



2015: THE TIME FOR MAJOR TAX REFORMS IN CHILE, COLOMBIA, AND OTHER SOUTH AMERICAN COUNTRIES

By Victoria Alvarez and Renaud Roquebert

The economies of Chile and Colombia, among the most dynamic in South America, are on the path to major tax reform. With an overall increase in fiscal pressure, the changes are mainly inspired by the need to support local sustainable growth and, at the same time, tackle fraud and inequality. International operators may need to review the tax impact of local transactions to see how they will be affected by the changes.

CHILE

TAXATION AS A PART OF A MAJOR ECONOMIC AND GLOBAL REFORM IN CHILE

The world's leading copper producer, Chile is the only South American country that joined the Organisation for Economic Co-operation and Development (OECD) as a full member. This is the consequence of several years of strong economic performance, as the GDP annual growth rate in Chile averaged 5.34 percent from 1987 until 2014. However, like many countries in the region, investment weakened and growth slowed in 2014, in part due to the fall of the price of copper. Furthermore, the depreciation of the Chilean peso triggered higher inflation.

Against this backdrop, the Chilean government decided to introduce an overall modernization of its social and economic policy. This included thorough changes in five key

sectors: education, energy, infrastructure, the labor market, and taxation.

The tax policy had stayed broadly neutral up until the present. The new rules aim to serve a double purpose: bolster long-term growth and reduce inequality, which is significantly higher than the OECD average. These goals are expected to be met through a more progressive tax structure, raising three percent of GDP in revenue to fund greater spending on education and health while raising public savings and maintaining incentives for private investment.

Presented by the government in March 2014, the reform was enacted by the Chilean National Congress, Law No. 20.780, published on September 29, 2014. It introduces substantial changes to the Chilean tax system, including two alternative methods for computing shareholder-level income taxation, corporate tax rate increases, limits for goodwill amortization, and general anti-avoidance rules (GAARs).

The Attribution-Basis Shareholder Taxation

Under this mechanism, shareholders of Chilean companies will be taxed on income attributed to them as of the end of the tax year in which the income is generated (irrespective of the date of receipt of the funds). These profits will be taxed at the shareholder level whether or not they are distributed. The corporate income tax paid by the entity will remain creditable against the final shareholder tax, so the combined total Chilean income tax burden will remain 35 percent. Taxpayers will also be able to opt for the so-called cash-basis shareholder taxation, explained next.

The Cash-Basis Shareholder Taxation

Within this mechanism, a 27 percent corporate-level income tax (CIT) applies, along with a 35 percent shareholder-level tax that is imposed on cash distributions. Sixty-five percent of the CIT (as opposed to 100 percent under the current regime) is creditable against the 35 percent shareholder-level tax. However, for shareholders resident in jurisdictions that

Victoria Alvarez (victoria.alvarez@lh-lf.com), PhD, JD, is an attorney specializing in taxation and working with LightHouse LHLE, a law firm created in 2008 in Paris by lawyers coming together from large international firms to respond to the new business environment. An IBFD correspondent for France, she also teaches European law in France and Mexico. **Renaud Roquebert** (renaud.roquebert@lh-lf.com) is also a tax specialist working with LightHouse LHLE. A former PricewaterhouseCoopers director, he manages global projects for international companies.



have a tax treaty in force with Chile, the underlying CIT is fully creditable against the 35 percent additional tax. This regime will be available on January 1, 2017.

The new regime aims to replace the system of tax deferral for undistributed earnings (in place since 1984), which has been a source of tax planning and evasion—mainly implemented by those with higher incomes. However, the new profit/dividend tax regime does not draw on international experience; thus it will need to be fine-tuned, if necessary.

A Higher CIT Rate

The Chilean corporate income tax rate was 20 percent through 2013. It will gradually increase to 21 percent for 2014, 22.5 percent for 2015, and 24 percent for 2016. For 2017, income will be taxed at 25 percent for shareholders on the attribution method and 25.5 percent for shareholders on the cash-basis method. Going forward into 2018, these rates will be 25 percent and 27 percent, respectively.

The increase in the CIT confirms a regional trend also adopted by Colombia. The measure is aligned with the search for progressivity and is a condition for sustainable growth with social stability.

The End of Goodwill Deductibility

As of January 1, 2015, for Chilean income tax purposes, goodwill will be considered a nondeductible intangible on the amount exceeding the fair market value of the assets received. This measure implies a dramatic constraint on goodwill deductibility, as, prior to the change, goodwill had been considered an asset and thus allowed a 10-year deductible amortization. In order to mitigate the impact of this limitation, a grandfather provision allowed “merger processes” initiated before January 1, 2015, to qualify for goodwill amortization under the old deduction rules if the merger is executed and completed before January 1, 2016. Chilean IRS Resolution No. 111 (Dec. 2014).

General Anti-Tax-Avoidance Rules (GAARs)

The introduction of GAARs targeting tax-motivated transactions is inspired by rules such as FATCA, BEPS, Global Transparency, and bank secret dismantlement. For the record, Chile has publicly pledged to adopt the standard of automatic exchange of tax information but has not yet provided an agenda for implementation.

The new GAARs allow the Chilean authorities to disallow tax benefits obtained from abusive or aggressive tax planning. These provisions will apply only to transactions executed or concluded after September 29, 2015. Under a

new consultation procedure, taxpayers may ask the Chilean IRS to determine whether a transaction may fall under the GAAR provisions. The opportunity to take advantage of this consultation procedure will need to be analyzed on a case-by-case basis in order not to motivate a tax audit.

Blessed by the International Monetary Fund, the new Chilean tax system is guided by the ultimate goal of preventing any possible avoidance of the tax payment. Press Release No. 14/357, International Monetary Fund (July 22, 2014). This is a major change in the local tax philosophy, which has historically been inspired by the promotion of savings and investment. But the Chilean government is pursuing an even more ambitious goal, that of breaking the dependence on the price of copper and achieving a modern and diversified economy. Today, services still represent 56 percent of the GDP, and mining follows with 13 percent, leaving only 12 percent to manufacturing. Most South American countries have struggled with this since 1930 for the sake of true economic modernization.

COLOMBIA **HIGHER TAXES IN COLOMBIA**

In recent years, Colombia has had one of the highest levels of growth in South America. The GDP annual growth rate in Colombia averaged 4.37 percent from 2001 until 2014. While the Chilean tax reform described above remains neutral overall and is framed in terms of a general modernization of the economy, the reform implemented by the Colombian government clearly seeks re-distribution and progressivity.

The Increasing Progressivity

The Colombian government opted for the creation of a net wealth tax assessed annually on net equity of domestic and foreign legal entities and individuals. Even if the tax is abolished in 2018 for legal entities and in 2019 for individuals, local and foreign operators will be significantly affected over the coming tax periods. Nonresident taxpayers will be concerned by the new tax as far as they hold any wealth in Colombia, whether directly or indirectly via branches or permanent establishments. In this specific case, the taxable base will be the net equity attributable to the permanent establishment, as determined in accordance with the group’s transfer pricing documentation.

Net equity will only be taxable if, as of January 1, 2015, it equals or exceeds \$1 billion Colombian pesos (COP) (approximately US\$425,000). The law has provided for a progressive rate of 0.20 percent up to US\$850,000, 0.35 percent up



to US\$1,275,000, 0.75 percent up to US\$2,125,000, and 1.15 percent over this amount. These rates will gradually decrease in 2016 and 2017. The following values will be exempt from the Colombian net wealth tax: (i) shares in Colombian companies; (ii) Colombian receivables related to an active financing business held by non-Colombian resident financial entities; and (iii) the tax value of international leases (including financial returns) into Colombia. The tax paid will not be deductible for income tax purposes.

It will be advisable to monitor the application of the net wealth tax regarding nonresident operators, since, in a December 16, 2014, decision, a similar tax was recently declared unconstitutional by the Argentinian Supreme Court with respect to local branches of foreign legal entities.

The Search for Equality

Like the Chilean government, the Colombian government justifies the tax reform (and the raise of overall taxation) on the pursuit of social equality. In this respect, it has permanently raised the CREE rate to nine percent (“special contribution on income for equality”). Furthermore, the law adds a “temporary” CREE surcharge, beginning in 2015, for taxpayers whose income exceeds US\$340,000. The surcharge will amount to five percent in 2015, six percent in 2016, eight percent in 2017, and nine percent in 2018, bringing the total CREE rate to 18 percent for 2018 (i.e. nine percent of CREE plus the nine percent surcharge).

It is important to note that many “temporary” tax raises instituted to address a specific and exceptional financial need are actually becoming perpetual. This is, for instance, the case of the Argentinian tax on checks or the French social contribution for the reimbursement of the social debt (CRDS). The multiplication of these temporary and ad hoc taxes can lead the economy to a heavy fiscal pressure and a burdensome tax complexity, both discouraging to private investment.

The Colombian tax reform law also increases domestic law income tax withholding rates on cross-border payments. This raise will be significant for nonresident operators, since Colombia has a rather limited tax convention network. In this respect, the rate applicable to any Colombian-source income earned by nonresident entities that is not attributable to a local permanent establishment or branch will be 39 percent in 2015, 40 percent in 2016, 42 percent in 2017, and 43 percent in 2018. It is thus recommended to verify the increase in tax costs burdening Colombian payments post-January 1, 2015.

Tax Amnesty in Colombia

The purposes pursued by South American governments

do not only concern the distribution of the tax charge per se, but also the method of tax assessment and auditing. In this respect, the Colombian government has implemented a broad tax amnesty regime, which targets litigation, tax audits in progress, and outstanding liabilities.

The public cost of tax litigation represents a significant burden in South American tax systems. In order to limit these costs without compromising public revenues, the new Colombian law provides for reductions of 20 percent or 30 percent of penalties and interest for any tax assessments subject to litigation as of January 1, 2015, provided that 100 percent of the relevant tax assessment is paid. The settlement agreements must be signed before September 30, 2015, to be eligible.

For administrative assessments not yet in litigation, a 100 percent penalty reduction is available until October 30, 2015, provided the tax liability is paid in full. There will be a 50 percent penalty if no taxes are reassessed. Penalties for failure to file tax returns may be reduced by 70 percent if 100 percent of the unpaid tax is paid in full. Penalties arising from unpaid taxes prior to 2013 may be reduced by 80 percent if the outstanding tax is paid in full on or before May 31, 2015. If payment is made after May 31, 2015, but no later than 10 months after the enactment date of the law, the penalties may be reduced by 60 percent.

Tax Amnesty: A Trend in South America

These tax amnesty measures reflect a global tendency in multiple countries in Europe and South America, such as France and Argentina. The philosophy of tax amnesty promotes efficiency over compliance, since public treasuries will thereby renounce theoretical receipt of tax revenues and penalties to improve actual timely payment.

Of course, the future implementation of the automatic exchange of financial information for tax purposes is significantly boosting the success of national tax amnesties. In France, for instance, which was an early adopter of the OECD standard, the office of tax regularization received €2 billion in 2014 of undeclared funds held by French residents in a foreign country. In Argentina, a tax amnesty launched in 2013 motivated the declaration of US\$82 million through September 2014. This regime provides for the investment of the undeclared funds in public bonds—the Certificate of Deposit for Investment (Cedin) or Argentinian Savings Bond for Energy Development (BAADE)—dedicated to construction or energy activities.

Colombia and Argentina are the only South American early adopters of the OECD Tax Transparency Standard, which implies an automatic exchange of financial information for tax purposes by September 2017. Thus, given the imminent



adoption of the automatic exchange of information provisions, the Colombian tax amnesty, compared to other national experiences, could achieve significant success in repatriating fresh fiscal resources. Other South American tax jurisdictions, such as Peru, are also evaluating the possibility of implementing tax amnesties, undoubtedly induced by the future transparency standards. Sandra Sevillano & Eduardo Sotelo, *Tax Arrears and Tax Litigiousness in Peru, Some Aspects to Be Considered*, 72 REVISTA DE LA PONTIFICIA UNIVERSIDAD CATÓLICA DEL PERÚ 71 (2014). It should be noted, though, that even if Chile and Uruguay have publicly pledged to adopt this standard, they have not yet set a date for adoption. GLOBAL FORUM ON TRANSPARENCY & EXCH. OF INFO. FOR TAX PURPOSES, TAX TRANSPARENCY 2014 REPORT ON PROGRESS 36 (2014), available at <http://www.oecd.org/tax/transparency/GFannualreport2014.pdf>. Brazil, however, is engaged as of 2018. Victoria Alvarez-Le Mentec, *Columna de Opinión: La Revancha de los Fiscos Occidentales*, THOMSON REUTERS (Dec. 2, 2014), <http://thomsonreuterslatam.com/articulos-de-opinion/02/12/2014/columna-de-opinion-la-revancha-de-los-fiscos-occidentales-por-victoria-alvarez-y-franck-le-mentec>.

CONCLUSION

As a consequence of this regional tendency toward tax transparency, South American countries are already adopting general tax reforms that match the new paradigm of tax rules: prevention of tax fraud, taxation in the country of the value creation, and control of the substance.

Of course, the method of reducing tax litigiousness by granting general or specific amnesties is frequently challenged on the basis of tax equality and legal certainty. As the case may be, the Colombian high courts will determine whether the terms of the current amnesty comply with the national constitutional principles of taxation.

Like Colombia and Chile, several South American governments have been induced to open their fiscal files. See generally THOMAS PIKETTY, *CAPITAL IN THE TWENTY-FIRST CENTURY* (2014). It is henceforth important to monitor the tax costs and opportunities that may be raised by recent and future reforms in the region. Achieving strong growth while reducing inequality is a key challenge for South America in the twenty-first century. If this challenge requires structural reforms, so be it—the national governments have already assumed that to be a priority. ♦