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Chilean Congress approves U.S. reservations to the U.S.-Chile Income Tax Treaty, clearing final step to become law

On October 25, 2023, the Chilean Government submitted to Chilean Congress the agreement to implement the reservations made by the U.S. senate to the U.S.-Chile bilateral income tax treaty (the " **Tax Treaty** ").

On November 15, 2023, after already clearing the Chamber of Deputies, the agreement was approved by the Senate.

The agreement's successful sprint through Congress is expected to result in the treaty becoming law before the end of 2023, enforceable on amounts accrued or paid as early as January 1, 2024.

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The Tax Treaty and its accompanying Protocol were originally introduced in 2010, and following certain refinements, were submitted to the U.S. Senate for consideration in 2012, but were not previously approved by the U.S. Senate. Chile's Congress, on the other hand, approved the Tax Treaty in 2015.

On June 21, 2023, the U.S. Senate approved a resolution recommending that the U.S. President ratify the Tax Treaty, subject to certain reservations relating to the base erosion and anti-abuse tax (BEAT) and Article 23 (Relief from Double Taxation).

The reservations relating to BEAT clarifies that the Tax Treaty does not prevent the United States from imposing such tax (very generally, a minimum tax on domestic corporations intended to protect the United States tax base from erosion due to payments of deductible expenses to foreign related parties). The reservation relating to Article 23 implies a revision to Article 23 to reflect the changes to the U.S. Internal Revenue Code in 2017, specifically with respect to repeal of Section 902 and adoption of Section 245A, relating to the deduction of dividends received by domestic corporations from foreign corporations provided certain requirements are met.

The Chilean and U.S. government exchanged diplomatic notes and agreed to include the U.S. Senate reservations in the Tax Treaty. The agreement was submitted by the Chilean government to the Chilean Congress for approval on October 25, 2023.

On November 15, 2023, after approval by the Chilean Chamber of Deputies, the Chilean Senate passed the agreement, clearing the final step in Chile for the amendment (and the Tax Treaty) to become law.

The Tax Treaty is expected to become enforceable with respect to amounts accrued or paid from January 1, 2024, assuming diplomatic notes confirming ratification are exchanged between both nations during November 2023.

The Tax Treaty is intended to provide relief from double taxation to residents meeting certain requirements.

- Withholding tax on dividends will generally be capped at a maximum rate of 15%, with a reduced rate of 5% available for taxpayers that directly hold at least 10% of the voting stock of the dividend-paying company. Additionally, dividends received by U.S. taxpayers from Chile may be treated as "qualified dividend income" and hence subject to preferential U.S. tax rates if applicable requirements are met.

- The abovementioned cap on withholding of tax with respect to dividend income will not practically apply to payments of dividends from Chilean corporations unless Chile makes certain modification to its integrated corporate tax system in the future. The Chilean integrated corporate tax system reduces the Chilean dividend withholding tax from 35% to an effective 10.96% for treaty country residents.

- Withholding on payments of interest made to a beneficial owner that is a bank, insurance company or a lending business, among others, will be limited to 4%. In all other cases, the maximum withholding rate on interest will be capped at 15% for the first five years after the treaty enters into force, after which time the withholding rate will decrease to 10%.

- Withholding on payments of royalties will be generally capped at 10%, but withholding on consideration for the use of (or the right to use) industrial, commercial or scientific equipment will be capped at 2%.

- Withholding on capital gains derived by a resident of a Contracting State from the sale of shares of (or other rights to or interest in) a company that is a resident of the other Contracting State will generally be capped at a maximum rate of 16% provided certain ownership percentage thresholds are met. The Tax Treaty will also provide certain exemptions for sales of shares by pension funds, mutual funds and other institutional investors in certain cases.

- In addition, the Tax Treaty will generally exempt most U.S. source service fees (normally taxed by Chile at 35% if paid from Chile) as business profits of U.S. residents. However, that exemption would generally trigger 19% value added tax if the services are used in Chile.

The Tax Treaty will also provide helpful guidance in respect of U.S. and Chilean foreign tax credit ("**FTC**") rules:

- The Tax Treaty will simplify the FTC analysis on the U.S. tax front by treating Chilean income taxes as creditable for U.S. tax purposes.

- In addition, the Tax Treaty is expected to reduce FTC leakage on the Chilean side, as the scope of FTC available for Chilean taxpayers under the Tax Treaty is broader than Chile's domestic FTC regime.

Limitation on Benefits: the Tax Treaty includes a Limitation on Benefits clause based on the U.S. Model Tax Convention. That clause is generally intended to prevent abuse of treaty benefits and treaty shopping by imposing additional qualification requirements on the purported beneficiary (often focusing on the level of activity, taxation or presence of such beneficiary at the applicable jurisdiction). When initially introduced, the Tax Treaty was the first Chilean treaty to include a Limitation on Benefit clause of any type. In recent years, especially after the OECD added a similar clause to its Model Convention in 2017, Chile has increasingly added a Limitation on Benefits clause to its treaties.