



***BRIEF ON LEGAL ISSUES RELEVANT FOR DOING BUSINESS AND
FOREIGN INVESTMENT IN CHILE***

A. - FOREIGN INVESTMENT CHANNELS.-

Investments made in the country by foreign individuals or corporate entities must be made through one of the investment systems that we analyze below.

1.- Decree Law 600

Under this system the foreign investor, with the authorization of the Foreign Investment Committee, enters into a contract with the State of Chile which guarantees it the following benefits:

- a) Repatriation of capital after one year has elapsed, counting from the date of entry into the country.
- b) Remittance of unlimited annual profits and even provisional quarterly profits.
- c) Invariability of the Value Added Tax and customs system for the period it takes to carry out the investment, if it is implemented in capital goods.
- d) No discrimination compared to local investors.
- e) Free access to the Formal Exchange Market to acquire foreign currency for the repatriation of capital and/or remittance of profits.

Under this channel, investments can be made in freely convertible foreign currency, new or used goods, loans duly approved by the Central Bank, technology and reinvestment of profits.

If this system is used to bring credits into Chile, the credit cannot exceed 75% of the total investment. Also, since June 2003, the minimum investment amount for a new project under D.L. 600 is US\$ 5,000,000. - when investments consist of foreign currency and associated credits. The minimum amount is US\$ 2,500,000. - when the investment is in the form of tangible assets, technology, and capitalization of profits or capitalization of credits.

Investors who choose this investment channel can choose either one of the following tax systems:

- i) Normal tax system, in which case they are subject to the variations that might occur in the general tax legislation, and they enjoy the same rights and obligations as local investors.
At the present time, as indicated previously, the total tax burden applicable under the normal system to Corporations, LLPs, and agencies of foreign corporations is 35%.

- ii) Invariable Tax Burden of 42% for a 10-year period from start-up of the local company that receives the investment. Therefore if tax rates vary, the changes would not affect the foreign investor. Invariability may be waived once, and as a result the investor joins the common tax system, but in that case it is not possible to return to the system of invariability so it will remain subject to the variations that may occur in general tax legislation. Invariability regime has been very scarcely used as general tax regime sets a lower 35% cap.

2.- Chapter XIV of the Compendium of International Foreign Exchange Rules of the Central Bank of Chile

This system can be used to bring capital contributions into the country in foreign currency or credits, with a minimum amount of US\$ 10,000.

This system implies a simple registration of the investment in the Central Bank, which is done through a commercial bank and is generally approved within 72 hours, after which time the Central Bank issues a certificate establishing the amount liquidated and the date.

The guarantee this system provides consists of the fact that remittances will be ruled by the norms in effect on the date of the certificate and, therefore, a change in the aforesaid provisions will not affect remittances. In any case, the investor is subject to the normal income tax system described above, and it is therefore subject to any change in income tax legislation.

B.- ALTERNATIVES OF ORGANIZATION IN CHILE.-

1.- Types of companies

In Chile, there are two main types of companies: Corporations and Limited Liability Partnerships. In addition to these there are non-limited liability partnerships, such as, civil partnerships, general partnerships, commandite partnerships. In addition to the above main two, there is the possibility to create an Agency of a foreign corporation.

a) Corporations (“sociedad anónima”)

A corporation is an entity formed by at least two shareholders that put together a common fund, and they are liable only for their respective contributions and managed by a board of directors (at least 3) that are essentially revocable. As a general rule, it does not have any minimum capital requirements. There is no nationality requirement for partners or directors.

There are two types of corporation in Chilean legislation;

i) Publicly held corporations: They are corporations that offer their stock to the public according to the Securities Market law; they have 500 or more shareholders, or less than 10% of the subscribed capital belongs to a minimum of 100 shareholders. This type of company must be registered in a special register subject to control by the Superintendence of Securities and Insurance.

ii) Closely held corporations: They are corporations that are not included in the concept described in the preceding paragraph, regardless of the fact they may voluntarily submit to the norms that rule publicly held corporations, and they are not subject to control.

Two shareholders are sufficient to form a corporation, either individuals or corporate entities, Chilean or foreign, domiciled in Chile or abroad, and there are no minimum capital requirements.

The corporation is subject to a First Category tax, on an accrued base, with a flat rate of 17%, and its foreign shareholders that are not domiciled or resident in the country pay an additional tax at a rate of 35% on amounts withdrawn or distributed, against which they have the right to a credit equivalent to 17% of the amounts distributed that were originally subject to the First Category Tax in the company. The amount of the credit is considered income for the stockholder and, therefore, it must be included in the taxable base of the Additional Tax, thus resulting in a final tax charge of 35%.

iii) Dividend policy

The amount of dividends that shall be distributed by the company is decided by the Shareholders Meeting, each fiscal year. Nevertheless, unless a different agreement is unanimously adopted in the respective meeting, publicly held corporations shall distribute annually as a cash dividend to their shareholders, in proportion to their shares, at least 30%

of the net profits of each fiscal year. The same rule applies to the close held corporations if by-laws do not establish something different.

In any case, the board may, under the personal responsibility of the directors that participate in the respective agreement, distribute interim dividends during the fiscal year, chargeable to the profits thereof, provided there are no accumulated losses.

b) Limited liability partnership ("LLP")

This type of company is defined as a contract in which two or more persons, establish a common enterprise with a view to distributing the profits that arise therefrom among themselves, and it is managed by all the partners or by one representative appointed by mutual agreement (not necessarily a partner). The liability of the partners is limited to the amount of their contributions or the amount that is indicated in addition thereto in the incorporation papers.

There are necessary at least two partners for its establishment, either individuals or companies, it does not have any minimum capital requirements, and it is not subject to the control of a supervisory body as publicly held corporations are.

These companies also pay a 17% First Category tax on an accrued base, and nonresident partners, either individuals or companies, not domiciled in Chile are taxed with an additional 35% tax on the basis of what they receive (withdrawals), with a credit of 17% on such withdrawn amounts, since it was originally taxed with the First Category tax at the company level.

In the case of LLPs, all items that correspond to withdrawals in kind or disbursements of money that are not deductible as expenses, and loans that are made to individual partners and to payers of the additional tax (partners that are not domiciled or resident in Chile), must be considered to have been withdrawn by the partners, at the end of the fiscal year.

2.- Similarities of these two types of companies

- a) Public deed requirement, they are both constituted by a public deed, which contains the constitution and the by-laws, an abstract of which has to be registered within 60 days of the constitution in the Commercial Public Register and published in the Chilean Gazette.
- b) No minimum capital requirement, there is no rule that provides a minimum capital for Chilean companies, except some exceptions as banks or regulated entities or unless its capital is registered under a foreign investment system.
- c) At least two partners, as a general rule, to constitute a company in Chile at least two partners or shareholders are required. There is one exception to this, which is the Individual Limited Liability Enterprise, but is not recommended for foreign investments, mainly because the corporate veil can be pierced if bad faith in the company actions is proven.
- d) No nationality requirement, the partners or shareholders do not need to be Chilean, neither the directors nor the managers need to be Chilean.
- e) Power of attorney both can be constituted by representatives or attorneys, constituted by public instrument granted in Chile or abroad. If abroad, legalization procedures must be met.

3.- Main differences of these two types of companies

- a) The management, in the case of Corporations is assumed by a Board of Directors (at least 3) appointed by the Shareholders, which in turn appoints a manager, whereas LLPs can be managed directly by all or some of the partners or by another person appointed by the partners, even though an agreement can be reached in the by-laws on a similar form of management to a corporation.

b) Rights or shares and its transference, in Corporations the rights and capital are represented by shares of stock, which can be freely transferred to third parties, unless there is an agreement to the contrary contained in the by-laws (not acceptable in publicly held corporations) or a shareholders agreement has been reached by separate instrument; alternatively, the rights of partners in an LLP are represented by rights in the company and can only be transferred to third parties by means of a modification of the by-laws, which requires the unanimous agreement of the partners.

c) Taxation, the partners of an LLP only pay an additional tax or complementary global tax on the taxable profit represented by the Taxable Profit Fund (FUT), in which the net taxable income or tax loss of the fiscal year, exempt income, equity investment, and dividends received are recorded. Withdrawals or remittances that are made above the FUT, which do not correspond to unearned income or exempt income, shall be considered to be realized in the first subsequent fiscal year that the company has taxable profits and if the taxable profits of that fiscal year are not sufficient to cover the amount of the withdrawals in excess, the remainder shall be understood to be withdrawn in the subsequent fiscal year when taxable profits are produced, and so on.

Final shareholders in corporations must pay the complementary or additional global tax, as applicable, on the amounts the respective company distributes thereto as dividends, regardless of whether the corporation is in a situation of tax profit or loss.

d) Reinvestment benefits, the partners in a LLP have the possibility to invest the income they withdraw from the LLP, within 20 days of the date of the withdrawal, in other company subject to First Category Tax without being taxed with the complementary or additional tax, until it is withdrawn from the company that receives the investment or distributed thereby. This benefit does not apply to shareholders of a corporation.

4.- Agency of a foreign corporation.

An Agency is the formally registered office in Chile of a foreign corporation, with residence, capacity and autonomy. Although, its organization implies acquiring tax, legal and commercial presence in the country, it does not enjoy its own legal personality separate from its parent company. Therefore it does not limit the liability of the foreign corporation. In addition, the Agency property is subject to Chilean laws and it does not require minimum capital.

The formation of an agency is relatively simple, but the formation of an LLP is faster, because establishing an agency, besides granting the agent a power of attorney, requires that all the information about the incorporation of the foreign corporation, certificate of validity, and by-laws be brought into the country, properly translated and notarized.

From the tax point of view there are no significant advantages in choosing this alternative or any one of the other alternatives, since all of them are subject to the same total tax burden. In any case, the limited liability partnership is easier to operate and manage and therefore more recommendable, and it may subsequently be transformed into a corporation if so desired.

C. - TAXATION IN CHILE.-

1.- General Rule

Any person domiciled or resident in Chile must pay taxes on its income of any origin, whether the source of income is located inside or outside of the country. Therefore, every Chilean company is obliged to declare in the country the income or profits from abroad. Nevertheless, foreign individuals in Chile are allowed to pay tax on only their Chilean income for the first three years of residence in Chile.

2.- Types of taxes

The main taxes in Chile are:

- a) First Category Tax, known as a corporate tax, which is a flat rate of 17%
- b) Second Category Tax, it affects employees and ranges from 0 to 40%
- c) Global Complementary Tax, it affects all incomes of individual persons and ranges from 0 to 40%
- d) Additional Tax, affects all incomes sent abroad, and is a withholding Tax; it ranges from 4% to 35%.
- e) VAT (GST) it has a flat rate of 19% and affects all imports and acquisition of goods and use of services.
- f) Other Taxes, such as, Seal and Stamps Tax, Municipal Tax.

3.- Corporate income taxation in Chile

a) General Corporate Tax

The general income tax at the corporate level, regardless of the type of company, is the First Category tax of 17%, which is applied to the real income of the respective legal entity, determined according to reliable accounting.

b) Additional Tax

Additional Tax of 35% is the tax payable by non-resident individuals and entities, on Chilean source business income withdrawn or paid from Chile, made available for or remitted abroad. This tax has to be withheld by the payer entity. Nevertheless, the 17% corporate tax, effectively paid, can be credited against Additional Tax.

The Additional Tax, normally at the rate of 35%, is also assessed on most other payments made abroad, such as:

- i) 30% on royalty payments for trademarks, formulas, etc. and similar fees;
- ii) 15% for software for computers to be used in Chile. Nevertheless, it increases to 30% in case of related parties.
- iii) 15% on payments for technical assistance or engineering work rendered in Chile or abroad to non-resident foreign individuals or entities. Nevertheless, it increases to 20% in case of related parties.
- iv) 4% on interest payments made to a foreign or international bank or to a foreign international financial institution registered as such with the Central Bank, or 35% to interest payments to all other entities and if excess of related indebtedness exists;
- v) Other source payments remitted abroad are subject to the 35% withholding tax rate.

4.- Tax treatment of dividends paid by publicly held corporations

a) Direct investment from abroad

If the investment is made directly from abroad, the remittance of dividends distributed by the publicly held Chilean corporation shall be taxed with the Additional tax of 35%, with a credit of 17% for the First Category tax paid by that corporation, with a total tax burden of 35%, unless the investment was made under Decree Law N° 600 and tax invariability of 42% was chosen as the total income tax burden.

b) Establishment of a subsidiary in Chile

The remittance of dividends abroad shall also be subject to the Additional tax of 35% with a credit of 17% and a final tax burden of 35%, except for the aforesaid 42%.

However, if the subsidiary in Chile is a limited liability partnership and it is in a situation of tax loss or has a zero FUT, the application of the Additional tax shall be suspended until the company has taxable profits, as analyzed above.

5.- Other Taxes to be considered

a) Value Added Tax ("VAT")

The Value Added Tax is contained in Decree Law N° 825 of 1974, has a current rate of 19%, and it is applied to the imports and acquisition of goods and use of services, in the form and within the terms defined by law.

According to the definition of seller established by law, for a sale to constitute an act taxed with VAT it is necessary for the seller to be habitually active in the sale of the goods in its line of business. Therefore, the sales of fixed assets, are generally not taxed with VAT, because the seller in that case is not considered to be a habitual seller. There are exceptions, such as, sale of chattel goods or real estate carried out by companies before twelve months have elapsed since their acquisition, which are not part of the liquid assets, carried out by taxpayers that, because they are subject to the rules of law, have had the right to a tax credit for the acquisition, manufacture or construction of such goods.

There are some services that are exempt from VAT. For instance, advisory services are not taxed with VAT (legal advice).

b) Seal and Stamp Tax

i) Money credit operations

The Seal and Stamp tax is normally imposed on the issue of letters of credit, certificates, promissory notes, simple credits or credits against transfer of documents, and any other document that contains a money credit operation, with 0.1% on its amount for each month or fraction between the issue of the document and the expiration thereof, and the rate that is finally applied may not exceed 1.2%. During years 2007 and 2008 these rates are 0.125% on its amount for each month or fraction, with a cap of 1.5%; and 0.1125% on its amount for each month or fraction 1.35%, respectively.

Instruments and documents that contain sight credit operations or credit operations without an expiration date must pay the rate of 0.5% on their amount.

ii) Imports

The documents necessary to execute an imports, under the system of collections, letters of credit, deferred coverage or any other where payment of the operation or the credits obtained to carry it out is made after the acceptance date of the respective customs document, shall be subject to the same tax referred above.

c) Municipal Tax

The Municipal Income Law imposes a municipal tax on the exercise of any profession, trade, industry, commerce, art or any other lucrative secondary or tertiary activity, whatever its nature or name.

The value for twelve months of the license shall be an amount between 2.5 per thousand and 5 per thousand of each taxpayer's declared capital, which may not be less than one monthly tax unit (A\$70) or higher than four thousand monthly tax units (A\$280.000). Each municipality sets its tax level between the above mentioned ranges.

Declared capital shall be understood to be the initial capital declared by the taxpayer in the case of new activities or the capital registered on the balance sheet ended on the December 31st immediately preceding the date when the declaration must be presented. However, the taxpayers may deduct from the declared capital, such part of the capital that is invested in other businesses or companies subject to payment of a municipal license.

D. - FORMS OF FINANCING AN INVESTMENT.-

An investment can be financed with contributed capital or with debt granted from abroad to the legal entity that is established in Chile to implement the investment.

1.- Tax treatment of credits granted abroad

a) Additional Tax on interest

The taxation of interest on foreign credits is specifically regulated in the Income Tax Law, which makes the Additional Tax applicable in those situations. Depending on the entity that grants the credit, the rate of this tax can be 35% or 4%.

This is a withholding tax, and such withholding must be made when the interest is paid, credited, or made available to the interested party without deductions of any kind. Persons obliged to make the withholding shall declare and pay the

withheld taxes by the 12th of the month following the month in which the interest was paid, remitted, credited or made available to the foreign creditor.

i) Additional Tax with general rate of 35%

Interest that is remitted abroad to persons without domicile or residence in the country is subject to the Additional Tax in the nature of a single income tax at a general rate of 35%. (i.e. Companies with domicile abroad).

ii) Interest that pays tax at a rate of 4%

There are a number of situations in which the rate applicable to interest remitted abroad is 4% instead of the aforesaid rate of 35%. One of these situations refers to credits granted abroad by foreign or international banking or financial institutions, in which case the financial institutions must have been authorized expressly by the Central Bank of Chile, and provided the respective credit operation has been authorized previously by the Central Bank of Chile.

iii) Deductibility of the expense for interest paid abroad

The interest paid or accrued on the amounts owed, is deductible as an expense in determining the taxable net income of the company that pays the interest. For this deduction to be possible it is necessary that the credit or loan was used directly or indirectly in the acquisition, maintenance and/or utilization of property that does produce income taxed in this category.

b) Seal and Stamp Tax

Any credit granted abroad shall be taxed with the Stamp Tax at the rates before mentioned. This tax shall accrue from the time the documents arrive in the country, which set forth the loan, or when they are notarized or entered in the accounting, as applicable.

2.- Exchange rules, registration in the Central Bank

According to Chapter XIV of the Foreign Exchange Compendium of the Central Bank of Chile, credits that enter the country must be authorized and registered in such bank before they are contracted abroad, and this shall be done through a banking company or a money exchange office in the Formal Exchange Market (FEM).

All foreign exchange that enters the country that corresponds to credits from abroad must be liquidated in the FEM. Also, the remittance of funds abroad that emanates from credits brought into the country or disbursed directly abroad shall require previous authorization from the Central Bank.

On the other hand, the credits shall be liquidated on the same date the entrance of the respective foreign exchange into Chile is verified. As soon as the foreign exchange has been liquidated, the beneficiary of the credit must send the Central Bank, through the banking company or money exchange office in reference, a copy of the loan agreement, promissory note or instrument required by the creditor.

E. - SUMMARY OF LABOUR LAW IN CHILE.-

Chilean labor legislation is mainly compiled in a Labor Code. It regulates the relations between workers and employers, unions and collective bargaining, lay offs and legal actions under labor laws. Nevertheless, there are other laws that set up norms regarding social security, labor accidents and other specific issues.

This labor legislation protects workers. Labor rights (individual or collective) may not be waived.

Labor contracts in Chile must be made in writing. If the contract is not written, it is construed in favor of worker and the employer could be fined.

The Chilean labor legislation support unionism and union negotiations to obtain better conditions for workers. Strikes are permitted in Chile, but limited within the context of a Union negotiation. In some cases the employers can hire other workers for replacement.

The employer is obliged to distribute among its workers a sum not lower than 30% of its profits or, alternatively, a sum of 25% of the accrued amount in the business year for individual monthly remuneration, with a yearly cap, equivalent to 4.75 minimum wages, currently approximately at A\$ 250 a month. There exists the possibility of agreeing on higher conventional rewards.

The business week lasts 45 hours distributed in a minimum of 5 days and a maximum of 6 days per week. A maximum of two extra hours per day is allowed. Sundays and holidays are resting days, except in some especial cases. In such especial cases, workers have right to be paid for extraordinary hours with the legal surplus (50%). Nevertheless, such holidays have to be compensated with other days in the week and workers must have at least two Sundays per month for resting.

1.- Labor contract termination

- a) Mutual consent or expiration of the term of a contract. In these cases, Chilean law does not require the provision of severance payment;
- b) Improper behavior of workers such as absence to work without justification, with no severance payment. However, if the worker files a claim against the employer, the latter has to prove the facts deemed as improper behavior of the worker. If the employer is convicted in the trial, he must pay severance;
- c) The employer can terminate the contract by company's necessity. In these cases, Chilean law obliges to provide severance payment with a cap limited to 11 years and considering a monthly remuneration of approximately A\$ 4,200. If the worker demands the employer and he can not prove the fact of the company's necessity, the severance payment could be recharged in 30%. The parties can agree a better severance payment than the legal one.

Regarding suits under labor laws, the judicial procedure is currently in writing, but it will be modified by a brief and oral procedure, which is supposed to be implemented from 2008.

2.- Foreign Employees

At least 85 per cent of the workers of a company must be Chilean, except in case of a company with less than 25 workers where there is no such minimum. Other exceptions: a) if technical personnel can not be replaced by Chileans; b) foreigners whose spouse or sons are Chileans, and c) those who have had residence for more than 5 years in Chile.

3.- Social Security

Chile has a private social security system where employees deposit around 10% of their monthly salary (with a cap) in their individual account, administrated by Pension Fund Administration Companies (PFA). A commission of 2 to 2.5% is charged for the administration of such funds. In addition employees pay around 7% for health insurance in a private or public institution. Employers have the duty to retain and pay such amounts to the PFA and health insurance.

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