The Double Taxation within Ecuador and its Legal Affections

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Abstract: In recent decades, society has been part of a process of internationalization in all areas of human activity, known as globalization which has highlighted a growing economic interdependence among all countries, so, the importance of conducting an analysis of the impact of double taxation in Ecuador and its legal effects that implies applying the Double Taxation Agreement (DTA) in tax collection. For this reason, the legal regulations on which International taxation in Ecuador is based have been reviewed as well as basic concepts of international, legal and economic double taxation, the causes of double taxation, tax evasion and taxation elusion. With this, it was possible to have a clearer idea about the legal part and what is the scope of the bilateral and multilateral agreements that Ecuador has. Subsequently, it has been revised by reviewing the methods that the domestic legislation of each country has established to avoid double taxation between states and making a later analysis of the agreements that Ecuador has with Spain, Chile, Canada and with the Andean Community (CAN). Finally, two examples have been presented in which it is clear what is the impact on the tax collection that Ecuador suffers in terms of withholding taxes for the DTA.

Key words: Globalization, double taxation, tax collection, DTA, CAN, tax evasion and taxation elusion

INTRODUCTION

In order to maintain current agreements to avoid double taxation, Ecuador is regulated according to the following legal basis constitution of the Republic of Ecuador Art. 24 “The constitution is the supreme norm and prevails over any other of the legal system. The rules and acts of the public power must maintain conformity with the constitutional provisions otherwise they will lack legal effectiveness”.

Tax Regime Law: Art. 48 “Withholdings at the source on payments abroad”. Those who make payments or credits in account abroad which constitute income taxed by this law, directly through compensation or with the mediation of financial entities or other intermediaries will act as withholding agents in the source of the tax established in this law. If the payment or credit in account made does not constitute an income taxed in Ecuador, the expense must be certified by reports issued by independent auditors that have branches, subsidiaries or representation in the country.

The internal revenue service will establish by resolution maximum amounts or other formal requirements, general or by type of income, so that, they automatically apply the benefits provided in the agreements to avoid double taxation. If the amounts are exceeded or the requirements are not met, the benefit will be applied through the tax refund mechanisms.

Reimbursements of fees, commissions and royalties will be subject to withholding at the source of the income tax (Ley de Regimen Tributario Interno, LRTI “Internal Tax Regime Law”).

Agreements that Ecuador maintains with other States to avoid double taxation: Germany, Argentina, Belarus, Belgium, Brazil, Canada, Chile, China, Korea, Spain, France, Italy, Mexico, Romania, Singapore, Switzerland and Uruguay, Andean Community (Peru, Colombia and Bolivia).

The international double taxation: To get an idea of what double taxation is some definitions of some jurists are cited, for example: According to, Lopez Freyle (1962) “International double taxation arises when the laws of two
The double taxation and the economic double taxation: According to Marquez (1999) states, “That the economic double taxation is used to describe situations in which the same income or the same capital is subject to taxation during the same period but by different taxpayers and even by different taxes but fall on the same taxable matter, this phenomenon has been considered as (absence of identity in the subject) differentiating it from the double legal taxation where there is identity in the taxpayer in the two taxes”.

An example where the economic double taxation is presented is in the case in which a state taxes a legal person in the place of residence while another state does not know the legal personality of the entity and taxes the income or capital in head of a resident shareholder in its territory (Marquez, 1999). When two different people can be imposed or taxed by the same income or the same equity and based on this the OECD determined that “economic double taxation should not be avoided at the international level when it subsists at the national level” (OECD, 2011).

Economic double taxation: This arises when the same income is taxed for different people, for example, in dividends. But for better understanding it can be indicated that dividends are part of the corporate benefits that are granted to shareholders.

The double legal taxation: The OECD (2011) in its model of the tax convention on income and equity consider that international double taxation is “the result of the collection of similar taxes in two (or more) states on the same taxpayer for the same taxable matter and for the same period of time”. In order to better understand the indirect double taxation and because it is generally, established in double taxation agreements, income tax is considered for natural and legal persons as well as taxes on assets without being prolonged to indirect taxes. When we refer to indirect double taxation, we consider taxes as ICE, VAT which if analyzed will be paying twice for the same service.

Causes of double taxation: The CIAT International Tax Planning Control Manual cites that: “its causes must be recognized not only in the existence of a conflict between the jurisdictional principles of personalism or territoriality applied by the states but also in those circumstances in which even if applied. In the same criterion, there are discrepancies in the definition of the resident person or in the location of the source and/or assets” (CIAT, 2007).

Conflict source or territoriality vs. residence: When a country recognizes residence as a principle to tax the world income is when there is a conflict between the source and residence. It is here where a country of residence recognizes that the country of source or territoriality has the primary right to tax income, derivatively the country of residence taxes the rent only after accepting a credit for the tax paid in the country of source or territoriality. If for different situations, the country of residence does not accept the credit, double taxation arises.

Conflict residence vs. residence: This is usually presented when a natural person or a legal entity is a resident under the laws of two countries. In the case of Ecuador, natural subjects, nationals or foreigners residing in the Ecuadorian State are subject to paying taxes on the generated and complementary income in relation to their income and occasional profits, coming from the local or from the outside and in the same way as the patrimony.

For fiscal purposes, residence in Ecuador consists of continuous permanence for a period of 183 calendar days or more within the country, these may be consecutive or not within the taxable year or contemplated within it, according to Art. 7 of the Reform Law for Ecuador’s Tax Equity.

Conflict source vs. source: This originates when two countries believe that income originates in their territory, these can be conflicts of facts or laws.

Evasion and elusion: In the countries there are several ways to evade taxes, so, states must adopt control measures, since, tax havens have become accomplices of tax evasion and avoidance, therefore, the Economic Commission for Latin America and the Caribbean (CEPAL) has recommended to Ecuador and the Andean Region, the
need to dedicate efforts to improve collection and levels of taxation to protect scenically the possibility of financing development.

MATERIALS AND METHODS

Methods to avoid international double taxation: According to Bernal (2002), “The methods to avoid double taxation consists in establishing the way in which those incomes that may become subject to taxation in two or more countries will be treated physically that is those measures that respond to the way of applying the techniques or mechanisms of taxation. Tax order applied to avoid over taxation, everything focused not on the income itself but on the consequences and tax treatment of such wealth”.

The methods can be unilateral or agreed and this depends on the internal administration of each state whether these are the result of agreements or pacts between states or unilaterally. To better understand, we will describe each of these measures.

Unilateral measures: These measures will be applied by the states of residence of the taxpayer when there has already been any taxation in the state where the source of income is generated.

Exemption method: The OECD (2011) refers to the exemption method: “The income or assets that can be taxed in the state of the source or situation are exempt in the state of residence but can be taken into consideration to determine the tax rate applicable to other income or patrimonial elements of the taxpayer”.

This type of method is adopted by the states as part of their legislation in order to mitigate the double taxation of the residents of each country, thereby mitigating the effects of double taxation in terms of taxes.

Integral exemption method: According with Art. 23 A1 of the OECD (2011) considers “When a resident of a contracting state obtains income or possesses assets that in accordance with the provisions of this agreement, may be taxed in the other Contracting State, the first state shall exempt these income or assets without prejudice of the provisions of paragraphs 2 and 3”.

In the same way Vallejo and Gutierrez (2001), mention “The state of the residence absolutely does not tax the income from the country of the source”. Below an example will be cited for a better understanding. If a taxpayer resides in the L state for his world income he obtains an income of USD 8000 in the country M the tax rate is taxed at 25% and the country L has a 30% tax rate (Table 1).

Exemption method with progressivity: In the study of the integral exemption method that performs Vallejo and Gutierrez (2001), considered that: “The state of the residence waives the tax of the income originated abroad excluding it from the tax base but takes into account its amount in order to determine the progressive rate that corresponds to apply to the other incomes, internal or external not excluded”.

Example: A person who resides in state M and who works as a professional in state L, receiving a remuneration of USD 12,000. In addition, this person as a taxpayer receives an income equivalent to $ 12,000 in the state M. The country L has established as a single tariff 30% while the country M has a progressive rate of 25% up to $10000 and 40% up $ 20000.

Method of imputation or tax credit: When it comes to the method tax credit is when the state where they reside recognizes the payment of taxes both of foreigners with domicile or of nationals abroad, this could be considered as a tax credit and it is necessary to consider the criterion of “world income” in reason that the tax paid in both the income-generating state and the state of residence is taken into account. In Ecuador, the legislation typifies a limited deduction is so in Art. 49 of the Law of Internal Tax Regime cites.

“Tax credit for taxes paid abroad”: Without prejudice to the provisions of international agreements, natural persons resident in the country and national companies that receive income abroad subject to income tax in the country of origin have right to deduct from the tax on income caused in Ecuador, the tax paid abroad on those same income, provided that the credit does not exceed the value of the tax attributable to said income in Ecuador”.

Deduction method: This type of method is that the residence status for your tax base consider income from national and Foreign sources. According to Rosembuj
method of unpaid tax (tax-sparing): If this method were applied, there would be favorable advantages that contribute to the investment, therefore, Vicchi (1999), states that: “The source state provides tax benefits, either exempting or granting deductions and that by applying the imputation method neutralizes this benefit because the investor subject who does not pay the tax in the country from the source, it will do so in the country of residence. In view of this situation, the tax-sparring clauses imply that the taxpayer who is allowed to deduct the tax calculated in the country of residence, the amount that would have corresponded to pay in the country of the source, if the tax benefit does not exist.”

imputation of the underlying tax: According to Aquino, “This method seeks to avoid economic double taxation because it allows to use as a tax credit not only the tax withheld on withholding tax but also the tax levied on the subsidiary for the distributed benefit”.

bilateral measures: As it has been possible to analyze each state, it has the power to create its own legislation but it is necessary to reinforce the control over the tax problem for which it is necessary to make agreements among the states in order to contribute and thus reduce double taxation as an example of this is that the libel of the agreements establishes the exchange of information as an integral part of them.

It is considered that, “treaties are agreements subscribed in the different states or between subjects of international law which are directed or whose function is to regulate their reciprocal proceeding. In principle, treaty rules only bind signatories to those that adhere to them” (Montano Galarza, 1999).

the double taxation agreements in Ecuador: The Ecuadorian State has adopted unilateral, bilateral and multilateral measures in its legislation in order to mitigate double taxation which is why Ecuador has signed 18 agreements.

In 1981, Ecuador adheres to Decision 40 which entered into force in 1975, this decision 40 is a multilateral agreement that was signed to avoid double taxation of income generated by the income of member states such as Bolivia, Peru, Colombia and Ecuador.

This agreement is governed by different principles including territoriality that is the payment of taxes must be made in the country where the income originates or there is a source of production that complies with the tax jurisdiction, regardless of the place of residence of people or taxpayers, for example, a musical group from Peru “Agua Marina” go on an international tour in Spain, they will pay taxes in Spain for being the place where they are giving the show that is to say where the entrance to the source.

When Ecuador signs agreements to avoid double taxation, most of it has been framed in the OECD Model, governed by the principle of residence that is to say that people will be taxed where they live.

results and discussion

brief analysis of the structure of the double taxation agreements signed by the Ecuadorian State: This analysis will consider synthesized information on the taxes considered by the Double Taxation Agreements (DTA), the residence, the Permanent Establishment (PE), real estate rents, maritime or air navigation, associated companies, dividends, interest, royalties, capital gain, the income from independent work, income from dependent work, artists and athletes, other income, equity which is the method to avoid double taxation, other clauses. Four DTA’s that Ecuador has with the countries of Spain, Chile, Canada and CAN will be analyzed.

Ecuador has made double taxation agreements with Spain, Chile, Canada and CAN. Examples of certain DTA taxes in relation to Ecuador with other states.

An example will be cited below regarding the interest. A supplier originating in Canada sells merchandise on credit to an Ecuadorian Company generating an interest of 2% on the total merchandise, the total amount oscillates between the USD. 16,000.00 for interest (Table 2).

In this case the 15% retention allowed by the legal regulations is applied, since, the DTA is applied with in the other contracting country, i.e., Canada. But what will happen if the DTA does not exist, then the same posting without DTA is detailed (Table 3).

If there were no DTA, the tax administration of Ecuador or the Internal Revenue Service would collect USD. 3520.00 which is the equivalent to 22% that should be applied for this concept. If the existing differences are analyzed, the negative value for the SRI can be observed (Table 4).

Example of independent professional services: If an expert in technologies from Chile is hired by an Ecuadorian Company for a value of USD 23,000.00 for implementation services of intelligent systems and his stay in Ecuador will be 90 days.
Table 2: Accounting in Ecuador with the DTA

<table>
<thead>
<tr>
<th>Date</th>
<th>Details</th>
<th>To retain</th>
<th>To have</th>
</tr>
</thead>
<tbody>
<tr>
<td>10/06/2018</td>
<td>Interest on loan Retention (15%)</td>
<td>16000</td>
<td>2400</td>
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<tr>
<td></td>
<td>Cash-banks</td>
<td>13000</td>
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Payment of interest to a Canadian Company

Table 3: Accounting in Ecuador without the DTA

<table>
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<th>Details</th>
<th>To retain</th>
<th>To have</th>
</tr>
</thead>
<tbody>
<tr>
<td>10/06/2018</td>
<td>Interest on loan Retention (22%)</td>
<td>16000</td>
<td>3520</td>
</tr>
<tr>
<td></td>
<td>Cash-banks</td>
<td>12480</td>
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Payment of interest to a Canadian Company

Table 4: Values against the SRI

<table>
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<tr>
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<tr>
<td>Applied retention DTA</td>
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<tr>
<td>Retention without DTA</td>
<td>3520</td>
</tr>
<tr>
<td>Counter value for the SRI</td>
<td>1120</td>
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Table 5: Accounting in Ecuador with the DTA in professional services

<table>
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<th>To have</th>
</tr>
</thead>
<tbody>
<tr>
<td>10/06/2018</td>
<td>Professional services Retention (0%)</td>
<td>23000</td>
<td>23000</td>
</tr>
<tr>
<td></td>
<td>Cash-banks</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Payment of professional services to Chilean specialist

Table 6: Accounting in Ecuador without the DTA in professional services

<table>
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<th>To have</th>
</tr>
</thead>
<tbody>
<tr>
<td>10/06/2018</td>
<td>Professional services Retention (0%)</td>
<td>23000</td>
<td>5660</td>
</tr>
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<td></td>
<td>Cash-banks</td>
<td></td>
<td>17540</td>
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Payment of professional services to Chilean specialist

Table 7: Values against the SRI in professional services

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<td>Retention without DTA</td>
<td>5660</td>
</tr>
<tr>
<td>Counter value for the SRI</td>
<td>5660</td>
</tr>
</tbody>
</table>

Consider that the tax is recorded in the country of residence of the professional (Table 5). With the DTA, Ecuador does not receive income for this professional unless the latter has a fixed residence or base in the country (>183 days), only then the income would be taxed in Ecuador (Table 6).

If the DTA did not exist, the tax administration of Ecuador would collect USD. About 5,060.00 which is the equivalent to 22% that is applied to this concept. Next what is value against the SRI is analyzed (Table 7).

CONCLUSION

Once we have proceeded to analyze the problem of double taxation, we have reached certain conclusions: the tax collection suffers loss, so, signing and applying these DTA for Ecuador is an advantage in terms of collection as has been shown with the examples cited above is observed the values against the SRI, it is clear that if there were no DTA, the value in the retention would be more significant for Ecuador. International treaties seek to avoid double taxation and avoid fraud and capital flight and tax evasion, since, this can strengthen legal support.

When double international taxation exists, it directly affects taxpayers and the company that conducts economic operations with different countries which puts Ecuadorian investment and tax collection at risk.

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REFERENCES