

THE SUBSTITUTE TAX: A NEW OPPORTUNITY

The recent 2020 Tax Reform includes an attractive mechanism known as the "Substitute Tax", which was formerly used in the 2014 Tax Reform. The "Substitute Tax" allows companies to pay a sole tax in replacement of the final taxes, which are the resident income tax (*Impuesto Global Complementario*) and the non-resident income Tax (*Impuesto Adicional*). Once the "Substitute Tax" has been paid upon eligible companies' profits, such profits may be distributed on a tax-free basis. In other words, the company shall borne the payment of the final taxes, which are, precisely, "substituted" by the "Substitute Tax".

This tax applies at an attractive 30% fixed rate *vis-à-vis* the current 40% rate of the resident income tax, which in the case of company distributions to local residents trigger a final tax burden of 44.45% under the General Tax Regime (ie, the Partially-Integrated tax regime). The reduced "Substitute Tax" rate is also attractive for non-residents, both individuals and companies, as they are subject to a 35% non-resident income tax upon distributions, which may also result in a total tax burden of 44.45% under the General Tax Regime if they reside in a country that has not signed a Tax Treaty with Chile.

The "Substitute Tax" may only apply to the company profits generated until December, 2016 (known as "FUT"). The following examples may help understanding the benefits of the "Substitute Tax".

If a company under the General Tax Regime has FUT of \$456 million and after the Corporate Income Tax gross-up such amount increases up to \$600 million, the "Substitute Tax" would be \$36 million (once the full \$144 million Corporate Income Tax credit is applied). This alternative would imply an effective rate of the Substitutive Tax of 7.89%.

Following the same example, if the "Substitute Tax" were not applied and assuming that after 2016 the company continued generating profits, the company shareholders would pay **\$90 million** resident income tax (applying the maximum 40% rate) regarding the \$600 million distribution (once applied the \$105 million partial Corporate Income Tax credit, the 5% additional Corporate Income Tax credit when the distribution exceeds \$187 million, and the resident income tax deduction). This alternative would import an effective resident income tax rate of 20.6%.

Eligible taxpayers for the "Substitute Tax"

Taxpayers subject to the Corporate Income Tax paying taxes based on a general balance sheet according to full accounting records may apply the Substitutive Tax, whether they are subject to the General Tax Regime or to the Small/Medium Size Companies Tax Regime.

Eligible profits for the "Substitute Tax"

Companies may apply the "Substitute Tax" upon the profits generated until December, 2016 (FUT), including profits received from subsidiaries or on the occasion of business reorganizations.

Deadline for declaring and paying the "Substitute Tax"

The "Substitute Tax" may be declared and paid, as follows:

1. Until the last business day of December, 2020, with respect to the FUT registered as of December 2019;
2. Until the last business day of December, 2021, with respect to the FUT registered as of December 2020; and
3. Until the last business day of April, 2022, with respect to the FUT registered in December 2021.

The declaration and payment of the "Substitute Tax" shall be performed online on one or more occasions within the deadlines indicated above, through Form No. 50 of the Chilean tax authorities.

Calculation of the "Substitute Tax" basis

The rules for calculating the "Substitute Tax" basis are complex and different depending on the year in which this tax is paid and the tax regime of the company. In any case, regardless of the applicable rules, the company must deduct from the tax basis of the "Substitute Tax", among other items, the dividends distributed between the end of the previous year and the day in which the option is exercised, including the business reorganizations profits allocations. Therefore,

As mentioned in our prior example, the Corporate Income Tax previously paid by the company with respect to the FUT or profits upon which the "Substitute Tax" is paid may apply as a credit against the "Substitute Tax".

Distribution of the "Substitute Tax" profits

The profits upon which the "Substitute Tax" is paid are deemed to have fully complied with Chilean taxes.

Therefore, these profits may be distributed at any time without applying any accumulated taxable profits allocation rules. These benefits apply both to the company paying the "Substitute Tax" as well as to its parent companies receiving the profits which, in turn, shall distribute them to their holdings companies.

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