EXPLANATORY MEMORANDUM TO

THE DOUBLE TAXATION RELIEF AND INTERNATIONAL TAX ENFORCEMENT (ECUADOR) ORDER 2024

2024 No. 1365

1. Introduction

1.1 This explanatory memorandum has been prepared by His Majesty's Revenue and Customs (HMRC) and is laid before the House of Commons by Command of His Majesty.

2. Declaration

2.1 James Murray MP, Exchequer Secretary to the Treasury confirms that this Explanatory Memorandum meets the required standard.

2.2 James Dunstan, Deputy Director for Business Assets & International at HMRC confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Daniel Berry at HMRC Telephone: 03000 585972 or email: taxtreaty.team@hmrc.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument brings into effect a Convention and Protocol (the "2024 Arrangements") made by the Governments of the United Kingdom and Ecuador. The 2024 Arrangements are a Double Taxation Agreement (DTA) for the avoidance of double taxation on income and gains from cross-border activity.

Where does the legislation extend to, and apply?

4.2 The extent of this instrument (that is, the jurisdiction(s) of which the instrument forms part of the law) is the United Kingdom.

4.3 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the United Kingdom.

5. Policy Context

What is being done and why?

5.1 The purpose of DTAs is to prevent income or gains being taxed both in the territory in which they arise and the territory in which the recipient is resident. They do this either by allocating an exclusive right to tax the income or gain to one of the territories, or by providing that one territory must give relief for the tax charged in the other territory in respect of the same income or gain. DTAs also provide additional protection for taxpayers by including specific measures that combat discriminatory tax

treatment. More generally, DTAs benefit taxpayers by ensuring certainty of treatment and, as far as possible, by reducing compliance burdens.

5.2 Like all of the United Kingdom's more recent DTAs, the 2024 Arrangements largely follow the Organisation for Economic Cooperation and Development's (OECD) latest Model Tax Convention on Income and on Capital (OECD Model). In doing so, they encourage and maintain international consensus on the appropriate tax treatment of cross-border economic activity, promoting international trade and investment.

5.3 DTAs also protect the Exchequer by including provisions to combat tax avoidance. For example, measures providing for the exchange of information between revenue authorities make it more difficult for residents of both territories to evade taxation by concealing assets offshore.

5.4 The 2024 Arrangements include the minimum standards recommended by the OECD/G20 Base Erosion and Profit Shifting (BEPS) project. The BEPS project created a single set of consensus-based international tax rules to protect against tax avoidance while offering increased certainty and predictability to taxpayers. These provisions are now included in the 2017 version of the OECD Model.

What was the previous policy, how is this different?

5.5 There was not previously a DTA between the United Kingdom and Ecuador. This instrument gives effect in the United Kingdom to the provisions of the new DTA.

5.6 The following paragraphs in this section explain the provisions of the 2024 Arrangements including the reasons for material departures from the OECD Model.

Title and preamble

5.7 The title and preamble of the 2024 Arrangements follow the latest OECD Model. The change to the OECD Model arose from the BEPS Action 6 Report on preventing the granting of treaty benefits in inappropriate circumstances. The statement in the preamble that the territories intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements, is one of the elements of the minimum standard on preventing treaty abuse agreed under the BEPS project.

Article 1 (Persons covered)

5.8 Article 1 sets out the general scope of the 2024 Arrangements. The 2024 Arrangements include two provisions from the OECD Model that were introduced following the BEPS project. The first concerns the treatment of income or gains derived through fiscally transparent persons such as partnerships. This provision confirms that the benefits of the 2024 Arrangements are only due where such income is effectively taxed in the hands of a resident of one of the territories.

5.9 The second provision clarifies that the 2024 Arrangements do not prevent a territory from taxing its own residents except where it explicitly provides otherwise. This puts beyond doubt that the provisions of a DTA cannot be used to circumvent anti-avoidance rules in a territory's domestic tax law.

Article 2 (Taxes covered)

5.10 Article 2 lists the taxes to which the 2024 Arrangements are to apply. The existing United Kingdom taxes to which the 2024 Arrangements will apply are income tax, corporation tax and capital gains tax. The existing Ecuador tax to which the Arrangements will apply is *el impuesto sobre la renta* (income tax).

Article 3 (General definitions)

5.11 Article 3 defines a number of terms used in the 2024 Arrangements and provides a rule for determining the meaning of terms not defined. In particular, the 2024 Arrangements include a definition of a "pension scheme", relevant to Articles 4, 10, 11 and 18, to ensure that schemes not treated as a separate person fall within the definition. The United Kingdom also uses a definition of "national" that differs from the OECD Model in order to reflect more accurately the provisions of its domestic law.

Article 4 (Resident)

5.12 Article 4 establishes the meaning of "resident of a Contracting State" and lays down detailed rules for resolving cases where individuals or other persons may be considered residents of both territories for tax purposes under their domestic laws. Unlike the OECD Model, the provisions of paragraph 1 include reference to "place of incorporation" as this condition establishes company residence under the domestic laws of the United Kingdom and Ecuador.

5.13 Paragraph 2(a) also confirms that a pension scheme that is established in either territory will be considered to be a resident. Paragraph 2(b) does not have an equivalent in the OECD Model, but reflects the United Kingdom's preference for confirming that certain non-profit organisations will enjoy the benefits of the 2024 Arrangements even if they are generally exempt from taxation.

5.14 Paragraph 4 provides a tiebreaker for persons other than individuals which are resident in both territories under paragraph 1 of the Article. Under the 2024 Arrangements the competent authorities will determine the residence status of such persons by mutual agreement. This uses the wording introduced to the OECD Model following the BEPS project and prevents companies manipulating their tax residence for tax avoidance purposes.

Article 5 (Permanent establishment)

5.15 Article 5 defines the term "permanent establishment" (PE) for the purposes of the 2024 Arrangements. Taken together with Article 7, it describes the circumstances and manner in which enterprises of one territory may be taxed on their business profits arising in the other.

5.16 It has a wider scope than the OECD Model, reflecting Ecuador's preference. In particular, it has a lower threshold of 183 days for a building site to give rise to a PE. It also deems there to be a PE where services are provided by an enterprise in the other territory for more than 183 days in total in a 12-month period.

5.17 The Article includes in paragraph 5 a rule recommended by the BEPS project that prevents companies from fragmenting their activities in order to avoid the PE threshold.

Article 6 (Income from immovable property)

5.18 Article 6 allows the territory in which the property is situated to tax income from immovable property. It also defines immovable property. The Article materially replicates the equivalent provisions of the OECD Model.

Article 7 (Business profits)

5.19 Article 7 provides that unless an enterprise of one territory carries on business in the other through a PE situated there, its profits will be taxable only in its territory of

residence. Where the enterprise has a PE in the other territory, that territory will be entitled to tax profits attributable to the PE. The provisions of this Article follow the relevant applicable provisions in the pre-2010 OECD Model, which continues to be the preference of many states, including Ecuador.

Article 8 (International shipping and air transport)

5.20 Article 8 governs the taxation of shipping and air transport operated in international traffic. It follows the OECD Model in providing that profits of an enterprise of one territory from the operation of ships or aircraft in international traffic shall be taxable only in that territory. In line with United Kingdom preferences, the provision also clarifies that certain incidental income will be included in profits from the operation of ships and aircraft in international traffic.

Article 9 (Associated enterprises)

5.21 Article 9 governs the evaluation for tax purposes of transfers of goods, services, finance and intangible property between associated enterprises. It is based on the "arm's length" principle, which requires such transfers to be evaluated as if they had taken place between independent enterprises.

5.22 Where an adjustment is made to the profits of an enterprise by one territory, the other territory will make an appropriate corresponding adjustment to the amount of tax charged on those profits, in order to relieve the double taxation which might otherwise arise as a result of an adjustment by only one territory.

Article 10 (Dividends)

5.23 Article 10 contains the rules for the taxation of dividends paid by a company that is a resident of one territory to a resident of the other territory. It allows the territory where the company paying the dividend is resident to tax the dividend but where the beneficial owner of the dividend is resident in the other territory the rate of tax is limited depending on the circumstances. Dividends received by pension schemes are exempt. Dividends paid by a Real Estate Investment Trust may be taxed at a rate up to 15%. Dividends paid by a company resident in Ecuador that fails to comply with rules in Ecuador to report details of the ultimate beneficial owners of the company may also be taxed at a rate up to 15%. In all other cases the rate of tax is limited to 15% unless the beneficial owner is a company that holds at least 25% of the capital of the paying company, in which case the rate is limited to 10%.

5.24 The definition of dividends in paragraph 3 of the Article differs slightly from the OECD Model by excluding instruments not found under the domestic law of either territory and in the manner in which it aligns the definition with income categorisation under domestic law.

Article 11 (Interest)

5.25 Article 11 contains the rules for the taxation of interest arising in one territory and paid to a resident of the other territory. It provides that a territory may tax interest arising there but where the interest is beneficially owned by a resident of the other territory the rate of tax is limited generally to 10% except where it is received by government agencies, central banks, financial institutions and pension schemes, in which case it is exempt from tax.

5.26 The definition of interest departs from the OECD Model to reflect the United Kingdom's preference for clarifying that the Article does not apply to amounts that are within the definition of a dividend in Article 10.

5.27 Unlike the OECD Model, the "special relationship" provision at paragraph 6 applies where the amount of interest paid is excessive "for whatever reason". This permits the territories to take into account both the rate of the interest and the amount of the debt in determining whether interest paid is excessive. In other respects, the Article largely follows the OECD Model.

Article 12 (Royalties)

5.28 Article 12 contains the rules for the taxation of royalties paid by a resident of one territory to a resident of the other territory. In line with Ecuador's preferences, it provides that the territory where royalties arise may tax the royalties but where the royalties are beneficially owned by a resident of the other territory, the rate of tax that may be charged is limited to 10%.

5.29 The definition of royalties extends to payments for the right to use equipment (leasing) and rights of plant breeders, and so is wider in scope than the OECD wording. Unlike the OECD Model, the "special relationship" provision at paragraph 6 applies where the amount of royalties paid are excessive "for whatever reason". This allows the territories to consider all factors in determining whether royalties paid are excessive.

Article 13 (Capital gains)

5.30 Article 13 contains the rules for the taxation of gains deriving from the alienation of property situated in one territory by a resident of the other. It materially replicates the equivalent provisions of the OECD Model.

Article 14 (Independent personal services)

5.31 Article 14 contains the rules for the taxation of income derived from individuals resident in one territory performing professional and other independent services in the other territory. It provides two separate tests of when such income may be taxed in the territory where the services are performed. First, where the individual provides services through a fixed base, which in practice is the same as the test in Article 5 of whether there is a permanent establishment. Second, where the individual is present in the territory for at least 183 days in any twelve-month period. It follows the United Nations Model Tax Convention and has been included to reflect Ecuador's preference.

Article 15 (Employment income)

5.32 Article 15 contains the rules for the taxation of employment income and follows the OECD Model.

Article 16 (Directors' fees)

5.33 Article 16 follows the OECD Model and provides that directors' fees may be taxed in the territory of which the company paying them is a resident.

Article 17 (Entertainers and sportspersons)

5.34 Article 17 contains the rules for the taxation of income derived from personal activities as an entertainer or sportsperson. It follows the OECD Model but with an additional paragraph that takes income derived from events supported by public funds out of the scope of Article 17, in line with Ecuador's preference and based on an alternative provision in the Commentary to the OECD Model.

Article 18 (Pensions)

5.35 Article 18 contains the rules for the taxation of pensions. It provides that all pensions, other than those in respect of government service, are taxable only in the territory where the recipient is resident. It also includes provisions to ensure that, subject to certain conditions, where an individual continues to contribute to a recognised pension scheme in their home territory after moving to the other territory, those contributions will be treated for tax purposes in that other territory in the same way as contributions to a pension scheme recognised in that territory.

Article 19 (Government service)

5.36 Article 19 contains rules for the taxation of remuneration paid to an individual in respect of government service, including pensions. The general rule is that the remuneration is only taxable in the territory to which the services are rendered, in line with the OECD Model. However, there is an exception for remuneration, other than pensions and other similar remuneration, paid to locally engaged staff. Such remuneration is taxable only in the territory where the individual is resident, provided that the individual is subject to tax there.

Article 20 (Students)

5.37 Article 20 contains the rules which govern the taxation of visiting students and business apprentices. Its provisions follow the OECD Model.

Article 21 (Other income)

5.38 Article 21 contains the rules for the taxation of income not dealt with elsewhere in the 2024 Arrangements. There are some deviations from the OECD Model. Paragraph 1 confirms that the benefits of the Article are only due where the recipient of the income is the beneficial owner. This is in line with similar conditions in Articles 10, 11 and 12. The general rule in paragraph 1 is that 'other income' within Article 21 is taxable only in the territory where the beneficial owner is resident but paragraph 4 provides an exception to this rule where the income arises in the other territory, in which case that territory may also tax the income, in line with Ecuador's preference. Paragraph 3 includes a "special relationship" provision similar to that found in Articles 11 and 12.

Article 22 (Elimination of double taxation)

5.39 Article 22 sets out the methods by which each territory will relieve double taxation and is broadly based on the equivalent article in the OECD Model, modified to reflect each territory's domestic double taxation relief rules. Paragraph 1 sets out the provision applying to Ecuador and provides for relief by way of credit. Paragraph 2 details the corresponding provisions that apply in the United Kingdom, which generally provide for relief by way of credit, but also include provisions that exempt dividends and the profits of PEs from tax in line with domestic law.

5.40 Paragraphs 3 and 4 determine which territory is obliged to provide credit relief in the unusual situation where both territories can tax a resident on the income, profits or gains. Paragraph 3 removes the obligation for Ecuador to provide relief for United Kingdom tax where the income in question is taxable in the United Kingdom solely because it is income of a resident of the United Kingdom and paragraph 4 is an equivalent provision relating to relief for Ecuadorian tax.

Article 23 (Non-discrimination)

5.41 Article 23 provides that, subject to certain conditions, neither territory shall impose discriminatory taxes or connected requirements on the nationals, PEs and enterprises of the other. Paragraph 2 extends the scope of the Article to stateless persons who are resident in either territory, in line with Ecuador's preference. Paragraph 5 confirms that the provisions of the Article only apply to the taxes covered by the 2024 Arrangements. In line with United Kingdom preferences, paragraph 6 deals separately with personal allowances granted to residents and nationals, confirming that the Article does not require these to be granted to such persons where they are not resident in the territory in question.

Article 24 (Mutual agreement procedure)

5.42 Article 24 establishes a procedure for resolving difficulties arising from the interpretation or application of the 2024 Arrangements and meets the minimum standard on improving dispute resolution agreed under Action 14 of the BEPS project. It departs from the OECD Model by not including a provision for mandatory binding arbitration, in line with Ecuador's preferences. It otherwise follows the OECD Model provisions, including a deadline of three years for a person to present their case, confirmation that mutual agreements will be implemented notwithstanding time-limits in domestic law and a provision confirming that the competent authorities may consult to eliminate double taxation in cases not covered by the 2024 Arrangements.

Article 25 (Exchange of information)

5.43 Article 25 follows the latest OECD Model and provides for the exchange of certain information between the competent authorities of the two territories in compliance with international standards.

Article 26 (Assistance in the collection of taxes)

5.44 Article 26 provides for the mutual assistance in the collection of tax debts between the United Kingdom and Ecuador. It is based on the OECD Model provisions and applies to all types of taxes, not just those covered by the 2024 Arrangements, except any that are imposed contrary to generally accepted taxation principles.

Article 27 (Members of diplomatic missions and consular posts)

5.45 Article 27 ensures that diplomatic or consular officials shall not receive less favourable treatment under the 2024 Arrangements than they are entitled to under international law or under the provisions of special agreements (such as the Vienna Convention on Diplomatic Relations). The Article follows the OECD Model.

Article 28 (Entitlement to benefits)

5.46 Article 28 is an anti-abuse rule. It includes "the principal purpose test" (PPT) which denies treaty benefits to a person who seeks to take advantage of the provisions of the 2024 Arrangements to secure a result which is contrary to their object and purpose. The PPT is one of the elements of the minimum standard on preventing treaty abuse agreed under Action 6 of the BEPS project.

Article 29 (Entry into force)

5.47 Article 29 contains the provisions governing how and when the 2024 Arrangements will enter into force and take effect.

Article 30 (Termination)

5.48 Article 30 contains the provisions that govern how the 2024 Arrangements can be terminated and how that termination has effect.

Protocol

5.49 The Protocol contains clarificatory and additional material relating to the Articles above and forms an integral part of the 2024 Arrangements.

5.50 Paragraph 1 of the Protocol makes clear that the scope of "Ecuadorian tax" in paragraph 3(a) of Article 2 does not extend to Ecuadorian taxes on transfers of capital.

5.51 Paragraph 2 makes clear that the definitions of each territory given in Article 3 are only for the purpose of the 2024 Arrangements and do not affect the position in issues of territorial sovereignty in other contexts.

5.52 Paragraph 3 provides detail on what is meant by a "pension scheme" in the United Kingdom. It also provides that the Competent Authorities of the respective territories may agree to extend the meaning to similar pension schemes that are introduced after the date that the 2024 Arrangements were signed.

5.53 Paragraph 4 confirms that the scope of Article 6 (Income from immoveable property) applies to certain specified rights that are granted by Ecuador under its domestic legislation to work mineral deposits and other natural resources.

5.54 Paragraph 5 confirms that domestic law determines the deductibility for tax purposes of expenses that are attributable to a permanent establishment for the purpose of calculating the profit attributable to it.

5.55 Paragraph 6 provides that a territory retains taxing rights under its domestic law over profits from non-transport activities of ships and aircraft, such as fishing, confined to places within that territory, notwithstanding the application of other provisions of the 2024 Arrangements.

5.56 Paragraph 7 confirms that a territory is only obliged to provide a 'corresponding adjustment' under paragraph 2 of Article 9 where it agrees that the primary transfer pricing adjustment in the other territory is justified under the 'arm's length principle' contained in paragraph 1 of Article 9.

5.57 Paragraph 8 makes clear that where Article 10 refers to "dividends paid" the term "paid" has a wide meaning.

5.58 Paragraph 9 clarifies that for the purpose of considering whether Article 10(2(a)(iv) applies to a dividend paid by a company resident in Ecuador, the relevant requirements to report the ownership chain are those set out in the Ecuadorian legislation and regulations. But that provision will not apply to the dividend where the relevant information has been reported or there is no requirement to report it.

5.59 Paragraph 10 confirms that the term "beneficial owner" in the 2024 Arrangements (except in the references to "ultimate beneficial owner") shall be interpreted in accordance with the relevant Commentary to the 2017 OECD Model.

5.60 Paragraph 11 provides detail of what is meant by "financial institution" for the purpose of paragraph 3(c) of Article 11.

5.61 Paragraph 12 clarifies that in the case of Ecuador, the scope of Article 19 (Government service) extends to any statutory body with the relevant definition in the Constitution of Ecuador.

5.62 Paragraph 13 confirms that paragraph 6 of Article 23 (Non-discrimination) does not prevent an Ecuadorian national who is resident in the United Kingdom from being entitled to the equivalent personal allowances, reliefs and deductions as a United Kingdom national who is also resident in the United Kingdom.

5.63 Paragraph 14 confirms that the 2024 Arrangements do not prevent a territory from applying its domestic anti-abuse rules to transactions that constitute an abuse of the 2024 arrangements so long as these rules are consistent with the principles set out in the Commentary to Article 1 of the OECD Model.

5.64 Paragraph 15 confirms that is meant by an abuse of the 2024 Arrangements. This is consistent with the anti-abuse rule in Article 28.

6. Legislative and Legal Context

How has the law changed?

6.1 This instrument brings into effect the provisions of the 2024 Arrangements.

Why was this approach taken to change the law?

6.2 This is the only possible approach to make the necessary changes.

7. Consultation

Summary of consultation outcome and methodology

7.1 The 2024 Arrangements were published on the gov.uk website on 8 August 2024 and a written ministerial statement to that effect was made on 23 October 2024. A consultation on the 2024 Arrangements was not undertaken as they were the product of bilateral negotiations with Ecuador that dealt with a wide range of complex issues not suitable for open negotiation. However, HMRC regularly consults with external interested parties, including business representatives, about the United Kingdom's network of DTAs.

8. Applicable Guidance

8.1 General guidance on the operation of the United Kingdom's double taxation agreements can be found on the HMRC pages of the gov.uk website[1] and in the Double Taxation Relief Manual[2].

8.2 This Manual will be updated once the 2024 Arrangements enter into force, which will be after Ecuador also completes its ratification of the 2024 Arrangements.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A Tax Information and Impact Note has not been prepared for this instrument because it gives effect to a DTA. DTAs do not introduce new tax burdens. Rather, they provide relief from tax. Taxpayers may have to make a claim to HMRC or the fiscal authority of Ecuador in order to benefit from the Arrangements.

[1]Guidance on the operation of the UK's DTAs: https://www.gov.uk/hmrc-internal-manuals/international-manual/intm150000

[2] Double Taxation Relief Manual: https://www.gov.uk/hmrc-internal-manuals/double-taxation-relief

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on business, charities or voluntary bodies because apart from one-off costs of familiarisation with the benefits of the DTA there are not expected to be further costs.

9.3 The legislation does impact small or micro businesses but as with other businesses, the impact is negligible and no special approach for small or micro businesses is necessary.

9.4 There is no, or no significant, impact on the public sector because apart from one-off costs of introducing the DTA any further costs of administration would be minimal.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation is that DTAs are kept under regular informal review through communication with affected taxpayer groups and other stakeholders, and this measure will be monitored as part of that process.

10.2 The instrument does not include a statutory review clause.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Exchequer Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Double Taxation Relief and International Tax Enforcement (Ecuador) Order 2024 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").