

# Setting up your Business in Ecuador

## Issues to consider



After the electoral process in Ecuador, the dialogue and consensus between the State and the business sector has begun to strengthen. The possibilities of access to tax incentives versus industry increase is an ambitious policy, as the income tax exemptions are maintained for five years in exchange for generating productivity in the private sector in the sectors of production of clean energy, food production, software development, petrochemical, foreign trade and others. In Ecuador the official currency is the Dollar, which is an attractive option for foreign investment.

However there are a number of issues which you must consider when you are looking to set up your business in Ecuador. This document takes you through some of the common questions we come across and gives you practical information about the issues you need to consider.

What type of Business Structure should we use?

There are advantages and disadvantages to all of them, and there is no one correct answer, it's all dependent on your specific business circumstances and needs. A brief overview of the main structures is below:

Establishment (a branch of your overseas business)

- Not a separate legal entity but an extension of the overseas parent company
- Establishment has limited liability in Ecuador operations
- Minimum capital is USD 20.000
- Parent company must grant a power of attorney (proxy) to an individual Ecuadorian resident
- For tax purposes it's considered a permanent establishment in Ecuador; therefore its profits are liable to Ecuador Corporation tax
- There is no obligation to file parent company accounts
- Establishment accounts must be prepared under IFRS and be submitted at the Superintendence of Companies for public inspection
- The tributary administration is Servicio de Rentas Internas – SRI, (Internal Revenue Services) and all of the tax reports are audited and reviewed there.

### How much Corporation Tax will the business pay?

Current Corporation Tax rate in Ecuador is 22%. The tax rate was reduced from 25% to 22% (from year 2011 onwards) as a way to promote investments in Ecuador. This rate may also be reduced 10 percentage points more when the company reinvests its profits. In addition, some tax benefits have been established for new investments, such as exemption on income tax for 5 years when the investment is in the following sectors: food production, forestry, metal mechanic, petrochemical, pharmaceuticals, tourism, renewable resources, logistics in foreign trade, biotechnology and software. Also the dividends to overseas shareholders are exempt from tax on currency outflows (5% rate).

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Investments made by new companies incorporated in Ecuador are exempt from advanced income tax during its first 5 years of operations. Companies also have to pay an advanced income tax, which is calculated on a percentage of its assets (0,4%), equity (0,2%), income (0,4%) and deductible expenses (0,2%). If at the end of the year the amount of income tax is less than advanced income tax, the latter becomes final payment.

Current List of principal tax types in Ecuador

No.	Tax Type	Periodicity	Rate	Exemptions
1	Income Tax: "IR"	Annual	22% (For Ecuadorian Companies)  25% For Companies residents in tax havens	Based on the the Tax Law
2	Value-added Tax: "IVA"	Monthly	0% (Goods or services with incentive as listed in the Tax Law )  12% (The rest of goods or services)	Based on the the Tax Law
3	Tax on Currency Outflows: "ISD"	Outflows over thousand dollars	5%	Based on the the Tax Law
6	Municipal Patent Tax	Annual	Based on Assets	Based on the the Tax Law
7	(1.5/1000) per Total Assets.	Annual	Based on Assets	Based on the the Tax Law

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8	Property Tax	Annual	Property Value	Based on the the Tax Law
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### What if we use Ecuador to set up our holding company?

There two ways for invest in Ecuador through a Company:

First, for the objet or activity, there are any activities that can gain access to exemptions, like the sectors mentioned in previous paragraph. Or,

Second, a Holding company in Ecuador that only holds shares in other local companies is exempt from income tax or advanced income tax. These exemptions are not applicable on dividends that the Holding company receives from overseas companies. The dividends paid by the Holding company to its overseas shareholders are not subject to withholding tax, except to shareholders that are companies located in fiscal havens. The profits obtained by the Holding company in the assignment of shares is subject to income tax.

### What if we make cross-border transactions between group companies?

Ecuador follows internationally recognized Transfer Pricing (TP) rules where cross-border trading and financial transactions between affiliated entities have to be conducted on an arm's length basis. The price and terms should be the same as if the transactions had been between completely independent parties.

A business will need to prepare a Transfer Pricing Report proving the arm's length basis of transactions if it has annual operations with local or overseas related parties over USD 6m. The report will include a functional and risk analysis, analysis of the adopted pricing model and benchmarking of the arm's length basis.

The companies exempt from Ecuador's transfer pricing regime are those that have an income tax 3% higher than its taxable income, do not have operations with fiscal havens and have not signed contracts with the government for exploration and exploitation of nonrenewable resources.

Generally, overseas payments are subject to withholding income tax of 22%, except specific situations, such as payments made to countries with which Ecuador has signed the Tax Convention on Income and on Capital (Germany, France, Italy, Spain, Switzerland, Belgium, Rumania, South Korea, Canada, Brazil, Mexico, Chile, Colombia, Uruguay, Peru and Bolivia).

Furthermore currency outflows are levied with 5% tax (ISD).

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### What Employment Taxes and Social Security will need to be paid?

If an individual is resident in Ecuador then they are subject to Ecuadorian tax laws. An individual is considered to be resident, for tax purposes, if it has remained in the country for 183 days or more, consecutive or not, in the same fiscal year.

We would advise any new entrant to Ecuador or person who spends time working in Ecuador to take professional advice to determine whether they are Ecuador tax resident.

Current Personal Income Tax rates in Ecuador are:

Basic Fraction	Excess	Tax over Basic Fraction	% Tax over Excess
0	11.290	0	0%
11.290	14.390	0	5%
14.390	17.990	155	10%
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	henceforth	22.534	35%

(NB: rates are for the tax year 2017)

Employers and employees also have to pay Ecuador social security:

Current Social Security rates are:

Nm.	Rate %
Employer	12,15% of salary paid to employee
Employee	9,45% of salary

NB: (rates are in forced since many years ago and there are no announced changes)

It is the employers' legal responsibility to withhold employee's income tax on a monthly basis and pay it to the Ecuador tax authority (SRI). Also the employer has to deduct social security contribution and pay it to the Ecuador social security authority (IESS).

All employers must pay annually 15% of its gross profits to its employees.



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### **What is Value Added Tax (VAT) and should the business be registered?**

All companies must be registered before the tax authority (SRI) with a "RUC", which is a registration number, in order to start its operations.

VAT is levied on the transfer of goods, intellectual property and services, at the rate of 12%. However there are some goods and services taxed with 0% rate.

There are two types of supply

- Taxable – must charge VAT on supplies, can reclaim input VAT only these cases:
  - Exporters of goods may claim VAT paid on the purchase of goods and services destined to its exports.
  - When tax withholding isn't compensated over six months
- Exempt – cannot charge VAT nor reclaim input VAT in these cases:
  - Contributions to companies in property
  - Transformation of companies
  - Donations to the public sector
  - Certain customs regimes

### **How else can we compensate our employees?**

Ecuador has a very comprehensive range of compensation and benefit options available for companies to offer their employees.

Pensions, private medical insurance, life and disability cover are now commonplace benefits provided by many Ecuador businesses to their workforce. Ecuador is the only country that provides Employees' Profit Sharing called "Utilidades" to his employees. (Calculated at 15% by the accounting profit in the income statement).

To discuss your requirements please contact the International Office on +44 (0) 1245 449266 or email us directly.

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