



Franchise

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Chile

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Overview

1 What forms of business entities are relevant to the typical franchisor?

The sociedades de responsabilidad limitada – (SRL, equivalent to a limited liability company), the sociedades anónimas cerradas (SA, privately held, joint-stock corporations) and the sociedades por acciones (SpA, sole shareholder privately held joint-stock corporations) are the relevant business entities available to the franchisors, as the majority of local franchisee prospects are legally organised through one of the said legal vehicles.

2 What laws and agencies govern the formation of business entities?

The formation of a SA is governed by Chilean Law No. 18,046 on Corporations whereas the formation of a SpA is governed by the Commerce Code. In turn, Chilean Law No. 3,918 regulates limited liability companies. Additionally, and in the absence of any specific provision in the foregoing laws, the Chilean Commercial Code and the Chilean Civil Code are also applicable in the formation of the above-mentioned business entities.

The formation of corporate entities is not subject to the oversight of governmental agencies, although applicable local laws mandate that an abstract of the articles of incorporation and by-laws (under Chilean law, the one and only company formation document) must be recorded in the Registry of Commerce of the city of the registered address of the company being formed.

3 Provide an overview of the requirements for forming and maintaining a business entity.

The formation of any of the above-mentioned corporate entities shall follow the following legal paths:

- two or more individuals or legal entities must sign and execute the new company's articles of incorporation and by-laws in the form of a public notarial deed. The foregoing also applies to the SpA except that only one individual or legal entity is required;
- an abstract of the deed of formation has to be published once in the Chilean Official Gazette and recorded in the Registry of Commerce in the city of the registered address of the company being formed. There is a mandatory 60-day deadline (counted from the deed of formation date) to meet the foregoing formation requirements;
- an information tax return has to be filed with the Chilean IRS for the purposes of obtaining a TID number for the new company and declaring the inception of business activities, which calls for the water sealing of official books and accounting records (including invoices and credit/debit notes).
- A filing is required with the municipality of the domicile of the company for the purposes of obtaining a business licence fee, which is paid semi-annually (up to 0.5 per cent of the stated capital of the company with a cap).

The new company will be then ready to trade.

4 What restrictions apply to foreign business entities and foreign investment?

There are no legal restrictions on foreign business entities and foreign investment. All remittances of funds into Chile must be reported to the Central Bank of Chile (equivalent to the Federal Reserve in the US) by means of an information return submitted thereto by the local recipient or intervening bank.

5 Briefly describe the aspects of the tax system relevant to franchisors. How are foreign businesses and individuals taxed?

Section 59 of the Chilean Income Tax Law establishes an income tax withholding rate of 30 per cent on amounts paid or credited to persons without domicile or residence in Chile for the use of trademarks, patents, formulae, technical assistance and other similar services, whether characterised as royalties or any other form of remuneration. Notwithstanding this, section 59 also establishes a specially reduced withholding rate of 20 per cent on remittances made for services rendered exclusively outside Chile for engineering works and technical assistance. A Chilean IRS Ruling has held that services rendered outside Chile under a franchise agreement may fall under this specially reduced withholding rate if:

'the amounts remitted abroad consist of funds destined to remunerate engineering works or technical assistance in general, that is, those professional or technical services which a person or entity knowledgeable of a science or technique supplies through advice, report or plans, [sent into Chile by a supplier of such services located outside of Chile]'.

(Chilean IRS Circular/Ruling No. 2,313 of 14 January 1990).

A subsequent IRS Ruling clarified that 'if the amounts remitted abroad constitute income destined to remunerate individuals for scientific or technical activities developed in Chile, the same 20 per cent tax rate applies'. (Chilean IRS Official Communication No. 1,845 of 14 July 1998).

By way of example, in Official Communication No. 423 of 30 January 1991, the Chilean IRS found that manufacturing, programming, quality control and production processes and equipment maintenance; market research, introduction and distribution of products; organisation of a commercial network; preparation of statistics; organisation of administrative work; cost and pricing calculations; planning, personnel training and personnel selection outside Chile; and inventory control of products exported out of Chile were all subject to classification as technical assistance and therefore subject to the 20 per cent tax assessment.

Tax gross-up provisions are generally valid and enforceable in Chile and local counsel advises that, even if challenged by the Chilean IRS, any adverse tax or legal consequences should be attributable to the franchisee.

There is no stamp duty or other amounts due upon the execution of the agreements. Interest charged on an overdue account is subject to a 35 per cent withholding tax, if the payee is a non-resident party, and reimbursable expenses should be devoid of withholding tax assuming the invoices clearly state that the amounts paid are for costs incurred. Local counsel advises that advertising fund contributions should not be subject to withholding tax (and that most franchisees do not withhold taxes from such payments), but that tax treatment of such contributions have not been settled fully by the Chilean IRS. Finally, legal services may also qualify for a reduced rate of 20 per cent.

Chile is a party to double taxation treaties with Argentina, Belgium, Brazil, Canada, Colombia, Croatia, Denmark, Ecuador, France, Ireland, Korea, Malaysia, Mexico, New Zealand, Norway, Paraguay, Peru, Poland, Portugal, Spain, Sweden, Switzerland Thailand and the United Kingdom. Tax treaties with the United States, Russia and Australia have been signed but not ratified as of yet.

- 6 Are there any relevant labour and employment considerations for typical franchisors? What is the risk that a franchisee or employees of a franchisee could be deemed employees of the franchisor? What can be done to reduce this risk?

Chilean labour and employment laws and regulations do not cover a franchisor's potential relationship with the franchisees' employees.

According to the Chilean Labour Code, the employer-employee relationship requires that a physical person be engaged as an employee. In consequence it is very unlikely that a franchisee will be deemed as an employee of the franchisor, as in the majority of cases the franchisee is organised as a legal entity. In respect of the employees of a franchisee, the franchisor is safe provided it refrains from entering into a continuous, day-to-day relationship with a franchisee's employees entailing a permanent and direct oversight and control of the means and ways in which an employee performs as such. In other words, if a franchisee's employees cannot show that the franchisor exerted permanent and continuous authority over him or her, then it is very unlikely that a local labour court could rule and recognise an employer-employee relationship between a franchisor and the franchisees' employees.

- 7 How are trademarks and know-how protected?

In addition to a proper trademark registration in Chile in respect of trademarks which are part of a franchise agreement, the parties may register a short-form trademark licence with the Chilean Trademark Office to gain further protection against third party trademark infringement (section 18bis D of Chilean Law 19,039 on Industrial Property, of 1991, as amended by Chilean Laws 19,996, of 11 March 2005; and 20,160, of 26 January 2007). This procedure is not required and most franchisors do not register unless they are aware of or are particularly concerned about possible infringers. Notwithstanding, in a recent case no damages were awarded against a third party infringer for lack of registration.

The franchisor must register its trademark and logo with the Chilean Trademark Office in order to prove their validity against third parties as the concept of 'common law' trademarks is not recognised in Chile. It is sufficient to have filed for trademark protection in order to enter into a franchise agreement or other trademark licence agreement (under the abrogated Central Bank of Chile remittance guidelines, full registration of a trademark was a prerequisite to registration of an agreement with the Central Bank of Chile). It normally takes approximately six months to a year to gain full registration of trademarks assuming the applications are not contested.

We note that there does not exist a procedure through the Trademark Office to enforce third-party trademark infringement or post-expiration or termination use of the trademarks by a former

franchisee. The sole remedy is to proceed with a criminal or civil complaint and ask for a seizure order to cease the offending use.

In general, the current Law No. 19,039 provides protection by way of:

- the cessation of the acts that violate the rights on trademark protection;
- the award of damages in favour of the titleholder of a trademark registration;
- allowing for the necessary to be done so as to avoid that the infringement be sustained; and
- mandating that the court decision condemning the infringing party be published in the newspaper of choice of the trademark owner.

As for trade secrets, section 284 of the Chilean Penal Code contains provisions that subject persons or entities that misuse trade secrets and other proprietary information to up to three years in jail and a fine of up to approximately US\$902-US\$1,640 per violation. However, these provisions remain relatively untested. Notwithstanding this, and while untested, a franchisor should be able to bring a civil injunctive relief action or action for damages in a Chilean court in connection with any criminal proceedings against the infringer. Still, enforcement of trade secret restrictions may be very difficult in a Chilean court that is inexperienced in these matters.

Through the last amendment to Law 19,039, its current text incorporates sections 86, 87 and 88 and deals with trade secrets. Violation thereof will include its illegitimate acquisition, disclosure or exploitation, provided that any such illegitimate act has been incurred with the intent of obtaining profit (to include third parties) or to damage the owner of the trade secrets.

- 8 What are the relevant aspects of the real estate market and real estate law?

The Chilean real estate marketplace is very active and highly sophisticated with a relevant role being played by the real estate brokerage firms (to include multinational firms such as CB Richard Ellis, Colliers and Engel & Völkers).

Pursuant to the pertinent provisions of the Chilean Civil Code, all transfers of real property shall be effected through the execution of a public notarial deed of transfer signed by and between transferor and transferee, which has to then be recorded in the Registry of Property of the competent property registrar (location). The same requirements are applicable when real property is encumbered; the only difference being that recordal shall be in the Registry of Encumbrances of the competent property registrar.

Laws and agencies that regulate the offer and sale of franchises

- 9 What is the legal definition of a franchise?

Please see question 10.

- 10 Which laws and government agencies regulate the offer and sale of franchises?

There is no franchise law or statute in Chile. General principles on contract law as provided for in the Civil and Commercial Codes would apply. There is no governmental agency that regulates or has oversight on the offer and sale of franchises.

- 11 Describe the relevant requirements of these laws and agencies.

Please see question 10.

12 What are the exemptions and exclusions from any franchise laws and regulations?

Please see question 10.

13 Does any law or regulation create a requirement that must be met before a franchisor may offer franchises?

Please see question 10.

14 In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

Please see question 10.

15 What is the compliance procedure for making pre-contractual disclosure in your country? How often must the disclosures be updated?

Please see question 10.

16 What information must the disclosure document contain?

Please see question 10.

17 Is there any obligation for continuing disclosure?

Please see question 10.

18 How do the relevant government agencies enforce the disclosure requirements?

Please see question 10.

19 What actions can franchisees take to obtain relief for violations of disclosure requirements? What are the legal remedies for such violations? How are damages calculated? If the franchisee can cancel or rescind the franchise contract, is the franchisee also entitled to reimbursement or damages?

Please see question 10.

20 In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

Please see question 10.

21 In addition to any laws or government agencies that specifically regulate offering and selling franchises, what are the general principles of law that affect the offer and sale of franchises? What other regulations or government agencies or industry codes of conduct may affect the offer and sale of franchises?

Please see question 10.

22 Other than franchise-specific rules on what disclosures a franchisor should make to a potential franchisee or a franchisee should make to a sub franchisee regarding predecessors, litigation, trademarks, fees etc, are there any general rules on pre-sale disclosure that might apply to such transactions?

There is no express, written rule on pre-sale disclosure, although franchisors shall be advised that preliminary, pre-contract negotiations must be conducted in accordance with the general legal principle of negotiating in good faith which obliges the parties to observe their duty of loyalty to the other party during the negotiations.

23 What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises? How does this protection differ from the protection provided under the franchise sales disclosure laws?

The franchisees' most probable course of action would entail issuing civil proceedings for damages against franchisors and filing a motion before the same court to obtain that an injunction order be issued over any assets of relevant value the franchisor may hold in Chile.

Legal restrictions on the terms of franchise contracts and the relationship between parties in a franchise relationship

24 Are there specific laws regulating the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

Please see question 10.

25 Do other laws affect the franchise relationship?

Please see question 10.

26 Do other government or trade association policies affect the franchise relationship?

Please see question 10.

27 In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

Early termination of the franchise relationship will depend on the terms and conditions of the termination clause agreed upon by the parties to that relationship in the pertinent franchising agreement. In the absence of a specific termination clause in the franchising agreement, the parties thereto may initiate proceedings claiming the application of a Civil Code provision stating that the non-breaching party of a bilateral agreement may opt for demanding the forced performance of the obligation being breached or for claiming that the court rule the termination of the agreement, along with a damage claim which the law makes available regardless of the option made by the non-breaching party.

28 In what circumstances may a franchisee terminate a franchise relationship?

Please see question 27.

29 May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

Yes, if so provided in the franchising agreement. Please note, however, that pursuant to the general legal principle that the parties to

a contract shall discharge it in good faith, which obliges them to observe their duty of loyalty to the other party, damages have been granted to parties when an agreement has not been renewed on the grounds that the term of the agreement has expired, because of the terminating party's material misrepresentation of the agreement's renewal. In other words, local courts have disregarded the enforceability of term clauses if the non-renewing party has previously conducted itself in a manner leading the terminated party to believe that the agreement would be renewed upon the expiration date.

30 May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Yes, if so provided in the franchising agreement.

31 Are there laws or regulations affecting the nature, amount or payment of fees ?

No.

32 Are there restrictions on the amount of interest that can be charged on overdue payments?

Any interest rate could be challenged and held to be invalid in Chile if it exceeds the maximum conventional interest rate determined periodically by the Central (Reserve) Bank of Chile.

33 Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

Chile abrogated its Central Bank restrictions on foreign currency (US dollars in particular). Thus, there is no required permission by the Central Bank or from any other governmental agency to obtain remittance of foreign currency (US dollars in particular).

There is no legal requirement that the franchisee have the signed agreement back before it can wire monies abroad. That said, it should be noted that the Chilean taxing authorities would likely require the Chilean taxpayer, if ever audited, to provide evidence of a signed and legalised agreement in place at the time of payment in support of taking a tax-deductible expense for the payment of the franchise fee incurred as an ordinary expense necessary for the production of income. More so, Chilean taxing authorities would likely want to see a signed, notarised and legalised agreement for this purpose (based on the wording of the tax regulation). Again though, this would likely only really be an issue if the franchisee is ever audited regarding a tax deduction for the payment.

34 Are confidentiality covenants in franchise agreements enforceable?

Yes, pursuant to the pertinent general provisions of the Chilean Civil Code.

35 Is there a general legal obligation on parties to deal with each other in good faith? If so, how does it affect franchise relationships?

Please refer to questions 22 and 29.

36 Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

No.

37 Must disclosure documents and franchise agreements be in the language of your country?

No.

38 What restrictions are there on provisions in franchise contracts?

Chilean Law permits in-term covenants against competition. However, post-termination covenants against competition have been held to violate the constitutional right to work and are thus unenforceable unless the franchisee would be compensated for the relinquishment of its right to work. The appropriate amount of compensation can be determined by the parties prior to contact or by a court at the time of enforcement. A reasonable approximation of profits during the restricted time should suffice. Few franchisors actually compensate franchisees for post-termination covenants. Instead, they include post-termination covenants against competition in the franchise agreement merely for deterrence purposes because their inclusion does not void or otherwise affect the remaining provisions in the franchise agreement.

39 Describe the aspects of competition law in your country that are relevant to the typical franchisor. How are they enforced?

Chile has a Competition Law (Decree Law 211 of 1974, as amended) that has been in effect since 1974 and the only restriction that is generally applicable to franchising relates to exclusive or designated supplier provisions, which are permitted as long as they are linked to the necessity for maintaining the quality of the system.

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- 40** Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

Chile has an ordinary circuit of courts system, as opposed to the dual, federal–state US court system. It consists of:

- the first instance ordinary trial courts;
- the courts of appeals; and
- the Supreme Court, which sits in the capital, Santiago.

The ordinary trial courts are subdivided into labour courts, civil tribunals and criminal courts.

Alternatively, arbitration – either domestic or international – is also available in Chile.

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- 41** Describe the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction.

As franchising is an area of law which Chilean civil courts are not familiar with and considering further that such courts are permanently dealing with a very heavy caseload affecting the pace of ongoing proceedings, it is highly advisable that foreign franchisors prevent the foregoing by inserting an arbitration clause in the franchising agreement.

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- 42** In what respects, if at all, are foreign franchisors treated differently from domestic franchisors?

They are not.



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