Digital Services Taxation in Chile: the “Digital VAT” Solution, Income Taxation, and Digital Permanent Establishment

By:

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Introduction

On August 23, 2018, Sebastián Piñera, president of Chile, with the general support of all political actors, sent to the Congress a Bill proposing a new tax, on the supply of digital services rendered by digital platforms. This Bill was introduced with a general objective, included in its title, to “modernize the Chilean tax system, intending to incorporate the best practices observed at the international level, as well as taking care of the challenges and particularities that technological advances imply, such as the digital and collaborative economy”. Such quotation even included a publication from one of the most internationally prestigious journals in the world, “The Economist”, who gave a diagnosis regarding the obsolescence of the international taxation system.

Thus, it is clear that, in the opinion of the Chilean Government which I share, the modernization of the tax system demands the use of digital channels in benefit of both, the Servicio de Impuestos Internos (the Chilean Internal Revenue Service) and taxpayers. Therefore, new tax tools were introduced in Chile such as electronic folders and files per taxpayer, mandatory electronic invoices and bills, and auditable tax treatment for the digital economy. Following, you will find a brief explanation of the new Digital Service VAT's, main characteristics and obligations that will provide a general guide about the system. After this, I analyze the benefits of the VAT in comparison with the Permanent Establishment solution.

Background of the new Digital VAT

On February 24, 2020, the Tax Modernization Law was published. The new law modified, among other regulations, the Decree No 825, also known as the Value Added Tax Code, hereinafter the VAT Code. Within such amendments the government included a new and special taxable event consisting in the supplying of digital services by digital platforms. However, it has to be understood that such services were, in general included among services taxed according the general VAT tax event, so the main problem was not the categorization of such services as a taxable activity according to the VAT law, but about the territoriality of the services when they are rendered by foreign entities in benefit of Chilean users. This situation was solved as we will mention below. The Digital VAT provisions entered into force on June 1st, 2020, introducing new process that is just being taking into account by foreign digital services providers and specially by entities with a substantial presence in the market. However, the new provisions are also applicable to small and medium providers that may not have the tools or resources to comply with the new obligations. The low awareness about the innovations introduced in the Chilean VAT system may be assessed by the fact that just 89 foreign providers are registered as digital services providers, in order to comply with the corresponding VAT obligations.

What is Digital Service, according to the Chilean Law?

- The intermediation of services provided in Chile, whatever its nature, or sales made in Chile or abroad, provided that, in the last case, they give

rise to an import.
- The supply or delivery of digital entertainment content (videos, music, games, texts, magazines, newspaper and books, or any other similar).
- The provision of software, storage, platforms, or IT infrastructure.
- Advertising, regardless of the medium through which it is delivered, materialized or executed.

As we stated, these services qualified within other tax events included in the VAT Law, previously to this amendment (*e.g.* software is included in the article 8 letter h) of the VAT Law). Therefore, the inclusion seeks to solve the Chilean tax authority has over the digital economy when is rendered by foreign providers, due to, before the Bill, they were not required to register as VAT taxpayers even they were VAT services providers.

The special inclusion of territoriality assumptions

Together with the "new tax event" (assuming that is a new one), the Law establish certain presumptions in order to identify when a service of such nature is effectively rendered by a foreign entity and, most important, used in Chile. Whether the payment is done either in Chile or abroad is nor relevant. So, in the interpretation of the IRS, the presumptions have the purpose to reinforce that this new taxable event is not intended to tax extraterritorial activities but only to services that are provided or used in Chile.

However, analyzing the new provisions, we may conclude that the objective was to embrace most of digital activities and providers with VAT. In fact, according to the OECD "Revenue Statistics 2019" Tax revenue trends in the OECD. Pag. 3. Published on December 5, 2019, Chile appears as the country that collects the most through taxes on goods and services and, additionally the VAT collects VAT 47% of the tax revenue.

The presumptions apply if, at the time of contracting said services or making the corresponding payments, at least two of the following situations are met:

- The IP address of the device used by the user or another geolocation mechanism indicate that this is in Chile.

- The card, bank checking account or other means of payment used for payment is find it issued or registered in Chile.
- The address indicated by the user for billing or issuance of proof of payment is located within the national territory.
- That the subscriber identity module (SIM) card of the mobile phone through which If the service is received, the country code is Chile.

Besides, the presumptions should be analyzed in two different instances:(1) when the customer hires a service, and (2) when the service is paid. Related with this, the IRS states that these temporary points are not cumulative, and must be analyzed separately period by period, towards the future, according to the last that occurs. Therefore, the two situations must be met in the same point of time.

Finally, as this is a rebuttable presumption, the taxpayer may claim that the requirements were not met or that the service was not actually used in Chile, notwithstanding the IP address, payment method, or SIM card registered. Is this VAT the best method to tax digital services? In my opinion yes, since the focus must me the Chilean customer due to the lack of information and control regarding foreign providers (excluding the big ones).

On the Payment of VAT and other obligations

Regarding the obligation of payment, there is a difference depending of the characteristic of the user. Should the services be provided to individuals or corporations that are not VAT taxpayers (B2C), in the meaning that they are not sellers or VAT services providers, the foreign entity is subject to the registration and a simplified regime for taxpayers not domiciled or resident in Chile, which was created for this purpose. In this case, the VAT must be declared and paid within a 1 to 3 months tax period, at the foreign taxpayer’s choice.

On the other hand, if the digital services are provided to VAT taxpayers (B2B), the law imposes a reverse charge mechanism. According the reverse VAT obligation, the beneficiaries of the service must withhold the corresponding tax and pay it in a monthly basis together with their normal tax duties. Additionally, the compliance with the reverse charge rule will entitle the taxpayer to use the VAT fiscal credit against their own taxes.

In the last scenario, the beneficiary of the service has the obligation to inform to its foreign providers that they should not carry out VAT withholding. In the case of the breaching of the aforementioned obligation or of the supplying of false information, the responsibility will not be attributable to the foreign provider who, in addition, will not have the obligation to verify the consumers' VAT status, whether taxpayer or not. However, the foreign provider will periodically send to the IRS a list of taxpayers who have not been subject to withholding taxes based on the information received.

Addressing a Digital Permanent Establishment

Before the introduction of this brand-new tax event, one of the challenges was to address the taxation of services that were not taxed with VAT neither other withholding taxes. Due to the lack of a legal solution, the Servicio de Impuestos Internos released in different instances private rulings in order to provide guidance for particular transactions. But the creation of Permanent Establishment by the carrying of digital activities has never been discussed. So, the creation of a digital permanent establishment that would attract the application of tax treaties remains open for the following reasons:

- Modifications to the exceptions from permanent establishment (PE) status

For example, some auxiliary activities related to the creation of a permanent establishments may be characterized as digital services, for example, call centers, storage, and after sales services. However, such kind of activities may not be relevant from the perspective of the Chilean economy because they are not carried out in Chile. For example, Amazon does not have storages in Chile and call center is usually subcontracted from other countries.

- Alternatives to the existing PE threshold

The Tax Modernization Law introduced a new definition of PE to the Chilean Income Tax Law: "a place that is used for the permanent or habitual realization of all or part of the business or activity by a person or entity without domicile or residence in Chile, whether or not it is used exclusively for this purpose, such as offices, agencies, facilities, construction projects and branches". Such definition is clearly close to the OECD recommendations, but, as the current Tax Treaties signed by Chile, does not solve the Digital Economy problem Thus, two

alternatives mechanism should be considered:

- The imposition of a withholding tax on certain types of digital transactions; and
- The introduction of an excise tax or other levy

Both alternatives seek the same objective, the application of a direct tax either through the withholding or the direct payment of a special tax by the provider. In fact, the original Chilean proposal included a special withholding tax with a 10% rate, but this was dismissed during the discussion of the bill and changed to a VAT event.

It must be noted that the regulation of PEs in Chile is related to the Income Tax. For legal purposes, that both the PE and the parent company are considered as a, but treated, for tax purposes, as separated. Nevertheless, the regulation does not contemplate certain concepts that may me relevant to presume a PE in Chile, such as the “significant digital presence” or just a “significant economic presence”. Therefore, carrying activities through a digital means, which is used by Chilean customers, does not mean that the activity is carried within the country, even if such revenues were higher than similar activities carried on by Chilean entities. In other words, the level of activities does not necessarily define the presence in a country because the Chilean Law does not have a nexus rule related to the generation of value without having a physical presence or having a reduced physical representation in the country.

Finally, there is another barrier to the creation of digital PE, the costs of compliance. In fact, a PE, once recognized as such, is subject to the obligation to obtain TAX ID, fill several affidavits from the beginning, stamp certain documents, appoint a mandatory declare and pay income tax related to its activity, and keep its book and records prepared for audits. The big companies can afford that, but what about the small or medium providers? Are we willing to stop the new era through a complex regulation? In my opinion, the new VAT event is enough.

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