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Recent Developments in International

Taxation

Ecuador

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Introduction: major tax developments in Ecuador

This year, Ecuadorian tax developments have targeted international transparency, corporate taxation and the digital economy. As a non-member of the Organisation for Economic Co-operation and Development (OECD),[1] Ecuador signed the Convention on Mutual Administrative Assistance in Tax Matters, and after its ratification released secondary regulations to enforce the Common Reporting Standard (CRS).

Regarding corporate taxation, new rules on dividends and thin capitalisation took effect. Finally, as countries have been expanding their consumption taxes to include digital goods and services, Ecuador imposed a tax of 12 per cent on the sale of digital services.

Common Reporting Standard

Under the Convention on Mutual Administrative Assistance in Tax Matters, the tax authority issued rules and procedures to obtain financial information to be exchanged. Under these regulations, financial institutions must report the different types of accounts and taxpayers covered, and follow common due diligence procedures.

The information to be reported annually follows the OECD standard. It includes interest, dividends, account balances, income from certain insurance products, deposits from the sale of financial assets and any other income generated from assets held in accounts that belong to non-residents.

The reporting duty applies to the following institutions, including Ecuadorian residents and branches of foreign companies established in the country:

- custodian institutions: any company that holds financial assets on behalf of third parties as a substantial component of its economic activity;
- depository institutions: any company that accepts deposits in the regular framework of its banking activity or similar economic activity;
- investment entities (including trusts): the regulations do not specifically define this category; and
- insurance companies: any company that is an insurance company (or the holding company of an insurance company) that offers an insurance contract with a cash value or an annuity contract, or that is thereof obliged to make payments.

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[1] In May 2019, Ecuador was admitted by the OECD Development Centre.

The aforementioned entities will require their reportable clients to provide express authorisation for their financial information to be delivered to the tax authority in compliance with international information exchange agreements or conventions ratified by Ecuador.

The due diligence proceedings will be different depending on whether the account holds more or less than $1m. Besides verifying that the account holder is resident in a foreign jurisdiction, financial institutions must require the self-certification of tax residence from reportable clients. The self-certification must be obtained prior to opening the account. However, the financial institution will not rely on the self-certification if it is already known, or there are reasons to believe, that it contains wrong information.

Income tax

Dividends

The Law for Simple Progressive Taxation amended Article 9(1) of the Internal Tax Regime Law, which regulates income tax exemptions for dividends, effective as of 1 January 2020. Since the Law for Simple Progressive Taxation came into effect, every dividend paid to Ecuadorians (with the exception of entities) and foreigners (either entities or individuals) is subject to income tax in Ecuador.

The taxable income corresponds to 40 per cent of the dividend distributed and the tax rate varies as follows:

- a tax rate of 25 per cent will apply to a non-resident provided that there are no Ecuadorian resident individuals as beneficial owners;
- a progressive tax rate of up to 25 per cent will apply to individual Ecuadorian tax residents; and
- a tax rate of 35 per cent will apply if the distributing entity does not comply with its annual obligation to report the shareholding structure to the tax authority.

Thin capitalisation

Ecuador changed the rules for the deductibility of interest paid on foreign indebtedness with a high debt-equity ratio. Before the Law for Simple Progressive Taxation was enforced, that is up to December 2019, the thin capitalisation rule restricted the tax deductibility of interest paid to related parties when the amount of debt exceeded 300 per cent of the target’s equity.

Under the new Law, interest on loans granted by related parties will be deductible if it does not exceed 20 per cent of the earnings before employee profit-sharing plus interest, depreciations and amortisation for the corresponding fiscal year. The older rule applies only to the financial sector of the Popular and Solidarity Economy, banks and insurance companies for which interest on external loans granted directly or indirectly by related parties will be deductible if it does not exceed 300 per cent of equity.

In all cases, the interest paid in excess of the aforementioned percentages will not be deductible.

VAT

VAT on the sale of digital services was enacted on 31 December 2019. As countries have been expanding their consumption taxes to include digital goods and services, Ecuador decided to implement a tax of 12 per cent on digital services (not yet defined as the regulations are still pending) rendered by foreign providers, which will be triggered at the time of payment.

A zero per cent tax rate will be applicable to the provision of web page domain names, hosting services and cloud computing services.

Delivery and dispatch services agreed digitally are also treated as digital services, with the commissions being taxable for VAT purposes.

Starting 180 days after the law was enacted, the tax will be paid by the supplier provided it has been duly registered at the Internal Revenue Service. If the supplier is not registered, the tax will be withheld at the time of payment by the credit card issuer or other payment intermediary.

In the case of non-resident companies, the tax authority implemented a registration process that involves: (1) obtaining an identification number as a VAT collection agent; (2) filing evidence of legal existence; (3) obtaining a password to access the web page and electronic media of the tax authority.

The tax authority will publish a database of digital service providers on its website. If a non-resident service provider is not registered, the user or the intermediary, if any, will be held liable.

There are more regulations on the horizon as addressing compliance and enforcement is a challenge in the digital arena.

Treaties to avoid double taxation

Ecuador has 20 tax treaties. It has expanded its network of bilateral tax treaties, and in 2019, the treaties signed with Russia and Japan came into effect, and in 2020, the Protocol amending the Tax Treaty with Switzerland came into effect, which includes a provision on the exchange of information on request according to the internationally applicable standard.

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