Chile's approach to the taxation of the digital economy

Manuel José Garcés
Carey, Santiago
mgarces@carey.cl

José Tomás Otero
Carey, Santiago

Introduction

In a world where, with every passing day, the digital economy takes on a more important role on a global scale (eg, as of May 2018, the top five most valuable companies in the world[1] were all directly or indirectly related to the digital economy: Apple, Amazon, Alphabet, Microsoft and Facebook), the tax systems of countries throughout the world are currently struggling to determine if economic activities carried out in each country are taxable and how much value, if any, is being created in the jurisdiction. Both issues are core principles of current tax systems, determining if a jurisdiction has the right to tax an event, and how the taxable basis should be determined.

The inability of tax regulations, both at internal and multilateral levels, to properly address the challenges arising from the constant advances and changes within the digital economy have been thoroughly addressed by the Organisation for Economic Co-operation and Development (OECD) through its 2015 *Final Report on Base Erosion and Profit Shifting (BEPS), Action 1 (Addressing the Tax Challenges of the Digital Economy)* and its 2018 *BEPS Interim Report on Tax Challenges Arising from Digitalisation*.

Even though the OECD has accurately spotted the new challenges entailed by the digital economy, the organisation has not yet reached a consensus on specific solutions to them. Nonetheless, the OECD criterion is that any solution should be consensus-based and aimed at a global level, whereas interim measures taken by countries are not encouraged or discouraged.

In this regard, as this is a pressing matter and as a multilateral solution is not likely to be reached and implemented in the short term, certain countries have taken unilateral measures to directly address certain issues arising from the digital economy.

Unilateral measures to address digitalisation

Pursuant to the OECD[2] criterion, unilateral measures to tax digital activities can be grouped into the following four categories:

Alternative applications of the permanent establishment (PE)

One of the main differences between the digital economy and almost every traditional business model refers to the means and assets used for the creation of value, relying heavily on intangible assets which, until the past few years, had little to no relevance for traditional businesses. As the creation of value in the digital economy is no longer directly associated with tangible assets and the physical location of employees, among other things, both the traditional PE approach (to determine the right of a country to levy income) and the OECD Transfer Pricing Guidelines (applicable to determine the attributable profits to a PE) have become insufficient to ensure that income is levied where value is created.

By virtue of the above, certain jurisdictions[3] aim to update the traditional PE approach, in order for their regulations to be able to capture situations within the digital economy in which value is created, by means of creating a new taxable nexus for income derived by non-resident companies or enterprises. This approach intends to identify when a foreign company carries out its activities in a country by non-physical means, such as digital or online, exceeding certain thresholds which will trigger a 'significant digital presence' or 'significant economic presence'.

The 'virtual' PE approach is the preferred course of action of the European Commission[4]-[5], which proposes a common reform to the corporate tax rules of Member States of the European Union, by which any digital platform deemed to have a significant digital presence shall be taxed in such Member States.[6]

Use of withholding taxes

Certain countries[7] have taken measures to strengthen their rules for income tax on non-residents through withholding regulations to capture certain payments that would not be taxed before. Whereas this is a very efficient measure when the payer is an enterprise, individual consumers are not likely to comply with their declaring and payment obligations. Also, as these measures are only at an internal level and double taxation treaties are not expected to be modified, such new withholding rules are possibly going to be limited by the application of such treaties and their standard provisions.

Measures related to withholding taxes usually include broadening the definition of royalties (in order to include concepts generally deemed as business profits), the adoption of withholding taxes on fees paid in consideration for technical services, and the introduction of new withholding taxes on other specific kinds of income.[8]

Turnover taxes

As both previous measures relate to income tax, some countries[9] have introduced turnover taxes especially applicable to certain services or digital activities, aimed at restoring the neutrality between foreign and local suppliers, as well as between digital and traditional suppliers. These taxes are usually combined with broader nexus rules (in opposition to income tax nexus), such as the location of the public audience, the location of the targeted audience, the location of the payer and particular collection methods, such as obligations over local intermediaries such as banks.

Specific regimes targeting large multinational enterprises

Finally, some countries have introduced new rules targeted specifically at multinational enterprises, to ensure that taxes are levied where value is created and to avoid profit shifting. Such countries include the United Kingdom, the United States and Australia. This has resulted in several multinational enterprises taking the necessary steps to restructure their trade structure or arrangements to comply with these regulations.

Chile's approach to the taxation of digital services

Just as many countries have taken unilateral measures to combat the challenges of the digitalisation of the economy, Chile is not an exception. Following this trend, the Chilean Government (the 'Government') has sought to introduce a new tax on digital services within a major tax reform bill (the 'Tax Reform Bill'), which was presented before the Chilean Congress on 23 August 2018. Despite its narrow scope (it is only aimed at digital services provided to individuals), it is Chile's first approach to taxing the digital economy.

Even though Chile has internal regulations providing the application of withholding taxes for services rendered abroad, paid by Chilean domiciled or resident taxpayers, as the OECD has pointed out,[10] it is complex for individuals to comply with withholding tax measures, as individuals are not likely to present their returns and payments. In this regard, the approach presented by the Government is focused on closing this loophole in the Chilean tax regulations, which had resulted in the Government being unable to tax any of the payments made by individuals for digital services provided by non-Chilean companies.

For these purposes, Article 15 of the Tax Reform Bill introduces a newly specific and indirect tax over digital services rendered by non-resident or domiciled entities or individuals, regardless of the platform or server that supports such services (the 'Tax on Digital Services', TDS). Even though the TDS seems to have standard withholding tax characteristics in the way it is applicable over gross-amount payments to non-residents in consideration for services, it may be also categorised as a turnover tax. The latter is a particular burden for specific transactions and it is regulated in a separate law (apart from the income tax law), with particular compliance rules.

In this sense, the proposed TDS behaves as an indirect tax that levies with a flat tax of ten per cent the payments made abroad for certain digital services utilised in Chile by individuals.

The following are some interesting aspects of the TDS:

1. Definition of digital services: Regardless of their denomination, digital intermediation services (eg, Airbnb), entertainment services for digital content (eg, Netflix and Spotify), paid services for marketing abroad and for the use and membership of technological services platforms and also hosting services will be deemed as 'digital services' and thus subject to the TDS, without consideration of the device used by the client.

2. Nexus: The TDS will levy the provision of digital services when they are utilised in Chile by individuals. It will be presumed that digital services are being used in Chile when the issuers of the means of payment are entities domiciled or resident in Chile, or Chilean branches of such entities.

3. Withholding duties and agents: To ensure proper compliance with the reporting and collection duties of the TDS, a withholding mechanism is established, falling upon the entities that issue the means of payment used in the transactions (eg, banks and credit card companies). This mechanism releases of any responsibility and obligation to the individuals utilising the services. If payment is made in cash, the foreign entity or individual who performs the services shall declare and pay the corresponding taxes (meaning to file annual/monthly tax returns).

4. Reporting and registry obligations:In order to ensure compliance, both withholding agents as digital service providers must be registered before the Chilean Internal Revenue Service. Withholding agents will also have several reporting duties regarding both payments made abroad and the beneficiaries of such payments.

It must be noted that recently certain Chilean political parties and commerce chambers are advocating that the TDS proposal made by the Government be revisited. The main suggestion has been to match the TDS to the local Value Added Tax, which has a 19 per cent rate. In this sense, it is expected that there will be a further discussion on this matter in the days to come as the bill enters into discussion in Congress.

Conclusion

Following international trends, Chile has identified certain challenges arising from the digitalisation of the economy and is taking unilateral measures to avoid non-taxation. With the purpose to set an even playing field between digital and non-digital service providers, a flat ten per cent tax is proposed. Even though it is debatable who will bear the final impact and economic burden of this tax, the introduction of the TDS may constitute an effective revenue measure until global consensus has been reached and a comprehensive and multilateral solution may be implemented.

---

[1] According to Fortune 500, The 10 Most Valuable Companies: **http://fortune.com/2018/05/21/fortune-500-most-valuable-companies-2018**

[2] OECD, Tax Challenges Arising from Digitalisation – Interim Report 2018, Chapter 4. Relevant tax policy developments.

[3] Israel, India and the Slovak Republic.

[4] On 21 March 2018, the European Commission issued a proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence (COM (2018) 147).

[5] European Commission, Taxation and Customs Union, **https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en**

[6] A significant digital presence or virtual PE will be deemed if one of certain thresholds is met, related to the amount of revenues in a EU Member State, number of users in a taxable year, and amount of business contracts.

[7] Eg, Greece and the Philippines.

[8] See note 2, above.

[9] Eg, France, Hungary, India and Italy. The European Commission has also proposed the implementation of a digital services tax by means of Proposal for a Council Directive, COM(2018) 148 final.

[10] See note 2, above, page 140.

Bibliography

1. *Tax challenges arising from Digitalisation – Interim Report 2018,* Chapter 4 ‘Relevant Tax Policy Developments’, Chapter 5 ‘Adapting the international tax system to the digitalization of the economy’ and Chapter 6 ‘Interim Measures to Address the tax challenges arising from digitalisation’, Organization for Economic Cooperation and Development, **www.oecd-ilibrary.org/docserver/9789264293083-en.pdf?expires=1542232382&id=id&accname=guest&checksum=AA67FAFD1F370ECE82F1CE0C75BFAAD5**

2. European Commission, ‘Communication from the commission to the European parliament and the council. Time to establish a modern, fair and efficient taxation standard for the digital economy’, Brussels, 21.3.2018, COM(2018) 146 final, **https://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-146-F1-EN-MAIN-PART-1.PDF**

3. European Commission, ‘Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence’, Brussels, 21 March 2018, COM(2018) 147 final, **https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_significant_digital_presence_21032018_en.pdf**

4. European Commission, ‘Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services’, Brussels, 21 March 2018, COM(2018) 148 final, **www.eumonitor.eu/9353000/1/j4nvke1fm2yd1u0_j9vvik7m1c3gyxp/vkmvow6cj9zm/v=s7z/f=/com(2018)148_en.pdf**

5. European Commission, ‘Commission Recommendation of 21.3.2018 relating to the corporate taxation of a significant digital presence’, Brussels, C(2018) 1650 final, **https://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-1650-F1-EN-MAIN-PART-1.PDF**

6. President of the Republic of Chile, Message No 107-366 of 23 August 2018, **www.camara.cl/pley/pley_detalle.aspx?prmID=12561&prmBoletin=12043-05**