December 20, 2023

U.S.-Chile Tax Treaty

The Long-Delayed Tax Treaty is the First to Come into Force in Over a Decade

SUMMARY

On December 19, 2023, the U.S. Treasury Department announced that the 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 (the "Treaty") had entered into force. The Treaty provides reductions in withholding taxes on dividends, interest, and royalties. Notably, the Treaty is the first new U.S. tax treaty to enter into force after changes to U.S. domestic tax regime introduced by the 2017 Tax Cuts and Jobs Act ("TCJA"), and the two governments modified the previously-agreed text to reconcile with these changes. The revisions could provide a template for the U.S. government's future tax treaty negotiations.

BACKGROUND

First signed in 2010, the Treaty faced a significant delay in the Senate. In July 2023, the Senate approved a resolution to ratify the Treaty subject to two TCJA-related reservations, paving the way for Chile to become the first country to have a new tax treaty with the U.S. in over a decade.

DISCUSSION

A. Key Provisions

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- The withholding rate on dividends from a U.S. corporation to a Chilean beneficial owner is generally reduced to 15%, or to 5% if the shareholder is a company that owns at least 10% of the voting stock of the payor.[1]
- The withholding tax rate on interest payments is reduced to 15% for the first five years from the date on which the Treaty takes effect, and 10% thereafter. The withholding tax rate is reduced to

4% if the beneficial owner of the interest is a bank, insurance company, or in an active lending or finance business.[2]

- The withholding tax rate on royalties is generally 10%, subject to different rates in certain limited cases.[3]
- Gains realized by residents of one country from sale of shares in companies in the other country are only taxable in the shareholders' resident country, if certain conditions are met.[4]

Consistent with U.S. treaty practice, the Treaty includes a limitation-on-benefits provision to reduce treaty-shopping.

B. Reconciliation with the TCJA

As mentioned above, the Senate ratified the Treaty subject to two reservations, both of which were then approved by the National Congress of Chile and incorporated in the ratified version of the Treaty. These reservations were made because of potential conflicts between the Treaty (as originally negotiated in 2010) and new provisions of U.S. tax law that were enacted in 2017 as part of the TCJA.

The first reservation provides that the Treaty will not prevent the imposition of the Base Erosion and Anti-Abuse Tax (BEAT) under Internal Revenue Code Section 59A.[5] The BEAT can, in some cases, impose a tax on certain deductible payments that are made to related non-U.S. parties.

The second reservation modifies Article 23 (Relief from Double Taxation) to reflect the TCJA's changes to the foreign tax credit under U.S. law. This reservation replaced the U.S. commitment to grant a Section 902 credit (which has been repealed by the TCJA) with an obligation to apply a dividends-received deduction for dividends paid by a 10%-owned foreign subsidiary (consistent with Section 245A, which was enacted by the TCJA).

C. Effective Date

The Treaty's provisions on withholding taxes will apply to amounts paid or credited on or after February 1, 2024. Its provisions on other taxes will become effective for taxable years beginning on or after January 1, 2024. The Treaty's information exchange provisions are effective immediately.[6]

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ENDNOTES

1. Treaty, Article 10. Protocol to the Treaty, Clause 12.
2. Treaty, Article 11.
3. Treaty, Article 12.
4. Treaty, Article 13(6).
5. Resolution of Advice and Consent to Ratification of the Treaty, Section 1.
6. Treaty, Article 29.

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