

AN ALERT FROM THE BDO INTERNATIONAL TAX PRACTICE

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► **SUBJECT**
**UNITED STATES AND CHILE
SIGN A NEW INCOME TAX
TREATY**

► **ISSUE**
The United States and Chile signed a new income tax treaty (“Treaty”) on February 4, 2010.

► **AFFECTING**
Taxpayers with cross-border activities between the United States and Chile.

► **EFFECTIVE DATE**
Upon ratification by the United States Senate, the Treaty will enter into force on the date of the exchange of instruments of ratification. The Treaty provisions will enter into force on the following dates:

- Concerning taxes withheld at source—for amounts paid or credited on or after the first day of the second month next following the date on which the new treaty enters into force; and
- Concerning other taxes—for tax periods beginning on or after the first day of January next following the date on which the new treaty enters into force.

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► DETAILS

On February 4, 2010, the Treasury Department announced a new income tax treaty between the United States and Chile.¹ The texts of the new Treaty and a diplomatic note, also dated February 4, 2010, have been released and are located at: www.treas.gov/offices/tax-policy/library/ChileTreaty2010.pdf and www.treas.gov/offices/tax-policy/library/ChileNote2010.pdf, respectively. Once entered into force, the Treaty will be only the second treaty with a South American country (the other being Venezuela).

The Treaty includes reduced withholding rates for certain transaction flows including dividends, interest, and royalties. Specifically, the following items are included in the Treaty:

With respect to dividends, the following provisions apply:

- Elimination of withholding on dividends paid to pension funds;
- Reduction of withholding on dividends to five percent if the beneficial owner is a company that owns at least ten percent of the voting stock of the company paying the dividend; and
- Reduction of withholding on other dividends to 15 percent in all other cases.

With respect to certain interest, the following provisions apply:

- Reduction of withholding rate to four percent on interest paid to a bank, an insurance company, certain finance companies, and certain enterprises issuing bonds, as well as interest related to the purchases of certain machinery and equipment;
- Reduction of withholding rate to 15 percent on interest paid (and a further reduction to ten percent after a period of five years from the date on which the Treaty enters into force); and
- Contingent or participating interest withholding rate of 15 percent.

With respect to royalties, the following provisions apply:

- Reduction of withholding rate to ten percent on payments related to the use of copyrights, patents, trademarks, plans, secret formulas, etc.; and
- Reduction of withholding rate to two percent on payments related to certain industrial, commercial or scientific equipment.

The Treaty also imposes a branch profits tax on deemed dividends at a five-percent rate and on deemed interest payments generally at 15 percent.

¹ Convention between the Government of The United States of America and the Government of The Republic of Chile for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, dated February 4, 2010.

Finally, the Treaty also contains several items common to other recent United States income tax treaties, including an extensive limitation of benefit provision (with a triangular case provision) to restrict the benefits of the Treaty to residents of the United States and Chile, provisions to ensure the full exchange between the United States and Chilean tax authorities of information for tax purposes, and protections against discriminatory tax treatment.

Recommended Action:

- Review by cross-border investors of prior decisions in view of more favorable withholding taxes on dividends, interest, and royalties;
- Review of intermediate country entities otherwise used to reduce withholding;
- Revisit existing transfer-pricing studies related to United States-Chilean activity in light of new provisions; and
- Review of any entity classification (check-the-box) structures.

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