

Chilean Government submits amendments to the Tax Reform Bill (Bulletin 15.170-05)

Tax Newsletter – October 6, 2022

After several sessions of the Finance Committee at the House of Representatives and announcements from the Government, on Tuesday, the Government introduced a series of **amendments** to the **tax reform bill** (Bulletin No. 15170-5).

The document contains a set of proposals to modify the original draft bill. Specifically, changes are mainly introduced in the following topics: (i) restructuring of the income tax; (ii) wealth tax, (iii) measures to reduce taxable income, and (iv) anti-avoidance rule.

As you may know, on September 26, the bill had already been approved in general in the Finance Committee by 8 votes in favor and 5 against. On that occasion, it was agreed that there would be a two-week period to submit the amendments of the Tax Reform Bill in order to vote on the project in particular.

Regarding the initiative announced by the Representative Naranjo on the “Financial Transactions Tax”, it generally taxes the trading of financial instruments such as shares, bonds or derivatives, and may have different variable tax rates depending on the type of asset. It would be necessary to review the comparative experience to see what economic effects the adoption of this tax would entail.

This tax initiative is not yet public, and, in order to move forward, it should be sponsored by the Government, which is the only one having initiative in tax matters. In addition, such tax should be compatible with the stamp duty, which is a tax applicable to money/ credit operations, and therefore could affect this type of financial transaction as well.

For the time being, the rest of the matters addressed by the original draft bill would be maintained, and the parliamentary discussions that will take place in the next few days in both the House of Representatives and the Senate will be awaited.

The main amendments proposed by the Government are described below.



I. Income Tax

a. Changes regarding the real estate lease (DFL 2 exemption)

According to the original project, all income generated by real estate rentals would be subject to income tax, revoking the exemption granted to DFL 2. In this regard, Law 21,420, published in February of this year, had already limited this exemption to two properties, including those that had been previously acquired.

Now, the **amendments** submitted **maintain the exemption in the following cases**: (1) Leasing of up to two DFL 2 properties for **people over 65 years old, whose income, without considering rent income, is in the exempt bracket or in the first bracket of taxes** (up to 30 UTA – i.e., USD 23,000 appx) with a rent income cap of 15,5 UTA (i.e., CLP \$11,000,000/ USD 11,800 appx.), and;

(2) For **individuals who have acquired a DFL 2 property during the last 5 years would continue to apply the current rules in force until December 31, 2026.**

Finally, the amendments also add that people who declare rental income will benefit from an alleged expense equivalent to 10% of the income declared for this concept.

It should be noted that, according to the law's history, the DFL 2 is a law-contract, so some judicialization of these amendments is likely.

b. Modifications to the final taxes deferral rate

Regarding this amendment, it is established that the **taxable base of the final taxes deferral rate will be the individuals deferred final taxes** instead of the retained earnings.

Thus, the proposed amendment indicates that the taxable base would be the 22% of the accumulated retained taxable profits. Likewise, the rate is **modified to 2.5% for the first year**, instead of the 1% and 1.8% originally proposed for year 1 and fully in force, respectively.

There is no clarity regarding the base that should be applied for those companies having among their shareholders or partners, individuals domiciled or resident in countries with which Chile maintains a Tax Treaty, whose pending burden would be between 8% - 10%, in case the proposed development rate is approved, or in the case of taxpayers who have local and foreign partners or shareholders. Indeed, the deferred tax is different depending on the tax residence of the foreign partner or shareholder.

c. Leasing's tax treatment

Through the proposed guidelines, **the tax treatment of leasing returns to the situation prior to the enactment of Law No. 21,420**, in February 2022, thus the lessor may continue deducting the fixed asset's depreciation expense and the lessee the expense for the leasing installments.

According to the amendments, these regulations, in practical terms, only implies transferring expenses from one company to another, **so returning to the regulations prior to the publication of Law No. 24,120 would have no effect on tax collection.**

d. Indirect credit for taxes paid abroad and credit for additional tax (withholding tax).

Among the regulation proposals incorporated into the original tax reform bill, a substantial modification was considered regarding the regulation of indirect credit for taxes paid abroad, that is, when the profits are distributed from the company in which direct investment is held come from a third country where taxes have been paid; as well as the elimination of the credit for withholding tax paid on Chilean source income that is remitted to Chile.

The amendments propose to restore the use of these credits incorporating the requirement that, in order to use them, it must be proven that said taxes have been paid with the corresponding certificates issued abroad, and in the case of Chilean source income, proving traceability that they have fulfilled their taxation and that they returned to our country again.

e. Limitation to the use of NOLs up to the 50% of the Net Taxable Income

Other amendment introduced relates to the limitation to the use of NOLs. In particular, it gradually introduces the limitation.

From FY 2025 onwards, it would be gradually limited to an 80%, FY 2026 to a 65%, and from FY 2027 onwards, a 50%.

f. Business reorganization

The criterion where corporate reorganizations will not be subject to Chilean IRS' appraisal powers is maintained provided the assets are transferred or assigned within the national territory is maintained.

Apparently, according to the amendments, foreign companies performing reorganizations affecting Chilean entities, or reorganizations initiated in Chile having effects abroad, should be governed by Chilean Transfer Pricing rules. The above, even if it is not a cross-border transaction, which could in principle derive in a conceptual confusion and imply taxation depending on the type of reorganization.

Furthermore, as an exception, it is stated that if the reorganization complies with the "arm's length" principles, these transfer pricing regulations will not apply to corporate reorganizations.

In our opinion, the wording of the amendment is not clear and its scope could generate different interpretations.

II. Wealth tax

One of the most commented novelties proposed in the reform project was the wealth tax. Specifically, a **Wealth Tax is proposed for individuals that are domiciled or resident in Chile, for their wealth, both in Chile and abroad, exceeding 5 million dollars approximately.**

In relation to this new tax originally presented in the tax reform bill, **the following amendments are introduced:**

In the first place, **the tax on deferral rate would cease to be a credit against the wealth tax.** With this, the Government expects to have a higher collection of 0.1% of GDP compared to the original project. With this change, there is a double economic taxation of the accumulated tax profits, since it is not possible to credit the payment of that tax against the wealth tax.

Furthermore, **a clause is incorporated that establishes a maximum tax burden of 50%** on the return on capital (considering income tax and equity tax together), assuming a 6% ROE.

Finally, the amendments state that foreign individuals who constitute their residence or domicile in Chile due to an employment contract, for a period of three years from their entry into the country, will be subject to this tax only for the part of their assets that had been acquired with Chilean sourced rents or income.

III. Measures reducing taxable income

a. Special VAT credit for new entrepreneurs


The Bill incorporated a special VAT credit for micro enterprises, within the first 12 months from its incorporation.

With the amendment, the terms of the benefit are doubled, as follows:

- A **100%** reduction of the VAT to be paid for the first 6 months,
- **50%** of the VAT to be paid for the following 6 months and;
- **25%** of the VAT to be paid for the last 12 months in which the benefit applies.

b. Semi-instantaneous depreciation during 2023

During 2023, 50% of the amounts invested in fixed assets related to investment projects could be instantly benefitted, and the remaining 50% would be subject to the accelerated depreciation method.



c. Corporate Income Tax (CIT) reduction for Small and Medium Enterprises (SMEs)

SMEs are temporarily subject to a 10% reduced CIT rate (from 2020 to 2022). The amendments propose to extend the CIT reduction for 2023 at a 15% rate, a 20% for 2024, and returning to the full 25% rate from 2025 onwards.

IV. Tax Code – Anti-avoidance rule

The amendments modify the procedure to apply the general anti-avoidance rule (GAAR). In particular, it states that once Chilean IRS' Anti-avoidance unit concludes an audit procedure, it should prepare a report and submit it before the Anti-avoidance Committee (formed by 3 different Chilean IRS' deputy directors) in case it considers there is an avoidance or simulation. The Committee should review the report and determine whether there is avoidance or simulation or not. Against the resolution issued by the Committee, taxpayers should be entitled to file a hierarchical appeal before the National Director and the general tax claim procedure.

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