New Chilean Tax Measures as to Digital Economy: Analysis from the OECD's Recommendations Perspective

By:

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The spread of the digital economy during the last years has led several countries to approach certain tax issues arising from the particular features of this type of operations and the business models utilized for their development.

As noted by the Organisation for Economic Co-operation and Development (OECD), the challenges for international taxation posed by digitalization arises from the fact that the digital economy is characterised by an unparalleled reliance on intangibles, the massive use of data (notably personal data), the widespread adoption of multi-sided business models capturing value from externalities generated by free products, and the difficulty of determining the jurisdiction in which value creation occurs. As a result, those tax challenges posed by cross-border digital transactions relate mainly to: (i) the

determination of the type of tax to be applied; (ii) the granting of taxing rights between residence and source countries; and (iii) the determination of profit allocation rules.

The OECD has highlighted in the *Tax Challenges arising from Digitalisation – Interim Report 2018*, that currently there is not consensus as to the possible solutions to address these challenges. While a consensus-based solution is expected to be released by the OECD during 2020, a number of countries have implemented some unilateral actions with respect to the tax treatment applicable to digital activities.

As part of this tendency, a tax reform has been recently enacted in Chile (Law No. 21,210, published in the Official Gazette on February 24, 2020), which among several matters applies Value Added Tax (VAT) to the following services rendered by non-resident or non-domiciled providers: (a) intermediation of services rendered in Chile, regardless of their nature, or of sales performed in Chile or abroad (provided that the latter case gives rise to an import); (b) supply or delivery of digital entertainment content, such as videos, music, games or other analogues, through download, streaming or other technology, including for these purposes texts, magazines, newspapers and books; (c) provision of software, storage, platforms or computer infrastructures; and (d) advertising, regardless of the means through which the service is provided. In addition, Law No. 21,210 provides for certain exemptions in order to avoid scenarios where both VAT and withholding tax apply. These amendments incorporated by Law No. 21,210 have entered into force on June 1, 2020.

Countries that are in favor of the introduction of this type of interim measures recognize the need that those measures be targeted, among other considerations. In this respect, a number of countries sustain that a targeted interim measure could focus on internet advertising and digital intermediation services because they perceive that these categories of e-services businesses typically operate remotely and rely heavily on intangible property, data, user-participation and network effects and believe that therefore value is being created in their jurisdiction.

However, in accordance with Law No. 21,210 VAT would apply, among other

services, to the intermediation of services rendered in Chile or of sales performed in Chile or abroad, regardless of whether that intermediation is performed digitally or not (unlike the original version of the bill of law, which levied with VAT only the “digital intermediation services”). Consequently, although commissions paid in consideration for intermediation services have been subject to VAT under the general rules prior to Law No. 21,210, the legal modification analyzed seems to go beyond the concern in question.

Regarding which type of tax should be applied to the services referred to above, it should be noted that the original version of the bill of law proposed a single, specific, indirect and substitute tax, with a 10% rate applicable on the total amount paid by individuals to non-resident or non-domiciled providers. Nevertheless, such a proposal was rejected by the Chilean Congress, as it would not follow the OECD´s recommendations on this matter, and a difference would arise between the tax treatment applicable to local and to foreign providers of digital services. For that reason, the original proposal was replaced creating a new taxable event subject to VAT with the general 19% rate, which was the alternative ultimately approved by the Chilean Congress.

This election of applying VAT to the transactions analyzed involves that Law No. 21,210 had to deal with the challenges that digital economy creates for VAT systems, in terms of providing an effective and efficient mechanism for VAT collection. As suggested by the OECD, this issue is posed particularly where goods, services and intangibles are acquired by private consumers from suppliers abroad, which is partly due to the absence of an effective international framework to ensure VAT collection in the jurisdiction of consumption.

For cross-border business-to-business (B2B) supplies of services and intangibles that are taxable in the jurisdiction where the customer is located, the OECD has recommended in the *International VAT/GST Guidelines* the implementation of a reverse charge mechanism to minimize the administrative burden and complexity for non-resident suppliers, where this is consistent with the overall design of the national VAT system. For business-to-consumer (B2C) transactions, and taking into consideration that the reverse charge mechanism does not offer an appropriate solution for collecting VAT in this scenario, the

OECD has indicated that the most effective and efficient approach to ensure the appropriate collection of VAT is to require the non-resident supplier to register and account for the VAT in the jurisdiction of taxation, where countries should consider establishing a simplified registration and compliance regime to facilitate compliance for those non-resident suppliers.

In line with the above, Law No. 21,210 provides for a reverse charge mechanism where the recipient of the service (rendered by a non-resident and non-domiciled provider) is a VAT taxpayer. Under such a mechanism, that recipient would be liable to declare and pay the VAT.

Conversely, where the recipient of that service is not a VAT taxpayer the reverse charge mechanism does not apply, so that the liability to declare and pay the VAT vests in the provider, which is the general rule. For these purposes, Law No. 21,210 includes a simplified tax regime, applicable to non-resident and non-domiciled providers of digital services, utilized in Chile by individuals that are not VAT taxpayers. Under this regime, a simplified VAT declaration procedure applies, providers are not under the obligation of issuing tax documents, the determination of the currency of VAT payments is subject to special rules, providers may opt to declare the VAT based on three-month tax periods (instead of the monthly declaration under the general rule), and those providers are not allowed to utilize any input VAT.

With regards to the granting of taxing rights, in line with the destination principle Chilean VAT generally levies services provided or utilized in Chile. The destination principle is designed to ensure that tax on cross-border supplies is ultimately levied only in the jurisdiction where the final consumption occurs, thereby maintaining neutrality within the VAT system as it applies to international trade.

In applying the destination principle to cross-border B2B supplies of services and intangibles, the OECD has recommended granting taxing rights to the jurisdiction where the recipient is located. For B2C transactions, the OECD has stated that the place of usual residence of the customer is a more appropriate proxy for the jurisdiction of consumption, as it can be assumed that these types of services and intangibles will ordinarily be consumed in the jurisdiction where

the customer has his or her usual residence.

In this respect, the OECD takes into account that the information provided by the customer may be considered as important evidence relevant to the determination of the jurisdiction of the customer's usual residence, including information collected within business processes (e.g. the ordering process), such as jurisdiction and address, bank details (notably country of the bank account), and credit card information. Following the above, Law No. 21,210 provides for a presumption under which digital services are deemed as utilized in Chile, including the case where the credit card, the current account, or the other payment method utilized has been issued or registered in Chile, as well as, the scenario in which the user has indicated an address located in Chile for invoicing or payment receipt issuance purposes.

Finally, in connection with the taxable base subject to VAT, Law No. 21,210 applies this tax to the services described under the general rule, namely, VAT levies the total amount of the fee paid to the foreign provider. Law No. 21,210, which follows to a great extent the current OECD´s recommendations on this matter, implies certainly an important advance in terms of aligning Chilean legislation with the international tendency and standards as to digital economy, as well as, of achieving equality in the VAT treatment applicable to Chilean and foreign providers of digital services.

However, there are still some challenges that will have to be addressed by the Chilean authorities, especially in respect of the applicability of direct taxes to these operations. In this regard, additional measures should be analyzed which could ultimately impact the current domestic provisions and the Chilean treaty network. This is particularly relevant in the approach of issues such as the appropriateness of the rules to determine nexus where foreign companies without physical presence in Chile render digital services to resident or domiciled recipients, the attribution of value created from the generation of data through digital means, and the characterization of payments made in consideration for digital products and services.

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