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U.S. and Chile Sign Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital

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In an effort to provide certainty and stability of tax treatment for U.S. and Chilean cross-border investors, U.S. Treasury Secretary Tim Geithner and Chilean Finance Minister Andrés Velasco signed on February 4, 2010 a new income tax treaty between the United States and Chile. If and when approved by the U.S. Senate and the Chilean Congress, the Convention will enter into effect and it would be the first bilateral income tax treaty between the United States and Chile and second U.S. tax treaty with a South American country. The following is a highlight of the Convention's key provisions.

Scope of the Convention

The Convention applies to persons (an individual, a company and any other body of persons) who are residents of one or both of the contracting states, except as otherwise provided.

Taxes Covered

The Convention applies to taxes on income and on capital imposed on behalf of the applicable contracting state regardless of the manner in which they are levied. Taxes on income and on capital shall include taxes on the following: total income, total capital, elements of income or of capital, including gains from the alienation of property as well as capital appreciation. The existing taxes to which the Convention applies are as follows:

- for the U.S.: the Federal income taxes imposed by the Internal Revenue Code (excluding social security taxes), the Federal excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations; and
- for Chile: the taxes imposed under Ley sobre Impuesto a la Renta (the Income Tax Act).

The Convention shall also apply to any identical or substantially similar taxes, and to taxes on capital imposed by the U.S. or Chile after the

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Our Practice

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signing of the Convention in addition to, or in place of, the existing taxes.

Taxation of Income

Business Profits:

The business profits (income from any trade or business) of an enterprise of a contracting state shall be taxable only in that contracting state unless the enterprise carries on business in the other contracting state through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the business profits of the enterprise may be taxed in the other contracting state but only so much of them as are attributable to that permanent establishment.

Dividends, Interest, and Royalties:

The Convention provides for the reduction of withholding taxes by the source country for certain cross-border payments of dividends, interest and royalties to the following amounts:

Dividends

- percent of the gross amount of the dividends if the beneficial owner is a company that owns directly at least 10 percent of the voting stock of the company paying the dividends; and
- 15 percent of the gross amount of the dividends in all other cases.

Interest

- 4 percent of the gross amount of the interest if the interest is beneficially owned by a resident of the other contracting state that is either: (a) a Bank; (b) an insurance company; (c) an enterprise substantially deriving its gross income from the active and regular conduct of a lending or finance business involving transactions with unrelated parties, where the enterprise is unrelated to the payer of the interest; (d) an enterprise that sold machinery or equipment, where the interest is paid in connection with the sale on credit of such machinery or equipment; or (e) any other enterprise, provided that in the three taxable years preceding the taxable year in which the interest is paid, the enterprise derives more than 50 percent of its liabilities from the issuance of bonds in the financial markets or from taking deposits at interest, and more than 50 percent of the assets of the enterprise consist of debt-claims against persons that do not have certain influences over said enterprise.
- 15 percent in all other cases for a period of five years from the date the interest withholding provisions take effect and 10 percent thereafter.

Royalties

- 2 percent of the gross amount of payments of any kind received as a consideration for the use of, or the right to use, industrial, commercial or scientific equipment, but not including ships, aircraft or containers; and

- 10 percent of the gross amount of payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, scientific or other work, any patent, trademark design or model, plan, secret formula or process, or other like intangible property, or for information concerning industrial, commercial, scientific experience, or gain derived from the alienation of any such property provided that such gain is contingent on the productivity, use, or disposition of the property.

Capital Gains:

With certain exceptions relating to, among others, gains derived by pensions funds, mutual funds and other institutional investors, gains derived by a resident of a contracting state from the alienation of shares or other rights or interests representing the capital of a company that is a resident of the other contracting state may be taxed in that other contracting state but the tax so charged shall not exceed 16 percent of the amount of the gain. The Convention also contains provisions clarifying the treatment of, among other items, gains from the sale of real property, personal property, ships, aircraft, or containers operated or used in international traffic.

Taxation of Capital

Capital represented by real property owned by a resident of a contracting state and situated in the other contracting state, may be taxed in that other contracting state. Capital represented by personal property forming part of the business property of a permanent establishment which an enterprise of a contracting state has in the other contracting state, or by personal property pertaining to a fixed base available to a resident of a contracting state in the other contracting state for the purpose of performing independent personal services, may be taxed in that other contracting state. Capital represented by ships, aircraft, and containers owned by a resident of a contracting state and operated in international traffic, and by personal property pertaining to the operation of such ships, aircraft, and containers shall be taxable only in that contracting state. All other elements of capital of a resident of a contracting state shall be taxable only in that contracting state.

Other Provisions

The Convention also contains other important provisions, including mechanisms through which the U.S. and Chilean tax authorities may collaborate to resolve tax disputes and relieve double taxation; provisions to ensure the full exchange between the U.S. and Chilean tax authorities of information for tax purposes; protections against discriminatory tax treatment; and provisions to ensure that only "qualified persons" enjoy the benefits of the Convention.

This newsletter is a general summary of key provisions of the

Convention, the specific application of which depends on an individual taxpayer's facts and circumstances. The Convention contains many articles, catch-alls, exceptions and complexities which are beyond the scope of this newsletter, therefore legal counsel should be sought out before the undertaking of any cross border investment. Manatt, Phelps & Phillips, LLP's corporate and tax attorneys will stand ready to assist you in taking advantage of this Convention if and when it enters into effect. For additional information, please contact one of the authors listed below.

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Cristian L. Vallejo Mr. Vallejo's practice focuses on both financial restructuring and finance and corporate transactions with particularly experience in cross border transactions. His experience includes: Representation of lenders and investors in corporate finance transactions of all types; Representation of clients in connection with the start-up and acquisition of companies in the US and throughout Latin America; Representation of bondholders, lenders, servicers and other creditors in connection with financial restructuring and workouts, involving multiple jurisdictions, of US based companies and Latin American companies; and Representation of clients in connection with the development and financing of large energy and other infrastructure projects throughout Latin America.



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Michael A. Lehmann Mr. Lehmann specializes in tax issues relating to tax-exempt organizations and in the tax treatment of cross-border transactions. In the tax-exempt organizations field he regularly advises a large number of tax-exempt organizations, including hospitals and other health care providers, research organizations, low-income housing developers (with a particular focus on Section 42 tax credits), trade associations, private foundations and arts organizations on issues that include obtaining and maintaining tax-exempt status, managed care, executive compensation, reorganizations and joint ventures, acquisitions, unrelated business income planning and foundation excise taxes.

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