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US-Chile Treaty Builds Tax Certainty for MNEs with MAPs and APAs

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As Chilean tax authorities increase audits, MNEs should consider using MAPs and APAs under the newly ratified US-Chile income tax treaty to avoid double taxation and achieve tax certainty, say KPMG practitioners.

On December 19, 2023, the US-Chile income tax treaty entered into force. Pursuant to this treaty, MNEs can now use US-Chile mutual agreement procedures and bilateral advance pricing agreements to prevent double taxation and achieve more tax certainty. Given the increase in audit activity in Chile—which is expected to continue going forward—this is a welcome advance for MNEs. For the US, the US-Chile treaty is only the second US comprehensive bilateral tax treaty in force with a South American country—and is the first new comprehensive bilateral tax treaty signed by the US to enter into force in over ten years.

Chile APA Program

There is already a well-established and efficient APA program in Chile. The Chilean tax authority (the “Chilean IRS”) has established a team separate from the audit function to focus exclusively on MAPs and APAs. Although the majority of the APAs executed have been unilateral, Article 41 E number 7° of the Chilean Income Tax Law, provides the ability for companies to pursue bilateral and multilateral APAs. In Chile, there is no filing fee for APAs.

Since the current transfer pricing regulations came into effect in Chile in 2012, a total of 24 APA requests have been submitted—17 unilateral requests (14 first time requests and three renewals) and seven bilateral requests. The Chilean competent authority has made progress on these cases—six unilateral

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and two bilateral (Canada and Switzerland) requests have been executed. Unilateral APA requests are efficient and are generally completed in six to 12 months. In terms of bilateral relationships, the counter-jurisdictions where APAs are under discussion or have been concluded include Canada, the United Kingdom, and Switzerland.

Taxpayers found it has been easier to reach agreement with the Chilean IRS for cases involving distribution, manufacturing, and services in industries (such as consumer goods, electronics and sports utilities) as compared to intercompany transactions related to natural resources (such as copper or lithium). The Chilean IRS views cases involving natural resources as having political implications; hence, even requests that are well grounded and make economic and tax sense can be slow moving.

Additionally, on September 24, 2024, the Chilean Congress approved the Tax Compliance Bill, which will become law shortly. The bill makes some updates to the APA program, including among others, the institution of rollback provisions, increase in covered APA years for new agreements from four to five, and the regulation of prefiling meetings. These updates were made to promote the APA program and increase the APA agreements between the Chilean Tax Authority and the taxpayers.

Chilean Audit Activity

A few years ago, the Chilean IRS focused on inbound distributors and recently initiated a second focus on companies in the mining industry. For inbound distributors, we observed assessments in several cases where these entities earned low or negative overall returns—even if those results were shown to be within the range of comparable companies performing similar distribution functions. The Chilean IRS often creates its own set of comparable companies which earn returns in excess of those of the tested party and the taxpayer's set of comparable companies.

The 2024 Chilean IRS's 2024 tax compliance management program is focused on controlling tax avoidance, particularly aggressive tax planning and is focused on three main areas: (i) multinational enterprises, (ii) transfer pricing and valuation; and (ii) business groups. Within the transfer pricing focus, executing new APAs is a specific area of focus. With regard to MNEs, the Chilean IRS is creating specialized groups to audit international transactions and transfer pricing and focusing on reviewing compliance risks related to Chilean affiliates with low effective tax rates and especially those that involve intangibles. One example of this new focus is if services are being charged from Chile overseas, the Chilean IRS is trying to understand if that is a service or, if instead, there is an intangible asset in Chile that requires compensation from its related parties.

Many Chilean headquartered companies recently received notification from the Chilean IRS that the Chilean IRS commenced the first phase of its audit that will, at least initially, focus on analyzing if any potential intangibles are being charged overseas (specifically as brands, know-how and similar), together with reviewing the benefits associated with all services rendered by the Chilean headquarters to its affiliates. The Chilean IRS often takes the position that many of the high value or strategic services performed by the Chilean headquarters have created an intangible asset that should be charged separately as a royalty to Chile over the sales of the overseas affiliates, rather than a mark-up over the cost of the Chilean affiliate rendering the services.

With regard to transfer pricing, the government's 2024 objectives—in addition to promoting APAs—include guiding taxpayers on the risks of base erosion in transfer pricing and the importance of control

over risk. On “business groups”, the Chilean IRS is focused on discouraging the use of tax planning as an evasive tool. The Chilean IRS is implementing econometric models to identify MNEs that present a risk of tax base erosion due to profit shifting abroad.

US-Chile APAs

The US advance pricing and mutual agreement program—with its program that has been operating successfully for decades—is keenly interested in working with Chile to advance US-Chile bilateral APAs. In 2023, APMA executed a record number of APAs (156). As of December 31, 2023, APMA’s cases were handled by 114 employees—and in 2024 APMA continued to hire seasoned tax professionals to support their team.

US-Chile MAPs and APAs will be a useful tool given the high audit activity in Chile, which shows no signs of abating. The Chilean IRS has a very active audit program with more than 215 companies having undergone tax audits from 2020 to 2022. The Chilean IRS’s transfer pricing team increased audit collections last year by 40% compared with the previous year through its transfer pricing audit program. Given the continuing high audit activity in Chile, MNEs with material operations in Chile should proactively consider APAs as a way to secure tax certainty. Given the focus and success of both the Chilean IRS and APMA, bilateral options are a good path forward.

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