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LATAM Insights

Recent Latam International Tax Developments: Brazil, Chile and the United States

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Tax treaties serve as a valuable mechanism for minimizing distortions and obstacles that arise from dissimilar tax systems among countries, ultimately benefiting cross-border investments. With a specific focus on enhancing its treaty network, the United States ("U.S.") aims to reduce friction for U.S. companies generating profits abroad while maintaining its appeal to foreign companies seeking to invest within its borders.

In the absence of a tax treaty, potential double taxation arises, limiting shareholders' returns and impeding the allocation of company profits for investment purposes, either within the U.S. or internationally. As per the year 2022 edition of the International Tax Competitiveness Index[1], the average magnitude of a tax treaty network encompasses 74 countries, with the U.S. occupying the 25th position among OECD countries, having ratified 66 treaties[2].

According to a recent survey conducted by the National Foreign Trade Council[3], prominent multinational companies have identified Brazil, Singapore, and India as their primary targets for negotiating and implementing cross-border tax treaties. While a tax treaty is currently in force between the U.S. and India, it is worth noting that the United States has yet to establish tax treaties with Brazil and Singapore. The continuous absence of double tax treaties between the U.S. and Latin American

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1 https://taxfoundation.org/publications/international-tax-competitiveness-index/

2 https://taxfoundation.org/us-tax-treaty-priorities/

3 https://www.nftc.org/2023-tax-treaty-survey/

countries has increased the tax burden for U.S. companies that have operations in the region, generating a competitive disadvantage for the U.S. as compared with other countries.

Brazil

Eliminating double taxation and other distortions can expedite commercial relations and promote the establishment of more effective tax frameworks. A noteworthy instance of such progress can be observed in Brazil's recent advancements in transfer pricing regulations, as the country is actively working towards aligning its transfer pricing rules with the internationally recognized standards set forth by the Organization for Economic Cooperation and Development ("OECD").

In December 2022, the Brazilian Government implemented measures to introduce new transfer pricing rules as part of a collaborative endeavor between the OECD and Brazil that commenced in 2018. In May 2023, The Brazilian Senate unanimously passed a Bill[4] that would enact significant changes to the Brazilian transfer pricing system, shifting from a formula-based transfer pricing rule to the arm's-length principle. The inclusion of the arm's-length principle, which requires related companies to engage in transactions as if they were unrelated entities, shows a significant milestone for Brazil towards its aspiration to join the OECD as a member. Brazil's new transfer pricing rules will be effective beginning in January 2024, but taxpayers can adopt them as an option if they file an electronic application by September 30, 2023.

Adopting arm's-length principles can potentially remove a barrier to claiming U.S. foreign tax credits on taxes paid in Brazil. Under U.S. foreign tax credit regulations, a foreign tax will be creditable in the U.S. if, among other requirements, the allocation made under the foreign country's transfer pricing rules is determined under arm's-length principles. Once the law adopting arm's-length principles is enacted, taxes paid in Brazil could have the potential to be eligible for the U.S. foreign tax credit[5].

In the absence of a tax treaty between the U.S. and Brazil, implementing an arm's-length standardized approach for calculating profits in cross-border transactions can alleviate the challenges businesses encounter when determining the tax consequences of profitable projects in Brazil. Nevertheless, **pursuing tax treaty negotiations with Brazil remains critical** and would offer additional advantages by fostering even greater facilitation of business operations in both countries.

Chile

In this context, the U.S. is making significant regional advances, particularly in its engagements with Chile.

4 Provisional Measure No. 1,152/Conversion of Bill No 8.

5 The U.S. Department of the Treasury and the IRS have yet to release guidance on whether these changes fulfill the requirement and, if so, the year the change would become effective.

The U.S. is undergoing the ratification process of a Convention to Avoid Double Taxation with Chile (the "Convention"). The Convention's provisions aim to alleviate double taxation and streamline the operational and transactional aspects for businesses operating in both Chile and the U.S., which have been adversely impacted by the absence of a bilateral tax treaty. Notably, the lack of such an agreement has led to a decline in U.S. foreign direct investment in Chile[6].

The continuous absence of a double tax treaty between the two countries has increased the tax burden for U.S. companies with Chilean operations. U.S. entities are at a disadvantage with respect to companies that are considered residents of countries with which Chile has double tax agreements in force, **China** an emblematic example.

In this setting, last Thursday, June 1, the United States Senate Foreign Relations Committee ("SFRC") voted out of committee[7][8] the Convention, only lacking its vote and ratification by the full Senate. **Senate Majority Leader Chuck Schumer indicated that ratifying the treaty is crucial for access to critical minerals such as lithium and that getting it done is a priority**. Also, more recently on June 9, representatives Gerry Connolly, Maria Elvira Salazar, and Joaquin Castro introduced a resolution urging the U.S. Senate to ratify the Convention, indicating that "*Chile is among our strongest democratic partners in the Western Hemisphere" and that "As the economic powerhouse of South America, Chile is well known for its strong defense of free markets and private property.*"

The Convention has already been ratified by Chile. Thus, after ratification by the U.S., only the exchange of diplomatic notes would be required for the Convention to enter into force.[9]

Main features:

1. **Elimination of double taxation**

   With the entry into force of the Convention, taxes paid in the U.S. will be creditable in Chile and vice versa. This is significant for interest paid from U.S. sources to a Chilean taxpayer and for capital gains from the sale of real estate assets subject to Foreign Investment in Real Property Tax Act ("FIRPTA") regulations.

6 https://www.bea.gov/sites/default/files/2022-07/dici0722.pdf

7 https://www.foreign.senate.gov/press/rep/release/risch-on-committee-passage-of-chile-tax-treaty

8 https://www.foreign.senate.gov/press/dem/release/sfrc-chairman-menendez-celebrates-historic-approval-of-the-chile-tax-treaty-to-protect-and-promote-us-foreign-direct-investment-in-chile

9 As a general rule the provisions of the Convention will be applicable as from January 1 of the year following its entry into force, i.e., January 1, 2024 (if approved this year). An exception being that the reduced withholding tax rates would become effective for amounts paid or credited on or after the first day of the second month following the date on which the Convention enters into force.

2. Exchange of information

Both countries will establish obligations and mechanisms for the exchange of information, which is highly relevant since the U.S. is not part of the OECD agreement that established the Common Reporting Standard.

3. Taxation of U.S. citizens under the Convention and dual residence conflicts

The Convention protocol establishes what is known as the saving clause, a clause that the U.S. has introduced in all its treaties and is intended to allow the taxation of citizens and permanent residents (i.e., individuals with a valid green card) without the limitations of the treaty. The above should not prevent U.S. citizens and permanent residents who are also Chilean residents for tax purposes from taking advantage of the tie-breaker rule of Article 4 of the Convention.

4. Reduced withholding tax rates

- **Interest**

  In a non-treaty scenario, interests paid from the U.S. to a Chilean resident entity are taxed with a 30% Withholding Tax ("WHT") (except portfolio debt). In the case of Chile, interest is taxed with a 35% WHT. The Convention reduces this rate to a general rate of 15%, which would be reduced to 10% in a period of five years.[10] A reduced rate of 4% will also apply if the beneficial owner of the interest is a bank or an insurance company, as well as in other particular situations.

- **Business Profits**

  Cross-border services will be exempt from WHT, including technical services. With the Convention's entry into force, Chilean taxpayers making remittances to the U.S. that involve a remuneration for services rendered in that country will no longer be subject to WHT in Chile (this tax is levied at rates varying between 15% and 35%)[11]. Insurance and reinsurance premiums will be taxed at 5% and 2%, respectively.

- **Dividends**

  Currently, dividends paid from a U.S. resident entity to a person domiciled or resident in Chile are subject to a WHT of 30%. With the Convention, this rate would be reduced to 5%.[12] In the case of dividends paid from Chile, the CDT will have no practical relevance.

[10] Article 11 of the Convention establishes rules for determining and taxing the agreed amount of interest, allowing countries to recharacterize interest as dividends or to tax it without limitation.

[11] As long as certain conditions are met and the business is not conducted through a permanent establishment (PE) in the country.

[12] 15% on holdings of less than 10%.

- **Capital gains**

  The general rule is that capital gains generated by the sale of rights or shares in a U.S. entity are not taxed in the U.S. when realized by a non-resident. In the case of Chile, capital gains on the sale of shares or rights obtained by a non-resident are taxed with a WHT of 35%. Under certain conditions, the Convention lowers this rate to 16%.

- **Royalties**

  Typically royalties paid from the U.S. to a Chilean resident are subject to a 30% WHT. This same rate applies, as a general rule, in Chile. Under the Convention, royalties would be subject to a WHT of 10%, or 2%, for the use of industrial, commercial, or scientific equipment.

- **Reservations**

  The SFRC's approval is subject to two reservations in relation to the Base Erosion and Anti-abuse Tax ("BEAT") and the relief from double taxation. The reservation concerning BEAT clarifies that (i) the Convention shall not prevent the imposition of BEAT under U.S. Internal Revenue Code Section 59A and (ii) paragraph 1 of Article 23 of the prior Convention would be deleted and replaced[13].

If you have any questions regarding this newsletter, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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[13] Should be replaced as follows: *In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle thereof):*

a. *the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income applicable to residents and citizens the income tax paid or accrued to Chile by or on behalf of such citizen or resident. For the purposes of this subparagraph, the taxes referred to in subparagraph b) of paragraph 3 and paragraph 4 of Article 2 (Taxes Covered), excluding taxes on capital, shall be considered income taxes; and*

b. *in the case of a United States company owning at least 10% of the aggregate vote or value of the shares of a company that is a resident of Chile and from which the United States company receives dividends, the United States shall allow a deduction in the amount of such dividends in computing the taxable income of the United States company.*