

More Than a Decade in the Making, The Chile-U.S. Tax Treaty Takes Flight

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In this article, Callahan and Snyder explain the Chile-U.S. tax treaty, review the elements of the treaty, and consider the underlying Chilean and U.S. tax law that has changed since the treaty's negotiation.

The wait is over. Thirteen years, 10 months, and 15 days after the United States and Chile signed their income tax treaty, it finally entered into force on December 19, 2023. Tax planning relating to the two countries will never be the same.

This article has three goals. First, it serves as a desktop reference for practitioners and clients — a quick tool to understand the treaty and its numerous provisions. Second, it offers insight into new tax planning opportunities that may exist as

a result of the treaty. Third, it provides analysis as to why the treaty was entered into force at this time and whether it signals a change in U.S. policy toward other income tax treaties and protocols.

Why Now?

Since Chile increased its corporate tax rate in 2014 (resulting in a potential global effective rate as high as 44 percent for U.S. companies doing business in Chile), U.S. companies were at a significant disadvantage competing against companies headquartered in the two dozen European, Asian, and Western Hemisphere countries with which Chile already has a tax treaty in force. The disadvantage grew to a politically untenable level in 2023 because the U.S. energy transition has evolved quickly (perhaps more quickly than many thought) and the U.S. technology sector requires metals and minerals (for example, lithium and copper) rare in the Western Hemisphere yet abundant in Chile. The industries that rely on the resources that Chile has to offer include manufacturers of:

- electric vehicles;
- solar cells;
- wind turbines;
- cell phones; and
- laptops.

The U.S. Chamber of Commerce on September 8, 2022, published a letter explaining why the treaty should be ratified. In support of the ratification, the letter stated that estimates provide that “global mining firms will have to raise the annual production of strategic minerals such as those Chile produces by 500 percent by 2030 to allow the energy transition to proceed.” Despite the U.S. being in the top five countries in terms of lithium reserves, most lithium used is imported from other countries because of the lack of lithium

mining production.¹ Chile, however, has the third-most lithium reserves and has succeeded in becoming the second-largest producer of lithium, recently implementing strategies to increase its production and export even more.² Moreover, Albermarle, a North Carolina-based company, owns the largest lithium mine in the world — and it is located in Chile.

Over the years, the United States has encouraged the use and production of electric vehicles through tax credits and other incentives.³ Because the production of mineral resources presented challenges, the tax credits and incentives mitigated some of the production expense and led to faster adoption. Similarly, the treaty will offset some tax costs, which may reduce the cost of goods sold for EV manufacturing. Thus, the need for government subsidies, such as tax credits, may now be reduced. Also, because the energy transition is a matter of national security, the need to have this treaty enter into force was paramount. It is therefore unclear whether U.S. policy toward income tax treaties generally has shifted or whether this treaty was an anomaly because of the unique circumstances.

This is only the second tax treaty with a country in South America (and only the fourth in all the Americas). It is expected that Chilean investment in the United States will grow. Because it will benefit Chilean investors, it will likely lead to the creation of thousands of jobs in the United States.⁴ It may also generate more investment into the Chilean mining sector, which may result in additional job creation and increased economic productivity.

A Shift in U.S. Tax Treaty Policy?

The treaty was first signed on February 4, 2010. Although it initially came up for consideration in 2012, it had been languishing in

the U.S. Senate for over a decade because Sen. Rand Paul, R-Ky., opposed the way the United States handled treaties with other countries. He was concerned about taxpayer privacy and the ability of another country's tax authorities to obtain information on U.S. citizens.⁵

Taxes tend to be the bedrock for trade despite the importance of trade agreements. Tax treaties can create incentives for companies to trade with certain nations or conduct business internationally. In this situation, the treaty can help the U.S. obtain resources necessary for economic growth of the energy sector. Thus, tax treaties can create tax efficiency not only for single interactions but create a level of continuity for business operations between the countries and their businesses.

Although some practitioners believe the enactment of the treaty may signal a shift in U.S. tax policy and a future filled with new treaties and protocols (for example, with Poland, Vietnam, Israel, Norway, Romania, and so forth⁶), we do not agree. Instead, we believe that the United States will likely not bring into force new treaties or protocols until the concerns about protecting U.S. taxpayer data collected through an information exchange agreement under a unique scenario like the Chile lithium situation provide the necessary political capital. Thus, the Chile treaty is likely a “unicorn treaty.”

Comparison to the U.S. Model Treaty

Treaty negotiations began toward the end of the Clinton administration,⁷ during the era of the 1996 U.S. Model Income Tax Treaty. Thus, it was drafted under the framework of the 1996 Model Treaty despite being signed on February 4, 2010. The delay in signing the treaty was the result of Chile's laws not allowing for exchange of bank information for tax purposes, until 2009 into account the U.S. Treasury Department's tax treaty policy at the time and its Model Income Tax

¹ Muhammad Jamal Akbar, “Lithium Reserves by Country: Top 5 Countries,” Insider Monkey (June 24, 2023).

² Andrew Fawthrop, “Top Six Countries With the Largest Lithium Reserves in the World,” NS Energy, Nov. 19, 2020; *see also* David D. Stewart et al., “Let's Make a Deal: Examining the Chile-U.S. Tax Treaty,” TaxNotes Talk, June 29, 2023.

³ *See e.g.*, section 25E, section 30B, and section 30D.

⁴ Letter from Neil L. Bradley to Chairman Menendez and Ranking Member Risch (May 31, 2023).

⁵ Patricia A. Brown, “How Hard Can This Be? The Dearth of U.S. Tax Treaties With Latin America,” 74 *U. Miami L. Rev.* 359, 412 (2020), *citing* Diane Ring, “When International Tax Agreements Fail at Home: A U.S. Example,” 41 *Brook. J. Int'l L.* 1185, 1198-1199 (2016); Michael Smith, “Reservations Leave Lasting Questions for Treaty Policy,” *Tax Notes Int'l*, July 24, 2023, p. 429.

⁶ *See* Smith, *supra* note 5.

⁷ Brown, *supra* note 5, at 412.

Convention, published on November 15, 2006. Negotiations also took into account the OECD's Model Tax Convention on Income and on Capital, and tax treaties concluded by both countries at that time.

That being said, because of its deviations from the 2016 U.S. Model Treaty,⁸ as well as U.S. tax law changes from the Tax Cuts and Jobs Act, the treaty is a throwback to prior tax policy considerations and may not provide a framework for future treaties.⁹ This is further confirmed in the treaty reservations (discussed below) and results in potential tax planning opportunities.

Desktop Reference Guide to the Treaty

The treaty came into force adding a 2023 protocol and exchange of notes, which modified, explained, and provided additional guidance. It is therefore important to review not only the treaty text itself, but its accompanying documents.

Effective Dates

The information exchange provisions are effective immediately from December 19, 2023 (the date of entry into force). On February 1 the treaty becomes effective for taxes withheld at source (paid or credited). On January 1 the treaty came into effect for other taxes.

Residence

There are residence rules in place for individuals and entities that are consistent with most income tax treaties. Further, charitable organizations and pension funds are treated as residents under the treaty, including when they are not subject to tax in their country of residence.

⁸For example, the Chile treaty and the 2016 U.S. Model differ on language in the limitation on benefits provision. The Chile treaty continues to use a modified version of the "derived from a business" standard while the 2016 Model Treaty switched to the "emanates from a business" standard (which allows aggregation to determine which countries are producing income, and mitigates against strategies to avoid taxation in multiple jurisdictions).

⁹See generally Department of the Treasury, Technical Explanation of 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 (signed Feb. 4, 2010).

Withholding Tax Reductions

Interest

The treaty reduces the withholding tax rate on interest to generally 15 percent for the first five years from the date on which it takes effect, and then to 10 percent. The rate may be decreased to as low as 4 percent for certain business ventures, for example, if the beneficial owner of the interest is a bank, insurance company, or lending or finance business. Despite this reduction, Chilean residents seeking to invest in the United States may prefer to use loans that qualify for the portfolio interest exemption (PIE) under section 871(h) and section 881(c).

This is particularly popular for U.S. real estate investment, and the following structures are common for Chilean residents investing in U.S. real estate.

Chilean residents with U.S. heirs will gift 10 to 20 percent of the purchase price of the U.S. real estate investment to a U.S. irrevocable trust (used to keep the assets out of the beneficiaries' gross estates) and make a PIE loan to the trust for the remaining purchase price. The trust will generally buy the property through a U.S. limited liability company, taxed as a disregarded entity. The U.S. irrevocable trust will then rent the property and pay interest to the Chilean settlor. The trust gets the benefit of the initial gift plus any appreciation in the property in excess of the principal and interest.

Another common structure for the Chilean investors is investing in a U.S. real estate fund. The promoter of the fund will generally create a non-U.S. corporation that owns stock representing 95 percent of the value and 5 percent of the voting power of the U.S. corporation. The remaining stock representing 5 percent of the value and 95 percent of the voting power is owned by another person (usually the promoter). The U.S. corporation is capitalized with a certain amount of equity and debt. The equity is usually in the form of cash from the promoter and non-U.S. corporation. The debt is in the form of a PIE loan from the non-U.S. corporation. The U.S. corporation then takes the cash (derived from both the equity and debt) to invest in a U.S. entity taxed as a partnership. When it receives cash flow from the U.S. partnership it uses those funds to first pay down the interest and principal on its

debt. The interest is usually not subject to U.S. withholding if it meets the PIE qualifications.

Dividends

In general, the treaty reduces the dividend withholding rate to 15 percent. As is common in other U.S. tax treaties, this rate can be further reduced to 5 percent for some corporate investors that own at least 10 percent of the voting stock of the dividend-paying company. Perhaps surprisingly, the United States failed to renegotiate an even lower dividend rate as it has in other treaties (for example, compare the treaty with the Spain-U.S. tax treaty). Notably, a protocol accompanying the treaty addresses cases in which a Chilean company makes a dividend distribution to a U.S. company that owns at least 10 percent of the vote or value of the Chilean company.

Instead of the U.S. providing a credit, it instead allows a deduction in the amount of the dividends in computing U.S. taxable income. This creates an opportunity for significant tax planning strategies for both U.S. investors in Chile, and Chilean investors in the United States. For example, Chilean investors seeking to limit U.S. withholding tax may prefer to invest through a *Sociedades de Responsabilidad Limitada* or *Sociedades por Acciones (SpA)*, which are eligible entities¹⁰ that likely default as foreign corporations for U.S. tax purposes,¹¹ and may qualify for the 5 percent dividend withholding rate.

Planning Tip: It may still be more beneficial to have a U.S. taxpayer, taxed as either a flow-through entity or an individual, invest in Chile through an SpA that makes an election to be taxed as a flow-through entity in the United States to receive direct foreign tax credits under section 901. Since Chile employs an integrated tax system featuring a two-tiered structure, the Chilean effective tax rate is 35 percent, which is 14 percent higher than the U.S. corporate rate. The first category tax imposes a 27 percent rate on Chilean resident corporations, while the “additional tax” applies at a rate of 35 percent to income distributed by these corporations to nonresident

shareholders, such as dividend payments. Shareholders subject to the additional tax can offset the first category tax against it.

To illustrate, consider the gross-up mechanism in Chile. A \$730,000 dividend (\$1 million net taxable income - \$270,000 first category tax) from a Chilean resident company to a U.S. shareholder would incur an effective tax rate of 10.96 percent (factoring in the Chilean withholding tax of \$80,000):

$$(\$1 \text{ million} * 35 \text{ percent}) = \\ \$270,000 \text{ (first category tax paid)}$$

In instances in which the domestically imposed additional tax rate surpasses 35 percent, the protocol mandates consultations between the United States and Chile to reassess the treaty’s benefits and potentially implement terms limiting the source country’s right to tax dividends under article 10.

Royalties

Possibly because it was negotiated about 25 years ago, the treaty fails to eliminate withholding tax altogether like some other U.S. treaties. Despite this, it still improves upon the domestic withholding rates and stipulates that the withholding tax rate applicable to royalties is capped at 10 percent when the payment pertains to the use or licensing of most categories of intellectual property. Notably, for the employment or licensing of specific industrial, commercial, or scientific equipment (excluding ships, aircraft, or containers), the rate is further reduced to 2 percent.

While this represents a significant enhancement compared to relevant domestic regulations, it falls short of a complete withholding tax exemption, a feature of some U.S. income tax treaties with European nations. This treaty provision is particularly welcome given the lack of clarity surrounding the 2023 changes to Chilean mining royalty tax policy. U.S. companies earning mining royalties in Chile may be significantly affected by the treaty and should reevaluate how contracts are drafted to potentially characterize more income as royalty income going forward.

¹⁰ Reg. section 301.7701-2(b)(8).

¹¹ Reg. section 301.7701-3(b).

Branch Profits Tax

The branch profits tax is limited to 5 percent under the treaty. This is a welcome reduction for Chilean businesses and investors and may affect the planning strategies for U.S.-based activities. In particular, the reduced rate may simplify the structures used to invest or operate in the United States and lessen the advantage of operating in the United States through a subsidiary corporation. In cases in which it may be preferable from a Chilean tax perspective, the reduced tax rate may have a positive effect on the global effective tax rate.

Limitation on Benefits

General Overview

The treaty contains a limitation on benefits article with similarities to the 2006 U.S. Model. It adds the “headquarters company test” and a triangular provision to reduce abuse of treaty shopping. To receive treaty benefits, certain criteria must be met. Because the treaty uses the 2006 U.S. Model, it does not contain the derivative benefits test under its LOB article.

Publicly Traded Test

To meet the publicly traded test and be eligible for treaty benefits, a resident company must have its principal class of stock regularly traded on recognized stock exchanges.¹² This can be accomplished if:

- the company’s principal class of stock is primarily traded on recognized stock exchanges in its country of residence; or
- the company’s primary place of management and control is in its country of residence.

The test is more restrictive than other tax treaties because “recognized stock exchange” is limited to the country of residence, while in other treaties, U.S. stock exchanges and those in other jurisdictions (for example, London, Tokyo, and so forth) are permitted.

¹² 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 (signed Feb. 4, 2010; entered into force Dec. 19, 2023), at art. 24(2)(c)(i).

Subsidiary Test

A company can satisfy the test for a subsidiary of a publicly traded company if at least 50 percent of the aggregate vote and value of the company’s stock is owned by five companies or fewer that qualify under the publicly traded test.¹³ If there is indirect ownership, each intermediate owner is required to be a resident of the United States or Chile.

Headquarters Test

A multinational group can qualify under the headquarters test to the extent its headquarters company is resident in the country claiming treaty benefits.¹⁴ This provision is unique to this treaty and contains specific requirements such as substantial supervision and administration, generating diversified gross income in at least five countries, and adherence to income tax rules.

Ownership-Base Erosion Test

There are two requirements for meeting the ownership-base erosion test:

- qualified residents must own at least 50 percent of the vote and value of the company; and
- a person must ensure that their gross income is less than 50 percent of the gross income paid to nonqualified residents in deductible payments.¹⁵

Active Trade or Business Test

A resident may also satisfy the active trade or business test if:

- the resident is engaged in the active trade or business in its country of residence;
- the income derived is in connection with or is incidental to the business; and
- there is substantial trade or business activity concerning the other state.¹⁶

Competent Authority Relief

If a resident does not qualify under the other LOB provisions, it may seek benefits from the

¹³ *Id.* at art. 24(2)(c)(ii).

¹⁴ *Id.* at art. 24(2)(d).

¹⁵ *Id.* at art. 24(2)(g).

¹⁶ *Id.* at art. 24(2)(3).

competent authority in the country in which benefits are claimed.¹⁷

Triangular Cases

This provision limits treaty benefits for triangular structures in which a resident of the contracting state earns income attributable to a permanent establishment in a third jurisdiction and the combined tax paid in the contracting state and third jurisdiction is less than 60 percent of the tax in the residence country.¹⁸

The technical explanation of the treaty provides an example of a triangular case. It involves a structure under which a resident of Chile earns interest income from the United States. The resident of Chile, who is assumed to qualify for benefits under one or more of the provisions of this article, sets up a PE in a third jurisdiction that imposes a low rate of tax on its income. The Chilean resident lends funds into the United States through the PE.

The PE, despite its third-jurisdiction location, is an integral part of a Chilean resident. Therefore, the income that it earns on those loans, absent this provision, would be entitled to a reduced rate of withholding tax. Under a current Chilean income tax treaty with the PE host jurisdiction, its income is exempt from Chilean tax (alternatively, Chile may choose to exempt the income of the PE from Chilean income tax by statute). Also, the third jurisdiction may exempt the PE income — for example, by statute or ruling. Thus, the interest income is exempt from U.S. tax, is subject to little tax in the PE host jurisdiction and is exempt from Chilean tax.

Competent Authority

Another divergence from the more recent 2016 U.S. Model is the absence of mandatory binding arbitration as part of the treaty's mutual agreement procedure. Instead, taxpayers are instructed to seek direct assistance from the competent authority in their country of residence during the three-year period starting with the first notification of the action resulting in taxation not in accordance with treaty provisions.

¹⁷ *Id.* at art. 24(2)(4).

¹⁸ *Id.* at art. 24(2)(5).

Pension, Social Security, Alimony, Child Support

Article 18 limits the taxation of pension payments and similar remuneration in the source country to 15 percent. In addition, the treaty contains the 2016 U.S. Model “pension neutrality” provision requiring the country of residence to exempt any payment that would be exempt from tax in the country in which the pension plan is established if the recipient were a resident. This may apply to U.S. Roth IRAs and private pension plans in Chile. The provision could have a substantial effect given Chile's large private pension system and its ongoing pension reform process.¹⁹ We will discuss this in more detail in a subsequent article.

Exchange of Information

The treaty provides a mechanism for the two countries to exchange tax information consistent with the U.S. and OECD models. It is a fairly broad provision and creates a new manner for information sharing as both countries continue to install domestic reporting requirements (for example, the new Corporate Transparency Act in the U.S.²⁰ requiring information reporting for some U.S. entities). Although this is a standard exchange of information treaty article, to Sen. Paul's dismay, it enables information sharing dating back to January 1, 2010. Although this is more limited than the Model Treaty, the January 2010 date likely indicates when Chile first began obtaining residents' information. In fact, it was Chile's lack of access to taxpayer information that concerned the U.S. before 2010 and likely stalled the treaty from entering into force closer to when it was negotiated toward the end of the Clinton administration. It is also worth noting that signature cards and other account opening documents may be exchanged regardless of when they were created.

¹⁹ OECD, “Pensions at a Glance 2023: OECD and G20 Indicators” (Dec. 13, 2023).

²⁰ 31 U.S.C. section 5336, enacted in January 2021 by the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021 (P.L. 116-283).

Reservations

The U.S. Senate's June 2023 approval of the treaty subjected it to two reservations to account for changes in U.S. tax law since 2010.

The first reservation confirms that nothing in the treaty "shall be construed as preventing the United States from imposing a tax under section 59A" (the base erosion and antiabuse tax). This resolves some practitioners' prior concerns that the BEAT may be in conflict with the treaty (for example, whether the BEAT violates the treaty's nondiscrimination provisions because it places residents and nonresidents on unequal footing with regard to the ability to take deductions; or the treaty's relief from double taxation provisions because of its potential effect on foreign tax credits) and if so, whether the treaty would override the BEAT. To the contrary, the treaty confirms that the BEAT will remain applicable to U.S. companies as well as Chilean companies with a U.S. PE.

It also appears likely that a similar BEAT reservation will be found in future treaties. It is integrated within provisions of the Croatia-U.S. tax treaty (signed on December 7, 2022), and it will be interesting to see which method (the Chilean reservation method or the Croatian integration method) the U.S. adopts going forward. Treasury's technical explanation to the Croatia treaty (which should be provided when the Croatian treaty is reviewed by the Senate) may provide additional insight as to how the United States plans to integrate the BEAT reservation in treaties and protocols moving forward. Despite this potential clarity, practitioners may still wrestle with issues related to the BEAT's interaction with older treaties (for example, whether, in application, the nondiscrimination article serves as a potential exemption to the BEAT).

Second, the reservation alters the relief from the double taxation provision (article 23 of the treaty) to account for the TCJA-imposed transition from indirect tax credits under former section 902 to the dividends received deduction under section 245A. By removing the indirect foreign tax credit language from article 23 and replacing it with a provision that equates to the dividends received deduction rule, the reservation may affect the section 960 indirect

credit for underlying taxes relating to income inclusions under section 951 and section 951A (for example, potentially enabling a Chilean corporation to fully credit U.S. withholding taxes on interest payments). Despite this, the 2023 Executive Report that accompanies the treaty states that "the terms of the reservation and this report are not intended to create any inferences regarding the interpretation of existing tax treaties to which the United States is a party."

Thus, it is unclear how the reservation may affect U.S. tax policy in general, and specifically when looking back at older treaties. Also puzzling is the parenthetical contained within article 23 of both the 2016 U.S. Model and the Chile treaties clarifying the limitation on the article "as it may be amended from time to time *without changing the general principle hereof*" (emphasis added). In contrast, the Croatia treaty contains the slightly different and more concise parenthetical "as it may be amended from time to time." Once again, perhaps Treasury's technical explanation to the Croatia treaty will provide additional insight. Absent clarification as to why Treasury took this different approach in the Chile and Croatia treaties, we are left to speculate it may have something to do with forthcoming changes to U.S. domestic law.

Declarations

As to be expected, the Senate resolution included a declaration that the treaty is self-executing. Unexpectedly, however, it also included a second declaration clarifying that additional work is needed in future treaties' "Relief From Double Taxation" articles because of the TCJA (for example, given that prior treaties continue to provide indirect tax credits). This second declaration was an important political talking point in the Senate during the past two years and sends the following two critical signals to the tax community:

- there may be gaps and opportunities within the four corners of the treaty; and
- future treaties may be dissimilar to the Chilean treaty.

PE

In addition to the 1996 U.S. Model Treaty's (or its successors') definitions of a PE, the treaty

expands into mineral exploration activities and services. The minerals addition seems to relate to U.S. investment into Chile: the services provision (which is based on the aggregate period or periods in any 12 months) may be bringing into focus situations that often arise in both countries. The treaty also places a limitation on treaty benefits for income attributable to a third-country PE. This limitation applies if combined taxation of the company's income by the treaty country and the third country in which the branch is located is less than 60 percent of the applicable home office country tax rate (if fully taxable in that jurisdiction).

Taxation of Insurance and Reinsurance Activities

The treaty takes a unique approach to insurance excise taxes, providing that in the absence of a PE, the United States may impose limited excise taxes on insurance premiums paid to foreign insurers, and Chile may impose its tax on payments for insurance policies contracted with foreign insurers. The limitations set forth in the treaty dictate that the excise tax cannot exceed:

- 2 percent of the gross amount of premiums in the case of policies of reinsurance; and
- 5 percent of the gross amount of premiums in the case of all other policies of insurance.

This provision appears to be more consistent with older treaties — not surprising given when the treaty was negotiated.

Capital Gains on Shares or Other Equity Interests

The treaty has a distinctive provision when it comes to taxing gains on the disposition of stock or other equity. A resident of one country that has stock or other equity in the other country pays the other country a 16 percent tax on the disposition. The deviation is meant to reflect Chile's unique integrated tax system and is intended to prevent the avoidance of the additional tax. The provision is also limited for taxpayers with substantial holdings (50 percent of stock and 20 percent of other equity arrangements) in which the dispositions of the holdings are not subject to the 16 percent limitation and would instead be taxed in the seller's country of residence. Further, the capital gains tax provision does not apply to real estate — each country will have the right to tax

gains on real estate located in the country. The definition of real property includes the definition of a U.S. real property interest so a Chilean resident that has U.S. stock (or a Chilean company that makes a section 897(i) election) that holds U.S. real property is still subject to U.S. tax on the disposition of the stock.

Incentivizing U.S. Investment in Chile

The avoidance of double taxation is paramount in cross-border tax planning. Under U.S. domestic law, FTC rules are meant to protect U.S. residents investing abroad. Tax treaties provide further protection and serve as a backstop to FTC statutory provisions. Before the treaty entered into force, U.S. investors faced tax uncertainty resulting in increased legal costs to navigate the complex FTC rules. Absent the treaty, and despite relief from Treasury, the burden has become more daunting with the implementation of new creditability regulations requiring the sourcing rules in Chile to follow the place-of-use standard rather than a residency-based standard.²¹

Even with elite legal assistance, many taxpayers were faced with an increased disallowance of FTCs (for example, with regard to the Chilean tax imposed on the sale of Chilean company shares by a U.S. resident), essentially creating a disincentive to invest in Chile. Although Treasury has recently provided taxpayers the opportunity to elect to defer indefinitely the effect of these regulations (providing a momentary respite from the related creditability deterioration), this policy could change at any moment. If so, articles 13(5) and 23(1) of the treaty, in combination, may protect U.S. taxpayers from losing valuable FTCs under the treaty coordination rule of the final FTC regulations, thus simplifying the related U.S. tax burden and improving the economics of U.S. investment in Chile.

In addition, U.S. shareholders of Chilean companies may be eligible to treat certain Chilean source dividends as qualified dividends under

²¹ Notice 2023-55, 2023-32 IRB 427, provides temporary relief to taxpayers by allowing the potential deferral of certain aspects of reg. sections 1.901-2 and 1.903-1 (which created additional requirements for FTC eligibility and may cause issues in the Chile-U.S. FTC context).

section 11(h).²² This should result in more efficient tax investment into Chile and enable a broader range of investors to participate in the growing Chilean economy.

The U.S. interest in Chilean mining operations was an influential factor leading to the treaty finally entering into force. Its passage was met with applause from the mining community. For example, in June 2023 (shortly after the treaty was ratified by the U.S. Senate), Rich Nolan, president and CEO of the National Mining Association, released the following comment:

Our industry has eagerly awaited today's action for well more than a decade, with U.S. companies that invest in Chile hanging in the balance in the interim. We applaud this action by the Senate which brings this long period of uncertainty to an end and protects U.S. investments in Chile, a key mining jurisdiction, where U.S. companies both mine the minerals that are key to our energy future and sell equipment and services to mining interests that operate in Chile.²³

It is important to note, however, that the treaty includes in the definition of a PE the following:

- installations for on-land exploration;
- building sites, construction, or installation projects and any supervisory activity connected with these activities; and
- any drilling rig or ship used to explore for natural resources.

This represents an expansion of the PE definition compared to the 2016 U.S. Model and necessitates careful tax planning for U.S. mining operations in Chile whose goal is to avoid having a Chilean PE.

In addition to benefitting large mining operations in Chile, the treaty exemption of some withholding taxes will benefit mining industry suppliers and startups. For example, the treaty eliminates the withholding tax of 15 percent or 35 percent that is part of the Chilean income tax law for the payment of technical or professional

services provided in Chile or the United States.²⁴ Note, however, that the VAT in Chile may still apply if services are used in Chile. Tax attorneys (and other professionals) reading this article may be very familiar with these withholding taxes and will be happy to learn of their elimination under the treaty. Consumers of such professional services will similarly be pleased by the related service cost reduction.

U.S. Persons Investing in Chile

Since the TCJA enactment, many U.S. tax residents have used a U.S. corporate structure to own a Chilean SpA when doing business in Chile. The Chilean SpA generates global intangible low-taxed income. Thus, the creation of the U.S. corporation served two purposes — to obtain the 50 percent deduction under section 250 and receive credit limited to 80 percent of the foreign taxes paid; and to obtain qualified dividend treatment for dividends made by the U.S. corporation. In contrast, a U.S. individual who makes a section 962 election would not have been entitled to qualified dividend treatment on dividends paid by the Chilean SpA.²⁵ Under the treaty, however, dividend distributions from the Chilean SpA can now receive qualified dividend treatment.²⁶

Planning Tip: For those U.S. clients who created U.S. corporations that invested in Chilean SpAs and who would like to restructure, they could think about having the Chilean SpA make an election to be taxed as a flow-through entity and subsequently make an S corporation election on the U.S. C corporation. This would allow them to get direct FTCs and avoid potential tax leakage associated with the 5 percent dividend withholding tax in Chile as a result of the participation exemption under section 245A(d).

Incentivizing Chilean Investment in the U.S.

The U.S.-centric view of the treaty focuses on U.S. investment into Chile (for example, the

²⁴ See Chile-U.S. tax treaty, *supra* note 12, at art. 14(1).

²⁵ See *Smith v. Commissioner*, 151 T.C. No. 5 (2018) (holding that distributions from nonqualified foreign corporations are taxed at the higher ordinary income rates under section 962(d)).

²⁶ See Notice 2024-11.

²² See Notice 2024-11, 2024-2 IRB 360.

²³ See National Mining Association release, "NMA Applauds Passage of Chilean Tax Treaty" (June 22, 2023).

important mining investments) and related “outbound” tax planning; however, the treaty also creates significant opportunities to make Chilean investment into the United States more efficient and profitable. The U.S. tax burden for Chilean firms investing in the United States may be significantly reduced under the treaty — from about 44.5 percent to nearly half that amount. These savings, in combination with the reduced withholding tax rates (for example, for interest and dividends), provide a favorable investment scenario for Chilean investors. Moreover, the treaty may provide less FTC leakage for Chilean investors because the scope of the FTCs available for Chilean residents may be broader than their domestic tax regime.

Appreciated U.S. Real Estate Restructuring

The treaty provides relief for Chilean tax residents that own appreciated U.S. real estate in their individual names or through single-member U.S. LLCs. As a result of the nondiscrimination clause under article 25, a Chilean tax resident can block the U.S. estate tax by contributing the U.S. real estate to a Chilean SpA and making a section 897(i) election. This would allow the Chilean tax resident to restructure a U.S. real estate structure in a tax-free matter under U.S. tax law and create protection from U.S. estate tax.

Reverse Inversion Planning

Over the last few years, many Chilean companies have decided to restructure their corporate group by creating a U.S. parent company to serve as the parent of the corporate

group. The treaty makes this more attractive because it creates the need for a PE, which is a higher threshold for being subject to U.S. tax than determining whether the Chilean company is engaged in a U.S. trade or business. Since a U.S. corporation is taxed on its worldwide income, it may make sense to use a U.S. entity taxed as a partnership to hold intellectual property for the Chilean corporate group.

Reverse Hybrid Canada Limited Partnerships

Over the years many Chilean investors have used a foreign grantor trust that owns a Canada limited partnership, which then owns a U.S. brokerage account holding a portfolio of U.S. stocks. The Chilean investors usually make an election to have the Canada limited partnership taxed as a corporation for U.S. tax purposes to block the U.S. estate tax. As such, practitioners may want to examine whether a Chilean investor may be entitled to treaty benefits under this structure.

Conclusion

Practitioners who work in cross-border investments with the United States and Chile should familiarize themselves with this “unicorn” treaty. The process of it finally coming into force after more than two decades necessitates careful consideration of the changes in tax laws in both jurisdictions in that time. Nonetheless, the treaty is a welcome addition to the U.S. tax treaty network and should create improved cross-border investment opportunities for investors of both countries. ■