

# Doing Business in Ecuador

This document describes some of the key commercial and taxation factors that are relevant on setting up a business in Ecuador.



## Background

### Country overview

Ecuador is located in western south America, crossed by the equator line in the middle of the world, has 16.8 million in population, estimate 2018. 80% of Ecuador's population is Catholic.

Spanish is the official and dominant language in Ecuador. There are other native languages, of the region such as the Kichwa and Shuar, official languages of intercultural relations user.

The Republic of Ecuador has four geographical regions: Coast, Rockies, Rain Forest and volcanic archipelago, the major cities are, Quito the capital, Guayaquil the economic capital, Puerto Ayora and San Cristobal entrance to Galapagos Island the biggest tourist attraction and Cuenca the Cultural capital. Bordering the Pacific Ocean and between Colombia and Peru.

Ecuadorian economy is based mainly on the export of oil and other products such as: bananas, cocoa, shrimp, flowers. The Gross Domestic Product in the first quarter of 2018 reached US \$ 26.47 million.

### Economic overview

Ecuador has substantial petroleum resources and rich agricultural areas. Because the country exports primary products such as oil, bananas, cacao, flowers, and shrimp; fluctuations in world market prices can have a substantial domestic impact. The work force is 8.2 million of the population. Unemployment rate 4.4% and underemployment 18.3%.

In 2000, Ecuador adopted the U.S. Dollar as the official currency of Ecuador, which has contributed in recent years to exist relative macroeconomic stability.

### Transport infrastructure

The main International Airports are in Quito (UIO), Guayaquil (GYE), San Cristobal (SCY) and Seymour (GPS) in Galapagos Islands. Ecuador and another 21 operational local airports. There are modern international airports in Quito and Guayaquil; that will be complete with Free Trade Zones. Ports and harbors in Guayaquil, with Free Trade Zones.

## Choice of Legal Form



### Limited liability corporations

Limited liability Corporation is the most common form of creating a business in Ecuador.

A minimum of two shareholders is required, which may be corporations, companies or individuals. Corporations may continue with only one shareholder after being organized.

There are no restrictions for foreign shareholders by laws must be converted into a public deed, approved by the Superintendent of Companies and registered at the Mercantile Registry.

The minimum subscribed capital is US \$400, and 50% must be paid in at the moment the corporation is organized. The remaining 50% must be paid within the following two years at the most. Funds in local and foreign currency for the initial

contribution should be deposited in a local bank. The capital contribution may be in cash or in kind, but must be related to the corporation's activity.

The main characteristics are:

- Limited liability - The Corporation is an organization where capital stock is divided, into negotiable shares, arising from the shareholders contributions, and the shareholders' liability is only limited to the par value of the shares they hold. In this organization are members are responsible only shares.
- Centralized management - Shareholders Meeting is the supreme body of the company and is responsible for decision-making in matters related to functions, activities and business operations. A Chief Executive Officer, appointed by the Shareholders' Meeting, may manage the company.

- Continuity - The death, illness, bankruptcy, retirement or resignation of any shareholder does not cause the dissolution of the entity.
- Corporations should allocate 5% or 10% of their distributable net profits, after employees' profit sharing and income tax, up to a limit equivalent to 20% of the paid-in capital in order to create a Legal Reserve for limited liability Corporation and other Corporation respectively. Shareholders must distribute at least 50% of the year net profit, unless they unanimously agree to distribute 100% or reinvest it entirely.

### Partnership corporations

A partnership corporation may be organized by a minimum three and a maximum of fifteen partners. These partners can be either individuals or corporations, banks, insurance and capitalization companies, are not allowed to incorporate limited liability companies. The procedures to incorporate partnerships are the same as those for limited liability corporations.

The minimum paid-in capital is US \$800. At the moment of incorporation, the whole capital must be subscribed and at least 50% paid in; the remaining capital must be paid within the next twelve months from the date of incorporation.

### Branch of a foreign corporation

Foreign companies may operate in Ecuador through a domiciled branch in Ecuador. For the establishment of a branch it is required to:

- Prove the good standing of the company in the country of origin.
- Prove the company's capability to establish a branch in a foreign country.
- Appoint a permanent legal representative in Ecuadorian territory legally authorized to conduct business, and to undertake obligations. If the legal representative is a foreign individual, he/she must be a resident in Ecuador.
- Assign a minimum capital to start operations is US\$2,000, which have to register in Banco Central del Ecuador BCE.

## Audit Requirements



All the companies that exceed of US \$500,000 in total assets; and Branch of foreign corporations that exceed of US \$100,000 in total assets, they must contract a financial audit.

### **International financial reporting standard IFRS.**

The Superintendent of Companies, Securities and Insurance in the body of control of companies who ratified and established the obligation to apply the International Financial Reporting Standards (IFRS) full or Small and Medium-Sized Entities (IFRS to SME), of companies under its control and surveillance should implement these standards.

## Taxation



In accordance with the Constitution of the Republic of Ecuador the tax regime is based on the principles of equality, and generality. The taxation laws have been designed to stimulate investment, reinvestment, and savings, which should be used for national development.

Internal Revenue Service IRS is the tax central authority.

### Corporate income tax

In general, the taxable base is constituted by the entirety of the ordinary revenues and others incomes burdened with the tax, less the refunds, discounts, costs, expenses and deductions, attributable to such revenue.

Corporations organized in Ecuador as well as Branches of foreign companies domiciled in the country that obtain taxable income, will be subject to an income tax on the rate of 25%, unless, by specific legal economic activities, they have a preference tax rate of 15% of the profit reinvested.

The tax rate increases to 28% the proportion of taxable income corresponding to the direct or indirect involvement of partners, shareholders, beneficiaries or the like, which are resident in tax havens or lower tax regimes.

Advance on income tax paid in two instalments, according to its share in July and September next year. Advance tax credit is, when the tax paid is less than the advance, the latter minimum tax is determined as final.

### Transfer pricing

According to the Law, tax authorities may regulate prices on the transfer of goods in the following cases:

- If local sales are done at cost or a value below cost.
- If prices paid on exports are below current International prices.
- If prices paid on imports are higher than International market prices.

Actually, in Ecuador the tax laws require and annex of transactions with related parties equal to or greater US\$3,000,000 and study transfer price of this transactions equal to or greater US\$15,000,000.

### Personal income tax

Foreigners are subject to the same treatment if they are considered as a resident for tax purposes. A resident, for tax purposes, is an individual who has carried out activities in Ecuador for more than 183 days in two calendar years.

Non-residents personal income tax: If the individual carries out activities for less than 183 days, he/she will not be liable for filing and paying income tax in Ecuador. However, payment to this individual will be subject to a 25% income tax withholding, to be performed by the payer (local company).

### Value added tax

All transfers of goods and services are taxed with a 12% VAT, unless they are exempted by the Internal Tax Law. Certain services and transfers are levied with a 0% VAT. A 12% value-added tax (VAT) is levied on all sales and commercial transactions, with the exception of the sale of unprocessed food products, drugs and veterinary products, material, machinery and equipment imported for agricultural use, as well as other items established by law.

As a general rule, the taxable base for this tax is the purchase price, of any discount recognized in the invoice. On the other hand, simple reimbursement procedures are established for the VAT paid by companies, which mainly export their products, except for oil exports. With regard to imports, the VAT settlement will be done in the corresponding bill of lading, and payment must be done prior to the customs withdrawal.

### Customs duties

Taxable base on imports is the CIF value of goods. Effective tax rate depends on the type of goods imported. Safeguard clause, this has been adopted as a special and transitory measure to protect foreign trade balance. This rate is levied in addition to the ad-valorem custom duty tariff.

## Allowances



### Depreciation y amortization

5% Buildings, 10% furniture and equipment, 20% vehicles and 33% computation equipment. The deferred assets amortize to 20%, the method uses is straight-line amortization, and any other method requires express authorization.

### Losses carry forward

Net losses can be carried forward to the five years following the year the tax loss was incurred. The use of the carry forward in each year should not exceed 25% of the annual taxable income. Any remaining balance after the fifth year will be lost.

### Tax payments and income tax return

The tax year is the calendar year.

### Tax credits

The Add Value Tax (VAT) in purchases is constituted a tributary credit applicable to the VAT sales.

### Free trade zones

These zones offer exporters the possibility to import free of customs duties, statistics rate and VAT, all the necessary equipment to build operations within the zones. Furthermore, exporters manufacturing within the zones enjoy the benefit of buying supplies and raw materials from third countries, without having to pay duties or taxes that lead to increased prices. Goods may remain in the zone for a maximum period of 180 days, which can be prorogues only for more 1 time for 180 days.

Goods have to be export in the period mention above and for Free Trade Zones otherwise the goods have to be nationalized with the payments of duties and taxes.

Also, in this category has Commercial Deposit which is a variation of Free Trade Zones. The company import or purchase the materials and according to the necessities in the elaboration of the product, releasing from Commercial Deposit. When they have the final product, it must be export in order to get the benefits of this Deposit. Currently, there are free trade zones in Quito, Guayaquil, Cuenca, Manabí, Esmeraldas, El Oro and Manta.



## Employment



### Social security

Employers must register their employees at the Ecuadorian Social Security Institute (IESS), on their first day of work. They also have to give notice about employees' dismissals, modifications in their wages, position, occupation, or any other work conditions to the same entity.

Employees' contributions must be withheld by the employer by deducting them from the salary and must be settled in the IESS together with the employer's contribution, within the first fifteen days of the subsequent month.

Contributions are estimated on the employee's total monthly salary, including overtime, commissions, bonuses, fees, or any other additional and regular payment in the industry (excluding the 15% sharing on net profits).

Monthly contributions are paid to the IESS on the basis of the following percentages:  
Employer 12.15% of the salary  
Employee 9.45% of the salary (worker in general)

Monthly basic salary is US\$386.00.

### Workers participation

Under labor laws, workers have the right to participate in company profits by 15% applicable to liquid or accounting profits each year.

## Withholding Taxes



### Dividends

Dividends distributed to natural persons resident in the country and companies domiciled in tax havens or lower taxation of distributed profits cause additional tax regimes, according to a table ranging from 1% to 13% extra.

Interest 25% - Foreign Loan should be registered at the Central Bank.

Royalties 25 % to 35% - There are taxation agreements with some countries in order to avoid double taxation: Argentina (only air transport rents), Andean Community (Bolivia Colombia and Peru), Belarus, Belgium, Brazil, Canada, Chile, China, France, Germany, Italy, Korea, Mexico Romania, Spain, Singapore, Switzerland and Uruguay.

Rental Property, 8% corporations and individuals.

Technical assistance 25% with tax havens.

Tax to outdoor payments (ISD in Spanish) 5% - All payments or wire transfers to out of Ecuador.

## Miscellaneous



### Municipalities

Regulated the commerce activities in the main cities of the country and authorize the operation with Patents that are due to renew annually depends of equity value in finance report; and, annual contribution equivalent to  $1.5 \times 1000$  of the company's total assets. This contribution has to be paid in each municipality in which the company develop the business, the rate may vary according to the city.

**This document is provided by Micelle Cia. Ltda. as a general overview of matters to be considered when setting up an overseas business in Ecuador. It is essential to take advice on specific issues. No liability can be accepted for any action taken or not taken arising from the information provided in this publication.**

If you are setting up a business in Ecuador, the members of DFK International can help you to achieve this efficiently. You will receive practical advice on business issues, tailored to meet your objectives, from experienced business advisers.

For further information on the services available from the DFK member firms in Ecuador please see overleaf.



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