



# THE PERSONAL INCOME TAX IN CHILE IN INTERNATIONAL COMPARISON

Diálogos Por Un Pacto Tributario

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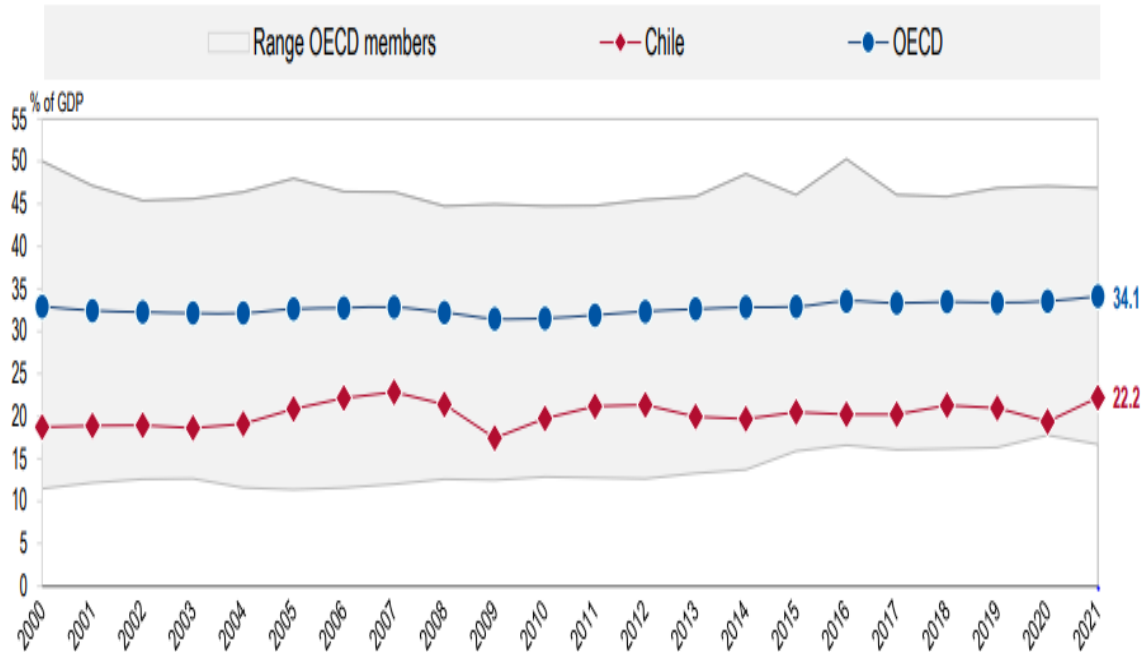
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# Chile's tax-to-GDP ratio is low compared to the OECD average & has remained surprisingly stable over time

## Tax-to-GDP ratio



Source: OECD (2022) Revenue Statistics Database

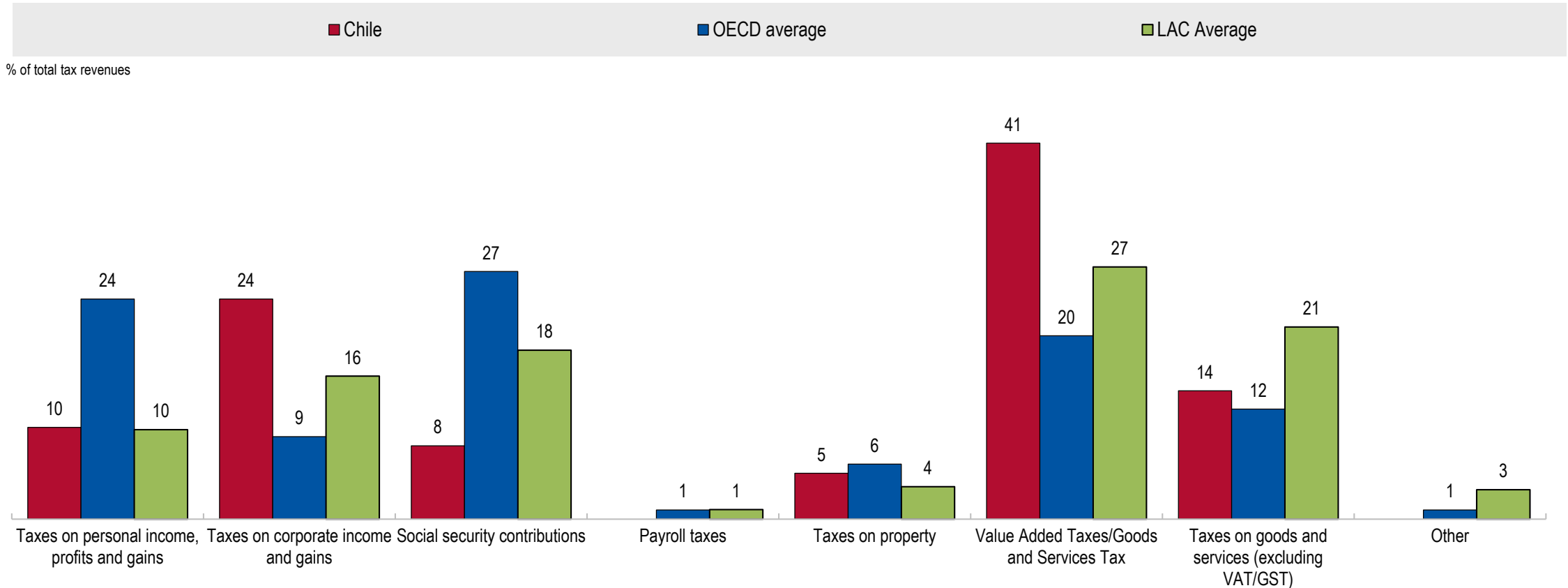
The fact that the tax-to-GDP ratio has remained relatively stable over time may (!) be driven by several factors, including:

- The natural resource boom resulted in an increase in GDP that exceeded the rise in tax revenues (also because royalties and production levies are classified as non-tax revenues)
- In order to make the transparent tax regime attractive, the CIT rate was increased to 27% and the dividend imputation credit was reduced from 100% to 65%. This increased the cost of capital and may have created a drag on investment and growth and/or resulted in tax uncertainty that may have induced businesses to postpone investment.



# The personal income tax is under-utilised in Chile compared to other OECD countries

## Tax mix in 2020, as a % of total tax revenues

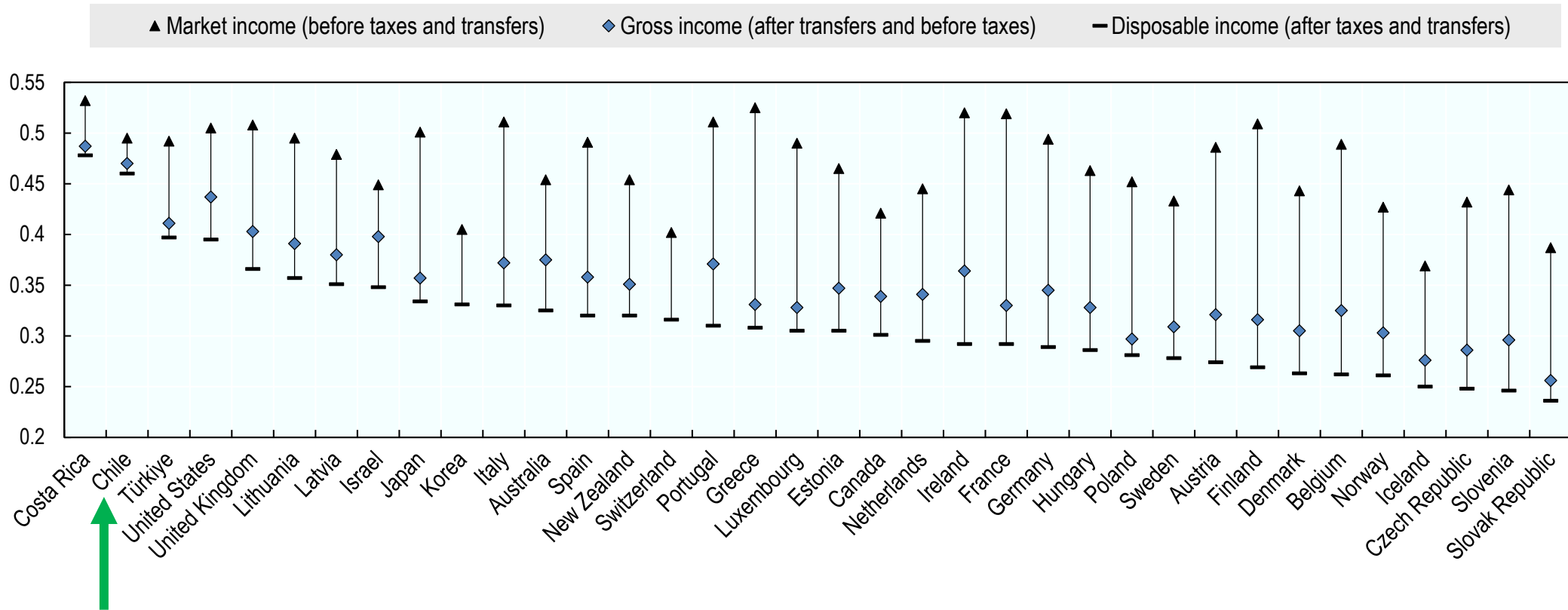


Source: OECD (2022) Revenue Statistics Database



# The low reliance on the PIT contributes to the limited role that the tax system plays in reducing income inequality

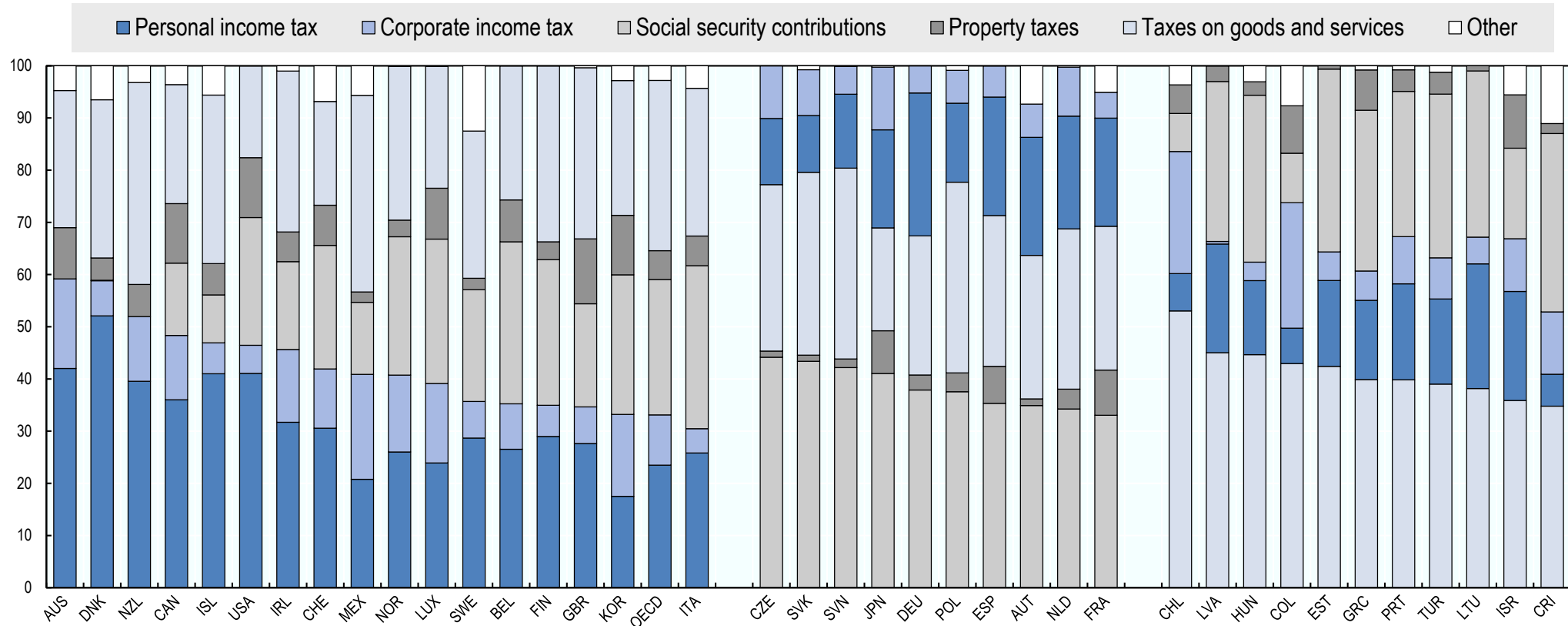
## Gini coefficients, 2019



Source: OECD Income Distribution Database.



# More progressive tax systems generally raise more revenue from direct taxes



Note: Countries are grouped and ranked by those where income tax revenues (personal and corporate) form the highest share of total tax revenues, followed by those where social security contributions, or taxes on goods and services, form the highest share.





# In Chile, a large proportion of individuals pay no or low levels of personal income tax

## Tax schedule

Tax rates	Taxable income (CLP)
0.0%	8,775,702
4.0%	19,501,560
8.0%	32,502,600
13.5%	45,503,640
23.0%	58,504,680
30.4%	78,006,240
35.0%	201,516,120
40.0%	

## Average wage in Chile in 2021 CLP 10,776,819



At 100% of the average wage (after accounting for tax allowances), the worker falls into first bracket of the tax schedule and pays no income tax



At 200% of the average wage (after accounting for tax allowances), the worker falls into the second bracket of the tax schedule. The average income tax rate at this income level is 1.6%



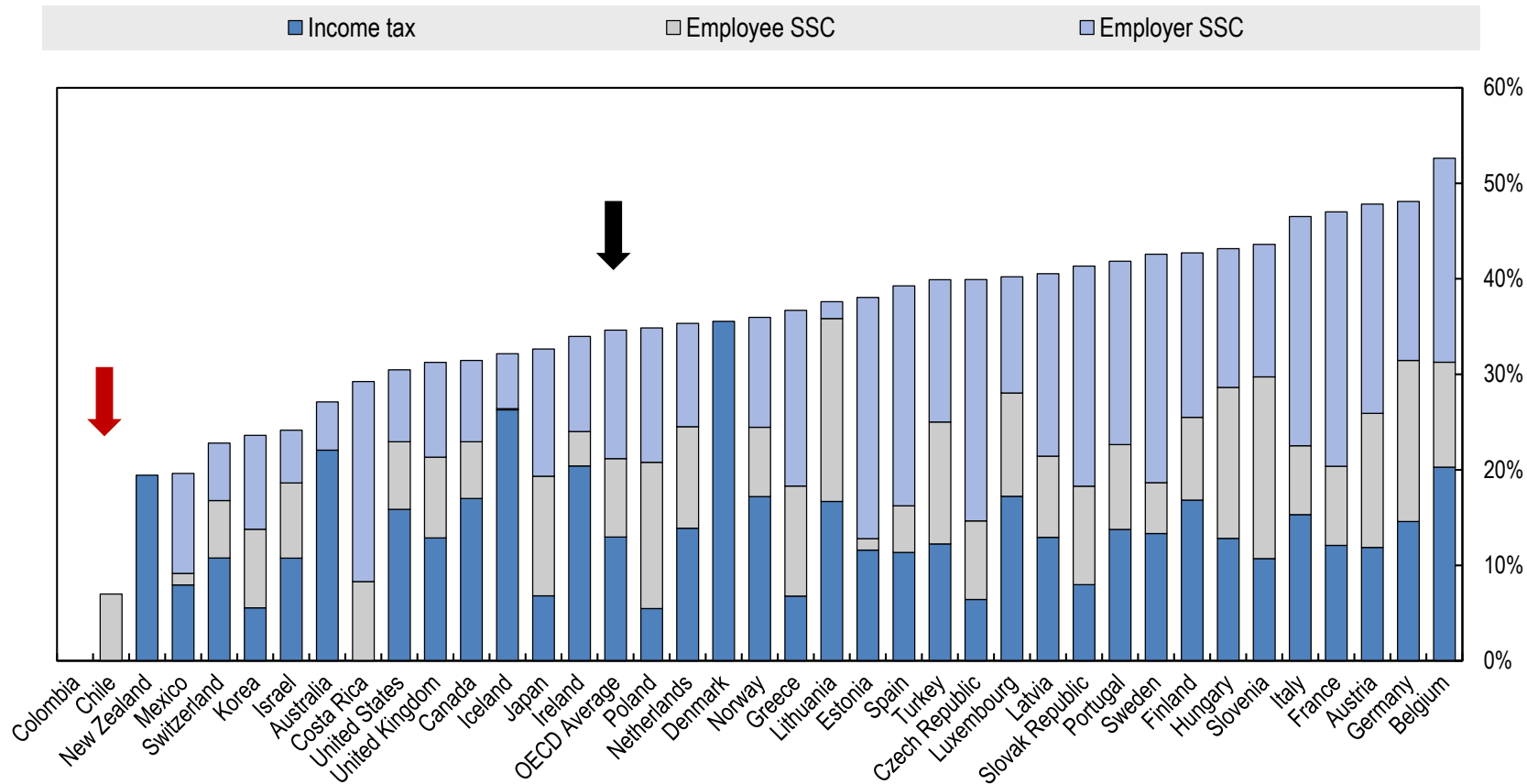
# All countries in the OECD exempt a “basic” amount of income from personal income tax

- > All countries in the OECD exempt a basic amount of income from personal income tax
- > Basic tax provisions are a significant source of tax progressivity
- > Basic tax provisions can take different forms:
  - > Basic tax allowance,
  - > Zero rate tax bracket
  - > Basic tax credit
- > Tax design matters:
  - > Basic tax allowances are similar to zero rate tax brackets: the value of the tax provision is increasing with taxable income and the marginal PIT rate; i.e. the value of the tax provision is higher for the richer than it is for lower-incomes – this is the case in Chile
  - > The value of the basic tax credit is independent of the level of taxable income (as long as tax liability is sufficiently high)
- > Why a basic tax provision?
  - > Exempt that part of earned income that taxpayers incur to earn their income
  - > Some countries allow individual taxpayers to declare their actually incurred costs; other countries just foresee a basic amount that is fixed and that is therefore the same for all individual taxpayers;
  - > Business tax expenses are typically deductible from taxable business earnings within the PIT.



# Chile's tax wedge is low compared to the OECD average

## Tax wedge for the average worker in 2021



Source: OECD (2022) Taxing Wages Database

Taxes are “compulsory unrequited payments to general government”. In Chile, almost all of the social contributions are paid by employees and employers to privately managed funds.

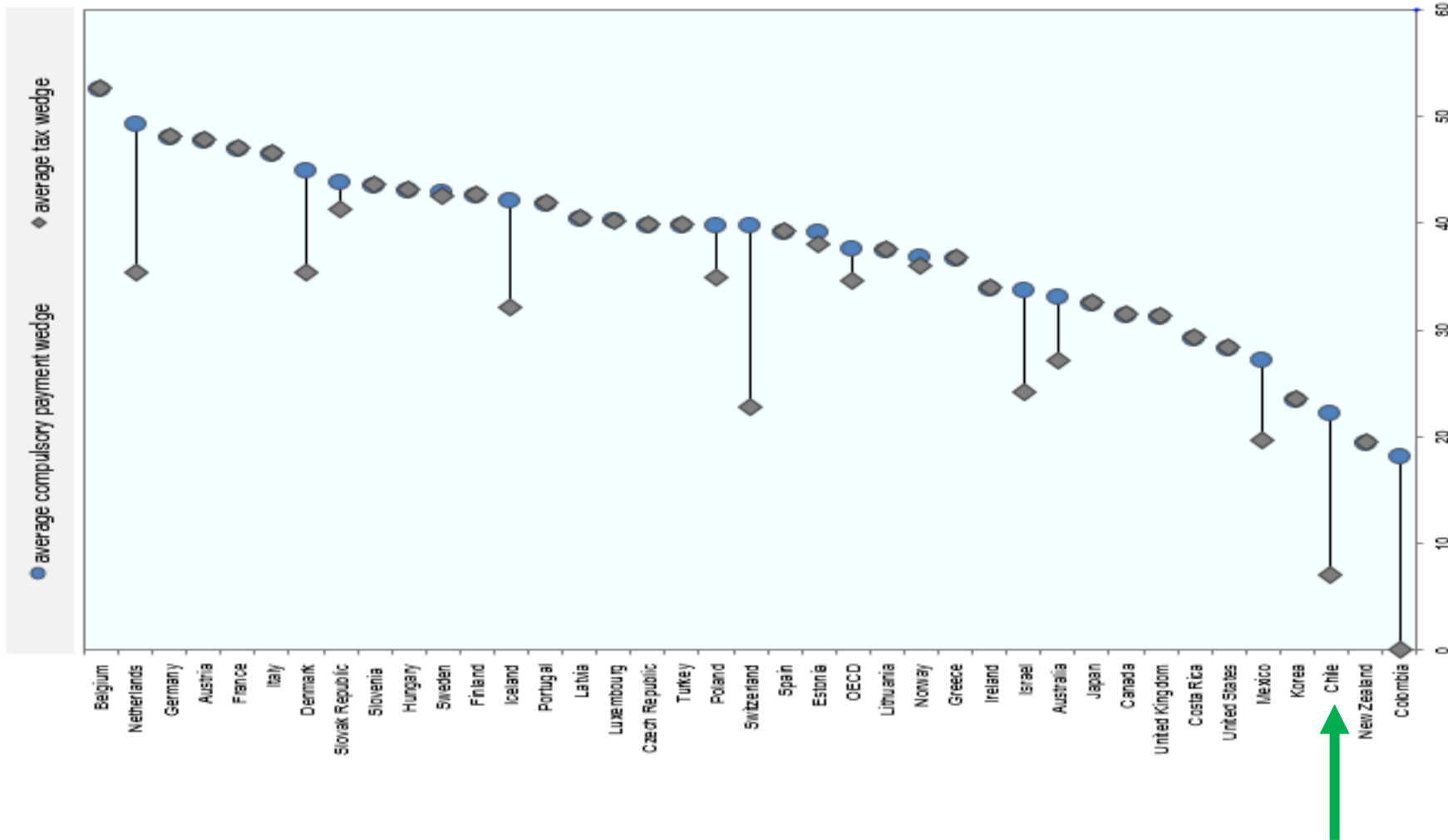
When “tax” and “non-tax compulsory payments” are combined, the burden increases (but remains relatively low).

Key observation: no PIT is paid at this income level (in contrast to most other OECD countries)





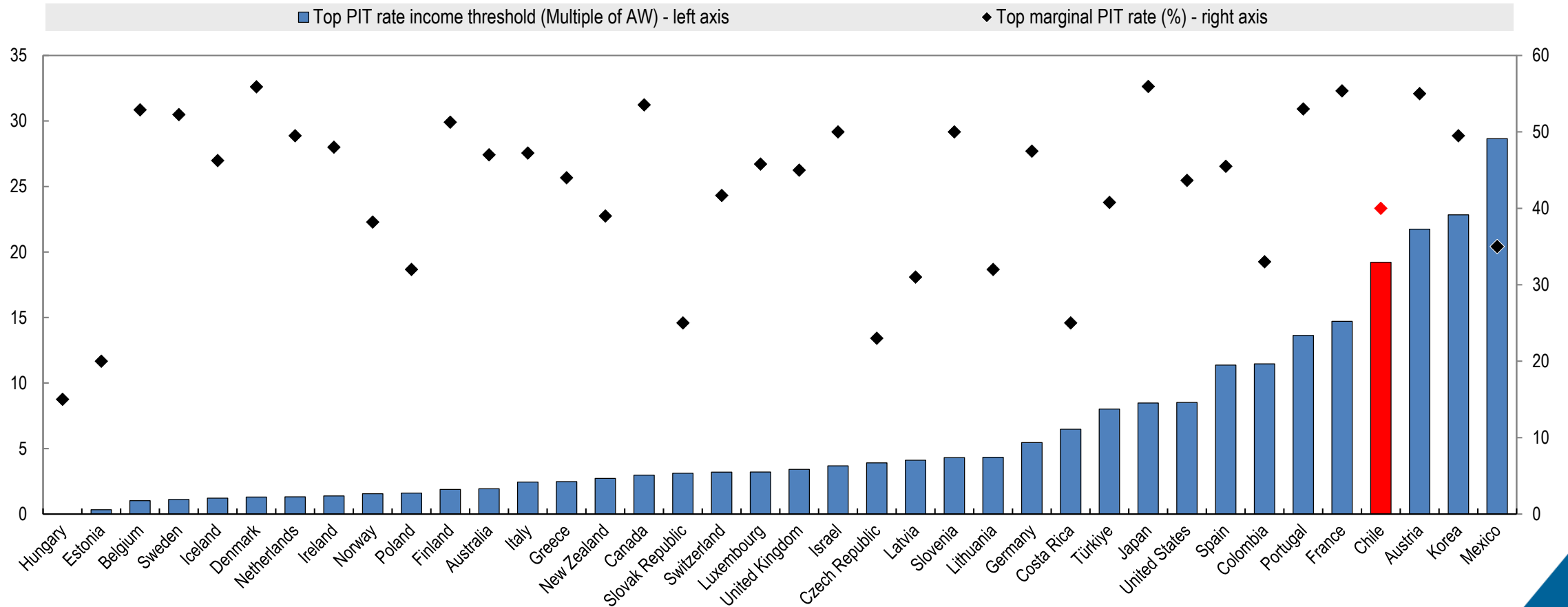
# The average tax wedge remains low if compulsory contributions to private funds in Chile are taken into account





# The top personal income tax (PIT) rate in Chile is not particularly high but it only takes effect at very high income levels

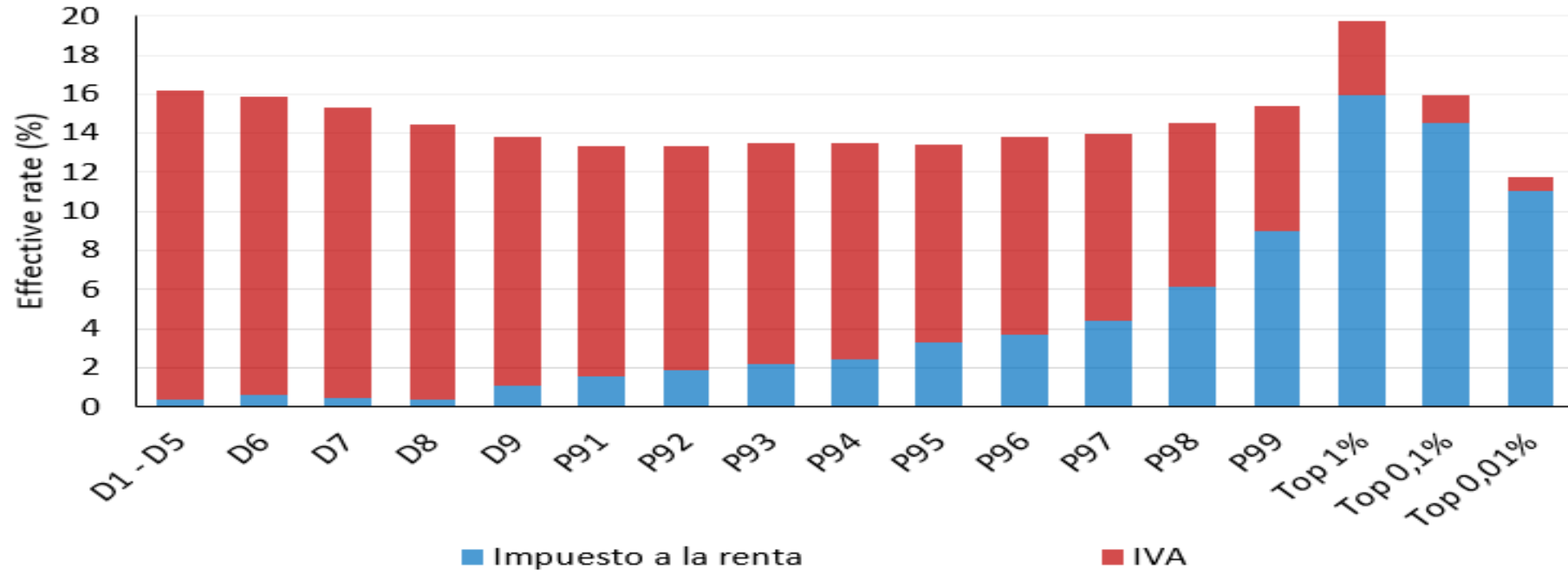
## Top PIT rate income threshold (multiple of the average wage) and top marginal PIT rate (%) in 2021





# Currently, only the very rich pay personal income tax in Chile, but the effective rates remain far below the top statutory PIT rates

Figure 1: Income and consumption effective tax rates



Source: Ministry of Finance (2022)

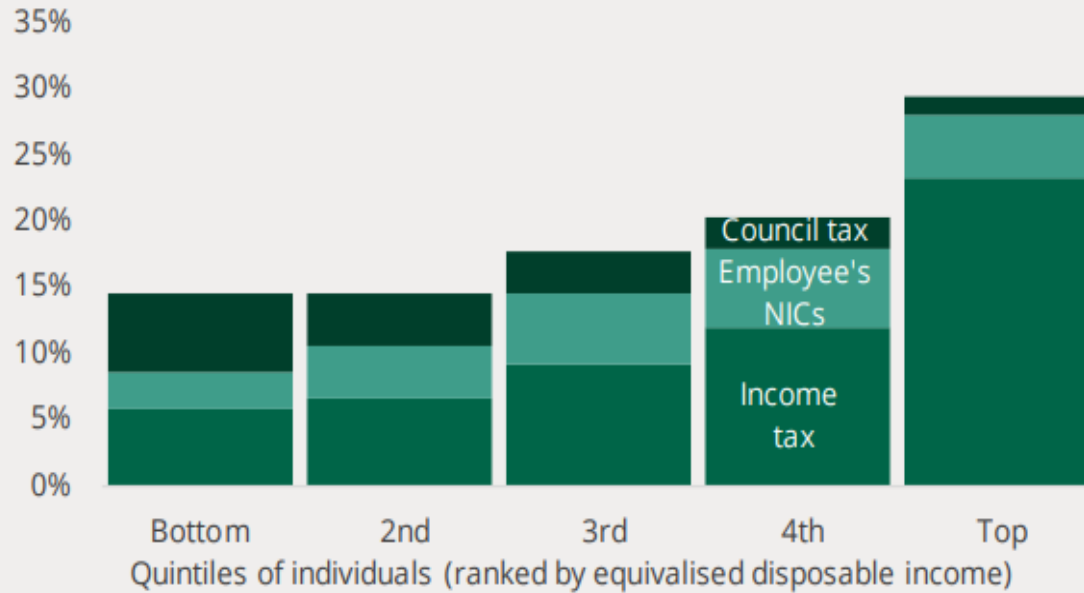
Note: D refers to deciles; P to percentiles; Top to the highest quantiles of income.

Source: : <https://www.hacienda.cl/noticias-y-eventos/documentos-reforma-tributaria/estudio-sobre-diagnostico-distributivo-de-ingreso-y-patrimonio>

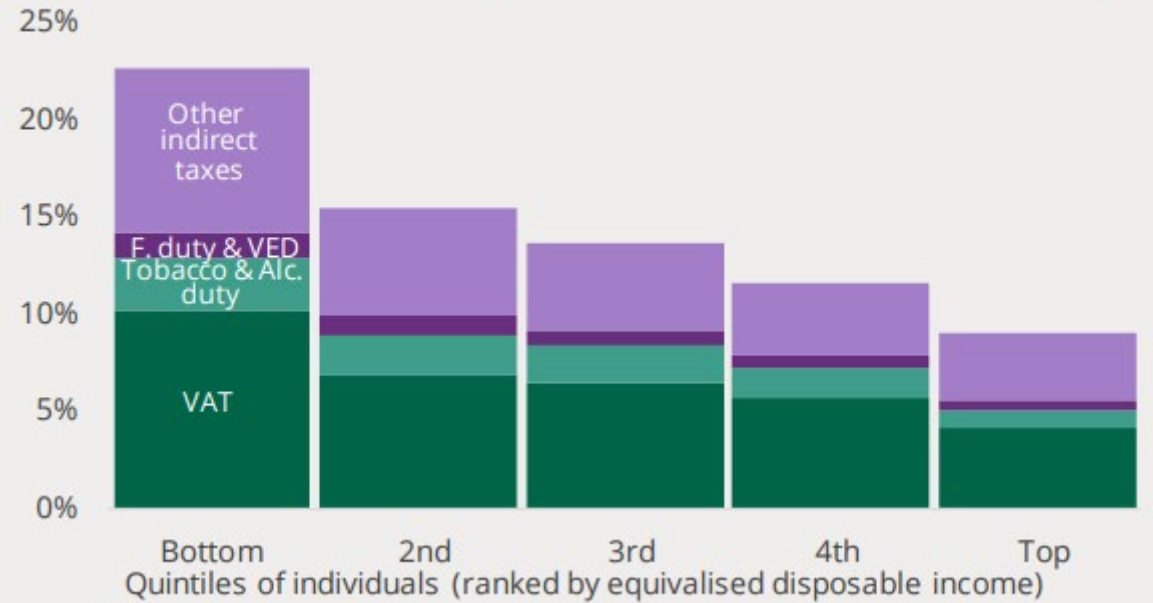


# The combined tax burden in Chile is lower than in many other OECD countries including the UK

Direct taxes as % of gross household income, 2020/21



Indirect taxes as % of disposable household income, 2020/21



<https://researchbriefings.files.parliament.uk/documents/CBP-8513/CBP-8513.pdf>



## OECD countries have moved away from comprehensive income tax systems

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- Capital income is taxed under the corporate income tax
- Distributed dividends are taxed at progressive PIT rates
- Outcome:
  - Very high tax burden on capital income, in particular dividends, that leads to a tax burden on dividends that may exceed the tax burden on labour income
  - Significant tax progressivity
  - Incentive to avoid high taxes (e.g. invest in owner-occupied housing or private pensions, which are often tax-favoured) OR to evade (e.g. by saving offshore and not declaring capital income in the tax residence) OR to avoid taxes by avoiding that dividends are paid (e.g. businesses retain profits and households save through capital accumulation funds that do not distribute dividends)



## Integration of corporate and personal capital income taxes is good practice – different implementation options

- Dividend Imputation system (as is the case in Chile)
- Schedular tax regimes (e.g. lower taxes at personal level), such as the Dual Income Tax (as in many EU countries)
  - CIT + low and proportional tax on dividends and capital gains
  - Lower tax burden – overall tax burden can be aligned with tax burden on labour income – reduced tax progressivity
- Automatic Exchange of Financial Account Information for Tax purposes has created an opportunity to revisit the taxation of personal capital income in the OECD and, possibly, move towards a Dual Progressive Income Tax System (DPIT)



## Dividend imputation systems: from theory to reality

- CIT is a withholding tax that can be (partially or fully) credited against PIT when dividends are distributed; the lower the dividend imputation credit, the higher the overall tax burden on dividends.
- Partial dividend imputation for domestic firms while full dividend imputation for non-resident firms creates a tax-induced disadvantage for domestic firms.
- In theory, distributed dividends to domestic shareholders are taxed at progressive PIT rates
- In reality, owner-managers of closely-held corporations can vary the timing of the dividend distribution to minimise their dividend tax liability – reduced tax progressivity
- Businesses can retain profits and invest in productive or financial assets – the PIT deferral creates a significant tax advantage
- In order to minimise tax planning incentives, a dividend imputation system may require levying a relatively high statutory CIT rate such that the gap between the CIT and top PIT rates is kept as low as possible; this in itself creates challenges in an international tax setting



## Remaining challenges in the taxation of capital income

- Tax-induced incentive for self-employed businesses to incorporate & tax-induced incentives for entrepreneurs not to be taxed under a tax transparent regime
  - If capital and labour income is not aligned
  - Capital income can be deferred by not distributing dividends – Chile has introduced a pass-through business form that tackles these challenges for certain businesses
  - In order to make the tax transparent regime attractive, the tax burden on the other regimes could be increased, but this will come at an economic cost
  - Other strategies: require manager-owners of closely-held businesses to pay themselves a “minimum” salary (e.g. in Belgium, twice the AW).
- Strict valuation and tax enforcement is required to avoid that entrepreneurs qualify “personal consumption” as “business expense”, including phone, business car that is used for personal purposes, computers, diners, etc.
  - If entrepreneurs can live out of their own business, there is less of a need to distribute dividends
  - Value of these private fringe benefits should be taxed under the PIT when the benefit accrues





## Addressing tax deferral

- The taxation of income on a realisation basis rather than on accrual creates opportunities for tax-deferral
  - > All countries face & struggle with this challenge
  - > No easy solution to restore neutrality
- Presumptive capital income tax in the Netherlands (similar to net wealth tax) was an attempt to avoid the tax deferral distortion – but effective returns vary widely across assets and types of taxpayers
- Retained (undistributed) profits can be invested in productive business assets (linked to the business core activity) >< funds can be invested in financial assets
  - > Taxation of undistributed profits (e.g. levy interest charge when capital gains are realised to capture deferral, business wealth tax on undistributed profits) may create significant economic distortions in particular for businesses that are cash-constrained and depend on internally generated profits to finance their investment
- Levying personal capital income at progressive tax rates (DPIT) would induce capital owners to distribute dividends gradually over time (rather than distributing them all at once)
- Tax undistributed profits as capital gains when owner passes away (to avoid indefinite deferral).



## Contact details

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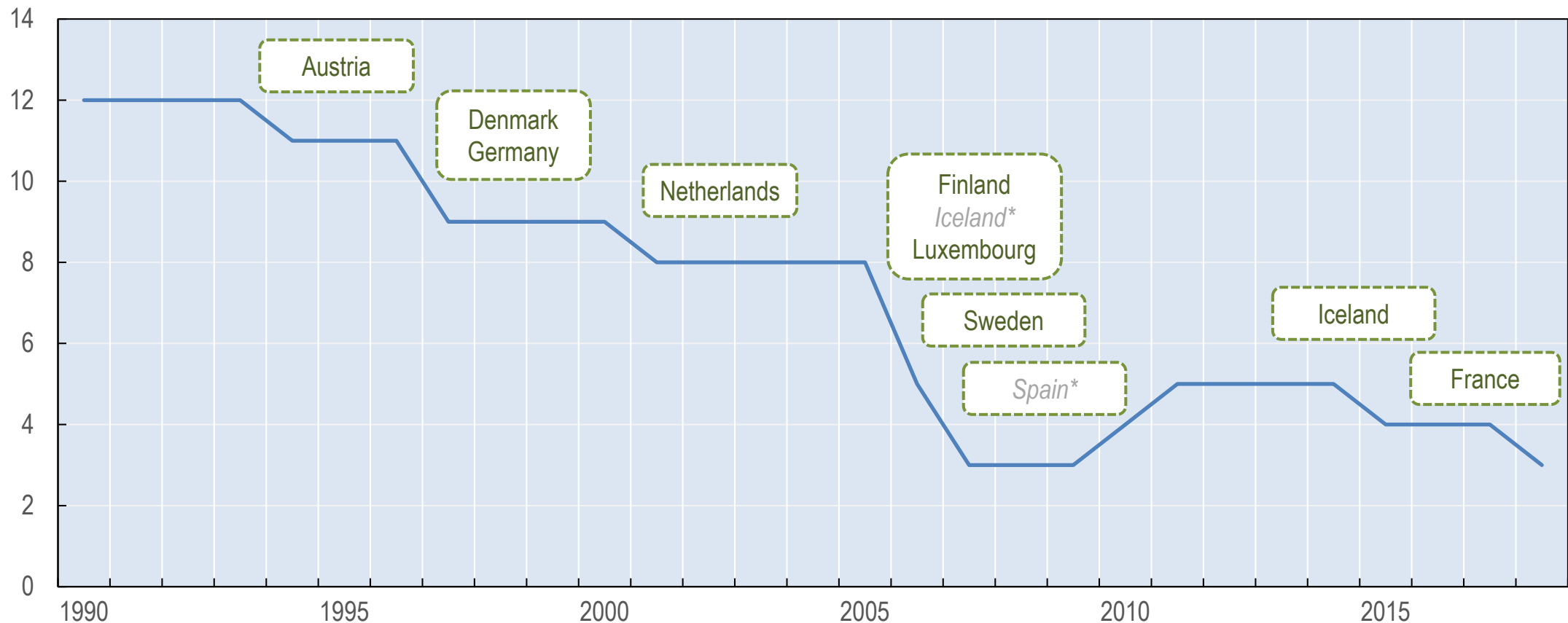


# ANNEX



# Net wealth taxes have been repealed in most countries

## Evolution of the number of OECD countries levying individual net wealth taxes over time



Note: \*Iceland and Spain re-instated wealth taxes after the crisis  
Source: OECD (2018), *The Role and Design of Net Wealth Taxes*



## Inheritance taxation in OECD countries (OECD, 2021)

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- 24 countries out of 38 countries levy inheritance taxes
- Most countries levy recipient-based inheritance taxes (exceptions Denmark, Korea, UK, US)
- Tax exemption thresholds vary considerable across countries (ranging from close to USD 17 000 in Brussels to more than USD 11 million in the United States for transfers to children)
- Most countries have progressive tax rates, but around one third apply flat tax rates.
- Low revenues largely reflect narrow inheritance tax bases and tax planning opportunities.



## Tackling income and wealth inequality through tax design

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- Given moderate levels of income and wealth inequality: well-designed capital income taxes and an inheritance tax can address inequality
- Role for recurrent taxes on immovable property
- Countries that would want to reduce wealth inequality more rapidly could consider a net wealth tax
  - If levied at very high levels of wealth only
  - Risk of resulting in high overall tax burden on capital income
  - Wealth tax = proportional tax rate on presumed return
- Coherence in design of overall capital income tax system is key.