EFFECTS OF THE ATTRIBUTED INCOME SYSTEM ON THE FOREIGN TAX CREDIT GRANTED TO UNITED STATES INVESTORS

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ABSTRACT

Chile is definitely an importer of foreign capital. Therefore, any change to the national rules should also be analyzed in the face of the effects that could be generated on foreign investment in Chile, including to what extent these consequences are justified for the sake of the objective of the new legislation. The Tax Reform incorporated by Law No. 20.780 has given rise to various questions, mainly regarding its effects when its provisions have to be applied in conjunction with foreign laws or with international treaties signed by Chile. Those consequences must be determined on a case to case review depending on the specific content of the provisions of foreign law and/or international treaty applicable to the situation of the taxpayer. The objective of this article is to present the main issues on international taxation that could generate the new income attributed system established by the aforementioned Law No. 20.780 and, in particular, explain the contingencies that might arise for investors resident in the United States, the use of credits for taxes paid in Chile under the said system.

KEYWORDS: Attributed income system, tax reform, US investors, international taxation

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I
INTRODUCTION

On September 29th, 2014, Law No. 20,780 was published in the Official Gazette, which replaces the current Chilean business profits tax system as from January 1st, 2017, establishing two new regimes: the attributed income system ("AIS"), and the partially integrated system ("PIS").

The enactment of Law No. 20,780 has raised concerns and criticism as to the potential consequences that those regimes could have in practice, especially where foreign legislations and international treaties concluded by Chile apply.

Chile is a capital importer country; and therefore any tax reform should endeavor to avoid creating tax inefficiencies for foreign investors, that could lead to a decrease in foreign direct investment. It should be noted also that the largest amount of foreign direct investment inflow received by Chile comes from United States.[73]

This paper aims at providing a basis for the discussion of the main international taxation issues for U.S. investors that could arise from the AIS, mainly with regards to the foreign tax credit to be granted by the United States to U.S. owners, partners, shareholders or head offices of Chilean entities.

This analysis has been made based on the U.S. domestic provisions, contained in the Internal Revenue Code ("I.R.C.") and the Treasury Regulations ("Treas. Regulations"), 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 ("Treaty"), and the Department of the Treasury Technical Explanation of the Treaty ("Technical Explanation of the Treaty").

The problems referred to above have been also examined taking into account the United States Model Income Tax Convention of February 17th, 2016 ("U.S. Model"), the United States Model Technical Explanation

[73] Between the years 2009 and 2014, this amount was US$24,895 million, which is equivalent to 20.4% of the total foreign direct investment received by Chile during this period. InvestChile, Foreign Investment Promotion Agency. FDI by country of origin. [online] <http://www.investchile.gob.cl/en/inversion-en-chile/ied-segun-pais-de-origen/> [last review on July, 3rd, 2016].

Accompanying the United States Model Income Tax Convention of November 15, 2006 ("U.S. Model Technical Explanation"), the Organization for Economic Co-operation and Development Model Tax Convention on Income and on Capital of July 22, 2010 ("OECD Model"), and the OECD Commentaries on the Articles of the Model Tax Convention ("OECD Commentaries"), when relevant.

SECTION I
NEW REGIMES SET FORTH BY THE CHILEAN INCOME TAX LAW

1. General aspects of the Chilean tax reform

On April 1st, 2014, a bill of law was submitted to the Chilean National Congress, which proposed a major tax reform. Such bill of law proposed amendments to several laws, including Decree Law No. 830 of 1974, Tax Code; Decree Law No. 824 of 1974, Income Tax Law ("ITL"); Decree Law No. 825 of 1974, Value Added Tax Law; Decree Law No. 3,475 of 1980, Stamp Tax Law; and Decree Law No. 600 of 1974, Foreign Investment Statute.

Generally, the purposes of the tax reform were increasing tax collection in order to finance an educational reform, improving income distribution, creating additional savings and investment incentives, as well as, reducing tax avoidance.

This bill of law was approved by the National Congress and enacted as Law No. 20,780 on September 26th, 2014, and was published in the Official Gazette on September 29th, 2014.

Then, an additional bill of law was submitted to the National Congress in order to simplify and improve certain provisions set forth by Law No. 20,780. Such bill of law was approved and enacted as Law No. 20,899 on February 1st, 2016. This law was published in the Official Gazette on February 8th, 2016.

In addition, from the enactment of Law No. 20,780 the Chilean Internal Revenue Service has issued a significant amount of circular letters and resolutions, to clarify certain aspects of the tax reform and facilitate its implementation.

2. *Description of the current Chilean business profits tax system*

Currently Chile has an "integrated" business profits tax system, since 100% of the Corporate Tax (First Category Income Tax or "FCIT") paid by companies and other entities is creditable against the final taxes affecting their owners. Likewise, these final taxes are applied on a cash basis, as they are triggered only by the time an actual distribution occurs.

In effect, under the current business profits tax system, companies and other entities are subject to FCIT, which is assessed on the net accrued taxable income of the business at a flat rate of 24%.[74] As mentioned above, no further Chilean income taxes apply until effective distributions to Chilean resident individuals, or to non-resident nor domiciled individuals or entities.

If a Chilean entity is owned by an individual resident or domiciled in Chile, distributions are subject to Global Complimentary Tax ("GCT"), whose rate ranges from 0% to 40%,[75] being the FCIT paid at the entity's level fully creditable against the GCT.

Where an entity is owned by a non-resident nor domiciled individual or entity, distributions are subject to a 35% Additional Withholding Tax ("AWHT"), against which the FCIT is also fully creditable, for an overall tax burden of 35%. Reduced Treaty, U.S. Model and OECD Model rates on dividends distributed from Chile are not applicable, as long as the FCIT is creditable against the AWHT.[76]

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[74] In accordance to Law No. 20,780 the FCIT rate is 21% for commercial year 2014, 22.5% for commercial year 2015 and 24% for commercial year 2016. Taxpayers subject to the AIS will be subject to a 25% FCIT rate as from commercial year 2017, while taxpayers subject to the PIS will be subject to a 25.5% FCIT rate for commercial year 2017 and to a 27% FCIT rate as from commercial year 2018.

[75] Under Law No. 20,780 the maximum GCT rate will be decreased to 35% as from commercial year 2017.

[76] Chile has included in all its double taxation treaties a provision known as the "Chile clause", according to which, because of its integrated taxation system, the limited rates provided by Article 10 does not affect the AWHT, provided that under the domestic law of Chile the FCIT is fully creditable in computing the amount of AWHT to be paid.

3. Description of the attributed income system

Law No. 20,780 has replaced the foregoing business profits tax system as from January 1st, 2017, establishing two new regimes, namely, the AIS and the PIS.

In accordance to the definition provided by the ITL[77] and to the Chilean Internal Revenue Service,[78] "attributed income" refers to the income that must be allocated totally or partially for tax purposes to GCT or AWHT taxpayers, at the end of the respective commercial year, based on their status as owners, partners or shareholders of an entity subject to FCIT, to the extent such income has been perceived or accrued by such entity, or successively attributed from other entities in which the former has an interest or ownership, in order to have the total amount of income perceived, accrued or attributed to the respective entity, being attributed to those GCT or AWHT taxpayers in the same commercial year, and affected with the corresponding final tax.

Under the AIS taxable income earned by companies, permanent establishments and other entities resident or domiciled in Chile must be attributed at year end to their owners, shareholders, partners or head offices, for application of final taxes, regardless of actual distribution. This is one of the most critical amendments to be incorporated by Law No. 20,780 to the current business profits tax system, whose final taxes have typically applied on a cash basis.

This particularity of the AIS could give rise to timing mismatch scenarios, where the final tax is applied by reason of the attribution but no income is distributed by the entity in that year.

It should be emphasized that the attribution of income operates exclusively for tax purposes and mainly with regards to the application of GCT and AWHT.[79] Consequently, such attribution does not cause any effect from a corporate perspective, nor on the income ownership where

[77] ITL. Article 2 No. 2, second paragraph.

[78] Section II(B)(2)(a) of Circular Letter No. 66, issued by the Chilean Internal Revenue Service on July 23rd, 2015. [online] <http://www.sii.cl/documentos/circulares/2015/circu66.pdf> [last review on July, 5th, 2016].

[79] Section II(B)(2)(a)(i) of Circular Letter No. 66, issued by the Chilean Internal Revenue Service on July 23rd, 2015. [online] <http://www.sii.cl/documentos/circulares/2015/circu66.pdf> [last review on July, 5th, 2016].

profits have not been actually distributed to the respective owner, partner, shareholder or head office.

The FCIT rate for entities subject to the AIS will be 25%, which will be fully creditable against the final taxes.

Consequently, the final tax burden of non-resident nor domiciled individuals or entities would remain 35%. In accordance to the "Chile clause", reduced Treaty, U.S. Model and OECD Model rates on dividends distributed from Chile would not apply, as the FCIT would be still creditable against the AWHT.

The AIS is available for sole proprietors, limited liability individual companies, joint ownerships, companies by shares, permanent establishments and limited liability companies, under the obligation of keeping full accountant records, as long as their owners, partners, shareholders or head offices are exclusively resident individuals and/or non-resident nor domiciled taxpayers. Note that corporations are not eligible for the AIS.

In accordance to some studies, other OECD countries would have implemented systems similar to the AIS, such as United States, Germany, Australia, Poland, Mexico, Spain, Austria, Belgium, Czech Republic, Greece, Sweden, Norway, Japan and United Kingdom. However, it is important to note that such regimes are exceptional and voluntary, having the purpose of simplifying the tax regime mainly for small and medium-sized companies.[80]

It could be argued that these systems are not comparable to the AIS to be implemented in Chile, as the latter is not exceptional, nor has the purpose of providing a simplified regime to certain taxpayers. Also, although being subject to the AIS is voluntary as certain taxpayers may opt between this regime and the PIS, in practice for some taxpayers choosing the AIS will be the only way of remaining a 35% total tax burden.

For purposes of supporting the approval of the AIS by the National Congress during the discussion of Law No. 20,780, it was claimed that such a regime had been already successfully implemented in United States, referring to the provisions applicable to S Corporations. Nevertheless, it should be noted that there are important differences between the S

[80] HERMANN, Jorge. Casos de renta atribuida en países OECD corresponden a excepciones. [online] <http://www.reformalareforma.cl/tributaria/2014/06/casos-de-renta-atribuida-en-paises-ocde-corresponden-a-excepciones/> [last review on July, 3rd, 2016].

Corporation treatment and the AIS, arising from the fact that S Corporations are subject to a pass-through regime, while the AIS has not this nature.

In effect, as a general rule S Corporations are not subject to Corporate Tax,[81] so that the income is taxed only at the shareholders' level. Conversely, an entity subject to the AIS is taxed with FCIT, which however is creditable against the final taxes. Moreover, S Corporations items of income, loss and deduction are passed through the entity to the shareholders, and retain their character in the shareholder's hands,[82] [83] whereas under the AIS no losses or deductions are passed through to the owners, partners or shareholders, as the only item attributed to final taxpayers is the income earned by the entity subject to FCIT.[84]

Therefore, the AIS is not a pass-through regime, but rather, it simply disallows any tax deferral where profits earned by a Chilean entity are not distributed to its owners. Accordingly, although under both systems the final tax is triggered in the same taxable year, these two regimes should not be viewed as comparable; and thus the advantage of implementing the AIS could not be based on the existence of the S Corporation treatment, given that both set of provisions have a different nature and a distinct purpose.

4. *Description of the partially integrated system*

Under the PIS taxable income generated by companies, permanent establishments and other entities domiciled in Chile are not attributed at year end to their owners, partners, shareholders or head offices for application of the GCT or the AWHT, as these final taxes apply upon effective distribution.

Taxpayers eligible to the AIS are also eligible to the PIS. Taxpayers other than those referred to above, including corporations, must be subject to the PIS.

The FCIT rate under this regime will be 25.5% for commercial year 2017 and 27% as from commercial year 2018.

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[81] I.R.C.§1363(a).

[82] McMahon, Martin, Simmons, Daniel and McDaniel, Paul. Federal Income Taxation of Corporations. LEG, Inc. d/b/a West Academic, 2014. P.357.

[83] I.R.C.§1366.

[84] Nevertheless, losses and deductions must be taken into account by entities subject to FCIT in calculating their net income, so that those losses and deductions are indirectly utilized by its owners, partners and shareholders.

However, only 65% of the FCIT paid is creditable against the GCT or AWHT. Consequently, under the PIS the final tax burden of non-resident nor domiciled persons would in principle increase up to 44.45%, as only 65% of the FCIT would be creditable against the 35% AWHT.

Nevertheless, if the beneficiary of the distribution is resident in a jurisdiction with which Chile has a treaty for the avoidance of double taxation, the FCIT will be fully creditable against the AWHT, and therefore the overall tax burden will remain 35%.[85] This exception has been criticized, as it would be an incentive for foreign taxpayers to invest in Chile from countries with which Chile has signed treaties for the avoidance of double taxation, which could breach the provisions preventing treaty shopping contained in certain treaties, as long as such structures have not enough economic substance.[86]

Additionally, Law No. 20,899 provides for another exception whereby the FCIT will be fully creditable in the case the beneficiary of the distribution is a resident of a country with which Chile has signed prior to January 1st, 2017 a treaty for the avoidance of double taxation, despite that treaty is not in force yet.[87] This provision will be in force until December 31st, 2019.

[85] Chile has treaties for the avoidance of double taxation in force with the following countries: Australia, Austria, Brazil, Belgium, Canada, Croatia, Colombia, Denmark, Ecuador, France, Ireland, Malaysia, Mexico, New Zeeland, Norway, Paraguay, Portugal, Peru, Poland, Russia, Spain, Korea, Sweden, Switzerland, Thailand and the United Kingdom.

[86] With respects to the scenario where, for purposes of having the FCIT fully creditable against the AWHT, foreign taxpayers change their domicile to countries that have a double taxation treaty with Chile, the Chilean Internal Revenue Service has stated that the relevant treaty provisions should apply (typically Article 4), in order to determine whether, after such a change, under the respective convention the foreign taxpayer qualifies as a resident of the jurisdiction having a treaty with Chile. In this regard, the Chilean Internal Revenue Service in principle would accept the foreign taxpayer's status as a resident of the other country, to the extent that he/she submits a certificate of residence issued by that other State. Also, in case the Chilean tax authority were to disagree with this treatment, it should resolve the case by mutual agreement with the competent authority of the other Contracting State, in accordance to the procedure provided by the same treaty. Revenue Ruling No. 1,985 issued by the Chilean Internal Revenue Service on August 3th, 2015. [online] <http://www.sii.cl/pagina/jurisprudencia/adminis/2015/renta/ja1985.htm> [last review on July, 5th, 2016].

[87] Chile has signed treaties for the avoidance of double taxation, which however have not become effective yet, with the following countries: United States of America, Uruguay, Argentina, China, Italy, Japan, Czech Republic and South Africa.

The foregoing provision is important, for example, for U.S. taxpayers, given that the Treaty was signed in year 2010, while it has not become effective yet, since its approval from the U.S. Senate is still pending. However, if the Treaty does not enter into force before January 1st, 2020, the FCIT paid by Chilean entities subject to the PIS would not be fully creditable against the AWHT affecting U.S. taxpayers.

SECTION II
MAIN INTERNATIONAL TAXATION ISSUES ARISING FROM THE AIS

1. *Applicability of Article 10 of double taxation treaties*

The purpose of the AIS is to apply final taxes on the income accrued or perceived by an entity subject to FCIT (or attributed to this entity), in the same year such accrual, perception or attribution occurred, regardless of actual distributions.

The treatment of dividends contained in Article 10 of both the U.S. Model and the OECD Model applies with respect to "dividends paid". The Treaty provides for the same provision.

Consequently, it might be asked if the attribution of income pursuant to the AIS actually gives rise to a "dividend", and if such dividend may be considered "paid" for tax treaty purposes.

Whether one were to conclude that such Article 10 is inapplicable, an additional issue would be determining if Article 7, Article 21, or other treaty provision should apply.

2. *Applicability of taxation on undistributed profits prohibition contained in double taxation treaties*

As the application of the so-called AIS implies that the income earned by a Chilean entity is levied with final taxes even where no distribution has been made, it might be asked if for tax treaty purposes the AWHT applied under this regime could be viewed somehow as a tax applied on undistributed profits.

In this regard, under paragraph 9 of Article 10 of the U.S. Model, as a general rule the source State may not tax corporations' undistributed profits, even if such undistributed profits consist wholly or partly of profits or income arising in that State.

In similar terms, paragraph 6 of Article 10 of the Treaty has provided for the same prohibition. Paragraph 5 of Article 10 of the OECD Model states an analogous provision, which Chile has included in all its treaties in force concluded under the OECD Model.

Consequently, whether the AWHT applied under the AIS may be deemed as a tax on undistributed earnings under the terms of the treaties signed by Chile, the application of the AIS would be contrary to those treaties.

3. Loss of foreign tax credit due to the application of AWHT without actual profit or dividend distribution

As indicated above, the AIS implies that an owner, partner, shareholder or head office may face a timing mismatch situation, where the AWHT has been already applied by reason of the attribution, but no flow of income has been received by such foreign investor. Then, the profit or dividend distribution to be made in any subsequent year would not be subject to additional taxation in Chile, as the AWHT already applied by the time of the attribution.

This scenario could give rise to an issue for foreign investors in their countries of residence as to the utilization of the credit for the taxes paid in Chile. The existence of restrictions in this regard and their significance must be analyzed under each relevant domestic provisions or convention for the avoidance of double taxation, if any.

This problem could be triggered, for instance, because those provisions in order to allow a credit for foreign taxes require an actual profit or dividend distribution from the source country, or because by the time of that distribution a term for the use of the credit has expired. For example, Peru, Argentina and Colombia have restricted the availability of the credit for taxes paid abroad where no actual distribution was made and that credit has not been utilized within certain term.[88]

[88] Recabarren, Soledad. Gran ausente en la discusión de la reforma tributaria: el inversionista extranjero. [online] <http://www.eychile.cl/SalaPrensa/Detalle/149> [last review on July, 4th, 2016].

Investors from countries whose legislations contain such restrictions will have to opt between repatriating all the profits earned each year, in order to guarantee the utilization of the foreign tax credit (preventing them from reinvesting that income in Chile), or accepting the loss of the credit giving rise to double taxation. In the latter scenario, the taxes paid in Chile would have to be utilized in the country of residence, to the extent possible, as a cost or as an expense, which certainly makes less attractive investing in Chile.

It is important to note that, evidently, a decrease in profits reinvestments in Chile, as well as, a decrease in the number of new investment projects to be developed in Chile, have a negative effect on the main purpose of Law No. 20,780, that is, increasing tax collection.

4. *Loss of foreign tax credit due to the disposal of shares of (or interest in) the Chilean entity*

Another problem under the AIS may arise where the income has been attributed to an AWHT taxpayer who then transfers its interest or shares to another AWHT taxpayer, and then the latter ultimately receives the profit or dividend distribution from the Chilean entity in a succeeding year.

In that scenario, the first owner (transferor) would be subject to AWHT by virtue of the attribution, which however could be deemed as non-creditable by the country of residence due to the absence of an actual flow of income, while the second owner (transferee) would probably have the foreign tax credit disallowed as the distribution received was not subject to AWHT.[89]

[89] Nevertheless, it should be noted that the economic effect of this issue for the transferor could be decreased at least partially by a reduction in the capital gain taxable income, in accordance to Article 17 No. 8(a)(ii), second paragraph, of the ITL effective as from January 1st, 2017. Under this provision where an owner, partner or shareholder of an entity subject to the AIS disposes of his/her interest or shares, the capital gain obtained in this transaction must be reduced by the amount of the entity's undistributed earnings at the year end immediately prior to the disposal, proportionately to the interest or shares transferred. However, this reduction in the capital gain does not allow the transferor to recognize a loss in the transaction. Thus, the actual impact of this provision on the consequences of the problem analyzed to the transferor must be examined on a case by case basis.

However, it should be noted that where the jurisdictions of the transferor and the transferee levy foreign source income on a cash basis, there would not be a double taxation issue but a mere loss of the credit for foreign taxes. In effect, the transferor would be taxed with AWHT by reason of the attribution but no further taxes should apply in its country of residence, since the distribution will not be perceived by that taxpayer. On the other hand, once the distribution is received by the transferee, this taxpayer would be only subject to taxation in its country of residence, as the AWHT was borne by the transferor.[90]

Once again the domestic provisions and the applicable treaty for the avoidance of double taxation, if any, should be analyzed in order to determine how this situation would be treated in the respective country, and whether any of the parties of this type of transactions would be entitled to a credit for the AWHT paid in Chile.

SECTION III
ANALYSIS UNDER THE U.S. DOMESTIC PROVISIONS OF THE AWHT APPLIED PURSUANT TO THE AIS

1. *General aspects and relevant provisions*

1.1. Foreign tax credit requirements

Section 901(a) of the I.R.C. allows for a credit for foreign income taxes paid or deemed paid by qualifying taxpayers who elect the credit in lieu of deducting the taxes under I.R.C.§164(a). The credit is intended to alleviate the double taxation that results when income earned in a foreign country is taxed by both the United States and the country of source. Because the United States taxes its citizens, residents, and domestic corporations on their worldwide income, double taxation typically occurs whenever a U.S. person is taxed by another country.[91]

Generally, under the U.S. unilateral credit system a tax paid or accrued abroad is allowed as a credit to the extent that the following requirements are met:

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[90] An additional analysis is required as to the capital gain tax treatment and its effect on the problem examined, which exceeds the objective of this paper.

[91] Bittker, Boris and Lokken, Lawrence. Fundamentals of International Taxation. Thomson Reuters, 2014, P.72-3.

i. The foreign levy must be a tax:[92] Under the Treas. Regulations a foreign levy is a tax if it requires a compulsory payment pursuant to the authority of a foreign country to levy taxes.[93]

ii. The predominant character of the tax is that of an income tax in the U.S. sense.[94]

First, in order to satisfy this requirement such tax must be likely to reach net gain in the normal circumstances in which it applies.[95] This test is subdivided into three requirements: (1) the foreign tax law must generally adhere to a realization concept similar to a realization doctrine of the U.S. income tax; (2) tax computations must usually begin from actual gross receipts, rather than from notional amounts; and (3) cost incurred in earning these gross receipts must be allowed as deductions.[96, 97]

Second, the tax must not be a soak-up tax, that is liability for the foreign tax cannot be dependent (by its terms or otherwise) on the availability of a credit for the tax against income tax liability to another country.[98]

Whether the foreign tax does not meet the net gain requirement explained above, it must be a tax in lieu of income taxes.[99]

The credit must be claimed by the person on whom foreign law imposes legal liability.

1.2. Limitations to foreign tax credit

The U.S. credit system has several restrictions in order to avoid granting credit for foreign taxes when it arises from transactions considered abusive, or simply where the policy behind the tax credit system is not being served.

Below there are the main limitations that could be applicable to the AWHT imposed in Chile pursuant to the AIS.

92 Treas. Regulation §1.901-2(a)(1)(i).
93 Treas. Regulation §1.901-2(a)(2)(i).
94 Treas. Regulation §1.901-2(a)(1)(ii).
95 Treas. Regulation §1.901-2(a)(3)(i).
96 Treas. Regulation §1.901-2(b)(1).
97 Bittker, Boris and Lokken, Lawrence. Op.Cit. P.72-18.
98 Treasury Regulation §1.901-2(c)(1).
99 I.R.C.§903.

1.2.1. Section 904(a) of the I.R.C. concerning the limitation of credit

Section 904(a) of the I.R.C. states that "The total amount of the credit taken under section 901(a) shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources without the United States (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year".

Consequently, under this provision the credit for foreign income taxes may not exceed the U.S. tax (before the credit) on income from foreign sources.[100] The limitation may be stated as taxable income from non-US sources, multiplied by the precredit U.S. tax divided by the entire taxable income.[101]

This provision must be applied separately with respect to passive category income and general category income.[102]

1.2.2. Section 909 of the I.R.C. concerning the suspension of taxes and credits until related income taken into account

In accordance to I.R.C.§909(a), if a foreign tax credit splitting event occurs with respect to a foreign income tax, the tax may not be taken into account for U.S. income tax purposes before the taxable year for which the payor of the tax recognizes the related income for U.S. tax purposes. There is a credit-splitting event with respect to a foreign income tax if the related income is taken into account for U.S. income tax purposes by a covered person.[103]

This provision defines for these purposes the term foreign income tax,[104] related income,[105] and covered person.[106]

[100] Bittker, Boris and Lokken, Lawrence. Op.Cit. P.72-118.
[101] Ibid. P.72-119.
[102] I.R.C.§904(d)(1).
[103] I.R.C.§909(d)(1).
[104] I.R.C.§909(d)(2).
[105] I.R.C.§909(d)(3).
[106] I.R.C.§909(d)(4).

1.3. Year in which the credit may be taken

Pursuant to I.R.C.§905(a) "The credits provided in this subpart may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued (…)".

Therefore, I.R.C.§905(a) allows accrual of foreign income taxes for credit purposes, even if the taxpayer generally uses the cash method of accounting.[107] In this regard, it should be noted that a foreign income tax generally accrues during the year in which is imposed.

1.4. Carryback and carryover of excess tax paid

In accordance to I.R.C.§904(c) if a taxpayer's foreign income taxes for any year exceed the I.R.C.§904 limitation for the year, the excess is carried back to the year preceding the taxable year, then to the year immediately following the taxable year, and then forward through the tenth year following the taxable year until the carryback or carryover is used.[108] This provision must also be applied separately with respect to passive category income and general category income.[109]

2. *Analysis of the compliance of the foreign tax credit requirements by the AWHT applied under the AIS*

2.1. Tax

Under the Chilean legislation, the payment of the AWHT is mandatory where a taxable event occurs, so that it is a tax as required by the I.R.C. and by the Treas. Regulations.

2.2. Income tax

i. Net gain requirement

As mentioned above, a tax is an income tax for tax credit purposes only if it is calculated to reach net gain. This requirement is met to the extent the realization, gross receipt and net income tests are satisfied.

[107] Bittker, Boris and Lokken, Lawrence. Op.Cit. P.72-287.
[108] Ibid. P.72-141.
[109] I.R.C.§904(d)(1).

a. *Realization requirement*

The realization requirement is met unless income or gain is recognized under the foreign law earlier than is permitted by any of the rules described below.[110, 111]

- Upon or subsequent to the occurrence of events that would result in the realization of income under the income tax provisions of the I.R.C.[112]

If under the U.S. law an item of income is to be recognized by an U.S. owner, partner, shareholder or head office only by the time of a profit or dividend distribution, the application of AWHT under the AIS would not comply with the realization requirement. In effect, under this regime the income is recognized by the final taxpayer for tax purposes in the same year such income is earned by the entity subject to FCIT, regardless of its perception by the foreign owner.

- Upon the occurrence of an event prior to a realization event provided the consequence of such event is the recapture (in whole or part) of a tax deduction, tax credit or other tax allowance previously accorded to the taxpayer.[113]

Since this rule refers to recaptures, it is inapplicable to the situation analyzed.

- Upon the occurrence of a prerealization event, but only if the foreign country does not, upon the occurrence of a later event, impose tax with respect to the income on which tax is imposed by reason of such prerealization event (or, if it does impose a second tax, a credit or other comparable relief is available against the liability for such a second tax for tax paid on the occurrence of the prerealization event).[114]

This rule applies, for example, where the income, loss or gain consist of the change in the value of property over a period of time, or where the foreign tax is imposed on the physical transfer, processing, or export of readily marketable property. Thus, this provision as to

[110] Bittker, Boris and Lokken, Lawrence. Op.Cit. P.72-24.

[111] Treas. Regulation §1.901-2(b)(2)(i).

[112] Treas. Regulation §1.901-2(b)(2)(i)(A).

[113] Treas. Regulation §1.901-2(b)(2)(i)(B).

[114] Treas. Regulation §1.901-2(b)(2)(i)(C).

unrealized items does not apply to the AWHT imposed by virtue of the attribution.

In light of the above, in principle the AWHT imposed under the AIS would not satisfy the realization test. However, under the Treasury Regulations[115] "A foreign tax that does not satisfy the realization requirement (…) is nevertheless considered to meet the realization requirement if it is imposed with respect to a deemed distribution (e.g., by a corporation to a shareholder) of amounts that meet the realization requirement in the hands of the person that, under foreign law, is deemed to distribute such amount, but only if the foreign country does not, upon the occurrence of a later event (e.g., an actual distribution), impose tax ("second tax") with respect to the income on which tax was imposed by reason of such deemed distribution (or, if it does impose a second tax, a credit or other comparable relief is available against the liability for such a second tax for tax paid with respect to the deemed distribution)".

For purposes of applying the foregoing provision it should be determined whether the AWHT is imposed under the AIS by reason of a "deemed distribution", if the amounts attributed meet the realization requirement in the hands of the Chilean entity, and whether actual distributions are subject to further taxation in Chile (other than the AWHT imposed by the time of the attribution).

The ITL as amended by Law No. 20,780 does not impose AWHT pursuant to the AIS by virtue of a "deemed distribution", but such final tax is applied by reason of the "attribution of income". However, irrespective any discussion as to the terminology utilized by the ITL, it would seem that the tax consequence in both cases is exactly the same, that is, the AWHT could be triggered regardless of an actual profit or dividend distribution.[116]

In connection with the realization requirement in the hands of the Chilean entity, note that the FCIT applies on a cash and on an accrual basis, so that the attribution of income, in general terms, is made with respect to income that has been realized by the entity domiciled in Chile.

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[115] Treas. Regulation §1.901-2(b)(2)(ii).

[116] Furthermore, note that Treas. Regulation §1.901-2(b)(2)(iv), Example 4, contains a case of a deemed dividend satisfying the requirement set forth by Treas. Regulation §1.901-2(b)(2)(ii), which is similar in substance to the application of AWHT under the AIS.

Nevertheless, it should be noted that the Chilean entity must also attribute to its owners income that, in turn, has been attributed to this entity due to its ownership, interest or shares in other Chilean entities. With regards to this type of income the realization test would be failed, since the attribution of this portion to final taxpayers (the deemed distribution) would be made with respect to income that, under the provisions of the I.R.C., would not be realized yet by the Chilean entity (but it has been only attributed to it).

Finally, distributions made by entities subject to FCIT are not levied with further taxation, where they have been previously subject to AWHT by reason of the attribution.

Consequently, in accordance to the deemed distributions provision referred to above, at least partially the AWHT applied under the AIS would comply with the realization requirement. However, it is still uncertain what could be the U.S. tax authority's view as to the attribution of income to U.S. taxpayers which was in turn attributed to the respective Chilean entity (with respect to which the realization requirement would be failed); and if it could lead to the denial of the entire credit or only of a portion of it.

b. *Gross receipt requirement*

In accordance to the Treasury Regulations[117] a foreign tax satisfies the gross receipts requirement if, judged on the basis of its predominant character, it is imposed on the basis of gross receipts; or gross receipts computed under a method that is likely to produce an amount that is not greater than fair market value.

Under the ITL,[118] the AWHT is imposed on the total amount of Chilean-sourced income attributed to, or perceived by, the non-resident nor domiciled recipient; and therefore such a tax complies with the gross receipt test.

c. *Net income requirement*

Pursuant to the Treasury Regulations,[119] a foreign tax satisfies the net income requirement if, judged on the basis of its predominant character, the base of the tax is computed by reducing gross receipts

[117] Treas. Regulation §1.901-2(b)(3)(i).

[118] ITL. Article 58 No. 2 and 60.

[119] Treas. Regulation §1.901-2(b)(4)(i).

to permit recovery of the significant costs and expenses (including significant capital expenditures) attributable, under reasonable principles, to such gross receipts; or recovery of such significant costs and expenses computed under a method that is likely to produce an amount that approximates, or is greater than, recovery of such significant costs and expenses.

In principle, the AWHT should comply with this requirement as dividends and profits are distributed out of the net taxable income of the Chilean entity. However, one could also sustain that the ITL[120] does not allow for recovery of any significant cost or expense at the foreign owner's level, so that at least theoretically the compliance of this requirement would be debatable.

Irrespective of the compliance of the net income requirement, the AWHT applied under the AIS could be treated as an income tax to the extent it complies with the requirements stated by I.R.C. §903.

ii. Soak-up tax

The AWHT to be applied in Chile is not a soak-up tax, as the liability for this tax is not dependent on the availability of a credit for the tax against income tax liability to another country.

2.3. Tax in lieu of income taxes

Section 903 of the I.R.C. and the Treasury Regulations[121] state that a foreign levy qualifies as an in lieu tax to the extent that such levy is a tax, the substitution requirement is met, and the tax is not a soak-up tax.

As indicated above, the AWHT applied by reason of the attribution qualifies as a tax in the U.S. sense.

In connection with the substitution requirement, a foreign tax satisfies this test if the tax in fact operates as a tax imposed in substitution for, and not in addition to, an income tax or a series of income taxes otherwise generally imposed.[122] In this respect, it might be argued that the AWHT imposed in this scenario substitutes the general income tax (i.e. FCIT), for a particular class of taxpayers (non-resident nor domiciled

[120] ITL. Article 58 No. 2 and 60.

[121] Treas. Regulation §1.903-1(a).

[122] Treas. Regulation §1.903-1(b)(1).

recipients), and income (profit or dividend distributions), so that it would comply with the substitution test.

Moreover, the AWHT is not a soak-up tax, as explained above.

Consequently, the AWHT applied in accordance to the AIS qualifies as an income tax under I.R.C.§903.

2.4. Legal liability rule

For purposes of I.R.C.§903 and I.R.C.§901, a foreign tax is considered paid by the person who is legally liable under the foreign country's laws for the tax.[123]

According to the ITL,[124] the person liable for the payment of the AWHT is the non-resident nor domiciled recipient of the income subject to this tax, or the non-resident nor domiciled person to whom such income was attributed.

It should be noted that taxpayers attributing, remitting to abroad, crediting into account, or placing at the recipient's disposal the income subject to AWHT are under the obligation of withholding and paying such a tax.[125] Nevertheless, the person legally liable for the AWHT is the foreign recipient (or the foreign person to whom the income was attributed) even if another person –such as a withholding agent– is actually making the payment to the corresponding tax authority.[126]

Therefore, the AWHT imposed under the AIS must be considered paid by the foreign owner, partner, shareholder or head office to whom the income has been attributed.

3. Analysis under the U.S. provisions of the main international taxation issues arising from the AIS

3.1. Loss of foreign tax credit due to the application of AWHT without actual profit or dividend distribution

As explained in Section (III)(2) of this paper, the AWHT imposed by reason of the attribution would comply with the requirements provided

[123] Treas. Regulation §1.901-2(f)(1).

[124] ITL. Article 58 No. 2 and 60.

[125] ITL. Article 74 No. 4.

[126] Treas. Regulation §1.901-2(f)(1).

by the I.R.C. and by the Treasury Regulations, in order to be creditable against U.S. taxes.

In effect, such AWHT qualifies as a tax.[127] Also, in principle the AWHT applied under the AIS would qualify as an income tax in the U.S. sense,[128] and even if one were to deem the net gain test failed, this tax do qualify as a tax in lieu of income taxes under I.R.C.§903. Consequently, to the extent the credit for foreign taxes is claimed by the person on whom the Chilean legislation imposes legal liability, the AWHT imposed by virtue of the attribution would give rise to a foreign tax credit under the U.S. domestic provisions.

However, the U.S. law is not clear as to the taxable year in which this credit would be available. In effect, although these domestic provisions do not require that the U.S. taxpayer has perceived the respective foreign source income for purposes of claiming the foreign tax credit, it should be noted that in this case no taxation would have been applied by the United States and, thus, the income would not have been subject to double taxation yet.

Under I.R.C.§905(a) the credit could be taken in the year in which the respective foreign tax accrued, even if the U.S. taxpayer uses the cash method of accounting. Therefore, in principle one could argue that under this provision an U.S. owner, partner, shareholder or head office could take the credit for the AWHT paid in Chile in the same year the attribution occurred.

However, an important limitation for the use of the credit in the same year the AWHT accrued would arise from I.R.C.§904(a). In effect, in case the U.S. taxpayer has not perceived in the year other foreign source income of the same category,[129] and since no distribution has been received from the Chilean entity either, the overall limitation contained in §904(a) for that year, that is, the precredit U.S. tax on foreign taxable income, would be zero. Even if the U.S. taxpayer has perceived other foreign source income of the same category in the year, the AWHT paid in Chile could be excluded under I.R.C.§904(a), depending on the amount of foreign taxes paid in that year on such other income from non-U.S. sources.

[127] As required by Treas. Regulation §1.901-2(a)(1)(i).

[128] In accordance to Treas. Regulation §1.901-2(a)(1)(ii).

[129] Pursuant to I.R.C.§904(d)(1), I.R.C.§904(a) must be applied separately with respect to passive category income and general category income.

Whether in accordance to the overall limitation of I.R.C.§904(a) the AWHT imposed in Chile is totally or partially deemed as an excess tax paid, under I.R.C.§904(c) such excess must be carried back to the year preceding the year in which the attribution occurred, then to the year immediately following this year, and then forward through the tenth year following the year of the attribution.

The consequences of these provisions must be analyzed in the following situations:

i. ***U.S. taxpayers perceiving foreign source income of the same category,*[130] *other than the potential distribution to be received from the Chilean entity***

In this scenario the credit for the AWHT paid in Chile could be used to the extent that in the preceding year the U.S. taxpayer recognized foreign source income of the same category, taxed abroad with an amount lower than the I.R.C.§904(a) limitation for that year.

Whether the credit carried back is larger than the excess limitation for that preceding year, the unused credit would have to be carried to the next year in the carry over period. Once again the use of the excess credit will depend on the perception of foreign source income of the same category within the ten years following the year of the attribution, and to the extent that the I.R.C.§904(a) limitation for those years allows the use of such an excess credit, unless the Chilean entity distributes the income levied with AWHT within the same ten-year term.

However, in case the entity subject to FCIT does not distribute any profit or dividend to the U.S. taxpayer within the term referred to above, or the U.S. taxpayer does not perceive other foreign source income of the same category within this term, or the I.R.C.§904(a) limitation for each year of such term does not allow the use of the excess credit carried back or carried forward, the AWHT paid in Chile would not be creditable under the U.S. domestic provisions. Consequently, it might be argued that if then the Chilean entity makes a distribution, after the expiration of the tenth year following the year in which the attribution took place, the U.S. owner, partner, shareholder or head office would be subject to double taxation.

[130] Pursuant to I.R.C.§904(d)(1), I.R.C.§904(c) must be also applied separately with respect to passive category income and general category income.

ii. U.S. taxpayers that do not perceive foreign source income of the same category, other than the potential distribution to be received from the Chilean entity

Under this fact pattern, the credit could not be carried back, since under the I.R.C.§904(a) limitation the amount to be allowed for the preceding year would be also zero. Similarly, the overall limitation of I.R.C.§904(a) should prevent U.S. taxpayers from carrying over the credit to the ten years following the year of the attribution, unless the Chilean entity makes a distribution within such period.

Therefore, in case the entity subject to FCIT does not distribute any profit or dividend to the U.S. taxpayer, or this distribution occurs after the expiration of the foregoing ten-year period, the credit for the AWHT paid in Chile would remain disallowed. Then, whether a subsequent distribution is made by the Chilean entity a double taxation issue would arise for the U.S. taxpayer.

Finally, it should be noted that the restriction set forth in I.R.C.§909 does not apply to any of the scenarios analyzed in Section (III)(3.1)(i) and (ii), since there would not be a foreign tax credit splitting event, given that the related income would not be taken into account by a covered person.[131]

3.2. LOSS OF FOREIGN TAX CREDIT DUE TO THE DISPOSAL OF SHARES OF (OR INTEREST IN) THE CHILEAN ENTITY

In this scenario the U.S. taxpayer would be subject to AWHT by reason of the attribution, but the interest or shares of the Chilean entity would be transferred by the taxpayer before perceiving the respective distribution with respect to which that AWHT applied. Then, the transferee of these interest or shares would receive the distribution, in his/her quality of new owner, partner or shareholder of the entity subject to FCIT.

With regard to the transferor, as indicated above, the U.S. law have not expressly required that the U.S. taxpayer claiming the credit has perceived the income on which the respective foreign tax was applied. Thus, the fact of becoming certain for the transferor that the profit or dividend distribution will not be perceived should not prevent him/her from using the credit for the AWHT paid in Chile.

[131] As defined by I.R.C.§909(d)(4).

However, the restriction for the use of this credit would arise from I.R.C.§904(a) and I.R.C.§904(c). In this regard, the same analysis explained above[132] applies to this scenario, with the exception that it is clear that any subsequent distribution will not be perceived by the transferor.

Note that I.R.C.§909 does not apply to this situation either, since there would not be a foreign tax credit splitting event. The related income in this transaction would not be taken into account by a covered person.[133]

In case the transferee of the interest or shares is also a U.S. taxpayer, it should be noted that he/she would not be entitled to a credit for foreign taxes due to the legal liability rule. In effect, for purposes of I.R.C.§903 and I.R.C.§901, a foreign tax is considered paid by the person who is legally liable under the foreign country's laws.[134] Pursuant to the ITL,[135] the person liable for the payment of the AWHT is the non-resident nor domiciled recipient of the income subject to this tax, or the non-resident nor domiciled person to whom such income was attributed.

In the scenario examined the AWHT is imposed by reason of the attribution, so that this tax must be deemed paid by the owner, partner or shareholder of the Chilean entity by the time of the attribution (transferor). Although the transferee is the recipient of the income when the profit or dividend distribution is made, such a distribution is not subject to AWHT, and therefore no tax may be considered paid by the transferee.

SECTION IV
ANALYSIS UNDER THE TREATY OF THE AWHT APPLIED PURSUANT TO THE AIS

1. *General aspects*

The Treaty was signed by the United States and Chile on February 4th, 2010. On the same date, the Department of the Treasury issued the Technical Explanation of the Treaty.

[132] See Section (III)(3.1) of this paper.

[133] As defined by I.R.C.§909(d)(4).

[134] Treas. Regulation §1.901-2(f)(1).

[135] ITL. Article 58 No. 2 and 60.

In accordance to Article 29 of the Treaty, for the purposes of its entering into force the Treaty shall be subject to ratification in accordance with the applicable procedures in the United States and Chile.

According to the Chilean Constitution,[136] in order for a tax treaty to enter into the Chilean juridical system it must be, firstly, negotiated and signed by the President. Secondly, approved by the Congress. Thirdly, the President must issue a decree to enact the treaty and finally, the text of the treaty must be published in the Chilean Official Gazette.

The Chilean Congress has completed the approval of the Treaty on September, 1st, 2015.

The U.S. Constitution vests the treaty making-power in the hands of the President with advice and consent of the Senate. After the Secretary of State formally submits a treaty to the President, the President transmits the treaty to the Senate for its advice and approval. Then, when the Senate has given its advice and consent to a treaty, the treaty is returned through official channels to the President for ratification.[137]

The Treaty was submitted by the President of the United States to Senate on May 17th, 2012. On November 10th, 2015, the U.S. Senate Committee on Foreign Relations approved the Treaty, so that now two-third of the full Senate must give their advice and consent to ratification. The latter approval is still pending.

Although the Treaty has not become effective yet, this section contains an analysis under the Treaty, the Technical Explanation of the Treaty, the U.S. Model, and the U.S. Model Technical Explanation, of the international taxation issues arising from the AIS, mainly with regard to the foreign tax credit to be granted to U.S. owners, partners, shareholders or head offices of Chilean entities. This analysis has been also based on the OECD Model and the OECD Commentaries, when they may be relevant to the issues referred to above.

[136] Politic Constitution of the Republic of Chile. Articles 32 No. 15, 54 No. 1 and 93 No. 3.

[137] VOGEL, Klaus. Double Taxation Conventions. Kluwer Law International, 1997. PP. 22-23.

2. *Analysis under the Treaty of the main international taxation issues arising from the AIS*

2.1. Applicability of Article 10 of the Treaty

As mentioned above, Article 10 of the Treaty applies with respect to "dividends paid". Therefore, it should be determined whether the attribution of income pursuant to the AIS gives rise to a "dividend", and if such a dividend may be deemed as "paid" for tax treaty purposes.

With regards to the existence of a "dividend" within the meaning of the Treaty, paragraph 4 of Article 10 of the Treaty defines the term "dividends" as "income from shares or other rights, not being debt-claims, participating in profits, as well as income from rights that is subjected to the same taxation treatment as income from shares under the laws of the State of which the company making the distribution is a resident".

This definition, however, is not significant by itself in determining if the attribution of income implies a "dividend" for tax treaties purposes. Neither the Technical Explanation of the Treaty nor the U.S. Model Technical Explanation have addressed this matter.

As a preliminary aspect, the applicability of Article 10 of the Treaty should depend on the approach applied by the ITL with regard to the attribution of income, and to the company whose profits are being taxed at the final taxpayer's level.

The provisions of the ITL as to the AIS have not referred to this matter. However, both Chilean and foreign legislations contain regimes that similarly levy undistributed profits in the hands of the shareholders of a company, such as controlled foreign corporations rules ("CFC rules").

These regimes have been based on different theoretical assumptions. The taxation of the resident shareholder may be based on the assumption that the sheltered income was actually realized in the hands of the shareholder. The foreign-based company may be disregarded as a corporate entity or the activities of the company may be regarded as the activities of the shareholder and attributed to the shareholder on a look-through basis.[138]

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[138] Helminen, Marjaana. The international tax law concept of dividend. Kluwer Law International, 2010. P.129.

The taxation of the shareholder may also be based solely on the assumption that the income is economically at the shareholder's disposal. The foreign corporation is not necessarily totally disregarded, but certain income of the foreign entity may be taxed in the hands of the shareholder.[139]

Income sheltered in a foreign entity may also be deemed to be distributed to the resident shareholders. This approach is called the fictive distribution approach.[140]

Whether these approaches were to apply to the AIS, it could be argued that this regime does not consider the Chilean entity as a disregarded entity. In effect, the application of FCIT at the entity's level demonstrates that the attribution of income is not based on a look-through principle.

One should conclude that the ITL, rather, applies the fictive distribution approach, so that it recognizes the Chilean entity as a separately taxable entity and only deems a distribution to exist. This would imply that, in principle, both States recognize the entity subject to FCIT as a resident in Chile dividend-distributing entity.

Having said that, it must be analyzed if the attribution of income falls within the meaning of "dividend" referred to above. In this regard, the Technical Explanation of the Treaty sets forth that "Paragraph 4 defines the term dividends broadly and flexibly. The definition is intended to cover all arrangements that yield a return on an equity investment in a corporation as determined under the tax law of the State of source, as well as arrangements that might be developed in the future".[141]

Although the Technical Explanation of the Treaty holds a broad interpretation on this matter, it emphasizes that a "dividend" implies a "return", which would seem to require an actual flow of income. Consequently, as the attribution of income does not generate any actual distribution, nor create the obligation of a Chilean entity of making such a distribution in the future, under this interpretation it might be argued, in principle, that the attribution of income would not give rise to a "dividend" in the terms of the Treaty.

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139 Ibid. P.129.

140 Ibid.

141 U.S. Treasury Department. Technical Explanation of the Treaty to paragraph 4 of Article 10. [online] <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Technical-Explanation Chile-2-4-2010.pdf> [last review on July, 3rd, 2016].

On the other hand, the definition of "dividend" contained in the Treaty assumes that an "income" exist, so that it should be asked, first of all, if there is actually an income for the U.S. owner by virtue of a fictive distribution. Since the Treaty has not defined the term "income", in accordance to Article 3 paragraph 2 of that Treaty this undefined term must be interpreted by reference to the Chilean legislation (the State applying the Treaty), if the context does not otherwise require.

In this regard, the ITL[142] defines "income" as "the revenues constituting profits or earnings arising from an asset or activity, and all earnings, profits and capital increase perceived, accrued or attributed (…)". As this definition suggests, a taxpayer should recognize income where profits have been attributed to him/her, regardless of the fact that such earnings have not been perceived or even accrued yet.

Hence, since the fictive distribution pursuant to the AIS is deemed to exist by reason of the attribution of income, it is possible to argue that such fictive distribution gives rise to income within the meaning of the Chilean legislation and, therefore, may be also considered income in the terms of paragraph 4 of Article 10 of the Treaty. This interpretation based on the Chilean legislation should become binding for the purposes of applying the Treaty also in the United States.[143]

In addition, the amount attributed in this scenario would be income arising from shares, or from rights that is subjected to the same taxation treatment as income from shares under the Chilean tax legislation.

In light of the above, it could be claimed under this approach that income attributed under the AIS qualifies as a "dividend" within the definition of paragraph 4 of Article 10 of the Treaty.

With regards to the existence of a dividend "paid" for tax treaty purposes, neither the Treaty nor the Technical Explanation of the Treaty have defined the expression "paid". The U.S. Model Technical Explanation has not defined this term either. Therefore, the expression "paid" must be interpreted also by reference to the Chilean provisions, in accordance to paragraph 2 of Article 3 of the Treaty.

The ITL does not contain a definition of the expression "paid". Nevertheless, the Chilean Civil Code[144] sets forth that "payment" is "the

[142] ITL. Article 2 No. 1 in accordance to its wording effective as from January 1st, 2017.

[143] Vogel, Klaus. Op.Cit. P.650.

[144] Chilean Civil Code. Article 1,568.

compliance of what is due". Hence, in order to have a dividend "paid" in the terms of this definition, the entity should have an obligation of making a distribution to its owners from the moment the profits are earned (since only in this case the distribution is "due" by the time of the attribution), and an action should be performed by that entity to comply with this obligation.

It might be argued that the owner, partner, shareholder or head office of a Chilean entity could be in a situation where he/she does not have any right or title with regard to the income that is being attributed to him/her under the AIS. Consequently, dividends or profits would not be due to the owners by the time of the attribution.

Likewise, the attribution of income should not generate any effect other than triggering the final taxes,[145] so that even if one assume that an obligation do exist, it should not be complied by virtue of the attribution.

Finally, it should be noted that the attribution of income does not require an action from the entity subject to FCIT.

Consequently, under this interpretation there would be in principle an argument to say that Article 10 should not apply to an attribution of income under the AIS, given that even assuming there would be a "dividend" in the terms of the Treaty, such dividend would not be "paid" as required by the same Treaty.

The Technical Explanation of the Treaty has not referred to the OECD Commentaries as to the definition of the expression "dividends". However, Article 10 of the OECD Model also applies with regard to "dividends paid", and the definition of the term "dividends" provided by the OECD Model is almost the same as the definition provided by the Treaty. In this regard, the OECD Commentaries state that "The term "paid" has a very wide meaning since the concept of payment means the fulfillment of the obligation to put funds at the disposal of the shareholder in the manner required by contract or by custom". [146]

By describing the term "paid" as synonymous with putting funds at the disposal of the shareholder, the OECD Commentaries makes clear

[145] Section II(B)(2)(a)(i) of Circular Letter No. 66, issued by the Chilean Internal Revenue Service on July 23rd, 2015. [online] <http://www.sii.cl/documentos/circulares/2015/circu66.pdf> [last review on July, 5th, 2016].

[146] OECD Commentaries. Paragraph 7 of Commentary to Article 10. [online] <http://www.oecd.org/berlin/publikationen/43324465.pdf> [last review on July, 3rd, 2016].

that processes that, by appearance, might not be covered, but are similar from an economic point of view, are not meant to be excluded in this connection (this is the function of the definition of "dividends" given in Article 10 paragraph 4).[147] Hence, the term "paid" should be given a broad interpretation and includes all of the various forms of satisfying the shareholder's claim to receive the dividend.[148] [149]

The term "paid" must, therefore, be understood to be determined by the definition of "dividends", in other words, payment is the provision of any advantage qualifying as a "dividend" under Article 10 paragraph 4.[150]

As explained above, for treaty purposes the attribution would give rise to income for the U.S. owner, partner, shareholder or head office, and that income actually would derive from shares or other rights in the terms of paragraph 4 of Article 10 of the Treaty. Therefore, since this income is recognized in the hands of the final taxpayer by reason of the attribution, it would be possible to argue that the so-called attribution would imply a "payment". From an economic point of view, however, the absence of an actual flow of income makes still doubtful this interpretation.

Notwithstanding the foregoing, it should be highlighted that Article 10 contains no provision regarding the date at which dividends may be taxed. If dividends are taxed which cannot yet be considered to have been "paid", even if the latter term is interpreted as widely as possible, their taxation would nevertheless not run counter to the convention. However, all restrictions imposed by the convention on the taxation of dividends must, of course, be observed in such a case, too.[151]

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147 Vogel, Klaus. Op.Cit. P.587.

148 Ibid.

149 In addition, although the AIS differs from the treatment applicable to partnerships, it should be noted that paragraph 6.4 of OECD Commentary to Article 1 states that where income has "flowed through" a transparent partnership to the partners who are liable to tax on that income in the State of their residence, the income is appropriately viewed as "paid" to the partners, since it is to them and not to the partnership that the income is allocated for purposes of determining its tax liabilities in their State of residence. However, it could be also argued that under the AIS the Chilean entity is not regarded as a transparent entity (in fact typically it should qualify as a resident of Chile for Treaty purposes), and that, as a general rule, U.S. taxpayers should not be taxed in the United States on the income when attributed to them, but only by the time this income is distributed.

150 Vogel, Klaus. Op.Cit. P.587.

151 Ibid. P.588.

2.2. Applicability of taxation on undistributed profits prohibition contained in the Treaty

Since the AIS seeks to tax income at the final taxpayers' level, even where no profit or dividend distribution has been received from the Chilean entity, it can be asked whether this regime could be subject to the prohibition of taxing undistributed profits contained in the Treaty.

Paragraph 6 of Article 10 of the Treaty states that "Where a company that is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company (…) nor subject the company's undistributed profits to a tax on undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State".

It must be determined, first of all, if the application of AWHT pursuant to the AIS falls within the scope of paragraph 6 of Article 10 of the Treaty. In this regard, it should be taken into account that such a provision restricts the power of each State to impose tax on –distributed or undistributed– profits of a non-resident company.[152] Therefore, since the provision rules out the extra-territorial taxation of dividends, the obligation of Chile under the Treaty would be refraining from taxing profits of a company resident in the United States. Accordingly, this rule would not apply to a scenario where Chile is applying a final tax on undistributed profits of an entity resident in Chile.

Even if one were to assume that the scope of paragraph 6 of Article 10 of the Treaty includes the situation of the AIS, there is an additional ground to sustain that the restriction contained in the Treaty is not applicable to this regime, based on the type of tax applied under the AIS. In effect, in accordance to the U.S. Model Technical Explanation[153] the rule analyzed restricts the right of a Contracting State to impose corporate level taxes on undistributed profits, other than a branch profits tax.

Consequently, the prohibition would apply only with regard to corporate taxes, so that this provision would be inapplicable to the AIS, since the AWHT imposed on undistributed profits is a final tax and not a

152 Ibid. P.693.

153 U.S. Treasury Department. U.S. Model Technical Explanation to paragraph 7 of Article 10. [online] <https://www.treasury.gov/press-center/press-releases/Documents/hp16802.pdf > [last review on July, 3rd, 2016].

corporate tax, unless one were to consider that the AWHT is supplementary to the FCIT; and therefore both would form part and would share the nature of the Chilean corporate taxation.

Finally, the OECD Commentaries have not expressly addressed this particular matter. However, if the AIS were to be considered similar to CFC rules, it should be noted that in accordance to the OECD Commentaries these regimes are not deemed contrary to the provisions of the OECD Model;[154] and accordingly CFC rules are not limited by paragraph 1 of Article 7 of the OECD Model.[155]

Specifically in connection with paragraph 5 of Article 10 of the OECD Model, the OECD Commentaries[156] state that CFC rules are not contrary to this provision either, although one of the reasons indicated to reach this conclusion is that the rule analyzed is confined to taxation at the source, which is exactly the scenario under the AIS.

Therefore, there are arguments to hold the position that the AWHT applied by virtue of the attribution is not a tax on undistributed profits in the terms of the Treaty. Under this interpretation the provisions of the ITL stating the AIS should not be restricted by paragraph 6 of Article 10 of the Treaty.

2.3. Loss of foreign tax credit due to the application of AWHT without actual profit or dividend distribution

Paragraph 1 of Article 23 of the Treaty sets forth that "In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income applicable to residents and citizens: (a) the income tax paid or accrued to Chile by or on behalf of such citizen or resident; and (b) in the case of a United States company owning at least 10 percent of the voting stock of a company that is a resident of Chile and from which the United

[154] OECD Commentaries. Paragraph 23 of Commentary to Article 1. [online] <http://www.oecd.org/berlin/publikationen/43324465.pdf> [last review on July, 3rd, 2016].

[155] OECD Commentaries. Paragraph 13 of Commentary to Article 7. [online] <http://www.oecd.org/berlin/publikationen/43324465.pdf> [last review on July, 3rd, 2016].

[156] OECD Commentaries. Paragraph 37 of Commentary to Article 10. [online] <http://www.oecd.org/berlin/publikationen/43324465.pdf> [last review on July, 3rd, 2016].

States company receives dividends, the income tax paid or accrued to Chile by or on behalf of the payor with respect to the profits out of which the dividends are paid".

Hence, although Article 23 paragraph 1 of the Treaty allows a credit for foreign taxes, the extent of the credit and the procedure for implementing the credit method would be determined in accordance to the U.S. domestic provisions.

It should be noted that the AWHT falls within the taxes covered by the Treaty in accordance to Article 2, paragraph 3(b),[157] while paragraph 1 of Article 23 provides that the taxes referred to in such Article 2, paragraph 3(b) must be considered "income taxes".

The significance of Article 23 paragraph 1 is that it stipulates that the taxes of the other contracting State contained in Article 2 of the Treaty shall be considered "income taxes", and as such they shall qualify as a credit allowed against U.S. Federal income tax. While, under domestic U.S. law, a special examination must be made to determine whether or not a foreign tax paid is an "income tax", a "war profit tax" or an "excess profit tax", or whether it is a tax paid "in lieu of" such a tax.[158]

The Treaty, the Technical Explanation of the Treaty and the U.S. Model Technical Explanation have not addressed the treatment of timing mismatch scenarios, and all of them have failed to stipulate the period in respect of which a foreign tax must be allowed as a credit. Consequently, these aspects should be analyzed under the U.S. domestic provisions.

As explained in Section (III)(3.1) of this paper, under U.S. law there could be scenarios where U.S. taxpayers are not allowed to a credit for the AWHT paid in Chile under the AIS, arising mainly from the overall limitation contained in I.R.C.§904(a) and from the carryback and carryover of excess tax paid provision set forth in I.R.C.§904(c). Accordingly, if the Chilean entity would make a profit or dividend distribution in these situations a double taxation issue would be posed.

157 This provision states that "The existing taxes to which this convention shall apply are: (b) In Chile: the taxes imposed under the Income Tax Act (*Ley sobre Impuesto a la Renta*)".

158 VOGEL, Klaus. Op.Cit. PP.1232-1233.

It might well be asked, however, whether these double taxation scenarios are acceptable under Article 23 of the Treaty. In this regard, the Technical Explanation of the Treaty[159] and the U.S. Model Technical Explanation[160] set forth that although the Treaty provides for a foreign tax credit, the terms of the credit are determined by the provisions, at the time a credit is given, of the U.S. statutory credit.

Accordingly, the Technical Explanation of the Treaty and the U.S. Model Technical Explanation also highlight that "the U.S. credit under the Convention is subject to the various limitations of U.S. law (see, e.g., Internal Revenue Code §901-§908). For example, the credit against U.S. tax generally is limited to the amount of U.S. tax due with respect to net foreign source income within the relevant foreign tax credit limitation category (see Internal Revenue Code §904(a) and (d)), and the dollar amount of the credit is determined in accordance with U.S. currency translation rules (see, e.g., Internal Revenue Code §986). Similarly, U.S. law applies to determine carryover periods for excess credits and other inter-year adjustments".[161, 162]

Consequently, the Technical Explanation of the Treaty and the U.S. Model Technical Explanation suggest that U.S. domestic provisions limiting the use of the credit should apply without any restriction. Under this interpretation, therefore, the same double taxation issues analyzed before would arise despite the existence of the Treaty.

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159 U.S. Treasury Department. Technical Explanation of the Treaty to paragraph 1 of Article 23. [online] <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Technical-Explanation Chile-2-4-2010.pdf> [last review on July, 3rd, 2016].

160 U.S. Treasury Department. U.S. Model Technical Explanation to paragraph 2 of Article 23. [online] <https://www.treasury.gov/press-center/press-releases/Documents/hp16802.pdf> [last review on July, 3rd, 2016].

161 U.S. Treasury Department. U.S. Model Technical Explanation to paragraph 2 of Article 23. [online] <https://www.treasury.gov/press-center/press-releases/Documents/hp16802.pdf> [last review on July, 3rd, 2016].

162 U.S. Treasury Department. Technical Explanation of the Treaty to paragraph 1 of Article 23. [online] <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Technical-Explanation Chile-2-4-2010.pdf> [last review on July, 3rd, 2016].

On the other hand, it could be also argued that although the Treaty refers to the U.S. law for purposes of granting a tax credit, these domestic provisions should not affect the general principle laid down by Article 23 of the Treaty, that is, granting relief to double taxation.

It is important to note that paragraph 4 of the protocol of the Treaty contains the "saving clause", according to which the Contracting States reserve their rights to tax their residents and citizens as provided under their domestic laws. However, under subsection (a) of this paragraph 4 of the protocol the "saving clause" does not apply to Article 23. Accordingly, the Technical Explanation of the Treaty sets forth that the United States must allow a credit to its citizens and residents in accordance with such Article 23, even if such credit were to provide a benefit not available under the Internal Revenue Code (such as the re-sourcing provided by subparagraph 3(c) and paragraph 5 of Article 23 of the Treaty).[163] Nevertheless, it is unclear if this could be understood as a limitation to the application of I.R.C.§904(a) and I.R.C.§904(c).

Under this approach, the U.S. legislation would be intended to complement the credit method provided by the Treaty, or even to supplement the Treaty by applying provisions that are more favorable to taxpayers, but the United States should refrain from applying domestic rules imposing restrictions to the credit that may result in a double taxation scenario.

Although the Technical Explanation of the Treaty does not refer to the OECD Commentaries on this matter, it should be noted that the latter, as opposed to the U.S. Model Technical Explanation and to the Technical Explanation of the Treaty, has addressed the treatment of timing mismatch issues.

In effect, the OECD Commentaries state that "The provisions of the Convention that allow the State of source to tax particular items of income or capital do not provide any restriction as to when such tax is to be levied (see, for instance, paragraph 2.2 of the Commentary on Article 15). Since both Articles 23 A and 23 B require that relief be granted where an item of income or capital may be taxed by the State of source in accordance with the provisions of the Convention, it follows that such relief must be provided regardless of when the tax is levied by the State

[163] U.S. Treasury Department. Technical Explanation of the Treaty to paragraph 1 of Article 23. [online] <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Technical-Explanation Chile-2-4-2010.pdf> [last review on July, 3rd, 2016].

of source. The State of residence must therefore provide relief of double taxation through the credit or exemption method with respect to such item of income or capital even though the State of source taxes it in an earlier or later year".[164]

Hence, apparently under the OECD Commentaries, the State of residence should grant a credit for the tax paid in the State of source (or provide relief under the exemption method), even if such taxation has been imposed in a year and then the distribution is made in a subsequent year, to the extent that such a tax has been applied in accordance with the provisions of the convention.

The OECD Commentaries also suggest that such a credit would be available only by the time the income is subject to taxation in the State of residence, which typically will occur when an actual profit or dividend distribution takes place.[165]

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[164] OECD Commentaries. Paragraph 32.8 of Commentary to Articles 23 A and 23 B. [online] <http://www.oecd.org/berlin/publikationen/43324465.pdf> [last review on July, 3rd, 2016].

[165] Irrespective of the role that this OECD Commentary to Articles 23 A and 23 B of the OECD Model could have on the interpretation of Article 23 of the Treaty, such OECD Commentary is also relevant to determine the position that other treaty partners should take with regard to the AWHT applied under the AIS. In this respect, only few of the treaties in force concluded by Chile under the OECD Model, with treaty partners using the credit method, have followed the wording of Article 23 B of such a model (this is the case, for example, of the treaty signed with Croatia, Denmark, Ecuador, Peru, Poland, Russia and Thailand). It might be argued therefore that these countries should grant a tax credit for the AWHT applied in Chile by reason of the attribution, even though the actual income distribution is done in a succeeding year. However, this obligation would apply only by the time of the distribution, and not when the AWHT is triggered.
All the other conventions concluded by Chile under the OECD Model state in Article 23 some restrictions, or link the relief of double taxation to be given under the convention to what is provided under the domestic provisions of the respective treaty partner, although several of those treaties further provide that these domestic rules shall not affect the principle laid down in Article 23. Consequently, despite those domestic provisions may restrict the granting of double taxation relief in cases with attribution of income, there is at least an argument to claim that these countries should also provide a tax credit for the AWHT paid in Chile under the AIS, since otherwise the purpose of Article 23 would be frustrated.
Where a reference to the domestic provisions has been made in the respective convention but these domestic rules have not been restricted by the general principle laid down in Article 23, based on the OECD Commentaries one could argue that the respective treaty partner would be expected to seek other ways (the mutual agreement

It should be noted that although the wording of the foregoing Article 23 B of the OECD Model and of Article 23 of the Treaty are not identical, both set forth the same in substance, namely, the obligation of the country of residence of granting double taxation relief under the credit method. However, it must be taken into account that the OECD Model does not refer to the domestic legislation as the Treaty does.

If the OECD Commentaries referred to above were to apply to the interpretation of Article 23 of the Treaty, they would support the position under which the United States should not apply its domestic provisions limiting the use of the credit, such as I.R.C.§904(a) and I.R.C.§904(c), where it leads to double taxation situations. Alternatively, under these commentaries whether those domestic rules were to be applied without restriction, United States would be expected to seek other ways to grant double taxation relief, where the subsequent distribution to be made by a Chilean entity would give rise to double taxation.

With regards to the potential application of the mutual agreement procedure provided by Article 26 of the Treaty to the scenario examined, it should be noted that under paragraph 1 of this provision, where a resident of a Contracting State considers that the actions of one or both Contracting States will result in taxation that is not in accordance with the Convention, he/she may present his/her case to the competent authority of the Contracting State of which he/she is resident, or, if his/her case comes under paragraph 1 of Article 25 (Non-Discrimination), to the competent authority of the State of which he is a national. Paragraph 3 of Article 26 of the Treaty provides that those competent authorities shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the convention.

Paragraph 3 of Article 25 of the U.S. Model also sets forth that competent authorities may consult together for the elimination of double taxation in cases not provided for in the respective convention. This could be, in principle, a possible way of invoking the mutual agreement procedure provision, under which the taxpayer would have to claim that

procedure, for example) to relieve the double taxation which might otherwise arise in cases where the State of source levies tax in a different taxation year, which would be the case under the AIS.

Therefore, the OECD Commentaries suggest that, where the AWHT has been applied pursuant to the AIS, countries with which Chile has a treaty in force concluded under the OECD Model should provide (or seek to provide) double taxation relief.

Articles 10 and 23 of the Treaty do not cover timing mismatch situations, and this would be demonstrated by the fact that a subsequent distribution would give rise to double taxation due to the loss of the foreign tax credit under the U.S. law, which would be contrary to the purpose of the Treaty.

Nevertheless, paragraph 3 of Article 26 of the Treaty does not include such a rule. The application of the mutual agreement procedure under the Treaty would have to be based on the general provisions of paragraph 1 and paragraph 3 explained above. Thus, the U.S. taxpayer would have to sustain that the application of I.R.C.§904(a) and I.R.C.§904(c) by the United States would imply a taxation contrary to Article 23 of the Treaty (as a double taxation scenario would arise). Accordingly, under this position United States and Chile would have to resolve this problem arising from the interpretation of the Treaty, given that United States would understand that pursuant to that Treaty its domestic provisions should apply without restriction.

In addition, although the Technical Explanation of the Treaty has not expressly referred to the OECD Commentary on this subject either, the wording of paragraph 3 of Article 25 of the OECD Model (concerning the mutual agreement procedure) is similar to the wording of the same paragraph of Article 26 of the Treaty.[166] In this respect, the OECD Commentaries provide that under paragraph 3 of Article 25 of the OECD Model the competent authorities can, in particular, where the laws of a State have been changed without impairing the balance or affecting the substance of the convention, settle any difficulties that may emerge from the new system of taxation arising out from such changes.[167] This could be a further ground to claim that, at least theoretically, a U.S. taxpayer subject to double taxation in the scenario analyzed could present his/her case to the competent authority under Article 26 of the Treaty, as the AIS would imply a new tax regime leading to a treaty interpretation issue.

Notwithstanding the above, it will be necessary to wait for the entering into force of both the AIS and the Treaty, in order to determine the actual position that the United States' tax authority will take with regards to this problem.

[166] With the only exception that the OECD Model also states in such paragraph that the competent authorities "may also consult together for the elimination of double taxation in cases not provided for in the Convention".

[167] OECD Commentaries. Paragraph 52 of Commentary to Article 25. [online] <http://www.oecd.org/berlin/publikationen/43324465.pdf> [last review on July, 3rd, 2016].

2.4. Loss of foreign tax credit due to the disposal of shares of (or interest in) the Chilean entity

The Treaty, the Technical Explanation of the Treaty, and the U.S. Model Technical Explanation have not addressed this issue.

With regards to the transferor of interest or shares of a Chilean entity subject to the AIS, Article 23 of the Treaty refers to the domestic provisions for purposes of granting a foreign tax credit. In accordance to I.R.C.§905(a), in principle the credit could be taken in the year in which the AWHT accrued. However, under the overall limitation contained in I.R.C.§904(a) the credit for the AWHT applied pursuant to the AIS would remain unused under certain circumstances, while I.R.C.§904(c) limits the amount of years in which such credit may be carried back and carried over, where that credit has been excluded under the I.R.C.§904(a) limitation.

Nevertheless, the particularity of the situation analyzed is that certainly the U.S. taxpayer will not be subject to double taxation, assuming that the United States, as a general rule, would levy the corresponding foreign source income on a cash basis. Given that the distribution to be made by the Chilean entity would be received by the transferee, the transferor would be subject only to the AWHT.

This implies that the benefits of the Treaty would not be available to a U.S. taxpayer in such a situation. Article 23 of the Treaty should apply where at least a potential double taxation scenario arises, so that there would be no basis to claim a credit assuming that the income will not be taxed in the United States.[168]

Likewise, the OECD Commentaries suggest that the obligation of providing double taxation relief would apply by the time the income is levied by the State of residence. Consequently, under the OECD Commentaries one could also lead to the same conclusion.

In relation to the transferee and in case he/she is also a U.S. taxpayer, besides not being subject to double taxation, a credit should not be allowed under the Treaty due to the legal liability rule as explained above.[169] In effect, the transferee must not be deemed as the person who is legally liable for the payment of the AWHT,[170] given that the income was

[168] A further analysis should be made to determine the capital gain tax treatment under the Treaty and its effects on the problem examined.

[169] See Section (III)(3.2) of this paper.

[170] In the terms of Treas. Regulation §1.901-2(f)(1).

attributed to the transferor, and accordingly the latter was the taxpayer levied with AWHT.

Therefore, there would be no arguments in favor of the granting of a foreign tax credit in this scenario.