

The General Anti-Avoidance Rule in Chile and Its Application

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Abstract

This paper aims to explain the GAARs in the Chilean tax system, its regulation, administrative sanctions and administrative and judicial proceedings of application. The authors explain the two kinds of GAAR (misuse or abuse of legal forms and simulation of agreement or contract), their requirements and conditions to be applied to specific cases. Then, it is explained the administrative proceeding for prior consultation of the taxpayers to the Tax Administration and their legal regime. The paper describes the administrative proceeding in situations of infringement of these rules, as well as the judicial proceeding and its consequences on the tax obligations of the taxpayer. Finally, the authors show how the Chilean Internal Revenue Service and Tax Courts have applied the GAARs.


Keywords: GAAR; tax avoidance; Chilean tax system; Chilean Tax Code.

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1. Introduction

Chilean legal doctrine is obsessed with the differentiation between tax avoidance and tax evasion, given that the first has been understood as lawful and the second as illegal.¹ This is based on a permanent distrust of the GAARs and opposition to its incorporation into the legal system.²

The GAAR, General Anti-Avoidance Rule or General Anti-Abuse Rule, can be defined as: “A rule in tax statutes or sometimes as evolved through judicial decisions (such as substance-over-form” approaches) empowering a revenue authority to deny taxpayers the benefit of an arrangement that they have entered into for an impermissible tax-related purpose (usually only where this is a main purpose or the sole purpose, differentiated for example from non-tax business or commercial purposes). It is general in nature and descriptive, because it is meant to be able to address abuses not specifically identified in law.”³

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1. ABBREVIATIONS: art.= article; par.= paragraph of the article; GAAR= general anti avoidance rule; IRS= Internal Revenue Service (Chilean IRS: *Servicio de Impuestos Internos de Chile*. The Tax Administration of Chile); SAAR= specific anti avoidance rule; Tax Court= Tax and Customs Court, for the first hearing or instance of a judicial process (*Tribunales Tributarios y Aduaneros*, Tax Code).
2. R. UGALDE & J. ESCOBAR. *Elusión, planificación y evasión tributaria*. Santiago, Chile, Legal Publishing, 2010.
3. ONU, *United Nations Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries*, United Nations Committee of Experts on International Cooperation in Tax Matters, New York, 2017, Glossary, 467 y ss.

However, since the incorporation of GAAR in the Tax Code in 2014, by Act of Parliament N° 20.780, the efforts of the specialists and theorists (and the Tax Courts for the first instance, Courts of Appeal and the Supreme Court) has been oriented to discover the distinction between lawful tax avoidance and unlawful tax avoidance. The majority of specialists looks for limiting the application of the GAAR by considering it contrary to the principle of legal certainty of taxpayers.⁴

The Chilean legal theory doesn't lose the hope to reach an adequate distinction between an illicit and a licit act of tax avoidance. But I prefer the approach of the Report of the Tax Law Review Committee: "*We think it impossible to define the expression 'tax avoidance' in any truly satisfactory manner. People routinely alter behaviour to reduce or defer their taxation liabilities. In doing so, commentators regard some actions as legitimate tax planning and categorise others as tax avoidance. No two commentators may agree on the categorisation of certain behaviour. So far as we have needed some broad framework within which to conduct our discussion of tax avoidance activity, we have regarded tax avoidance (in contra-distinction to legitimate tax mitigation or planning) as action taken to reduce or defer tax liabilities in a way that Parliament plainly did not intend or could not possibly have intended had the matter been put to it.*"⁵

In other papers we have defended the idea of tax legislation based on legal principles. This does not preclude the establishment of GAAR, because it only implies that tax legislation must incorporate not only detailed rules but also legal principles. Both are legal norms, and there are different and specific rules of application for each one.⁶ In a general sense, we believe that GAARs constitute legal norms that establish prohibitive rules, that is, negative obligation — obligation not to do — (not to avoid the tax obligation, in this case). This is based on the taxpayer's duty to act in accordance with a general principle of good faith and transparency, in relation to the tax administration. By the way, also the Tax Administration must act in good faith, in what has been called "*the principle of the legitimate expectations.*"⁷ In these papers, we have also referred to the fact that the tax obligation is an obligation that belongs to the scope of Public Law, not the scope of Private Law. On the other hand, the tax rule can only be applied through dialectical methods, that is, there is often no single solution to the case before the law and, then, the tax obligation is specified through administrative or judicial decisions. This is, in turn, a foundation of the alternative dispute resolution schemes without violating the principle of tax legality or the principle of unavailability of the tax credit.

In the following pages, we will show the regulation of the GAAR in Chile (although we make it clear that there are multiple SAARs⁸), and then we will refer to some important cases in which the Supreme Court and the Courts of Appeal have addressed the problem of tax avoidance, as an illegal activity of taxpayers.

4. F. YÁÑEZ, *Análisis de la Nueva Clausula General Antielusiva*, in *Revista Estudios Tributarios*, FEN, Universidad de Chile, 2014, págs. 233-250; M. MATUS, *La elusión tributaria y su sanción en la Ley N°20.780: Hacia un concepto de negocio jurídico elusivo*, in *Ius et Praxis*, vol.23, N°1, 2017, pp.67-90; M.P. NAVARRO, "La evolución en la jurisprudencia de la Excm. Corte Suprema en la concepción de la elusión fiscal," *Revista de Estudios Tributarios* N°20, 2018, pp. 169-191.
5. TAX LAW REVIEW COMMITTEE, *Tax Avoidance*, Institute for Fiscal Studies, London, 1997, p. 9. Available at: <https://www.ifs.org.uk/comms/comm64.pdf>.
6. These issues have been discussed, for example: J. FREEDMAN, *General Anti-Avoidance Rules (GAARs) – A Key Element of Tax Systems in the Post-BEPS Tax World? The UK GAAR*, University of Oxford Legal Research Paper Series, Oxford, 2016. p. 7. Located at: <http://www.ssrn.com/link/oxford-legal-studies.html>.
7. P. DÍAZ, *Fundamento y requisitos del principio de confianza legítima en la Unión Europea: la experiencia italiana*, *Crónica tributaria*, N° 160, 2016, pp. 65-94
8. A Specific Anti-Avoidance Rule (SAAR) as defined as "A rule in tax statutes empowering a revenue authority to deny taxpayers the benefit of a particular known and defined arrangement. It has a very limited scope of application and allows only limited discretion to the tax authorities compared to a GAAR. Like most GAARs, however, some specific rules have a purpose test, rather than relying purely on objective factors such as publicly quoted market prices." ONU, *United Nations Handbook...*, op. cit., p. 467 y ss.

1.1. The legal regime of the GAAR in Chile

As we have pointed out, the GAAR was introduced in the Tax Code 2004, by Act of Parliament N° 20780. In relation to this normative scheme, we can distinguish the following aspects, all of them regulated by the Chilean Tax Code:

- GAAR as a “*substance over form rule*” or “*substance over form legal principle*.”
- Legal presumption of the taxpayer’s good faith and its legal consequences.
- GAAR and SAAR coordination.
- *Onus Probandi (burden of proof)* in case of application of the GAAR.
- First legal figure of GAAR: the misuse or abuse of legal forms (legal provision).
- Second legal figure of GAAR: anti-simulation provision.
- Administrative proceeding for taxpayer consultation with the Internal Revenue Service.
- Administrative proceeding against the breach of the GAAR.
- Judicial proceeding against the breach of the GAAR
- Sanctions for the taxpayer who infringes the GAAR.
- Sanctions to tax advisor who infringes the GAAR.

1.2. The GAAR as a rule or legal principle that privileges the substance over form

The legislation seeks to tax certain facts, acts (unilateral act intended to have legal effect), contracts or business operations (described as “*taxable events*”), and does not consider the form or names that taxpayers give them. The tax legislation does not limit its specific effects (according to Private Law) in the case that these arrangements present legal defects.

The tax obligations will be born and will become enforceable according to the legal nature of the facts, acts or contracts carried out (taxable events), whatever the form or denomination that the interested parties have given to them, and disregarding the defects that could affect them (article 4° *bis* par.1, Tax Code).

1.3. Legal presumption of the taxpayer’s good faith

The good faith of the taxpayer is presumed by legislation.⁹ This means that the IRS must obey or acknowledge the effects of the acts or contracts carried out by taxpayers.

However, the misuse or abuse of legal forms or simulation of agreements (in cases described by legislation) mean breaches of the taxpayers’ good faith.

According the article 4° *bis* par. 2, the Chilean IRS must admit the good faith of taxpayers. The good faith in tax matters means admitting the effects that arise from the business operations or a series of them, according to the way in which they were concluded by the taxpayers.

But there is no good faith if by means of said acts or business operations or set or series of them, the taxable events established in the corresponding tax legal provisions are avoided. The legislation will understand that there is avoidance of taxable events in cases of misuse or abuse of legal provision or simulation according the rules of the Tax Code (article 4° *bis* par. 3).

9. “*Artificial Presumptions. Also called ‘legal presumptions’; those which derive their force and effect from the law, rather than their natural tendency to produce belief.*” BLACK’S LAW DICTIONARY (1968), *op. cit.*

1.4. GAAR and SAAR coordination

There are many special anti-avoidance rules (SAARs) in Chilean tax legislation, since many years ago, before the establishment of the GAAR. In the specific cases, they have primacy by the principle of specialty.

The article 4° *bis* (*indisponibilidad del crs de nclusionleas sin violar el principio de reserlusioney tributaria o indisponibilidad del crs de no par. 4*) prescribed that in cases where a SAAR is applicable, the legal consequences shall be governed by this provision and not by articles 4° *ter* and 4° *quáter*.

1.5. Onus Probandi in case of application of the GAAR

The Chilean IRS must prove the taxpayer's illegal actions, even if these refer only to acts whose form is legal but whose intention is in bad faith, and which results in a decrease of the tax burden.

Indeed, the Chilean IRS has the responsibility to prove the existence of abuse of legal forms or simulation under the terms of articles 4° *ter* and 4° *quater*, respectively. For the determination of abuse of legal forms or simulation, it is necessary to initiate an administrative and judicial proceeding according to the articles 4° *quinquies* and 160° *bis* (article 4° *bis*, par. 5).

1.6. First legal figure of the GAAR: the misuse or abuse of legal forms

The first figure of the anti-avoidance rule is the abuse of legal forms,¹⁰ *i.e.*, the use of acts or contracts only with fiscal goals (reduce the amount of the tax bill or deferred the obligation¹¹). However, this provision admits the reasonable choice of behaviours and alternatives incorporated in the tax legislation. The consequence of the abuse of legal form is the rejection of the act or business operations carried out with the exclusive objective of avoiding the taxes, being considered by the IRS the natural act or operation which had to be done with its respective fiscal burden. The act or contract is ignored but no annulled or revoked.

The Chilean Tax Code understand that there is abuse (of legal forms or legal provision) in the tax matters when the realization of the taxable event is totally or partially avoided, or the taxable base or the tax obligation are reduced, or the date of said obligation is postponed or deferred, through acts or business operations that, individually considered or as a whole, do not produce relevant legal or economic results or effects for the taxpayer or a third party, but only the deferment or the reduction of taxes (article 4° *ter*, par. 1).

However, the reasonable choice of behaviours and alternatives incorporated in the tax legislation is legitimate. Consequently, the only circumstance that the same economic or legal result can be obtained with another or other legal acts that would result in a greater tax burden will not be abuse (of legal provision); or if that act or operation chosen, or set of them, does not generate any tax effect, or generate them in a reduced or deferred manner in time or in a lesser amount, provided that these effects are a consequence of the tax legislation (article 4° *ter*, par. 2).

10. Similar to "Abuse of Law - The doctrine which allows the tax authorities to disregard a civil law form used by the taxpayer which has no commercial basis" (OCDE, Glossary of Tax Terms, *op. cit.*, At: <https://www.oecd.org/ctp/glossaryoftaxterms.htm>).

11. "Deferment of Tax: The postponement of tax payments from the current year to a later year. A number of countries have introduced legislation to counter the kind of tax avoidance whereby a taxpayer obtains a deferment of tax which is not intended by law," OECD, Glossary of Tax Terms, *op. cit.*

1.7. Second legal figure of the GAAR: anti-simulation provision (article 4° *quáter*)

The Tax Code prescribed that there will also be tax avoidance in acts or business operations in which there is simulation.¹²

This statutory regulation refers to the simulation of acts or contracts, *i.e.*, the parties of an operation wish to perform a business operation but do not want their fiscal effects, so they carry out different business operations but with similar results, to avoid paying taxes.

For tax purposes there is simulation when the legal acts and business operations carried out by the taxpayer disguise the configuration of the taxable event or the nature of the constituent elements of the tax obligation, or its true amount or date of the operation.

In these cases, the taxes will be applied to the facts actually carried out by the parties, regardless of the simulated acts or business operations.

1.8. Administrative proceeding for consultation of the taxpayers to the Chilean IRS about the application of the GAAR in specific or generic cases

Taxpayers may ask the opinion of the IRS before carrying out specific tax planning, in order to know what the administration thinks about whether or not it constitutes a form of tax avoidance not permitted by legislation. If the query is specific, it will be binding on the taxpayer who makes the consultation, but if the query is generic the response will not be binding.

Taxpayers or others persons obligated to pay taxes, which have a direct interest, may ask questions to the IRS about the application of articles 4° *bis*, 4° *ter* and 4° *quater* to the acts, contracts, business operations or economic activities that they wish to perform. For such purposes, they can inform to the IRS. In this case, the IRS response is binding on who makes the query (article 26 *bis*, par. 1).

Likewise, any person may make inquiries in order to obtain general responses, not binding, in relation to the any case or operation (article 26, *bis* par. 1).

The IRS shall establish by administrative regulation the manner in which these consultations shall be submitted, as well as the requirements that it shall satisfy. The deadline for answering the query shall be ninety days, counted from the receipt of all the background information necessary for its adequate resolution. The IRS may request reports or opinions from other administrative agencies, or request new information from the taxpayer for the resolution of the consultation (article 26 *bis*, par. 2).

Exceptionally, the IRS may extend the response period up to thirty days, through a well-founded resolution (article 26 *bis*, par. 3).

12. "Simulation. In the civil law. Misrepresentation or concealment of the truth; as where parties pretend to perform a transaction different from that in which they really are engaged. A feigned, pretended act, one which assumes the appearance without the reality and, being entirely without effect, it is held not to have existed, and, for that reason, it may be disregarded or attacked collaterally by any interested person. In French law, Collusion; a fraudulent arrangement between two or more persons to give a false or deceptive appearance to a transaction in which they engage." BLACK'S LAW DICTIONARY (1968), *op. cit.*

"Simulate. To assume the mere appearance of, without the reality; to assume the signs or indications of, falsely; to counterfeit; feign; imitate; pretend. To engage, usually with the co-operation or connivance of another person, in an act or series of acts, which are apparently transacted in good faith, and intended to be followed by their ordinary legal consequences, but which in reality conceal a fraudulent purpose of the party to gain thereby some advantage to which he is not entitled, or to injure, delay, or defraud others." BLACK'S LAW DICTIONARY (1968), *op. cit.*

But, if expire the deadline for answering without a response by the IRS, the query shall be deemed not submitted for all legal purposes (article 26 *bis*, par. 4)

The response of this consultations will have binding effect for the IRS only in relation to the consultant and the case raised, and this answer must expressly state whether the acts, contracts, business operations or economic activities on which the consultation was made, are or may not be qualified as abuse or simulation in accordance with article 4^o *bis*, 4^o *ter* and 4^o *quater*. The response shall not bind the Chilean IRS if the factual or legal background on which it was founded varies (article 26, *bis* par. 5).

1.9. Administrative proceeding against the breach of the GAAR

The existence of the abuse (of legal provision) or the simulation referred in articles 4 *ter* and 4 *quater* have to be declared, at the request of the National Director of the Chilean IRS, by the competent Tax Court and in accordance with the judicial proceeding established in article 160 *bis* (article 4^o *quinqüies* par. 1).

This judicial declaration may only be required to the extent that the amount of the tax differences provisionally determined by the IRS to the respective taxpayer, exceeds the amount equivalent to (approximately) US\$16000 (at December 2019) calculates in the date of the submission of the claim (article 4^o *quinqüies*, par. 2).

Prior the IRS file the lawsuit for the judicial declaration of abuse or simulation and for the purposes of founding it adequately, the IRS must subpoena the taxpayer under the terms of article 63 of Tax Code, and may request the necessary and relevant background, including those that they serve for the establishment of the fine of the article 100 *bis*, as a consequence of abuse of legal forms or simulation (article 4^o *quinqüies* par. 3).

The National Director of Chilean IRS must request the judicial declaration of abuse (of legal provision) or simulation to the Tax Court within nine months following the issuing the answer to the taxpayer or the date of the citation to the taxpayer. When this period is over, the Director cannot request (it is a limitation of the administrative power) the judicial declaration of abuse (of legal provision) or simulation in respect of the case for which the taxpayer or advisor was cited (article 4^o *quinqüies*, par. 4).

During the elapsed time between the date on which the judicial declaration of abuse or simulation is requested to the Tax Court, until the judgment that decided about de claim, the calculation of the deadlines of the prescription¹³ of the legal action of the IRS (established in articles 200 and 201 of the Tax Code) will be suspended (article 4^o *quinqüies*, par. 5).

In the event that the existence of abuse of legal provision or simulation for tax purposes is established by judgment, the Tax Court must thus indicate the abusive or simulated acts or operations, the factual and legal backgrounds on which that qualification is based, determining the amount of the taxes that are owed, with the respective inflationary adjustment, interests and fines. The taxpayer and the IRS have the right to appeal this judgment according to article 160 *bis* (article 4^o *quinqüies*, par. 6).

1.10. Judicial proceeding against infringement of the GAAR

The Tax Court in whose jurisdictional territory the taxpayer has his domicile have the competence to know both the trial (judicial proceeding) of abuse (of legal provision) or simulation, established in article 4^o *quinqüies*, as well as the determination and application of the fine of article 100^o *bis*. If

13. "The prescription by which debts are released, is a peremptory and perpetual bar to every species of action, real or personal, when the creditor has been silent for a certain time without urging his claim." BLACK'S LAW DICTIONARY (1968), *op. cit.*, p. 1345:

taxpayer is an artificial persons, the domicile shall correspond to that of the parent (head) company (article 119).

The National Director of the IRS must claim the declaration of abuse of tax provision or simulation and the application of the fine before the competent Tax Court, in a well-founded plea, with the factual and legal background of his petition for allowing the judge the determination of the taxes, interests and fines (article 160 *bis*, par. 1).

The claim of the IRS shall be notified the taxpayer and those responsible for the design or planning of the acts, contracts or business operations likely to constitute abuse of legal provision or simulation. The defendant has the term of ninety days to answer. This answer must contain a clear statement of the facts and grounds of legislation on which the defendant bases his opposition to the claim of the IRS or the reasons because denies the responsibility for the design or planning of the acts, contracts or business operations that constitute abuse (of legal provision) or simulation (article 160, *bis* par. 2).

After this deadline, whether or not the defendant has responded, the Tax Court shall summon the parties to a hearing with the object that the parties state about the points raised both in the claim and in the answer. In the event that one part provides in this hearing new information to which the counterpart have not had prior access, the judge will give a brief period to issue the relevant discharges (article 160 *bis*, par. 3).

Then, and to the extent that there is controversy over any substantial and pertinent point, the Tax Court will open a probationary period (trial period) for twenty days. Once the probationary period is concluded, the parties will be granted a period of five days to make observations on the evidence given, after which the Tax Court will resolve the lawsuit within twenty days. The Tax Court will appreciate the evidence according to the rules of sound or healthy criticism, and must base its judgment taking into account the economic nature of the taxable events in accordance with the article 4 *bis* (article 160 *bis*, par. 4).

Against the judgment of the Tax Court, the parties have the right to claim before the Court of Appeals; and against the judgment of the Court of Appeals, the parties have the right to present the cassation appeal before the Supreme Court (article 160 *bis*, par. 5).

Once the judicial process is over, the Chilean IRS has to issue the resolution determining the amount of taxes and fine, according to the judgment.

Disputes that arise regarding compliance with the judgment will be resolved incidentally by the Tax Court that issued it (article 160 *bis*, par. 6).

1.11. Fine to tax advisors who infringe GAAR¹⁴

The natural person or artificial person with respect to whom be accredited to have designed or planned the acts, contracts or business operations constituting abuse of legal provision or simulation, will be sanctioned with a fine of up to 100% of all taxes that should have been paid, but this fine may not exceed US\$75000 -approximately, at December 2019- (article 100 *bis*, par. 1).

In case that the infringement has been committed by a legal entity, the indicated penalty will be applied to its directors or legal representatives if they have transgressed their management and supervision duties (article 100 *bis*, par. 2)

14. *“The term ‘penal’ is broader than ‘criminal,’ and relates to actions which are not necessarily criminal as well. The term ‘penalty’ in its broad sense is a generic term which includes fines as well as other kinds of punishment, but in its narrowest sense is the amount recovered for violation of the statute law of the state or a municipal ordinance, which violation may or may not be a crime, and the term applies mostly to a pecuniary punishment. The word ‘forfeiture’ is frequently used in civil as well as criminal law, and it is also used in actions for a penalty, although the action is a civil one.”* BLACK’S LAW DICTIONARY (1968), *op. cit.*, p. 1289.

Finally, the Chilean IRS may only apply this fine when, in the case of a claim against the respective tax bill, the proceeding is decided by final judgment, or when the advisor had not submitted a lawsuit in the deadline. The prescription of the action to pursue this pecuniary sanction will be of six years from the expiration of (the final date of) the fiscal period to declare and pay the avoided taxes (article 100 *bis*, par. 3).

2. The judicial and administrative application of the GAAR and its difficulties

There are several important cases in which the Chilean courts have address proceedings in application of the GAAR, which is incorporated into the legal system in 2014.

However, it is illustrative to refer to some previous cases to observe how Chilean courts have appreciated tax avoidance or aggressive planning, in general, as lawful acts.

In “*Bahía Real Estate Company vs. IRS*”, the Supreme Court (2003)¹⁵ argued that the tax avoidance was a cunning and clever act, not necessarily unlawful. In that case, a company artificially divided its operations to avoid paying VAT. In this opportunity, the Supreme Court could not face the problem of illegal tax avoidance because a legal rule as a GAAR was not incorporated into the Chilean tax system.

In “*Coca-Cola Embonor S.A. vs. IRS*” (2013)¹⁶ the company declares a financial loss that is attributed to the tax results, requesting a refund of about US\$ 500,000. The IRS questioned that tax result, since it corresponds to losses of an agency of the taxpayer company that is resident in Cayman Islands, because it argues that these expenses were not proved in the administrative phase before the Chilean IRS. Therefore, the IRS rejected part of the requested tax refund. The Tax Court the District of Arica held that the taxpayer’s action couldn’t be seen as a legitimate business reason, as it seeks only to avoid the tax burden. This is a matter of taxation in Chile of agencies and other permanent establishments abroad. A triangle operation was generated, in which agency in Cayman Islands lends money to a subsidiary (company “C”) to acquire an industrial plant, and who pays the interest is “*Coca-Cola Embonor S.A.*” (company resident in Chile). Then the company “C” sells at a high price the industrial plant to the company resident in Chile. The Tax Court considers that the Chilean resident company was able to acquire the plant directly and it was not necessary to pay those interests. Therefore, it does not accept these payments as tax losses, since it considers it an artificial loss, which lacks a ‘legitimate business reason’ (*business purpose test*).

In the case “*P.G. versus IRS*” (2015)¹⁷ the Tax Court of the District of Temuco underpins that the IRS may not accept the legal effects of an aggressive tax planning. The Tax Court declared that the taxpayer subscribes a company into a more beneficial tax regime that did not correspond to it, because this company did not meet de legal requirements. The court attributed bad faith the performance of the taxpayer. The Court of Appeal confirms the judgment. The taxpayer filed an application for review (in cassation) with the Supreme Court, which confirms the previous judgment. This Court distinguishes between licit tax planning and illicit tax Avoidance, and it defines tax planning as “*the capacity to choose between several lawful alternatives for the organization of business or economic activities, or even forgo business or activities, all in order to obtain tax savings.*” Defines the tax avoidance, arguing that “*it does not consist in the lawful election within certain options that the tax legislator himself delivers, but in the behaviour of the taxpayer consisting in avoiding the situation of any tax obligation, or in reducing the tax burden through of a legally anomalous means,*

15. Court of Appeals of Santiago, case N° 3.253-1997, (judgment: 31/07/2001). Supreme Court (judgment: 28/01/2003), case N° 4.038-2001.

16. Tax Court of the District of Arica (judgment: 03/04/2012), case RIT GR- 01-0003-2011; Court of Appeals of Arica, case N° 3-2012, (judgment: 06/06/2012). Supreme Court (judgment: 23/07/2013), case N° 5118-2012.

17. Tax Court of Temuco (judgment: 06/12/2013), case RIT GR-08-00094-2021; Court of Appeals of Temuco, case N° 4-2014, (judgment: 04/09/2014); Supreme Court (judgment: 27/07/2015), case N° 25.915-2014.

without directly violating the mandate of the legal rule but the values or principles of the tax system,” adding then that in this affairs, *“it turns out that tax avoidance, without necessarily being an illicit, it avoids the tax that, by the usual route of the development of the activity, would have corresponded to it, an objective for which he uses unusual or anomalous legal forms”* (par. 10^o).

In *“Sandoval vs. IRS”* (2015), the Supreme Court maintains that the taxpayer did not act in good faith in the interpretation that the IRS gave to the rules applicable to the case, when proceeding to a self-determination of taxes.¹⁸

The case *“Key Market vs. IRS”*¹⁹ is about a tax planning strategy for a group of family companies. One situation addressed consisted that one partner alienated his property from one company to another, leaving of being a partner of the company, and then being hired as a dependent worker of the same company, in capacity of general manager, commercial manager and other similar. In this way, it was agreed between the companies and the supposed *“workers,”* the payment of *“agreed deposits”* for millionaire amounts, with the aim of avoiding the corresponding taxation of the Income Tax (and in this way it was generated expenses against earnings for the companies, thereby reducing tax basis). The Supreme Court held that *“the tax avoidance does not involve the lawful election within certain options that the tax legislator himself provides, but in the behaviour of the taxpayer consisting in avoiding the weight of any tax obligation, or in reducing the tax burden through a legally anomalous means, indirectly infringing the applicable legal provisions, under an appearance of legality,”* these are acts (activities, contracts, operations, etc.) that may be *“lawful but illegal in light of the unusual context surrounding such granting or awarding.”* In such a way, in principle lawful acts had an illicit purpose, which is to build a context that prevents the normal taxation of income, generating a reduction in tax revenue that, in this case, given the appearances that were used to cover up the operation, is not admissible for the Court (about US \$ 1,000,000 of unpaid taxes).

In *“Inbet S.A. vs. IRS”* (2018),²⁰ the Court of Appeals of the District of Concepcion affirmed that were not accredited the reasons of economic, commercial or financial order that serve as the basis for the decision to divide and merge alleged by the taxpayer. For the Court, there is only a purely tax effect that manifests itself in the absorption of the one company losses (*Vialat – Inbet S.A.*) by the profits of other company (*Bethia Dos S.A.*) that only had a legal life of a couple of days.

Again the underlying idea is the lack of a legitimate business reason. The judgment of the Tax Court of the District of Bio-Bio²¹ (first instance) upholds that the taxpayer’s action *“appears the abuse of corporate forms, legal entities and simulations, for the sole purpose of obtaining a tax benefit, because although they constitute formally legal acts, it is true that, altogether they correspond to illegal or illegitimate tax avoidance operations.”* And consequently, the judgment decides that the Chilean IRS performed in accordance with the law, as soon as, to reject the tax refund required by the taxpayer, the Administrative Resolution declares that it was *“indispensable to dispense with the external form of the acts celebrated, penetrating its interiority and revealing the underlying subjective interests that are hidden behind them, thus avoiding the abuse of legal personality and, definitively, fraud against the law.”*

Matus explains that the GAAR establishes certain guidelines to define the rationality of behaviour. Thus, some activities do not constitute abuse: (a) The only circumstance that the same economic or legal result can be obtained with other legal acts that would result in a lower tax burden; (b) That the legal act chosen, or set of them, does not generate any tax effect or generate tax effects in a reduced or deferred manner over time or to a lesser extent. Matus thinks that these cases are merely illustrative and that they seek to guide the judge in his work to specify the rationality

18. Supreme Court, N° 27783 – 2014 (Judgment 25/12/2015).

19. Supreme Court (Judgment 14/09/2015).

20. Court of Appeals of Concepción, N°1-2018, (Judgment 10/98/2018).

21. Tax Court of Bio-Bio. Judgement of November 13, 2017.

of the conduct. At the same time, he has the opinion that in all cases of abuse of legal form, the Chilean IRS must prove the tax rule fraud. The frontier between tax planning and tax avoidance has not been set by the legislator, given the high complexity of the tax planning processes, and for these reasons, the GAAR will not be used frequently, or its application will result in endless control processes that will fall into the judicial phase due to lack of standard of sufficient evidence.²² The article 4 *quater* sanctions the tax simulation as a synonym for tax avoidance, specifying that for tax purposes these are legal acts or business operations that disguise the configuration of the taxable event or the nature of the elements of the tax obligation, or its true amount or date. The legislative inaccuracy in this case is evident when defining the simulation with the action of disguising, an issue that is obvious, the legislator had to deliver precise guidelines to identify the behaviour it wanted to sanction. In this case, also for tax purposes, the simulation declaration has the effect that the tax law will be applied to the facts actually carried out by the parties.

Matus thinks that, unlike situations of abuse of forms, in the cases of tax simulation the concepts of private law are better applied: lawful and illegal simulation; absolute and relative simulation; etc.

The difficulties in the application of GAARs have led the Chilean IRS to publish a list of tax avoidance schemes that are permanently renewed of tax figures,²³ such as:

- Profit Shifting (income) from a resident in Chile to a low or zero tax jurisdictions using an instrumental society.

Scheme analysed: Instrumental company created with the purpose of transferring income from a company resident in Chile to a company resident in a low tax jurisdiction or reducing the tax base of the corporate tax income regime or non-resident tax income regime.

Doctrine of the case: Companies must label their acts or contracts according to the real economic support that guides their actual interest and not adapt them or qualify them according to their tax purposes. Specifically, there are instruments that, based on their characteristics, may receive a different legal categorized for each contracting party, given that the applicable laws in the case described interpret this contract differently. A taxpayer resident in Chile makes a contract that categorise as an investment in assets (preferred shares) and in turn, the co-contracting party, a related company not domiciled in Chile, qualifies said contract as indebtedness, with its respective deduction in the income tax base.

- Increase in the cost of investment abroad of underlying assets located in Chile.

Scheme analysed: Successive alienation of investments abroad with Chilean underlying assets with a mixture of foreign services, which increase the cost of the investment for subsequent transfer to an independent third party.

Doctrine of the case: The articles 10 and 58 N° 3 of the Income Tax Law establish a regime of special recognition of profits or value increase that are determined from the alienation abroad of an investment whose value is partly or totally determined by an asset located in Chile. Specifically, income obtained by a non-resident is taxed in Chile (Chilean source income), which comes from the transference of titles of ownership of “*limited liability company*,” shares of “*public limited company*,” bonds or other securities convertible into shares or titles of ownership, or the transference of other representative titles of the capital of a legal entity constituted or resident abroad, or of titles of property rights with respect to any type of entity or patrimony, constituted, formed or resident

22. M. MATUS (2017), *op. cit.*, p. 77

23. IRS (Chile) Circular Servicio de Impuestos Internos N° 55, de fecha 24 de junio de 2015; IRS (Chile) Circular N° 65, 23/07/2015. Materia: Imparte instrucciones acerca de las normas incorporadas en el Código Tributario por Ley N° 20.780, en materia de medidas anti elusión. Available at: <http://www.sii.cl/documentos/circulares/2015/circu65.pdf>; IRS (Chile), Norma Anti Elusión, Available at: http://www.sii.cl/destacados/catalogo_esquemas/casos_043.html; IRS (Chile), Examples of Tax Avoidance Schemes. Norma Anti Elusión. Available at: http://www.sii.cl/destacados/catalogo_esquemas/casos_043.html

abroad, in the cases that this financial instruments represent underlying assets or investments located in Chile that give value and profits to the operation abroad. As a general rule, the cost of the underlying assets located in Chile is that which would have been applicable in accordance with Chilean Law, as if these assets had been transferred directly (not indirectly).

- Change of residence of a foreign company with assets in Chile

Scheme analysed: Foreign company that owns shares or social rights of a Chilean company, change the tax residence in a State with which our country maintains an “*Double Taxation Agreements*” (or DTA), with the sole purpose of taking advantage of the benefits of the agreement.

Doctrine of the case: Being a resident of a Contracting State, in accordance with the rule about the residence of a tax agreement signed by Chile (DTA), implies that a person has a link with a contracting state that subject his income to general taxation therein. That is, an income that is obtained from Chile by a person (beneficiary) who is not resident in Chile, must be effectively affected by tax in the other Contracting State, because it is subject to a taxation system that taxes the income, whatever its origin (worldwide income), to be correctly qualified as a resident of that other Contracting State in accordance with the current agreement.

- Portfolio management contract, for investment in securities or instruments abroad.

Scheme analysed: Signature of a portfolio management contract between related entities, a resident in Chile (principal) and another abroad (agent), for investment in securities or instruments abroad.

Doctrine of the case: Any company domiciled in Chile, must recognize income from a foreign source under the terms provided in article 12 of Income Tax Law, even if the taxpayer uses legal structures abroad, and the income associated with such investments has always been available to society in Chile.

- International reverse merger

Scheme analysed: International corporate reorganization, consisting of a reverse merger by incorporation, which could increase the tax costs of the shares or titles of ownership.

Doctrine of the case: Taxpayers who, using the lack or scarce information and / or control existing in territories with preferential tax regimes, obtain tax advantages by way of improperly increasing the tax costs of actions or social rights, in order to reduce their tax burden in the subsequent disposal of said assets. These taxpayers may be subject to a review of the tax declaration in the corresponding tax inspection instances, which should focus on the accreditation of tax costs.

- Transfer of obligations in contract to obtain Tax Benefits.

Scheme analysed: Company resident abroad, provider of services and movable goods of difficult and reserved commercialization, signs contract of sale with buyer resident in Chile. Subsequently, the foreign selling company assigns the rights of the contract signed with a Chilean buyer to its subsidiary resident in Chile (hereinafter an *assignee*), who is a seller and importer subject to the payment of the Value Added Tax. In the signing of the contract for the sale of movable goods and services, to the parties agree transfer the obligation to import the acquired goods, placing this obligation in the national buyer, who has an exemption to the Value Added Tax in the import of movable goods, favouring this way to the assignee, with which the payment of the VAT that taxes the importation would be avoided in the opinion of the participants in the scheme.

Case Doctrine: The application of tax benefits will be only on those goods, agreements or persons indicated in the respective legal text. Therefore, taxpayers cannot benefit, directly or indirectly and abusively, from an exemption that is not established in their favour.

Concrete situation: Company domiciled abroad signs a contract for the sale of movable goods and services with a buyer domiciled in Chile. Subsequently, the foreign company assigns the rights of the contract in favour of a Chilean subsidiary (assignee). The latter participant, within its business

activity, is dedicated to importing and selling movable goods, therefore its business model consists of importing goods (and to pay the VAT that taxes imports) and delivering the merchandise to the buyer. However, in the scheme analysed, the assignee changes its quality of importer, transferring such obligation to the buyer, due to an agreement in the contract of sale of goods and services signed between buyer and company resident abroad. Due to this modification, the importation would not be subject to tax, since the buyer, by application of the VAT Law, would be exempt from the payment of VAT for having an exemption in his favour. In general terms, it is not possible to observe that there is an economic reason that justifies the change in the normal business dynamics of the assignee. The change in the quality of importer would have the purpose of taking advantage of the tax exemption that the buyer would have, potentially obtaining the assignee that tax benefit, who would have had to pay VAT if he had made the import directly. In this situation, a possible case of abuse of legal forms could be configured under the terms of article 4 *ter* of the Tax Code, since as a result of the series of legal acts or business operations that are part of the described scheme, the participant taxpayers seek to obtain a tax advantage through the use of an exemption, which according to the normal dynamics of the businesses or the reasonable choice of behaviours and alternatives, does not apply in the manner in which the contracting parties have done. In this way, the participants of the scheme manage to avoid the realization of the taxed event, avoiding the VAT.

3. Conclusions

We can put the conclusions in one sentence: given the difficulty of applying the GAARs (maybe because this kind of rule “*provides a road map to successful avoidance*”²⁴), the Chilean IRS has had to establish a list of suspicious tax avoidance situations, but this method does not offer a complete certainty for taxpayers, given that the tribunals finally decide the particular operations on which GAARs are applied, case by case. Perhaps, this is a picture similar to that described by Friedman: “...*subsequent decisions arguably reduced the doctrine to a rule of statutory interpretation that resulted in uncertainty and was sometimes ineffective.*”²⁵

GLOSSARY: Court of Appeals (*Corte de Apelaciones*), tribunal for the second hearing or instance of a judicial process, including in tax matters; *Ley* = Statutes (Act of Parliament); Taxable Base: The thing or amount on which the tax rate is applied, e.g. corporate income, personal income, real property; Taxable Event: Term used to define an occurrence which affects the liability of a person to tax; Avoidance: A term that is difficult to define but which is generally used to describe the arrangement of a taxpayer’s affairs that is intended to reduce his tax liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow (OCDE, Glossary of Tax Terms; <https://www.oecd.org/ctp/glossaryoftaxterms.htm>); Artificial person or legal entity: “*Persons are of two kinds, natural and artificial. A natural person is a human being. Artificial persons include a collection or succession of natural persons forming a corporation; a collection of property to which the law attributes the capacity of having rights and duties. The latter class of artificial persons is recognized only to a limited extent in our law*” (BLACK’S LAW, 4th ed., 1968, St. Paul, Minn. West Publishing, p. 1300)

“Abuse-of-rights doctrine abuse-of-rights doctrine. Civil law. The principle that a person may be liable for harm caused by doing something the person has a right to do, if the right is exercised (1) for the purpose or primary motive of causing harm, (2) without a serious and legitimate interest that is deserving of judicial protection, (3) against moral rules, good faith, or elementary fairness, or (4) for a purpose other than its intended legal

24. R. AVI-YONAH & A. PICHHADZE, *Formulating a general anti-abuse rule (GAAR) in tax legislation insights and recommendations*, N. HASHIMZADE & Y. EPIFANTSEVA (editors), The Routledge Companion to Tax Avoidance Research, New York, 2018, p. 124

25. J. FREEDMAN, (2016), *op. cit.*, p. 3.

purpose. [Cases: Torts 6. C.J.S. Torts §§ 5, 16–22.]” BLACK’S LAW DICTIONARY (2008), op. cit., p. 31.

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