SOFTWARE TAXATION IN THE CHILEAN–SPANISH TAX AGREEMENT - DS VERMEHREN PUGA VARELA

Posted on 15/12/2016

Category: Tax

In recent years, the Chilean economy has become one of the most attractive economies in Latin America for foreign investment. As a result, many Spanish companies consider Chile as a land of opportunity and a strategic place to land in the South American market, in the way Colombia and Peru have been recently.

From a tax perspective, since 2004 the economic traffic between Chile and Spain is covered by an international Double Taxation Avoidance Agreement (Tax Agreement).

The existence of such a tax convention, Chilean economic development and the cultural proximity of both countries, make Spain one of the main countries through which European investments in Chile are channelled. In this sense, the content of such a Tax Agreement is especially important in the age of the digital economy, especially regarding software commercialisation and distribution.

Contrary to many other tax conventions, *software* revenues are not directly defined as a royalty in Article 12 (*royalties*) of the Spanish–Chilean convention. The agreement, which is based on the OECD Model on Tax Convention (MOECD), does not specifically include revenues derived from software commercialisation in the royalties definition, opening the door to its qualification as a business profit. From a tax point of view, it is a key question because under the text of the Tax Agreement the consequences of the characterisation of such revenues as royalties or business profits are quite important because: (i) on one hand, their consideration as royalties will imply a 10 per cent withholding of tax at source (Art. 12 Tax Agreement); and (ii) on the other hand, their consideration as business profits will entail their exclusive taxation in the country of residence, with the sole exception of permanent establishment (Art. 7 Tax Agreement).

From the Spanish perspective, two key elements should be taken into account: (i) first, although software could be considered as a written code in the field of intellectual property, the Spanish Supreme Court does not consider software as a literary work for tax purposes, excluding its interpretation as royalty under the text of the Tax Agreement (*vid.* recent Spanish Supreme Court Sentence, 9th February 2016); (ii) software revenuesmay be considered as an expression of "other intangible properties" as defined under the Tax Agreement, but ultimately it is not a clear definition and it will finally depend on the Tax Administration criteria.

Furthermore, the observation made by Spain to the Commentaries on Article 12 of the MOECD concerning the taxation of royalties, applied by the Spanish Tax Administration and confirmed by the resolutions of the Spanish General Directorate of Taxes (DGT), should be taken into account: Spain considers revenues deriving from software distribution rights (software distribution agreements) as royalties, with the sole exception of standardized software copies, not adapted for or by the customer, in which case they are considered as business profits. For this reason, from the Spanish point of view, the key discussion is about the adaptability of the commercialised software, which should be decided on a case-by-case basis (*vid.* Resolution V2039-15 DGT). In this sense, following the most recent resolutions on this issue, it seems that this adaptabilityshould be understood in general terms, but would not include the mere possibility to modify the user interface (*vid.* Resolution V0799-16 DGT).

However, from the Chilean point of view, the content of the article 59 of the Chilean Income Tax Law should also be taken into account, which generally applies a non-deductible additional tax rate of 15 per cent (30 per cent in some cases) on the revenues derived from the use, enjoyment or

exploitation of computer programmes, regardless of the existence of an eventual assignment of intellectual property rights and with the sole exception for commercialisation of the so-called "base programmes", understood as those which are indispensable or essential for operating equipment or a machine.

The rise of the digital economy opens a new branch of international tax law which is strictly related to the combination between national and international regulations, among other kinds of soft law rules, standards, principles, practices and so on. The taxation of digital commerce could be understood differently depending on the counties involved – this is why the Chilean-Spanish software treatment is just one of the multiple existing possibilities, opening the door to new combinations of tax planning schemes.

Eduardo Huidobro is a partner at DS Vermehren Puga Varela. He can be contacted at ehuidobro@dsabogados.cl

Alberto Moral is a lawyer at DS OVSLAW. He can be contacted at Alberto.Moral@ds-ovslaw.com