THE TAXATION OF DIVIDENDS IN ECUADOR

Marlon Manya Orellana

SYNOPSIS

This article focuses on how the tax system deals with dividends in Ecuador. To this purpose, it begins with a brief definition of the term from several perspectives: Legal, economic, financial and fiscal. The source principle is analyzed for determining the tax to be applied thereon, the use of treaty shopping and the beneficial owner as avoidance mechanisms, and the normative analysis of the Ecuadorian legislation in their treatment, including a case study on the issue of withholding.

The Author: *Economist Degree from the Escuela Superior Politécnica del Litoral - ESPOL. Master in Applied International Relations, International University of Andalusia. Master's Degree in Public Finance and Financial Management. Instituto de Estudios Fiscales Madrid Spain. Professor at the Faculty of Natural Sciences and Mathematics FCNM ESPOL. Former Head of Planning and Management Control SRI. Former Director of BCE Economic Research. Former Director of Control Management of the APG concessionaires. Former General Director of HTMC IESS. Winner of the IV Edition of CIAT, AEAT, IEF Research Grant. Researcher of GRIDE Research group and Economic Teaching.*

Content

According to the dictionary of the Real Academia Española, the term dividend refers to the "quantity to be divided by another", which, if considered as active dividend, determines the " quota corresponding to each share of a mercantile company distributing its profits", while if considered as passive dividend refers to "each partial quantity that the subscriber of a share or bond promises to satisfy at the request of the issuer".

From a legal perspective, this term is used in commercial law, financial and stock market law, accounting law and tax law. From an economic and financial point of view, it is used to describe a flow of assets of an entity to its owners, established by the opportunity cost of capital, pursuant to the economic rights of their shares.

"Dividends" usually means profits distributions made to shareholders or business partners by limited companies or limited liability companies. In the first case through stocks, while in the second case through shares. Therefore, for the stockholders or shareholders, dividends constitute income from capital contributed to the society.

The Organization for Cooperation and Economic Development (OECD) in its Model Tax Convention on Income and Capital, article 10, expresses in the third paragraph: "The term "dividends", as used in this article, means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in the profits, as well as income from other corporate rights which is subjected to the same taxation as income from shares by the laws of the State of which the company making the distribution is resident."

Because of the diversity of laws among OECD member countries, it is not possible to offer a complete and exhaustive definition of the concept of dividend. Therefore, the definition in article is limited to examples contained in the majority of these laws and, in any case, are not treated differently. Another commonly used model is the one of the Andean Community (CAN), which in its Decision 578 deals with the regime to avoid double taxation and prevent tax evasion, where the taxation of the "dividends and shares" of companies is limited by regulation; where these will be only taxed in the country where the company that distributes them is domiciled, thus excluding the tax on the basis of the principle of residence, in order to avoid double taxation; However, there is no definition provided for these terms.

What we can see within the comparative tax law, is that the distributions of benefits from shares result from participating in a company whose responsibility is limited to its shares, and their taxation will depend on the tax authority of each State to tax or not certain revenues, in this case from the capital, such as the dividends.

In the tax regulations of Ecuador, after article 7 of the regulation for the implementation of the Internal Organic Tax Law, a non-numbered article defines the term dividend: "For tax purposes, all types of participation in profits, surplus, profits or similar that are obtained based on rights representing capital held by the beneficiary, directly or indirectly, shall be deemed dividends and will have the same tax treatment “.

It should be noted that, given the existing standard, capital rights or titles or ownership rights shall be understood as any type of entity, assets or any term appropriate according to the nature of the society, with determined monetary value, such as shares, participations, and land rights, among others. Therefore, the holders or beneficiaries of these rights will be the shareholders, partners, participants, beneficiaries or similar. The amplitude of this last definition show that incomes which in principle are not dividends for commercial purposes could be considered as “implied dividend” or failing this, “covert distributions of dividends” from a tax point of view.

International tax law provides three elements relating to the concept of dividend:

- The existence of an entity distributor of dividends, to which the profits are attributed.
- Participation in such an entity that gives right to distributed income.
- The relationship between the source and the return, which is what the doctrine has called “societatis causes”, i.e., the link between what is paid by the company and the participation in the company.

1. THE SOURCE PRINCIPLE TO ESTABLISH THE TAXATION ON DIVIDENDS

The development of the income tax has been influenced by two economic theories of income: Firstly the theory of source whose origin lies in the Roman law (income resulting from fruits of capital goods), and second theory of the net accumulation which gives form to the traditional concept of the global income tax, based on the concept of income by Schanz-Haig-Simons. This concept of global income focuses on the “net accumulation of economic power of a subject between two temporary references”. On the other hand, the theories of source include only the income from the source, or the source itself, and exclude capital gains and losses resulting from the sale of the source. In the current income tax of many countries, the tax base is a mixture of theories of accumulation and source, in the best of cases completed by a separate regime for capital gains and capital losses.

In that sense, the design of the income tax requires to define the source of the dividends for the purpose of determining the real obligation to contribute, which will be directly the property of the company’s shares, but indirectly the activity that generates the benefits of society. Within the tax allocation criteria, this could be understood as the state of residence of the company that distributes, where the shares are registered, or where the payment obligation is fulfilled.

The tax residence is determined by factors such as the place of constitution of the company, its commercial address or the place of its effective management. However, if one takes into consideration that the source of income is the underlying economic activity, the objective criterion is what has been called “origin”, that is, the place where the profit from which dividends are derived is obtained. In other words, the origin of the economic benefits of the company paying the dividends is not necessarily in the entity that distribute them, but where the capital is generated.

In relation to this idea, the Committee on Fiscal Affairs of the OECD has expressed its views in the comments of article 10, indicating that there is no exclusive right to tax dividends in the State of residence of the beneficiary or in the residence state of the society that pay the dividends. The exclusive taxation of dividends in the Source State is not acceptable as a general principle. There is also a certain number of States that do not tax the dividends at the source, while, as a general rule, all States tax residents for the dividends obtained from corporate non-residents. It is not possible, either, to establish as a general rule the exclusive taxation of dividends in the State of residence of the beneficiary. This taxation would correspond better to the dividends that are obtained income from movable capital. But it would not be realistic to expect that the taxation of dividends at the source would be abandoned. For this reason, the Committee only states that dividends may be taxed in the State of residence of the beneficiary.

Adopting the criterion of the Source State, we can observe an economic double taxation, since the entity (resident) that distributes the dividends paid the corporate income tax for the fiscal year; While at the same time, the individual or legal entity that shares the company's capital (shareholder) receives these benefits that have already been taxed, and the dividends are also included as part of their global income. This is a situation that good international tax practice recommend to correct through the exemption methods (total or escalated) , to consider these income from dividends as exempt from tax income, or through the method of allocation (full or regular), giving shareholders a tax credit corresponding in proportion to the tax paid by the institution that distributes the dividends. The exemption method solves many of the problems posed by the allocation method, which contrary to the principle of simplicity that a good tax system should adopt.

The two other methods increasingly used in order to minimize taxation and eliminate economic double taxation are: The underlying tax credit, and the deduction for unpaid taxes (tax sparing).

- The first option makes possible that in tax compensation, those who have paid from an economic point of view, and not only those who have contributed legally as taxpayers are taken into account. In the case of dividends, it can be admitted that a shareholder will benefit from a tax credit for the income tax paid by the institution distributing the dividends, in the part corresponding to the received dividend, and this in addition to the tax credit that corresponds for the double taxation resulting from taxation through the income tax dividends withheld at source. It should be noted that the problem of their double taxation is avoided, provided that the tax credit is not subject to limitations.

- The second is a tax benefit consisting in the recognition of existing tax incentives or specific exemptions typified in the law. It aims to attract investments, exclusively benefiting to the investor taxpayer. A variety of this tax benefit is the matching credit that supposes the concession of a tax credit for unpaid taxes, which can be more effective than the tax benefits recognized in the source income country.

As a good practice in international tax matters, the valuation of the described methods cannot stand against basic tax principles such as neutrality and equity. Tax neutrality refers to the relationship between taxes and the goal of economic efficiency. The purpose is that the tax should not affect, or do so at the lowest possible degree, the efficiency of economies, allowing resources to be allocated to their most productive uses, so that such assignment is the answer to real differences in costs and rates of return, and not a response to differences between taxes.

In the field of the taxation of capital revenue, such as dividends, and in a situation of international mobility of these revenues, the concept of tax neutrality requires that the tax burden on capital should not be altered by the location of investments that would take place in the absence of taxes. For this reason, it is said that the exemption methods aim at obtaining neutrality in the importation of capital: In the State hosting the foreign investment, all investments made in its territory keep the same degree of effective taxation, regardless their origin, which promotes foreign investment.

Conversely, the imputation system achieves the neutrality in the export of capital when all residents of a State support the same effective taxation on their obtained incomes, regardless of their origin (national or foreign), which overrides the interest of investing in countries other than the residence of the investor only for tax purposes. For Ecuador, being an importer of capital, from the perspective of the country host of the investment, the tax administration should ensure efficiency in the international localization of the capital, favoring fair competition and preventing discrimination.

Likewise, the criterion of taxation at source is the most often used to achieve international equity; This means, that the country at the origin of income has a legal priority to tax it, even when the income recipient factors are not residents of that source country, but the definition of the tax base as part of the global income and the tax rate can cause issues. Therefore, the economic double taxation of dividends can cause distortions in the efficiency of the allocation of resources, in the corporate composition, in the choice of its financial structure, investment decisions, policy dividends, at the level of private savings. The system based on the integration of the company's taxation and the shareholders' taxation allows reducing, but not eliminating, this problem.

2. TREATY SHOPPING AND THE BENEFICIAL OWNER

Treaty Shopping, also called treaty purchase, is a mechanism of tax avoidance, which usually is related to international agreements to avoid double taxation, and can be defined as incorrect or abusive use of conventions of double international taxation, which occurs when residents of a third State create a legal entity in one of the two contracting countries in order to benefit from the reduced rates of withholding or other tax benefits, to which they would have no right if acting directly.

Notwithstanding that, this can also take place by using loopholes in the internal law for the application of exemptions and tax incentives in force. For that operation to make sense, intermediary companies that are created or used to reduce the taxation in the source State, subject to no taxation or a minimum taxation amount, while the accumulated profits in the intermediary company, when they are distributed, regardless the method used, should not be subject to real taxation in the State of residence of that company. This type of economic-financial structures takes its name from conduit companies, or instrumental companies or also called intermediate corporate holdings, which form part of the equity capital of the dividend distribution entity, and once they have paid the corporate income tax, the dividends obtained will be exempt from income taxes for these intermediary companies. Usually, behind this operation, there is a shareholder resident who owns these resources, and has evaded the tax payment. Their use intend to optimize the taxation of dividends and capital gains as a result of the holding of shares in the capital of resident companies which can even be domiciled in different States.

Article 10 of the OECD Model Tax Convention on Income and Capital, in its sections 1 and 2, states the following:

"1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

   a. 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends;

   b. 15 per cent of the gross amount of the dividends in all other cases.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid".

In this way, we can indicate that in agreement with the OECD model, some taxation power is reserved to the source State of the dividends; that is, the state of residence of the company paying the dividends; However, this right to collect the tax is limited considerably. The tax rate cannot exceed 15%. A higher rate is not justified, given that the source state has already been able to tax the corporate benefits.

The section 4 states the following: " 4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, holds a business in the other Contracting State of which the company paying the dividends is a resident through a permanent establishment situated therein and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment...

The beneficial owner condition was incorporated in paragraph 4 of article 10 of the OECD Model, to explain the meaning of the words "paid to a resident", the Committee on fiscal affairs of the OECD concluding that a conduit company cannot be considered in normal situations as the beneficial owner, what should conduct a thorough analysis of the powers of that conduit on the obtained incomes.

The Financial Action Task Force International FATF designates as beneficial owner "the individual(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is made." It also includes those persons who exercise ultimate effective control over a legal person or arrangement". The treatment of the concept goes far beyond a simple conclusion to find the actual individuals behind possible corporate and involves a widespread study of their transactions, their accounting, their tax contributions, etc. The important part of this approach lies in showing the true background of participants in companies.

The expanded FATF recommendations require to establish mechanisms for accessing a comprehensive information of companies, as well as their real beneficiary. To this effect, the different legal definitions of companies must be identified, the processes of creation of such legal entities must be verified, with the respective collection of information concerning the beneficial owner, information and previous data on public access database. We must include the necessary international cooperation so that the authorities of different countries can access the databases collecting the information on the beneficial owner of each national society, and the exchange of information on the tax, corporate, banking and commercial information of the taxpayer

From the entry into force of the law of incentives to production and prevention of tax fraud in Ecuador; that is, from January 1, 2015, to the regulations for the enforcement of the internal tax regime, a non-numbered article has been added after article 7, defining the beneficial owner:

> “Art. (…). “- **Beneficial owner**.- “for tax purposes, the beneficial owner is understood as the one who legally, economically or in fact has the power to control the allocation of the income, benefit or utility as well as to use, enjoy or dispose of it”.

The essential elements of the beneficial owner are similar characteristics that a tax resident of a Contracting State in a Convention to avoid double international taxation must have, conditions to apply a reduced rate of withholding on dividends from income, in this case. This beneficial owner must be able to use, enjoy and dispose of the total use of resources, without limitation, also demonstrating the essence of his personality. I.e. that he is holder of the rights acquired by the registrant, as well as the intellectual property rights, and credit rights, among others. And is not legally obliged to transfer such income; that is, the exclusivity of ownership over them.

In an illustrative way, in order to identify the beneficial owner, we can mention that in first instance the stock percentage of a company must be verified, i.e. If they control more than 25% or 50% of the shares, we could observe a partial or absolute control respectively, and by contrast, after observing a transaction log, when a company sells or trades only with another company and not with any other, this will help to understand if we are facing the beneficial owner or a simple transfer agent. Specifically, both cases are described in our tax legislation on possible relations regarding control of companies or related parties.

3. ANALYSIS OF THE TAX TREATMENT OF DIVIDENDS IN ECUADOR

3.1. Internal Taxation Act

In Ecuador, article 8 of the Organic Law of Internal Revenue (Spanish: Ley Orgánica de Régimen Tributario Interno), considers earnings and dividends distributed by incorporated companies or companies established in the country as Ecuadorian source income.

Article 9 of the Organic Law of Internal Revenue, in its first paragraph, indicates that: “Dividends and profits, calculated after the payment of the income tax, distributed by national or foreign companies resident in Ecuador, in favor of other national or foreign, companies, not domiciled in tax havens or jurisdictions of lower taxation or individuals not resident in Ecuador.

This exemption does not apply if the beneficial owner, in the terms defined in the regulation, is an individual resident in Ecuador.

“Also will be exempt of the income tax, the dividends in shares that are distributed as a result of the application of the reinvestment of utilities in the terms defined in article 37 of this law, and in the same proportional relationship.”

It is necessary to clarify that by definition, dividends are exempt from income tax revenue, a situation allowed by the domestic tax legislation. However, one of the amendments to this law, as of January 1, 2010, excludes from this exemption foreign corporations domiciled in tax havens and individuals resident in Ecuador. Among the justifications given to this reform, there is the change in the table of the income tax on individuals with the Tax Equity Act of Ecuador (Ley de Equidad Tributaria del Ecuador, effective from January 1, 2008), which maximum percentage on the surplus fraction reached 35%, while on the other hand, the maximum corporate income tax rate was kept at that time at 25%.

This surplus to the tax authorities is regarded as a revenue, since the shareholder did not include it in his global income, because according to the control agency, personal income was disguised in the form of corporate income.

Notwithstanding this, on this last aspect, dividends and profits of companies distributed in favor of individuals resident in the country will be part of their global income, situation that causes for them an economic double taxation, because the company which distributed dividends has already paid the tax corresponding to the income obtained by the companies obtained in the fiscal year; while at the same time, the resident individual in Ecuador (shareholder), who receives these benefits, will be subject to withholdings at source from the income tax in respect of dividends.

Product of various avoidance practices used by conduit companies, instrumental companies or also called intermediate holdings companies, which form part of the capital stock of the entity distributor of dividends: the resident shareholder who holds these resources as beneficial owner, and has evaded payment of the tax, is also excluded from this exemption since January 1, 2015, in accordance with the Law of Incentives to Production and Prevention of Tax Fraud.

A third important aspect that this law considers, refers to the types of dividends that can be paid in cash or in shares. A cash dividend is paid by a company in the form of cash payment to each shareholder of a fixed amount per share. Thus, each shareholder receives a payment based on his or her number of shares. However, there are also dividends paid in shares, which shareholders receive in the form of shares, newly issued or not. Distributing this dividend represents a decrease of reserves and an increase in capital accounts As a result, cash dividends are therefore different from dividends in shares, which are paid to the holders of ordinary shares through additional shares from the social capital of the company.

Analyzing the case from a tax point of view, with the current standards, there is a different tax treatment, the cash dividend constitutes an income taxed to the partners or resident shareholders in Ecuador, and is part of their global income; this dividend is subject to income tax withholding at the source by the distributing company, which must deliver proof of the corresponding withholding, within the five days following its date.

On the contrary, when new shares are received from the company, the partner or shareholder registers a capital increase, raising the percentage of participation in the company capital, and this would not be subject to withholding since the company is not making any payment or crediting an account in the name of the partner or shareholder at the time of distribution of the dividend; and therefore, taxation is postponed until the moment that the shares are sold, since it is at that time that the taxable fact takes place. We must remind that profits from direct or indirect sales of shares, participations, or other capital representation rights or other rights that allow the exploration, exploitation, concession or similar of companies domiciled or permanent establishments in Ecuador, constitute income of Ecuadorian source.

The payment of dividends in shares is part of the flexible remuneration forms, which include other in-kind payments such as the granting of subscription rights, compensation for passive dividends, among others. The granting of the right to choose the form of remunerating the shares to the partner, who can opt for a payment in shares or subscription rights or shares, is referred to as scrip dividend.

The partner or shareholder resident in Ecuador, however, must inform the tax administration regarding his statement of assets considering for the calculation, the percentage that corresponds to him or her in the marital or common-law union members, and of their non-emancipated children.

3.1.1. Loans to shareholders

Article 37 of the tax law excludes this practice: "When a company grants financial loans to its partners, shareholders, participants or beneficiaries, or any non-commercial loans to its related parties, this operation shall be considered as payment of advance dividends and, therefore, the company must perform the corresponding withholding on the transaction amount, at the corporate rate specified."

"Such withholding shall be declared and paid the month following the operation within the time limits provided for in the regulation and shall constitute a tax credit for the company on its income tax return"

3.2. Rules for the application of the Organic Law of Internal Revenue

Article 15 of the regulation for the implementation of the Organic Law of Internal Revenue, states: "In the case of dividends and profits calculated after the payment of the income tax, distributed by national or foreign companies or resident in Ecuador, in favor of other national or foreign companies, not domiciled in tax havens or jurisdictions of lower taxation, or of individuals not resident in Ecuador, there will be no withholding or additional income tax payment." This provision will not apply if the beneficial owner of the income is an individual resident of Ecuador.

Notwithstanding the foregoing, the tax administration may determine the obligations of the beneficial owner and of the withholding agent when, due to being related parties or any other circumstance, the withholding agent would know that the beneficial owner is an individual resident in Ecuador.

Dividends or profits distributed directly or through intermediaries in favor of individuals resident in Ecuador constitute taxed income for those who collect them, and therefore the corresponding withholding at source must be performed by those who distribute them. The withholding percentage shall be established by the internal revenue service through resolution within the legal limit.

Where dividends or profits are distributed, directly or through intermediaries, in favor of companies residing or established in tax havens or jurisdictions of lower taxation, the corresponding income tax withholding at source must be performed.

The value on which the withholding established by this article shall be calculated will be the one which should be considered as income taxed within the global income, i.e., the distributed value plus the tax paid by the company, corresponding to that distributed value.

Regarding the tax base for the income tax of the company, in the fiscal year corresponding to the dividends or profits distributed, a proportional rate will be applied if they had a corporate composition corresponding to tax havens or jurisdictions of lower taxation of less than 50%, the tax attributable to dividends that correspond to that composition will be 25%, while the tax attributable to the rest of dividends will be 22%."

According to the law on internal tax procedure in its article 9, first clause, the distribution of dividends or profits calculated after the payment of the income tax, in favor of individuals resident in Ecuador is taxed and subject to the payment of such a tax; i.e., paid by the partners or shareholders.

For the calculation of the overall income for dividends; the company's taxable base and the corresponding distributed value will be considered, plus the tax paid by the society corresponding to this distributed value.

Article 37 of the Organic Law of Internal Revenue considers the corporate income tax rate, indicating: "Companies incorporated in Ecuador, as well as branches of foreign companies domiciled in the country and permanent establishments of non-resident foreign companies will pay a 22% rate on their taxable income.” However, the tax rate will be 25% when the company has shareholders, partners, partners, constituents, beneficiaries or similar resident or established in tax havens or regimes of lower taxation with a participation, direct or indirect, individual or joint, equal to or greater than 50% of the capital stock, in agreement with the stipulations of the regulation...”

Article 137 of the regulation implementing the Organic Law of Internal Revenue gives the possibility to consider the tax credit for utilities, dividends or profits distributed to resident individuals. To consider as tax credit the income tax paid by the company, in the case of utilities, dividends or profits distributed to resident individuals in Ecuador, the following considerations will be taken into account:

a. Within the global income, the value distributed plus the tax paid by the society, corresponding to that value distributed, is considered as taxable income, regardless the bookkeeping obligation.

b. The tax credit cannot exceed any of the following values.

    i. The tax paid by the company corresponds to the dividend.

    ii. The value of the taxable income multiplied by the rate of 22% or 25%, as has been applied to profits from which dividends originated.

    iii. The income tax that an individual would pay for that income within his or her global income, i.e., the difference resulting from subtracting the tax caused on its global income including the value of the utility, profit or dividend, minus the tax caused on their global income if the revenue, profit or dividend had not been considered.

c. When a same dividend, profit or benefit is obtained through more than one company, the tax paid by the first company that distributed it shall be considered as a tax credit.

d. In case the company that distribute the profits, dividends or benefits, within its tax reconciliation had right to some incentive or tax benefit or include tax-exempt income, under provisions of the law on tax procedure, the beneficiary individual can use as tax credit the value of income tax that the distributing company would have had to pay, if it had not applied some of these exempted income, incentives or tax benefits, without prejudice to the limits established in clause b) of this article. This provision shall not apply to those cases in which the dividend, utility or benefit is paid or credited to shareholders domiciled in tax havens or preferential tax regimes.

e. in any case, when companies that distribute utilities, dividends or profits, are requested to inform the recipients of the income, in the terms defined by the Internal Revenue Service, about the value to be considered on their global income and the tax credit they are entitled to, inclusive for the case referred to in clause c) of this article.

3.2.1. Anticipated dividends.

Article 126 of the implementation rules of the Organic Internal Tax Law, refers as follows to the withholding for anticipated dividends or other benefits: “When a company distribute dividends or other benefits with charge to earnings in favor of their partners or shareholders, before the end of the financial year and, therefore, before that the results of the activity of the company are known, the company should perform the withholding at the general rate of the corporate income tax, except when the beneficiary is resident or established in a tax haven or lower taxation regime, in this case the 25% rate will apply on the total amount of such payments.

Such withholding shall be declared and paid the following month and within the time limits provided for in this regulation and shall constitute a tax credit on for the company on its income tax return.

This withholding will not proceed when the dividends ore anticipated dividends are distributed by a company who whose purpose is exclusively shareholding, in which case only the withholding established in article 15 applies".

4. SUBJECTS TO WITHHOLDING FOR THE INCOME TAX ON DIVIDENDS

Among the subjects of income tax withholding for dividends are:

1. If the distribution is in favor of a resident company or established abroad which is NOT located in a tax haven jurisdiction of lower taxation or preferential tax regime whose beneficial owner is a resident individual in Ecuador, the said income is taxed to whom it is distributed, therefore it is subject to a withholding proportional to the dividend. This will also apply in the case of non-compliance with reporting the composition of the company.

2. If the distribution is in favor of a company resident or established in Ecuador, the revenue will be exempted for the company, and therefore is not subject to the income tax withholding, even if the beneficial owner of the company is resident in Ecuador

3. If the distribution is in favor of a company resident or established abroad, unless in a tax haven, jurisdiction of lower taxation or preferential taxation, income are exempt and therefore will not be subject to income tax withholding provided that the beneficial owner is a non-resident in Ecuador.

4. If the distribution is in favor of a company resident or established in a tax haven or lower taxation or preferential taxation jurisdiction, the income is taxed, therefore, it is subject to income tax withholding.

5. If the distribution is in favor of a resident individual in Ecuador, the income will be taxed and subject to withholding. He must consolidate it in his global income, declare and pay the tax on all of his or her income.

6. If the distribution is in favor of a NON-resident individual in Ecuador, the income is exempt and is not subject to withholding.

Table 1

Table 1. Tax Treatment of dividends in Ecuador

RECEIVER OF DIVIDEND	BENEFICIAL OWNER	DIVIDEND	% WITHHOLDING
EXT. COMPANY NO TAX HAVEN	ECUATORIAN	TAXED	
EXT. COMPANY. NO LOW TAXATION	ECUATORIAN	TAXED	
COMPANY ECUATORIANA	ECUATORIAN	EXEMPTED	0%
EXT. COMPANY NO TAX HAVEN	FOREIGN	EXEMPTED	0%
EXT. COMPANY. NO LOW TAXATION	FOREIGN	EXEMPTED	0%
EXT. COMPANY NO TAX HAVEN	ECUATORIAN	TAXED	
EXT. COMPANY. NO LOW TAXATION	ECUATORIAN	TAXED	
EXT. COMPANY. PARAISO FISCAL	FOREIGN	TAXED	10%
EXT. COMPANY. LOW TAXATION	FOREIGN	TAXED	10%
INDIVIDUAL	ECUATORIAN	TAXED	
INDIVIDUAL	FOREIGN	EXEMPTED	0%

Source: Resolution NAC-DGERCGC15-00000509 SRO 545 of July 16, 2015
Elaboration: By author

In this regard, the resolution NAC-DGERCGC15-00000509 shows us how the withholding must be calculated by companies resident or established in Ecuador, if they distribute dividends to individuals resident in Ecuador or to companies residing abroad, not located in tax havens, lower taxation or preferential tax regimes jurisdictions, but having a beneficial owner resident in Ecuador.

For this calculation the dividend distributed to each shareholder or partner should be added to the tax paid by the company that distributes it, attributed to that dividend; on this item shall apply the income tax for individuals, according to the table of the Internal Tax Law, article 36, clause a).

Finally, based on this result, companies must subtract the tax credit to which the resident individual in Ecuador is entitled, in accordance with the provisions of article 137 of the regulations for the application of the Internal Tax Law. The value thus obtained will be withheld at source by the company that distributes the dividend and should be reported in the corresponding withholding statement.

Graph 2

Calculation of dividend income tax withholding at source

TAX BASE (BI)	$ 500.000,00
Income Tax (IR)	$ 110.000,00
Profit after tax (UDI)	$ 390.000,00

Shareholder	Nationality	% Share holding
Pepito Piguave (INDIVIDUAL)	Ecuatorian	40%

Distributed value for dividends	$ 156.000,00
ITax paid by the Company corresponding to those distributed values	$ 44.000,00
Income tax (Global income)	$ 200.000,00

Article 36 LORTI (Tax year2015)	$ 52.999,50

Article 137 RALORTI. (-) Tax credit for dividends	
1)	$ 44.000,00
2)	$ 44.000,00
3)	$ 52.999,50

Value to withhold for dividends	$ 8.999,50

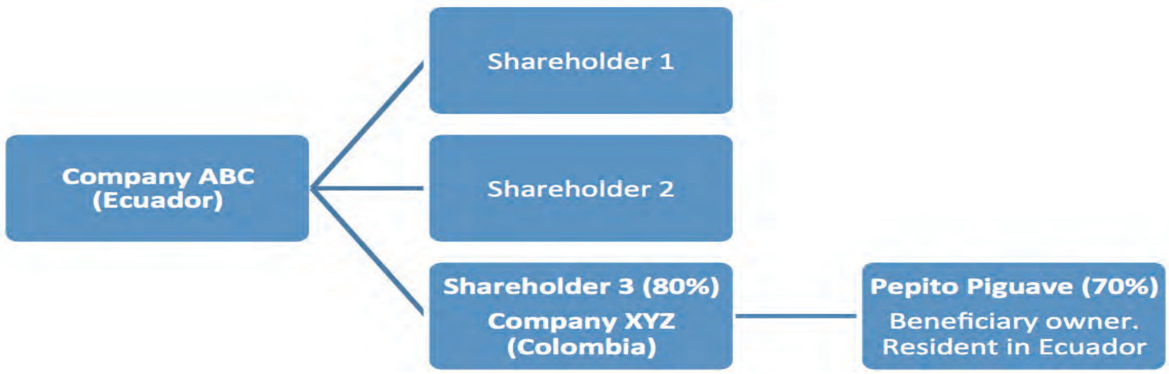
Source and development: By author

In the case of dividends distributed to residents companies, or established in tax havens, lower taxation or preferential tax regimes jurisdictions, on the part on which the company distributing dividends has been taxed with the 25% rate, the withholding will be 10%, applicable to the sum of the value of the dividend, plus the tax attributable to this dividend.

Let's take the example for ABC Company resident in Ecuador, which distributes dividends to its shareholder the company XYZ, domiciled in Colombia, which has a percentage of 80% of the shares, and with Pepito Piguabe, tax resident in Ecuador, as one of its shareholders, with a shareholding of 70%, making him beneficial owner, according to the normative of Ecuador.

Graph 3

Calculation of the withholding at source for the income tax for dividends when the beneficiary owner is resident in Ecuador



THE WITHOLDING AT SOURCE WILL DEPEND ON THE PARTICIPATION OF THE BENEFICIARY

COMPANY ABC (ECUADOR))

TAX BASE (TB)	$ 1.000.000,00
Income tax (IT)	$ 220.000,00
Profit after taxes	$ 780.000,00

Shareholder	Nationality	% Shareholding	Observations
Company XYZ	Colombian	80%	The Company composition includes Pepito Piguave as beneficiary owner. Tax Resident in Ecuador with a shareholding of 70%.

Dividend corresponding to the beneficiary owner	$ 436.800,00	Corresponding to profit after tax: 780,000 multiplied by the shareholding of COMPANY XYZ (80%) and the shareholding of beneficiary owner Pepito Piguave (70%)

Tax corresponding to the beneficiary owner	$ 123.200,00	Corresponding to the income tax paid by the company that distributes the dividends 220,000 multiplied by the shareholding of COMPANY XYZ (80%) and the shareholding of the beneficiary owner Pepito Piguave (70%)

TAX BASE (BENEFICIARY OWNER)	**$ 560.000,00**

Article 36 LORTI (Fiscal period 2015)	$ 178.999,50
(-) Tax credit for Dividends	$ 123.200,00
Value to withhold for Dividends	$ 55.799,50

Source and development: By author

The ABC company, which distributes the dividends in Ecuador, will have to withhold on the taxable base value calculated for the beneficial owner, applying article 36 of the Organic Internal Tax Regime Law (Income tax table), and discounting the tax credit for dividends, in this case, the tax paid by the society that generated and distributed dividends in proportion to the taxed and declared dividend, the value of $55,799.50 being withheld for dividends, which results from the difference between $178,999.50 and the tax credit for dividends of $123,200, by application of the income tax table corresponding to the fiscal year 2015.

4. CONCLUSIONS

- In view of the diversity of laws of OECD member countries, it is not possible to offer a complete and exhaustive definition of the concept of dividend. Therefore, the definition is limited to the examples contained in the majority of these laws and, in any case, are not treated in them in a different way.

- The exclusive taxation of dividends in the State of source is not acceptable as a general principle. In addition, there are also a number of States that are not taxing dividends at the source, while, as a general rule, all States tax residents for the dividends obtained from non-resident companies.

- It not possible, either, to establish as a general rule the exclusive taxation of dividends in the State of residence of the beneficiary. This taxation would correspond better to the dividends of income from movable capital. But it would not be realistic to expect that the taxation of dividends at the source would be completely abandoned.

- Adopting the criterion of the Source State, we can observe an economic double taxation, since the entity (resident) that distributes the dividends, has paid the corporate income tax in the fiscal year; While at the same time, the individual or legal entity, shareholder of the company capital, who receives these benefits that have already been taxed, includes dividends as part of its global income

- The best international tax practice recommends to correct this via exemption methods, considering these incomes from dividends as income tax exempt, or through the allocation method, giving shareholders a tax credit for the proportion corresponding to the tax paid by the entity distributing the dividends.

- In Ecuador, the ordinary imputation method is used, as a mechanism to counteract the economic double taxation which arises when distributing the dividend to the shareholder, individual resident, which attenuate the issue but does not eliminate it.

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