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Corporate Tax

Law and Practice – Ecuador

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The ‘Law & Practice’ sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

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Law and Practice

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Tobar ZVS Spingarn Tax and Finance division is a team made of eight high-profile professionals specialised in several tax and accounting areas including: tax law, accounting and auditing, management and application of IFRS, tax litigation and business valuation. The team has its main office in the city of Quito; however, it has a presence in the main cities of Ecuador, being the head consultants for several of the largest companies in the country. This unit is committed to provide a range of strategic tax and financial services that answer to the requirements of local and international businesses and contributes to the proper functioning and growth of companies. The practice covers tax consultancy (Administrative processes with tax authorities, tax compliance, tax disputes, international taxes, due diligence, personal planning, among others) and financial advisory work (Forensic accounting, balanced scorecard, company valuations, etc.).

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1. Types of Business Entity, Residence and Tax Treatment

1.1 Corporate Structures and Tax Treatment

In Ecuador, business generally adopt a corporate form for the following reasons:

- When establishing a company, as (in some cases) it is a company and not an owner, who assumes all obligations. This implies that the debts or obligations that may be incurred by a company are guaranteed and only limited to the assets that a company may have in its name (both capital and equity).
- When a company has greater availability of capital, since it can be contributed to by several partners.
- When a company has greater possibilities to access credit (banks or financial institutions are often more willing to lend to legal entities rather than individuals).
- Because the corporate income tax rate is 22%, while as an individual the income tax rate can be up to 35%.

In Ecuador, according to Article 2 of the Law of Companies there are five types of entities that can be incorporated in order to carry a business, each one with different characteristics, including:

A company in a collective name which is characterised by the following:

- It is contracted between two or more natural persons who trade under a social name.
- Legal entities cannot associate with this kind of company.
- It does not allow public subscription of capital. Capital is not divided into shares. Their contributions to capital are not represented by negotiable instruments.
- For its constitution a payment of not less than 50% of the subscribed capital is necessary. The law does not establish a minimum or maximum amount for the payment of capital. In addition, the partners can contribute money, movable goods, real estate and industrial machinery.
- The administrator(s) may be appointed in the articles of incorporation of a company or later by an absolute majority of votes of its members.
- Its partners respond to a subsidiary, unlimited and jointly with respect to social obligations.
- There is no maximum limit of members who can participate. The minimum number of partners is two.
- These types of companies are not subject to the control and supervision of the Superintendence of Companies, however it may ex officio ex post controls.

The simple limited partnership which is mainly characterised by the following:

- It exists under a company name and is contracted between one or more partners.
- Different partners coexist, being jointly and unlimited in responsibility; and other simple providers of funds, whose responsibility is limited to the amount of their contributions (limited).
- The corporate name shall be the name of one or more of the partners jointly responsible, to which the words “Company in Comandita” shall be added.
- Only individuals may be limited partners of this type of company.
- The law does not establish a minimum or maximum amount of capital, for the constitution of this kind of company.
- The administration will oversee only the limited partners.
- It is not subject to the control of the Superintendence of Companies.

A limited partnership divided in shares which is characterised by the following:

- In this, as in a simple limited partnership, there are two types of partners with different legal status: unlimited and limited responsibility.
- It exists under a corporate name that is formed with the names of one or more responsible partners, followed by the words “Company in Comandita” or its abbreviation.
- Its capital shall be divided into registered shares with an equal nominal value.
- The minimum current amount of capital is USD80.
- At least one tenth of the share capital must be contributed by the jointly and severally liable partners, and for their shares non-transferable nominative certificates will be issued.
- Also in this type of company, as in the Comandita Simple, the administration corresponds only to the partners.
- It is subject to total or partial control of the Superintendence of Companies.

A limited liability company which is characterised by the following:

- It is contracted between two or more parties, those who only respond by social obligations up to the amount of their individual contributions and make the trade under a corporate name or objective name.
- It cannot function as such if its partners exceed 15, if it exceeds this maximum the company must be transformed into another kind of company or be dissolved.
- Its members only respond for social obligations up to the amount of their individual shares.
- A limited liability company is always mercantile, but its partners do not acquire the quality of merchants.
- This company is constituted with a minimum capital of USD400.
- The capital must be subscribed in full at the time of the constitution of the company and must be paid at least 50% of the nominal value of each stake.
- Capital is represented by transferable shares which can be assigned or transferred only with the approval of all shareholders.
- A company will deliver to each partner a certificate of contribution in which it will necessarily be included of its non-negotiable nature and the number of the shares that corresponds to each partner contribution.
- Contributions may consist of cash or movable goods, immovable and intangible assets, or even money and assets at the same time. The shares comprise capital contributions, which are equal, cumulative and indivisible.
- The general meeting, formed by the partners legally convened and gathered, is the supreme entity of a company.
- These companies are subject to the control and total or partial supervision of the Superintendence of Companies.

A corporation which is characterised by the following:

- It cannot subsist with less than two shareholders. There is no defined maximum number of shareholders.
- The minimum subscribed capital of a company must be USD800.
- It cannot be constituted without its capital being fully subscribed and paid, at least, in a quarter.

- The capital can be integrated into cash or movable goods and immovable and intangible assets, provided that, in any case, they correspond to the type of activity of a company.
- Its capital is divided into negotiable shares, formed by the contribution of shareholders who only respond by the amount of their shares.
- The general meeting, formed by the shareholders legally convened and gathered, is the supreme entity of a company.
- Corporations are subject to the control and supervision of the Superintendence of Companies.

A company of mixed economy which is characterised by the following:

- For the constitution of these companies, it is indispensable that legal entities of public law or semi-public entities be associated with individuals or entities of private law.
- The state, municipalities, provincial councils and entities of the public sector may participate, together with private capital, in the capital and in the social management of this entity.
- Participating entities must subscribe their contribution in money or delivering equipment, agricultural or industrial instruments, movable and immovable property, public and negotiable effects, or by granting the provision of a public service for a certain period.
- By-laws establish how a board should be integrated, in which both public and private sector shareholders must necessarily be represented, in proportion to the capital contributed by both.
- If the contribution of the public sector exceeds 50%, one of the directors of this sector will be president of the board.
- The provisions contemplated in the Companies Law concerning a public limited company will apply to this mixed economy company.
- Mixed economy companies are subject to the control and supervision of the Superintendence of Companies.

1.2 Transparent Entities

The main transparent entities adopted in Ecuador for business are companies and trusts.

Companies are associations of two or more individuals or entities who seek a common object.

There are five types of trading companies, see above for details.

Trusts are contracts under which one or more persons transfers property, money or present or future rights of their property to another person (a natural or legal person called a fiduciary) to administer or invest the assets or goods for their own benefit or for the benefit of a third party, to the fulfilment of a term or condition.

This agreement or contract must have a deadline for compliance. It cannot last more than 30 years.

1.3 Determining Residence

Pursuant to Articles 4.2 and 4.3 of the Organic Law of Internal Tax Regime, corporations or companies will have Ecuadorian tax residence when they are incorporated in Ecuador, based on Ecuadorian laws.

1.4 Tax Rates

The main taxes paid in Ecuador by incorporated businesses or transparent entities are the following:

Income Tax

The income tax levy on taxable profits is applicable to Ecuadorian entities in a fiscal period (from 1 January to 31 December). The corporate income tax rate is 22% regardless of the industry in which they operate.

Income Tax Advance Payment

Income tax is determined by the profits generated by a company at the end of the fiscal year however, in accordance with Ecuadorian regulations, at the beginning of each period a company must determine an income tax advance payment which is attributable to the tax that will be generated in the current period.

The calculation of this advance is made based on the assets, equity, income and expenses recorded in the previous period using the following proportions: 0.4% of assets, 0.2% of equity, 0.2% of expenses and 0.4% of income.

The advance must be paid in two instalments in July and September, and at the end of the fiscal year once the income tax has been determined the advance payment will be discounted.

Finally, if at the end of the fiscal year the advance of income tax is greater than the tax caused, the advance will be the tax caused.

Value Added Tax

This tax levies the sale of goods and services. The applicable rate for all types of transactions is 12% of the total value of the transferred goods or services.

This tax is not levied on contributions in kind to companies, sales of businesses in which assets and liabilities are transferred, mergers, splits and transformations of companies, or the transfer of shares and other securities.

Currency Exportation Tax

The currency exportation tax levies the value of payments executed abroad, with or without the intervention of the institutions of the financial system.

The taxable event of the currency exportation tax consists of the transfer of currency, whether in cash or through the drafting of checks, transfers, withdrawals or payments of any nature, including international compensation, whether the transaction is carried out or not with the intervention of the institutions that make up the financial system.

The taxable rate is 5%.

Municipal Patent Tax
This tax is paid to the municipalities where a company operates. The tax is determined based on total assets and the applicable rate varies in each jurisdiction.

Contribution to the Superintendency of Companies and Securities
This tax is regulated by the Superintendence of Companies and Securities. The contribution is calculated based on the total assets of a company and the rate varies depending on the total assets of a company according to the following table:

From	To	Contribution per thousand on the real asset
USD0	23,500,00	0
USD23,500	100,000	0.71
USD100,000	1,000,000	0.76
USD1,000,000	2,000,000	0.82
USD2,000,000	500,000,000	0.87
USD500,000,000	+	0.93

Tax of 1.5 per thousand on total assets
This tax is paid to the municipalities where a company operates. The tax is calculated based on the total assets of a company.

2. Key Features of the Tax Regime

2.1 Calculation of Taxable Profits

In general terms, in Ecuador, the taxable profits of corporations is calculated from the total of ordinary and extraordinary income, income that is fixed based on effective billing not individual projections, fewer costs and deductions attributable to such income.

It is important to mention that only the costs and expenses that have been generated to obtain, improve or maintain the income subject to the payment of the Income Tax are deductibles.

In accordance with the provisions of the Labour Code, for the determination of taxable profits, labour participation is also deducted from the profits of a company, this labour participation is equivalent to 15% of the accounting benefits, this participation must be distributed to all employees of a company.

In summary, taxable profits in Ecuador are determined according to the following scheme:

+	TAXABLE INCOME
-	DEDUCTIBLE COSTS AND EXPENSES
=	**ACCOUNTING PROFITS**
-	LABOUR PARTICIPATION
+	NON DEDUCTIBLE EXPENSES
-	EXCEPT INCOME
+	COSTS AND EXPENSES ATTRIBUTABLE TO EXEMPT INCOME
+/-	OTHER ACCOUNTING ADJUSTMENTS
=	**TAXABLE PROFITS**

2.2 Special Incentives for Technology Investments

The Ecuadorian tax legislation contemplates the following income tax incentives related to investments in technology and R & D expenses:

Additional deduction of 100% of the depreciation and amortisation of equipment and technologies for cleaner production and renewable energy generation

Depreciation and amortisation corresponding to the acquisition of machinery, equipment and technologies for the implementation of cleaner production mechanisms, mechanisms for generating energy from renewable sources (solar, wind or similar) or reducing the environmental impact will be deducted with the additional 100%.

Additional deduction of 100% of expenses incurred by medium-sized companies for: 1) training for research; and 2) productivity improvement

For the calculation of income tax, during a period of five years, medium-sized enterprises will have the right to deduct the additional 100% of the expenses incurred in the following areas:

- Technical training aimed at research, development and technological innovation which improves productivity. The benefit cannot exceed 1% of the value of expenses incurred by salary and wages in the year in which the benefit was applied; and
- Costs to improve productivity through the following activities:
  - (a) Technical assistance in product development through studies and market analysis and competitiveness; and
  - (b) Technological assistance through the contracting of professional services for process design, products, adaptation and implementation of processes, packaging design, specialised software development and other business development services.

Exemption from the obligation to pay the income tax advance payment on software or technology development activities, whose development stage is more than one year

Taxpayers whose economic activity is exclusively related to the development of software or technology projects, and whose development stage is more than one year will be exempt from the advance to income tax payment during fiscal periods in which they do not receive taxed income.

2.3 Other Special Incentives

Income Tax

Exception of the Payment of Income Tax for New Productive Investments Made Outside the Cities of Quito and Guayaquil

The companies that are constituted with the object of making new and productive investments outside the cities of Quito or Guayaquil, and that are within the following economic sectors, are exempt from the payment of income tax for five years:

- Production of fresh, frozen and industrialised foods;
- Forest and agroforestry chain and its processed products;
- Metalworking;
- Petrochemistry;
- Pharmaceutical;
- Tourism;
- Renewable energy included in bioenergy or energy from biomass;
- Logistics services of foreign trade; and
- Biotechnology and applied software.

Single Income Tax Rate for the Banana Industry

In Ecuador, companies in the banana industry have a single tax rate of 2% on total sales generated.

Exoneration for Five Years of the Obligation to Pay the Advance of Income Tax by Start of Activity

Newly incorporated companies and new investments are exempt from the payment of the income tax advance during the first five years of effective operation.

Exoneration of the Obligation to Pay the Advance of Income Tax on Productive Activities of Agroforestry and Forestry, with a Stage of Growth of More Than One Year

Taxpayers whose economic activity is exclusively related to agricultural productive forestry and forestry projects, with a growth stage of more than one year, are exempt from the advance of income tax during the fiscal periods in which they do not receive taxed income.

Value Added Tax

In Ecuador, the general value added tax rate is 12%, however, the following areas/industries are exempt:

- Tyre tractors up to 200 hp including kangaroo type and those used in rice cultivation. Ploughs, dredges, furrows and spillways. Harvesters, seeders, lawn mowers, portable spray pumps, sprinklers and sprayers for irrigation equipment and other elements of agricultural use.
- Air-fumigation services.
- Transfers and imports of raw material and inputs used to produce fertilisers, insecticides, pesticides, fungicides, herbicides, agricultural oil used against black sigatoka, antiparasitic and veterinary products.
- Transfers and imports of goods for agricultural use.
- Cooling, cooling and freezing services for preserving foodstuffs. Services for slaughtering, cutting, grinding, grinding and the extraction by mechanical or chemical means to produce edible oils.
- Food products of agricultural origin, poultry, livestock, beekeeping, rabbit, bio-aquatic and forestry. Meats in the natural state and sausages. Fishing that remain in the natural state.
- Milk of national production (natural, pasteurised, homogenised or powdered). Cheeses. Yogurts. Maternity milks, infant proteins.
- Bread, sugar, panela, salt, butter, margarine, oats, cornstarch, noodles, flour for human consumption, national

canned tuna, mackerel, sardine and trout, edible oils (except olive).

- Certified seeds, bulbs, plants, cuttings and live roots. Fishmeal and balanced feed, fodder preparations and others used as animal feed for human consumption. Fertilisers, insecticides, pesticides.
- Financial and stock services provided by legally authorised entities.
- Transfer of securities.
- Medicines and drugs for human use.
- Individual health and life insurance and reinsurance, in group, medical assistance and personal accidents, as well as those required for land traffic accidents.
- Planes and helicopters intended for the commercial transport of passengers, cargo and services.
- Transportation services: National land and water passenger and cargo. International cargo and to and from the province of Galapagos. Transportation of crude oil and natural gas by pipelines.

Tax on Non-Returnable Plastic Bottles

In Ecuador, a special tax is imposed on bottled products in plastic of USD0.02 per bottle. However, dairy products and medicines are exempt from payment of this tax.

2.4 Basic Rules on Loss Relief

In Ecuador, companies can carry forward losses (as a deductible expense) up to five years following their registration, in portions not exceeding 20% of the taxable income in each of the years in which they are amortised.

2.5 Limits on Deduction of Interest

Local Credit Interest

The interest on debts incurred locally due to business turnover are deductible up to the limits established by the Central Bank of Ecuador. For business credits the maximum deductible rate is 10.21%.

Foreign Credit Interest

The interest on foreign debts due to business turnover are deductible up to the limits established by the Central Bank of Ecuador. For foreign loans the maximum deductible rate is 8.35%.

2.6 Basic Rules on Consolidated Tax Grouping

There are no tax consolidation rules for tax purposes as each company is responsible for the settlement of their own taxes.

Individual companies will accumulate their losses and will be able to carry them forward when they generate profit.

2.7 Capital Gains Taxation

According to Article 8, numeral 3.1 of the Internal Tax Regime Law (LORTI), profits received by companies domiciled or not in Ecuador, and natural persons, Ecuadorian or foreign and resident or not in the country; arising from the direct or indirect disposal of shares, participations, other rights representing capital or other rights that allow exploration, exploitation, concession or any other similar; of companies or permanent establishments domiciled in Ecuador, are considered as taxable income.

Direct disposal of shares is made by an owner of shares of an Ecuadorian company.

According to an Article unnumbered that follows Article 26 LORTI, the profit on the disposal of shares or other rights representing capital is calculated as follows:

- The taxable income corresponds to the real value of the alienation.
- The deductible cost constitutes the nominal value, or the acquisition value; or the proportional equity value of the shares or other rights representing capital, as applicable, in accordance with the applicable financial technique for its valuation.
- The expenses directly related to the disposal are also deductible.

In the first sale as of 1 January 2015, the deductible cost, (meaning the value that should be considered as the cost of acquisition) is the proportional equity value calculated according to the income tax return of the 2014 fiscal year of the company whose shares are sold.

The taxable income is the real value of the alienation, less the proportional equity value of the shares and that of those expenses directly related to the alienation; the final value on which the tax rate is applied.

If a seller of shares is an Ecuadorian tax resident the applicable income tax rate will depend on its nature; ie if a seller is a natural person the profit will be part of their overall income and the applicable income tax rate may be up to 35%, or if a seller is a company the applicable income tax rate is 22%. However, for a seller who is a company or natural person not resident in Ecuador a rate of 22% will apply.

If a seller is an Ecuadorian tax resident, this person shall directly pay the income tax derived from the transfer/assignment of shares. However, when a seller is a company or natural person resident abroad, the company whose shares are transferred will be responsible for the payment of income tax derived from the transaction.

Finally, in relation to these formal duties the most important is the obligation of the company whose shares are sold to report transfers to the Ecuadorian IRS. In the case of not reporting or doing so in error, a company will be fined 5% of the actual value of the transaction.

Exemptions
There is an exemption for capital gains. According to Article 9, numeral 24 of the LORTI, capital gains are exempt from the payment of income tax; profits received by companies domiciled or not in Ecuador and natural persons, Ecuadorian or foreign, resident or not in the country, arising from the direct or indirect disposal of shares participations, other rights representing capital or other rights that allow the exploration, exploitation, concession or any other similar of companies or permanent establishments domiciled in Ecuador or carried out on Ecuadorian stock exchanges for up to an annual amount of a basic fraction taxed with zero tariff (as of 2017 USD11,290) of the payment of the income tax.

Also, if a seller is a foreign company or individual resident of a jurisdiction with which Ecuador has signed an agreement to avoid double taxation, capital gains generated in an alienation of shares will be subject to taxation in the jurisdiction of their domicile and, consequently, the transaction will not be subject to any tax in Ecuador.

2.8 Other Taxes on Transactions
Other taxes that may generally apply include VAT and income tax withholding tax.

2.9 Other Notable Taxes
Please see **1.4 Tax Rates**.

3. Division of Tax Base Between Corporations and Non-Corporate Business

3.1 Closely Held Local Businesses
In Ecuador, most closely held businesses operate in corporate form, please see **1.1 Corporate Structures and Tax Treatment**.

3.2 Corporate Rates and Individual Rates
In Ecuador, there is a single rate of corporate income tax applicable to all legal entities (22%) regardless of the industry class in which they operate. For individuals, the applicable income tax rate depends on their total income at the end of a fiscal period according to the following table:

Year 2017			
Basic Fraction	**Excess Up**	**Basic Fraction Tax**	**Excess Fraction Tax**
0	11.290	0	0%
11.290	14.390	0	5%
14.390	17.990	155	12%
17.990	21.600	515	12%
21.600	43.190	948	15%
43.190	64.770	4.187	20%
64.770	86.370	8.503	25%
86.370	115.140	13.903	30%
115.140	Onwards	22.534	35%

3.3 Accumulation Earnings for Investment Purposes
There are no rules that prevent closely held corporations from accumulating earnings for investment purposes. on the contrary, tax benefits are granted to companies that reinvest their profits so they may obtain a reduction of ten percentage points of the income tax rate on the amount reinvested in productive assets, provided that they are allocated to the acquisition of new machinery or new equipment that is used for their productive activity, as well as for the acquisition of goods related to investment and technology that improve productivity, and generate productive diversification and increase of employment, for which they must make the corresponding capital increase.

3.4 Sales of Shares in Closely Held Corporations
Dividends are tax as follows:

In Ecuador, taxable income is considered to be the profits and dividends distributed by companies incorporated or established in the country to individuals.

Paragraph 5 of Article 8 of the Organic Law of the Internal Tax Regime, states:

"Art. 8.- Income from Ecuadorian source. - The following revenues will be considered from Ecuadorian source:

5.- Profits and dividends distributed by companies incorporated or established in the country; (...)"

The rule for tax treatment in the distribution of dividends establishes that when a company, resident or established in Ecuador, distributes calculated dividends after the payment of income tax to individuals, it must apply the following rules:

- If dividends are distributed directly in favour of a natural person resident in Ecuador, dividend income is taxed and subject to withholding. The natural person must consolidate the dividend with his global income, and declare and

pay tax on all his income (the tax burden could be up to 35%).
- If dividends are distributed in favour of a non-resident natural person in Ecuador, dividend income is exempt and not subject to withholding.

In addition, the tax legislation states that dividends and profits calculated after the payment of income tax and distributed by a national or foreign company's resident in Ecuador are exempt in favour of other national or foreign companies not domiciled in tax havens or jurisdictions of lower taxation or natural persons not resident in Ecuador. This exemption does not apply if the beneficial owner, in the terms defined in the regulation, is a natural person resident in Ecuador.

Tax treatment of the payment of income tax on capital gains:

In Ecuador, the profits (capital gains) received by natural persons, Ecuadorian or foreign, arising from the direct or indirect disposal of shares is considered as taxable.

The numeral 3.1 of Article 8 of the Organic Law of the Internal Tax Regime, states:

"Art. 8.- Income from Ecuadorian source. - The following revenues will be considered from Ecuadorian source:

3.1. The profits received by companies domiciled or not in Ecuador and natural persons, Ecuadorian or foreign, resident or not in the country, arising from the direct or indirect disposal of shares, shares, other rights representing capital or other rights that allow the Exploration, exploitation, concession, or the like; of companies domiciled or permanent establishments in Ecuador. (...)"

The direct alienation is that made by the owner of shares in an Ecuadorian company.

The taxable income is the real value of an alienation, less the proportional equity value of shares and that of those expenses directly related to an alienation; the final value on which a corresponding tariff is applied. For the seller of shares that is an Ecuadorian resident, the profit will be part of their overall income and the rate of individuals (up to 35%).

When the owner is a company or natural person resident abroad, the company whose shares are transferred directly or indirectly will have the status of substitute, and is jointly and severally liable for the payment of tax and the fulfilment of formal duties.

Finally, in relation to these formal duties, the most important is the obligation of the company whose shares are sold to report those transfers to the SRI. In the case of not reporting or doing so in error, a company will be fined 5% of the actual value of the transaction.

3.5 Sales of Shares in Publicly Traded Corporations

Tax Treatment Dividends of Companies that are Listed on the Stock Exchange Distributed to Individuals

The tax treatment of the dividend income tax of listed companies is the same as that of closely held corporations.

Tax Treatment, to Individuals, on the Capital Gains of Companies Listed on the Stock Exchange

In Ecuador, incomes generated by individuals on capital gains of companies listed on stock exchange are considered as taxable incomes, regardless if they are Ecuadorian Tax Residents or not.

In the case of publicly traded companies, taxable income is the actual value of the disposal less the purchase value of the shares and that of those expenses directly related to the disposal. If the seller of shares is an Ecuadorian resident, the profit will be part of their overall taxable income. While, if the seller who is a company or natural person not resident in Ecuador, the rate of 22% will apply the company whos shares are sold will be responsible to withhold and pay this tax.

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

Interest

In the absence of agreements to avoid double taxation, the withholding tax applicable to interest paid abroad is 22%, in addition the Foreign Currency Exit Tax must be paid (equivalent to 5% of the amount effectively transferred), however, the tax regulations consider the following exception:

Income Tax Considerations

Articles 2 and 13 of the LORTI provides that the interest on foreign loans will be deductible, in terms of income tax base and they will not be subject to Ecuadorian income tax nor be subject to withholdings, if they comply with the following:

- The loans must be registered in the Ecuadorian Central Bank, within a maximum term of 45 calendar days, counted from the last disbursement.
- If loans are granted by abroad related parties, its total amount may not be greater than 300% of equity, this rule does not apply if the loan does not generate interest.
- The abroad company, which grants the loan, must be qualified by the Superintendence of Banks as a non specialised financial entity.
- The agreed interest rate may not exceed the limit established by the Monetary and Financial Regulation Board, at

the time of its inscription, to date the referred maximum rate is 8.35% per year.
- A lender must reliably demonstrate the full entry of resources to Ecuador, through the national financial system.

Currency Exportation Tax Considerations
In Ecuador, currency exportation tax is taxed with a rate of 5% of all transfers of money abroad, however, Article 14 of the currency exportation tax rules provides an exemption from this tax to all payments abroad for external financing, if the loans from which they originate meet with the requirements.

Dividends
The treatment of dividends has already been dealt with in previous points.

Royalties
In the absence of agreements to avoid double taxation, the withholding tax applicable to royalties paid abroad is 22%, in addition the currency exportation tax must be paid (equivalent to 5% of the amount effectively transferred), and there are no exceptions.

4.2 Primary Tax Treaty Countries
The countries with double taxation agreements include the following:

- Argentina;
- Belgium;
- Brazil;
- Chile;
- France;
- Germany;
- Italy;
- Mexico;
- Romania;
- Singapore;
- South Korea
- Spain;
- Switzerland;
- Uruguay;
- China;
- Bolivia;
- Colombia;
- Peru;
- Venezuela; and
- Canada.

Those mainly used are:

- Spain;
- Uruguay;
- China;
- Colombia;
- Peru;
- Venezuela; and
- Canada.

4.3 Use of Treaty Country Entities by Non-Treaty Country Residents
Local tax authorities do not challenge the use of treaty country entities for investment purposes, however, they have established a special mechanism to apply the treaties in Ecuador, which is explained below:

- Entities that make payments abroad must act as income tax withholding agents.
- The IRS is empowered to establish maximum amounts for the automatic application of an agreement, as well as to define mechanisms for the purpose.
- Finally, it is established that if amounts are exceeded or the requirements are not met, the benefit will be applied through the tax refund mechanism.

Regarding the maximum amounts of the automatic application of an agreement to avoid double taxation, the ecuadorian tax authority establishes the following:

1. Automatic application of the agreement with a certificate of fiscal residence:

Understanding as automatic application, the fact of allocating a lower tax rate to the general corporate income tax rate (22%) in application of Conventions to Avoid Double Taxation, ie, if the income tax rate established in the agreement, for technical services is 10%, the company may apply this tax rate directly, provided that the value of the service to be paid is within the established limit.

The maximum limit for automatic application of the agreement for 2017 is USD225,800 equivalent to twenty basic fractions taxed with zero rate of income tax for natural persons.

2. Payments greater than USD 225,800.

If an Ecuadorian Company registers payments, on the course of a fiscal year, to the same supplier for over USD225,800.00, the Company will apply the withholding of 22%, without considering the benefits provided in the Conventions for Avoid Double Taxation, from the moment in which the maximum limit is exceeded.

However, if it is considered that payments made can be accepted to the agreement, it is possible to request the refund of the taxes retained, however, this request for a refund must be made directly by the foreign supplier.

4.4 Variation from OECD Standards

The Organisation for Economic Co-operation and Development (OECD) maintains guidelines for the application of transfer pricing for multinational corporations and tax administrations, in which they present certain guidelines for the application of the "arm's length principle" on transfer pricing.

Ecuador, in accordance with the provisions of the LORTI for the application of the principle of full competition principle, accepts the following methods:

- Uncontrolled comparable price method;
- Resale price method;
- Added cost method;
- Method of distribution of profits; and
- Transactional margins method of operational utility.

Also, when entering into transactions with related parties and if it exceeds the limits established in the regulations, they will be obliged to present:

Annex of Transactions with Related Parties

If, within the same fiscal period, the cumulative amount is more than USD3 million, they must submit to the IRS the annex of operations with related parties.

Annex of transactions with related parties is a form that must be presented to the IRS, within a period of no more than two months from the closing date of the fiscal year in which it is presented in summary of the transactions made with related parties.

Transfer Pricing Report

If, within the same fiscal period, the cumulative amount is more than USD15 million they must present, in addition to the annex, a comprehensive transfer pricing report.

A transfer pricing report is a formal study that must contain the following structure according to the IRS:

- Executive summary presenting scope, objectives, content and conclusions.
- Functional analysis which shall detail the functions carried out by each of the related companies, including their nature and frequency, the risks assumed by each of the parties, and contain details of inter-company operations, making a description of each one of them, plus mentioning amounts and the companies and countries in which they were made.
- A market analysis that must provide information regarding the industry and the economic activity in which the operations are carried out.
- An economic analysis where the nature of the items to be analysed are described.

5. Key Features of Taxation of Non-Local Corporations

5.1 Taxation of Non-Local Corporation Versus Local Subsidiaries

In Ecuador, there is no distinction between branches of non-local corporations and local subsidiaries of non-local corporations. The tax treatment is the same as that of corporations constituted in Ecuador that has been previously explained.

5.2 Capital Gains of Non-Residents

Capital gains of non-residents on the sale of stock in local corporations are taxed.

The taxable income is the real value of an alienation less the proportional equity value of shares and that of those expenses directly related to the alienation; the final value on which the tax rate is applied. For the seller of shares that is an Ecuadorian resident, the profit will be part of their overall income and the rate of individuals (up to 35%) or companies respectively (22%) will be applied. While, for the seller who is a company or natural person not resident in Ecuador, the rate of 22% will apply.

In principle, the owner must pay the shares that are transferred. However, when the owner is a company or natural person resident abroad the company whose shares are transferred, directly or indirectly, will have the status of substitute, and is jointly and severally liable for the payment of the tax and the fulfilment of formal duties.

Finally, in relation to these formal duties, the most important is the obligation of a company whose shares are sold to report those transfers to the Ecuadorian IRS. In the case of not reporting or doing so in error, a company will be fined 5% of the actual value of the transaction.

5.3 Change of Control Provisions

According to Article 8, numeral 3.1 of the LORTI, the following are considered Ecuadorian source income: profits received by companies domiciled or not in Ecuador and natural persons; Ecuadorian or foreign and resident or not in the country; arising from the direct or indirect disposal of shares, participations, other rights representing capital or other rights that allow exploration, exploitation, concession or any other similar; of companies or permanent establishments domiciled in Ecuador.

According to Article 39 of the LORTI, indirect disposal of shares shall be deemed to have occurred provided the following facts occurred concurrently:

- That at any time during the fiscal year in which the disposal of shares takes place, the real value of the capital rights of the Ecuadorian company directly or indirectly represents

20% or more of the actual value of all capital rights of a company not resident in Ecuador.

- That within the same fiscal year, or during the 12 months prior to the transaction, the disposals of shares of a non-resident company, whose alienator would be the same natural person or company or its related parties, correspond directly or indirectly to an accumulated amount of more than 300 basic fractions of the exempt tax base of income tax of natural persons (USD11,290). This amount will be extended to 1,000 basic fractions of the exempt tax base of income tax of a natural person (USD11,290) when said transaction does not exceed 10% of the total share capital.

According to the article it is important to remark that the two conditions should occur simultaneously to generate an indirect disposal of shares, according to the law.

According to Article 39 of the LORTI, an Ecuadorian company whose shares are directly or indirectly disposed of will act as a substitute of a foreign company, and will be responsible for the payment of the capital gains tax.

The capital gains tax rate is 22% over the profit reported in the transference of shares.

5.4 Determining the Income of Foreign-Owned Local Affiliates

There are no formulas as the tax treatment of a foreign-owned local affiliate is the same as an Ecuadorian company.

5.5 Deductions for Payments by Local Affiliates

For management and administrative expenses assigned to local companies by their parent companies, a 5% deductibility limit is established based on the taxable profit of the period plus the value of the management and administrative expenses allocated. The excess is considered as a non-deductible expense.

5.6 Contraints on Related Party Borrowing

Income Tax Considerations

Articles 2 and 13 of the LORTI provides that the interest on foreign loans will be deductible in terms of income tax base and they will not be subject to Ecuadorian income tax nor be subject to withholdings, if they comply with the following:

- The loans must be registered in the Ecuadorian Central Bank, within a maximum term of 45 calendar days, counted from the last disbursement.
- If loans are granted by abroad related parties, its total amount may not be greater than 300% of equity, this rule does not apply if the loan does not generate interest.
- The abroad company, which grants the loan, must be qualified by the Superintendence of Banks as a non specialised financial entity.
- The agreed interest rate may not exceed the limit established by the Monetary and Financial Regulation Board, at the time of its inscription, to date the referred maximum rate is 8.35% per year.
- A lender must reliably demonstrate the full entry of resources to Ecuador, through the national financial system.

Currency Exportation Tax Considerations

In Ecuador, currency exportation tax is taxed with a rate of 5% of all transfers of money abroad, however, Article 14 of the Currency Exportation Tax Rules provides an exemption from this tax to all payments abroad for external financing, if the loans from which they originate meet the aforementioned requirements.

6. Key Features of Taxation of Foreign Income of Local Corporations

6.1 Foreign Income of Local Corporations

For Ecuador, the tax period runs from 1 January to 31 December of each year, and the rate of income tax fr corporations is 22% regardless of the industry in which they operate.

6.2 Non-Deductible Local Expenses

Foreign income is not exempt and so local expenses are treated as deductible if they are attributable to such income.

6.3 Taxation on Dividends from Foreign Subsidiaries

Foreign dividends are exempt from Ecuadorian taxation if they meet the following conditions:

- If they were subject to local taxation in the country in which they originated; and
- The local company includes the same revenue in its income tax return as exempt.

Failure to comply with these two conditions or in case the income comes from tax havens, means a company must proceed with the payment of income tax in Ecuador.

6.4 Use of Tangibles

Intangibles cannot be used since taxpayers entering into transactions with related parties must determine their income, costs and deductible expenses, considering for such transactions the prices and values of consideration that they would have used with or among independent parties is comparable.

6.5 Taxation of Income of Non-Local Subsidiaries Under CFC-Type Rules

CFC-type rules are not applicable in Ecuador, see the parameters set out in **6.1 Foreign Income of Local Corporations**

and **6.3 Taxation on Dividends from Foreign Subsidiaries** for more details.

6.6 Taxation on Gain on the Sale of Shares in Non-Local Affiliates

Local corporations have a rate of 22% applied, as income tax, on the profit of the sale. The earnings are the result of the difference between the price of the shares and the proportional equity value of them.

7. Anti-Avoidance

7.1 Overarching Anti-Avoidance Provisions

There is no tax legislation specifically sanctioning anti-evasion activities, however, Ecuadorian penal legislation contemplates tax evasion as a felony established in Article 298 of the Organic Criminal Code currently in force.

As a preventive mechanism, the competent authority has the power to issue a warning, after noticing inconsistencies in reported revenues. In answer to this notification the taxpayer must justify the differences reported by the authority, or in absence of this, make an amended tax report.

8. Other

8.1 Regular Routine Audit Cycle

In Ecuador, the Companies Act regulates firms whose assets exceed USD100,000 through external audit reports. The inspector will also be required to supervise the management of a company.

In Ecuador, the IRS in use of its determining authority will verify the declaration.

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