends on whether the acquisition was made by a VAT taxpayer. When an acquisition is subject to VAT and the buyer is a company that, in turn, makes sales which are subject to VAT, then the VAT paid by such company is not considered part of the acquisition cost, but rather as a VAT credit, which can be offset against the VAT debit due by the company. On the other hand, if the buyer is a company which is not subject to VAT (as will be the case in most share transfers), then the VAT paid by the acquiring company is considered part of the acquisition cost.

14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION BY FOREIGN COMPANIES?

If a foreign company acquires a Chilean entity, it is important to take into account the following matters:

A) Pursuant to the Chilean foreign exchange regulations, all inbound transfers of funds in relation to investments, deposits, loans, or capital must be made through the formal exchange market and must be informed to the Chilean Central Bank.

B) Under the current legislation, an "integrated" income tax system applies in Chile. Income tax is broken down in two parts:

- **i)** A Corporate Income Tax ("CIT"), currently at a 27% rate at the level of the local company, calculated annually on the net taxable income accrued.
- **ii)** A withholding tax called "Additional Tax" ("WHT") at a rate of 35% at the foreign owner level, payable upon profit distributions. CIT effectively paid for such profits may or may not be fully creditable against the referred WHT, depending on whether the owner resides in a treaty country. For this reason, for treaty country residents the effective income tax rate is 35%, but it can go as high as 44.45% for residents of other countries. This tax must be withheld, declared and paid by the local company within the first 12 days of the month following the distribution.

C) Also, article 10 of the Chilean Tax Income Law provides that the capital gain obtained from the sale of shares of a company incorporated or domiciled abroad by a non-Chilean resident (the "Foreign Seller"), may trigger Chilean income tax on such capital gain (the "Indirect Sales Income Tax"). This provision applies provided that the Foreign Entity owns, either directly or indirectly, the following underlying assets in Chile, as long as certain conditions are met:

- **i)** Shares, equity rights, quotas or any other title that gives right to participation, control or profits on a company, fund or entity incorporated in Chile;
- **ii)** A branch or other kind of permanent establishment in Chile of a non-Chilean domiciled person, for which purposes of which such permanent establishment shall be considered as a separate entity from its parent company; or
- **iii)** Any movable or fixed property located in Chile, as well as any rights in connection therewith, whose owner or title holder is a non-Chilean domiciled or resident company or entity.

15. CAN THE GROUP REORGANIZE AFTER THE ACQUISITION IN A TAX NEUTRAL ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

Yes, but in connection with operations carried out and intended to qualify as a corporate restructuring pursuant to Chilean tax laws, and therefore aimed to modify the corporate structure of a corporate group without generating any tax effects in Chile, it is important to take into consideration that article 64 of the Chilean Tax Code provides as a general rule that the Chilean IRS is entitled to challenge the value agreed upon in any agreement that produces the transfer of assets from one taxpayer to another, provided that such value is noticeably lower than the market price of the assets being transferred.

However, as an exception to the above rule, the Chilean IRS cannot challenge the value agreed upon when assets are contributed by one entity to another within a corporate restructuring process, provided that the following conditions are met: (i) The restructuring process must meet a criterion known as "legitimate business purpose"; broadly speaking, this means that it must be beneficial from an economic point of view and not carried out solely because of its tax benefits; (ii) The company making the contribution of assets to another company must not cease to exist as a result of the restructuring process; (iii) The assets transferred must be contributed as capital to the company receiving them, and this company's capital must be increased as a result; (iv) The company contributing the assets must not receive an actual sum of money as a result of its contribution; and (v) The assets must be transferred and registered by the transferee at the same tax basis or book value at which they were recorded in the transferor's accounting records, and this tax basis or book value must be shown in the Shareholders' resolution or public deed by which the assets were contributed to the company receiving them.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

Under Chilean rules, in general there are no particular issues to take into account in case of acquisition of companies whose main assets are real estate, other than the fact that such companies will many times be subject to VAT, and therefore it must be examined whether the target company has complied with applicable rules regarding VAT.

In addition, pursuant to several tax treaties entered into by Chile, the sale of a company whose assets are real estate may not qualify for reduced WHT rates, as would be the case with other kinds of companies.

17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

The unity/tax grouping is not allowed in Chile yet.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

In order to answer this question, it is important to distinguish between taxpayers with no accounting records and taxpayers that determine their income using full accounting records.

A. Taxpayers with no accounting.

The former sole First Category Income Tax ("FCIT") applicable to the sale of shares or capital rights was eliminated starting 2017, so the tax regimes that would affect the capital gain on the sale of shares or capital rights sales are the following:

- **a)** Sales before one year from acquisition: FCIT and Global Complementary Tax ("GCT"), in the case of Chilean resident individuals; or Additional Withholding Tax ("AWT"), in the case of taxpayers resident abroad, on a cash or accrual basis, as chosen by the taxpayer.
- **b)** Sales after one year from acquisition: GCT/AWT on a cash or accrual basis, as chosen by the taxpayer.
- **c)** Losses derived from other transactions of the same kind in the same year may be deducted.
- **d)** Only accumulated attributable profits obtained by the entity being transferred are considered as part of the cost, not those attributed by third parties.

e) If profits do not exceed 10 "UTA" (Yearly Tax Units), the totality of the capital gain value is considered as a
non-profit income and is therefore exempt from taxation.

B). Taxpayers that determine their income in accordance with full accounting records.

a) Sole FCIT does no longer apply, so capital gains will always be considered as income, on a cash or accrual basis.

b). Interests accrued from credits used to acquire shares or capital rights are tax deductible.

c) Only accumulated attributable profits obtained by the entity being transferred are considered as part of the cost, not those attributed by third parties.

Capital gain taxation under Double Taxation Treats (DTTs)

Notwithstanding the rules explained above, if the seller is resident in a DTT country, reduced rates could apply.

Several DTTs in force set forth reduced WHT rates for capital gains obtained in the sale of shares and other rights representing the capital of a Chilean resident company to the extent that:

i) The seller has, at any time during the 12 month period preceding such alienation, owned shares or other rights representing, directly or indirectly, less than 20% of the capital of that company; and

ii) The value of the shares does not derive in more than 50%, directly or indirectly, from immovable property situated in Chile.

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES ARE REINVESTED?

There are no fiscal advantages if the profits from the sale of shares are reinvested.

20. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING COMPANIES?

There are no special requirements for holding companies in Chile. However, companies that are under the holding entity can only choose the cash-basis tax regime, which provides for corporate tax being applied at a higher rate than the rate applicable to companies held directly by individuals (27% starting from 2018, as opposed to 25%). Local resident shareholders and/or partners subject to Global Complementary Tax and non residents subject to Additional Withholding Tax (hereinafter "final taxpayers") will be subject to taxes on a cash basis, when profits are distributed or withdrawn from the entity. Final taxpayers will only be able to use 65% of the corporate tax paid by the source entity. As a consequence of the above, the overall tax burden may reach 44.45%. Therefore, as of today, under this system shareholders will still be able to defer taxation on Global Complementary Tax or Additional Withholding Tax applied on profits generated by the source companies until these are distributed, but with the right to use a lower tax credit for the corporate tax paid.

Notwithstanding the aforesaid, final taxpayers who are residents of treaty countries will always be subject to an effective tax burden on 35%.

21. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

Generally speaking, mergers and spin-offs are neutral from a tax point of view in Chile. It is, however, important to note that, if the target company is merged into another, some of the target company's assets cannot be transferred to the surviving company. For example, the net operating losses may not be used if the target company is merged into the buyer company; the same applies to the VAT credit balance the target company may have. Therefore, in some cases it may be important to preserve the legal existence of the target company.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

As a general rule, managers' remunerations are deemed as ordinary income and are therefore subject to payroll tax with a top marginal rate of 35%.

It is possible to implement a "sweet equity" plan, for example, by issuing preferred stock (such as shares entitled to preferred dividends) to management members. There is no tax issue in managers acquiring preferred shares at a discount value when a company first issues such shares. However, there would be a tax issue if other investors sold stock to managers at a discount price. In such a case, the IRS would be entitled to challenge the value agreed upon, as such a transaction would probably not be arm's length considering the company's net worth.

It is also possible to set forth a stock option plan in which managers or employees are given the right to acquire stock at a discount value. However, this kind of stock option is taxable as ordinary income and subject to payroll tax with a top marginal rate of 35%.

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