



Doing Business In Ecuador

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1. About HLB International

HLB International is a world-wide organization of professional accounting firms and business advisors, each providing clients with a comprehensive and personal service relating to auditing, taxation, accounting and general and financial management advice.

Formed in 1969, HLB can assist clients in over 100 countries, with more than 1,430 partners and 9,900 staff in over 400 offices.

Up-to-date information and general assistance on international matters can be obtained from any of the partners of HLB – Consultores Morán Cedillo Cía. Ltda. listed in this booklet or from the Executive Office in London:

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2. Foreword

This booklet has been prepared for the use of clients, partners and staff of HLB International member firms. It is designed to give some general information to those contemplating doing business in Ecuador and is not intended to be a comprehensive document. You should consult us, therefore, before taking further action.

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**Consultores Morán Cedillo Cía. Ltda.
Auditores Independientes**

Guayaquil, October, 2004

3. General Information

3.1 Location and Climate

The Republic of Ecuador is located on the northwest coast of South America. The Republic of Colombia to the north, the Republic of Peru to the south and east and the Pacific Ocean to the west surround it. In addition, Ecuador is situated right on the equator and covers 283,830 sq. Km. including 8,000 sq. Km. of the Galapagos Islands 965 Km. off the coast. Its capital is the Metropolitan District of Quito.

Ecuador has four geographical regions: the coast that represents approximately one fourth of the country's land; the highlands mainly represented by the Andes mountains extending from north to south in two parallel ranges; the eastern region represented by the tropical jungle and the Amazon river and the Galapagos islands composed by six large and nine smaller islands of volcanic origin, mostly inactive.

Ecuador is politically divided into 22 provinces, with cities and towns with urban and rural population.

The capital Quito is located in the highlands lying at an elevation of 2,810 m with average temperature of 12.8° C, and an estimated population of 1,839,853. Guayaquil is located at the southwest with an estimated population of 2,039,789; it is Ecuador's largest city and its chief port and manufacturing and commercial center. Cuenca is the third largest city with significant agricultural and commercial activity

and 417,632 inhabitants. All population estimates are based on the 2001 census.

Although Ecuador is situated at the equator, its climate varies due to the height of some areas and the influence of the cold Humboldt Current in the summer (May to November) and the warm El Niño Current in the winter (December to April). The coastal plain is hot and humid, with an average temperature of 26° C. In the highlands, the temperature varies with altitude and time (from 21° C at midday to 7° C at night). The eastern or jungle region is warmer and more humid than the coast with temperatures reaching up to 37.8° C. The annual average rainfall is 2,030 mm.

3.2 Population, Language, Religion and Education

The population is mainly of Indigenous, Spanish and African origin. Approximately 61% of the population lives in urban areas.

In 2001 Ecuador's population was estimated at 12,156,608 inhabitants, with a density of 43 inhabitants /sq.km of which 46% live in the highlands, 50% on the coast and the remainder is distributed between the eastern tropical jungle and the Galapagos Islands.

The official and commercial language of Ecuador is Spanish, although most of the indigenous population speaks Quechua, the predominant language of the region before the Spanish conquest. English is generally spoken in business circles.

Approximately 95% of the Ecuadorian population professes the Catholic religion and less than 1% belongs to the Protestant churches.

Elementary education is mandatory in Ecuador. Government sponsored elementary and secondary education is 100% subsidized while superior education is partially subsidized. According to the 2001 census, 90% of the population older than 14 years is literate. Elementary school begins at the age of 5 and secondary education generally finishes at the age of 18.

3.3 Currency

Until January 9th of 2000, the official currency was the Sucre (designated by the symbol S/.) and from January 10th of that year the United States dollar was decreed to be the official currency and medium of exchange. Each dollar is 100 cents. The National Council on Narcotics and Psychotropic Substances-CONSEP has established controls over monetary transactions to prevent money and assets laundering. Such controls include the justification of the source of money or assets.

3.4 Legal System

The Legal System in Ecuador is the Roman System, which is generally the system adopted by most countries of Latin Origin.

This system is based on a constitutional regime supported by laws and regulations of civil, commercial and administrative areas.

3.5 Political System

The last military dictatorship ended in 1978 and since then democratic governments have been elected. Ecuador's Constitution establishes three Governmental branches: Legislative, Executive and Judicial.

The Legislative branch consists of the Congress, made up of legislators democratically elected. The Executive branch is in the hands of a President who is also democratically elected for a four-year term.

The President cannot serve consecutive terms but can be elected again subsequently. The Judicial branch exercises judicial power through the Supreme Court and lower courts. Even under the military dictatorships, government has generally had a political tendency to be moderately right of center.

Ecuador has eight political parties among which the Partido Social Cristiano-PSC, Partido Roldosista Ecuatorino-PRE, Izquierda Democrática- ID, Democracia Popular-DP and PRIAN are the most representative. The President in office took over in January 2003 and belongs to the Sociedad Patriótica - PS political party.

According to the Constitution, the party or political movement that in two successive national elections does not attain a minimum five percent of the valid votes is deleted from the electoral records.

3.6 Economy

Inflation. - The annual inflation rate in Ecuador for 2003 and 2002 was 6% and 9% respectively. The expected inflation rate for 2004 is estimated at 3%.

Exports. - The Ecuadorian economy is based on the biodiversity of its territory combined with its active population and entrepreneurial initiatives. The primary exportable goods that have mainly contributed to the Ecuadorian economy are crude oil, bananas, shrimp, natural flowers and cocoa. Industrialized exportable goods are oil derivatives, seafood products and metals.

Main destinations of exportable products are America (69%) and Europe (21%), of which 40% for the United States and 10% for Italy and Germany respectively.

Ecuador is a beneficiary of trade preferences from the United States and from the European Union, which allow the duty free entry into the US and Europe of selected items, including tuna in airtight containers and textiles.

Imports- Ecuador imports raw materials, minerals, textiles, equipment, oil derivatives, household appliances, vehicles, medicine, cereals and consumer goods among others. 68% of imports are from America while 16% are from European countries, being our main suppliers the United States with 23% and Italy and Germany with 5% of the total imports.

Ecuador is a member of the Andean Community of Nations and of the Latin American Association of Integration – ALADI that promote the

expansion of the integration of the region with the objective of establishing a common market.

Ecuador participates in the negotiations of the Free Trade Area of the Americas – ALCA that promotes the development of the Western Hemisphere by means of the expansion of the commercial flows, the liberalization of trade and investment.

3.7 Key Macro-Economic Indicators

	2003	2002
GDP US \$billion	27.2	24.4
GDP per capita (US\$)	2,118	1,920
Exports–FOB US \$billion	6,0	5,0
Imports–CIF US \$billion	6,5	6,4
Trade balance US \$million	-59	-969
Reserves US \$billion	1,2	1,0
External debt US \$billion	16,6	16,3
Budget deficit (% GDP)	0.0	-2.8

Source: Central Bank of Ecuador

3.8 Time Zone and Business Hours

There are two time zones in Ecuador: GMT -5 hours (Ecuador time) and Galapagos Islands GMT -6 (normal).

Business hours usually start at 8:00 a.m. for an 8-hour day. Some businesses close one or two hours for lunch. Banks open at 9:00 a.m. and close at 6:00 p.m. Government offices open at 8:00 a.m. and close at 5:00 p.m.

Workdays usually go from Monday to Friday; however a large number of commercial establishments are open on Saturdays and Sundays. Factories usually open between 8:00 a.m. and 9:00 a.m. and close between 7:00 p.m. and 8:00 p.m. Some factories run two or three shifts a day.

4. Investment Factors

4.1 Government Policy

Ecuador like most Latin American countries has undertaken a series of actions aimed to modernize the economy in line with the globalization trend of the world economy. Actions to attract foreign investment include:

- Free remittance of profits abroad
- Free remittance of proceeds from the sale of stock or other investments.
- Advantage of duty free treatments derived from trade agreements.
- Unrestricted and full access to the mechanisms of promotion, technical assistance and cooperation under the same conditions as the domestic investor.

The government encourages the security of the domestic and foreign investor. Discriminatory or other irregular practices are investigated and corrected.

4.2 Legal Environment

The legal and institutional environment of Ecuador for the foreign investor is transparent.

It provides an open and favourable climate for the investments thus constituting a safe alternative for the investor. The following is the legal framework for foreign investments:

- **The Constitution of Ecuador.**
- **The Decision 291 of the Cartagena Agreement (On the treatment of foreign investment, know how, trademarks, licenses and patents)**
- **Regulations on transfers of technology, trademarks, patents, licenses and royalties.**
- **Foreign Trade Law**
- **Law for the promotion of and incentives to foreign investment**
- **Law for the economic transformation of Ecuador**
- **Law for the economic reorganization of Ecuador**
- **Companies Law, immigration law and Law for the Financial Institutions**

The Decision 291 of the Cartagena Agreement clearly defines foreign investment as capital contributions from foreign individuals or entities in freely convertible currency or in physical or tangible assets, such as industrial equipment new or reconditioned, industrial parts, raw materials or intermediate products.

4.3 Regulatory Agencies

The following are the Governmental Regulatory Agencies for foreign investment:

- **Ministry of Industries, Trade, Integration and Fisheries- MICIP**
- **Foreign Trade and Investment Committee**
- **Foreign Promotion System**
- **Central Bank**
- **Superintendent of Companies**
- **Superintendent of Banks**

4.4 Investment Sectors

Foreign individuals and foreign entities are free to operate in almost any kind of business activity in Ecuador without restrictions, with the exception of national strategic sectors.

National strategic areas include energy, oil, mining, security, border areas, reserved areas and communications. The government is the sole proprietor and administrator of natural resources, however the government promotes the delegation of some of these sectors in the form of concessions or administration to foreign or domestic investors.

Currently the largest foreign investment in Ecuador is in the oil industry, followed by mining and the food industry. Other potential areas of investment include agriculture, tourism and services.

4.5 Tax incentives

Businesses may be authorized to undertake in-bond assembly operations. Under this special customs regime businesses import raw materials on a duty free basis provided the finished goods are ultimately re exported. Exemption includes customs duty, Value Added Tax and Excise tax.

The law also prescribes the drawback of duties and VAT paid on the importation of raw materials and the VAT paid on the local supply of goods and services provided the finished goods are ultimately re exported.

Imports from the Andean Community are duty free while imports of oil derivatives from ALADI member countries have preferential customs duties rates.

As to income tax, the Development Laws prescribe income tax exemptions for a period ranging between 5 to 10 years for businesses investing in industrial activities and agricultural development and tourism in the province of Loja. Such incentives will expire by 2008. In the tourism sector, exemptions are granted country wide for businesses established by April 1999 and for 10 years beginning in 1997.

4.6 Monetary Regime

The Monetary Regime Law established the monetary system of the Country whose execution falls to the Central Bank of Ecuador. The monetary system is based on the principle of free circulation and remittance of foreign currency.

4.7 Environment

Investors must maintain and preserve the environment and natural resources (and restore any damage caused.) COMEXI may prohibit totally or partially the operation of businesses that are damaging the environment or eroding natural resources.

4.8 Tax Stability for Foreign investors

Foreign investors are entitled to a frozen income tax rate for a specified period for investments over \$500,000 under the following conditions:

- New investments in existing companies- 10 years**
- New investments for the development of new projects or expansion- 20 years**

The use of this benefit is effective automatically with the presentation of the registration of the investment in the Central Bank or proof of the actual investment.

5. Labour, Work and Residence Permits

5.1 Basic Legislation

Labour legislation is contained in the Labour Code. The fundamental aspects of labour legislation are summarized as follows:

5.2 Wages

The minimum monthly general wage in Ecuador is fixed at \$143.62.

Depending on the economic sector this general minimum rate may vary to recognize higher minimum wages for qualified labour included in 113 rate tables issued by the Department of Labour.

The hourly rate is set at fully loaded \$0.95.

Workers are entitled to two bonuses during the year, the scholarship bonus equivalent to \$135.62 and a Christmas bonus equivalent to one actual monthly wage.

5.3 Working Hours

- The normal hours per shift are 8 and the normal shifts per week are five for a total of 40 hours per week. Shorter or longer shifts are permitted, depending on the nature of the work, but in any case the minimum off time will be observed.

- Overtime during weekdays will not exceed 4 hours per shift, or 12 hours per week. Overtime premium during weekdays is equivalent to 50% of the hourly rate.
- Overtime premium during weekends and holidays is equivalent to 100% of the hourly rate.
- Annual vacation is 15 days per year including weekends and public holidays.

Ecuador observes 9 public holidays during the year. Specific regions may observe additional public holidays.

5.4 Social Rights

The Constitution and the Labour Code recognize the following social rights:

- The right to association without restrictions.
- The right to undertake strikes against employers in the defence of their interests.
- The right to indemnification.

5.5 Labour Contracts

Labour contracts may be for a fixed term or for an indefinite term. Employers can terminate the relationship unilaterally without indemnification if legal reasons for such termination are present; such

legal reasons include major offences and non-compliance. If no legal reason for termination is present, the employer will be obliged to indemnify the worker with one monthly wage per year of service with a maximum of 25 monthly wages and a minimum of 3.

Other more flexible forms of contracting include:

- Trial contracts
- Maquila contracts: under this contract the term is equal to or lesser than the maquila program.
- Part-time contracts: for the contracting of work during weekends and holidays, in full or partial shifts.
- Occasional, seasonal and by the hour contracts: designed to meet higher production or other extraordinary labour demand.
- Production-based contracts: wage is based on rates by units of production regardless of the time.
- Crew contracts: designed for the contracting of groups of workers for a specific work at a location different from the regular residence of the workers

All written contracts have to be registered with the labour inspector. Oral agreements give the same rights and obligations as written contracts.

Labour outsourcing- In Ecuador it is a common practice to source labour through intermediary entities. Under this system third

companies hire labour and transfer the payroll cost plus a fee to the contracting entity.

5.6 Social Security

Employers and employees pay taxes to the Social Security at the rates of 9.35% and 11.15% respectively on the minimum monthly taxable wages as established for the different contributing categories by the Social Security. Such categories are revised annually.

The most significant minimum taxable wage categories are the following:

- a. For general workers, maquila workers and part-time workers the minimum monthly taxable wage is \$135.62.
- b. For full time workers contracted by the hour the minimum taxable wage is \$152.00. Part-time workers hired by the hour and several employees must pay taxes on a minimum wage of \$38.00.

Employers also contribute to a retirement fund to the Social Security equivalent to one monthly wage or salary per year.

5.7 Foreigners in Ecuador

Foreign individuals intending to reside in Ecuador temporarily or permanently must obtain a proper visa. The Director General of Immigration grants immigrant visas while the Ministry of Foreign Affairs grants non-immigrant visas.

In order to maintain immigrant status, foreigners must not remain abroad for more than 90 days in each year during the first two years, or more than 18 consecutive months after the first year of residence. The types of immigrant visas are generally issued for:

- **Persons living on income from abroad.**
- **Investors in real estate and securities.**
- **Investors in business activities.**
- **Administrators and technicians of foreign entities established in Ecuador.**
- **Independent professionals.**
- **Economically supported relatives.**

Non-immigrants do not intend to reside in Ecuador. They apply for a particular purpose visa, which is generally extended for a three to six month period depending on the activity. The types of non-immigrant visas are generally issued for:

- **Diplomatic and political exiles.**
- **Students.**
- **Technicians.**
- **Missionaries.**
- **Intercultural exchange.**
- **Tourists and businessmen.**

6. Types of Business Organisations

6.1 General Characteristics

Business activities in Ecuador may be carried out by individuals and entities residing or not in the country.

Foreign companies and individuals intending to carry out business in Ecuador on an ongoing basis must either establish a branch or invest in a locally constituted company. Investors in public works, utilities and natural resources, banking, insurance, leasing and securities intermediation must necessarily operate as a company.

The main types of companies in Ecuador are:

- The Sociedad Anónima (S.A.) or Corporation,
-
- The Compañía de Responsabilidad Limitada (Cía. Ltda.) or Limited Liability Company,
-
- The Sucursales, or Branches of Foreign Companies.

Corporations are the most flexible form of companies and offer the same major characteristics of corporations in other countries. It provides limited liability for its shareholders and the possibility of unrestricted transfers of shares. This type of company allows a mixture of foreign and domestic capitals. The Limited Liability Company is a more restricted type of company and provides for limitations on the transfer of shares.

6.2 Setting up a Business in Ecuador

Lawyers generally handle formalities for setting up of a company. The cost for its formation and maintenance is approximately \$500. The regulatory agency in charge of the approval and subsequent supervision of companies is the Superintendent of Companies. In the case of financial institutions and insurance companies the regulatory agency is the Superintendent of Banks and Insurance Companies.

On incorporation, corporations require at least two shareholders; however at any time following incorporation the number of shareholders can be reduced to one.

The procedure for the setting up of a company is the following:

- Deed of incorporation before a Notary Public including the names and nationalities of the founders, the articles of association, the legal name, domicile and the capital constitution and form of payment.**
- Approval of the deed of incorporation by the Superintendent of Companies or Banks.**
- Registration of the deed of incorporation and its resolution of incorporation in the Mercantile Registry.**

- Publication by the press of the resolution of incorporation and an extract of the deed of incorporation.**

If corporations are formed by public subscription of shares, registration at the Stock Market registry has to be notified in the press.

6.3 Capital

A Corporation's capital cannot be less than \$800. For Limited Liability Companies it cannot be less than \$400.

A Corporation and a Limited Liability Company will be constituted once at least 25% and 50% of the capital is paid in. Capital contributions may be in cash or in kind. In the latter case, the assets are subject to an appraisal and real estate is subject to registration at the property registrar.

Capital contributions of foreign investors are to be registered at the Central Bank.

The Minimum capital required for the constitution of Banks and financial institutions is set at \$2,628,940 and \$1,314,470 respectively and must be paid in cash.

The capital shares of corporations must have a par value or face value and are freely transferable. The transfer of capital contribution certificates of Limited Liability Companies requires unanimous consent by the shareholders.

6.4 Administration

The Shareholders' Meeting is the top governing body of a corporation or LLC. The Shareholders appoint a legal representative and may also

appoint a Board of Directors with a Chairman elected and delegated special powers not involving matters reserved to the shareholders.

Administrators are required to act prudently and to exercise the rights and obligations contained in the Companies' Law or the Law for the Institutions of the Financial System, the Commerce Law, the Tax laws, Labour code and other laws relative to the corresponding economic sector of the Company.

6.5 Accounting and Financial Statements

Companies are to maintain accounting records in United States dollars and in conformity with Ecuadorian Accounting Standards. Such standards are based on International Accounting Standards. The fiscal year is the calendar year. All companies must have a statutory year-end close on 31st December for tax and corporate purposes; however subsidiaries of foreign companies and branches normally have an additional closing date in line with their parent companies for consolidation or other reporting purposes.

Administrators have to file the financial statements by April each year with both the IRS and the Superintendent of Companies. Companies holding investment in the capital of other companies equal or greater than 50% are required to file consolidated financial statements

6.6 Review and Statutory Audits

The review of corporations' books is delegated to a Commissary (an internal auditor with legal requirements) appointed by the shareholders.

Limited Liability Companies with more than 10 shareholders may constitute an audit committee with three individuals. Financial statements audited by independent accountants are required for Companies with assets over \$1,000,000. All financial institutions are required to file audited financial statements.

6.7 Dividends

Profits are subject to a 15% employee profit sharing and 25% income tax calculated after deducting the 15% profit share. At least 10% of Corporations and 5% of Limited Liability Companies' net income must be transferred to a legal reserve until this reserve reaches 50% or 20% of capital respectively. The legal reserve may be capitalized or used to offset losses, but cannot be distributed among the shareholders, except at liquidation.

Dividends may be distributed from retained earnings. At least 50% (30% for public companies) of the annual profits must be distributed. Shareholders may decide on higher distributions. The Superintendent of Banks rules on the dividend distribution policy of Financial Institutions.

6.8 Liquidation

Companies may decide to liquidate at any time. The Superintendent of Banks or Companies may order liquidation if companies accumulate losses in excess of reserves plus 50% of the capital.

6.9 Branches of Foreign Companies

Foreign companies may elect to operate as a branch for which they must comply with the following:

- Obtain an operating license and approved power of attorney by the Superintendent of Companies or Banks. Proof of the foreign company's legal establishment and ability to operate abroad certified by the Consul of Ecuador in the originating country is required.**
- The branch must have a minimum assigned capital of \$2,000 in cash or in assets (For financial institutions the minimum assigned capital is as stated in 6.3 above and must be paid in cash)**
- Registration with the mercantile registrar of the corresponding license and the power of attorney**
- Publication by the press of an extract of the operating license and the full power of attorney**

Branches are subject to supervision by the superintendent of Companies and Banks. They are mandated to file information at request of authorities and pay contributions as prescribed by regulatory agencies.

Branches with assets in excess of \$100,000 must file audited financial statements.

7. The Ecuadorian Tax System

7.1 Basic Legislation

The Tax Code is the main tax law and it prevails over other supplementary laws governing tax relationships. The Internal Tax Regime Law regulates income tax, Value Added Tax and Excise Tax for all business sectors.

The Internal Revenue Service (IRS) administers the law. This administrative function includes issuing rulings and regulations to administer and clarify the law, developing and processing tax forms, auditing tax returns, and collecting taxes. The specialized tax courts rule on tax issues when there are litigated disputes between the government and taxpayers.

7.2 Taxation of Companies

Tax rate- Companies are subject to a flat income tax rate of 25% on taxable income.

This rate is 15% on the portion of taxable income that the company reinvests in the business. Reinvestment will be in the form of a formal capital increase.

Taxable income- represents the total taxable income less the costs and expenses associated with the income.

Exempt income- The following are exempt income: a) dividends from domestic companies, b) income from the occasional sale of real estate and capital gains from the sale of shares or participations in businesses; c) interest income from investment funds and income from trusts; d) income from non-monetary investments with the Government for the exploration and exploitation of hydrocarbons; e) income of foreign countries and international organizations under reciprocity rule and f) exempt income from international agreements.

Costs and expenses- Costs and expenses are deductible to the extent they are associated with taxable income. They include but are not limited to wages and salaries including benefits, the profit share, depreciation, amortization, travel expenses, insurance, interest, pensions and exchange differences, and accounts receivable write offs.

Personal expenses, donations and payments without making the mandatory withholding tax deduction are not deductible. Losses on transactions with related parties are not deductible either.

Depreciation and amortization- The straight-line method of depreciation is the generally accepted depreciation or amortization method, however the law permits accelerated depreciation provided an authorization from the IRS is obtained. Annual depreciation rates for fixed assets are the following:

Buildings, airplanes and ships	5%
Premises, Machinery, Equipment, Furniture and Fixtures	10%
Vehicle and transportation equipment	20%
Hardware and software	33%

Deferred assets are amortized over 5 years. Intangibles are amortized over 20 years or on the terms of the contract whichever is lower.

Loss carry forward- Losses may be carried forward for the following 5 years. Amortization cannot exceed 25% of the taxable income.

The transfers of assets and liabilities derived from mergers or spin offs are not subject to taxes.

Deduction of expenses abroad- Expenses abroad are generally deductible to the extent they are required to generate taxable income in Ecuador and as long as the corresponding 25% withholding tax is deducted.

The following remittances abroad are deductible and are not subject to withholding tax: remittances for importations, interest and commissions on foreign loans and on vendors credit, commissions on exports (maximum 2% of the value of the exports), reinsurance, international press agencies, charter of airplanes or ships, lease or rights of video films and international lease of equipment. Reimbursement of expenses abroad is deductible and not subject to withholding tax provided they are certified by independent auditors in the originating country.

Tax returns- Income tax filing and payment is due by April each year. Late filing is subject to interest (at a market interest rate of approximately 0.96% per month in 2004) and penalty at a monthly rate of 3%.

Advance payments equivalent to 50% of the income tax of the previous year less any withholding tax suffered in that same year are to be made during the year on account of the income tax for the current year.

Withholding of income tax is mandatory on all local payments for the purchase of goods and services at the following rates: 0.1%, 1%, 5%, and 8%. Withholding tax on a company's income is generally 1% and is on account of the income tax for the year.

Statute of Limitations- The Internal Revenue Service has the power to assess tax obligations within the next three years from the filing date. This limit goes to six years if the tax return was inaccurate or incomplete.

7.3 Taxation of Branches of Foreign Companies

Non-resident entities may operate in Ecuador in the form of a Branch. The tax rules applicable for local companies are also applicable for branches.

7.4 Individual Taxation

Resident individuals whether Ecuadorian or foreigners are liable for income tax at progressive rates ranging from 0% to 25% on their worldwide income. Their income is subject to the regular withholding tax of 1%, 5% and 8% on account of the income tax. They are also given tax credit for the taxes paid in a foreign country on the same income.

Non-resident individuals are taxed only on their Ecuadorian-source income at the flat rate of 25%. This tax must be withheld at payment with no obligation to file an annual tax return.

Income derived from assets in Ecuador or from activities carried out in Ecuador is always considered Ecuadorian-source income, regardless of the residence of the taxpayer.

Exempt income of individuals include dividends, interest on savings accounts, social security benefits, pension and the income of peasants, agriculture workers, disabled and the elderly.

Deductions include the costs and expenses which are deductible to the extent they are associated with taxable income and are incurred for the generation and conservation of taxable income.

Individuals carrying out business activities are required to maintain accounting records if their equity at the beginning of the year exceeds \$24,000 or if their annual income for the previous year exceeded \$40,000. Individuals whose equity or income declines in a subsequent period must continue to maintain accounting records unless they obtain authorization from the IRS.

Income tax returns of individuals are due by March of each year.

The following individuals are not required to file annual tax returns:

- Non-resident Individuals whose total income was subjected to income tax withholdings**
- Individuals whose annual income is under \$6,800**

Individuals carrying on a business are also required to make advance payments on account of the income tax. Withholdings and advance payments are deducted from the annual income tax due.

7.5 Double Tax Relief

Ecuador has ratified agreements with Germany, Brazil, Chile, the CAN (Bolivia, Colombia, Venezuela and Peru) Italy, Spain, France, Belgium, Romania, Switzerland, Argentina, Mexico, Canada and Albania to prevent double taxation and evasion of income tax and wealth tax.

7.6 Tax Reform Proposed, 2004

As at the close date of this booklet the Congress is reviewing a tax reform. The main proposed changes include:

- **Transfer pricing rules**
- **Restrictions on offshore transactions**
- **Sworn statements on the wealth of individuals**
- **Changes in the statute of limitations**
- **Increased excise tax rates**
- **Increased motor vehicles tax rates**
- **Simplified tax system for small businesses.**

8. Other Important Taxes

8.1 Value Added Tax (VAT)

This tax is levied on the supply of most movable goods and services, including imports at the rates of 12% or 0%.

Businesses offset the VAT paid against the VAT collected and forward the difference to the Internal Revenue Service. If the VAT paid is higher this will be a tax credit for the settlement of VAT of the following months. However the recovery of the VAT paid is proportional to the actual 12% VAT sales versus overall sales. Exporters, who are not able to offset the VAT, are granted the drawback (return.)

Goods subject to the 0% rate include food, medicine, books and magazines, newspapers, agricultural products and exportations. Services subject to 0% rate include transportation of individuals, health, house lease, public services, education, printing, exportation of services, services rendered by artisans and financial services.

VAT withholding- The IRS classifies taxpayers in two groups, special taxpayers (generally large taxpayers) and others. Special taxpayers are mandated to withhold VAT on their purchases at the rates of 30% for goods and 70% for services. All taxpayers whether special or not are mandated to withhold 100% of the VAT on purchases made from individuals. Amounts withheld have to be paid to the IRS in the next month.

8.2 Excise Tax (ICE)

This tax is imposed on the consumption of the following domestic or imported goods and services: cigarettes, beer, soft drinks, alcohol and alcoholic beverages and communications and radio broadcasting.

For local goods, the taxable value is the manufacturing cost plus the commercialization mark-up. For imported goods, the taxable value is the value declared for customs plus the commercialization mark-up. For services the value is determined by the invoiced price to the final consumer.

Excise tax rates range between 18% to 98% for cigarettes; 30% to 32% for alcoholic beverages; 10% for soft drinks; 5% and 10% for motor vehicles up to 3.5 ton. load capacity, planes, airships and helicopters and 15% for communications and radio broadcasting.

8.3 Other Taxes and Contributions

Municipal taxes- Municipal taxes mainly finance the operating budget of municipalities and other sectional units as prescribed by the Municipal Regime Law; among such taxes are licenses, permits as well as a 1.5 per thousand tax on the total assets of businesses and real estate taxes based on a municipal valuation.

Customs duties- Duties and other taxes are levied on the importation of all kinds of goods. Contribution to the Superintendent of Companies and Banks- Companies and Banks must pay a contribution calculated on their total assets.

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