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Global Tax Alert

News from EY Americas Tax

Ecuador's tax reform eliminates dividend tax exemption and modifies VAT rules

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Ecuador's tax reform, enacted on 30 December 2019, eliminates the tax exemption applicable to dividends and modifies the value-added tax (VAT) and outflow tax (i.e., currency exportation tax) rules. The tax reform went into effect on 1 January 2020. For more information on the tax reform, see EY Global Tax Alerts, *Ecuador's National Assembly to consider tax reform bill*, dated 5 November 2019, *Ecuador's National Assembly rejects and archives tax reform bill*, dated 21 November 2019, *Ecuador's President proposes another tax reform bill*, dated 6 December 2019, and *Ecuador's President vetoes second tax reform bill and proposes amendments*, dated 24 December 2019.

Income tax

The tax reform repeals the tax exemption for dividends distributed by Ecuadorian entities, except for those paid to other Ecuadorian entities.

Dividends distributed by Ecuadorian companies to nonresident entities or individuals will be subject to income tax withholding. The tax basis will be 40% of the dividend distributed. The general effective dividend withholding tax will be 10% (tax base of 40% taxed at a 25% rate), which may be reduced under applicable tax treaties assuming eligibility requirements are met.

Income from agricultural activities will be taxed at a rate from 0% to 2%.

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Thin-capitalization rules

Additionally, the tax reform sets the thin-capitalization threshold for cross-border, intercompany loans at 20% of income, before profit-sharing, interest, depreciation and amortization. For banks and insurance companies, the threshold remains at 300% of the entity's equity.

VAT

The tax reform adds certain goods to the list of transferred or imported goods that are subject to a 0% VAT rate. The tax reform also amends the list of VAT withholding agents.

In addition, the tax reform imposes a 12% VAT rate on digital services, when the consumer is an Ecuadorian resident.

Nonresidents may act as collection agents for VAT by registering with the Ecuadorian tax authority. For the VAT payments on digital services:

- The nonresident acts as a collection agent of the VAT if the supplier is registered in Ecuador.
- The VAT is directly assumed by the importer of the service if the supplier is not registered in Ecuador.
- The credit card company will act as a withholding agent if there is an intermediary involved in the payment process.

Outflow tax modifications

The tax reform eliminates the 360-day requirement to exempt from the outflow tax principal and interest paid on loans made by international financial institutions or non-specialized financial institutions. Also, the tax reform eliminates the 360-day requirement for publicly-traded debt in the Ecuadorian stock market.

Additionally, the tax reform exempts from the outflow tax dividends distributed to foreign corporations and nonresident individuals located in low-tax jurisdictions or tax havens. The outflow tax, however, will be triggered when dividends are distributed to foreign corporations owned directly or indirectly by individuals or entities resident in Ecuador that are shareholders of the company distributing the dividends.

The tax reform simplifies the outflow tax exemption for principal and interest payments on loans made to acquire housing, "microcredits" and productive investments and eliminates the 360-day requirement.

The tax reform eliminates the period during which fixed-term certificates of deposit will be exempt from the outflow tax. It also will not allow the outflow tax exemption to apply to payments made between related parties.

Special contribution tax (*Contribución Unica*)

Companies that carry out economic activities and have taxable income equal to or greater than US$1 million dollars in tax year 2018 will pay a special contribution tax ranging from 0.10% to 0.20% for tax years 2020, 2021 and 2022, as follows:

Taxable income from	To	Rate
1,000,000	5,000,000	0.10%
5,000,000.01	10,000,000	0.15%
Over 10,000,000.01		0.20%

Companies will pay this special contribution tax based on the total taxable income determined in the tax year 2018 tax return.

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