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Marketing manager (subscriptions)
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Subscriptions@GettingTheDealThrough.com

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Editor-in-chief
Callum Campbell

Publisher
Richard Davey

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87 Lancaster Road
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Fax: +44 20 7229 6910

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Chile

Jaime Carey and Manuel José Alcalde

Carey

Acquisitions (from the buyer's perspective)

1 Tax treatment of different acquisitions

What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?

The main difference from the acquirer's perspective is that there is only a step-up in the tax basis on an asset purchase, while a stock acquisition as a general rule does not allow for a step-up on the basis of the target's assets.

Another important difference is that an asset acquisition would generally be taxable for the seller as ordinary income. In a stock acquisition, the seller may benefit from a sole corporate tax of 20 per cent as capital gains tax (note that the corporate tax was temporarily increased from 17 per cent to 18.5 per cent for 2012, however there is a tax reform bill currently being discussed in the Chilean Congress that is proposing to increase the corporate tax to 20 per cent on a permanent basis, entering into force retroactively from 2012) and even benefit from a capital gains tax exemption in the case of dispositions of regularly traded, publicly listed stock, and provided some specific conditions are met. Tax-free acquisitions through corporate reorganisations are also generally available only for stock acquisitions and not for asset acquisitions.

Finally, VAT, registration duties and transfer taxes may apply on asset transfers but not to a stock acquisition.

2 Step-up in basis

In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?

If a Chilean acquisition company acquires all of the issued shares of the target, which as a consequence is wound up into the acquisition company, the difference between the acquisition price and the tax equity of the target has to be assigned pro rata to the tax basis of the non-cash assets of the target. If the target does not have non-cash assets, this difference may be amortised in a six-year period.

As a general rule, goodwill and other intangibles may not be depreciated for tax purposes. However, tax goodwill, which is defined as the difference between the acquisition price and the tax equity of the target, may be indirectly deducted through depreciation and inventory costing of the increased tax basis of non-cash assets that occurs as explained above.

The purchase of stock in the target may not be depreciated or amortised. The stock acquisition, cost-adjusted for inflation, may be recovered as basis upon disposition or liquidation of the investment.

3 Domicile of acquisition company

Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?

A Chilean acquisition company is generally preferred, except in the specific cases described below.

Having a local acquisition company will allow deferral of the 35 per cent dividend withholding tax, applicable to dividends paid to non-resident shareholders until dividends are effectively paid by the acquisition company to its non-resident shareholders, since inter-company dividends between local entities are not taxed. It should be noted that, under the corporate tax integration system, the effective rate of withholding on net dividend payments to a non-resident is 18.75 per cent, assuming that the underlying profits were subject to a 20 per cent corporate tax. See question 13 for how corporate taxation and the dividend taxation integration system works.

Another reason for having a local acquisition vehicle is that this structure allows for interest relief in the case of borrowings to finance the acquisition. Although group tax filings are not allowed, interest expenses deducted by the acquisition company may be offset against dividends received from the target and a refund for the 20 per cent corporate tax paid by the target on the underlying profits may be requested by the acquisition company. In addition to the interest deduction benefit, in the case of interest payments to a non-Chilean bank or financial institution, the interest withholding tax is reduced from 35 per cent to 4 per cent. This could generate an efficient repatriation mechanism, as cash distributed as dividends would be subject to a 35 per cent dividend withholding tax.

A local acquisition company would also be preferable for an asset acquisition, since it may be able to use the VAT normally applicable in this case as an input credit against the VAT charged on its sales or provision of services.

If the stock of the target has appreciated in value and the seller is a non-resident that holds the target through an offshore intermediate holding, it may prefer to sell the intermediate holding to an acquisition company located outside Chile. In such cases, the gain derived from the sale would not be subject to income taxes in Chile. If the purchase company is located in Chile, the gain from the sale of an offshore intermediate holding would be subject to Chilean taxation.

4 Company mergers and share exchanges

Are company mergers or share exchanges common forms of acquisition?

Mergers or share exchanges are common where parties are seeking to conduct the transaction without incurring income taxes for the target or the sellers, given that the tax code normally allows reorganisations such as mergers, spin-offs and other forms of corporate reorganisations at cost basis without having to book any gain for income tax purposes that would otherwise result if the transaction were conducted as a taxable transfer.

5 Tax benefits in issuing stock

Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

Generally there is no tax benefit to the acquirer in issuing stock as consideration rather than cash. In addition, using appreciated stock of a Chilean company as consideration might result in taxation for the acquirer.

6 Transaction taxes

Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

There are no documentary taxes or other transaction taxes payable on the acquisition of stock.

In an acquisition of business assets, VAT would normally be applied at 19 per cent on the transfer of inventory, personal property, real estate developed by a construction company and fixed assets, if sold before fully depreciated or within four years of their acquisition. The seller would be liable for charging VAT on the transfer. The purchaser, if it is a local acquisition company registered as a VAT taxpayer, would be entitled to offset such VAT as an input credit against its VAT output debits on its own sales or services.

7 Net operating losses, other tax attributes and insolvency proceedings

Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

As a general rule, net operating losses, tax credits and other tax attributes, such as accelerated depreciation of the target, may not be used by the acquirer if the target is liquidated or merged into the acquirer. Consequently, in a post-acquisition reorganisation, it is important to preserve the legal existence of the target. Losses and other tax attributes are not affected, however, if the name of the target or other corporate attributes are changed as a consequence or after the acquisition, that do not affect its existence as a legal entity.

In addition, the net operating losses of the target may not be deducted from earnings obtained after a change in control occurring during a calendar year if, in addition, any of the following conditions is met:

- as a consequence of the change in control or in the 12-month period immediately preceding it, the company changed or expanded its main line of business, unless it keeps its original line of business;
- upon the ownership change, the company does not own capital assets or other assets related to its trade or business that allow the continuation of the same trade or business or the value of which is not related to the acquisition value of the company; or
- following the ownership change, the company solely obtains passive income from investments in other companies or as a recipient of profit reinvestments.

For these purposes a change in control is deemed to occur in the calendar year when the new shareholders or owners acquire or end up acquiring directly or indirectly at least 50 per cent of the capital or participation in the company.

An exception to this limitation on the use of losses exists when the change of ownership occurs between companies belonging to the same corporate group.

Acquisitions or reorganisations of bankrupt or insolvent companies are subject to general rules.

8 Interest relief

Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

As explained in question 3, interest relief is only available if a Chilean acquisition company is used. In addition, interest expenses may not be deducted if the target company is organised as a corporation and not merged into the acquirer, since potential income from the target (ie, dividends and capital gains) may not be subject to ordinary income taxation. Additional acquisition structuring, such as interposing an intermediate Chilean limited liability company between the local acquisition company and the target, could be used to ensure interest relief at the level of the acquisition company.

Deductibility restrictions do not depend on whether the lender is foreign, a related party or both, although under transfer-pricing rules the Chilean Revenue Service has the authority to challenge excessive interest charges made to a local borrower by a foreign related party.

Generally interest payments to a foreign lender are subject to a 35 per cent withholding tax. This tax may be reduced where the lender is resident in a tax-treaty country. Most tax treaties signed by Chile provide for a maximum interest withholding tax of 15 per cent.

In addition, interest payments made to a foreign bank or financial institution may be subject only to a 4 per cent interest withholding tax. If the funds are already available within the acquirer's group or borrowings are made outside of Chile, it is common to use back-to-back transactions, where the local acquisition company borrows from a foreign bank, using as security cash deposited by a member of the acquirer's group in the same bank. A non-Chilean resident financial entity registered with the Chilean IRS under a procedure established in 2008 can also be used instead of a back-to-back transaction with a bank. Interest paid on the back-to-back loan to the foreign bank or to a foreign registered financial entity would qualify for the reduced 4 per cent interest withholding tax. However, the back-to-back loan as well as a loan from a related party financial entity would be subject to thin capitalisation rules, under which, if the borrower's debt with related parties benefiting from the 4 per cent withholding tax exceeds three times its equity, interest payments deemed to be in excess of such ratio would be subject to a 31 per cent surtax. It is important to note, however, that related party borrowings are only subject to these thin capitalisation rules if interest payments on those loans may benefit from the reduced 4 per cent withholding tax.

It may be possible to achieve debt pushdown without much structuring if the acquisition has taken place as a taxable transaction. It could be more complicated to achieve debt pushdown in cases where the acquisition is not taxable in Chile, when both the seller and acquirer are foreign companies. Debt pushdown would be subject to the same thin capitalisation rules mentioned above, also only on its related party debt.

9 Protections for acquisitions

What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?

In stock acquisitions, the acquirer would be legally liable for taxes owed by the target. In an asset acquisition, the acquirer would be held as guarantor for the tax liabilities of the seller if the seller has ceased to carry on its business activities as a consequence of the sale. Warranties, indemnities, price adjustment clauses, escrow accounts and other means may be used by the acquirer as protection against tax liabilities, assessments and contingencies. These forms of protection are only binding between the parties and cannot be held

Update and trends

Currently a tax reform bill is being discussed in the Chilean Congress. The bill is proposing the following amendments to the Chilean tax system that affect the inbound investments: (i) the corporate tax rate is increased to 20 per cent on a permanent basis, entering into force retroactively from the year 2012 (note that for reconstruction purposes after the 2010 earthquake the corporate tax rate was already temporarily increased from 17 per cent to 18.5 per cent for year 2012); (ii) the Chilean taxation rules on the indirect transfer of Chilean assets are expanded; (iii) establishes new rules for the use of tax goodwill and badwill, where the goodwill is first distributed among the non-monetary assets, increasing the value of said assets up to the fair market value, and the remaining difference is deemed as a deferred expense that is amortised in a 10-year period; (iv) equates the capital gain tax treatment of the limited liability companies with the one currently applicable to corporations; (v) establishes a new set of transfer pricing rules in accordance with guidelines determined by the OECD; (vi) equates the treatment of rejected expenses for all kinds of entities establishing new rules; (vii) establishes that permanent establishments are taxed on their worldwide income source considering the attribution criterion suggested by the OECD; (viii) establishes a withholding tax exemption for standard software and digital books; (ix) limits the refunds of interim payments for absorbed income (PPUA in its Chilean acronym) only in cases of taxes paid in Chile; (x) the stamp tax rates are reduced to 0.4 per cent in case of long-term operations (12 months or more to maturity), to 0.4 per cent divided for 12 for each month or fraction of a month to maturity in case of shorter term operations, and to 1 per cent divided by six in case of documents payable on demand or without maturity. The government aims to have the tax reform bill enacted no later than September 2012. We note that in the first days of September the government and the opposition reached a political agreement to approve the tax reform bill, so the bill could be enacted within the term stipulated by the government.

On 22 October 2011, Law No. 20,544 (the Derivative Law) was published in the Chilean official gazette, which regulates the tax treatment applicable to derivative agreements entered in Chile after 31 December 2011. As a general rule, the Derivative Law states that payments obtained by a non-Chilean resident from a derivative transaction are not subject to Chilean income taxes.

The tax treaty subscribed by Chile and Russia should enter into force on 1 January 2013 since the treaty was ratified by the Congress, and published in the Chilean official gazette on 2 August 2012. Also, on 29 June 2012 Argentina decided to terminate the tax treaty with Chile by giving notice of its termination through the diplomatic channels. According to its provisions this tax treaty should remain in force until 31 December 2012.

against the Treasury. Although according to the Chilean tax law payments received as consequential damages are not taxable income, in the event these damages cannot be determined with exact certainty it is likely that the tax authority will treat them as taxable profits. Payments for the loss of profits are also taxable in Chile.

Post-acquisition planning

10 Restructuring

What post-acquisition restructuring, if any, is typically carried out and why?

If the acquisition price paid for the target was greater than the target's tax equity, the target may be amalgamated into the Chilean acquisition company by having the latter acquire any remaining shares in the target to obtain a step-up in the basis of the target's assets as explained in question 2.

Additionally, a Chilean acquisition company that borrowed funds to finance the purchase may be merged with the target. This would allow applying interest deductions against operating income rather than offsetting them against dividends received from the target. This would avoid having to request the refund of the corporate tax paid on the underlying profits distributed by the target.

11 Spin-offs

Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?

Spin-offs may be executed in a tax-free manner. The assets and liabilities transferred to a new company, belonging to the same shareholders and in the same proportion, would preserve their tax attributes such as basis and holding periods. The net operating losses of the spun-off business as well as other tax attributes would be preserved, although they may not be transferred to the new company formed as a consequence of the spin-off. No transfer taxes are applicable to spin-offs in Chile.

12 Migration of residence

Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?

Chilean corporate law does not contemplate the possibility of migrating a foreign company into Chile or a Chilean company to a foreign jurisdiction. Accordingly, to migrate a Chilean company to a foreign jurisdiction it may be necessary to liquidate the company and reincorporate it in the other jurisdiction. The company's liquidation may trigger a 35 per cent tax on its retained taxable earnings.

13 Interest and dividend payments

Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?

Interest payments made to a foreign lender are generally subject to a 35 per cent withholding tax. An interest withholding tax rate of 4 per cent may be available for interest payments made on loans obtained from a foreign bank or registered financial entity. Reduced rates (usually 15 per cent) may also be available for interest payments made to a beneficiary resident in a tax treaty country. Local interest payments are not subject to withholding tax.

Dividend payments are also subject to a 35 per cent withholding tax. As a consequence of the corporate tax integration mechanism, the effective rate of withholding on net dividends would be 18.75 per cent, assuming that the underlying earnings were subject to a 20 per cent income tax. Chile has negotiated with all its tax treaty partners that this dividend taxation would not be limited by the dividends article of the treaties as long as the corporate tax can be used as a credit against the dividend withholding tax. Dividends paid between local resident companies are not subject to taxation.

This corporate tax integration mechanism works as follows:

Chilean entity earnings before taxes	100 pesos
Corporate income tax at 20 per cent	-20 pesos
Dividend distribution to foreign shareholder	80 pesos
Grossed-up dividend	100 pesos
Dividend withholding tax at 35 per cent	-35 pesos
Corporate tax credit	20 pesos
Dividend withholding tax payable	-15 pesos
Available to foreign shareholder	65 pesos

14 Tax-efficient extraction of profits

What other tax-efficient means are adopted for extracting profits from your jurisdiction?

Reasonable fees paid for management services provided by a foreign affiliate outside of Chile may be subject to a 20 per cent withholding tax. If provided by a foreign entity in a treaty country these payments could be made without any Chilean tax. Certain royalty payments to a foreign affiliate may also benefit from a reduced 30 per cent withholding tax, which could be reduced to 15 per cent if royalties are paid to a beneficiary resident in a tax treaty country.

Disposals (from the seller's perspective)

15 Disposals

How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

The sale of stock in a foreign holding company may be preferred by the seller if the buyer is also a foreign company or entity. No Chilean taxes would be applicable on the potential gain derived from this sale.

If the acquirer is a local company, the seller may prefer to sell the stock in the local company and benefit from the reduced capital gains tax at a 20 per cent rate. However, the seller may prefer to sell the business assets if it has enough net operating losses to shelter any gain derived from the asset sale.

16 Disposals of stock

Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?

The disposal of stock in the local company is as a general rule taxable in Chile, regardless of the residence of the seller. If the seller is a non-resident, a resident buyer may be required to withhold applicable taxes upon remittance of the purchase price. An exemption may be available for the disposal of stock in publicly listed companies that are regularly traded, provided certain specific requirements are met.

There are no special rules in Chile dealing with the disposal of stock in a real estate, energy or natural resource company.

17 Avoiding and deferring tax

If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?

If the local target is organised as a limited liability company, the seller may defer taxation on the gain if the sale proceeds are reinvested within 20 days as a capital contribution into another Chilean company.

/Carey

Jaime Carey **jaime.carey@carey.cl**
Manuel José Alcalde **mjalcalde@carey.cl**

Isidora Goyenechea 2800, 43rd Floor
Santiago
Chile

Tel: +562 928 2224
www.carey.cl

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