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Main Tax Policy Matters for Establishing Chile as a Regional Operative Investment Hub

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Main Tax Policy Matters for Establishing Chile as a Regional Operative Investment Hub

by

*Hugo Hurtado and Jaime Del Valle**

Abstract

Unlike other OECD countries, Chile has not yet established a uniform tax policy toward foreign investment. Moreover, Chile had past experiences of unsuccessful legislation on specific exempted investment vehicles created with the purpose of establishing the country as a hub or platform for foreign investment. An effective international tax policy design requires taking a holistic view of the challenges and their corresponding solutions. As a country's tax regime is a key policy instrument that may negatively or positively influence investment, Chilean tax policy is being oriented in this regard. This Article reviews the progress of those projects and current legislation, compares other OECD countries' experiences in this matter, analyzing the main facts or elements to consider upon deciding the relevant tax policy, and finally proposes a tax regime that could make Chile more competitive when attracting foreign operative investment, focused on a more regional approach. Accordingly, this Article also intends to serve as guide or help to be considered by regulators on the hard road of designing tax standards.

* Professors Hurtado and Del Valle are both professors at Pontific Catholic University of Chile. We would like to thank Fernanda Yoma, Trinidad Fernández, and Pelayo Vial for their research and support for this work. All mistakes are ours.

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I. Introduction

Countries use different methods to regulate the taxes to be paid by their residents on foreign sourced income in order to avoid double taxation. Two of the most popular systems are the exemption system and the tax credit system, terms often used as synonyms for territorial and worldwide taxation systems, respectively.[1] Countries using a worldwide approach apply taxes on all of their residents' income, whether such income was generated from domestic or foreign sources. The method used by the domestic authority to alleviate double taxation issues under this approach is to provide tax credits for taxes paid abroad.

Unlike other OECD countries, Chile has not established a uniform tax policy toward foreign investors that decide to incorporate entities in Chile in order to make investments mainly in other Latin American countries. This is true for both operative and passive outbound

1. *See Key Comparisons of International Tax Systems of Major OECD and Developing Countries*, Bus. Roundtable, https://www.businessroundtable.org/archive/resources/key-comparisons-of-international-tax-systems-of-major-oecd-and-develop (last visited Oct. 5, 2020).

investments, with past experiences of unsuccessful legislation on specific exempted vehicles for similar purposes, and current fund laws that provide interesting alternatives for passive outbound investments with non-Chilean residents as beneficial owners. The enactment of a direct policy toward foreign investors is generally considered a positive step for a country, as it has been observed that if a country has solid macroeconomics and political systems, an appropriate tax policy could foster the arrival of foreign investment.[2] That subject has been deeply studied by the most developed economies and in comparative law, considering its importance as an accelerator of development. It may be seen as a long-term commitment between the investor and the host country, which in many cases—especially for developing countries—may contribute to the creation of fixed capital.

Regularly, the injection of capital will entail growth and the possibility of expanding current business relationships of the target activity, but foreign direct investment also has important advantages that differentiate it from other capital contribution alternatives: stable capital flow and positive externalities for the host country. The United Nations summarizes the benefits of foreign direct investment as a direct contribution to the financing of long-term economic development, which is particularly important due to its potential for transferring knowledge and technology, creating jobs, boosting production development, encouraging entrepreneurship and competition, and eradicating poverty through long-term sustained economic development.[3] The spillover benefits could include the application of new knowledge, production, and process technologies by other host country firms. Foreign investment may confer general training and skills that could be employed elsewhere in the economy and demand for various factors of production in the host country that might not exist otherwise.[4]

For example, at the end of the 1990s, Spain created a favorable tax framework to attract foreign companies that were looking to

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2. Joong-Wan Cho, *Foreign Direct Investment: Determinants, Trends in Flows and Promotion Policies*, *in* Investment Promotion and Enterprise Development Bulletin for Asia and the Pacific No.1, at 99 (2003).

3. U.N., *Report of the International Conference on Financing for Development*, U.N. Doc. A/Conf.198/11 (Mar. 18–22, 2002).

4. OECD, *Corporate Tax Incentives for Foreign Direct Investments* (2001), https://doi.org/10.1787/19900538.

concentrate their investments in nearby countries into a single country. For such purposes, it created a holding regime that provided important tax benefits to investments made through certain Spanish domiciled companies—known as ETVE, or entities holding foreign securities—that were exempted on their worldwide source income connected to the direct investment. This Spanish holding regime has been recognized as a tax-efficient vehicle for structuring cross-border investments, developing Spanish investments abroad, and attracting capital from the rest of Europe.[5]

In other countries, such as the United Kingdom, the substantial shareholdings exemption (SSE) was implemented. However, given its strict conditions for applicability, the regime was not fully applied, even though the policy was intended to provide the exemption for the majority of the qualified investors. Some recently introduced changes have been positive for corporate businesses, constituting a way to encourage overseas investment and more international group companies to base themselves in the United Kingdom.[6]

In general, a country's tax regime is a key policy instrument that may negatively or positively influence investment.[7] It is a well-known fact that tax-related matters, such as transparency, simplicity, tax rates and tax incentives, and stability and certainty in the application of the tax law and in tax administration, directly influence foreign investment.[8] Actually, such factors may often be ranked ahead of tax incentives, determining the willingness of the investor to analyze a country or region. When policymakers intend to design an environment that fosters direct investment, it is important to reduce all potential associated

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5. *See* Guía de Negocios en España 87–88 (2020), https://www.investinspain.org/invest/wcm/idc/groups/public/documents/documento/mde2/nje2/~edisp/doc2016616337.pdf.

6. *Budget 2017 Bring Relaxation to Substantial Shareholding Exemption Rules*, RJP (Mar. 29, 2017), https://www.rjp.co.uk/2017/03/29/relaxation-substantial-shareholding-exemption-rules/.

7. *See* OECD, *Foreign Direct Investment for Development: Maximising Benefits, Minimizing Costs* 9–14 (2002), https://www.oecd.org/investment/investmentfordevelopment/1959815.pdf.

8. OECD, *Tax Incentives for Investment—A Global Perspective: Experiences in MENA and Non-MENA Countries* (June 2007), http://www.oecd.org/mena/competitiveness/38758855.pdf.

risks and allow or implement policies that facilitate the structuring of cross-border investments from the host country.[9]

The current Chilean administration has launched a policy with a challenging and important goal: to transform Chile into a world-class regional financial center. The idea behind this policy is to use Chile's well-reputed sophisticated capital market to lead the provision of financial services in Latin America as an opportunity to create growth, employment, and prosperity, based on successful models such as Singapore or Luxemburg. For such purposes, the government is working on some important regulatory and legal changes that seek to open the market and Chilean borders from a financial perspective, using the country's important human resources and sophisticated local capital market to provide services for foreign investors who want to invest in the region, using Chile as a hub or platform for their regional passive portfolio.

Therefore, this Article focuses on a potential, complementary public policy that, piggybacking on other policies fostering investment through Chile in regional passive income, provides an additional tool and encourages foreign companies—mainly multinational enterprises (MNE)—to establish in Chile their parent companies and management, which generally serve as a hub or platform for their regional operative investments in Latin America, generating the resulting positive externalities of such direct investment. For such purposes, this Article reviews, from a tax perspective, the existing and repealed legislation on the subject in Chile, provides a comparative analysis taking into consideration three OECD countries' experiences, analyzes the main facts or elements to consider upon deciding the relevant tax policy, and finally proposes a regime that could be applicable to operative income obtained abroad by Chilean entities that are controlled by foreign investors.

II. Tax Regime for Platform Companies in Chile Until 2017

Under the regular provisions of the Chilean Income Tax Law (CITL),[10] Chilean domiciled/resident taxpayers—among them companies

9. Martin Simmler, *The Impact of Worldwide vs Territorial Taxation on the Location of Assets and the Scale of Investment: A Survey of the Empirical Evidence* (Univ. of Oxford Ctr. for Bus. Tax'n Policy Paper, 2017), http://www.etpf.org/files/Simmler_ETPF_policy_paper_2017.pdf.

10. Law No. 824, Ley Sobre Impuesto a la Renta, Dec. 28, 1974, Diario Oficial [D.O.].

incorporated in Chile—are taxed on their worldwide income, regardless of where such income is obtained. Non-Chilean residents are taxed only on their Chilean-source income. Thus, as a general rule, CITL adopts and follows a worldwide regime for its residents, granting a tax credit for taxes paid abroad (total or partially) to relieve the double taxation effect that might arise from this rule.

In 2002, Law No. 19,840[11] amended the CITL to include a new article 41.D. According to this provision, companies controlled by foreign shareholders were deemed non-resident for purposes of Chilean income taxes if certain conditions were met. As a result, they were only subject to taxes in Chile for their Chilean-source income, whereas foreign-source income—including capital gains from the sale of these non-Chilean domiciled entities—was exempted.

The principle behind this amendment was that the positive effect on the hiring of qualified labor, the contracting of professional service companies, rental of real estate property, and revenues arising from labor law taxes would outweigh the potential minor impact on Chilean fiscal revenue. In this regard, the history of Law No. 19,840 summarized the purpose of this provision as follows:

> Para los inversionistas extranjeros, Chile constituye hoy una alternativa altamente atractiva, particularmente en el contexto regional. Ello por cuanto el país posee una estabilidad y solidez económica e institucional que no es observable en otras economías emergentes de la región.
>
> Nuestro país posee una sólida estabilidad social y política; respeto por el derecho de propiedad; transparencia de sus instituciones y gobiernos; bajos niveles de corrupción; alta apertura económica y amplia libertad para emprender. Posee, a su vez, una macroeconomía sólida y ordenada; baja inflación; bajísimo riesgo país; política fiscal austera y transparente; Banco Central independiente; tipo de cambio libre; exportaciones diversificadas y bajo endeudamiento público; infraestructura moderna y recursos humanos calificados.
>
> Así, un inversionista extranjero que invierte en el país, tanto para hacer negocios en Chile como para

11. Law No. 19840, Nov. 23, 2002, Diario Oficial [D.O.].

> ocuparlo como plataforma para invertir en el exterior, puede gozar de la solidez antes mencionada como de servicios atractivos que derivan de lo anterior.
>
> Una de las alternativas que ofrece este escenario es la de atraer capitales extranjeros para que sean invertidos a su vez en el exterior.
>
> En particular, el inversionista extranjero podrá, utilizando a Chile como plataforma de inversión regional, desarrollar su actividad con más eficiencia en el exterior, disminuyendo costos y riesgos de diversa especie y consideración.
>
> En tanto el país generará un aumento en su exportación de servicios profesionales y de asesoría, a la vez podrá acceder al conocimiento y uso de nuevas tecnologías.
>
> Sin embargo, el mayor impedimento que tienen las empresas extranjeras para constituirse en el país, con el objeto único de realizar actividades en el exterior, es que de todas maneras deberán pagar impuesto en Chile, además de los tributos exigidos en el país fuente y, eventualmente, también en el país de origen del capital y destino final de las utilidades.
>
> En tales circunstancias, el proyecto pretende no desestimular este tipo de inversión extranjera desde una Sociedad constituida en Chile, con capitales extranjeros, al no volver a gravar sus utilidades que se generaron en el extranjero, obteniendo a cambio el beneficio de un mayor desarrollo de la infraestructura nacional en los distintos aspectos necesarios para su instalación y funcionamiento.[12]

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12. Historia de la Ley Nº 19.840, Primer Trámite Constitucional: Cámera de Diputados 3–4 (2002), https://www.bcn.cl/historiadelaley/nc/historia-de-la-ley/5884/ (authors' translation of quote: "For foreign investors, Chile constitutes a very attractive alternative, particularly in its regional context. The reason for this is the significant stability and soundness enjoyed by both the institutions and economy in this country, which cannot be found in other emerging economies from the same region. Our country possesses a healthy, stable political and social landscape, respects property rights, has transparent institutions and government, low corruption levels and remarkably

In order for companies to be eligible for this special tax regime, they needed to meet the following requirements:

(a) Be incorporated as publicly traded corporations, or include in their bylaws the obligation to abide by regulations—including administrative supervision—for publicly traded corporations;

(b) Have in their bylaws the exclusive corporate business purpose of investing in foreign companies or Chilean corporations. However, they were also allowed to render certain limited services to related foreign parties, provided they were not domiciled in jurisdictions deemed tax havens;

(c) At least 25% of equity had to be contributed by non-resident shareholders, applying general tax provisions—worldwide income taxation—for Chilean-domiciled shareholders, and

(d) Waive bank secrecy law protection granted to all Chilean entities.

In addition to those requirements, these companies would also have to register in a special registry maintained by the Chilean Internal

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open markets together with financial freedom. Its macroeconomic plans are also solid and well organized, aside from also benefiting from low inflation rates, a very low country risk rate, restrained, limited and transparent government spending, an independent Central Bank, free exchange rates, diverse exports and low public debt, modern infrastructure and qualified human resources. A foreign investor could use Chile as a business platform, carrying out its activity more efficiently as a result of the decrease in risks and costs related to that investment. On the other hand, the country will foster the export of professional and consulting services. At the same time, Chile will access new knowledge and technologies. Nevertheless, the major barrier for this type of investment is the taxes it will have to pay in Chile, in addition to taxes paid in the source country and the final owner's country of residence. In such circumstances, the project aims to avoid discouraging that type of investment by applying Chilean taxes on the income obtained by the platform companies. At the same time, this policy will boost development of the national infrastructure needed to install and operate such investments.").

Revenue Service (SII); pay up to 0.5% municipal tax on net equity; and up to 1.2% stamp tax on loans received from abroad.[13] In addition, as Chilean platform companies were not considered tax residents for purposes of the CITL, they were not granted a certificate of residence from the SII, and therefore they were not eligible for tax treaty benefits.[14]

Despite the solid macroeconomics and regulatory environment that Chile offered when compared to other countries in the region, this regime was not generally adopted by foreign investors. Indeed, the amount of restrictions and requirements to be eligible for this special regime made this provision unattractive for most foreign investors that were seeking a hub for their regional investment, with only 17 platform companies being incorporated under this special regime since its enactment. Considering its unattractiveness for foreign investors, as well as the "unjustified specific and differentiated treatment for certain taxpayers" that provides "arbitrary difference in the treatment" of their relevant income, and which might have been considered potentially harmful under the OECD's Base Erosion and Profit Shifting (BEPS) provisions,[15] article 41.D of the CITL was repealed in 2017.[16]

III. Chilean Funds as Exempted Platform Vehicles for Investing Abroad

Even though the platform company specific regulation was abolished in 2017 due to, among other reasons, the inefficiency and unfairness derived from the preferential tax treatment granted to certain taxpayers, there is a similar tax treatment for non-Chilean source income coming from foreign investments made through Chilean funds under Law No. 20,712 from 2014, the Chilean Fund Law (CFL).

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13. The stamp tax varied several times during the relevant period in which article 41.D was in force, including fixed tax rates from 0% up to 1.2%.

14. In contrast to what happened in Spain with ETVEs, which were considered beneficiaries of the relevant tax treaties from the Spanish standpoint.

15. Historia de la Ley Nº 21.047, Primer Trámite Constitucional: Cámera de Diputados 3–4 (2017), https://www.bcn.cl/historiadelaley/nc/historia-de-la-ley/7081/ (translation by authors).

16. Law No. 21047, Nov. 23, 2017, Diario Oficial [D.O.].

Generally speaking, Chilean mutual or public investment funds (Funds) are not subject to corporate tax in Chile, serving as exempted vehicles for their investments in their legally allowed activities (passive investments).[17] Their investors—unitholders—will be taxed when they receive the relevant income in the form of a dividend from the Fund, or when they sell or dispose of their interest—units. For Chilean residents, such income—dividends or capital gains—will be generally subject to corporate tax (25%/27%), and personal income tax (progressive up to 35%), with the corporate tax serving as a credit against the personal tax.

Investors that are not Chilean residents or domiciled in Chile enjoy a preferential tax treatment of a 10% sole withholding tax applicable to dividends, or capital gains on disposal.[18] Moreover, such investors who invest in Chilean Funds as platform vehicles for foreign investments may be exempted from any tax in Chile if certain requirements are fulfilled. According to article 82 of the CFL, any distribution, payment or disposal made to a non-resident investor of profits from Funds where at least 80% of the asset portfolio consists of assets or securities located or issued abroad, will be tax exempt if the following requirements are fulfilled:

(a) During 330 consecutive or inconsecutive days in the same commercial year, at least 80% of the total asset value of the Fund is represented by: (i) instruments, titles, or securities issued abroad by non-Chilean resident entities, or certificates that represent such instruments, (ii) assets located abroad or securities representing such assets, and/or (iii) derivative instruments and other similar instruments classified as such by the Financial Market Commission (CMF).[19]

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17. Among other general requirements, public Funds require at least 50 unrelated unit holders, none of them with more than 35% of property over the Fund, or the participation of an institutional investor, who will not be limited in its property.

18. If the 10% sole tax is applicable, the tax credit registered at the Fund level may not be used. Preferential tax treatment is not granted to non-resident unit holders of private funds, but only to public Funds, which have more strict atomization requirements. *See supra* text accompany note 17.

19. Securities may not have as underlying assets Chilean domiciled assets or activities performed therein.

(b) That the Fund's bylaws include: (i) a coherent investment policy regarding the preceding requirement (a), and (ii) the obligation to distribute any Chilean source income perceived or accrued by the Fund.

Consequently, such investors not resident or domiciled in Chile that invest in Funds that fulfill the above-mentioned requirements—mainly represented by the obligation to invest at least 80% of their underlying assets abroad in the terms referred before—will be exempted from all Chilean tax on flows received because of ownership of those Funds (dividends, capital gain on sale, or redemption). The only exception will be the applicable 10% sole tax on Chilean source income dividend distributions (maximum of 20%), if applicable. Even though Funds are not properly separate legal entities with juridical personality, like companies, including abolished platform companies, and having in mind as well that public Funds require important atomization requirements regarding their unit holders, for these purposes Funds may serve perfectly as platform vehicles for investing abroad, being used as holding entities to structure or manage regional operative investments from Chile. The Fund would have subsidiaries in Chile and the rest of the countries in the region, with Chile exempting the unitholders from any foreign source income, or taxing them with only a maximum 10% withholding tax in certain scenarios (Chilean source income, or if the Fund would not fulfill the above-mentioned requirements to exempt its foreign investors).

Likewise, in an old, similar provision contained in article 11 of the CITL, which currently coexists with the above-mentioned article 82 of the CFL, Chilean investment funds with at least 90% of equity in foreign underlying securities, will be treated as non-Chilean domiciled entities for all CITL purposes.[20] Consequently, non-Chilean domiciled unitholders of such funds will not be taxed in Chile on their income connected to the relevant investment funds.[21] The Chilean government drafted a new tax reform bill (August 2018), which proposes—among other major aspects—repealing CITL article 11 with a special tax treatment based on the preferential regulation in article 82 of CFL.

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20. The remaining percentage may only be invested in fixed income instruments with a duration up to 120 days from acquisition.

21. Including Chilean-source income derived from the underlying assets. *See supra* text accompanying note 17.

IV. Applicability of the Special Regime in Other Jurisdictions

A. Spain

Apart from the ETVE companies, Spain offers tax credit double taxation relief as well as a participation exemption regime applicable to both dividends and capital gain income generated abroad. In order for the tax credit to apply, the following requirements must be met:

(a) It should apply for direct taxes;

(b) Foreign taxes paid must be similar to Spain's corporate income tax;

(c) Application will be subject to the lesser of: (i) the tax that would have been payable in Spain had the income arisen in Spain, or (ii) the actual income tax incurred.[22]

On the other hand, in order for a dividend or capital gain received from abroad to be exempted from taxation in Spain, it must comply with the following requirements:

(a) The Spanish parent company must have an interest of at least 5% in the foreign subsidiary. The 5% interest requirement is considered to be met if the holding in the subsidiary exceeds EUR 20 million;

(b) The interest must have been held by the parent for at least one year (it also considers the time it was held by another company of the same group);

(c) The foreign subsidiary should be subject to a tax that is identical or similar to Spanish corporate income tax;

(d) The tax so applied must be of at least a nominal 10% tax rate in the year of the dividend distribution (this requirement

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22. *International Tax Spain Highlights 2020*, Deloitte (Jan. 2020), https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-spainhighlights-2020.pdf.

is considered to be met if the subsidiary is domiciled in a country with which Spain has a double tax treaty signed containing an information exchange clause);

(e) In order to be applicable for exemption, the distributing subsidiary or the entity generating the capital gain may not be a resident of a country considered to have harmful tax regimes according to the OECD.[23]

However, if the dividend is deductible as an expense at the subsidiary level, the tax exemption at the parent company does not apply. The tax exemption is limited in certain cases. Special rules, among others, apply to the following: (i) Dividends received from companies that obtain dividends or capital gains generated from transfers of interests in other companies, when the dividends/capital gains exceed 70% of the company's gross income, and (ii) capital gains generated from transfers of interests in companies that receive dividends or capital gains generated from transfers of interests, when the dividends/capital gains exceed 70% of the company's gross income.

As an alternative to this tax exemption regime, and applicable to dividend distributions only, a tax credit based on imputation is established. This tax credit allows the crediting of the foreign tax paid abroad on the income from which the dividends are paid, and the foreign withholding paid on the profit distribution, up to the limit of the tax that would have been paid on the gross amount in Spain. The only requirement for the application of this tax imputation regime is that the Spanish company has at least a 5% interest in the foreign company during the 12 months prior to the date on which the dividend is due and payable. This one-year holding period is deemed to be met if it is completed after the dividend is distributed. The part of the tax paid abroad with respect to which the taxpayer is not entitled to this tax credit may be considered tax deductible, provided that it corresponds to the foreign company's business activities carried out abroad. The tax credit can be carried forward for an unlimited number of years.

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23. This exception does not apply for companies domiciled in E.U. Member States as long as said company can prove it is an operative company (substance).

B. Netherlands

The Netherlands was at some point the largest conduit country through which large corporations channeled their investments in order to obtain tax benefits.[24] The Netherlands has been characterized as being a tax friendly country, mainly because it has an extensive tax treaty network,[25] and also due to the tax benefits granted in favor of "Dutch holding companies." In this regard, it is worth mentioning that there is no special definition of holding companies in the Netherlands. Therefore, they are understood as simply companies that hold shares on behalf of subsidiaries, acting as a channel to collect and distribute different kinds of income to their owners.

As a general rule, a Dutch resident company is subject to corporate income tax on its worldwide income. On the other hand, non-resident entities have a limited tax liability because they are only taxed on their "Dutch source income." In particular, the Dutch tax regulation (Dutch Corporate Income Tax Act, article 13) establishes the commonly called "participation exemption," which aims to eliminate economic double corporate taxation of profit distributions paid by a subsidiary—domestic or foreign—to its parent company. This treatment has been in force for more than 50 years, but its regulation has suffered several changes throughout the years (the last one was in 2019). Also, there is a special regime which provides double taxation relief for profits that are attributable to a permanent establishment. Under this latter provision, commonly called "object exemption," the profit that is attributable to a foreign permanent establishment is exempt from corporate income tax at the level of the Dutch head office.

The participation exemption works as an exemption at the level of the recipient with respect to benefits derived from its subsidiaries, including dividends, realized and unrealized capital gains, foreign exchange rate results, and other income. Some requirements must be met

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24. Francis Weyzig, *Tax Treaty Shopping: Structural Determinants of Foreign Direct Investment Routed Through the Netherlands*, 20 Int'l Tax Pub. Fin. 910 (2013).

25. A Dutch holding company that holds investment in other countries is eligible for the tax benefits of more than 100 tax treaties in force. *See Overview of Treaty Countries*, Belastingdienst, https://www.belastingdienst.nl/wps/wcm/connect/bldcontenten/belastingdienst/individuals/tax_arrangements/tax_treaties/overview_of_treaty_countries/ (last visited Oct. 5, 2020).

to qualify for this exemption. First, the holding company needs to own at least 5% of the nominal paid capital of the subsidiary ("ownership test") and the participation shall not be considered to be held as a portfolio investment ("motive test").

In general, the motive test is met if the shares in the subsidiary are not purely held for the return that can be expected from normal asset management. Nevertheless, if a taxpayer fails the motive test and the participation is deemed to be held as a portfolio investment, the exemption would still apply if: (i) the subsidiary is subject to tax that is reasonable according to Dutch standards (e.g., effective tax rate of at least 10%) ("effective tax rate test"); or, (ii) less than half of the assets of the direct subsidiary usually consist of, directly or indirectly, low-taxed "free" portfolio investments on an aggregated basis ("asset test"). For the application of this test, assets of lower-tier subsidiaries are taken into account pro rata. Generally, investments in real property do not qualify as free portfolio investments. There are also deemed free portfolio investments (e.g., group receivables, assets leased or licensed to related parties unless some conditions are met).

As an outcome of the above-mentioned exemption, a capital loss that might result from the acquisition and disposal of the shareholding is similarly nondeductible. However, a liquidation loss of a subsidiary company may be deductible under certain circumstances.[26] Additionally, in case the participation exemption applies and some of the income received by the holding company was previously subject to a withholding tax, such tax cannot be credited.

A taxpayer who receives income from a participation that first qualified, but at a certain point in time no longer qualifies, for the participation exemption, or vice versa, must attribute the income to the taxable and the tax-exempt period accordingly ("compartmentalization rules"). The compartmentalization rules apply to all changes in the application of the participation exemption regime irrespective of whether caused by a change in facts and circumstances or change in legislation. It applies to both capital gains and dividend distributions.[27]

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26. *Worldwide Corporate Tax Guide*, EY 1103 (2018), https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/tax/guides/ey-worldwide-corporate-tax-guide-2018.pdf.

27. *Netherlands Corporate—Income Determination*, PwC, http://taxsummaries.pwc.com/ID/Netherlands-Corporate-Income-determination (last updated July 6, 2020).

Since January 1, 2016, as a consequence of changes to the E.U. Parent-Subsidiary Directive, a corporate taxpayer is not eligible for the participation exemption to the extent that such distributed profits are deductible by the subsidiary ("anti-mismatch rule"). Therefore, the participation exemption no longer applies if a shareholder receives a dividend and this dividend is deductible by the subsidiary. On the same path, benefits derived from the disposal of the participation and foreign exchange results remain exempt, given that they are non-deductible at the level of the subsidiary.

Furthermore, please note that CFC rules are in force since 2019 in the Netherlands.[28] Although portfolio investment should not be covered by the participation exemption, there might be cases when the exemption still applies if the asset test or the effective tax rate test are met. Therefore, CFC effects might be cancelled by the participation exemption regime.

Finally, it is also worth mentioning that dividends paid by a Dutch company to its shareholders are generally subject to 10–15% withholding tax. However, this withholding in most cases can be reduced due to tax treaties subscribed by the Netherlands, or due to the E.U. Parent-Subsidiary Directive (in accordance with the E.U. Parent-Subsidiary Directive, profits distributed by a subsidiary in one Member State to its parent company in another Member State will be exempt from withholding tax provided that the parent company holds at least 10% of the subsidiary).

C. United Kingdom

The United Kingdom has a Substantial Shareholdings Exemption (SSE), which provides an exemption from foreign dividends and capital gains (and disallowance of capital losses) for disposals of shares by companies, on or after April 1, 2002, which meet certain requirements.[29] The SSE is an exemption designed to make it easier for U.K. sellers to

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28. *Doing Business in Netherlands 2019*, PwC (2019), https://www.pwc.nl/nl/assets/documents/pwc-doing-business-in-the-netherlands-2019.pdf.

29. HM Rev. & Customs, *Reform of Substantial Shareholding Exemption for Qualifying Institutional Investors* (Dec. 5, 2016), https://www.gov.uk/government/publications/reform-of-substantial-shareholding-exemption-for-qualifying-institutional-investors/reform-of-substantial-shareholding

dispose of their shares in trading companies. The tax policy is meant to enhance the value by allowing the vendors to sell shares free of tax.[30]

The main conditions for the SSE to apply relate to (i) the shareholding held in the company being invested in (the target) by the investing company (the seller), and (ii) the trading status of the target and the target's group. Since its incorporation in 2002, the SSE has been a valuable corporate capital gains relief on the sale of trading subsidiaries. However, this regime of exception has been subject to modifications for the purpose of expanding its scope of application and making the regime more attractive and effective. The main amendments introduced to the SSE intended to provide relief from the strict requirements that were contained in the previous SSE regulation and remove many of the uncertainties that arose under the original rules.

After the introduction of these modifications, for all disposals made on or after April 1, 2017, the rules to qualify for SSE are as follows:

> 1. *Shareholding condition:* The seller must hold an interest of at least 10% of the target's ordinary share capital. The seller must hold or have held the interests described above throughout a 12-month period beginning not more than six years before the disposal of the relevant shares in target (previously two years).[31]
>
> For example, for a disposal in July 2018 to qualify for SSE it would have been sufficient for the 10% interest to have been held for the 12 months from July 2012 to July 2013. This means that from July 2013 the seller could hold an interest of less than 10% and the SSE may still apply on its disposal, allowing the shares held in a subsidiary to be sold down

-exemption-for-qualifying-institutional-investors [hereinafter HMRC Policy Paper].

30. Pete Miller, *20 Questions on the Substantial Shareholding Exemption*, Tax J. (Apr. 12, 2018), https://www.taxjournal.com/articles/20-questions-substantial-shareholding-exemption-12042018.

31. *See* Chartered Inst. of Tax'n, *The Substantial Shareholding Exemption (Clauses 27 and 28): Briefing Note for Fin. Bill 2017-19* (Oct. 25, 2017), https://www.tax.org.uk/sites/default/files/171016%20FB2017-19%20Substantial%20Shareholding%20Exemption%20FINAL.pdf.

gradually. Thus, the exemption was extended so it widens access to SSE.

Moreover, Qualifying Institutional Investors (QII) are not required to hold the 10% interest in a target, provided certain requirements are met.[32]

2. *The trading condition:* the company being sold must be trading or the holding company of a trading group (without, to a substantial extent, any nontrading activities) for at least 12 months before the disposal (longer in some cases). In certain circumstances, the company being sold also must be either trading or the holding company of a trading group immediately after the disposal. There is a broader exemption for certain "qualifying institutional investors."[33]

The new rules improved the SSE because they amplified the scope of applicability of this exemption, promoting investment and corporate business in the United Kingdom. For example, under these new rules, a private equity company would now be able to sell shares in different stages over the years and once the total shareholding had been reduced below 10%.

Moreover, the U.K. authorities state the aim of the SSE to be eliminating the potential double taxation of trading profits in a company or sub-group being disposed of when these are realized by the shareholder by way of a disposal of their shareholding rather than, for example, by way of a dividend, which would be exempted from tax in the hands of a corporate shareholder, and to facilitate the restructuring of groups without triggering a tax charge.[34]

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32. Where at least 25% of the capital of the seller is owned by one or more QII, the condition relating to the seller's shareholding is met if: (i) the seller holds an interest in ordinary shares in the target and the acquisition cost of these shares was at least £20,000,000; and (ii) the seller's beneficial interest in the company is proportionate with such shares. Eloise Walker, *United Kingdom*, *in* Outbound Acquisitions: Tax Planning for European Expansion in a Changing Landscape 223, 224 (2019), https://nmerhejelaw.com/wp-content/uploads/2019/11/2019-PLi-Master-FINAL-PUBLISHED.pdf.

33. *International Tax: United Kingdom Highlights 2020*, Deloitte 3 (Jan. 2020), https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-unitedkingdomhighlights-2020.pdf.

34. HMRC Policy Paper, *supra* note 29.

V. Main Tax Considerations of Implementing a Regulation for Chilean Operative Hub Companies

A. Tax Credit vs. Exemption System

The first element to review for establishing a tax policy applicable to hub companies is whether an exemption or tax credit system is more appropriate to achieve the effect of promoting Chile as a hub country for foreign operative investment. By an overwhelming majority, the OECD countries have territorial tax systems, consequently only taxing income coming from domestic sources. The only member countries that do not have participation exemptions are Chile, Canada, Korea, Latvia, Mexico, and New Zealand.[35] The United States recently changed its tax system from worldwide to territorial. However, like the majority of the OECD countries, it still has a tax credit system for passive income.[36]

Tax burden on foreign profits under a worldwide tax regime like that of Chile depends on the parent tax rate on corporate profits.[37] But Chile has a corporate tax rate for worldwide income of 27%,[38] which is regularly considered high compared with other countries in the region. If the parent company is located in a worldwide tax regime country, the host tax rate will not be an important factor for the decision of where to

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35. Daniel Bunn et al., *Anti-Base Erosion Provisions and Territorial Tax Systems in OECD Countries*, Tax Found. (Apr. 2019), https://files.taxfoundation.org/20190501114822/Anti-Base-Erosion-Provisions-and-Territorial-Tax-Systems-in-OECD-Countries-FF-652.pdf.

36. In December 2017 the United States enacted the Tax Cuts and Jobs Act (TCJA), which sought, among other things, to adopt some characteristics of territorial tax systems like participation exemptions. In the case of the United States, the participation exemption proposed by the TCJA is limited to dividends received by corporations that have at least a participation of 10% in the foreign corporations paying the dividends. I.R.C. § 245A. The provision allows the foreign portion of the dividend to be deducted. However, not all dividends can apply for the benefit. So-called "hybrid dividends" (dividends that are treated differently for tax purposes according to the law of two jurisdictions) are not eligible for the participation exemption. The TCJA does not allow tax credits for taxes paid or accrued with respect to dividends distributed from a subsidiary in a foreign country when a deduction for the dividend is applicable in the other country.

37. *See* Simmler, *supra* note 9, at 2.

38. Or 25%, depending on the local tax system.

locate the subsidiary as long as the host tax rate is lower than the parent tax rate,[39] which is not an easy hypothesis in Chile's case.

Currently, Chilean law contemplates a rather complicated tax credit method that applies different credit caps according to the nature of the income received from abroad, and depending on the domicile of the payer, providing more extensive benefits for those payments coming from countries with which Chile has a double tax treaty in force. In order to use foreign taxes as credit for local tax, Chilean tax credit legislation requires foreign taxes to be mandatory, definitive, similar to Chilean income taxes, and to meet some formal requirements.[40] The tax credit will gross up the local tax base and will be limited by a net specific calculation of foreign source income, which will include directly or indirectly related expenses and deductions.

According to Simmler,[41] there is clear evidence that multinational parent companies prefer to be located in countries with a territorial tax regime, and that MNEs located in worldwide tax regime countries are less likely to locate subsidiaries in low-tax jurisdictions and are less successful in acquiring firms when competing with other MNEs. Also, territorial tax systems prevent the "lockout-effect" that arises when domestic law applicable to the holding company taxes profits generated abroad, discouraging the company to repatriate those benefits to both the hub country and its country of residence.[42] This Article does not pursue comprehensive debate regarding the reasons for transforming Chile into a territorial tax regime but does analyze the positive externalities of encouraging operative foreign investment through this alternative method, considering Chile's current tax credit system has not produced the same effects seen in other legislations where similar objectives have been reached.

Within the scope of territorial countries, there are several differences in the way the exemptions work. Some countries provide full exemptions, while others only partial; some offer exemptions to both dividend distributions and capital gains, while others differentiate the treatment based on the nature of the relevant income. Likewise,

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39. *See* Simmler, *supra* note 9, at 4.

40. CITL art. 41 A; *see supra* notes 10 & 16.

41. Simmler, *supra* note 9, at 9.

42. Kyle Pomerleau & Kari Jahnsen, *Designing a Territorial Tax System: A Review of OECD Systems*, Tax Found. (July 2017), https://files.taxfoundation.org/20170822101918/Tax-Foundation-FF554-8-22.pdf.

countries differ on the mechanisms to avoid BEPS schemes, including CFC rules, interest deductibility limitations, tax exemption habilitating requirements, and other anti-avoidance regulations, usually targeted toward passive income. The different approaches taken by territorial system countries obey their need to balance opposing interests and desirable features of their relevant tax systems. Thus, the battle for lawmakers in choosing one method over another, as well as defining the different characteristics of the chosen method juggles at least three inversely proportional variables: (i) eliminating taxes on foreign profits; (ii) protecting the country's tax bases; and (iii) keeping the tax law simple and accessible.[43]

As a rule, only two of these variables can be reinforced at the same time, as shown below:

Protected feature		**Weaked feature**
Local tax base	Foreign exemption	System simplicity
System simplicity	Local tax base	Foreign exemption
Foreign exemption	System simplicity	Local tax base

Consequently, it will be imperative for lawmakers to have a clear, well-defined objective or pursued policy, bearing in mind that order of priorities will be a critical decision when defining both positive and negative expected externalities.

B. Expense Deduction Issues

Regularly, and particularly in cases of platform or hub structures, parent companies that generate foreign source income through subsidiaries may incur local expenses that may be directly or indirectly related to foreign subsidiary activity and not directly connected to the parent's direct income—whether local or foreign sourced. Considering that such expenses may not be related to the production of the parent company's taxable income, they can be deemed to be non-deductible from the domestic corporate income tax base.

43. *Id.*

For example, in a hypothesis where due to exemption or tax credit regimes, the foreign sourced income would not be taxable under local law, should the expenses incurred by the parent company in understanding foreign legislation be deductible at host level against local source income? What about labor compensation of employees performing services for both parent and subsidiary companies? Or management compensation when strategic decisions are made at parent level?

Therefore, it is important to define the tax treatment of such expenses incurred by the parent for the production of the foreign sourced income, which can differ as follows:

(a) It may be disallowed from the domestic tax base altogether;

(b) It may be deducted only against foreign generated income that is not eligible for the different participation exemptions;

(c) It may be allowed to be fully deductible from the domestic income tax base, regardless of the fact that it is not related to the production of taxable income.

The combination of the three alternatives leads to multiple choices, particularly when entering into details such as determining direct, indirect, and proportional expenses. Maintaining simplicity as part of the main goals, some OECD countries such as France, Germany, Belgium, Italy, and Japan opted for deduction allowances, but granting a 95% participation exemption instead of 100%, as a way of indirectly taxing those local expenses.

In our view, if a proper transfer pricing methodology is implemented and clear, broad economic methodologies are conceived for determining expense proportionality; the impact of allowing expenses related to the foreign source income should not be relevant, as the Chilean hub company should charge an arm's length price that would offset the relevant expense. In this scenario, Chile would actually be allowing local related expenses to be deducted, because all activities, services, and efforts made at the local level for foreign subsidiaries should be accordingly compensated at arm's length at the parent level, thus resulting in Chilean source taxable income.

C. General Anti-Avoidance Rules (GAAR) and Tax Base Protection Measures

Given that Chile is a member of the OECD,[44] it is worth mentioning and taking into consideration the OECD's recommendations on GAARs when defining potential tax benefited treatment. This element is especially important considering that in debating Law No. 21,047, one of the factors considered in repealing CITL article 41 D—the Chilean platform company regulation—was precisely the OECD's opinion on platform transparent structures and their potential consideration as harmful practice entities.

Following the OECD's recommendations, Chile included a general anti-avoidance rule in 2015, which establishes that tax obligations shall be determined in accordance with the nature of the acts or business carried out, whatever the form or denomination given by the taxpayers (substance over form). However, specific related potential GAARs may be analyzed in order to fit a tailored legislation to be proposed into the world base and profit allocation context.

GAARs typically apply by focusing on the substance of a transaction or arrangement. One common feature is to limit or deny tax benefits when insufficient economic substance is present. For instance, this can occur when the taxable income of a firm is reduced as a result of a transaction that has no reasonable commercial purpose or where the purpose of a transaction is to directly or indirectly alter the tax consequence. On this topic, it has been universally agreed that taxpayers should be free to structure their affairs efficiently, as long as their arrangements are not artificial and abusive.

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44. Chile became a member of the OECD on May 7, 2010, and from that moment our tax legislation amendments have considered the OECD's guidelines. *See Chile's Accession to the OECD*, OECD, https://www.oecd.org/chile/chilesaccessiontotheoecd.htm (last visited Oct. 7, 2020). For instance, the Tax Reform approved in 2014 (Law No. 20780, Sept. 29, 2014, Diario Oficial [D.O.]) included CFC rules in the Chilean Income Tax Law and an anti-abuse provision in the Tax Code. Moreover, in June 2015 Chile adhered to the information exchange model developed by the OECD, known as Common Reporting Standard (CRS), committing itself to carry out the first exchanges of information from September 2018 onward. Subsequently, the Tax Code was modified by Law No. 21047, *supra* note 16, in order to adjust and make possible the exchange of information.

The OECD has drafted 15 action points in order to address some weaknesses in the existing international tax principles (BEPS). The action plan identified 15 actions along three key pillars: introducing coherence in the domestic rules that affect cross-border activities, reinforcing substance requirements in the existing international standards, and improving transparency as well as certainty.[45] Related to the topic under analysis, we will refer to Actions 2, 5, and 6.

BEPS Action 2 aims to neutralize the effects of hybrid mismatch arrangements. There are different types of mismatches, but commonly they are related to hybrid instruments[46] and hybrid entities.[47] According to Action 2,[48] mismatch arrangements often lead to double non-taxation that may not be intended by either country, or may alternatively lead to a tax deferral that, if maintained over several years, is economically similar to double non-taxation. The Action 2 Final Report[49] has pointed out that hybrid mismatch arrangements may be used to exploit differences in countries' tax rules and achieve results such as (i) the multiple deduction of the same expense in different countries, (ii) the deduction of a payment in the country of the payer without a corresponding inclusion in the country of the payee, and (iii) multiple tax credits for a single amount of foreign tax paid.

The OECD has indicated that the terms of general anti-avoidance rules are not sufficient to deal with mismatching arrangements. For that reason, it has recommended introducing specific rules to address mismatches, which usually take the form of linking rules that align the tax

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45. *International Collaboration to End Tax Avoidance*, OECD, https://www.oecd.org/tax/beps/ (last visited Oct. 11, 2020).

46. Instruments that are treated differently for tax purposes in the countries involved, most prominently as debt in one country and as equity in another country.

47. Entities that are treated as transparent for tax purposes in one country and as non-transparent in another country.

48. OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (2012), https://www.oecd.org/ctp/aggressive/HYBRIDS_ENG_Final_October2012.pdf.

49. OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2—2015 Final Report*, https://dx.doi.org/10.1787/9789264241138-en.

treatment of an instrument or entity with the tax treatment in the counterparty jurisdiction.[50]

On the other hand, BEPS Action 5 aims to identify harmful tax practices, taking into account transparency and substance. The Final Report for Action 5[51] points out that countries agreed that the substantial activity requirement used to assess preferential regimes should be strengthened in order to realign taxation of profits with the substantial activities that generate them.

Action 5 identifies four key factors, and eight other factors that are used to determine whether a preferential regime is potentially harmful, which include foreign source income exemption, tax treaties network availability, and tax driven decisions.[52]

Among these factors, we believe there are three issues that must be addressed when discussing a hub regime: (i) the exemption at the parent level must be limited to only certain types of income; (ii) the access to a treaty network must be carefully regulated in order to avoid treaty abuse and treaty shopping; and (iii) the holding company must have some level of substance in the country ensuring that the tax regime will not be employed as a mechanism to avoid taxes but as a tool to attract investments and talents into the country. The idea of requiring substance is to ensure that taxable profits can no longer be artificially shifted away

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50. Certain countries have introduced rules that in specific circumstances deny the deduction of expenses that are also deductible in another country, or certain rules that deny a tax exemption when the same income can be deducted in the source country.

51. OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5—2015 Final Report* (2015), https://dx.doi.org/10.1787/9789264241190-en.

52. The four key factors are: (1) "[t]he regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities"; (2) "[t]he regime is ring-fenced from the domestic economy"; (3) "[t]he regime lacks transparency"; (4) "[t]here is no effective exchange of information with respect to the regime." *Id.* at 20. The other eight factors are: (1) "[a]n artificial definition of the tax base"; (2) "[f]ailure to adhere to international transfer pricing principles"; (3) "[f]oreign source income exempt from residence country taxation"; (4) "negotiable tax rate or tax base"; (5) "[e]xistence of secrecy provisions"; (6) "[a]ccess to a wide network of tax treaties"; (7) "[t]he regime is promoted as a tax minimisation vehicle"; (8) "the regime encourages operations or arrangements that are purely tax-driven and involve no substantial activities." *Id.*

from the countries where value is created. According to the OECD, the substantial activity requirement should also establish a link between the income qualifying for benefits and the core activities necessary to produce the income.

Regarding holding company regimes, the Action 5 Report distinguishes two categories: "(i) those that provide benefits to companies that hold a variety of assets and earn different types of income (e.g. interest, rents, and royalties) and (ii) those that apply only to companies that hold equity participations and earn only dividends and capital gains."[53] In the case of holding companies that fall within category (i), "the substantial activity requirement should require qualifying taxpayers to have engaged in the core activities associated with those types of income."[54] However, in the case of holding companies mentioned in (ii), the Report points out that they "may not in fact require much substance in order to exercise their main activity of holding and managing participations."[55] We are of the opinion that certain substance may be required even in this last scenario, lending seriousness and practicality to the pursued foreign investment.

BEPS Action Plan 6 aims to prevent treaty abuse, through developing model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances: "Taxpayers engaged in treaty shopping and other treaty abuse strategies undermine tax sovereignty by claiming treaty benefits in situations where these benefits were not intended to be granted, thereby depriving countries of tax revenues."[56]

Accordingly, the OECD states that a specific anti-abuse rule, the Limitation on Benefits (LOB) rule, shall limit the application of treaty benefits to certain entities under certain circumstances and conditions (based on legal ownership or legal nature that intends to ensure that there is a sufficient link between the entity and the State of residence).[57] The

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53. *Id.* at 39.

54. *Id.*

55. *Id.*

56. *OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6—2015 Final Report* 9 (2015), https://dx.doi.org/10.1787/9789264241695-en.

57. There is also a general anti-abuse rule aimed at addressing another form of treaty abuse, which is called principal purpose of transactions or arrangements (the Principal Purpose Test). *Id.* Under this rule, "if one of the principal purposes of transactions or arrangements is to obtain treaty

Action 6 Report also recognizes that "the adoption of anti-abuse rules in tax treaties is not sufficient to address tax avoidance strategies that seek to circumvent provisions of domestic tax laws."[58] As a result, these problems must be addressed with domestic anti-abuse rules.

Bearing in mind the recommendations of the OECD through the above-mentioned BEPS Actions, we believe that benefits for holding companies in Chile should contain a special anti-avoidance rule that requires some degree of substance for the holding company in the country (e.g., some level of management); rules to avoid mismatch arrangements (e.g., if foreign income is not considered foreign for source purposes, exemption in Chile should not apply); and a special test for treaty benefits, assuring that benefits can only be used by companies that have a real business purpose connection with the domicile country.

As the company established would likely have economic substance in Chile, it should be eligible for the benefits of the treaties. However, special attention should be paid when enacting this provision to make sure it complies with the limitations included in article 7 of the MLI. In this regard, the MLI currently being discussed in the Chilean Congress includes a provision that requires a principal purpose test or PPT.[59]

To determine whether one of the primary purposes of establishing a company was to access the benefit of a tax treaty, an objective analysis should be performed considering all the commercial and legal reasons for implementing such arrangement. In other words, if the tax benefit arising from a tax treaty was one of the main reasons to establish the company in Chile, the benefits of the treaty should not be granted. As a result, the hub company must have business functions and economic substance for benefits to apply.[60]

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benefits, these benefits would be denied unless it is established that granting these benefits would be in accordance with the object and purpose of the provisions of the treaty." *Id.*

58. *Id.* at 10.

59. In some case a Limitation on Benefits will also apply in addition to the PPT if certain conditions are met. Boletín 12547-10, Mensaje 25-367, Apr. 8, 2019, at 19, https://www.senado.cl/appsenado/templates/tramitacion/index.php?# (available by searching for 12547-10 and selecting "Ingreso de proyecto" from the "Tramitación" list).

60. Jasper Korving & Loes van Hulten, *MLI: Testing the 'Principle Purpose,'* Int'l Tax Rev. (Dec. 12, 2018), https://www.internationaltaxreview

VI. Proposed General Model for a Chilean Hub Company for Operative Income

In addressing today's complex business structures and transactions, a certain degree of complexity in the tax system is to be expected. However, where investors view a tax system to be excessively complex relative to other tax systems, the added expense to project costs incurred in understanding and complying with the tax system would tend to discourage the investor's interest.[61]

Consequently, we propose a general framework for a simple, clear tax policy that helps attain the pursued objective: encouraging foreign direct investment in Chile and its positive externalities. This is done through a holding company regime that allows MNEs to establish their head offices in Chile for operative regional income, taking advantage of our well-reputed stability and transparent institutions. There is already solid regulation for passive foreign investment allowing Chilean Funds to be used as passive regulated platforms for investing in the region in a sort of exemption regime. This allows us to focus our proposal on a complementary aspect: establishing a legal structure for centralizing operative income through domestic entities, providing foreign investors the necessary—and globally utilized—tools to avoid tax leakage. This in turn, encourages the use of Chile as a serious regional center.

Our main proposal is based on the approach adopted by an overwhelming majority of OECD countries: implementing a tax exemption system for certain income obtained from foreign companies. The income is subject to compliance with certain requirements established to protect our tax base interest and the worldwide presentation of a serious system. Such characteristics should include a percentage of minimum participation over subsidiaries, a minimum timing as owner or investor, definition of the nature of income to be included, and excluded from exemption benefits, among others.

.com/Article/3848991/MLI-Testing-the-principal-purpose.html?ArticleId=3848991.

61. OECD, *Policy Framework for Investment: A Review of Good Practices* (2006), https://www.oecd.org/daf/inv/investmentfordevelopment/policyframeworkforinvestmentareviewofgoodpractices.htm.

Based on the previous analysis, we are of the opinion that the main structure of a tax policy designed for the described objectives should consider:

(a) *Exemption system*. Following the OECD and global trends, we think an exemption system is easier, simpler, and accepted worldwide. A tax credit regime is based on a different scenario, where local entities avoid double taxation but do not help in avoiding tax leakage from investing through Chile as a hub instead of making the direct investment in each country in the region. Similar to Funds' specific described benefits, we propose a regime where foreign investors are not taxed in Chile except for their Chilean-source connected direct income.

(b) *Nature of the investment and the income*. Similar to other OECD jurisdictions, our proposal refers to operative underlying investment. Like the Dutch regime, we propose excluding portfolio investment, which has its specific Chilean regime and structured benefits through the regime applicable to investment funds mentioned above.

Only dividends and capital gains arising from investments in operative companies, defined as all entities whose main business purpose and effective activities over an important percentage are not considered passive according to CITL article 41.G, should be eligible for the exemption. Interest, royalties, service considerations, and all other income coming from abroad should follow the general rule, being taxed at the Chilean entity level once received. Tax credit relief should be available if taxes are applied abroad. We also believe that it would be important to keep CFC provisions in order to prevent the erosion of the domestic tax base, thus complying with the general OECD recommendations.

(c) *Beneficial owners exempted taxpayers*. This special regime should only be granted to companies controlled by foreign investors. In this regard, we propose that at least 2/3 of the shares must be held directly or indirectly by foreign investors. Specific anti-avoidance rules should be included in order to prevent Chilean domiciled

taxpayers from using these structures to opt for benefits out of their scope.

At the same time, non-Chilean domiciled or resident beneficial owners—shareholders of Chilean hub companies—should be exempted from any withholdings on dividends and capital gains connected to the relevant Chilean company. There should be an exception with respect to dividends or capital gains connected to Chilean source income, or income not particularly exempted.

(d) *Minimum investment participation*. As we are dealing with operative underlying investment, and in order to prevent a portfolio investment, we think a 10% minimum investment in a defined period is a reasonable requirement for this kind of entity. We are of the opinion that a minimum 10% participation should be required in the same period contained in the Investment Fund Law, 330 days in a commercial year, in order to opt for the annual benefit.

(e) *Entity*. One of the problems of the repealed platform company legislation was the requirement to be incorporated as a publicly traded corporation. We think this benefit should be applicable to all companies.

(f) *Underlying taxation*. We think a specific definition of an underlying corporate tax rate or applicable tax at relevant source is not necessary. However, in order to avoid tax only motivated structures, we propose establishing the requirement that the relevant income should have been taxed at source, whether with corporate tax or withholding on its distribution/payment. If no tax was paid at origin, the exemption should be maintained provided that such country does not tax the relevant income due to local exemption or any other analogous reason. This should also not be because of a treaty provision with Chile, or as a consequence of a hybrid structure, where the domicile country does not consider the subsidiary as domiciled therein for tax purposes. Thus, it should not be a requirement that the income has already been taxed at any level, which would depend on foreign tax legislation, but rules have to be clear to avoid hybrid combinations.

(g) *Mismatch prevention*. Following general trends and OECD guidelines on the subject, exemption should not be provided for such cases where dividends are deductible in the payer's country or multiple deductions have been permitted in several countries in an indirect property structure.

(h) *Substance*. The Chilean general GAAR provision contained in its Tax Code is too general in order to avoid specific behavior and harmful consequences in this regard. Accordingly, specific anti-avoidance rules should be included, particularly referring to substance.

Even though OECD substance requirements are reduced considerably for holding structures where exemption is only provided for dividends and capital gains, as in the proposed scenario, we are of the opinion of requiring a clear rule of basic substance that demonstrates a real business purpose in connection with Chile, the hub domicile country. As such, we suggest analyzing a requirement on domestic management, where at least one member of the board should be a Chilean domiciled individual; board and/or management meetings should be made at least twice a year in Chile; there should be a fixed base of business, meaning an office, plant, or factory. Exceptions should be applicable when incorporating a local operative subsidiary, with the local investment providing the relevant substance.

(i) *Treaties*. Since substance will be required and companies will be incorporated under Chilean legislation, we do not see a problem with considering Chilean regional hub companies' residents for treaty benefits.

VII. Conclusions

The establishment of Chilean companies controlled by foreign companies intended to serve as hubs for their regional operative investments in Latin America could generate positive externalities to the country. The lack of revenues arising from a potential lower payment of corporate income tax or withholding tax when profits are remitted abroad from the Chilean hub company should be offset by the payment of

employment tax, withholding tax for services rendered abroad (the rate varies between 10% and 35%), corporate income tax received from suppliers in Chile (sales of goods, services, and rental payments), and the positive externalities that may arise from the foreign investment, as transfer of know-how, technology, competition, and skilled expatriates that could arrive to Chile.

Regulation should be clear and simple in order to maintain the pursued objective, centralizing regional operative investment through domestic entities, with an exemption regime for non-Chilean domiciled investors. The enactment of this regime would be in line with those established in several OECD countries and could make Chile more competitive when attracting foreign investment focused on a more regional approach, as returns on these investments would not be burdened with additional taxes to those applicable in the country where the operative subsidiary is incorporated (source country).

Specific anti-avoidance rules should be included, including mismatch provisions and participation requirements. Also, we believe that requiring a certain level of substance in the country is essential to preventing pernicious purposes. As to which level of substance is enough to accomplish this goal, we believe that the holding must be able to demonstrate at least one economic reason for being incorporated in the country, beyond the tax benefits to which it may have access. The incorporation of Chilean subsidiaries should be considered as such. Likewise, a real management activity in the country should be required, in order to demonstrate a real connection with the state of residence.