THE INTERNATIONAL ECONOMIC DOUBLE TAXATION OF DIVIDENDS: ITS HANDLING IN THE CONVENTION BETWEEN ECUADOR AND SPAIN

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Abstract

This article analyzes the effects of the international economic double taxation of dividends. For this purpose, a conceptual distinction is made between legal and economic double taxation. The term "dividends" is defined and possible tactics that could be adopted when drafting double taxation agreements in order to resolve any potential issues, with specific reference to the case of Ecuador, are discussed.

It was necessary to conduct a thorough review of the doctrine and a comprehensive analysis of possible methods by which international economic double taxation could be avoided or corrected. The paper includes a study of the 1993 double taxation agreement between Ecuador and Spain, and a simulation exercise in which the effects of the agreement's application are determined.

We find that that the existence of international economic double taxation affects businesses' management policies, indebtedness, and location decisions, as they often look to invest in jurisdictions with lower levels of taxation. Moreover, it affects the evolution of foreign investments and, therefore, the development capacity of countries, especially the least developed ones.

Keywords: Dividends, Double Taxation Conventions (DTCs), Economic Double Taxation, Business Taxation.

1. INTRODUCTION

The Concept of Dividends in Comparative Tax Regulations

A taxable event is defined as the factual circumstance, of a legal or economic nature, which, under the law creates tax obligation, that is, may require the payment of tax. In accordance with Article 2 of the Law of the Internal Tax Regime of Ecuador, taxable income is defined as:

1. Ecuadorian-sourced income obtained from labor, capital, or both sources, in the form of cash, services, or payment in kind.

2. Income obtained abroad by individuals domiciled in Ecuador or by national companies.

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In accordance with the first paragraph, the criterion of territoriality, also known as the “source principle”, is adopted in order to establish the link between the tax obligation and the source. This approach is based on the idea that all income earned within the territory of Ecuador must be subject to taxation there, regardless of the taxpayer's country of tax residence.

The second paragraph refers to the personal criteria of domicile and nationality, also known as the “residence principle”. This approach is based on the idea that all of the income that a taxpayer earns worldwide must be subject to taxation in the country where the taxpayer resides.

According to Article 8.5 of the Law of the Internal Tax Regime Law of Ecuador, the profits and dividends distributed by companies registered or established in the country are considered to be income earned in Ecuador. Therefore, this type of capital income (dividends) is subject to taxation in Ecuador, no matter who the beneficiary of the dividend is or where their tax residence is.[3]

Definitions of “Dividend” in Internal Legislation and Economic Double Taxation

As mentioned by Pérez (2012), in order to analyze the tax treatment of dividends, it is necessary to establish the existing difference between profit and dividend, since the right to profits arises from the nature of the corporate business and is unavailable by the corporate bodies (p. 220). The dividend, on the other hand, depends on the existence of distributable profits and on the Assembly (i.e., the Shareholders’ General Meeting) agreeing on the distribution among the partners of the profits resulting from the previously approved balance sheet; it is, therefore, a right that the Assembly can dispose of (Pérez, 2012, p. 220).

In the opinion of Salamanca (1976), the right to the dividend is to be understood as the right that every shareholder has to participate in the profits. Salamanca (1976) notes that the right to the dividend is one, but its exercise, that is, its enforceability, is carried out in several stages, through a series of facts and legal acts. The right to the dividend, in fact, requires a materialization of assets, which is made effective in each period through the establishment of the surplus or net profit determined by the reliable balance sheet approved at the Shareholders’ General Meeting (p. 69).

On the other hand, Litzenberger and Van Horne (1978) describe how shareholders were subject to double taxation in the United States at the time:

> With the present tax system, the investor pays personal income taxes on cash dividends distributed to him and, in addition, his portion of the total earnings of the company is subject to the corporate tax rate. Thus, unlike other sources of income, corporate source income is taxed under two different income taxes - personal and corporate (p. 737).

They argue that there are a number of methods by which the double taxation of dividends could be eliminated, including “the deduction of dividends at the corporate level, the stockholder credit method, or some combination of the two” (Litzenberger & Van Horne, 1978, p. 727).

[3]Servicio de Rentas Internas (SRI), 2020, 1-6

In their research on the economic effects of dividend taxation and how these affect the decisions of companies and their shareholders, Poterba and Summers (1985) argue that "dividend taxes reduce corporate investment and exacerbate distortions in the intersectoral and intertemporal allocation of capital" (p. 5).

In his analysis of dividends and their relationship with double taxation, Vega Borrego (2002) concludes that dividends, on the other hand, are susceptible to double economic taxation because the profit from which they derive is taxed both at the headquarters of the paying company and at the partner. The systems articulated by Spanish legislation do not completely eliminate, in all cases, the economic double taxation that occurs (p. 92).

Similarly, Bustos Gisbert and Pedraja Chaparro (1999) indicate that:

> The question is not whether dividends are taxed twice, nor the alleged bias in favor of undistributed profits, but whether or not the income from the company, whether distributed to shareholders or not, is taxed according to the marginal personal income tax rates. Therefore, the root of the problem is not so much the existence of a corporation tax, but what connection can be established between it and personal income taxation (p. 57).

For Gota Losada (1988), the conceptual requirements for the double economic taxation of dividends are as follows:

a) the companies must have a legal-tax personality distinct from that of their partners or shareholders;
b) the companies must pay corporate income tax on the total income obtained;
c) the partners must pay personal income tax on the dividends received, which are included in their overall income;
d) there should be no option in favor of the companies to stop paying corporate income tax in exchange for the partners paying personal income tax on the total corporate profit, whether distributed or not; and
e) it is necessary that the entities do not pass on income tax to the companies in the sale price of the products, nor in the acquisition prices of the raw materials or of the production factors (p. 33).

Morck (2005) considers that:

> the arguments for eliminating the double taxation of dividends apply only to dividends paid by corporations to individuals. The double (and multiple) taxation of dividends paid by one firm to another—intercorporate dividends—was explicitly included in the 1930s as part of a package of tax and other policies aimed at eliminating U.S pyramidal business groups (p.135).

Jugurnath et al. (2008) describe the tax reforms implemented in Australia in 1987 in order to "eliminate the distortions of double taxation" (p. 209). They explain that the country "adopted a dividend imputation system" (Jugurnath et al., 2008, p. 209). Their empirical results show that the allocation of dividends "is an effective way to reduce the distortions caused by the traditional system of taxation" and has been "able to positively stimulate corporate capital investment" (Jugarnath et al., 2008, p. 209).

In her analysis of the Belgian tax system, Lamensch (2009) notes that, in order to avoid:

> the double taxation of dividends, the Belgian 'definitively taxed income' rules allow parent companies to deduct the dividends received from their subsidiaries resident in another Member State but only up to the amount of their taxable profits in the same taxable period, which potentially limits the deductibility of the dividends received (p.473).

According to Kao and Chen (2011), in Taiwan, the double taxation of dividends was eliminated. They note that, as a result, companies now tend to pay larger dividends.

In his research on the U.S. tax system, Berner (2003) analyzes "the irregular slide in the dividend-payment ratio from fifty-five percent to sixty percent in the 1960s to only thirty percent to thirty-five percent" at the date of his research (p. 58). He explains that this is, in part, "because of the treatment tax of dividends compared to that of capital gains: corporate income is taxed once at the corporate level—thus decreasing what is available to pay out to shareholders—and again to the shareholder on receipt of a dividend" (Berner, 2003, p. 58).

Ahmad and Xiao (2013) examine "the effectiveness of the "end of double taxation" (on dividends) policy in stabilizing an economy", taking "both announced and unannounced policies" into account (p. 928). They state that "a reduction in double taxation stimulates investment and improves welfare, but its impact on output is moderate and it has a negative effect on work hours" (Ahmad & Xiao, 2013, p. 928).

The Organisation for Economic Co-operation and Development (OECD) defines the double economic taxation of dividends as "the simultaneous taxation of the company's profits at the level of the company and of the dividends at the level of the shareholder" (OECD, 2019, p. 196).

In the same sense, the OECD (2007) considers the terms of legal double taxation and economic double taxation from an international point of view, referring to the first one as the situation in which the same benefit accrued to a taxpayer is taxed by two jurisdictions. On the other hand, a double economic taxation occurs when the same benefit accrued to two economically related entities is taxed twice, by two jurisdictions (OECD, 2007).

Cross (n.d., as cited by Montaño Galarza, 2006) points out that the term economic double taxation usually refers to the situation in tax law in which the same tax source is taxed by two (or more) identical or analogous taxes in the hands of different people (p. 91). Montaño Galarza (2006) also mentions some of the cases in which economic double taxation occurs:

a) double taxation on dividends (as a company and as an individual);
b) double inter-company taxation (the company distributes dividends to individuals);
c) economic double taxation arising from tax adjustments in transactions between related companies (p.119).

Meanwhile, in his analysis of the Constitutive Treaty of the European Community (TCCE), Marín Benitez (2005) notes that if the possibility of the same taxable event being taxed twice constitutes one of the most serious obstacles to the internationalization of economic activities, and this internationalization is essential to the achievement of a single European market, the double taxation of cross-border dividends constitutes a serious interference with the achievement of the objectives sought by the TCCE (p.4).

Gale (2016) states that, in the United States, the "classical tax system" employed means that "corporate profits are subject to double taxation, once at the corporate level when they are earned, and again at the individual level when they are paid out as dividends" (p. 839). He notes that the Bush administration, at the time, was "reportedly considering corporate tax reform options in part because of concerns about double taxation" (Gale, 2016, p. 839). He adds that "dividends are not taxed twice if they are paid to nonprofit institutions or foundations; federal, state or local governments, public or private pension funds; and 401(k) plans or Individual Retirement Accounts" (Gale, 2016, p. 839).

In this context, we assume that economic double taxation has a negative impact on the principle of tax neutrality by influencing various decisions in the society (for example, dividend distribution policies, the decision to capitalize, accumulate, or to distribute those benefits, the sources of financing and even the development of aggressive tax strategies to divert resources into jurisdictions with less taxation. According to this principle, the application of tax should not change the economic behavior of taxpayers, unless this tax-induced change reduces the inefficiency of the market equilibrium. Therefore, measures taken towards the elimination of double taxation facilitate tax neutrality.

When discussing tax neutrality, Furman (2008) claims that "the basic concept is simple: generally, the tax system should strive to be neutral so that decisions are made on their economic merits and not for tax reasons" (p. 1). He adds that:

> Examining ways that the tax system approximates or departs from neutrality can be a helpful lens for thinking about a range of tax policy and economic problems.
>
> Tax neutrality is a widely accepted concept in principle. In practice, however, tradeoffs between different concepts of neutrality and different goals can be difficult to resolve. But in several cases this concept can provide a useful way to cut through some of the debates about tax policy and identify a more economically efficient way to organize the tax system. (Furman, 2008, p. 1)

Kleist (2012), elaborating on the concept of neutrality, writes that:

> the concept of tax neutrality is sometimes used to describe an ideal situation where a taxpayer's choices are unaffected by tax laws. However, tax neutrality in the sense of CIN[4] and CEN[5] does not require that the taxation is optimal with regard to freedom from distorting effects in the marketplace. Rather, the word *neutrality* in CIN and CEN refer to the fact that a cross border investment is taxed equal (uniform) to domestic investment or investments made within the other state. Although this does not meet the criteria for tax neutrality in a narrow sense, it would be reasonable to assume that CIN or CEN (or a tax burden in between these two) will generally result in less distortion in the marketplace than if a cross border

[4] Capital import neutrality.
[5] Capital export neutrality.

> transaction is subject to a higher or lower tax burden than the range set by CIN and CEN (p. 41).

In accordance with the OECD (2011) guidelines on the neutrality of taxation, a tax system can only be considered to be neutral with respect to business decisions when two requirements are met:

a) a certain social benefit before taxes creates the same profitability after taxes for partners independently of the form that the remuneration takes (for example, the payment of dividends);
b) the joint tax burden must be equal for all benefits, whether distributed or reserved.

From this point of view, if the issue of double taxation is not resolved, the behavior of the company will be influenced by tax issues and indebtedness (which is deductible) will be preferred. For that reason, retention of profits will place the continuity of the company in jeopardy and be detrimental to the efficient allocation of capital.

2. INTERNATIONAL DOUBLE TAXATION AND THE METHODS ESTABLISHED IN THE CONVENTIONS TO COUNTERACT IT

The appearance of double taxation is also remarkable because of the discrepancies in the specification of the adopted approach. Although most of the laws make the residence the determining connection point for the tax application, different definitions of the constituent elements of the residence make it possible for cases of double residence to occur: for example, the head office where the activity is performed and from which the income comes, and the location of the income source, rather than the location of the payer of the income.

As regards international economic double taxation, there is identity of taxable object and similarity of tax (income taxation), but the requirement of subjective identity proper to international legal double taxation is missing. It can occur if the ownership of the patrimonial elements or of the factors of production from which the taxed income derives are attributed by the domestic legislation of the states to different people, or when the regime of qualification and attribution of income is different (Vallejo Aristizábal, 2019, pp. 91-92).

This type of double taxation is directly related to the economic capacity that can be perceived from the performance of the taxable event. This can be verified when the same income, transaction, or assets are taxed in two or more countries during the same tax period, but in respect of different taxpayers. As claimed by Borrás Rodriguez (1974), the causes for double taxation could be systematized as follows:

1. As a consequence of the adoption, by the two different states, of two opposing criteria to determine their tax competence.

2. When two countries adopt the same criterion to determine their tax competence.

3. As a result of the existence between two countries of different criteria for determining the tax base (pp. 124-125).

As the problems arising from fiscal sovereignty have been presented at international level, various general solutions have been proposed and used by different states according to their economic and fiscal policies. These solutions can be summarized as the exemption method and the imputation (or attribution) method.

The Exemption Method

The country of residence will not tax the income that was already taxed in the host country. Therefore, the country of residence will consider it as exempt income.

The exemption method constitutes an exception to the principle of the taxation of the global income of the residents, since it supposes that the country of residence refrains from taxing income that was created in the other country. This method is also known as a distribution system, since it involves the distribution of tax between the country of residence and the host country.

According to the international tax planning studies carried out by de Arespacochaga (1998), when this method is used in the hypotheses of concurrence of real and personal taxation criteria of two states, in which the source country taxes the taxpayer on the income obtained in its territory and the state of residence taxes them on their worldwide income (subject to the same taxable event), this mechanism corrects the effects of the juxtaposition of fiscal sovereignties through the granting by the latter of a tax exemption in relation to the taxable events subject to double taxation (p. 369).

The use of the exemption method causes overseas investments to become more attractive than investments made within the country of residence. This often occurs in developing countries, which usually apply lower tax rates than developed countries, and provide tax exemptions or incentives in respect of such investments.

Calderón Carrero (1997) specifies that as long as the eventual tax sacrifice made by an underdeveloped state to attract or retain investment is not prejudiced, it seems feasible that the following are among certain conditions to be met for the application of the exemption technique:

- The resident taxpayer must have obtained foreign source income.
- The foreign source income must be subject to taxation by the taxpayer granting the application of the exemption (p. 150).

The exemption method can be classified in two ways:

• **Full exemption:** The country of residence will not tax income which comes from the source country.

• **Exemption with progression:** The country renounces the taxation of income created abroad, excluding this from the tax base. However, the amounts involved are taken into consideration when determining the corresponding progressive rate that is applied to the remaining income, whether internal or external.

The Imputation (or Attribution) Method

When the imputation method is used, the country of residence maintains the principle of taxation on global income and takes foreign income into consideration when determining the tax base of its residents. The problem of double taxation is then solved by way of a tax credit; the tax administration has the capacity to subtract income tax that has already been paid abroad from the amount of tax due.

There are two types of imputation:

- **Full imputation:** The country of residence allows for a deduction corresponding to the total amount of tax paid in the host country to be made without limitation.

- **Ordinary imputation:** The tax credit granted by the country of residence in terms of the deduction of foreign tax is limited to the portion of the tax that corresponds to income earned abroad.

According to de Arespacochaga (1998), total or integral imputation occurs when the state of residence allows the deduction of the totality of the tax previously paid by the taxpayer in the state of source for the same income or wealth that is now intended to be taxed again; and partial or limited imputation is the formula in which the state of residence deducts the tax previously paid, but up to the maximum limit of what would be payable if the income had not been obtained in that state (p. 370). In short, de Arespacochaga (1998) adds, the deduction of the foreign tax is limited to the amount resulting from applying the average tax rate of the state of residence to the income obtained in the other state (p. 370).

When using the ordinary, or limited, imputation method, the deduction of foreign taxes cannot exceed the level of tax that would need to be paid in the country of residence if the income or assets obtained abroad were of national origin. This is the method that is used most frequently by countries, since it allows them to mitigate or eliminate double taxation at the level of taxation of the countries involved, according to the tax principles of equity and equality.

3. EXAMPLES OF THE APPLICATION OF THE ECUADOR-SPAIN AGREEMENT (OECD MODEL)

Article 425 of the Constitution of the Republic of Ecuador (2008) states that the hierarchical order of the application of regulations should be as follows: "the Constitution; international treaties and conventions; organic laws; ordinary laws; regular laws; regional regulations and district ordinances; decrees and regulations; ordinances; agreements and resolutions; and the other actions and decisions taken by public authorities" (República del Ecuador Asamblea Nacional, 2008, p. 121).

Some examples[6] are presented below in order to analyze the effects of double taxation and the application of the current convention between Ecuador and Spain that was designed to regulate it).[7]

[6] All examples in this article are for the illustrative purpose only. Any coincidence of names and financial information is unintentional.
[7] Published in Registro Oficial No. 253 on August 13, 1993, and applicable from 1994. https://www.sri.gob.ec/fiscalidad-internacional2

In 2020, M&K (a company resident in Ecuador) recorded a profit before labor costs and interest, taxes, depreciation and amortization (EBITDA) of $ 1,500,000. After fulfilling its tax obligations to the Ecuadorian tax administration, the company had profits of $820,000 available for its shareholders. M&K's corporate structure consisted of the shareholders detailed in Table 1.

At the shareholders' general meeting, it was decided that 100% of the $820,000 profit mentioned previously would be distributed in the form of dividends, as shown in Table 2.

According to Tables 1 and 2, Q&Z is a company that holds a 10% stake in the Ecuadorian company M&K, for which it is entitled to the sum of $82,000 in concept dividends. This income has already been taxed in Ecuador, although Q&Z is resident in Spain for tax purposes.

Table 1: M&K Corporate Structure

Shareholder	Taxpayer	Tax residence	Shares
Interpex C.A.	Legal entity	Ecuador	10%
Printad S.A.	Legal entity	Canada	30%
Q&Z	Legal entity	Spain	10%
Carlos Herrera	Individual	Ecuador	30%
Ana Gonzalez	Individual	France	20%

Source: Prepared by the authors.

Table 2: M&K Dividend Distribution

Shareholder	Tax residence	Shares	Dividends
Interpex C.A.	Ecuador	10%	$82,000.00
Printad S.A.	Canada	30%	$246,000.00
Q&Z	Spain	10%	$82,000.00
Carlos Herrera	Ecuador	30%	$246,000.00
Ana Gonzalez	France	20%	$164,000.00

Source: Prepared by the authors.

The tax treatment of the distribution of dividends as detailed in the Double Taxation Convention (DTC) signed between Ecuador and Spain[8] is based on Article 10 of the OECD's (2017) model tax convention on income and on capital, which states:

[8] International Taxation [Conventions to avoid double taxation]. https://www.sri.gob.ec/fiscalidad-internacional2

1. Dividends paid by a company that is a resident of a Contracting State to the 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 which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);

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.

3. 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 profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

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 carries on business in the other Contracting State of which the company that 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. In such case the provisions of Article 7 shall apply.

5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State, nor subject the company’s undistributed profits to a tax on the company’s undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State” (pp. 35-36).

When the Ecuadorian company (M&K) distributes dividends to the Spanish entity (Q&Z), three different scenarios can be presented in which the Spanish entity is considered as a non-resident foreign company in Ecuador:

Scenario 1: Without Applying the DTC Regulations

The Ecuadorian company (M&K) pays 25% withholding tax on the 40% of the distributed dividend according to the current internal regulations regarding the payment of dividends, in accordance with Article 39.4 of the Law of the Internal Tax Regime.

- Value of the dividend: $82,000
- Percentage of withholding tax in Ecuador for non-residents: 25%
- Calculation of the withholding tax determined in Ecuador: $82,000 * 40% * 25% = $8,200
- Net value to be received by the company resident in Spain: $73,800.

Table 3: Accounting Journal for the Distribution of Dividends - Scenario 1

Description	Debt	Credit
Paid Dividends	$82,000.00	
Withholding tax		$8,200.00
Cash and cash equivalents		$73,800.00

If Spain applies tax of 25% to the dividends received by its residents, the total amount of tax to be paid by Q&Z would be $18,450 plus $8,200, that is, $26,650, and the after-tax dividend received would be $55,350.

In Ecuador, when the source principle is applied, distributed dividends are considered as taxable income regardless of the tax residence of its shareholders, except when the dividends are distributed to a company resident in Ecuador. In this scenario, since the shareholder is a Spanish company, the respective withholding is made.

Meanwhile, in Spain, when the residence principle is applied, dividends obtained abroad by a resident in Spain are considered to be part of their global income, which means that this income must be taxed again. In this way, the same income will have been taxed in two different countries.

In this scenario, economic double taxation of dividends takes place because the corporate profit made by the company resident in Spain (Q&Z) is taxed when it is distributed in the country in which the dividend is received and again in Spain.

Scenario 2: The DTC Regulations are Applied while Ignoring the Residence of the Beneficial Owner

Ecuador does not tax the dividends to be distributed since it is known that they must be taxed in Spain.

Table 4: Accounting Journal for the Distribution of Dividends - Scenario 2

Description	Debt	Credit
Paid dividends	$82,000.00	
Cash and cash equivalents		$82,000.00

Consequently, Spain applies 25% withholding tax to companies' foreign-earned income, as follows:

• Calculation of tax value applied in Spain: $82,000 * 25% = $20,500
• Net value to be received by the company resident in Spain (Q&Z): $82,000 - $20,500 = $61,500.

In Ecuador, when the source principle is applied, distributed dividends should be considered as taxable income. However, as the result of a unilateral mechanism and/or bilateral agreement made with the purpose of encouraging foreign investors, there is an exception to this regulation. Ecuador considers income earned by non-resident companies and/or companies that maintain permanent establishments in the country to be tax exempt. Therefore, all income is expected to be taxed in the resident country (in this case, Spain) through the exchange of tax information between the two tax administrations.

Under these conditions, the country of residence taxes the income earned in its territory and, applying the exemption method, totally or partially excludes any income received from dividends abroad. This system of exemption of income obtained in the country where the investment is made is highly attractive to developing countries, which have traditionally been importers of capital. Some developing countries, on the other hand, have criticized this method since, with the constant mobility of capital, they are almost always the lenders and investors.

Developing countries have benefited from this method, either through unilateral mechanisms after they have reformed their domestic legislation, or through the negotiation and signing of agreements or treaties aimed at minimizing international double taxation.

In reality, a tax treaty is required because nothing will prevent capital from going to other developed countries that offer better conditions for investors if the exemption relating to income earned abroad is not limited.

Specifically, in the field of taxation of capital income (such as dividends) and in an era of international financial mobility, neutrality requires that when taxes are levied on capital, this does not result in a change of the location for these investments, i.e., the investments would still have taken place in the same location had the taxes not have been levied on the capital.

For this reason, it is argued that the exemption methods achieve so-called neutrality in the importation of capital: i.e., when a country receives foreign investment, all investments made in its territory are subject to the same degree of effective taxation regardless of their origin. This favors foreign investment.

Ecuador imports capital and, from its perspective as a country receiving foreign investment, it must ensure that its tax system is efficient. Fair competition must be favored and discrimination must be avoided.

Scenario 3: The DTC Regulations are Applied Based on the Residence of the Beneficial Owner

Ecuador withholds tax of a maximum of 5% of the gross value of the undistributed dividend, in accordance with the provisions of the DTC.

• Value of the dividend: $82,000
• Percentage withheld by Ecuador as a result of applying the DTC: 5%
• Calculation of the amount withheld by Ecuador: $82,000 * 5% = $4,100
• Net value to be received by the company resident in Spain: $77,900

Table 5: Accounting Journal for the Distribution of Dividends - Scenario 3

Description	Debt	Credit
Paid dividends	$82.000.00	
Withholding tax		$4,100.00
Cash and cash equivalents		$77,900.00

The Spanish tax administration will apply tax of 25% to foreign-earned income (i.e., that earned in Ecuador) but, in order to avoid double taxation, it must use the limited imputation method[9] when dealing with this income. The amount paid in Ecuador would represent a tax credit on the global income tax paid.

Table 6: Withholding Tax - Ecuador – Spain DTC

Ecuador	Spain
Corporate income tax rate: 25% Dividend: $82,000.00 DTC rate 5%: $4,100.00	Corporate income tax rate: 25% Dividend: $82,000.00 Tax 25%: $20,500.00 Withholding tax: ($4,100.00) Tax payable: $16,400.00

In this case, the net dividend to be received in Spain would be: $82,000 - $16,400 = $65,600. In this scenario, the tax collected ($20,500) is distributed between the public finances of the two countries involved. Most of that amount goes to Spain ($16,400) and the rest ($4,100) goes to Ecuador. This is a similar tax load to that in the scenario in which there was no agreement to regulate double taxation. It generates revenue for both the country obtaining the dividend

[9] Within the limit of 15% of the amount of benefits.

(Ecuador) and the recipient's country of residence (Spain). However, it allows the recipient to retain more of the dividend ($65,600 rather than $61,500).

The model for the type of agreement applied to avoid double economic taxation between Ecuador and Spain is that of the OECD, where the residence principle and the concept of permanent establishment are applied. In Ecuador, a withholding tax of 5% is applied to non-resident companies, as this percentage is used as a tax credit in Spain (according to the imputation method), where a rate of 25% is applied to the taxpayer's global income. The fact that Spain uses the imputation method in its domestic legislation implies tax equality in residency; however, it provides an incentive not to repatriate income. From a taxation point of view, it does not generate tax collection costs. From an economic point of view, it generates neutrality in the export of capital, as it makes no difference to the exporting country where it invests.

If another Andean Community of Nations-type agreement, based on Decision 578 of the Andean Community[10], were to be applied, the source principle would apply, which means that income of any nature obtained by residents or non-residents would only be taxable in the country in which the income was generated. Along these lines, 25% of the dividends received by the Spanish company (Q&Z) would be withheld directly in Ecuador, while this income would be excluded from the taxable base in Spain and, therefore, would be exempt from tax.

From a tax point of view, when Spain uses the exemption method in its domestic legislation, it is beneficial for the capital exporter, as this method reinforces the capital exporter's tax policy. From a tax collection point of view, this method results in a tax loss or waiver for the country that applies the method. Finally, from an economic point of view, it leads to neutrality in the import of capital. A local investor does not repatriate income, so does not pay. A foreign investor should pay as they repatriate income—however, when this method is used, they do not pay. The method favors the repatriation of profits.

4. DISCUSSION

We believe that the international economic double taxation of dividends violates the principle of tax neutrality by affecting the decisions adopted by companies regarding the distribution of dividends by two means: first, it influences the suitable management of dividends by conditioning the preference for certain forms of financing (indebtedness and reinvestment of profits) over other forms (shareholders); and second, it has an impact on the origin of their investors, favoring those coming from jurisdictions with lower tax loads.

To the best of our knowledge, this is the first study to analyze the effects of the economic double taxation of dividends that are obtained in Ecuador and distributed to a resident in Spain in several scenarios: in the absence of a specific convention between these countries, and when the same agreement exists in two different modalities (without or with taking residence into account).

We believe that the international tax treatment of dividends is of major importance as it influences the location choices of companies that look for tax advantages, especially in the contexts of globalization and heavily delocalized production systems.

[10] International Taxation [Conventions to avoid double taxation]. https://www.sri.gob.ec/fiscalidad-internacional2

We have learned that the different solutions adopted domestically by the different countries produce different results, depending on whether the regulations of the recipient's country of residence or the host country are used as a criterion for taxation.

We assume that the absence of a uniform tax regime at the international level does not encourage equal treatment of corporate profits or of shareholders' dividends. For this reason, it is necessary to analyze the bilateral agreements signed between the different countries.

Our opinion is that the multiple solutions provided by the bilateral conventions on this subject do not contribute to the standardization of the treatment of dividends at international level. The use of the solutions agreed by the signatory countries in order to avoid double taxation may lead to discrepancies depending on the solution choice.

Thus, use of the solution based on the exemption (either in full or progressively) of the dividends that have already been paid in the host country, which is often adopted by developing countries, makes internal investments even more difficult and penalizes their economic growth.

The imputation method, whether full or ordinary (the tax credit granted that allows the total or partial deduction of the dividend from the total tax paid in the country of origin), is more sophisticated and less damaging to the interests of the country of residence of a recipient of international dividends.

The analysis conducted shows that the result, both in terms of taxation and the effective perception of the dividend, differs dramatically according to the assumptions considered. The scenario that results from the current DTC between Ecuador and Spain and includes the application of the regulations based on the residence of the beneficiary is far more advantageous for investors. In addition, the distribution of the tax collected between the host country (Ecuador) and residence country (Spain) results in an increase in the total effective tax to which the dividend is subjected.

Finally, the OECD's CFA has indicated that there is no exclusive right to tax dividends either in the state of residence of the dividend recipient or in the state of residence of the company paying the dividends.

The exclusive taxation of dividends in the source country is not acceptable as a general principle. Moreover, there are a number of countries that do not tax dividends at source whereas, as a general rule, all countries' impose taxes on dividends that their residents receive from non-resident companies.

It is also impossible to establish the exclusive taxation of dividends in the beneficiary's country of residence as a general rule. Residence-based taxation would be more appropriate, especially when dividends are generated by a highly mobile capital. However, it would be unrealistic to expect that the taxation of dividends at source would be totally waived. For this reason, the solution is restricted to stating that dividends may be taxed in the beneficiary's country of residence.

5. CONCLUSIONS

In view of the preceding analysis, we can conclude that:

• Dividends represent income (earnings) for their beneficiaries and are regulated according to the allocation criteria (source and residence). In the case of Ecuador, this regulation is combined, either by the tax obligation that falls on the company at the time of distribution, or according to the shareholder that is taxed upon receiving them.

• Under the principle of residence, all global income is taxed (i.e., income generated in Ecuador and income obtained abroad by individuals or by companies domiciled in Ecuador. Under the principle of source, also known as the principle of territoriality, taxation is applied to income generated in Ecuador (for example, those free of charge or for onerous title, capital or both sources, or consisting of cash, payment-in-kind or services).

• The application of the principle of territoriality means that all income generated in Ecuadorian territory (including dividends) is subject to tax regardless of the residence of the recipient of the income. Hence, double economic taxation occurs when the shareholder who receives the dividends resides in another country and is taxed again there.

• Similarly, prior to the payment of the income tax that corresponds to the resident company that distributes the dividend, the only exempt income will be the one distributed to resident companies in Ecuador and/or non-resident companies with permanent establishment in the country. For all other shareholders, that is, for those who do not reside in Ecuador, the dividend will be taxed and subject to income tax withholding.

• For this reason, there is a double economic taxation of dividends: first in the country where they are created (Ecuador) and, second. in the country where the recipient resides (Spain). This affects the efficiency of the allocation of resources and influences foreign investment decisions, discouraging fair competition in a globalized world. Consequently, one of the bilateral measures used to mitigate this impact is the adoption of conventions designed to avoid international economic double taxation.

• In the conventions signed by Ecuador with other jurisdictions in order to avoid double taxation in respect of income tax, the most widely used tax allocation criterion for dividends is the principle of residence. The most frequently used method to counteract it is the imputation method.

• In the case of the convention signed with Spain (published in Registro Oficial No. 253 on August 13, 1993), the residence method is used (OECD model), anticipating an exemption of a maximum of 15% on the gross amount of the profits if the recipient resides in Spain, according to the ordinary imputation method and progressive exemption.

• The case study developed in this paper allows us to conclude that, in the absence of a convention, when dealing with an amount of Ecuadorian-sourced benefits of $82,000, the recipient that resides in Spain would receive $73,800 and be taxed according to current legislation. In the scenario where the tax is applied in Spain and there is no notification of residence of the beneficiary of the dividends, the company would receive $82,000 minus the 25% that would be applied in Spain. Thus, the company would receive $61,500. In the scenario where the residence of the recipient is notified, the net value that the company would receive is $65,600, which results from imposing a tax of 25% on the profit obtained in Ecuador once taxed there ($77,900), having discounted the $4,100 already paid in the country of origin (Ecuador). In the latter case, the tax is still $20,500 but the tax collection is distributed between both countries ($16,400 for Spain and $4,100 for Ecuador), and the dividend received is higher ($65,600 versus $61,500).

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