After extensive negotiations, Chile’s National Congress has approved an amended version of the 2014 Tax Reform. This tax reform, like its predecessor, includes in its core a gradual increase in the corporate tax rate from 20% to 25% and more importantly, the “attributed income” system whereby business income is attributed to its shareholders to enable, in practice, second-tier taxation on an accrued basis. In other words, residents and non-residents are to be taxed on accrued dividends instead of being taxed on those they effectively receive on a cash basis.

All the same, the above regime is just one of the two alternatives between which taxpayers must choose. Under the amendments the Congress included in the Tax Reform Bill, taxpayers will be allowed to select either the “attributed income” regime described above (the so-called “A System”) or a new “semi-integrated” regime named the “B System.”

The B System is a tax regime tailored for taxpayers interested in keeping the tax deferral historically applicable to undistributed business profits, in exchange for a higher corporate tax rate of 27% and a higher taxation on distributed dividends (achieved by reducing to 65% the corporate tax credit effectively available to offset dividend taxation; notwithstanding, residents in a treaty country may still claim 100% credit for corporate taxes).

The choice between one regime and the other is not trivial, as the B System may ultimately mean a 44.45% effective rate on business profits if the shareholder is not resident in a treaty country. ¹

Apart from choosing which regime suits their needs best, our clients from the mining and metals sector should be most concerned with changes in tax-deductible goodwill, thin capitalization rules, the revocation of the Foreign Investment Statute (Decree Law No. 600) and changes to the deductibility of accrued expenses, as well as the new Controlled Foreign Corporations (CFC) rules. This has led many of them to seek our advice and counsel to help them keep up with the best practices in the market and evaluate the future impact of this major tax reform.

¹ That is, a 27% corporate tax on yearly accrued taxable income, plus second-tier taxes ranging up to 35% upon distribution of such income, against which the taxpayer may credit only 65% of the corporate tax effectively paid on the profits being distributed as dividends.
The tax reform will become effective in stages, starting in October 2014, until it is fully in force by 2018.

**What does this mean to you?**

As the tax reform is gradually implemented, taxpayers will face an entirely new scenario in Chilean taxation:

- Alternative “attributed” vs. “semi-integrated” regimes, with effective rates on business profits ranging from 35% to 44.45%
- To implement either system, an entirely new set of accounting rules and ledgers have been enacted by Congress that taxpayers will be required to keep in order to register tax-retained earnings and attributed earnings under these new systems. This will dramatically change the long-standing Taxable and Non-Taxable, Retained Earnings Pools (called “FUT” and “FUNT,” respectively)
- New thin capitalization rules, with the measurement of the 3:1 debt-to-equity ratio made annually affecting all outgoing payments made during that year, and a much broader base for the debt component of the ratio, which will now include non-related and local debt as well as foreign related debt
- Limited amortization of goodwill — parent entities absorbing their subsidiaries must allocate goodwill in non-monetary assets up to their fair market value, and the excess will no longer constitute a deductible expense, but instead become frozen as an intangible asset
- Deductibility of expenses — e.g., expenses accruing from transactions with foreign related parties may only be deducted on a cash basis and only once applicable withholding tax liabilities — if any — are fulfilled
- New CFC rules under which Chilean taxpayers controlling foreign entities abroad may be required to consider in their own Chilean income taxes all passive income earned by the CFC on a cash or accrued basis, as the case may be. Special assumptions apply for foreign entities resident in blacklisted countries (namely control and income presumptions)
- Wider concept of tax-haven jurisdictions which may change this qualification if they have a signed and enforceable Double Taxation Treaty (or a Convention for the Exchange of Information) in place with Chile
- New General Anti-Avoidance Rule, with fines of up to 100% of the tax avoided through the abuse of forms or simulation. This requires a verdict from a tax judge, and the fine is capped at approximately USD 100,000.00
- Elimination of the Foreign Investment Statute (Decree Law No. 600) — as of 1 January 2016, the Foreign Investment Committee will accept no new applications for the Foreign Investment Agreement, but this measure will not affect agreements currently in place.
- New rules on capital gains — most are to be taxed as ordinary income (subject to first- and second-tier taxes), but palliative measures have been enacted to reduce the impact of this increased taxation; tax-free benefits for publicly traded shares of stock and bonds remain unaltered
- Changes affecting VAT, policing abilities of the IRS, electronic invoicing, taxation of funds and others

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Still, the Chilean thin-cap rule will not limit deductibility of interest expenses, but only the applicability of the reduced 4% WHT on outgoing interest payments.
EY’s Global Mining & Metals Center

With a volatile outlook for mining and metals, the global sector is focused on cost optimization and productivity improvement, while poised for value-based growth opportunities as they arise. The sector also faces the increased challenges of changing expectations in the maintenance of its social license to operate, skills shortages, effectively executing capital projects and meeting government revenue expectations.

EY’s Global Mining & Metals Center brings together a worldwide team of professionals to help you succeed—a team with deep technical experience in providing assurance, tax, transactions and advisory services to the mining and metals sector. The Center is where people and ideas come together to help mining and metals companies meet the issues of today and anticipate those of tomorrow. Ultimately it enables us to help you meet your goals and compete more effectively.

Area contacts

Global Mining & Metals leader
Mike Elliott
Tel: +61 2 9248 4588
michael.elliott@au.ey.com

Oceania
Scott Grimley
Tel: +61 3 9655 2509
scott.grimley@au.ey.com

China and Mongolia
Peter Markey
Tel: +86 21 2228 2616
peter.markey@cn.ey.com

Japan
Andrew Cowell
Tel: +81 3 3503 3435
cowell-ndrw@shinnihon.or.jp

Africa
Wickus Botha
Tel: +27 11 772 3386
wickus.botha@za.ey.com

Commonwealth of Independent States
Evgeni Khrustalev
Tel: +7 495 648 9624
evgeni.khrustalev@ru.ey.com

France and Luxembourg
Christian Mion
Tel: +33 1 46 93 65 47
christian.mion@fr.ey.com

India
Anjani Agrawal
Tel: +91 982 061 4141
anjani.agrawal@in.ey.com

United Kingdom and Ireland
Lee Downham
Tel: +44 20 7951 2178
ldownham@uk.ey.com

United States
Andy Miller
Tel: +1 314 290 1205
andy.miller@ey.com

Canada
Bruce Sprague
Tel: +1 604 891 8415
bruce.f.sprague@ca.ey.com

Brazil
Carlos Assis
Tel: +55 21 3263 7212
carlos.assis@br.ey.com

Chile
Lachlan Haynes
Tel: +56 2 2676 1886
lachlan.haynes@cl.ey.com

Service line contacts

Global Advisory Leader
Paul Mitchell
Tel: +612 9248 5110
paul.mitchell@au.ey.com

Global Assurance Leader
Alexei Ivanov
Tel: +495 228 3661
alexei.ivanov@ru.ey.com

Global IFRS Leader
Tracey Waring
Tel: +61 3 9288 8638
tracey.waring@au.ey.com

Global Tax Leader
Andy Miller
Tel: +1 314 290 1205
andy.miller@ey.com

Global Transactions Leader
Lee Downham
Tel: +44 20 7951 2178
ldownham@uk.ey.com

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