

Transfer Pricing Guide

CHILE





Legal Background and Requeriments

“Chilean tax authority has demonstrated to be assertive and quick in the audit processes, with more than 265 audit processes in the past 2 years”

“All transactions with related parties, including restructuring processes could be subject to a TP audit”

LEGAL BACKGROUND

The application of the arm’s length principle between related parties is prescribed by Article 41 E of the Income Tax Law (“ITL”).

Based on the provisions of Article 41 E paragraph 3 of the ITL, taxpayers may prepare transfer pricing reports for purposes of evidencing the determination of prices, values and profitability of those operations which are carried out with related parties.

The aforementioned means that such reports are not mandatory, but it is advisable for the company to prepare them, in case the Chilean IRS (“SII”) challenges the amounts of the prices paid pursuant to cross border operations. Indeed, this paragraph specifies that this faculty’s existence is without prejudice of the taxpayer’s obligation to make available all background explaining the application of the method used or the elaboration of the corresponding studies.

DOCUMENTATION REQUIREMENTS

Every year, pursuant to Article 41 E paragraph 6 of the ITL, taxpayers who carry out cross boarder operations subject to transfer pricing regulations, must submit a sworn statement to the SII (**Form 1907**) every last working day of June, on annual basis.

Transfer Pricing Report (TP Report) must be kept in the Company and submitted upon SII’s request.

Since 2015, it was also issued a new sworn statement, **Form 1913**, including several questions referred to different aspects such as: i) Operations made with tax heavens or entities without economic substance; ii) Percentage of incomes and expenses with local related parties; iii) Percentage of intercompany expenses over EBITDA; iv) Financial instruments (debt, forwards, hedge, etc.); v) Restructuring processes; vi) Information of economic scheme that involves foreign entities and implies a shifting of profits, among other questions. Form 1913 must be submitted annually before the income tax affidavit’s deadline (exact day depends on the SII calendar, but it’s commonly on April).

TP: Transfer Pricing.

SII: Chilean Tax Authority (“Servicio de Impuestos Internos”)

Which companies are subject to TP obligations?



Taxpayers who are subject to documentation obligation (Form 1907 and transfer pricing report) are the following:

- Medium and Large companies who have carried out operations with related parties who are not domiciled nor resident in Chile
- Those who are not part of the aforementioned category who carry out operations with parties who are domiciled or resident in countries which are considered as tax haven or harmful preferential tax regime as listed by the OECD.
- Those who are not part of the two preceding categories and who have entered into transactions with related parties for a total amount superior to 500.000.000 Chilean pesos (or its equivalent at the rate of exchange of December 31 of the corresponding year).

Regarding the Form 1913, companies have this obligation in the following cases:

- Large companies.
- Companies included in the “Large Taxpayers List” issued annually by the SII.

TRANSFER PRICING RELATED PENALTIES

The failure to submit the sworn statement, or its inaccurate, incomplete or untimely presentation, shall be sanctioned with a fine of between 10 and 50 annual tax units (8.400-42.000 USD approx.). Nevertheless, this fine may never exceed 15% of the taxpayer’s equity capital or 5% of the total of its effective capital. If the submitted sworn statement is intentionally false, the fine shall amount to between 50 and 300% of the tax due, and jail sanctions may apply.

If, in the SII’s opinion, the taxpayer cannot prove that the operation(s) with its related parties have been carried out at arm’s length prices, the SII will determine them. As a consequence, the taxpayer will have to pay a unique tax of 40% on the difference. Furthermore, a fine of 5% might be applied, if the taxpayer does not provide the SII with the documentation requested for review by the latter in a timely manner. Fines, interests and currency re-adjustments may be also applicable increasing significantly the amount to be paid.



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“Any TP Adjustment is subject to a 40% of penalty tax rate, and can be increased significantly after fines, interests and re-adjustments”



General rules

“Chilean TP rules have a very broad definition of related parties. Tax Heavens are also treated as related parties. If a party carries out transactions with a third party that in turn carries a similar operation with a related party, then it’s considered a controlled transaction”

“APA can be requested and in case of acceptance it is valid for the 3 immediate following years including the year in which it is requested”

RELATED PARTIES

For Transfer Pricing purposes, parties shall be considered as related when:

- One of them participates direct or indirectly in the management, control, equity, profits or incomes of the other, or
- One or various identic people or entities participate direct or indirectly in the management, control, equity, profits or incomes of both parties, all of them being understood as related to each other.
- An agency, branch or any other form of permanent establishment is considered as related to its parent company; to other permanent establishments of the same parent company; to related parties of the latter and their permanent establishments.
- When the taxpayer carries out operations with parties who are domiciled or resident in countries or territories which are considered as tax haven or harmful preferential tax regime, they will be considered as related parties.
- Natural people shall be understood as related when they are spouses or if there exists a blood relationship or affinity up to the fourth degree included.
- When a party carries out one or more operations with a third party which, in turn, carries out, direct or indirectly, with a related party of this party, one or more operations which are similar or identic to those carried out with the first party, they shall all be considered as related, regardless of the capacity in which this third party and the parties act in these operations.

ADVANCE PRICING ARRANGEMENT (“APA”)

Chilean law provides the possibility for the taxpayer to propose an Advance Pricing Agreement (APA) to the SII, in order for the company to establish ordinary market return of its operations. In the event the SII accepts the proposal of the taxpayer, the agreement shall be applicable from the commercial year it is subscribed, and for the 3 immediately following years. Said term may be extended by mutual agreement of the parties (taxpayer and SII).

INTERCOMPANY LOCAL TRANSACTIONS

Following Article 64 of Tax Code, the SII can determine the market value of any local intercompany transaction if it has been done at a significant different price from the one that would have been agreed between independent parties under similar circumstances.



Technical aspects

“The general statute of limitations in Chile is 3 years starting from the latest date at which the income tax was due”

“Comparable companies with operating losses (average of last 3 years) are commonly rejected”

TRANSFER PRICING METHODS

The Chilean legislation follows the recommendation of the OECD Guidelines. The following methods are accepted:

- Comparable Uncontrolled Price Method
- Resale Price Method
- Cost Plus Method
- Transactional Net Margin Method
- Profit Split Method

If none of them is applicable, the tax payer has the opportunity to define and use other approaches (“Residual Method”). The method chosen must be the most appropriate given the characteristics and circumstance of the particular case.

ARM'S LENGTH RANGE

When the appropriate method is used and it still results in a broad range of prices or margins, statistic tools which allow to narrow it by reference to the central tendency (for example, the interquartile range or other percentiles) may be used to improve the reliability of the analysis.

COMPARABLES

When choosing comparable companies, comparability factors set out in the OECD guidelines must be taken into account, namely: the characteristics of the goods or services, the functional analysis, the contract clauses, the economic circumstances as well as the companies' strategies.

Commonly only publicly information companies are included as comparable by the SII and comparable companies with operating losses in the past 3 years of available information are usually rejected.

STATUTE OF LIMITATION and LANGUAGE

The general statute of limitations in Chile is 3 years starting from the latest date at which the income tax was due. It could be extended to 6 years if no return is filed, or if the authorities consider that the returns are false.

Only documentation in Spanish is accepted by the SII. In some cases simple translation of agreements is accepted.



BEPS* impact and recent changes

The SII has recently issued - on December 27, 2016 – the first regulation as to the country-by-country reporting obligation.

Taxpayers who are subject to such an obligation have to inform the SII through an additional sworn statement, Form 1937, which aim is to provide the SII with financial, functional and tax information.

The taxpayers who must submit this file are the parent or controlling entities domiciled in Chile of Multinational Groups of Companies (the controlling entity being subject to this obligation only if the Group's annual income amount to 750.000.000 euros or more, as at the rate of exchange of December 31 of the corresponding year). Information must be provided over the last commercial year (starting with commercial year 2016).

Any national holding subject to CbC obligation that aims to designate a surrogated foreign entity must inform to the SII 30 days prior of CbC's deadline. Also, any taxpayer that has being designated as a surrogated entity of a foreign Group subject to CbC, will have to inform such situation to the Chilean IRS 30 days prior to the CbC's Chilean deadline by written notification.

Failure to submit the Form 1937 or submission of an erroneous, late or incomplete Sworn Statement will result in fines pursuant to the provisions in No. 6 of Article 41 E of the Income Tax Law (mentioned *u-supra*). If the submitted Sworn Statement is intentionally false, a fine will be applied as stated in No. 4 of Article 97 of the Tax Code.

OTHER RECENT CHANGES

Last Tax Reform has incorporated the so called Anti-Avoidance Rules establishing its application to those that have designed or planned acts, agreements or businesses considered abusive or as simulation.

Also thin capitalization rules has been introduced establishing that if he debt-to-equity ratio exceeds a 3:1 threshold, the excess interest is subject to a sole tax rate of 35% (reduced by the withholding tax paid on the interest).

*BEPS: Base Erosion and Profit Shifting

“As off the date there has not been introduced any rule regarding Master File”

“Chile has signed the multilateral competent authority agreement on the exchange of Cbc reports promoted by the OECD”

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