PRICEWATERHOUSECOOPERS

Doing Business and Investing in Ecuador*

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Information Guide Series

This Guide is one of a series on business conditions in the countries in wich PricewaterhouseCoopers firms have offices or carry out work, and is based on the latest available information from these offices. Doing Business and Investing in Ecuador is a publication of PricewaterhouseCoopers.

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Doing Business and Investing in Ecuador

PricewaterhouseCoopers

Foreword

PricewaterhouseCoopers is the world's largest professional services organization. Drawing on the knowledge and skills of more than 130,000 people in 148 countries, we provide accounting, auditing and related services on a globally integrated basis, helping our clients to solve complex business problems and measurably enhancing their ability to build value, manage risk and improve performance.

The practice in Ecuador began 37 years ago. It was initially intended to serve multinational companies and, since then, it has steadily grown expanding its list of clients to include diverse major Ecuadorian business concerns and non-for-profit organizations. Today, PricewaterhouseCoopers is the leading professional services firm in Ecuador, operating with offices in Quito and Guayaquil.

PwC Industry focus enhances our effectiveness. Clients benefit from access to people who have relevant industry knowledge and who can tailor solutions to specific needs. The industry programs cover the main economic sectors: Financial Services, Energy and Utilities, Retail and Consumer, Industrial Products and Services, Technology, Entertainment and Media and Government Services.

"Doing Business and Investing in Ecuador" is aimed at providing answers to some of the important questions that investors usually ask. Ecuador is undergoing a period of considerable change and this is turning the country into a potential investment target. With its young population, highly trainable and dedicated workers and diversified natural resources, Ecuador has enormous internal growth potential.

PricewaterhouseCoopers' highly trained professionals are ready to expand upon and provide support on the matters covered in this publication or on any other professional subject relating to your activities in the country, as you may need to ensure that your business in Ecuador is successful and profitable.

Francisco J. P. Fagundes
Country Leader

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Chapter 1
Ecuador - A profile

Investor Considerations

- The country has vast oil and high mineral potential.
- Agricultural resources are diverse.
- The cost of energy is subsidized, and costs of transportation and labor are relatively low.
- The country makes an excellent base for serving the Andean Market due to its geographical location.
- The US Dollar is used as the official currency since 2000.

Geography and Climate

Ecuador is situated on the northwestern coast of the South American continent. With a total area of 281,341 square kilometers (108,200 square miles), including the Galapagos Islands, Ecuador is one of the smallest countries in South America. Its boundaries are Colombia to the north, Peru to the east and south and the Pacific Ocean to the west.

Two parallel chains of Andes mountain ranges that cross the country divide it into three geographical regions: the coastal plains (Costa), the Andean highlands (Sierra) and the Amazon tropical rain forest (Oriente).

The Costa region has an area of about 1,000 square kilometers (386 square miles). It consists of hot and humid tropical plains. The climate in combination with a very rich soil makes for a highly productive area. The main products are coffee, bananas, sugarcane, rice, cocoa beans, timber, and fruits.

Additionally, export-oriented fishing and shrimp industries are highly developed. They are concentrated near the port cities of Guayaquil, Manta and Esmeraldas. Natural gas and oil are also found offshore in the Gulf of Guayaquil.

The Sierra region is located in central Ecuador, along the Andes range. It is an area of varying altitudes, with villages as high as 4,500 meters (15,000 ft) above sea level. This region has many fertile valleys dedicated to temperate-climate products such as wheat, corn, barley, vegetables, citrus fruits, and flowers for export. Cattle raising is also a profitable activity; meat and milk production supplies the internal market. Geological studies show that the area is rich in mineral deposits yet to be exploited.

The Oriente region is located on the eastern side of Ecuador and is mainly a tropical rainforest forming part of the Amazon basin. It occupies approximately one half of the country's territory. Except for petroleum production, most of this region remains unexploited. Large portions have been set aside to become national parks. A few tea and sugarcane plantations, some cattle-raising and forestry companies have made inroads in the region. The major oil reserves of Ecuador are found here. The exploitation of oil and the operation of two pipelines have contributed to the economic integration of the region with the rest of the country.

A fourth region of Ecuador is the Galapagos Islands, consisting of 13 volcanic islands and numerous rocky islets. These islands are located in the Pacific Ocean 1,000 kilometers (622 miles) from Ecuador's mainland. The islands are considered a natural wonder with unique fauna and flora of great scientific value. They also constitute a major tourist attraction, though most of the islands have been set aside as protected wildlife parks.

Altitude, the Humboldt Current and mainly the country's location on the earth's equator influence climatic conditions in Ecuador. The northern coastal region is rather hot all year long, while toward the south the cooling influence of the Humboldt Current makes the climate quite mild. The altitude of the highlands and valleys of the Sierra makes for relatively cool days despite the hot equatorial sun. Ecuador is privileged to possess within its diverse geography nearly all-climatic conditions, from tropical rain forest to temperate zones to mountains that are snow-covered all year round.

There are two main seasons, winter and summer, winter is a rainy season that lasts from October to April; summer is a dry season that nonetheless has scattered showers throughout the rest of the year. Because of the equatorial location of the country there are no significant temperature changes between seasons, and the length of the days remains the same.

Quito, the capital city, is located in the Sierra region on a plateau 2,830 meters (9,349 ft) above sea level. Quito's weather is spring-like all year round, with an average temperature of 58°F (14°C). The warmest month tends to be July, when average daytime temperature can reach 68°F (20°C), while the coolest is March, daytime temperature reaching 64°F (18°C). Year-around average low nighttime temperatures is 49°F (9°C)

Guayaquil, the largest city of the coastal region and principal seaport, enjoys tropical weather with temperatures averaging 79°F degrees (26°C), though temperatures can reach 97°F (36°C) between December and April.

Most of the industrial and commercial activities of the country are concentrated in these two cities. They demonstrate wide differences in their cultural, political, economic, geographic, and climatic aspects.

History

Ecuador was once part of the Inca Empire, which extended from modern day Colombia to Chile. Quito was the capital and the most important city of the northern part of the empire.

The Spaniards, attracted by stories of cities paved with gold, conquered the native populations and founded most of the modern day cities on the sites of native villages. Post-Inca Quito, the country's capital, was founded by Sebastián de Benalcázar on December 6, 1534. Guayaquil, the main port city, was founded twice because the natives destroyed the first settlement. Guayaquil was founded for the second time on October 9, 1537 by Francisco de Orellana, who later discovered the Amazon River while searching for El Dorado.

After approximately 300 years of Spanish colonial rule, Ecuador declared its independence on August 10, 1809, but royalist armies quickly repossessed it. It was not until May 24, 1822, that Antonio José de Sucre, one of Simón Bolívar's lieutenants, defeated the Spanish forces in the historic Battle of Pichincha and obtained the country's independence.

At that time Ecuador became part of the republic known as La Gran Colombia, founded in 1819 by Bolívar, which included modern Colombia, Panama and most of Venezuela. In 1830 this alliance was dissolved, and in 1835 the name Republic of Ecuador was adopted. The name has a direct relation to the country's geographical location, since the equator runs through the country.

Political System

After a long history of successive civilian-military governments, the armed forces of Ecuador were the first in Latin America to restore power to a democratically elected government in 1979. The next general and presidential elections are scheduled for October 2006 and the next president will take office in January 2007.

The Republic's Constitution provides for an executive branch headed by the nation's president, who is popularly elected to a four-year term, with no reelection. The legislative branch consists of a one-chamber Congress composed of congressmen of every province (their number determined on the basis of each province's population) elected for four-year terms. There are currently 100 congressmen and there is a general consensus in the need of reducing that number. The judicial branch is centered on a Supreme Court and includes various special-purpose courts and lower courts.

The central government is located in the capital city of Quito, and for administrative purposes Ecuador is divided into provinces, counties and parishes. Cities are managed directly by elected municipal governments, whose chief officers are mayors.

Legal System

Ecuador's Civil Code, which dates back to 1860, is based on Roman law. Thus many legal norms are similar to those existing in other countries that also apply Roman law.

Many other codes and laws are in force. In general, court decisions are valid only for the specific cases for which they are delivered, though past cases can be used to establish precedent. Cases must, in the first instance, be tried by specialized judges in provincial courts. In the event the accused party cannot afford an attorney, one will be provided by the state; otherwise, legal costs are borne by the litigating parties.

Appeals are handled by superior courts, with the possibility of a cassation appeal before the Supreme Court. There is no capital punishment, and maximum jail sentence is 25 years, with the possibility of accumulating sentences for up to 35 years.

Population and social patterns

Population

According to 2001 census data, Ecuador's population totaled 12,156,608; about 61 percent of which was urban. Population density was approximately 43.20 people per square kilometer. Current growth is estimated at less than 2%; the estimated population for 2005 is set approximately at 13,215,000.

About 33 percent of the population was under 14 years of age, while the male/female ratio was approximately 1 to 1. A population breakdown for 2001 is shown in Table I.

I Population by Province

	Total	Male %	Female %
North			
Azuay	599,546	47	53
Carchi	152,939	50	50
Cotopaxi	349,540	48	52
Chimborazo	403,632	47	53
Esmeraldas	385,223	51	49
Imbabura	344,044	49	51
Pichincha	2,388,817	49	51
Tungurahua	441,034	48	52
	5,064,775		
East			
Morona Santiago	115,412	50	50
Napo	79,139	51	49
Pastaza	61,779	52	48
Zamora Chinchipe	76,601	52	48
Orellana	86,493	51	46
Sucumbios	128,995	54	46
	548,419		
South			
Bolívar	169,370	49	51
Cañar	206,981	46	54
El Oro	525,763	51	49
Loja	404,835	49	51
	1,306,949		
West			
Guayas	3,381,622	50	50
Los Ríos	650,178	52	48
Manabí	1,186,025	50	50
Galápagos	18,640	55	45
	5,236,465		
Total all regions	12,156,608		

Ecuador's population is heterogeneous. Present population composition is estimated to be approximately 65 percent of mixed Indian-European origin, 25 percent being of native Indian descent, 7 percent of European (principally Spanish) origin, around 3 percent of African origin, and the rest principally of Asian origin.

Language

The official language in Ecuador is Spanish; native languages such as Quechua are part of the national cultural heritage and are spoken by specific sectors of the population. English is commonly used in international business relations.

Religion

Freedom of religion is guaranteed by the state. The majority of the population consider themselves Roman Catholic. Non-Catholic groups are growing rapidly, presently accounting for about 10 percent of the population.

Education

The state guarantees all citizen access to education, which is available at all levels from preschool through university in both public and private institutions. Primary education is obligatory, as are the first three years of secondary schooling.

Public education is non-religious. Preschool normally lasts one year and elementary school for six more. High School education is provided in two cycles of three years each. There are 66 centers of higher learning, both public and private.

The literacy rate is approximately 91.6 percent. Pockets of illiteracy are found mostly in the Andean rural highlands.

English is taught in most schools, and a number of private schools are supported by the American, German and French communities.

Living standards

Average per capita income is calculated at US$ 2,502 for 2005. Per capita income for year 1998, prior to the financial crisis, was US$ 1,946; for year 1999 it was US$ 1,376. In year 2000 the US Dollar was adopted as the official currency of Ecuador following a deep economic and financial crisis that placed average per capita income at US$ 1,296. Ecuador still struggles to distribute wealth more evenly among its population.

Living standards for the lower and middle class population have fallen in the past five years. Present living conditions for middle to top management as well as for expatriates are comparable to those existing in neighboring countries. Conveniences such as shopping malls, cable television, modern housing, and recreational facilities are common.

Cultural and social life

Ecuadorians in general are very family oriented. There is great respect for parents, and their opinion carries much weight in the decisions people make. Other important influences are social customs and church.

Social classes remain an important factor in society, with clear differences in behavior according to class. The upper classes are fully westernized, many having studied in the United States and Europe, having assimilated the values of their counterparts there. The middle classes maintain more traditional values, with heavy reliance on social morals and national values. The lower classes, on the other hand, have different value systems based on the ownership of land and animals and strong cooperative commitments.

There are many cultural activities, which are supported by the state or by private foundations. The Quito symphony is held in high regard, as are folkloric dance companies. There is a very active amateur theater, and international groups visit the country regularly.

There are some excellent museums, the most important of which are supported by the Central Bank of Ecuador (CBE) and the “House of Culture”. Ecuadorians place great importance on the arts, and from colonial times the country has produced many great painters, among them world-renowned artists such as Guayasamín, Kingman and Endara Crow.

Sports and recreational facilities are fairly well developed. The diverse climatic and geographical conditions provide excellent opportunities to practice a wide range of sports such a boating, water skiing, hiking, surfing, mountain climbing, and bicycling. There are also a number of good clubs in Quito and Guayaquil where swimming, tennis, squash, racquetball, and golf can be practiced.
Nightlife is active in Guayaquil and to a lesser extent in Quito. There are a number of good nightclubs and discotheques, though some are reserved for members.

The Economy

General description of the Ecuadorian economy

The Ecuadorian economy can be characterized as a relatively open, mixed-market economy with key sectors reserved to control by the state (nonrenewable natural resources, utilities, and defense and strategic industries); private investment in these areas is possible through concessions granted by the state. Other industries are mostly handled by the private sector. The role of the private sector is well recognized and private enterprise ranks very high in popular-confidence surveys.

Ecuador's economy depends to a large extent on the production and export of a few primary products. More than half of export (56% in 2004) revenues are derived from crude oil. Other important sources of revenue are bananas, coffee, shrimp and flowers. Ecuador is one of the world's largest suppliers of bananas and shrimp; however, the traditional and non-traditional production has not displaced oil as the main source of revenue.

Ecuador has good prospects in most areas of economic activity. Ecuador's diverse climate conditions and rich, varied soil, as well as its cultural and biodiversity also make agro industrial and tourist investments particularly attractive. A breakdown of gross domestic product and projected variance rates is shown in Table II.

II Gross Domestic Product for 2005, in US Dollars thousands (estimated)

	2005(1)	**2004(1)**	**Var.**
Agriculture, forestry, fishing	1,944,913	1,866,978	4.2%
Oil and mines	4,476,614	4,432,291	1.0%
Manufacturing	1,044,139	1,031,421	1.2%
Construction	1,422,359	1,384,965	2.7%
Commerce	2,995,603	2,868,552	4.4%
Transport & Communication	1,935,688	1,857,666	4.2%
Real estate	1,159,164	1,130,479	2.5%
Public administration & services	1,981,953	1,916,665	3.4%
Hotels & financial services	800,962	764,253	4.8%
Others	1,888,976	1,763,003	7.1%
Total	19,650,371	19,016,273	3.3%

(1) Dollars of year 2000

Ecuador's growth potential is high. However it depends on the country's ability to avoid lax fiscal policies, faulty development policies and political instability and to make good use of oil resources which are presently at high prices.

Ecuador's economy is very susceptible to external shocks, as there are only few main providers of export revenues (oil, bananas, shrimp, cacao, tuna and flowers). Oil alone accounts for more than 50% of export revenues. Growth for 2005 was only 3.3% (6.95% in 2004), with the non-oil economy expanding by 4%. Ecuador is also vulnerable to economic downturns in the United States and Europe, since remittances from Ecuadorian workers living abroad are Ecuador's second largest source of foreign currencies (around $1.6 billion in 2004).

The external shocks, plus the economic and financial crisis of the late 1990s, led to an annual inflation that reached a level of close to 100 percent and a fall of 66.1 percent in foreign currency reserves, during the year 2000. However, since the establishment of the US Dollar as the national currency, these figures have greatly improved; inflation for the year 2005 was 3.14%.

Unemployment and underemployment have consistently been a problem for the country. From year 2000 these figures have not improved and unemployment has ranged from a low of 8% to a high of 11%, and underemployment has ranged from a low of 30% to a high of 48% of the labor force.

Table III shows trends and a projection of two key economic measures.

III Trends in GDP Growth and Inflation Rate, 1998-2005

	GDP growth %	Inflation Rate %	
1998	2.12	43.41	Before dollarization
1999	-6.30	60.70	
2000	2.80	91.01	After dollarization
2001	5.12	22.40	
2002	3.41	9.36	
2003	2.66	6.10	
2004	6.95	1.95	
2005	3.33	3.14	

Ecuador carries a heavy foreign public debt burden amounting to US$ 10.33 billion. Debt service in 1999 amounted to US$ 1.7 billion and the total debt represented 116.2 percent of GDP. By 2004 the debt burden had decreased and it represented 36.53 percent of the GDP.

The Dollarization Scheme

As mentioned previously, the economic and social indicators for Ecuador, during the latter years of the 1990s, showed an emergency situation and the need for a transformation of the old economic system.

In an attempt to correct the effects of distortions in the economy and in the financial information, on March 13, 2000 the Ecuadorian Government announced the adoption of the Dollarization scheme, and the CBE fixed the exchange rate at 25,000 Sucres per 1 US$. For the official implementation of this new scheme the economy exchanged the local currency, the Sucre, for Dollars from the United States of America. The execution of this new scheme required the implementation of reforms in the economical and legal system, especially in topics related with Public Finances, Monetary and Exchange Policies, Salaries, and foreign investment. The legal framework regarding the official Dollarization of the country is found in the Law for the Transformation of the Economy (Ley Trole 1), that introduced changes in the financial and fiscal systems.

The Dollarization scheme stabilized the country's economy. GDP growth in 2004 was in the order of 6.95 and inflation rates had plummeted to one-digit figures, 1.95% in that same year. For year 2005, GDP growth was 3.33% and inflation rate 3.14%. Under the administration of President Lucio Gutierrez - January 2003 to April 2005 - Ecuador benefited from high world petroleum prices, but the country has made little progress on economic reforms necessary to reduce Ecuador's vulnerability to petroleum price swings and financial crises. Ecuador continues to be in need of structural reforms, increase foreign investment, and support fiscal stability.

Energy and Mineral Resources

The oil industry is of prime importance to the country. Overall, Ecuador’s oil sector accounts for around one-fourth of the country’s economy, and is Ecuador’s most important source of foreign exchange. Ecuador exported approximately 355,000 barrels per day during 2004. Ecuador has two pipelines, which run from oil fields in the eastern Ecuadorian Amazon rainforest region, across the Andes Mountains, to a port on the Pacific Ocean. Oil export revenues accounted for around 50% of Ecuador’s total merchandise exports in 2004. This reliance on oil exports makes Ecuador’s economy vulnerable to sharp fluctuations in oil prices.

Petroecuador, the state’s oil holding company, is responsible for all phases of oil production and commercialization, though the company has entered into contracts with private oil companies for the crucial exploration and exploitation stages. Petroecuador is currently trying to streamline its own operations, thus cutting its workforce, and seeking greater independence over its fiscal and administrative affairs. Ecuador’s main export market currently is the U.S. West Coast.

The mining potential of Ecuador is large, but it remains underdeveloped. Reserves of gold have been detected; these are being exploited primarily at artisan levels. Studies reveal that large reserves of silver, copper, manganese and other minerals remain unexploited. The government passed a mining law aimed at guaranteeing mining rights and establishing a legal framework for this activity to develop. This area appears to have great potential and presents good opportunities for foreign investment.

Ecuador has an enormous hydroelectric potential. Ecuador's power demand is growing, but generation capacity and transmission and distribution infrastructures are having trouble keeping pace. According to the official data of the 2001 national census, about 10% of the population remains without access to electricity, and there is an increasing demand in the areas that do have access.

Regarding power subsidies, these were progressively reduced during the last decade. The Consejo Nacional de Electrificación establishes tariffs according to formulas contained in the legislation of the electrical sector and which result in real prices of electricity, which, however, are not adopted. Political considerations play an important role when establishing new tariffs at lower rates as those determined according to the law.

Agriculture and Fisheries

Agriculture is an important sector of the economy, and its importance is expected to grow in the coming years. In the mid 1980s when most price controls were lifted, agriculture experienced significant growth rates, surpassing 10 percent in some years. Recent growth in the agricultural and fishing sectors has had fluctuations; data for the latter years is as follows:

IV Growth Rates for the Agricultural and Fishing Sectors, 2000-2005

	Agricultural[1] %	Fishing %
2000	4.29	-21.59
2001	0.37	2.83
2002	7.47	5.67
2003	0.90	5.40
2004	0.06	4.24
2005	3.95	5.50

(1) Includes livestock and related

The agricultural sector is greatly benefited by the Andean Community's free trade zone. However, even though the production capacity has the ability to increase rapidly, the dollarization was not beneficial for product competitivity. With the use of the dollar, local costs for the production of Ecuadorian goods have increased. Therefore this sector faces great challenges to maintain its position in international markets and to maintain profitability and growth.

Traditional agricultural export products (with over 10 years of production) include bananas, coffee, cocoa, tea, rice, sugar, African Palm oil and flowers (roses and carnations). Nontraditional products have recently been growing in importance, among them beans, corn, potatoes, tropical fruits, strawberries, melons, asparagus, broccoli, heart of palm, and tomatoes. Foreign investors are primarily exporting specialty products grown in the diverse climatic regions of the country. Fishing relates basically to shrimp, tuna and other fish species, which are mainly export goods.

Ecuador is a foremost producer of canned tuna, and good industrial facilities exist for the cleaning, freezing or canning of fish. Some plants offer cleaning and freezing services to large deepwater fishing fleets from around the world.

Shrimp farming has been of great importance to the point that Ecuador became the leading shrimp producer in the Americas. Shrimp exports amounted to US$ 444 million in 2005, mostly to the United States. Competition from China, as well as credit conditions and other factors have slowed the recovery of this industry which suffered a low turn in year 2000.

Rainbow trout farming in the Andean highlands and of tilapia in the lower regions, though still a fairly new industry is growing rapidly and is beginning to undertake exporting activities. Conditions are very favorable for this activity in many areas of the country.

Manufacturing

During the decades when Ecuador followed an industrialization policy based on the import substitution model, industries were heavily protected from competition and granted many benefits. As a result, a very diversified industrial base developed, from textiles to footwear manufacturing to automobile assembly. However, most industries are not sufficiently integrated and depend on foreign supply of raw materials. They consist of little more than assembly of foreign components. With very short production runs, sales are generally limited to the domestic market and some exports. Heavy industry is almost non-existent.

The Andean Community's free trade zone is expected to cause a shift in industrial production, with enlarged markets allowing industries to develop rapidly where there are competitive advantages. Textiles, footwear, leather goods, food and drink, tobacco, electronic goods, and white goods, which Ecuador manufactures, all seem to have potential in the near to medium term.

The Maquila or in-bond processing law enacted in 1990 allows foreign investors to benefit from relatively low costs, the existing industrial base and existing tax incentives in order to serve foreign markets. Foreign investors can also benefit from Ecuador's central location and hard currency.

Service Industries

The service sector, as a whole, is one of the most important elements of the economy, contributing about 37 percent to the GDP. Industries in this sector are a significant and growing part of the economy. There is good growth potential in these sectors as shown below. Services to businesses have improved substantially and is an area where foreign investors may participate. However, there are requirements to be filled in the banking, financial services, electricity & water, and telecommunications.

V Service Industries, Gross Domestic Product for 2004 and 2005, in US thousands Dollars

	2005(1)	2004(1)	Var.
Electricity & water	185,265	179,347	3.30%
Construction	1,422,359	1,384,965	2.70%
Hotels & restaurants	219,006	209,359	4.61%
Transport, storage & communications	1,935,688	1,857,666	4.20%
Financial services	581,956	554,894	4.88%
Real estate	1,159,164	1,130,479	2.54%
Public administration	911,258	885,642	2.89%
Education	599,501	575,127	4.24%
Health & social services	285,929	276,549	3.39%
Total	7,300,126	7,054,028	3.49%

(1) Dollars of year 2000

Auditing, management consultancy and computer services are well developed, and many foreign entities can be found operating in these fields.

As the economy continues to open, more and more specialized services will be required, leading to good growth prospects.

Tourism

Ecuador has a great variety of tourist attractions because of its: 1) varied climatic and geographic conditions; 2) natural beauty, great biodiversity, history and cultural background; 3) unique mix of European, North American, and Indian lifestyles. Many types of climate can be found within a few hours' drive, from the tropical sun of the Pacific beaches, to the snow-covered mountains and lakes of the Andes, to the Amazon jungle. Additionally, the Galapagos Islands are Ecuador's best known tourist attraction for foreign visitors. Because of this and the rich cultural background present in Ecuador's art, handicrafts, archaeological sites, and colonial architecture, tourism has steadily grown. Many small local operations exist, but foreign investment in this area is limited. Ecuador is very well suited for ecological, endurance and adventure tourism.

Ample opportunities are considered to exist and the government has targeted this area for development.

Transport and Communications

The country maintains a satisfactory internal transportation system. Because of limited rail service, most freight is transported by road. Road transportation is relatively good.

Many international airlines operate through the airports of Quito and Guayaquil, connecting the country with major cities in the United States and Europe, as well as with Latin American capitals. Tame, which is ascribed to the Ecuadorian Air Force, is the most important Ecuadorian carrier that provides local services. There are other privately owned carriers, like ICARO, Aerogal, VIP, that provide transportation within the country with growing service and availability. In general, airline services within the country are good.

There are four major ports with good facilities; the principal of which is Guayaquil. Port services have been substantially transferred to private operators. The port of Esmeraldas is run by private management through a concession and it is expected that the Manta port will follow this scheme. Rules governing international freight transport have been made more flexible; and costs are expected to decrease and service to improve over the next few years.

Communications are controlled by the state through licenses. All phones have domestic direct dialing, and most of them have international direct dialing. Local rates for conventional lines have been raised during the recent past years while cellular rates have significantly dropped, but remain relatively high. International rates, particularly to the USA, Spain and Colombia, have dropped significantly.

Cellular or mobile communications, which have experienced high growth rates during the last ten years, are privately owned, and show eminent conditions for additional growth and investment opportunities. Currently, Telefónica, Porta Celular and Alegro are the three companies operating in this market.

Also, the increasing demand of Internet users has opened an important market for providers. During the past few years this market has grown extremely fast, and is currently hosts more than 20 companies.

The postal service has improved considerable over the past few years, though most companies still prefer to use alternative private postal services.

Foreign trade and balance of payments

In 2004 exports amounted to US$ 7.8 billion (US$ 8.9 for Jan-Nov 2005) and imports to US$ 7.3 billion (US$ 8.2 for Jan-Nov 2005), broken down as show in Table VII. This accounts for the second consecutive year of surplus in the foreign trade balance.

The main trading partners are the United States, the Latin American Free Trade Association (ALADI) and Europe. Table VIII shows the net trade activity over the last five years.

Imports have been growing significantly during the latter years, since most restrictions have been lifted and Ecuadorian products have increased in price.

As shown in Table IX, the balance of payments has shown continuous deficits over the last few years, which are due for the most part to the impact of the debt services.

VI Foreign currency reserves have increased in the latter years:

	US$ billions
December 2001	1.07
December 2002	1.00
December 2003	1.16
December 2004	1.44
December 2005	2.15

VII Exports and Imports, 2005

Exports	%
Oil	54.9
Industrialized goods	21.1
Bananas	11.0
Shrimp	4.5
Flowers	3.7
Cacao	1.2
Other primary goods	3.6
	100.0%

Imports	
Raw materials (agricultural, industrial, construction)	33.7
Capital goods	28.2
Fuels & lubricants	11.8
Consumer goods	26.1
Other goods	0.2
	100.0%

VIII Foreign Trade (in US$ millions)

	2001	2002	2003	2004	2005
Imports	4,980.6	6,005.6	6,123.4	7,307.9	8,181.3
Exports	4,678.4	5,036.1	6,222.7	7,752.9	8,875.5
Surplus (deficit)	-302.1	-969.5	99.3	444.9	911.9

IX Current Account Balance/Deficits (in US$ millions)

1999	876.8
2000	920.5
2001	-665.3
2002	-1,398.5
2003	-340.5
2004	-154.7

Hints for the business visitor

Visitor's Visas

Foreigners may conduct business in Ecuador, provided they have entered the country legally and obtained the appropriate business or investor's visa. Tourist visas are generally not required. For nationals of some South American countries, including Ecuador, an identification card is sufficient to enter said countries. Foreigners are, in general, subject to the same laws and enjoy the same civil rights as Ecuadorians.

Currency

The monetary unit of Ecuador, since March, 2000 is the United States Dollar. In accordance to the Law for the Economical Transformation, the CBE is able to issue fraction coins with similar characteristics to those used in the USA. This emission is necessary to facilitate the transactions with the adopted currency. After the Sucre was substituted for the US Dollar, this currency is the only one that can be used for transactions within the country.

As of December 31 the exchange rates for major currencies were as shown in Table X.

X Dollar Exchange Rates at December 31, 2005

International Market

US$ 1	2,283	Colombian Pesos
	3.42	Peruvian Nuevo Sol
	3.03	Argentinean Pesos
	2.34	Brazilian Real
	10.74	Mexican Pesos
	0.86	Euro
	0.58	English Pounds
	1.32	Swiss Francs
	117.80	Japanese Yen

International Time

Ecuadorian time is five hours behind Greenwich Mean Time (GMT). This is the same as US Eastern Standard Time (EST).

Business hours

Office hours are generally from 8:30 a.m. to 6:30 p.m. with a one and a half to two hour lunch period, generally from 1:00 p.m. to 3:00 p.m. Banks are allowed to set their own hours open to the public (minimum four hours a day); this flexibility includes Saturday and Sunday. Industries, especially those located outside (but close to) cities, have changed to a continuous workday from 7:00 a.m. to 4:00 p.m.

Statutory holidays

The national and municipal holidays for the most important cities are as follows.

National Holidays

New Year's Day	January 1
Good Friday	March or April
Labor Day	May 1
Pichincha Battle Day	May 24
Independence Day	August 10
Guayaquil's Independence Day	October 9
Memorial Day	November 2
Cuenca's Independence Day	November 3
Christmas Day	December 25

Municipal Holiday

Guayaquil Foundation Day	July 25
Quito Foundation Day	December 6

Weights and measures

Officially, the metric system is used in Ecuador. In practice, however, a few other measures are still in use, such as pounds for weight and the gallon for volume.

Local suppliers of machinery parts and tools and equipment apply the measures used by the product's manufacturers.

Dates and Numbers

Dates, when written or abbreviated, normally indicate the day, month and year in that order (e.g. 4/1/2005 or 4 January 2005).

Periods indicate thousands and millions, while commas indicate decimals. Thus, one thousand five hundred dollars and ten cents would be written as $1.500,10.

Business information services

See Appendix XVIII for sources of business information.

Local Customs

Ecuadorians are formal people when engaged in business relations. Business meetings are conducted in offices or restaurants; the latter often used in order to get better acquainted with a potential working partner. Meetings normally start somewhat after the appointed time.
With regard to social courtesies, Ecuadorians are very polite and well mannered. Superiors are treated in a friendly but respectful way, and the use of a title (such as doctor, economist or engineer) before the name is common.

Chapter 2
Business environment

Investor considerations

- Changes facilitating investment and trade have been made.
- A highly trainable semiskilled work force is available, as are professionals.
- Ecuador is a member of the Andean Community.
- Both the United States and the European Community have granted Ecuador preferential tariffs.
- Ecuador is negotiating a FTA with the United States.

Industrial Climate

The business climate in Ecuador has responded to the social and economic needs of the population and the changes the world is experiencing. Tax and tariff reforms, Maquila and Free Trade Zone laws, and legislation dealing with foreign investment, currency and mining were put in place. These have helped eliminate restrictions but some structural changes are still needed for greater growth.

With the issue of Decision 291 of the Andean Community in 1991, the country started to liberalize its market. This trend was further strengthened with the approval of the Foreign Trade and Investment Law in 1997. This law promoted foreign trade and direct investment, sought to increase competitivity, supported the efficient use of the productive resources of the country, and encouraged the sustainable development and integration of the Ecuadorian economy with the rest of the world. It also created the COMEXI (Foreign Trade and Investment Council) and the Ecuadorian Investment and Export Promotion Corporation-CORPEI (refer to Exports later on this chapter). The COMEXI is the entity in charge of establishing foreign trade policies for goods, services, transfer of technology, integration and direct investment; in accordance with the principle of free trade, the macroeconomic program and the development plans for the sector and the country.

In September 2005, President Alfredo Palacio created the Nacional Council for the Reactivation of Production and Competitiveness CRPC *(Consejo Nacional para la Reactivación de la Producción y la Competitividad)*. This entity is charged with dictating national policies for increased production and competitiveness and for the design and implementation of the National Agenda for the Productive and Competitive Development of the country.

Although the country continues its efforts to improve the industrial climate and promote foreign investment and foreign trade, the business community continues to demand further structural changes, a greater simplification of bureaucratic procedures, energy-sector reforms, and rapid privatization. Moreover, Ecuador is currently finalizing negotiations to sign a FTA with the United States. This however may become a point of controversy among different sectors of the population. In all, a climate of free enterprise and free trade is fostered by the business community, a process that apparently will grow stronger in the immediate future.

Framework of industry

Certain public services and key industries, mainly oil, utilities and defense, are reserved to the state, which is the only proprietor or participates with majority holdings. The government can grant private operators access to these industries through service contracts, joint ventures and concessions. The government also holds shares in a number of so-called mixed-economy companies. Privatization of certain sectors, particularly of conventional telephone communications and energy sector has been delayed for several years.

Most companies are closed corporations arising from former family-owned enterprises. A relatively small number of business groups located in Guayaquil and Quito still control large segments of the economy. Over the past years, as credit and economic conditions changed, new businesses have grown. Capital markets are basically nonexistent, which has led to very narrow share ownership.

Industrial groups are generally oligopolistic in nature, with only a few large concerns in each type of industry and limited competition.

Aims of government policy

Economic development plans

Ecuador's next presidential election is scheduled for October 2006. President Palacio has made a series of proposals aimed at reforming Ecuador's political system. Ecuador has also moved, over the past year or so, towards granting greater autonomy to Ecuador's provinces, and in general towards more decentralization.

- Poverty reduction is one of the main priorities in the Government's development plans.

- Under the slogan of "Ecuador Competes," the government adopted a national agenda for competitivity and proclaimed 2002 the Year of Competitivity. Improving competitivity can stimulate growth and reduce poverty.

In general, adherence to development plans has decreased, as it has become obvious that appropriate reaction to rapid changes in the world economy cannot be achieved through detailed plans. Also, the need for a simplified taxation system and development of competitive advantages has led the government to do away with most industry-specific incentives.

Trend toward privatization

During the last decade, Ecuador's administrations, recognizing the inefficiency of many state-run companies, acknowledged that privatization is one of the most important aspects in the development plans for Ecuador. This is especially true as a true competition between businesses and industries becomes essential. Nevertheless, privatization has had mixed results over the years. Ecuador is still struggling to privatize a large part of state-owned companies including electricity generation and distribution as well as conventional telephone services.

Regional/special industry development

The government has pursued a policy of promoting economic growth and development in rural areas where employment opportunities and increased incomes are needed. The aim is to provide equal development opportunities to all economic sectors and all regions of the country. Though most tax and other incentives have been eliminated, low tariffs and special deductions have been maintained for investment in agriculture, mining and tourism-sectors the government wants to promote.

Tax incentives were granted in November 2005 by the Tax Benefits Law to promote the development of specific industries (see Taxation Policy in Chapter 3).

Free-trade zones

The Free Trade Zone is aimed at industrial expansion, employment generation, promotion of export projects, foreign exchange generation, and transfer of technology. Efforts are under way to secure financing for the required infrastructure and to attract foreign companies. Special foreign currency provisions, 20-year- tax exemptions and special labor regulations are among the benefits granted to companies establishing themselves or starting up in free-trade zones.

Maquila Industry

A Maquila law has been in effect since 1990, but only a few companies, most of them local, in the textile and fish processing industry, have taken advantage of it. Low-cost production centers in Ecuador (in-bond processing) can bring into the country free of tariffs the raw materials and equipment needed for assembly operations (though a bond must be deposited). Also, special labor regulations apply to companies operating under the system. “Shelter” operations, where Ecuadorian companies lease out their excess capacity and run assembly operations under a foreign company's guidance and specifications, are the most commonly used.

Public/private sector cooperation

The government committed itself to implement programs that would enhance cooperation with the private sector. Joint committees were set up with different chambers of commerce and industry to analyze the challenges facing the country and the steps that need to be taken. Dialogue often proved constructive, and the government implemented a number of private sector initiatives.

Labor/management relations

Ecuador has an ample supply of semiskilled workers available. Ecuadorian workers in general are considered highly trainable and dedicated. Managerial personnel and skilled labor are in good supply, and the educational level in these categories tends to improve constantly. Younger workers are generally very dedicated and motivated, somewhat compensating for any lack of education. Many specialized private training programs are available, though the government does not provide any incentives for them.

Labor unions in the public sector are common and well organized. Labor federations tend to be highly politicized and left-leaning, though their effective powers are limited. Workers in general prefer to work for foreign-owned companies, as the perception is that these pay higher wages and provide better work environments.

The executive branch through the Ministry of Labor sets national minimum wage levels. Aside from the national minimum wage, trade sets other minimum wages, through joint government and private sector committees, depending on the type of work performed. Minimum wages apply to all sectors, both public and private; hence, they are often established in relation to the government's capacity to pay.

Strikes and work stoppages are common in government institutions and companies. They are much less common in Ecuadorian private sector companies, and in general are rare in foreign-owned companies. Labor federations call national work stoppages from time to time in order to protest government measures; their effect on the private industry is limited.

Fringe benefits required by law (social security and additional wages and bonuses) are significant, representing around 30 percent of nominal wages. Labor costs are normally calculated inclusive of fringe benefits and then are worked down to arrive at nominal salaries. Additional voluntary fringe benefits vary for each company, depending on collective agreements with shop unions.

Fringing benefits are generally a secondary concern to employers, being less of a burden than severance payments. Severance payments, as a matter of law and through collective bargaining, in spite of legislation to the contrary, are substantial.

Statutory profit sharing is required by the Labor Code, which establishes the right of workers to share in the profits of a business in adjusted amounts equivalent to 15 percent of such profits (see Profit Sharing in Chapter 10).

Overseas trade relations

Membership in trade blocs

Since January 1996 Ecuador is a member of the WTO (formerly GATT). This important membership broadens the country's possibilities for international trade, beyond the preference systems of specific European or other developed countries.

Ecuador is a member of the Andean Community along with Colombia, Peru, Bolivia and Venezuela. Founded in 1969, this organization has the following basic objectives:

1. To foster economic development and integration of member countries through the reduction and eventual elimination of tariffs among members.
2. To establish a uniform common external tariff.
3. To distribute industrial activities among members.
4. To enlarge consumer markets.

Though of little economic relevance for many years, the Andean Community has taken on new life and started to move toward economic integration. Tariffs and other trade barriers have been abolished between member countries, thus establishing a free-trade zone. Since February 1995 the country applied a Common External Tariff (CET) with two of its Andean Community partners, Colombia and Venezuela. The CET has a four tiered structure with levels of 5 percent for most raw materials and capital goods, 10 or 15 percent for intermediate goods, and 20 percent for most consumer goods. Agricultural inputs and equipment are imported duty free. On January 31st, 2002, at the Andean's Presidents Council, the five member countries (Colombia, Venezuela, Perú, Ecuador and Bolivia) agreed to establish a free trade zone, a CET and a customs harmonization policy by January 2004. A new CET agreement established a new unified tariff schedule coming to effect at the end of January 2006. Because of economic policies that excluded competition for much of its existence, the Andean Community offers considerable opportunities to foreign investors. Within the pact itself Ecuador offers the foreign investors many benefits, including lower costs.

Ecuador is also a member of the Latin American Integration Association (ALADI). The ALADI's stated objective is to achieve free trade for goods produced within the member nations, which include most Latin American countries.

Ecuador has concluded bilateral free trade agreements with Bolivia, Chile, Colombia, and Venezuela, and is negotiating a trade agreement with Mexico. Additionally, Ecuador has engaged in trade talks with the MERCOSUR nations of Brazil, Argentina, Paraguay, and Uruguay.

Moreover, the process initiated in the 1994 Summit of the Americas to integrate the economies of the Western Hemisphere into a single free trade arrangement ended with the creation of the Free Trade Area for the Americas (ALCA). The ALCA can coexist with bilateral and sub-regional agreements, to the extent that the rights and obligations under these agreements are not covered by or go beyond the rights and obligations of the ALCA. In 2001, at the Third Summit of the Americas, the heads of state and government assured that negotiations of the ALCA Agreement would be concluded no later than January 2005 and to seek its enforcement as soon as possible, but in any case, no later than December 2005. Nevertheless, the process has suffered delays and the ALCA participants are still negotiating an Agreement.

For investors, Ecuador's commitments under the Andean Community are of more immediate importance, since progress has been slow in solving the complexities involved in making ALADI and ALCA successful.

Along with other nations, Ecuador was granted special tariff treatment by the European Community. According to the GSP for the European Union, because the Andean Community is undertaking effective programs to combat drug production and trafficking, the Common Customs Tariff is reduced in its entirety for some industrial products; and duty-free entry is also granted to some agricultural products.

As regards to the US market, the United States is the main trading partner of the Andean Community member countries. During the effectiveness of the Andean Trade Preferences Act (ATPA) two-way bilateral trade doubled. This Act had been passed by the United States Congress on December 4, 1991 to support drug control and benefits most imports from Bolivia, Colombia, Ecuador and Peru. The Andean countries recognize the benefits stemming from the initiative and considered that it must be extended and broadened. The United States Senate on May 23, 2002 approved Bill H.R. 3009, the "Andean Tariff Preferences Expansion Act " (ATPEA), extending and broadening the trade benefits granted unilaterally to the beneficiary countries (Bolivia, Colombia, Ecuador and Peru) under the Andean Trade Preferences Act (ATPA), which had expired on December 4, 2001. The proposed ATPEA retroactively extends and expands the trade benefits accorded to the ATPA beneficiary countries from December 5, 2001 to February 28, 2006.

Ecuador expressed its interest in signing a Free Trade Agreement with the United States in October 2003. One month later the United States Government informed of its intentions of starting negotiations with the members of the Andean Customs Preference Act. Negotiations were formally started in Cartagena, Colombia, in May 2004 and negotiations have been held since that date. As a result of this process, most negotiation tables have been closed, those remaining open relate to intellectual property rights, agriculture and sanitary measures. Currently, negotiations are expected to be concluded during 2006.

Exports

The government through the CBE monitors exports. Administrative procedures for exports have been substantially overhauled and streamlined during the past years, leading to elimination of export permits and the introduction of the “single export documentation window” where all export requirements are handled. Exporters are required to register at the CBE by completing a “unified exportation form”; must provide their relevant corporate information and their Ecuadorian Taxpayer Identification number (TIN). This registration is a one-time requirement and does not have to be repeated thereafter.

After the exporter has been registered at the CBE he is granted immediate permission to export. This allows access to the “single export documentation window” to declare and process exports, either through local banking institutions authorized by the CBE or through the internet. Approval is granted once the formal requirements have been completed.

In accordance with the Foreign Trade and Investment Law (LEXI), issued in June 9th, 1997, the Export and Investment Promotion Corporation of Ecuador (Corporación para la Promoción de Exportaciones e Inversiones-CORPEI) was created. This corporation contributes to the sustainable and economic development of the country through the design, execution and promotion of exports and investments in the country and abroad. The entity is in charge of coordinating the actions between public and private sectors, and encouraging the formation of exporters unions with the objective of acquiring a more dynamic presence in the international markets. The CORPEI facilitates enterprises and entrepreneurs with all the necessary information concerning documentation and procedures required for exporting.

Trade Barriers

Local industry was traditionally protected through tariffs, volume limitation, import prohibitions, previous deposits for importation, and other trade barriers. Beginning in the mid-1990s a major reform of the tariff and import structure was adopted. Most non-tariff barriers were eliminated, and tariffs were reduced considerably.

Chapter 3
Foreign investment and trade opportunities

Investor Considerations

- The government recognizes the significant role of private business in economic development.
- Liberalization of the economy continues.
- Ecuador is a member of the Andean Community and ALADI.
- Ecuadorian exports receive special tariff treatment from the United States and EC.
- Ecuador is finalizing negotiations to sign a Free Trade Agreement with the United States.
- The volume of imports is growing, as most barriers have been eliminated.
- There is no foreign exchange control.

Investment climate

Government attitude toward foreign investment

The Andean Foreign Investment Code, the guiding document for investment in the region, has undergone substantial modifications over the years. Decision 24 of the Andean Community, adopted in 1971, was very restrictive and brought about the withdrawal of Chile from the Pact. Investment regulation was then liberalized somewhat by Decision 220 in 1987 and again by Decision 291 in early 1991. Most restrictions on foreign investment have now been lifted, and member countries have been granted greater flexibility in dealing with investors.

The need for foreign investment is recognized, and the current government welcomes it. In addition to the lifting of most restrictions on foreign investment, tax rates have been reduced. Presently foreign investment is particularly encouraged in mining and tourism. The framework established by Decision 291 of the Andean Community, the Foreign Trade and Investment Law (June 1997), and the Investment Promotion and Guarantee Law (December 1997), protect the investment rights of foreign investors and ensure that they will be treated similarly to Ecuadorian nationals.

Tax incentives were granted in November 2005 by the Tax Benefits Law to promote the development of specific industries (see Taxation Policy below in this chapter). Other matters covered by this law are as follows.

Foreign individuals may conduct business in Ecuador provided they enter the country legally, with the appropriate visa, and comply with the appropriate business registration requirements. Specifically, foreign investors enjoy the following legal protections:

- Right to own property.
- Freedom to transfer profits abroad.
- Freedom to fully negotiate investments.
- Access to all tariff preferences granted to Ecuador, including the Andean Trade Preference Act.
- Freedom of access to the domestic financial system, including the country's stock markets.
- Freedom to dispatch resources in case of total or partial liquidation of companies.
- Freedom of access to domestic resources for promotional and/or technical purposes.

Business entities, including foreign investors, must be legally and officially constituted in Ecuador before they can enter into valid contracts. Foreign investors enjoy the same benefits and investment incentives granted to Ecuadorian investors, including access to Andean markets and other trade agreements.

Types of investments are defined in the provisions of Decision 291 of the Commission of the Andean Community. Transfer of capital may include: a) financial resources in freely convertible currency; b) physical or tangible property; and c) intangible technological contributions covered by agreements recorded with the Ministry of Foreign Trade, Industrialization and Fishing

Current investment climate in Ecuador is favorable, as compared to other Latin American countries. A dollarized economy, combined with reasonable wage levels, create many opportunities for foreign investors. Other investment advantages include an abundance of natural resources and a growing economy with a GDP growth rate of 6.95% for 2004 and 3.33% in 2005.

Nevertheless, the Ecuadorian economy also poses various risks and obstacles for potential investors. These risks include those typically found in most developing nations. For example, political instability and corruption are still a persistent problem. Infrastructure, such as roads, are also still not on par with those found in developed countries.

Trade policy

The government's policy on trade is generally based on the principle of free enterprise. Most protectionist legislation has been revoked, and the country's economy has been liberalized and opened to foreign competition. The country's membership in the Andean Community, the ALCA and the ALADI will provide for more competition and greater access to markets.

Taxation policy

The tax system has undergone major reforms. The structure has been greatly simplified, and tax rates for profits remitted abroad were reduced from 36 to 25 percent (a 44.4 percent rate applies to oil companies operating under risk services contracts which are currently a minority). Companies establishing themselves in the free-trade zones are granted a 20 year tax holiday.

The recently introduced Tax Benefits Law of November 2005 established temporary taxation benefits for new investments limited to the following activities:

1. Hydroelectric and alternative-source generation projects (thermoelectric generation is specifically left out);
2. Refining and industrialization of hydrocarbons, as well as the production of petrochemicals;
3. Industrial production of high tech electronic and fiber optic equipment, as well as other digital and electronic devices. Also, industrial plants for the assembly of electronic and digital integrated circuits, microprocessors, data storage, electronics boards and portable computers, scientific sensors, software and hardware;
4. Development, implementation and operation of regional distribution centers for air traffic and cargo interconnection for international flights;
5. Construction and operation of deep water harbors for international transfer of cargo and containers;
6. Production of agricultural and agro industrial machinery and equipment that are not currently available in the country;
7. Production of oxygenated additives of renewable sources, such as ethanol.

Tax benefits granted through this law apply only to local companies that have been established after the expedition of the law and to foreign companies that are legally domiciled in Ecuador after the law's expedition (November 2005). The capital of the companies must be at least 10% of planed investment and minimum investment in fixed assets must be at least 7.5 million US dollars for items 1, 2, 3, and 5 (above), and 2 million US dollars for items 4, 6 and 7. The investment has to be completed in a maximum period of 2 years from the date of issue of the Presidential Decree granting the tax benefits.

Tax benefits granted under this law include exemption of income tax, custom duties (for goods not produced in Ecuador) and taxes involving the incorporation of companies, as well as partial exemptions (up to 95%) of local taxes. Exemptions are granted for a period of 10 years for the provinces of Pichincha and Guayas, and 12 years for the rest of the country.

Local competitor attitude toward foreign investment

A certain dichotomy exists between the official business position and the position of the private businessperson. Officially, business associations strongly support foreign investment and seek equality of conditions for local and foreign investors. Businesspersons, on the other hand, as is to be expected, can be wary of foreign investment when it competes directly with them.

Local investors have been known to attempt to delay foreign investment when it is in direct competition with their own efforts. However, they are generally unsuccessful. Joint ventures, production agreements and other forms of cooperation between foreign and domestic investors have become more common in the past years.

Labor attitude toward foreign investment

Labor federations are primarily political organizations and traditionally have been against foreign investment. However, in recent years the political clout of these organizations has been reduced, and consequently their point of view has not affected foreign investors. On the other hand, workers frequently prefer foreign-owned companies because the general perception is that they pay higher wages and maintain better work environments than domestic companies.

Special investment opportunities

The investment climate is attractive in Ecuador. An economy in clear recovery, with diverse natural resources, contributes to favorable investment conditions. Expanded markets provided by the Andean Community and special treatment granted by the United States and the European Community, provide for ample investment opportunities. A largely unexploited mining and tourism potential also awaits foreign investors. Present tariff and trade conditions allow for demand for many previously unavailable foreign products. Import volume is experiencing significant growth.

Planning guide for the foreign investor

National and local government policy considerations

Ecuador's economy is undergoing rapid transformation, opening up to trade and investment. Foreign investment is welcome and is guaranteed nondiscriminatory treatment and access to Andean, European and US markets at preferential tariffs.

Investment possibilities/restrictions

Foreign ownership in general is not restricted. There is no legal discrimination against foreign investors at the time their investments are made. Some areas (oil production, utilities, and defense) are reserved for the state. The government, especially in the oil industry, normally enters into contracts with private companies, which receive a participation of the extracted oil if exploitable oil is found. The mining sector is open to foreign investment, with individual concession arrangements to be worked out with the Ministry of Energy and Mines.

Regarding telecommunications, conventional telephone utilities are state-owned; while cellular telephone systems have been in private hands since 1993; satellite and paging services are also in private hands. All other sectors are open to 100 percent foreign ownership.

Prior approval or registration

Most investments do not require prior authorization, the exceptions being oil contracts with the state, ownership in banking and insurance entities and the acquisition of existing ones, investment under international covenants where investment guarantees are granted, and those subject to special laws. All foreign investments must be registered with the CBE.

Possible Business Structure

Normally a corporation (subsidiary), branch or partnership can be used. Treatment for profits remitted abroad is the same for all companies, local or foreign. If reinvestment or capitalization of profits is expected, the incorporation of a corporation would prove to be the most advantageous type of organization.

Setting up or acquiring

The choice between setting up a new business or acquiring an existing one depends on the particular circumstances of the investor. Generally, setting up and/or acquiring assets is recommended, as buying an existing company means assuming past tax and labor contingencies (including social security).

Investment incentives

Tax and labor incentives are granted to companies establishing themselves in a free-trade zone. Labor incentives are granted to maquila or in-bond processing companies; however, serving the local market through these mechanisms is difficult.

Additional tax incentives were granted in November 2005 by the Tax Benefits Law to promote the development of specific industries: hydroelectric and alternative-source generation, Refining and industrialization of hydrocarbons, high tech electronics, distribution centers for air traffic and cargo, deep water harbors, production of agro industrial machinery and production of fuels from natural resources (ethanol). For more detail see Taxation Policy above in this chapter.

Location/industries

Tax incentives are available for investments in the export-processing (free-trade) zones (see “Free Trade Zones” in chapter 2). Services are generally better in the larger cities and in the industrial parks located throughout the country.

Finance

Major financing is generally obtained abroad. Although there are no local financing limitations affecting foreign investors, in general, because credit in Ecuador is rather scarce, and of a short-term nature, investors in need of medium- and long-term credit find it easier to contract foreign loans.

Repatriation of capital and profits

Capital can be repatriated at any time, but only from the proceeds of sale or liquidation of the investment. Profits can be remitted every year after payment of related local taxes. There are no other restrictions.

Tax planning considerations

Companies should withhold income tax at 25 percent of total payments abroad other than profits, dividends and interest on foreign loans.

Tax and duty-free importation of personal and household effects is available to expatriate personnel under certain conditions.

Labor and labor costs

An abundant supply of semiskilled and readily trainable unskilled labor is available. Labor costs, including fringe benefits and profit sharing, are in the higher echelon of South American countries.

Market Studies

The rapidly changing business environment and increased competition from all sources (particularly other Andean countries), as well as “unofficial” imports make market studies highly advisable.

Information and Assistance

A list of agencies and business organizations that can be of assistance to the potential investor is provided in Appendix XVIII.

Trends

The Ecuadorian government publicly welcomes foreign investment and offers an open foreign investment regime. Ecuador's long term economic health depends on the success of modernization and liberalization reforms, including efforts to reduce the country's disproportionate reliance on a few export commodities. Economic indicators across the board have improved; and the process of dollarization, along with substantial help from the IMF and World Bank, have helped stop the extreme inflation that undermined Ecuador's economy at the turn of the century. Also, Ecuador's Congress reaffirmed its support for free market principles with its March 1, 2000, approval of the Economic Transformation Law, a decision that relieved the concerns that companies already doing business in Ecuador had, and one that will do much to attract new foreign investment.

The modernization of the State has started and the implementation of a viable privatization program should allow for immediate realization of Foreign Direct Investment potential in the still large state-owned sector. However, the government still faces a difficult task in implementing many of its reform commitments.

Chapter 4
Investment incentives

Investor Considerations

- Incentives take the form of tax holidays for qualified operations and exemption from customs duties.

- Incentives are available to both foreign and domestic companies.

- Tax and non-tax incentives encourage production for export of merchandise with value added in Ecuador.

Investment Policy

The main objectives of Ecuador's domestic and foreign trade regulations and strategies continue to be the promotion of local industry, increasing the volume and classes of exports and creating opportunities for employment of an ever-growing work force. A good number of the measures aimed at fostering national as well as foreign capital investment are therefore directed toward inducing potential investors to participate in the production of goods to replace imports or increase exports.

As noted in Chapter 5 under "Regulatory Legislation", Andean Community provisions have been modified since 1991 to remove many of the previously existing restrictions on foreign investment, thus making it more attractive to place investments in the countries of the region.

To a great extent, the concessions offered to foreign investors are the same as those offered to domestic investors, which are described in this chapter as well as in Chapters 13 and 15.

Tax Incentives

Foreign and local investors are both entitled to the normal income tax exemptions, deductions and discounts (See Chapters 15 and 20). Basic income tax rates are moderate: 25 percent for branches of foreign corporations and local companies (including subsidiaries of foreign corporations), and low progressive rates with a maximum of 25 percent for individuals.

Profits of oil companies working under production sharing contracts (the majority) are taxed at 25 percent, while oil companies working under risk services contracts are taxed at 44.4 percent (25 percent when reinvesting in the same operation in which the profits were earned or other activities).

Non-tax incentives

The non-tax incentives available to both foreign and local investors include a simplified documentation process for exporters.

In addition to the legal right of access to foreign currency in a free market in order to remit profits and eventually repatriate their investment in currencies other than the US Dollar, foreign investors may also enjoy participation in the Andean Community, the ALADI, and in the future in the FTA with the United States. Since the year 2000, the foreign exchange market is very limited because almost all transactions abroad are carried out in US Dollars; Euros, Colombian Pesos and other currencies may be obtained in limited amounts.

Regional and industrial incentives

Beginning in 1994, all exemptions, deductions, benefits, and any other preferential income tax treatments provided for under the different development laws were eliminated or phased out.

In November 2005 Congress issued the Tax Incentives Law applicable to specific industries: hydroelectric, industrialization of hydrocarbons, high tech electronics, air traffic and cargo, deep water harbors, industrial machinery and production of fuels from natural resources. For more detail, see Taxation Policy in Chapter 3.

Free Trade Zones

A Free Trade Zone Law has been in effect since 1991 which purpose is to promote exports, foreign investment, and employment in free trade zones established by the government. Within the designated areas (subject to an approved application), any domestic or foreign natural or legal entity may freely import merchandise, raw materials and machinery with the exception of inflammable explosives or otherwise harmful materials and armaments. Goods so imported may be stored, packed, unpacked, manufactured, assembled, or transformed and then traded in accordance with zone regulations.

All goods or raw materials entering a zone are exempt 20 years from any national, state or municipal tax, including customs duty. They are, however, subject to storage and handling charges; shipments must be consigned to an entity duly authorized to operate in the area or to the free-trade zone itself.

Profits deriving from operations within the zone, by users of the zone, are not subject to any income tax. The managing entity is also exempt. Sales to the zone are to be considered exports for all purposes, and purchases from the zone are considered imports subject to relevant legislation (see Chapter 8).

Foreign investment in such zones is exempt from any current or future restrictions on capital repatriation. Companies established in a free trade zone may develop industrial or commercial activities and must pay a fee equal to two percent of their investment to the National Council of Free Trade Zones in order to operate in the zone. Currently, there are 8 free trade zones in the country: Esmeraldas Duty Free Zone CEM- ZOFREE, Cuenca Duty Free Zone CEM, Ecuador Duty Free Zone ECUAZOFRA, El Oro Duty Free Zone ZOFRAORO, Guayas Duty Free Zone ZOFRAGUA, Manabí Duty Free Zone - ZOFRAMA, Manta Duty Free Zone ZONAMANTA, Quito Duty Free Zone - METROZONA.

International financial center operations

Under certain conditions an investor could use Ecuador as a base for carrying out meaningful international operations. The country does not, however, qualify as a tax haven.

Export Incentives

Exporters welcomed a reduction in the paperwork required to export goods. The creation of the CORPEI (refer to Chapter 2) promotes export. This institution helps the exporter by providing with the appropriate information required for the exportation process and everything associated with foreign trade and investment. Another positive aspect is that with the use of the US Dollar, transactions are much more efficient. Notwithstanding, credit facilities can be limited and expensive.

Incentives to invest in other countries

No incentives are currently available to invest in other countries; however, the Andean Community provisions make it possible for an investment in any of its member countries.

Incentives and foreign investment strategy

In order to attract foreign capital, it is the government's policy to extend to all foreign investors the rights and privileges granted to domestic investors, and to enact tax regulations that are compatible with those in other countries. Provisions exist for tax credits or to avoid double taxation by way of special tax covenants signed with other countries (see Appendix V).

Chapter 5
Restrictions on foreign investment and investors

Investor Considerations

- A simplified investment process has been in effect June 1991.
- Prior authorization is not needed in most areas.
- There are no restrictions on foreign ownership in most areas.
- Capital and profit may be remitted abroad without authorization and limits.
- The US Dollar is used as local currency.

Regulatory Climate

Regulatory authorities

Foreign investment legislation is administered through the Ministry of Foreign Commerce, Industry, Fisheries and Competitivity (MICIF). The CBE is the authority charged with the registration of foreign investments as well as special contracts and foreign credits as provided by law. It operates as an independent agency in charge of monitoring the economy, designing the national macroeconomic program, guaranteeing the normal functioning of the financial system, administering the country's International Reserve, and publishing of current interest rates. The CBE controls import and export licensing, and records and maintains statistics on all of the areas aforementioned.

Regulatory Legislation

Foreign investment is regulated generally in accordance with Andean Community regulations. Currently, Decisions 291 and 292, enacted as of March 22, 1991, contain the basic guidelines regarding foreign investment in the Andean Community countries. Each country is free to issue regulations regarding the application of the decisions within its territory. Ecuador's foreign investment regulations are contained in the Foreign Trade and Investment Law- LEXI (June 1997) and the Investment Promotion and Guarantee Law, passed in December 1997. These documents protect the investment rights of foreign investors. CBE's regulations are part of the legislation that regulates investments in Ecuador.

After decades of being relatively closed to foreign investment, the Andean Community and the government of Ecuador embarked on a process of economic liberalization. Foreign investment, integration, free trade, and minimal government intervention are now seen as vehicles to growth and prosperity and are thus encouraged. Andean Community legislation is now general in nature, allowing individual countries wide discretion in implementing the regulation of foreign investment to meet their particular needs.

Current investment legislation is relatively open and broad in scope, and MICIF has powers of interpretation, though its judgments can be appealed at the country's administrative courts. Within general investment guidelines, special arrangements are possible and are treated on a case-by-case basis.

Exchange Controls

Inward Investment

Since the adoption of the US Dollar as the official currency of Ecuador in year 2000, a very small free exchange market (for currencies different than the US Dollar) exists.

Importers and exporters execute their transactions in US Dollars. Foreign investments, foreign credits, repatriation of earnings, travel currency, and transfers are carried out in this currency. These transactions are done through banks, exchange houses, or other financial institutions. For all purposes the exchange rate of the different currencies with the dollar is set in the international market.

As regards the general rules concerning investment, except for those special cases mentioned below (see "Restrictions on foreign ownership"), foreign investments do not require prior approval. However, all foreign investments must be registered with the CBE for statistical purposes.

Registration of technology transfer and other agreements

The CBE registers foreign investment and credits, as well as contracts for transfer of technology and licensing and royalty contracts. These contracts have also to be registered at the MICIF; no specific approval is required.

Currency Accounts

Residents and nonresidents in Ecuador maintain their accounts in US Dollars. Currency from export proceeds can be also maintained outside Ecuador. Foreign investors could use the free exchange market to convert their inward investment flows. Currently there is no rationing of US Dollars, but other foreign currencies are scarce. Offshore accounts are very common in Ecuador.

Repatriation of capital and earnings

Regulations concerning repatriation of capital and earnings are contained in Andean Community Decision 291 and CBE regulations.

- Capital

The Foreign Investment Code guarantees repatriation of capital upon sale or liquidation of a company, provided all taxes due have been paid. Foreign investors are free to remit 100 percent of net profits without restriction. They may also repatriate the proceeds of liquidation of their investment. There is no minimum time period in which the investment must remain in the country.

Reinvestments are considered capital when registered and are part of the foreign investment that can be repatriated. Investments are registered in dollars or other originating hard currency. Consequently, repatriation of reinvestment must be made through the free market.

- Loans

Foreign credits must be registered with the CBE. No prior approval or authorization is involved. There are no limitations on interest rates, but interest rates in excess of those determined by the CBE gives rise to withholding of income taxes. Prime and LIBOR rates serve as the basis for comparison. For related parties, arms length interest rates are required under transfer pricing tax legislation.

- Dividends and Profits

Earnings can be remitted abroad annually, after the payment of corresponding taxes. The CBE does not authorize remittances nor does it intervene in their transmittal. There are no limitations on profits available for remittance abroad or on access to currency.

- Interest

Currency for interest payments on foreign credits registered with the CBE must be obtained through the free market. No authorization or registration of the payment is required. Interest payments abroad are not subject to income tax withholding provided the foreign credit is duly registered in the CBE and that the interest rate does not exceed that established by this entity.

- Royalties

In general, there are no limits on royalty payments abroad. Contracts for royalties payable to head offices require authorization by MICIF and must be registered with the CBE. Tax withholding is required.

- Service Fees

Similar treatment to that of royalty payments.

- Branch Profits

No specific regulations exist with respect to the remittance of branch profits. See “Dividends and Profits”, above.

- Imports

Imports are subject to the granting of import licenses by the CBE. Payments abroad for imports are not subject to tax withholding. See Chapter 8.

Restrictions on foreign investment

Industries closed to private enterprise

The Constitution reserves the following areas to the state.

1. Nonrenewable resources and underground resources (hydrocarbons).
2. Utilities, water, electricity, and telecommunications.
3. Strategic enterprises as defined by law (defense industries).

Such activities, according to the Constitution, can be contracted out to private companies. This is commonly done in the oil industry, where private (including foreign) investors can enter into production sharing contracts with the state. Upon finding oil, the investor receives the agreed share of the extracted oil. Regarding electricity distribution utilities, the government has been struggling to attract foreign investment in this area for several years without much success. It is foreseeable that the government will continue to push for foreign investment in these areas or, at least, to contract for their private administration in the short or medium term. Investment has also been lagging behind in the electrical generation sector due mainly to the lack of adequate guarantees for the payment of bills by the distribution companies.

Restrictions on foreign investment

Most areas are open to 100 percent foreign investment, the exceptions being communications media (radio, TV and newspaper), which are reserved to local companies with a maximum of 25% of foreign investment.

There are no percentage restrictions on foreign holdings other than those stated above, nor are there any restrictions on foreign ownership of buildings, land or assets. Additionally, there are no restrictions on joint ventures by foreigners; local partners are not essential, though in some industries it may be advisable to work through a local partner, particularly where intimate knowledge of legislation is required.

Foreign companies entering into contracts or associations with the government are required to domicile themselves in the country. Aside for the cases detailed below, no prior authorization is required.

Other types of restrictions

In addition to the industries closed to foreign investors, restrictions on foreign investment include the following.

1. The Superintendence of Companies requires that a branch of a foreign company must have a minimum capital of US$ 2 thousand in order to become domiciled in Ecuador.
2. Investments in banking and insurance have no ownership restrictions, but must have prior authorization from the Superintendence of Banks and MICIF.
3. The cognizant agencies must authorize investment in the following.
   (a) Electric generation and distribution;
   (b) Mining;
   (c) Commercial fishing;
   (d) Maquila zones;
   (e) Free-Trade Zones.

Bilateral investment treaties

Ecuador is a member of the Andean Community, the ALADI, the ALCA, and other; regional investments are encouraged in these organizations.

The United States' Andean Trade Preferences Expansion Act (ATPEA) seeks to significantly benefit the diversification of the country's production systems and to accomplish control of illegal drug production and trafficking as well as other related offenses.

Policy Trends

Foreign investors are now granted equal status with domestic investors, with the same rights and guarantees. The industries closed to foreign investment have been sharply reduced, and most prior authorizations have been done away with. All profit-remittance limitations have been eliminated, and exchange is not an issue for investors as there is no problem in accessing US Dollars. All other currencies are less available.

All requirements to sell investments to Ecuadorian investors within a specified period of time have been eliminated. Companies that under prior legislation had agreed to admit local investments may renegotiate such agreements. Foreign branches and companies have access to all expanded market initiatives (through the Andean Community and the preferential tariffs offered by the United States and the EC) under the same conditions as local investors.

Additionally, the CORPEI's National Plan for Investment Promotion for the period 2001-2010, tries to attract investment to the mining, agro-industrial, touristic and ecoturistic, fishing and construction sectors. The major goals of the Plan are:

- To approve State Policies related to Direct Investment (DI), whether national or foreign.
- Increase in 7 times the minimum average DI of the private sector (non-petroleum), registered during the 90s, towards obtaining an accumulated DI of US$7,000 million in year 2010.
- Contribute to the diversification and growth of non-petroleum exports.
- By 2010 create at least 300 000 new jobs.
- Generate Direct Investment, in amounts greater than US$3,500 million, through privatizations and concessions during the first four years of the Plan.

Chapter 6
Regulatory environment

Investor Considerations

- Government intervention in business has decreased.
- Price Controls are limited to certain basic goods.
- Retail prices must be printed in package labels.
- Foreign Investment does not require prior authorization.
- Patents are granted for up to 20 years and are nonrenewable.
- Trademarks are protected for 10 years, and the registration may be renewable for an ongoing period of 10 years.
- Intellectual property rights are currently being discussed within the negotiations of the FTA with the United States.

Regulation of business

The executive branch of government, through the different ministries, is charged with controlling and regulating the economy. All investors will at one point or another have direct dealings with the different ministries, particularly the Ministries of Finance (taxes); Industry (MICIF, on contract authorizations); Energy (particularly oil and mining companies); and, to a much lesser extent, the Ministries of Agriculture, Public Health and Labor.

Ecuador's economy is considered to be market oriented. The economy can still be considered bureaucratic due to remaining state interventions, but progress continues. Required approvals are the exception and not the rule.

At the corporate level, the main regulatory bodies are as follows:

1. Superintendence of Companies (SC):

   This is the regulatory agency responsible for the control and supervision of all commercial and industrial companies except those in banking, finance and insurance. It supervises compliance with laws and regulations, dictating norms for accounting and auditing as well as the conducting of directors' and stockholders' meetings, among other things.

2. Superintendence of Banks and Insurance Companies (SB):

   This agency regulates the operation of banks and finance and insurance companies. It supervises compliance with the relevant laws (the General Bank Law, General Law of Insurance Companies, Finance Companies, etc.) and examines the financial statements of those entities under its jurisdiction.

3. Central Bank of Ecuador (CBE):

   This institution controls imports and export licensing, registers foreign loans, and registers foreign investments and the repatriation of profits.

4. Ecuadorian Standards Institute:

   This agency sets technical and quality standards and measures to be complied with by commercial and industrial enterprises.

5. National Securities Council:

   This is the regulatory body that oversees the securities' market and its participants.

Competition policy

At present there is no specific policy to promote free competition. In the past, the government, in an effort to protect specific industries, regulated the economy to the degree that it aided in the creation of private and state oligopolies and monopolies. However, as Ecuador's trade continues to be liberalized, and with the existence of the Andean Free Trade Zone, competition at all levels has grown and is expected to increase significantly.

Price Controls

The Consumer Protection Law authorizes the government to establish maximum consumer prices or minimum producer's prices in order to stabilize prices and protect the supply of basic consumer goods and services. Price controls are administered by inter ministry committees and are limited to establishing maximum prices for items of popular basic consumption and minimum prices for agricultural and livestock raw materials. Traditionally, the number of products and services controlled has been very limited. At present they include sugar, milk, rice, flour, soft drinks, beer, public services, and a few others.

The Consumer Protection Law also requires industrial companies to display, printed on product or its packaging, the final consumer sales price as well as a description of the characteristics of the product based on certifications issued by the Ecuadorian Standards Institute. Retailers are forbidden to alter marked prices and may not sell the products at higher prices. In fact, producers set retailers' gross profit margins, though these are normally negotiated.

Prices of medicines are controlled. They are subsidized by the Ministry of Health and fixed on the basis of audited and approved industry cost studies.

Monopolies and antitrust

Ecuador does not have a specific law covering monopolies or trusts. However, the law governing the incorporation and conduct of businesses (the Company Law) states that the incorporation and operation of enterprises tending to monopolize any industry is prohibited. Because of trade liberalization, competition is increasing significantly, thus reducing oligopolistic power.

Acquisitions and mergers

There are few regulations pertaining to acquisitions and mergers, and these are generally limited in scope. The Company Law, in accordance with provisions of the Foreign Investment Code of the Andean Community, requires that all stock must be nominative (registered). Stock transfers between domestic stockholders (except in banking) can be carried out without any prior authorizations or other restrictions. Whenever a foreign investor is involved, such investment must be registered at the CBE. Prior authorization is required for the oil industry.

There are very few publicly held companies in the country. Consequently, most acquisitions are not effected through the exchanges but in private dealings with the owners.

Additionally, mergers must be approved by the Superintendence of Companies, and, in such cases, merging companies must normally liquidate and form a new company. In cases where one company absorbs another, the absorbed entity must first be liquidated.

Security Markets

There is a general consensus that a healthy securities market is needed to provide companies with an alternative to debt financing. Two stock exchanges operate in Ecuador, one in Quito and the other in Guayaquil. The reformatory Security Market Law, issued on February 2002 (Law 61) regulates the Security Markets. Only broker firms may be members of stock exchanges, and the exchanges are now nonprofit in nature. Listings are entirely voluntary, and transactions need not be channeled through the exchanges.

For securities to be listed, the company must be registered with a stock exchange. For debt-type securities, credit rating services must be used. Audited financial statements are required.

The volume of transactions is generally small, consisting mainly of government and private sector mortgage bonds traded by government entities. Most large private sector transactions are not handled through the exchanges. Trade of shares is minimal.

Imports and Exports

Ecuador is undergoing a continuing process of trade liberalization, with the elimination of most non-tariff import restrictions.

Importers and exporters must be registered with the CBE. Declaration and approval for exports and imports is obtained through a “single documentation window”, which combines all exports/imports requirements. This can be done through banks that have been authorized by the CBE or through the Internet. Imports determined to be dangerous or hazardous to health require, in some cases, prior approval from the appropriate ministry.

The government maintains a policy of allowing exports of basic goods only when supply of domestic demand is assured; to this end, the government maintains and frequently revises lists of products that cannot be exported and products with export volume limitations. Products not specifically included in these lists can be exported with no restrictions.

Consumer protection

The Consumer Protection Law is the basis for all standards and other measures considered necessary for the protection of consumers. Under this law, the Ecuadorian Standards Institute is charged with the issuance of norms regarding weight, measures, labeling of products and minimum quality standards that must be met. Labeling requirements include retail sales price, ingredients, weights and measures, dates of manufacture, and dates of expiration.

Food and drug standards are regulated by the Ministry of Health, which is charged with determining whether a product is fit for human consumption and certifying its nutritional value. To this end, and in conformity with existing standards, the Ministry registers the products. The registration number must be printed on the label; food and other products cannot be marketed unless registered. Additionally, quality control certificates issued by the Ecuadorian Standards Institute are required for food exports.

Products that are dangerous or are considered health hazards- particularly pesticides, poisons, chemicals that can be used for the production of illicit drugs, and other such goods – require authorization from the Ministry of Agriculture (or other appropriate ministry) before their importation or commercialization.

Pollution Control, Protection of the Environment

Legislation related to environmental protection and pollution control has steadily become abundant and complex at the national and local levels. The Ministry of the Environment is charged with implementing environmental protection policies, enforcing environmental legislation and managing the process of granting environmental licenses. According to current environmental regulations, all projects to be implemented in the country have to present a declaration of environmental impact to the aforementioned ministry or to other government entities dully authorized by the ministry. Projects with environmental impacts have to obtain an environmental license which involves the preparation and approval of and Environmental Impact Study, including an environmental management plan.

There is a series of technical regulations regarding pollution and contamination standards and limits for air, water, land and noise, as well as regulations on solid and liquid waste.

In special cases, specific authorities are in charge of enforcing environmental regulations within their area. This is the case of the Ministry of Energy, for matters relating to the oil industry, and Consejo Nacional de Electrificación, in electricity generation projects. Also, certain local governments have been accredited to control and enforce environmental regulations by the Ministry of the Environment.

Special Industries

Banks, insurance companies and other financial institutions

The operation of banking, insurance and other financial institutions is regulated by the Superintendence of Banks under the Financial Institutions Law, the Law of Insurance Companies and auxiliary regulations.
There are some branches of foreign banks in Ecuador, and these are subject to the same rules and regulations as local banks. More information can be found in Chapter 7.

Hydrocarbons (oil)

Norms for the oil industry are set forth in the Hydrocarbons Law of November 15, 1978 and its reforms and subsequent regulations. In addition, the Ministry of Energy regulates this industry.

Oil exploration, exploitation, transport, and commercialization are areas reserved to the state and handled by Petroecuador, the state oil holding company and its subsidiaries. Private investment in exploration and exploitation is implemented normally through different type of concession contracts. If exploitable oil is found, the companies receive a participation of the extracted oil and are taxed at a 25% rate. Other legal contractual forms include risk service contracts under which, should commercially exploitable oil be found in the areas allotted to them, exploration costs are reimbursed. In this case, once companies enter the exploitation stage, a service fee is paid for all exploitation and transport services rendered. Under these contracts, the fee can be paid either in cash or in oil and companies are taxed at 44.4 percent on the service fee, not the reimbursements, and pay an additional production tax when applicable. A tax for technical development and research also applies. Activities regarding transport and commercialization are carried out by the private sector through regular contracts.

Mining

The Ministry of Energy regulates the mining industry under the Mining Law issued on May 31, 1991, which was last amended in August, 2000. The state's mining company, private companies or private/state joint ventures can carry out mining activities. The state, through the Ministry of Energy and Mines, grants mining concessions for renewable 30 year periods which give the bearer the right to prospect, explore, benefit, smelt, refine and commercialize the mineral substances existing in the area of the concession. All minerals found are the exclusive property of the mining company and can be freely sold within or outside the country. Foreign investors are prohibited from obtaining mining rights in zones adjacent to international boundaries without permission of the President and approval of the Armed Forces.

Mineral commercialization companies can also be formed for the purpose of buying and selling minerals both within and outside the country. Exploration and exploitation rights can be freely sold, leased or mortgaged. Mining companies are taxed at the rate of 25 percent.

Tourism

As contemplated in the Tourism Development Law of January 1997, amended in May 2001, the tourist industry has been specifically targeted for development by the government and consequently has been granted some special tax benefits. All official fees and taxes in connection with the incorporation of corporations in this area have been waived. Municipal taxes on property transfers have also been lifted, and investments made in tourism companies through the purchase of shares are fully deductible by the purchaser. The law imposes registration and classification requirements for companies wishing to operate in this sector.

Patents, trademarks and copyrights

For the most part, Ecuadorian law provides adequate protection for property rights under the Intellectual Property Rights Law (IPRL) that incorporates Decisions 292, 344, 345, and 351 of the Andean Community and many aspects of the intellectual property provisions ("TRIPS") of the World Trade Organization. The law provides criminal and administrative relief to right holders. Ecuador has ratified the Berne Convention for the Protection of Literary and Artistic Works and the Geneva Phonogram Convention. Ecuador has observer status in the World Intellectual Property Organization (WIPO).

Patents

The IPRL of May 1998 regulates patents, and grants exclusive rights to exploit all inventions, perfections or imports that have been registered. The IPRL extends patent protection for 20 years from date of filing. Patenting of pharmaceutical products is permitted. Compulsory licensing is relatively limited. In infringement cases, the burden of proof lies with the alleged infringer. The law also provides patent protection for new drugs. The IPRL also provides protection for industrial designs and extends protection to industrial secrets and denominations of origin. Semiconductor chip layouts are protected. The law provides protection for development of new varieties of plants and biotechnology products.

Trademarks

Trademarks are regulated by the IPRL, which in general terms guarantees producers (foreign or domestic) the right to distinguish their products by the use of an exclusive trademark. Trademarks, both domestic and foreign, must be registered in order to assure ownership rights and exclusive use. Trademark registration is permitted for renewable 10-year periods, but registration may be canceled if the mark is not used in the Andean region for a period of three years. The IPRL provides protection for well-known trademarks. A trademark registration cannot be voluntarily surrendered without consent of licensee.

Copyrights

The IPRL protects printed and recorded works for the life of the author plus 70 years. Computer programs are protected, albeit as a type of work distinct from literary works. The IPR law covers software.

Patent, trademark, and copyright registrations must be made at the Ecuadorian Intellectual Property Institute (IEPI). Pirating of recorded material, textbooks, and software programs is widespread. The National Police and the Customs Service are responsible for carrying our IPRL enforcement orders.

Intellectual property rights issues, which are considered controversial, are being discussed at length within the negotiations which Ecuador is carrying out with the United States at present and which are in their final stages.

Chapter 7
Banking and finance

Investor considerations

- Ecuador's banking system provides a full range of services.
- Medium- and long-term credit is limited.
- Leasing and factoring are functioning as alternative sources of funds.

Banking system

The Codification of the General Law of the Institutions of the Financial System and its Reforms Law (Law 60), issued in 2001 and 2002 respectively, constitute the current normative under which the Superintendence of Banks regulates the creation, organization, activities, functioning and extinction of all the institutions pertaining to the private financial system. These laws try to reduce the distinctions between the different types of financial entities and allow a broader scope of services to be offered by all of them. Also, they try to serve the needs of the customers, and relieve the Superintendence of Banks of the need to analyze trivial matters; thus fostering an increase in the efficiency with which financial entities are governed.

Due to the problems that affected the financial system, the insolvency and unreliability of certain banks, on December 1st, 1998, the Deposits Guarantee Agency was created. This autonomous entity is in charge of guaranteeing the efficiency of the entities in the financial system and the deposits of all customers in these institutions. The agency is currently in the process of recuperating the portfolio of those banks that went bankrupt at the end of the 1990s, as well as selling their remaining assets. The funds obtained through this process are used to reimburse deposits made by the general public.

In addition, the law that regulates the financial institutions states that financial entities are given the right to perform the same operations and activities as banks, except for acceptance of monetary deposits for checking or savings accounts. In exchange, they are permitted to promote investment projects, although specific divestiture requirements must be met.

“Financial groups” can be headed by a holding company, a bank or a financial entity, and they can include an insurance company, reinsurance company, financial services company, and any of the institutions mentioned in the banking law (Law 60) or Securities Market Law (Law 107) and its amendments.

There are 22 private local commercial banks in Ecuador, and two foreign banks have branches in the country; there are various other financial institutions. Aside from banks, financial institutions include finance companies, financial intermediaries, leasing companies and savings and loan companies. Through separate legal entities most of those companies belong to a few large financial groups.

The financial system had traditionally been over-regulated and heavily dependent on the CBE. Over the past few years, deregulation and a reduced role for the CBE have spurred competition and development of services.

Banks and financial institutions in Ecuador have excellent computer systems and provide a wide range of services.

Central Bank

The CBE is an autonomous state institution responsible for, among other things, establishing, controlling and directing the monetary, exchange and credit policies of the nation. With the implementation of the dollarization scheme, and the issue of the Law for the Economical Transformation of Ecuador, reforms to its role have been introduced:

- Monetary Policy: The CBE has to assure the free circulation of the US dollar in the country and its transferability to the international market.
- Credit Policy: This entity is no longer allowed to grant loans to any of the institutions of the financial system, including the government banks.
- Exchange Policy: As the Sucre is no longer the national currency, the CBE can no longer establish exchange rates for any foreign currencies; exchange rates against the US Dollar are however published by the CBE.
- The CBE is in charge of issuing local coins (equivalent to the penny, nickel, dime, quarter and half dollar of the United States of America). These coins can only be used within the country.

Banking market

- Commercial banks

Commercial banks are the largest financial institutions in the country; they offer a full range of banking services including current and savings accounts, short- and medium-term financing, foreign currency trading, letters of credit, income tax collection, foreign currency deposits, and local and foreign fund transfers.

Foreign banks (at present, Citibank and Lloyds Bank) engage in the same activities as Ecuadorian banks, except that law prevents them from taking savings deposits.

- State development banks

There are certain special-purpose banks owned by the state. These are engaged in economic development programs that receive support from international organizations such as the Inter-American Development Bank (IDB) and the World Bank. The following institutions are the most important:

1. *Banco Nacional de Fomento (BNF):*
   The BNF finances agriculture, cattle raising, small industry, and handicraft production programs.

2. *Banco Ecuatoriano de la Vivienda (BEV):*
   The BEV is engaged in financing urban and rural housing programs. Its activities are complemented by the savings and loan associations *(mutualistas)*.

3. *Banco del Estado (State Bank):*
   The State Bank finances programs, projects and services for the public sector.

4. *Corporación Financiera Nacional (CFN):*
   The main function of the CFN is to stimulate and accelerate the economic development in the country; especially in the manufacturing, agro-industrial, fishing and tourism sectors.

Specialized financial institutions

Most leasing services are limited to finance-lease agreements where the purchase option at the end of the contract is very small and usually exercised. Operating-lease agreements are less common.

Leasing is used primarily as a mechanism to finance purchases of assets because of the absence of other sources of credit. Leaseback agreements are also very common as sources of working capital.

Investment institutions

The Securities Market Law contributes to the development of investment and pension funds. Similarly, investment institutions will contribute to the growth of the national stock markets.

Financial Markets

Securities Markets

There are two stock exchanges in Ecuador, one in Quito and the other in Guayaquil. They deal mostly in government securities and other fixed-income securities. Stock transactions grow yearly but remain minimal in comparison to total trading. Banks in the REPO market, outside the exchanges, do most securities' trading.

In general, the securities market is underdeveloped with government institutions as the largest players, both as sellers and buyers.

Commodities Market

The commodities market is limited to domestic trading of grains and livestock. It operates through the *Bolsa Nacional de Productos Agropecuarios*, which was created as an independent nonprofit institution with branches in Quito and Guayaquil. Its main objective is to provide a transparent market for basic grains and livestock by offering a means for exchange of information and a central location for buyers and sellers to meet. Only domestic transactions are permitted, and primarily ranchers and farmers utilize this market. Since most transactions are closed outside the market, its growth has been limited.

International Financial Markets

Ecuador is not an international financial center. The foreign exchange market is made up of commercial banks, finance institutions and other authorized exchange agents.

Offshore financial services

There are no offshore financial services in Ecuador, though a number of local banks have branches in Panama, Nassau and Miami.

Source of Funds

A very serious constraint on investment in the country is the lack of a well-functioning credit system. There is a lack of medium- and long-term credit; short-term credit is available. Leaseback agreements and factoring can be used as sources of finance.

Availability to foreign investors

There are no restrictions on foreign investors’ access to financing in the Ecuadorian market. Local and foreign investors are guaranteed equal treatment. In practice, foreign investors can meet collateral requirements with greater ease than local investors and thus qualify more readily for the limited credit facilities available.

Chapter 8
Exporting to Ecuador

Tips for exporters

- Although Import licenses are required, procedures have been streamlined and are entirely carried out on the Internet.
- Tariffs range from 0 to 35 percent.
- Ecuador is part of the Andean Community and is working toward removal of all intrazone tariffs and other trade barriers for most goods.
- The in-bond processing industry (*maquila*) offers attractive opportunities to exporters.
- Market surveys are highly recommended.
- The services of a specialist customs agent are commonly used.

General note

The Customs Law issued in July 2001 (Law 43) regulates the relations between the State and those who operate the international traffic of products in Customs. In this law it is approved, among other things, that foreign and Ecuadorian private firms can perform activities related to warehousing, control, transit, and other functions previously reserved exclusively to the Customs authorities. Real changes are expected in Customs so this area can become efficient, productive and helpful to the flow of commerce. This reflects the trend of modernization sought by the government.

Import restrictions

Since the 1990s Ecuador began a comprehensive reform of the Import system that has tried to eliminate most non-tariff restrictions on imports and substantially reduce tariff rates. Non-tariff restrictions such as advance deposits, foreign financing requirements and surcharges have already been eliminated. Prohibited-import lists remain in force; and they include some products that may interfere with the development of national production, and mostly those substances that may cause damage to the environment and to human health. This list has been substantially reduced and is scheduled for almost complete elimination.

Import duties

Customs duties

Since Ecuador is a member of the Andean Community, goods to be imported are classified under the Pact's NANDINA nomenclature, which is based on the Customs Cooperation Council Nomenclature (also known as the Brussels tariff nomenclature). When Ecuador joined the WTO in January 1996, it consolidated most of its tariff rates at 20 percent or less (with the exception of automobiles, which is 35 percent). Consistent with the Common External Tariff (CET), the tariff range is 0-20 percent. Most consumer goods imports pay 20 percent, while intermediate goods are usually imported at the 10 or 15 percent rates. Raw materials and capital goods generally pay 0 or 5 percent. Ecuador has negotiated exceptions under the Andean common tariff that allow lower duties on certain capital goods and industrial inputs. There is duty-free import of agricultural inputs and equipment.

When a subsidy from abroad for a particular item is substantiated, the authorities can impose a surcharge equivalent to the subsidy in order to eliminate the unfair advantage.

The price listed in the commercial bill or invoice is the basis for the assessment of duties, except when the CBE considers the listed price unreasonable, in which case market prices in arm's-length transactions will be used. The burden of proof lies with the importer.

Legislation in Ecuador allows for the temporary import of goods to the country in special cases determined by the Customs Law and its regulations. Paramount among these cases is the import of goods destined to the executions of contracts signed with public entities. In this case, imported goods must be used for their specific purpose within the execution of the contract and then re-exported.

Other taxes

In addition to import duties, all imports are subject to 12 percent value-added tax, 0.25 percent for the Exports and Investment Promotion Corporation-CORPEI, and an additional 0.5 percent tax for the Children's Development Fund.

Except for the 0.25% for CORPEI, which is based on the FOB value, all other charges are based on the CIF value of the merchandise. Imports exempted from value-added tax include agricultural supplies, books and medicines. Imported raw materials to be used in the production of pharmaceuticals are exempt from this tax. VAT paid on imports is fully recoverable against VAT charged by the importer upon sale of the goods. For further details see Chapter 22.

All Ecuadorian imports and exports are subject to inspection by authorized international verification companies operating in the country (there are some imports exempt from verification). Goods are appraised for value, quantity, quality and weight at the port of origin.

Andean Free Trade Zone

As of January 1992, Ecuador, as a participant in the Andean Community, reduced its tariffs by 50 percent. Since February 1995 the country applied a CET with two of its Andean Community partners, Colombia and Venezuela. The CET has a four tiered structure with levels of 5 percent for most raw materials and capital goods, 10 or 15 percent for intermediate goods, and 20 percent for most consumer goods. Agricultural supplies and equipment are imported duty free. On January 31st, 2002, at the Andean's Presidents Council, the five member countries (Colombia, Venezuela, Perú, Ecuador and Bolivia) agreed to establish an Andean Free Trade Zone, a CET and a customs harmonization policy by January 2004. The new CET agreement establishes a new unified tariff schedule coming to effect at the end of January 2006.

The Andean Free Trade Zone will allow the free circulation of goods among member countries. Consequently, multinationals operating in one Pact country will be in an excellent position to service the others. If a permanent establishment is desired, a company should carefully evaluate the investment opportunities in each country before committing resources.

Documentation procedures

Importer register

In general, all individuals and companies wishing to import goods into the country must register as importers with the CBE and obtain import register numbers.

Import permit

Import permits, known as DUI-Documento Unico de Importacion (Import Document Authorization), must be obtained from the CBE through its website before incoming goods are shipped from the port of origin. The tariff reform changed the nature of this permit from an import approval to a matter of record.

Currency

Importers can obtain foreign exchange in the free-market without restrictions, but supply of currencies such as euros, yens, etc. is scarce. This market handles all transactions, including foreign investments, foreign credits, repatriation of earnings, provision of travel currency, and transfers. These transactions must be effected through authorized banks, or other financial institutions. The exchange rate of the different currencies with the dollar is set in the international market.

Customs documentation

Once the merchandise has arrived in the country, the import permit must be presented, along with the commercial invoice and bill of lading. All information must match that on the import permit. Partial or incomplete shipments must be declared, and a bond must be deposited to cover the unused portion. The process in customs can be lengthy, though one week is normal. The use of a specialized customs agent is highly recommended in order to expedite the process.

Customs and storage

Customs and storage facilities are generally not adequate for the volume of cargo handled. Customs warehouses are small, and it is not uncommon for cargo to be stored in open-air patios. Although security is generally not a major concern, merchandise must be insured and insurance must be contracted locally. Independent bonded warehouses *(almacenes generales de depósito)* are available for storage of imports at an additional cost. These warehouses generally provide good facilities and security.

Port of entry and inland transport

Four seaports and two airports are capable of handling international freight in Ecuador. The seaports are Guayaquil, Puerto Bolívar, Manta, and Esmeraldas. The airports are located in Guayaquil and Quito.

Most cargo is handled in Guayaquil, though many importers prefer Manta because it connects closer to Quito, the capital. Inland transport by truck is generally good. The choice of port of entry will generally depend on considerations of timing and proximity. The port of Esmeraldas is part of a free-trade zone for this area. Air cargo is handled at either Simón Bolívar International Airport in Guayaquil or Mariscal Sucre International Airport in Quito.

There is easy access to inland transport facilities from all Ecuadorian ports, but for practical reasons it is best to get information as to reputable companies.

Re-exports

Ecuador promotes in-bond or *maquila* industries for which foreign goods are allowed in the country for assembly and subsequent re-export. Import duties and taxes are waived, though a bond must be deposited until the goods are re-exported. There are no local content laws; however, goods imported for this purpose must be re-exported.

Local representation

Market surveys

In general, market surveys are highly recommended before exporting to Ecuador, primarily because of regional market differences (the Quito and Guayaquil markets are totally different) and "informal" imports that may compete directly.

Local agent

The use of specialized customs agents, though not strictly necessary, is highly recommended, as they can expedite documentation and customs clearances.

Employee/salesperson/agent

The use of an employee or salesperson is normally limited to cases where service and direct technical assistance are required. Otherwise, an import house or local representative is the preferred method. Subsidiaries or branches are usually established when extensive service facilities, large inventories or local content are needed. See Chapter 16 regarding the tax implications for the foreign company.

It is not difficult to retain the services of an Ecuadorian employee or salesperson. Expatriate employees are subject to regulations imposed by the Immigration Law and must secure employment permits from the National Immigration Office *(Dirección Nacional de Migración)*. For more details see Chapter 10.

Sources of information

Information or assistance may be obtained from the commercial departments of Ecuadorian embassies in many countries. More complete information may also be obtained from the Ministry of Industries, Commerce, Integration and Fishery (MICIF); the CORPEI (The Export and Investment Promotion Corporation of Ecuador); Chambers of Industry and Commerce; and the Tax Department of PricewaterhouseCoopers in Ecuador (see Appendix XVIII).

Chapter 9
Business entities

Investor considerations

- Except in the case of exporting to Ecuador, establishing a local presence - whether as corporation, company or branch - is absolutely necessary when doing business in Ecuador.
- Commercial considerations are the most significant factors when choosing between a branch and a subsidiary.
- A corporation is the business entity most commonly used by foreign investors.
- Subsidiaries may be wholly owned.
- Foreign investors may enter into joint ventures with government entities.
- Organizing an entity is normally not expensive, but approximately 90 days' lead time is required.

Forms of business enterprise

Business entities in Ecuador are subject to the Commercial Code, the Company Law and assorted regulations. The most usual forms of business organization are as follows.

1. Corporation *(compañía anónima or sociedad anónima):*

   This type of organization is preferred by most large enterprises and foreign investors. Ownership of the corporation is evidenced by shares of stock; owners of capital are described as “stockholders,” and their liability is limited to the amount of their stock.

2. Company *(compañía limitada):*

   This type of organization is the second most common business entity in Ecuador. Companies may engage in all aspects of commerce and industry except for banking, insurance and savings. Owners are described as “shareholders.” Shareholders’ liability is limited to their investment in the company.

3. General partnership *(sociedad colectiva):*

   A general partnership is an association of two or more people who have executed a written partnership agreement. Participants are described as partners.

4. Limited partnership *(sociedad en comandita):*

   In this type of organization, one or more of the general partners has unlimited liability, and the limited partners have liability up to the amount of their capital contributions. In Ecuador these organizations may also be formed by issuing shares *(sociedad en comandita por acciones.)*

5. Joint venture *(sociedad de riesgo):*

   Joint ventures are ad hoc organizations in which risks and profits are shared by two or more parties. In Ecuador, formal joint ventures are based on contracts and are found principally when associations of companies, local, foreign or both, contract with the state to execute specific jobs or projects.

6. Branch of a foreign corporation *(sucursal):*

   Corporations legally constituted abroad can domicile themselves in the country through the incorporation of a branch.

7. Mixed economy company *(compañía de economía mixta):*

   In a mixed economy company, private investors; state, provincial, or municipal governments; and autonomous government agencies may contribute capital and participate in management.

8. Sole proprietorship *(proprietario):*

   Legislation regulating sole proprietorship of businesses with limited liability is expected to be enacted by Congress during the initial months of 2006. These regulations will establish the requirements to be fulfilled by individuals interesting in setting up a limited-liability one-person enterprise in terms of purpose, duration, capital requirements, incorporation procedures, administration and legal representation, etc.

Foreign enterprise entities

Corporations, companies and branches are the most common forms of business organizations used by foreign investors in Ecuador. The choice of establishing a local enterprise (subsidiary) or domiciling a branch is dependent on the following factors.

1. Capital requirements and accessibility.
2. General business considerations.
3. Liability of the owner(s).

The tax considerations applicable to a subsidiary compared to branch operations are analyzed in Chapter 16. Other considerations are treated below in this chapter.

Corporation

Incorporation procedures

The incorporation of a *sociedad anónima or compañía anónima* (hereafter corporation) is relatively simple. It may be formed privately or through the public subscription of stock under the provisions of the Ecuadorian Company Law.

- Incorporation of privately owned corporations

If a corporation is to be privately formed and owned, two or more individuals or legal entities must execute a public deed which constitutes the company's bylaws *(escritura)*. After the establishment of a corporation, capital can be sold so as to be owned by a single stockholder. The values of the capital and stocks presented in the bylaws should be in US dollars. This charter, along with the bylaws, must be notarized and submitted to the Superintendence of Companies for approval. After approval, these documents, together with the certificate of approval issued by the Superintendence, must be registered in the Mercantile Register and an extract of the charter published at least once in a local newspaper. The legal existence of the corporation is effected upon inscription in the Mercantile Register.

The deed of constitution, or charter, must include the following.

1. Date and place of execution of the contract.
2. Names, addresses and nationalities of the founding members (individuals or legal entities).
3. Name, purpose, domicile, and duration (term of life) of the corporation. (Duration cannot be unlimited.)
4. Individual capital contributions; amount of total authorized capital; type of shares to be issued; and names, addresses and nationalities of those subscribing the capital.
5. Method (cash or kind) and dates of payment of capital.
6. Form of administration, organization, control by stockholders, and method of designation of officers.
7. Indication of who will act as legal representatives.
8. Method of distributing profits.
9. Liquidation procedures.
10. Other agreements by stockholders.

The corporate name must include *Compañía Anónima, Sociedad Anónima* or the abbreviations C.A. or S.A. No minimum or maximum terms of corporate life are provided by law. Approval by the Superintendence of Companies is required for the extension of the life of a corporation beyond the term specified in the charter or for the dissolution of a corporation before the expiration of that term.

- Incorporation by public offering

If the corporation is to be formed by public offering of stock, the promoters must first execute a public deed or covenant *(convenio)* proposing the incorporation of the corporation as well as the statutes to govern it. This deed *(escritura)* must contain the following.

1. Names, addresses and nationalities of the promoters.
2. Name, purpose and domicile of the corporation.
3. Rights and benefits reserved to the promoters.
4. Number, type and par value of shares to be issued.
5. Conditions and period for the subscription of stock.
6. Name of the bank where payments for subscribed shares are to be deposited.
7. Period within which the incorporation of the corporation is to be concluded.
8. The domicile of the company.

Once capital stock has been subscribed, the promoters must convene an organizational meeting of stockholders to appoint the persons who will be in charge of executing the final organization charter, as described above.

Promoters of a corporation may not receive payment for their services in the form of cash or stock. However they may, subject to approval by the stockholders, reserve for themselves the right to receive a portion of the corporation's earnings for a period no longer than one-third of the stated life and not to exceed 10 percent of annual net income of the corporation. Promoters are personally liable for any obligations incurred in connection with the organization of a corporation; however, expenses may be reimbursed, and such payment is not considered as remuneration to the promoters.

- Time and costs

The incorporation of a corporation involves various legal procedures and authorizations; foreign investors should expect the organization process to last approximately 90 days.

Incorporation costs - principally notary, registration and publication fees - are normally not significant and vary according to the complexity of the public deed (charter). Notary fees are charged at the rates shown in Appendix XII. All corporations must submit financial statements on a yearly basis to the Superintendence of Companies. Obligatory annual contributions based on total assets must be paid to the Superintendence.

Capital structure

The basic requirements for the organization of a corporation are as follows.

1. Capital must be not less than 800 US dollars.
2. Capital must be fully subscribed.
3. Twenty-five percent of subscribed capital must be paid in.
4. The minimum number of stockholders is two; there is no maximum number.

- Shares

There are no limitations as to the total number or value of shares or the number of shares that may be held by one stockholder. Shares can be subscribed for investments in cash or in kind (property or assets); however, investments in kind must be of assets related to the business, and the values assigned to such properties or assets must be independently appraised and approved by the stockholders. As of March 13, 2000, the nominal value of the shares is presented in US Dollars. Valuations may also be reviewed by the Superintendence of Companies. The stockholders' liability is limited to the extent of their capital investment.

The capital must be divided into shares or certificates of specified par or stated value; no-par-value shares are not permitted under Ecuadorian law. Shares may not be issued for less than par value, nor can their total amount be more than the amount of authorized capital. A corporation may issue certificates for more than one share.

Shares must be registered and may be common or preferred. Preferred stock may grant the owner certain special rights but may not have voting rights or fixed dividend rights. Preferred stock issued may not exceed 50 percent of total capital. Common shares have equal voting rights - one share, one vote.

Corporations may acquire their own stock. The rights attributed to such stock are suspended during the time the corporation maintains the shares in its treasury. Capital stock may be retired with the approval of the Superintendence of Companies.

- Debentures

Existing legislation allows corporations to issue debentures. A resolution to issue debentures must be approved by the stockholders, a public deed must be executed and approval must be obtained from the Superintendence of Companies. The total nominal value of the issue may exceed neither 80 percent of total assets unencumbered nor 80 percent of the value of the properties that guarantee them. Financial statements of corporations that issue debentures must be certified annually by a public accountant and published.

When debentures are issued to cover an existing debt, the proceeds must be deposited in a special bank account, under supervision of the Superintendence, until used to pay the debt. If a corporation has outstanding debentures, it may reduce its capital only in the same proportion as it redeems its obligations.

- Increase and decrease of capital

Corporate capital may be increased or decreased by amendment of the charter, but such changes require the approval of the Superintendence of Companies and must registered in the Mercantile Register.

Capital increases may be made either by issuing new stock or by raising the par value of existing shares. Payment for new stock issued can be made in cash or property, by applying dividends accrued or through capitalization of reserves or retained earnings. Capital increases that increase the par value of stock require the unanimous consent of the stockholders.

A reduction of capital may be made only after the Superintendence of Companies has been notified of the stockholders' resolution to that effect. The Superintendence's approval may be denied if the decreased capital is considered to be insufficient to fulfill the corporation's objectives or if the reduction affects the interests of third parties.

- Transferability of shares

Basically, the right to trade in stock is not restricted. Stockholders can sell their shares without the consent of the other stockholders.

Transfers of shares must be recorded in the corporate books upon notification to the interested parties. Certification of the transaction must be evidenced by the signature of the corporation's legal representative and reported to the Superintendence of Companies.

Relationship of stockholders, directors and officers

- Conduct of entity

A corporation is managed for a specified term by administrators, who may be directors, officers or managers, and who may or may not be stockholders.

Officers are not permitted to vote on matters regarding approval of the financial statements or on any deliberations with respect to their own responsibilities.

Apart from the day-to-day conduct of the business entrusted to officers or managers, whose powers are generally defined in the statutes, the stockholders in ordinary and extraordinary meetings exercise the control of a local corporation. Minutes must be kept of all stockholders' and directors' meetings. Managers are not required to hold qualifying titles, and there are no nationality requirements. Foreign executives, if appointed as legal representatives, must reside in Ecuador.

Stockholders do not ordinarily have the right to examine the corporation's accounting records except during a 15-day period prior to the general stockholders' meeting at which financial statements are to be reviewed and approved. For stockholders' meetings, management must prepare and make available to the stockholders the corporation's financial statements, the auditor's report and the manager's report on the corporation's activities.

Any stockholder may be appointed to administer and represent the corporation. The elected directors are fully responsible for the decisions they take. To delegate power, directors need the approval of a majority of stockholders. Directors can be removed from their positions only when proved guilty of fraud or incompetence in administering the business.

- Stockholders' meetings

The principal governing body of a corporation is the stockholders' meeting. Most matters of importance require approval by the stockholders. Meetings are ordinary (e.g., to approve financial statements, distribute profits, elect members of the board of directors) or extraordinary (e.g., to issue debentures, change bylaws, approve capital increases or decreases, or liquidate the corporation).

An annual ordinary general stockholder meeting must be held within three months of the corporation's official year-end. At this meeting, at least 50 percent of total paid-in capital must be represented in order to constitute a quorum.

Extraordinary general stockholders' meetings may be convened at any time, provided all paid capital is represented and all present sign a certificate to the effect that the meeting is valid.

Stockholders representing not less than half the nominal value of paid-in capital must be present or represented by proxy when discussing increases or decreases of capital, dissolution or liquidation of the corporation or modification of the statutes.

Each share held grants the right to one vote. Unless otherwise provided in the statutes, matters under discussion are resolved by a majority vote at ordinary or extraordinary general meetings of which due notice and details have been given.

- Dividends

Unless otherwise provided for in the statutes, the stockholders at the annual general meeting decide upon the distribution of profits. Management is usually empowered to pay interim dividends. Dividends declared must come from realized profits. The law requires that at least 50 percent of annual profits must be assigned for dividends, unless at the general stockholders' meeting it is unanimously agreed to do otherwise. Dividends may be distributed from yearly profits even though the corporation has accumulated losses, under certain circumstances. Any existing surplus from valuation or revaluation of fixed assets may not be distributed as cash dividends but may be capitalized, provided existing accumulated losses, if any, are absorbed first.

Before dividends are paid, a corporation must appropriate 10 percent of its annual net profits to a legal reserve (restricted retained earnings) until such reserve reaches 50 percent of its capital. The balance of the legal reserve is not available for distribution to stockholders as cash dividends but may be capitalized, provided appropriate authorization is obtained.

Liquidation, receivership

If accumulated losses of a corporation equal one-half of its capital plus total reserves, the corporation is deemed to be in the process of dissolution, unless stockholders decide to re-capitalize the corporation.

Before a corporation is liquidated, it should be declared dissolved by the Superintendence of Companies. Unless otherwise provided in the statutes, an extraordinary stockholder meeting must set the procedures for liquidation of a corporation. A liquidator (receiver) or liquidators (of odd number) must be named and are empowered to sell the corporation's assets. Real estate must be auctioned unless the stockholders' meeting authorizes the liquidator(s) to act otherwise.

Books and records

The Ecuadorian Company Law requires corporations to maintain their accounting records in the Spanish language and in US dollars. They are required to keep a correspondence book, as well as minute books (for stockholders' and directors' meetings) and a share register. For further details, see Chapter 12.

Banks and insurance companies are required to publish a semiannual balance sheet in a daily newspaper. Corporations trading debentures have an obligation to publish their balance sheets annually.

Statutory audit

Unless the organization charter or bylaws specify otherwise, the Company Law establishes that every corporation must appoint at least two statutory auditors *(comisarios)*, who may be shareholders but not employees of the corporation.

Statutory auditors are required to examine the year-end balance sheet and related statements and report on them to the stockholders.

Independent external audits, different from those carried out by *comisarios*, are also required by law in some cases. See Chapter 11.

Company

Incorporation procedures

A limited liability company is formed under the provisions of the Company Law by the execution of a public deed or agreement, to which all of the company's shareholders must be parties. This deed requires approval by the Superintendence of Companies and must include the following minimum information.

1. Names, addresses, nationalities, and civil status of the shareholders (individuals or legal entities).
2. Name, purpose, domicile, and term of the company (the term cannot be indefinite).
3. Amount of total capital, number and value of individual

   contributions to capital, and amounts paid toward contributions subscribed by each shareholder.
4. Form of the company's administration and financial control; positions of executives who will serve as the company's legal representatives.
5. Procedures for calling and conducting shareholders' meetings, and manner of arriving at decisions.

After approval from the Superintendence, the agreement must be inscribed in the Mercantile Register and an extract published in a newspaper circulating in the region where the company has its domicile.

Individuals and legal entities, either foreign or national (except banks, insurance companies and other financial enterprises and foreign corporations), may be shareholders of a company. Companies can be organized to do business in all areas of commerce and industry, except banking, insurance and savings institutions. In all cases, the company's name must include the designation *Compania Limitada* or the abbreviation Cia. Ltda.

Cost and time requirements for the incorporation of a company are similar to those for a corporation.

Capital structure

The basic requirements for organizing a company are as follows.

1. Capital may not be less than 400 US dollars.
2. At least 50 percent of each participation in capital must be paid in at the time of forming the company; the balance is payable within one year of the date of constitution.
3. Participation of each shareholder must be of 1 US$ or multiples thereof.
4. There must be a minimum of 3 shareholders; the maximum is 15.

Capital contributions may be made in cash or in property, but the latter must be appraised independently or by the shareholders. Certificates issued for capital contributions must indicate the number of participations held by each shareholder. These certificates are not negotiable, and this must be stated on the certificate.

The shareholders' liability in a company, as in a corporation, is limited to the amount of their capital contributions. The difference lies in the number of shareholders and the fact that the transfer of shares must be made with the unanimous consent of all shareholders. A public deed must be signed in all cases of transfer of capital, and a new certificate must be issued to the new shareholder to replace the old one, which must be voided.

Capital increases may occur through the capitalization of reserves or retained earnings, or both, or from new contributions. Capital may not be reduced unless an existing shareholder is being excluded.

Conduct of the entity

The company's deed should name the shareholders entrusted with the administration of the business and the legal representative. In the absence of special provisions in the deed, the company's operations are subject to general commercial law and procedures.

All shareholders have access to financial and other records of the undertaking and may participate in the management of the business. In the absence of special authorization in the deed, a shareholders' general meeting may name other executives to manage the company.

The frequency of extraordinary meetings of shareholders is governed solely by need. Annual general meetings are obligatory and must be held within three months of the official year-end. If more than 50 percent of capital is not represented, second shareholders' meeting should be convened, which can be held with those present.

Each capital contribution grants the right to one vote. A majority must make decisions, unless otherwise established in the statutes; blank votes and abstentions are added to the majority.

Profits are distributed to the shareholders in the form of dividends and are paid in proportion to their respective capital contributions unless otherwise provided for in the bylaws.

Companies must apportion 5 percent of annual profits to a legal reserve (restricted retained earnings) until an amount equal to 20 percent of capital has been reached. The reserve is not available for distribution as cash dividends, but it may be capitalized.

Liquidation

According to the Company Law, if accumulated losses amount to one-half of capital plus total reserves, a company incurs in a cause of dissolution and must be liquidated or steps have to be taken to recapitalize it. The law does not require the automatic dissolution of a company upon the death or withdrawal of a shareholder. However, certain legal requirements must be met in order to continue operations. Liquidation procedures are similar to those applicable to corporations.

Books and records

Comments under "Corporations" above also apply to limited liability companies.

Statutory audit

The law does not require the appointment of statutory auditors; however, whenever there are more than ten shareholders, a vigilance committee *(comité de vigilancia)* may be named. Three members, who can be either shareholders or outsiders, can form this committee. Independent auditing is also required for companies under certain conditions (see Chapter 11).

Partnership

General partnership

- Incorporation procedures

The sociedad colectiva (unlimited liability partnership) is formed when partners (at least two) execute a public deed *(escritura)* or partnership agreement, which must be approved by a civil provincial judge. An extract of the deed must be published in a newspaper, and then the agreement must be inscribed in the Mercantile Register. The partnership's name must include the names of some or all of the partners. In the former case, the words "and Company" must follow the adopted name.

- Capital structure

Capital is composed of subscribed contributions of the partners, of which at least 50 percent must be paid at the incorporation. The partners have unlimited and joint liability. When admitted, a new partner becomes liable for all the obligations previously incurred by the partnership. A retiring partner is liable for all obligations incurred until the date of leaving the partnership.

- Conduct of the entity

Unless otherwise provided in the partnership agreement, all partners have the right to manage the business. Real estate may be sold or mortgaged only with the approval of all partners. Decisions are to be adopted by majority vote unless unanimity is required in the partnership agreement. Minority partners may appeal to the Superior Court resolutions arrived at without their consent. Partners are prohibited from taking on interests in other businesses whose objectives are similar to those of the partnership.

Profits are distributed according to rules contained in the partnership agreement. If capital is reduced, it must be reestablished through subsequent earnings before new profits can be distributed.

- Dissolution

The death of a partner does not automatically liquidate the partnership, and the business may continue under the same name, provided the word "successors" is included. Any changes in the name of the partnership must be made through public deed.

- Books and records

The Company Law requires that accounting books and records be kept and the results made available to all partners semiannually.

- Statutory audit

No statutory audit is required. Nonmanagerial partners may designate an inspector or auditor from among themselves. Independent auditing is not obligatory for these entities, but it may be required by the Superintendence of Companies.

Limited partnership

A sociedad en *comandita simple* and a *sociedad en comandita por acciones* (limited partnerships) are organized according to the procedures described for a general partnership. These types of limited partnership include at least two partners who have unlimited and joint liability and other partners with limited liability. The partners who contribute only capital *(comanditarios)* are liable only up to the amount of their contributions, which may be in stock, as is the case with the sociedad en comandita por acciones. In this case, stock may amount to 90 percent of total capital. The partnership's name must include the names of the partners having unlimited liability and the words *"en comandita."* This form of entity is not common.

Joint venture

Two or more parties may enter into a contract to carry out a particular business activity; these joint ventures have to be registered at the Superintendence of Companies. In accordance with the provisions of the Company Law, a joint venture may be considered as an association or a participation account *(asociación o cuenta en participación).*

Under the applicable regulations of the Company Law, a business entity may give to others (associates) the right to participate in its business, but the associates do not acquire rights to the assets of the business. Associates' rights are limited to obtaining information regarding the funds contributed and the profits obtained or losses incurred. Associates are not liable to third parties and, if the business enters bankruptcy, they are liable only for their share of the investment. All other matters are regulated by the terms of the contract of association.

In Ecuador this type of joint venture occurs primarily when foreign corporations are contracted as associates to carry out specific projects with government entities. It is normal for foreign corporations entering into this type of agreement to set up branches.

Branch of a foreign corporation

Incorporation procedures

Any corporation legally established abroad may domicile a branch under its own name in Ecuador.

In order to set up a branch, the following documents must be submitted to the Superintendence of Companies.

1. The statutes or bylaws of the company.
2. A certificate from the Ecuadorian consul in the company's country of domicile stating that it is legally and properly constituted and authorized to do business.
3. An authorized power of attorney for the corporation's legal representative in Ecuador. (This power must be broad in scope.)
4. A copy of the board of directors' minutes authorizing the incorporation of the Ecuadorian branch and assigning capital to it.

These documents must be in Spanish or accompanied by a certified translation for presentation to the Superintendence of Companies. A summary of the registration must be published and inscribed in the Mercantile Register.

Capital structure

Assigned capital of a branch must be at least US$ 2,000. This amount must be deposited in full at a bank until such time as the branch is authorized to do business in Ecuador. The Company Law does not specifically cover the matter of increases or reductions of branch capital; however, authorizations for increases can be obtained. A foreign corporation that operates through a branch has generally the same legal rights and obligations as locally organized enterprises.

Relationship of shareholders, directors and officers

Normally, and for legal purposes, the holder of the corporation's duly registered power of attorney manages the branch of a foreign corporation. This power can be revoked only by the corporate executive who granted it or by the holder of an overriding power of attorney in Ecuador. The scope of this power of attorney may vary according to corporate policy, but it should be broad enough to allow for adequate representation in Ecuador. It is advisable to delegate as much power as necessary for the agent to carry out all activities that might be asked of a legal representative, because the law requires that all juridical matters be dealt within Ecuador.

Liquidation

In practice, if a branch has accumulated losses in excess of 50 percent of assigned capital plus reserves, the branch may be considered to be in liquidation unless the head office assigns additional capital to it. Liquidation requires the approval of the Superintendence of Companies, which is normally granted after clearance has been received from the Ministry of Finance, the Ministry of Labor, and the Ecuadorian Social Security System.

Books and records

The financial statements of the company need not be filed locally. Branch financial statements must be filed with the Superintendence of Companies.

Statutory audit

There are no statutory audit requirements; however, independent external auditing is mandatory.

Mixed economy company

A mixed economy company (MEC) is one in which the state, a provincial or municipal government, a semipublic entity, or some combination of these holds stock and participates in the company's management.

The discussion under “Corporation” above applies to mixed economy companies, with modification to allow for the following special conditions.

1. The board of directors must include representatives of the government in proportion to the stock held. If 50 percent or more of the stock is held by the government, the president of the board must be from the government sector.
2. Although this type of company is subject to paying the same taxes as other entities, it is exempt from taxes in amounts corresponding to government participation.
3. Private investors may acquire stock held by the government sector.

Sole proprietorship

Legislation regulating sole proprietorship of businesses with limited liability is expected to be enacted by Congress during the initial months of 2006. These regulations will establish the requirements to be fulfilled by individuals interesting in setting up a limited-liability one-person enterprise in terms of purpose, duration, capital requirements, incorporation procedures, administration and legal representation, etc.

Guide to “doing business” entities

Choice of entity

Foreign investment is normally channeled through corporations, limited liability companies (companies) or branches. There are no restrictions on foreign participation in local companies. For tax and commercial reasons, wholly owned corporations are most commonly used.

A detailed checklist of considerations in structuring an investment in Ecuador is given in Appendix XV.

Capital requirements

The minimum capital investment required for corporations and companies is US$ 800 and US$ 400 respectively. Branches must have a minimum authorized capital of US$ 2,000.

Founders’ requirements

- Corporations

There must be a minimum of two stockholders; there is no maximum limit. There are no limitations on share ownership or required percentages of ownership, nor are there any restrictions on nationality or residence of founders. Liability is limited to stock owned, and shares can be freely transferred. Purchases by foreign investors require registration.

- Companies

There must be at least 3 and no more than 15 shareholders. There are no required percentages of ownership and no restrictions on nationality or residence of founders. Companies cannot participate in banking, insurance or other financial services. Liability is limited to shares owned, and unanimous approval of all partners is required to sell shares.

- Branches

In order to establish a branch in Ecuador, a foreign entity must be legally constituted in the country of origin and must bestow broad powers of attorney on the person who will represent the company locally. Capital must be provided by the head office.

Time and costs

The process of organizing corporations and companies is generally not expensive, but approximately 90 days' lead time may be necessary.

Foreign ownership/participation in management

There are no regulations requiring local participation in management of foreign entities and no limitations on the nationality of shareholders or managers. Local partners are taken strictly for business reasons.

Repatriation of funds

Profits can be remitted yearly, upon payment of taxes, with no limitations. Capital can be freely repatriated upon liquidation of investment.

Liquidating an investment

Companies with accumulated losses of 50 percent of capital plus reserves incur in a legal cause of dissolution and must be liquidated or steps have to be taken to recapitalize them. Liquidation is normally carried out as provided in the statutes of the company or by law.

Tax considerations

Distributed profits of local corporations and companies as well as of branches are taxed at a 25 percent rate. Dividends are not subject to additional taxation. Reinvested profits are taxed at 15 percent.

Professional advice

It is advisable to retain professional advice at an early stage to ensure a smooth setup and regulatory compliance.

Chapter 10
Labor relations and social security

Investor considerations

- Ecuador has a sufficient semiskilled work force.
- Social security contributions are obligatory for all employees, local and foreign.
- Employee fringe benefits constitute approximately 30 percent of payroll costs.
- Employee dismissals require recognition of substantial severance pay.
- Foreigners need work permits.

Labor relations

Availability of labor

Ecuador has sufficient semiskilled, highly trainable labor, as well as qualified management personnel. (See “Labor/management relations” in Chapter 2.) Unemployment is high and qualified labor is, in general, concentrated in the bigger cities.

Employer/employee relations

Ecuadorian labor relations are governed principally by the Labor Code *(Código del Trabajo)*, and labor matters generally come under the jurisdiction of the Ministry of Labor. The government in most areas closely supervises labor practices. The Labor Code provides that workers’ rights may not be waived and that whenever the authorities are in doubt with respect to the meaning of legal, regulatory or contractual provisions, these should be interpreted in favor of employees.

The comments in this chapter apply mainly to workers engaged in industry and commerce. There are special provisions in the Labor Code pertaining to domestic and agricultural workers and artisans which are not discussed here because of their specific nature and restricted applicability. Discussion of special protection laws applicable to certain specific professions has also been omitted.

Labor relations are also governed by collective bargaining agreements and, to a lesser degree, by individual employment contracts and company regulations.

Unions

Regional, national and industry-wide labor organizations exist in Ecuador, but collective bargaining is carried out mostly at the company level.

For a union to be organized, at least 50 percent of the employees must be represented, and a minimum of 30 employees is required. Membership in unions is not obligatory, but legally recognized labor organizations represent all company workers, regardless of membership.

Shop unions can be found in all industries, and a large percentage of public servers labor force is unionized. At present, industry-wide unions operate mainly in electricity and transportation. Most collective bargaining agreements are negotiated at the company level.

Labor federations are primarily political organizations. Their influence has waned considerably in recent years, but they still maintain a strong presence in the public sector and to a much more limited extent in the private sector.

- Strikes

Strikes are somewhat common in the public (government) sector, less frequent in Ecuadorian-owned companies and relatively rare in foreign-owned companies. Workers normally prefer employment in foreign-owned companies because salaries and working conditions are considered better. The right to strike is guaranteed by law, and strikes can be legal, illegal or sympathetic (solidarity strikes).

1. Legal strikes:

   Legal strikes can be called for the following causes:

   (a) The employer does not respond to labor petitions within the allotted time period;

   (b) Employees are dismissed during the collective bargaining process;

   (c) The employer does not follow conciliation procedures;

   (d) Arbitration tribunals are not instituted because of employer interference;

   (e) Employers remove assets with the intention of moving production elsewhere.

   During legal strikes, employees' compensation must continue to be paid, and workers can occupy the installations for the duration of the strike for the purpose of ensuring that production activities have ceased. Strikebreakers (replacement workers) may not be hired.

2. Illegal strikes:

   Illegal strikes are those called for reasons other than those listed above and otherwise legal strikes involving acts of violence or vandalism. Employers can unilaterally terminate employees in cases of illegal strikes, and salaries do not have to be paid while the strike is in progress.

3. Solidarity strikes:

   Solidarity strikes are those declared by a union in support of the collective bargaining process in another company or companies. These strikes must be voted by 50 percent plus one of the affected company's employees and three days' prior notice must be given to the employer. Solidarity strikes cannot last more than three working days, and no remuneration is payable during this type of strike.

Employee training programs

There is at least one public entity in charge of developing skilled labor and to this end coordinates and controls the provision of technical courses by private entities. Specialized laborers brought from abroad are required by law to initiate training programs for Ecuadorian workers in their areas of expertise. Such programs are seldom anything other than on-the-job training.

Workers' councils

Ecuadorian labor legislation does not provide for labor participation in management through workers' councils or other means, though labor representatives may participate in tax disputes affecting statutory profit sharing. At present this is not an issue, and no significant changes in this area are expected in the near future.

Profit sharing

Statutory profit sharing is required by the Labor Code, which establishes the right of workers to share in the profits of a business in adjusted amounts equivalent to 15 percent of such profits. The base for calculating this statutory profit participation is adjusted income before taxes and before the participation; consequently, profit sharing amounts are deductible for income tax purposes. This 15 percent profit distribution is paid as follows.

1. An amount equivalent to 10 percent of profits must be distributed equally among all workers; for partial years (periods of service of less than twelve months), the amount to be paid is proportional to the time of service.
2. The remaining 5 percent is distributed on the basis of the number of the employees' dependents and time of service during the year. Dependents include spouse and children under 18 years of age.

The Labor Code also contemplates, for profit sharing purposes, the consolidation of income of related enterprises when one or more companies are exclusively dedicated to production and the others to the commercialization of the goods produced.

Working conditions

Wages and salaries

Employee remuneration is freely negotiated by the contracting parties, except as provided by applicable collective bargaining agreements, the statutory minimum basic salary, or specific trade or profession minimum salaries as established by the Labor Ministry in conjunction with industry representatives.

The minimum general monthly unified salary for 2006 is US$160. Work paid by the hour can be contracted. Minimum hourly wage includes all the additional benefits required by law.

Table XI, showing monthly salary ranges, should be considered in light of these adjustments.

XI Typical Monthly Salary Ranges

	Monthly salaries	
	From	**To**
	US$	US$
CEOs	5,000	10,000
Managerial	2,500	6,000
Professional - Middle management	800	2,000
Professional	500	1,000
Office staff	250	500
Blue-collar	160	300

Compensation of managers and other professional staff depends on the size of the enterprise and on the profession. Compensation of managerial personnel has a substantial difference in cost from that of skilled blue-collar workers and even clerical staff. Salaries are paid monthly for professional staff, biweekly for administrative staff and weekly for blue-collar workers. Hourly wages are allowed.

Fringe benefits

In addition to employees' statutory profit participation (see "Profit sharing" above), Ecuadorian labor legislation provides for some special payments. These statutory fringe benefits (including social security) increase the cost of labor by about 30 percent of an employee's basic salary. In addition, collective bargaining agreements often establish certain additional benefits to which all employees are entitled, such as days off for marriage, death of a relative, and education assistance.

Labor Code cash fringe benefits include the following.

1. Christmas Bonus (Thirteenth salary) - One-twelfth of total compensation (excluding statutory fringe benefits and profit participation) received by employees in the year (December to November) immediately preceding payment of this benefit (payable before December 24th). If length of service is less than a year, payment is proportional.

2. Education Bonus (Fourteenth salary) - Equivalent to one Unified Basic Salary, payable before September 15[t] in the “Sierra” (Andean provinces) and April 15 for the coastal provinces. Employees not having completed a year receive a sum proportional to their time of service.
3. Reserve fund (fondo de reserva) - Equivalent to one-twelfth of the year’s remuneration. This amount is payable from the second year of employment in a particular company and must be deposited with the Social Security Institute.
4. Employer’s contribution to social security system, equivalent to 12,15% of monthly compensation. See “Social Security” bellow for more details.

Company retirement fund (Jubilación Patronal) - In addition to social security contributions, companies must set up a pension plan for their employees. Benefits have to be distributed only to employees completing 25 years of service with a company. Pensions are to be determined and paid according to provisions of the Labor Code. The monthly pension cannot be higher than the monthly unified salary (US$ 160 for 2006) nor less than US$ 30. It is important to note that financial reserves need not be set up to cover pension liabilities. Only accounting charges should be made. For income tax purposes, only yearly pension charges corresponding to employees with 10 years seniority or more are tax deductible.

Additional wage components that existed in the past were incorporated into the Unified Minimum Salary in a process that was completed in 2005.

Non-cash fringe benefits include the following.

1. General stores - Companies with ten or more employees must establish stores to supply their employees with basic food items at cost. In practice, most companies affiliate their employees with supermarkets established by third parties.
2. Meals - Companies with 50 or more employees must provide dining halls for their workers if the place of business is more than two kilometers from the nearest town. In practice, most industries provide meals.
3. Schools - Companies located more than two kilometers from the nearest town and whose employees have (in all) more than 20 children of school age are required to establish a school.
4. Medical services - Companies with 100 or more employees must establish medical service facilities within the plant. Those with more than 50 but less than 100 employees may form associations among themselves to provide this service.

5. Pensions and sickness benefits - Pensions and sickness benefits are covered by the Ecuadorian social security system, to which both the employer and employee must contribute established percentages of gross payrolls (see “Social security” below). If for any reason an employee has not been enrolled in the social security system and the employee becomes ill or disabled, employers are obligated to pay for all medical services provided to the employee and to pay a pension to the employee’s heirs in the event of death.
6. Day care - Companies with 50 or more employees must provide day-care centers for workers’ children. Food service must be included.

Hours worked

The normal work period is limited to eight hours a day, 40 hours a week from Monday through Friday. Saturdays and Sundays are obligatory rest days, but by agreement and in case of necessity the rest days can be moved to other days.

Overtime involves a premium of 50 percent for normal weekdays. For overtime work on Saturdays, Sundays, holidays, and between midnight and 6:00 a.m. the premium is 100 percent. Normal workdays are divided into two shifts, with a rest period of up to two hours between shifts. Single-shift days can be approved by the authorities.

Paid holidays and vacations

Statutory holidays are listed in Chapter 1 (see “Hints for the business visitor”). Workers must take these days off; they are fully payable and non-recoverable.

Employees and laborers are entitled to annual paid vacations of fifteen calendar days a year, plus an additional day for each year of service in excess of five years, with a maximum of 30 days. At the request of employees, vacations may be accumulated over a period of three years to be taken in the fourth year. Under certain circumstances, employers can request employees to defer vacations pertaining to one year until the following year. Payment for vacation days not taken must be made whenever the employee leaves the company.

Equal opportunities

The Ecuadorian Constitution prohibits employment discrimination on any basis, including race, color, sex, religion, national origin, or age. There are no regulations differentiating or categorizing workers.

According to recent legislation, employers must adequate their installations to allow the participation of disabled workers; those employers that have more than 25 employees must include at least one disabled person. By year 2011, all employers must have at least 4% of disabled persons among their workforce.

Health and safety

The Labor Code contains minimum occupational safety and health standards that must be met by all companies. Sanctions for employers not meeting these standards are defined in the Code. All accidents must be reported to the responsible labor authorities, and, in the case of workers not covered by the social security system, the company must indemnify employees suffering from physical or mental incapacity resulting from occupational accidents.

Termination of employment

Written contracts are required for permanent technical and professional services. These may contemplate a fixed term (one-year minimum) or be renewed indefinitely. Fixed-term contracts automatically become indefinite after two years, and contracts must be registered with the labor authorities within 30 days of being signed.

Employment contracts may be terminated for the following reasons.

1. When their specified term has been completed (fixed-term contracts).
2. For just cause, in accordance with the law.
3. When the object of the contract has been fulfilled.

- Fixed-term contracts

Notice of termination of employment must be given to the employee at least 30 days before the termination date of a fixed-term contract. When a fixed-term contract is unilaterally terminated before the term expires, indemnities must be paid. If the employee or employer terminates the relationship, the indemnity to be paid by the employer, regardless of who terminated the relationship, is equivalent to 25 percent of the employee's remuneration and is calculated for each year of service. No severance is required for termination of a contract for a specific job.

New employees are frequently engaged under a 90-day trial-period contract, during which period either party may terminate the contract without prior notice or indemnities. Thereafter, the contract continues until the completion of at least a one-year period.

- Dismissal for just cause

The Labor Code grants employers the right to dismiss workers for just cause without being liable for severance payments, but prior approval from labor authorities is required. According to law, just cause includes the following.

- Unjustified absences.
- Abandonment of employment for three consecutive days without notice.
- Lack of discipline and reported refusal to obey orders.
- Immoral conduct.
- Acts of violence.
- Negligence.
- Manifest lack of ability to perform job properly.
- False testimony against the employer in disputes related to social security.

The burden of proof lies with the employer.

- Severance payments

In the case of indefinite-term contracts, whenever an employee is terminated without just cause, the Labor Code provides for severance payments calculated on length of service as follows.

1. Up to three years of service: 3 months' pay.
2. Three years or more of service: 1 month's pay for each year of service, to a maximum of 25 months.

In addition to items 1 and 2 above, in the event that a contract runs its term, 25 percent of the employee's most recent monthly remuneration must be paid for each year of service. Collective bargaining agreements normally contemplate additional severance payments.

Union leaders are entitled to job security while holding a union position. If union leaders are dismissed while serving as union officers, an indemnity of at least one year's salary must be paid in addition to normal severance payments. Dismissal does not prohibit the individual from continuing to act as a union leader.

- Special cases

The in-bond processing *(maquila)* industry and operations in the free-trade zones benefit from special labor legislation. The main differences consist in greater flexibility in employment and the ability to terminate employment with no special job-security indemnities. The Labor Code provides for some more flexible contractual forms in these areas, including specific job contracts, seasonal contracts and training contracts, though normally these cannot exceed six months' duration.

Social security

Social security system

Regulations regarding the Ecuadorian social security system are contained in the Social Security Law. The Ecuadorian Social Security Institute (IESS) is the public institution that administers the systems of health, pensions and certain social payments. Payment of contributions by employers and employees is obligatory.

Benefits

- Health

Employees are entitled to medical treatment, hospital services, medicines, and temporary payments in lieu of salary equivalent to 75 percent of their monthly salary for the first ten weeks of illness and to 66 percent for the following sixteen weeks. Employers pay full remuneration for the first three days of illness. No contributions are paid during the period of illness.

Female employees are entitled to maternity medical attention and temporary payments in lieu of salary equivalent to 100 percent of their monthly salary for twelve weeks (two before childbirth and ten after) if the employee cannot access social security (IESS) assistance.

- Pensions

Male employees who are at least 60 years old (starting on 2006) and have contributed to the social security system for at least 30 years are entitled to pensions. After 35 years of contributions, employees may retire regardless of age. Female employees are entitled to pensions regardless of age, provided contributions to the system have been made for a minimum of 25 years.

Pension payments vary according to the number of contributions paid to the system and salaries earned. Pensions are also payable when an employee becomes disabled. Under certain conditions, workers may retire with reduced pension payments. Special pension plans exist for teachers and for printing and telecommunications workers.

Disability payments for employees who have contributed to the IESS for at least 60 months are also covered by social security. Monthly pensions cannot be lower than one minimum monthly salary or higher than six minimum monthly salaries.

- Accident and work-related illness

Any employee who suffers an accident or becomes too ill to continue working is covered by the IESS, which is obligated to provide medical assistance through temporary payments similar to those described above. If the employee becomes permanently disabled, pensions become permanent at the rate of 66 percent of monthly salary. Loss of limbs gives rise to payment of additional pension payments.

- Unemployment compensation

The Ecuadorian system of unemployment compensation calls for a one-time payment. The amount of the compensation depends on the number of monthly contributions paid and the amount of salaries earned. To qualify, an employee must have made at least 24 monthly contributions to the system and must be unemployed for at least 60 days.

- Loans

Employees may obtain loans from the IESS. Short-term loans (for up to two years) are normally guaranteed by the reserve fund and may not exceed ten minimum monthly salaries. Long-term loans are normally mortgage loans for the purpose of acquiring real estate (housing).

Totalization agreements

There are reciprocal social security agreements with the members of the Andean Community and Spain. Regarding all other countries all personnel must be enrolled with the Ecuadorian social security system, regardless of enrollment in another country.

Payroll costs

Labor costs vary from industry to industry; however, in general terms they are a small part of total costs. On average, total labor costs, including fringe benefits, for industries employing mostly semiskilled labor range from 8 to 12 percent of total costs. The development system applied by Ecuador during the past two decades favored capital over labor, but as industry becomes more labor-intensive and more competitive, labor costs are expected to rise somewhat. However, no radical change is expected in the near term.

Foreign personnel

Work permits

Foreign personnel require either a nonimmigrant work visa or an immigrant visa in order to be allowed to work in Ecuador.

- Immigrant visas

Immigrant visas (9-IV visas) may be granted to foreign personnel moving to Ecuador to take up administrative or technical positions for indefinite periods of time. To obtain this type of visa from the Immigration Department, the interested local company must first obtain approval of the work contract from the Director of Employment and Human Resources at the Labor Ministry.

The duration of the visa is usually for the period of the contract. In some cases, authorities may limit the number of years of authorized residence (for example, to two years), but the visa may be renewed. Under current legislation, visas allow the foreign person to perform only the activity for which approval was granted. Foreigners with a tourist visa may not work in Ecuador.

- Nonimmigrant visas

The most common nonimmigrant visas for foreign businesspersons or employees on temporary assignments are the following.

1. Specialist visas (12-VI visas): For professionals and technical experts and their families who are specifically needed by companies established in Ecuador, either to work in their specialties or to provide industrial training.
2. Visitors' visas (12-IX visas): For businesspersons and others on short-term visits (three to six months) who do not import household belongings.
3. Transit (tourist) visas (12-X visas): For businesspersons and tourists whose stay in Ecuador will not exceed three months in the year.

All foreigners (except those with transit visas) who arrive in Ecuador must be registered with the Ministry of Foreign Relations. Visitors and transit visas may be requested from consular officials abroad. U.S. and Canadian citizens and those of most Western European nations do not require tourist visas to enter the country.

Special arrangements or concessions

As regards labor and social security regulations, there are no special arrangements or concessions. Foreign personnel are subject to social security legislation under the same conditions as nationals when in an employment relationship.

Restrictions on employment

In general there are no restrictions on the number of foreign personnel or the time period for which they may be employed. However, some specific industry legislation (oil, mining) requires companies to employ Ecuadorians; percentages vary according to the industry and type of work (professional or blue-collar).

Living conditions

Foreign personnel and dependents assigned to Ecuador should encounter no problems in regard to living conditions, especially in Quito and Guayaquil. Excellent housing, food, medical facilities, and education are readily available, along with modern conveniences such as shopping malls, aerial and cable television, and internet services. Domestic helpers (cooks, chauffeurs and guards) are engaged by many expatriates and are reasonable in cost.

Living conditions in Quito are very favorable, with close proximity to mountains and lakes, good food and an attractive climate. Most expatriates reside in Quito, among others, because central public service offices are located in the capital and so are the company's headquarters.

Guayaquil offers facilities as good as any, along with close proximity to beach resorts and related attractions (yachting, surfing, deep sea fishing). Air-conditioning is required, as the climate can be uncomfortable in Guayaquil.

There are a number of schools and churches catering specifically to the expatriate community in French, English, German, and other languages.

Foreigners establishing residence in Ecuador can usually import household goods and personal effects free of import duties. Automobiles tend to be expensive, and some luxury models are particularly so. There are no currency restrictions or exchange limitations. Additionally, the cost of living is considered to be reasonable for expatriate personnel.

Chapter 11
Audit requirements and practices

Investor considerations

- Corporations are subject to statutory audit requirements with specific reporting to stockholders and to control agencies. Statutory audits differ from internal and external independent audits.

- Full scope examinations of financial statements by independent external auditors are required for local corporations and local branches of foreign corporations whose assets exceed certain predetermined amounts.

- As part of their examinations, external auditors are required to report on the compliance by the audited entities with certain tax obligations.

- Accounting records shall be carried in US dollars and in the Spanish language.

Statutory requirements

Books and records

All juridical entities and individuals that conduct business with a capital in excess of US$24,000 or with an annual gross income in the preceding fiscal year exceeding US$40,000, are required by law to carry the following minimum accounting records in the Spanish language and in US dollars:

- General ledger *(libro mayor)*.
- Journal entries book *(libro diario)*.
- Inventories book *(libro de inventarios)*.
- Cash register *(libro de caja)*.
- Record of movements in bank accounts.
- Auxiliary *(subsidiary)* ledgers.

The law states that accounting records shall be bound, pages must be sequentially numbered and a licensed accounting professional shall initial each page. Books may be carried by means of loose sheets or cards, which should be bound at the year-end. Enforcement of these requirements falls under the responsibility of the Superintendence and of the Internal Revenue Service; although in practice this is not done. Authorization is not required for the use of computerized accounting systems. A hard copy of the general ledger must be kept at all times.

For tax purposes, books, vouchers, correspondence, and other business documents shall be retained for a period of, at least, five years provided that income tax returns have been appropriately filed; a seven year retention period applies in the case of incomplete or omitted returns. The law also states that individual detailed records shall be carried for inventory and fixed asset (including depreciation) items; these may also be computerized. Accounting entries must be prepared and recorded in chronological order; all adjustments or corrections shall be supported by appropriate accounting entries. Invoices must bear preprinted sequential numbering, as well as the identification of the printing entity and the authorization number given by the tax authorities who control the sequence and quantity of invoices. This also applies to other accounting documents (i.e. certain purchase receipts, withholding receipts, sales debit and credit notes, etc.). The entity's accounting documents (such as invoices, receipts, payroll records) and other documents (such as tax returns and import and export licenses) must bear the company's tax identification number. Computerized invoices may be used, provided local requirements are met.

Regulations require that general expense accounts shall be supported by auxiliary (subsidiary) records classified into, at least, under the following types of expenses:

Advertising and sales promotion expenses	Salaries and wages,
Bad debts	Commissions
Depreciation, amortization	Social benefits
Interest	Taxes
Office supplies	Transportation
Rent	Travel expenses

All business concerns are required to carry a correspondence book. Corporations are also required to carry a book of minutes (for directors' and stockholders' meetings) and a share register. Entities shall hire the services of a registered public accountant.

Other required accounting records include the following.

1. Sales register - All sales transactions shall be individually recorded in a sales book which, among other information, must detail the amount of value-added tax charged. Sales documented by means of cash register machines may be summarized over daily periods.
2. Purchase register - All purchases shall be entered in detail in a record or purchases book, which must also detail value-added tax paid.

Failure to carry adequate financial records may cause serious problems to the taxpayer. Inadequate records may be inadmissible in court and not acceptable for income tax purposes, in which case the tax authorities are entitled to assess taxes based on indicators developed on the basis of percentages of capital invested or on sales.

Banks and insurance companies are required to publish their semi-annual balance sheets in local daily newspapers.

The fiscal years are equal to the calendar years (January 1 through December 31.) Books must close by December 31, even when businesses start operations after January 1 in any given year. Fiscal years other than the calendar year are not allowed. More information on tax related issues may be found in Chapter 13.

Audited financial statements

- Statutory audits

Corporations and mixed economy companies (described in Chapter 9) are required to contract the services of statutory auditors, normally referred to as *"comisarios" (surveillance agent)*. Statutory auditors carry out a function which differs from that assigned to external auditors (see "Independent audit" below) and is defined in the Company Law. Unless otherwise specified in the company's bylaws, two *"comisarios"* shall be appointed.

"Comisarios" are appointed by the stockholders and continue to serve until they resign or new statutory auditors are appointed. According to the Company Law, the *"comisario"* should not be an employee of the corporation and may not represent any stockholder at the general annual meeting. Although the law contains relatively few restrictions as to who may be designated as statutory auditor, this function is generally carried out by local accountants. Under the Company Law, statutory auditors of small companies need not be accountants or professional auditors, although their duties and obligations normally require solid accounting and audit experience. The Accountants' Law states that one of the functions of an accountant is to serve as *"comisario"*.

Statutory auditors are required to give an opinion on the annual financial statements presented to the shareholders and on those filed with the Superintendence of Companies. Non-compliance with the responsibilities assigned to the *"comisario"* is penalized with fines (which may be imposed by the Superintendence of Companies) and dismissal ordered by the stockholders, and may also be subject to legal action if deemed appropriate.

- Independent audits

Apart from the above-mentioned statutory audit legal requirement , business concerns regulated by the Superintendence of Companies and Superintendence of Banks are required to file financial statements examined by external auditors in the following cases.

- Corporations with assets in excess of US$ 1'000,000.
- Companies or partnerships with assets of, at least, US$ 100,000.
- Branches of foreign companies, or their associations, with assets in excess of US$ 100,000
- Mixed economy companies with assets in excess of US$ 100,000.

- Other companies with assets in excess of US$ 1,600 if the Superintendence has doubts as to whether the accounting records adequately represent the entity's financial situation or if its statutory auditors request that external audits be performed.
- Banks and other financial institutions subject to control by the Superintendence of Banks.

Companies may contract full audits, limited reviews or special-purpose examinations. Where external audits are mandatory, only full audits must be conducted.

Accounting profession

The accounting profession in Ecuador is present in various areas, such as bookkeeping, internal and external auditing, managerial accounting, and accounting systems. The National Federation of Public Accountants *("Federación Nacional de Contadores del Ecuador")* governs the profession. Additionally, each province has an accountants' association *("Colegio de Contadores")*, affiliated with the National Federation. In order to practice the profession in any province, an accountant must be a member of that province's *"colegio"*.

To join an accountant's association, a valid accounting degree granted by an Ecuadorian university is necessary. No special examinations or continuing education requirements apply after obtaining a university degree; however, valid licenses to practice are necessary. These are issued by the local accountants' association and must be renewed annually. Fees apply.

The National Federation of Public Accountants, as member of the International Federation of Accountants (IFAC), adopted on July 1999 (Resolution FNCE 07.08.99) the Ecuadorian Accounting Standards (Normas Ecuatorianas de Contabilidad), which generally follow the contents and structure of International Accounting Standards. The Ecuadorian Accounting Standards regulate the accounting registration of transactions and the preparation and disclosure of information in the financial statements of all entities subject to control by the Superintendence of Companies.

These standards are similar to International Accounting Standards, and in cases where the concepts are not covered by Ecuadorian Accounting Standards, IAS may be used. However, there are some differences between the standards used in Ecuador and abroad (See Chapter 12).

Auditing standards

Ecuadorian Auditing Standards (Normas Ecuatorianas de Auditoría) are set by the National Federation of Public Accountants generally following International Standards on Auditing issued by the International Federation of Accountants.

Independent auditors must be qualified by the Superintendence of Companies and registered at the National Register of Independent Auditors.

In order to maintain independence, the following persons are barred from rendering external audit services.

- Employees and statutory auditors of the audited enterprise.
- Relatives of the administrator of the entity, up to the fourth degree of kinship.
- Individuals not residing in Ecuador.
- Employees of the Superintendence of Companies.
- Employees and administrators of the entity being audited.
- Shareholders or representatives of the audited company.

A majority of shareholders or, in the case of branches, the legal representative, shall appoint the Independent Auditors. Audits must be contracted at least 90 days before the end of the fiscal year, and the name of the selected auditor (individual or firm) must be reported to the Superintendence of Companies.

External audits do not replace or preclude additional reviews by fiscal or other authorities.

An example of an unqualified audit report is presented below (as Ecuadorian Auditing Standards require the presentation of comparative financial statements the report covers both years presented).

To the shareholders of XYZ

We have examined the balance sheets of XYZ as of December 31, 2XX1 and 2XX0 and the related statements of income, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Ecuadorian Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for an opinion.

In our opinion, the financial statements referred to above present fairly, in all material aspects, the financial position of XYZ as of December 31, 2XX1 and 2XX0, and the results of its operations, the changes in shareholders' equity and cash flows for the year then ended, in conformity with accounting principles generally accepted in Ecuador.

Qualified opinions, explanatory paragraphs, adverse opinions, and disclaimers are issued as deemed necessary when they apply to circumstances similar to those requiring such opinions under International Standards on Auditing.

Chapter 12
Accounting principles and practices

Accounting principles

Ecuadorian Accounting Standards generally follow International Accounting Standards (IAS). Ecuadorian Accounting Standards were adopted in July 1999 to regulate the accounting registration of operations and the preparation and presentation of information in financial statements. Whenever these standards do not address any specific type of transaction or reporting need, IAS may be used instead; however, utilization of IAS is not mandatory.

Differences in accounting practices usually derive from tax regulations which prescribe standards at variance from Ecuadorian Accounting Standards and, in the case of financial institutions, by specific regulations issued by the Superintendence of Banks. Presently differences from international accounting treatment are as follows:

1. Deferred taxes:
   Comprehensive tax allocation is not applied in Ecuador.

2. Leases:
   Lease transactions are generally treated as operating leases by lessees and as financing leases by lessors.

3. Income tax and statutory profit sharing:
   Certain regulated entities such as insurance companies report the income tax provision as part of the distribution of profits and not as an income statement component.

4. Deferral of start up costs:
   Deferral of start up costs is less restrictive than that contemplated by international accounting practice.

5. Investments, foreclosed assets, past-due accounts receivable, certain income and expenses and reserves carried by banks are classified and valued on the basis of specific standards prescribed by the Superintendence, which are at variance from Ecuadorian Accounting Standards.

Form and content of financial statements

The Ecuadorian Accounting Standards issued to date are as follows:

- *No.1 - Presentation of Financial Statements*
  Prescribes general requirements regarding the presentation, structure and minimum standards that shall be met for the preparation of financial statements. It also ratifies that financial statements are the responsibility of each entity's management.

- *No.2 - Disclosures in Financial Statements of Banks and other Financial Institutions*
  Details the minimum disclosures regarding the accounting policies used for the preparation of financial statements of banks. These disclosures are aimed at providing banks and users of financial statements with information that facilitates the interpretation of financial data and the understanding of the entities' performance and general banking risks.

- *No.3 - Cash Flow Statement*
  Prescribes the requirements to be followed for the preparation of cash flow statements either using a direct or an indirect method.

- *No.4 - Contingencies and events occurring after the balance sheet date*
  Prescribes that the amount of a contingent loss shall be accrued by charge to income for the year, if it is probable that future events will confirm that an asset has been impaired or a liability has been incurred at the balance date, and a reasonable estimate can be made of the amount of the resulting loss. Contingent gains may not be recorded in the financial statements. Contingent gains must be disclosed if it is probable that the gain will be realized.

- *No.5 - Net Profit or loss for the period, fundamental errors and changes in accounting policies*
  Addresses subjects such as the presentation of operating results, the segregation of extraordinary items in the Income Statement, the disclosures that should be made for discontinued operations, changes in accounting estimates and policies, and for the correction of fundamental errors relating to prior periods.

- *No.6 - Disclosures of related parties*
  Prescribes the manner in which transactions with related parties shall be disclosed in the financial statements.

- *No.7 - The effects of changes in foreign currency exchange rates*
  Establishes that all exchange differences shall be recorded as gains or losses of the period in which the rate of exchange changes, except for exchange differences arising from a net investment in a foreign entity.

- *No.8 - Reporting financial Information by segments*
  Primarily applies to entities whose equity or debt securities are publicly traded and by companies in the process of issuing debt or equity securities to be traded in stock exchange markets. The standard requires the segregation of financial information by business or geographical segments.

- *No.9 - Revenue*
  Defines that revenue is recorded when there is a flow of future economic benefits (from sales, supply of services and use of entities' assets deriving interest, royalties and dividends) and these economic benefits can be reliably quantified.

- *No.10 - Financial Costs*
  Prescribes that financial costs (including exchange differences) shall be treated as expenses.

- *No.11 - Inventories*
  Provides practical guidelines on cost determination and its subsequent recognition as expense, including any decrease in net realizable value.

- *No.12 - Property, Plant and Equipment*
  Sets guidelines for the accounting registration of property, plant and equipment (fixed assets) and for their related depreciation.

- *No.13 - Accounting for depreciation*
  Defines the fundamental standards applicable to depreciation of Property, Plant and Equipment.

- *No.14 - Research and Development Costs*
  Prescribes standards for the accounting registration of research and development costs, but does not apply to costs incurred for the exploration and development of oil, gas and mineral reserves in extractive industries.

- *No.15 - Construction Contracts*
  Prescribes the accounting treatment that shall be given to revenues and costs associated with construction contracts. The key issue when accounting for construction contracts is the allocation to the appropriate accounting period of revenues and costs.

- *No.16 - Monetary Correction for Financial Statements*
  Applicable to financial statements presented in an environment where there are significant variations in inflation. Application of the standard has been in suspense since the US dollar was adopted as the country's currency.

- *No.17 - Conversion of the Financial Statements according to the dollarization scheme.*
  Defines the accounting treatment arising from the adjustment of financial statements expressed in Sucres (previous currency used in the country) before the conversion to US dollars; and the criteria to convert the accounting records from Sucres to US dollars as of March 31, 2000.

- *No.18 - Accounting for Investments*
  Prescribes the accounting treatment and disclosure requirements for investments.

- *No.19 - Consolidated Financial Statements and Accounting of Investments in subsidiaries*
  Prescribes the preparation and presentation of consolidated financial statements for a group of businesses under the control of a parent company. The standard defines the accounting for investments in subsidiaries included in the individual financial statements of the parent company.

- *No.20 - Accounting for Investments in Associated Companies*
  Stipulates the accounting by the investor for investments in associated companies.

- *No.21 - Business combinations*
  Refers to the accounting treatments applicable to business combinations. . .

- *No.22 - Discontinued Operations*
  Prescribes the principles that should be used to report information regarding discontinued operations or in process of discontinuation.

- *No.23 - Earnings Per Share*
  Applicable to business concerns that publicly trade their shares and to those that are in the process of issuing ordinary shares in the stock market and prescribes the principles for the determination and presentation of earnings per share.

- *No.24 - Accounting of Government subsidies and disclosure of information pertaining to governmental assistance*
  Defines concepts such as subsidies related with capital goods, profits, loans subject to waiver, and fair value.

- *No.25 - Intangibles*
  Prescribes the accounting treatment of those intangibles not specifically mentioned in other Ecuadorian Accounting Standards.

- *No.26 - Provisions, Contingent Assets and Liabilities*
  Details the appropriate bases for the recognition and measurement of provisions, contingent assets and liabilities, and the disclosure of all necessary information.

- *No.27 - Asset impairment*
  Establishes the procedure that a business concern should use to ensure that the value of its assets does not exceed its recoverable value.

Basic financial statements

The following are defined in the standards as basic financial statements:

- Balance sheet.
- Income statement.
- Statement of changes in equity.
- Statement of cash flows.

These statements should include explanatory footnote disclosures containing a description of accounting polices applied and other information as prescribed in the accounting standards and specific regulations issued by the authorities. The financial statements shall be presented with comparative financial statements for the preceding year.

Capital

Balance sheets usually disclose the amount of authorized, subscribed and paid-in capital. Capital in excess of par value (a relatively infrequent occurrence) is shown as part of equity; stock dividends are deducted from the carrying value of the investment when equity accounting is applied (generally when the investor exercises significant influence on the investee).

Valuation of assets

In accordance with income tax legislation and Ecuadorian Accounting Standards, assets are valued as described below, being cost the basic accounting policy. Non monetary accounts arising prior to adoption of the US dollar as the country's currency in 2000 were restated for inflation and translated into US dollars following Ecuadorian Accounting Standards that ruled this process:

1. Accounts receivable are reported at nominal value less an allowance for bad debts.
2. Inventories are shown at lower of cost or market value, cost usually being determined by the average or last-in, first-out (LIFO) method.
3. Real estate property is carried at cost or revalued on the basis of technical appraisals.
4. Plant and machinery is valued at cost or at the amounts determined by the conversion procedure applied in the dollarization process, is usually depreciated at the rates prescribed by the income tax law. Plant and machinery may be revalued on the basis of technical appraisals.
5. Natural resources: Expenses incurred in the exploration stage are usually deferred for amortization as from the commencement of exploitation.

Business combinations

Business combinations are generally accounted for following the purchase method. Goodwill arising on acquisition is amortized over a minimum 20 year period.

Consolidation

Consolidation of financial statements is compulsory but the parent company is also required to prepare and file with government control agencies individual (non-consolidated) financial statements. Subsidiaries are also required to prepare and file individual financial statements.

Provisions and reserves

Provisions for doubtful accounts, depreciation of fixed assets and amortization of intangible assets are recorded by charge to operations. Provisions for statutory social benefits are, for the most part, provided for throughout the year and adjusted at the year-end. Provisions made in conformity with tax regulations are deductible for income tax and employees' statutory profit sharing calculation purposes.

The legal reserve is generally recorded as an appropriation of earnings after the end of the year in which the income was earned; earnings appropriated to the legal reserve are included in taxable income in the same manner as other earnings. Reserves resulting from the revaluation of non-monetary accounts made before the US dollar was adopted as the country's currency may be capitalized or used to absorb accumulated losses.

Footnote disclosures

Footnote disclosures are required by the Ecuadorian Accounting Standards and standards prescribed by the Superintendence of Companies and Superintendence of Banks. They generally follow the structure recommended by the International Accounting Standards.

Recording of income

The accounting period must correspond to the calendar year. New companies starting business after the beginning of the year must file their income tax return, as well as the report to the Superintendence of Companies, for the period comprised between the date on which the entity's creation is registered in the Mercantile Registry and December 31. The accrual accounting method is generally followed to account for income and expense items. As a general rule expenses recorded under Ecuadorian Accounting Standards are allowed as deductions for income tax and employees' statutory profit sharing calculation; there are certain exceptions to the amount of expense that may be claimed for certain concepts (eg. Provision for bad debts) and, in others, the expense may only be claimed if approved in advance by the tax authorities.

Trends in accounting

Probably the most important development in recent years has been the adoption of the Ecuadorian Accounting Standards in 1999. Adoption of the International Financial Reporting Standards is already being considered by local regulators and the accounting profession, but no decision has yet been made in this regard.

Financial statement disclosure requirements that may be of particular interest to foreign investors include the following.

- Details of transactions with related parties.
- Name of ultimate holding company.
- Directors' interest in shares.

Chapter 13
Tax system

Investor considerations

- Income is taxed on a territorial base (Ecuadorian-source income) and on foreign income if resident in Ecuador.

- Foreign income taxes paid on foreign source income can be claimed as tax credits.

- Administrative rulings are applicable only to the specific cases on which they are delivered.

- A system of local withholdings and prepayments is in effect; amounts withheld are treated as credit on tax due at year-end.

Principal taxes

The principal taxes in Ecuador are as follows.

- Income tax- IT
- Value-added tax- VAT
- Special consumption tax- SCT
- Property taxes (municipal).
- Asset tax (municipal).
- Import duties and tariffs.

Direct and indirect tax burden

The percentage distribution of tax revenues for the year 2004 is shown in Table XII.

XI National Tax Revenue by Category for 2004

	US$ million	%
VAT	1,720	54.3
Special consumption tax	202	6.4
Income tax	702	22.2
International transactions	454	14.3
Vehicles	56	1.8
Others	32	1.0
Total	3,166	100.0

Latter years have shown substantial increases in tax revenues; however oil revenues still represent the most important non-tax income for the state, as it is shown in Table XIII. The participation of oil revenues varies considerably because of the instability of oil prices in the world.

XIII Sources of National Revenue

	2003	2004	2005
			%
Oil	32.66	24.16	23.48
Taxes	67.34	75.84	76.52
	100.0	100.0	100.0

Tax guarantees

The Investment Promotion and Guarantee Law (December 1997) established a fiscal stability regime by which the income tax rate is maintained unchanged, for a determined period of time, for duly registered investments made by national or foreign citizens, according to the following rules:

- Amount of investment must be at least US$ 500,000.
- For a period of 10 years, to the proprietors of new reinvestments in existing entities, when these cannot be considered as increase or expansion of production.
- For a period of 20 years, to the proprietors of new investments aimed at the development of new investment projects or the increase of production.

Legislative framework

Statute law

Under the Ecuadorian Constitution, any person or juridical entity may introduce laws, including tax statutes, but it must be approved by Congress (or legislative commissions during recess of Congress) and ratified by the President of the Republic.

The Tax Code *(Código Tributario)* contains general principles of taxation and establishes the ground rules for relations between the tax authorities and taxpayers. The main body of tax legislation is the Internal Tax Regime Law (ITRL), enacted as of January 1, 1990, amended throughout the years and last codified on November 2004. The executive branch of government is empowered to issue regulations on the application of tax laws. While these regulations can interpret or clarify the law, they may not alter it.

Laws and regulations take effect upon their publication in the Official Registry. Consequently, as a general rule they have no retroactive effect.

Administrative interpretations

Within the executive branch, the Ministry of Finance has the responsibility of administering the tax system of the Republic. This function is specifically carried out by the Internal Revenue Service and the Directorate General of Customs. The main duties of these administrative bodies are, among others, as follows.

1. To issue regulations needed for the correct application of the tax laws.
2. To determine through audits the existence of taxable income, the tax base and the amount of tax due.
3. To interpret the tax laws and issue resolutions on specific points raised by the taxpayer. In case of disputes, resolutions can be appealed to the Tax Court.
4. To impose sanctions as required by law on specific violations of the law.

Case law

Judicial interpretations provide varying degrees of precedent, depending on the nature of the issue and the jurisdictional authority of the court that rendered the opinion. In situations where the statutes alone do not provide a definite resolution for a particular tax issue, the taxpayer must consult judicial as well as administrative authority (Internal Revenue Service) in order to settle the matter.

Anti-avoidance

There is no specific anti-avoidance legislation in Ecuador. Taxpayers have the legal right to decrease their tax burden within the parameters set by the law; however, the results of having applied such legal means are subject to review, acceptance or questioning by the tax authorities.

Form versus substance

The law establishes that substance takes precedence over form, although it is possible to obtain alternative tax results from a given transaction through proper tax planning. If the terms of a contract are clear, the literal meaning of its stipulations takes precedence. If, however, the wording of a contract contradicts the intention of the parties or the substance of the transaction, the latter prevails over the former. Nevertheless, the government may question the validity or legitimacy of a transaction whenever necessary to block taxes evasion.

Clearance procedures

There are no general clearance procedures. In order to liquidate a company a tax inspection is generally applied.

If after analysis of a transaction its fiscal treatment appears unclear or seems to involve a large risk, a consultation with the Internal Revenue Service (SRI) may be advisable. An SRI written response with regard to a consultation is valid and binding only with respect to the taxpayer that requested it. A taxpayer in similar circumstances can invoke an existing ruling but cannot directly benefit from it, as the ruling is applicable solely to the facts presented by the entity or person in whose favor it was issued.

Income tax

Concepts of income taxation

The tax system in Ecuador is mainly unitary, most categories of income being taxed at a single rate. A system of local withholdings is in operation whereby a certain percentage of a payment is withheld by the payer and deposited with the fiscal authorities. This amount is considered a tax credit toward taxes due at year-end.

Classes of taxpayer

Income taxes in Ecuador are levied on individuals and corporate entities, national or foreign, on their Ecuadorian-source income. Consequently, all individuals, partnerships and corporations, whether national or foreign, are subjects to tax on that part of their income that is earned in Ecuador. Individuals or corporations, residents in Ecuador, national or foreign, are also taxed on their foreign source income. Credit is granted for taxes paid abroad on such income.

Non-domiciled corporate entities and nonresident individuals are not required to file tax returns on income subject to withholding.

Taxable income

Taxable income is defined as Ecuadorian source income and foreign source income received by Ecuadorian residents, national or foreign.

Ecuadorian source income includes income derived from economic activities performed in the country, regardless of where such income is received, and income obtained abroad by non residents, when paid or credited by an individual or corporation domiciled in Ecuador. Other examples of Ecuadorian source income include: gains on sales of fixed assets or real estate; royalties and rights; export income; interests and other financial benefits within the country; inheritances, lotteries, and in general any income received by persons or entities resident in Ecuador.

Gains on occasional sale of shares and real estate are exempt from income taxes. Dividends received from any domestic company are also exempt. Any other income is added to the tax base.

Tax year

The fiscal year established by the authorities is without exception the calendar year, January 1 through December 31. Partial periods must also end at December 31.

Tax-free zones

Tax concessions pertaining to free-trade zones, certain industries, exporters, and others are dealt with in Chapter 4.

Tax holidays

Tax incentives were granted in November 2005 by the Tax Benefits Law to promote the development of specific industries (for example: hydroelectric generation, industrialization of hydrocarbons, high tech, air traffic and cargo, deep water harbors, agro industrial machinery, ethanol). These incentives include a 10 and 12 year tax holiday. For more detail see Taxation Policy in Chapter 3.

Tax holidays are offered to companies in free-trade zones for a period of 20 years.

Capital taxation

Companies

Ecuador levies a capital tax called “tax on total assets” *(impuesto sobre los activos totales)*, which applies to both national and foreign entities engaged in business in Ecuador. It is levied at a rate of 1.50 per thousand on assets. The tax is calculated on total assets (as shown on the balance sheet) less current liabilities and contingencies. For more details see Chapter 23.

Individuals

No taxes are levied on total wealth or on the value of assets, except for property (real estate) taxes. See Chapter 23 for more details.

International aspects

Foreign operations

Resident business entities are taxed on their foreign source income when earned. Taxes paid abroad on foreign income subject to tax in Ecuador can be utilized as tax credits up to the amount of tax due in Ecuador. Outward investment is limited, with the exception of dollar bank accounts.

International financial center operations

Under certain conditions an investor could use Ecuador as a base for carrying out meaningful international operations. The country does not, however, qualify as a tax haven.

Chapter 14
Tax administration

Investor considerations

- The Internal Revenue Service (SRI), implements tax legislation.
- The Ecuadorian tax system is based on self-assessment, with subsequent inspection by the tax authorities.
- Withholding and VAT returns are due monthly. Income tax returns must be filed by April each year.
- Varying rates of withholding taxes apply to all payments for economic activities.
- Penalties are imposed for failure or delinquency in filing returns and/or paying tax.
- Tax assessments may be contested and appealed.
- Spouses may choose the governing form of property relations (i.e., community property or separation of property).
- Foreign nationals in Ecuador are subject to the same compliance requirements as Ecuadorian citizens.

Administration of the tax system

Taxes are levied in Ecuador under the provisions of the Tax Code *(Código Tributario)*, which contains general principles of taxation and establishes the ground rules for relations between the tax authorities and taxpayers. Legal provisions governing filing and payment of taxes, the nature of penalties, audits and claims, and the statute of limitations are covered by the Tax Code.

Taxes are imposed and collected mainly by the central government; exceptions are some minor municipal taxes and licenses. The tax administration system of Ecuador may be outlined as follows.

1. Internal Revenue Service (SRI):
   Administers income taxes, value-added taxes and special consumption taxes (e.g., on beverages, cigarettes). The SRI also conducts tax audits and issues resolutions on tax matters. The SRI (see Chapter 13.) also handles first-level challenges to assessments

2. Directorate General of Customs *(DGC)*:
   Administers customs duties and taxes.

3. Municipal councils:
   Collect real estate taxes and other assessments.

4. Authorized banks and financial institutions:
   Act as tax collection agents for the treasury.

5. Tax Courts *(Tribunal Fiscal)*:
   Final court of appeal for resolution of litigation related to tax matters.

Corporate taxpayers

All business entities constituted in Ecuador, as well as branches of foreign corporations operating in the country, are subject to the provisions detailed below.

Tax returns

Corporations are required to file annual income tax returns by the date specified in the Regulations to the Internal Tax Regime Law (RITRL). Enterprises are entitled to a 15% income tax rate over earnings destined to capitalization, which must be done before December 31 of the year following that in which they were earned. A 25% rate applies on any other earnings. For business entities the period for filing tax returns starts on February 1st and ends by the date established according to the ninth digit of the Tax Identification Number (TIN) of the company. These dates are presented below:

Ninth digit	Due date
1	April 10
2	April 12
3	April 14
4	April 16
5	April 18
6	April 20
7	April 22
8	April 24
9	April 26
0	April 28

If in a given year one of these dates corresponds to a weekend or a holiday, the due date is moved to the next working day. Returns must be filed on official preprinted forms, which must be completed by the company and signed by its legal representative and accountant. Supporting documents such as financial statements, details of taxes withheld and the like are not to be filed, however they should be kept by the taxpayer for future review, as required, by the SRI. Additionally, monthly returns must be filed for VAT, SCT and withholdings (VAT and income tax).

Tax returns filed with the authorities constitute a self-assessment; however, the authorities are empowered to question these assessments, increasing taxable income if deemed appropriate.

Assessments

The Ecuadorian tax system operates on the basis of self-assessment with subsequent review by the tax authorities, who have the right to examine the tax computations and supporting documentation for a given year within three years of the filing of the corresponding tax return. Tax inspections may be reopened within one year from the date of their completion. The statute of limitations is extended from three to six years if the corresponding tax returns have not been filed.

Information included and provided by the taxpayer in the tax return is binding. Errors of calculation and interpretation in tax returns may be corrected once they have been filed.

Appeals

Taxpayers have the right to file objections with the Internal Revenue Service (SRI) against additional tax assessments established as a result of tax audits. If such actions are unsuccessful, the taxpayer can appeal before the Tax Court *(Tribunal Fiscal)*. This body is organized into three chambers of three judges each. Each chamber processes claims and hands down judgments independently from the others. In the event that taxpayers do not agree with the judgment made by a particular chamber of the court, they have the right to appeal before the entire Tax Court (i.e., all three chambers). Only legal issues are discussed before the full court, and judgment passed is final and becomes obligatory as law until such time as it is confirmed, repealed or amended by law.

Payment and collection

Income tax returns for corporations must be filed according to the schedule presented above that is published in the RITRL. Payments must accompany the return and must be made during the given period.

Taxpayers are required to pay tax advances. The amount of such advances is calculated at the moment of filing the income tax return and corresponds to 50% of the previous year's income tax, less the retained amounts for that year. This tax advance is made in two payments: the 1st in July, the 2nd in September. These tax advances constitute tax credit for income tax purposes. The dates determined for these payments are also set by the Regulations for the Internal Tax Regime Law, and they are established according to the ninth digit of the company's TIN:

First payment

Ninth digit	Due date
1	July 10
2	July 12
3	July 14
4	July 16
5	July 18
6	July 20
7	July 22
8	July 24
9	July 26
0	July 28

Second Payment

Ninth digit	Due date
1	September 10
2	September 12
3	September 14
4	September 16
5	September 18
6	September 20
7	September 22
8	September 24
9	September 26
0	September 28

If current period revenue is less than previous period revenue the advance payments can be discontinued with prior authorization from the SRI.

Also, if income tax liability from the current period proves to be less than the advance payments plus any withholdings, the taxpayer has the right to request the excess payment and receive a refund within six months. In case the refund is not received within this stated period, the taxpayer may choose to: 1) File a formal claim at the SRI (procedure stated in the Tax Code) for the disbursement of the excess payment, or, 2) Notify the SRI the will to use the excess payment as a balance in favor for future tax obligations (balance to be used within a period of 3 years).

Withholding taxes

Withholding agents should file and pay taxes withheld by the subsequent month to that of the withholding, according to the ninth digit of their TIN and following the dates noted below:

Ninth digit	Due date
1	10 of the next month
2	12 of the next month
3	14 of the next month
4	16 of the next month
5	18 of the next month
6	20 of the next month
7	22 of the next month
8	24 of the next month
9	26 of the next month
0	28 of the next month

Most payments made either locally or abroad are subject to withholding. All payments made domestically, including wages, salaries, company purchases, and payments for services are subject to withholding. Local payments, except wages, are subject to withholding at rates between 1 and 10 percent, depending on the type of transaction involved. The SRI, on the basis of income, fixes wage withholdings according to progressive rates (0 to 25 percent).

Income other than dividends paid to nonresident recipients is subject to 25 percent withholding; however, they can deduct any tax credit to which they are eligible.

Tax audits

Major corporate tax payers are normally conducted within the prescribed three-year period. Inspections are carried out first as desk reviews based on detailed information provided by the taxpayers and, subsequently, in the taxpayer's office. The company must make available all basic accounting records, auxiliary records as well as all sources of information supporting the financial statements and tax returns. After completing the audit, inspectors prepare an assessment, confirming the taxable income declared and the tax paid or, alternatively, requesting payment of additional taxes arising from the objections raised as a result of the audit. The law also obliges the authorities to determine overpayments if any have occurred.

Penalties

Penalties are imposed as follows.

Failure to present tax returns is subject to a fine equivalent 3% of the total income tax liability for each month (or fraction of a month) overdue, without exceeding 100% of the income tax. In case the filing presents no income tax liability, the taxpayer will pay an amount equivalent to 0.1% of its gross Income (corresponding to the period of the income tax filing) for each month (or fraction) overdue, without exceeding 5% of the gross income.

Failure of individuals and entities to provide the SRI with the information it requests are fined with an amount equivalent to between 10 and 100 minimum general unified salaries (US$1,500 to US$15,000 in 2005).

Failure to withhold taxes, partially or totally: The withholder is responsible for 100% of the amount not withheld and is fined with the equivalent of 3% of the total liability. Criminal sanctions for tax fraud are also applicable.

Statute of limitations

Fiscal authorities have three years from the due date of the return, or the date of filing, if late, to start proceedings for tax audits or assessment and collection of taxes.

The statute of limitations is extended from three to six years if the corresponding tax returns have not been filed. A tax audit can be reopened, verified or amended within one year from the date of completion.

Individual taxpayers

Income tax returns

The individuals not required to file tax returns are: 1) Taxpayers domiciled outside the country, with no legal representative in the country and where the withholdings made are deemed sufficient; 2) Employees without any other income different from their salary and who have had only one employer in the year, and 3) Those individuals whose gross income is less than the minimum taxable base (US$ 7,680 for 2006).

The income tax that an individual person would pay for FY 2006 is based on the following table:

Base	Over Base	Tax on Base	Tax on Over Base
-	7,680	-	0%
7,680	15,360	-	5%
15,360	30,720	384	10%
30,720	46,080	1,920	15%
46,080	61,440	4,224	20%
61,440	and over	6,965	25%

Employers are responsible for the correct withholding and payment of taxes of personnel in their employment. Monthly withholdings are required for all employed personnel, based on tables issued by the SRI or on estimates of the tax liability for the year. At year-end, total tax payable for the year must be recalculated, and any difference between the total income tax due and the sum of all withholdings must be paid in January along with the December withholdings. Nonresident individuals performing occasional work in Ecuador (present for less than six months) are subject to withholding at a flat 25 percent rate.

Individuals receiving income other than from a sole employment relationship or earning self-employment or other income must file returns during the next fiscal period, starting on February. Specific due dates are determined by the ninth digit of the national ID card, TIN or passport, for nationals and foreigners:

Ninth digit	**Due date**
1	March 10
2	March 12
3	March 14
4	March 16
5	March 18
6	March 20
7	March 22
8	March 24
9	March 26
0	March 28

Assessments

Individuals in an employment relationship have their taxes assessed by their employers. Other individual taxpayers operate under self-assessment. Both are subject to review and audit by the SRI. Taxes not withheld from employees are required from employers who, however, can collect them from employees.

Community property

Community or separate property relations between husband and wife may be agreed upon at any time. In the absence of an agreement, community property governs. Under community property, all property acquired after marriage and all property specifically included by spouses belongs to both of them. Inherited or donated property remains the exclusive property of the recipient spouse, unless specifically included in the community. Either spouse or both can administer the community, as they agree. Under separation of property, each spouse may own, dispose of, possess, administer, and enjoy his or her separate property without the need of the other spouse's consent.

Spouse

Husband and wife are required to file separate income tax returns for the income derived from employment, a profession or a business. Joint income or income that cannot be definitely attributed to one spouse in particular must be split equally and added to the spouses' respective tax returns. This allows for a much lower effective rate than if joint returns were permitted. There are no exemptions for children.

Foreign personnel

Foreigners are subject to tax on their Ecuador-source income regardless of their domicile or place of residence. Foreigners residing in Ecuador for a short period of time (less than six months) who receive income from local sources are subject to a flat 25% income tax, which is withheld at source. Payments made to foreigners occasionally working in Ecuador, when not charged to an Ecuadorian company or branch, do not give rise to income tax. Foreigners with resident visas are subject to income tax on any earnings and are not entitled to exclusion of income for periods of temporary absence from Ecuador. Individuals leaving the country should file a tax return up to 30 days after the completion of their economic activity.

Exit permits

Tax clearances are not required in order to leave the country, but foreigners leaving the country permanently must file a tax return before leaving.

Trusts, partnerships and joint ventures

Trusts

The basic rules applicable to trusts are found in the Civil Code, but the Security Market Law contains most operational and other regulations. Trusts under Ecuadorian tax legislation are considered to be a business entity and thus taxed. However, if it is so established in the trust contract, the tax liability can be endorsed to the beneficiary, in which case, if an individual person, such benefits would be taxed at personal rates.

Partnerships (sociedades colectivas)

A partnership is considered to be a business entity for the purpose of determining the income earned by the partnership. Income thus determined is taxed at the rates applicable to corporate entities.

Joint ventures

A joint venture is considered to be business entity for purposes of determining its taxes at the regular 25% rate. Alternatively, income and expenses can be attributed to the participants in the venture according to their share and results included in their respective tax returns.

Chapter 15
Taxation of corporations

Investor considerations

- Dividends distributed are tax exempt.
- Interest payments abroad are tax exempt under certain conditions.
- Payments on imports are tax exempt.
- Non-dividend remittances abroad are taxed at 25 percent.
- Lease installments are deductible.
- Losses incurred in a fiscal year are deductible with limitations. There are no carryback provisions.

Corporate tax system

Current regulations set the income tax rates as follows:

- 15% on earnings destined to capitalization, which must be done before December 31 of the year following that in which they were earned.
- 25% on distributable earnings, independently of whether the beneficiary is a local or foreign investor.
- 25% on all non-dividend payments abroad (i.e., royalties, technical fees).
- Branches of foreign companies are given tax treatment equal to that of local entities. Moreover, the law indicates that the income tax paid by the corporation is attributed to non-resident shareholders.

Taxable entities

Local corporations, limited liability companies, branches of foreign entities, partnerships, joint ventures, trusts and holding companies, as well as other economic entities are subject to corporate tax as indicated above.

Territoriality

Local entities and branches of foreign corporations are taxed on their Ecuadorian-source income and foreign source income as indicated previously. Tax credit is granted for taxes paid abroad on foreign-source income.

Gross income

Accounting period

The fiscal year, for income tax purposes, runs from January 1 to December 31 (calendar year). Partial periods (activities initiated during the year) must close on December 31.

Accounting methods

Accounting records must be maintained according to Ecuadorian Accounting Standards and regulations issued by the Superintendence of Companies and the Superintendence of Banks as described in chapters 11 and 12. In general, business entities are required to use the accrual basis of accounting. Consequently, for payments within or outside Ecuador the tax liability arises upon "payment or credit to account."

Business profits

Taxable business profits comprise the totality of income received for professional, labor, commercial, industrial, agricultural, mining, service, and other economic activities (whether ordinary or extraordinary in nature), less discounts, costs, expenses, and deductions arising from activities necessary for the obtaining of such income.

Inter-company transactions

In December 2004, Ecuador enacted legislation that introduced Transfer Pricing regulations. For more detail see “Transfer Pricing” bellow in this chapter.

Inventory valuation

Valuation of inventories is not specifically treated in the tax law or accompanying regulations. As Ecuadorian Accounting Standards must be followed, inventories are carried at cost or market, whichever is lower. LIFO, FIFO and average are used, being the latter the preferred method.

Write-offs of inventories must be justified through a sworn declaration before a judge or notary public on the legality of such write-offs.

Capital gains

Capital gains on securities transactions (debentures, bonds, and bank and finance company mortgage bonds) are considered regular taxable income; accordingly, capital losses are normal deductions when realized. Gains on the occasional sale of real estate and shares are tax exempt. Gains on sale of urban property are subject to a municipal tax.

Interest

Interest income is to be added to the tax base and taxed at regular rates.

Dividends

Dividends received from a domestic company are tax exempt.

Royalties and service fees

Royalties, service fees and similar income are treated as regular business income subject to tax. If royalties or fees originate abroad, any taxes paid abroad can be used as tax credits up to the amount of tax owed in Ecuador.

Exchange gains and losses

Foreign exchange gains are taxable as regular income upon accrual. Exchange losses are normal deductions when accrued. These are very rare at present as few transactions are done in currencies different of the US Dollar.

Nontaxable income

The following types of income, among others, are exempt or nontaxable income.

- Dividends received from companies.
- Capital gains on occasional sale of real estate and shares.
- As per the Tax Benefits Law, income relative to specific industries: hydroelectric and alternative-source generation, refining and industrialization of hydrocarbons, high tech electronics, distribution centers for air traffic and cargo, deep water harbors, production of agro industrial machinery and production of fuels from natural resources (ethanol). For more detail see Taxation Policy, in Chapter 3.
- Indemnities paid by insurance companies, except compensation for lost earnings.

Deductions

Business expenses

The basis for assessment of corporate income taxes is taxable income, generally defined as the difference between gross revenue and expenses allowed under the Internal Tax Regime Law. In general, all expenses required to obtain income are deductible, be they incurred within Ecuador or abroad. Remuneration for services rendered abroad is also deductible. There are no territorial limits or prohibitions on payments to foreign affiliates or others; however, all such payments abroad (with certain minor exceptions) are subject to withholding at a rate of 25 percent. There are no distinctions among or limitations on capital expenditures.

Depreciation

- Fixed assets

Depreciation (for tax purposes) is computed on a straight-line basis, under the following guidelines.

- Buildings - 5 percent a year (20 years).
- Machinery, equipment and most other capital assets - 10 percent a year (10 years).
- Vehicles - 20 percent a year (5 years).
- Computer equipment and software - 33 percent a year

Used assets are depreciated on the basis of their remaining useful life. The useful life thus calculated, added to the life of the asset under the previous owners, cannot be less than the legal useful life listed above for a new asset in the same category. No other depreciation methods are allowed for tax purposes. Gains on sale of assets over their book value are treated as normal income, except for land and buildings, the gains on which are exempt from national income tax but subject to municipal taxes.

- Intangible and deferred assets

In general, intangible assets can be amortized over the life of the related contract or over twenty years.

Preoperational expenses, including organization and constitution expenses, experimentation and development expenses, and installation and other such expenses, can be amortized over a period of no less than five years (20 percent a year).

Other deferred expenses are amortized according to specific industry regulations, as follows:

- Investments in mining operations can be amortized in a four-year period.
- Exploration expenses in the oil industry, according to the specific terms of the contract (basically based on production).
- Investments made by concessionaries during the term of the concession contract.

Leasing agreements

All lease rentals can be deducted for income tax purposes. Financial leasing (where the leased good is transferred to the lessor for a low price at the end of the contract) is most commonly used in Ecuador. The lessor can take depreciation of the leased goods during the lease contract period.

Depletion

Percentage depletion of natural resources is not allowed. However, in the case of mining rights, preoperational expenses (such as exploration) can be amortized over four years. Special rules apply to the oil and gas industry, but in general natural resources are considered the property of the state.

Interest

Interest accrued or paid on business loans during the fiscal year can be deducted for tax purposes. Interest on foreign loans is fully deductible subject to registration of the loan with the CBE. Whenever interest rates exceed those approved, withholding of income taxes applies on the portion of excess. These rules apply to interest payments abroad to affiliate companies. There are no regulations as to thin capitalization in effect in Ecuador. Foreign investments are sometimes structured on a debt basis in order to take advantage of withholding-free interest payments.

Royalty and technical fees

Royalty and technical fees are normal deductions for tax purposes, provided withholding is made at a 25 percent rate if payments for such expenses are made abroad. Contracts must be filed with the Ministry of Foreign Commerce, Industry, Fisheries and Competitivity (MICIF). If contracts contemplate a fee greater than 5 percent of sales, prior approval from MICIF must be obtained. It makes good sense to establish royalty and technical fees in order to benefit from lower effective corporate tax and related costs.

Professional Service Fees

Payments for professional services (the term is usually interpreted broadly to include many types of services) rendered abroad on behalf of local entities and branches of foreign corporations, as well as payments for occasional services rendered in Ecuador by nonresidents, are subject to a 25 percent withholding at source.

Employee remuneration and severance indemnity payments

Remuneration is fully deductible, including taxes paid by the company on behalf of an employee. There are no limits on payments to foreign employees or employee shareholders. Social benefits and indemnities paid in accordance with labor or social security legislation and certain other statutory, contractual or voluntary fringe benefits (including employees' statutory profit sharing) are normal deductions for income tax purposes. Indemnities resulting from violations of labor laws are nondeductible.

Insurance premiums

Insurance premiums on coverage of income-producing properties are deductible for tax purposes except insofar as they relate to the acquisition (importation) of fixed assets and inventories, in which case premiums are considered part of the cost of such assets (and subject to depreciation). Losses on non-insured business property are also deductible. Ecuadorian legislation generally does not allow for the contracting of insurance with non-domiciled insurers (including insurance related to imports). Consequently, insurance premiums paid abroad will not be deductible and may be subject to additional fines.

Reimbursement of expenses abroad

In addition to royalty and technical fees discussed above, companies can reimburse expenses incurred abroad on their behalf provided that heavy requirements are met. These reimbursements are not subject to any tax withholding, and cannot include fees, commissions or royalties.

Intercompany charges

Oil companies operating under risk service contracts with Petroecuador, the state oil company, receive special treatment regarding inter-company charges where upon finding oil these are reimbursed by Petroecuador with no withholding.

Other deductions

- Commissions on exports

Commissions paid abroad are deductible as per contracts but may not exceed 2% of exports. Tax withholding applies if paid to tax heavens or related parties.

- Travel and entertainment expenses

Expenses related to business-connected domestic travel, hotel and food are normal deductions. Travel expenses abroad normally require documentary support in the sense that they related to business matters. Entertainment expenses are limited to a maximum of 3% of total general expenses.

- Bad debts

The write-off of bad debts is permitted if it can be proved that all reasonable steps have been taken to obtain collection and the debts have appeared in the accounts as uncollectable for five years.

Tax legislation allows for a bad debts provision to be made at the rate of 1 percent of the credit granted during the year, less those amounts collected by year-end. The balance of the accumulated allowance for bad debts at any given year-end may not exceed 10% of accounts receivable and must be used first to write-off outstanding trade accounts.

Banks, finance companies and others controlled by the Superintendence of Banks must apply rules issued by said control authority for uncollectible accounts and other risk assets.

- Taxes

Taxes are deductible except for income taxes and related fines and interest and those that form part of the cost of goods sold, as well as those where tax credit can be obtained and those that can be passed on to the final consumer.

- Donations and contributions

Inventories can be donated provided that specific procedures are complied with. Regulations require use of a public notary, payment of VAT in certain cases, among others.

- Company pension funds

Accounting provisions and accruals made to cover company pension funds for employees are fully deductible when made according to locally recognized actuarial methods. No provisions can be made for employees working less than 10 years for the company.

- Expenses related to nontaxable income

Expenses necessary to produce and maintain nontaxable income cannot be deducted for income tax purposes.

- Employees' statutory profit sharing

Following guidelines contained in the Labor Code regarding workers' rights, companies must distribute 15 percent of their pre-tax earnings among their employees. This amount is fully deductible for income tax purposes.

Nondeductible items

In general terms, inadequately supported expenses are not deductible, nor are non-business expenses, such as personal expenses of directors, executives and owners and expenses incurred by their wives or children. Income taxes together with interest and fines related to those taxes, depreciation and amortization exceeding the established limits, loss of assets due to activities that do not generate income, and the purchase of personal items such as jewels and works of art are also nondeductible. Payments abroad, when no withholding has been made, are also nondeductible.

Reserves and provisions are not deductible unless provided for in tax legislation (such as reserves for bad debts and depreciation).

Losses

Losses incurred by corporations in a given fiscal year can be charged against profits obtained in the following five years, up to a limit of 25 percent of each year's profits. If a company is liquidated or terminates its activities in the country, the sum of accumulated losses over the previous five years can be charged in the fiscal year of the liquidation or termination. Losses on the sale of fixed assets are allowed, except those occurring from sales to affiliated companies or to partners, owners or their families. There are no carryback provisions, nor is it possible to group profitable and unprofitable affiliates for tax purposes.

Transfer pricing

Transfer pricing regulations were introduced by Executive Decree No. 2430, published in the Supplement to Official Gazette No. 494 dated December 31st, 2004. These regulations follow the guidelines established by the Organization for Economic Cooperation and Development (OECD).

According to these, for tax purposes the principle of Arm's Length is defined as that in which, when two related parties impose or establish conditions in their financial and commercial transactions, that differ from those which would have been established with, or between, independent parties, the profit that would have been obtained by one of the parties had such conditions not existed but that due to their application were obtained, should be quantified and registered.

The enacted reforms include various methods of determining Arm's Length: Comparable Uncontrolled Price (CUP), Resale Price, Cost Plus, Profit Split, Residual Profit Split and Transactional Net Margin Method (TNMM).

The reforms also establish that taxpayers undertaking operations with related parties, in addition to filing their income tax return, will present before the Internal Revenue Service (SRI) the Transfer Pricing Appendix regarding transactions between such parties, within five days after the filing of the return. Moreover, the taxpayers will present the Integral Transfer Pricing Report regarding operations between related parties, in the form and containing the information established by the SRI through a general ruling, in a term no greater than 6 months since the filing of the income tax return. Economic effects or adjustments arising from transfer pricing regulations must be included in the tax return and affect taxable income.

For fiscal year 2005 only international operations of over US$ 300,000 carried out between related parties were subject to the above described regime.

Tax computation

Net income

For practical purposes, net taxable income may be broadly defined as the difference between gross profit and various operating expenses, allowances, provisions, and other charges; plus non-operating income; and less certain non-operating expenses. This broad definition of taxable income is subject to certain limitations as to the deductibility of some expenses and the exclusion of exempt income.

Tax rates

Taxable income for domestic corporations and branches of foreign companies are subject to tax at a flat rate of 25 percent on profits to be distributed. A 15% rate applies to capitalized profits.

Corporate tax rates are tabulated in Appendix I.

XIV Remittance to Nonresidents of Ecuadorian Corporation Profits

Net Income	100
Less: Statutory profit sharing	15
Taxable Income	85
Less: Tax on distributable income at 25%	21,25
Available for remittances abroad	63,75
Net remittance abroad	63,75

Tax credits

The law allows local enterprises tax credits for income taxes paid abroad. Tax credits on foreign source income may not exceed the amount of income taxes due in Ecuador.

Consolidation

Consolidated income tax returns of parent and subsidiary companies are not customary, and the law does not make specific reference to them. In practice, each company is considered an independent taxpayer, and losses of one company may not be offset by profits of another.

Other taxes

Corporations are liable for the following additional taxes.

1. Tax on total assets: 0.15 percent of total assets less current liabilities and contingencies (for more detail see Chapter 23).
2. Property tax: Municipal taxes levied on land and buildings, based on estimated commercial value less deductions.
3. Contributions to the Superintendence of Companies: 0.1 percent of total assets.

These taxes are fully deductible for income tax purposes and are not considered significant. Little planning is devoted to them. Various other taxes, including those affecting particular industries and those levied by local governments, are discussed in Chapters 22 and 23.

Branch versus subsidiary

See Chapter 16 for taxation of branches. See Chapter 9 for an analysis of the non-tax advantages and disadvantages of these two forms of operating.

Special industries

Petroleum

Foreign and local companies or investors may participate in the petroleum industry through association, service, production sharing contracts and risk service contracts with Petroecuador, the state oil holding company. Most companies presently in Ecuador are exploring for, and producing, oil under production sharing contracts.

Profits of oil companies working under production sharing contracts (the majority) are taxed at 25 percent, while oil companies working under risk services contracts are taxed at 44.4 percent (25 percent when reinvesting the profits). In risk service contracts companies are taxed exclusively on the fees paid to them by Petroecuador, once commercially exploitable oil has been found in the areas allocated to them. Reimbursements made by Petroecuador on the investments and expenses incurred by the contractor during the exploration, development and operational stages are not considered income and hence are not subject to tax.

Other companies in the oil sector (non-operators such as drilling and survey companies) are taxed the same as companies in other sectors of the economy. Companies operating under contracts recognized by previous legislation are taxed on the basis of such legislation.

Mining

Mining companies operating in Ecuador are taxed on all ordinary and extraordinary income received in the country and on all income obtained abroad that originates from mining activities in Ecuador. The Internal Tax Regime Law, the country's general Tax Code, refers to the Mining Law for the specifics of taxing income from mining operations. According to the Mining Law, from gross income obtained the following deductions are allowed.

1. Expenses required to generate income from minerals, including those related to exploration, exploitation, refining, and commercialization as well as those relating to the protection of the ecosystem.

2. Interest on domestic loans (or on foreign loans if registered with the CBE), insurance premiums, exchange losses, and uncollectable accounts.
3. All labor costs, including wages, salaries, insurance premiums, indemnities, and others.
4. Special mining taxes, such as fees payable for exploration and exploitation rights.

Pre-operational expenses and capital investments can be amortized over four years by the accounting method of choice. Loss carry-forwards are allowed for up to five years, with a limit of 50 percent of the taxable base of a given year.

Tourism

According to the Tourism Law qualified entities can enjoy the following special exemptions:

1. Taxes involving the incorporation and other legal corporate acts.
2. Local taxes on the transfer of real estate.
3. Import duties on planes, boats (for a period of 10 years) and land transportation vehicles (for a period of 5 years).
4. Import duties on equipment, building and decorative materials, machinery and operational assets, when these are not produced in the country.

Additionally, the law establishes special deductions for income tax purposes for tourism activities of attracting and serving tourists, such as: payments made abroad for publicity and marketing, subscription to information & reservation services, inscriptions to participate in promotional events and commissions paid abroad as long as they do not exceed 8 percent of sales.

Real estate

The most important tax feature for the real estate industry is that municipal transfer taxes are creditable in full against income tax, but any excess over the income tax liability for the year cannot be recovered.

Construction

Construction companies are permitted to choose the accounting method to be used in determining taxable income. The Internal Tax Regime Law indicates that any acceptable accounting system is permissible and specifically mentions the completed contract method and the percentage-of-completion method. Once a method has been chosen it cannot be changed without the SRI’s authorization.

International transportation

Foreign companies involved in sea or air transportation that operate in Ecuador are taxed at 25 percent of 2 percent of their sales in the country. No deductions are allowed. These companies generally maintain branches, but some operate through agents or have permanent establishments (i.e., de facto branches).

Holding companies

The Securities Market Law (SML) issued in May 1993 recognized holding companies. The modified SML and its reforms, in effect since July 1998, state that each affiliate is liable for its own taxes. Local holding companies receiving dividends from shares held in domestic affiliates would receive these dividends free of any withholding tax. However, they would be taxed on income other than dividend income and would be required to withhold at the 25 percent rate from payments remitted abroad.

Whenever the holding company receives dividend income, a disadvantage could exist in that dividends received would be subject to the payment of the statutory employees' profit sharing, both by the dividend-paying company and at the holding company level.

Corporate tax planning strategies

Sourcing rules

There are no advantages or disadvantages in operating through foreign corporations (branches) or local corporations (including wholly owned foreign subsidiary) as they are taxed similarly.

Type of entity

Subsidiaries and branches are in general taxed at 25 percent. Dividends distributed abroad are tax exempt.

Holding companies

There are no tax advantages for a holding company, although the transfer of income could reduce the cumulative impact of statutory profit sharing when the holding company has no employees.

Royalties and technical service contracts

Although a withholding tax of 25% applies on these charges, their use as a deduction reduces the statutory profit sharing and income taxes.

Special industry companies

Oil companies operating under risk service contracts are taxed at 44.4 percent for distributed profits. The rate is 25 percent on undistributed profits, under certain investment conditions; other industry-related companies are taxed at regular rates.

There are special tax deductions for companies involved in tourism.

As per the Tax Benefits Law, income relative to specific industries (hydroelectric and alternative-source generation, refining and industrialization of hydrocarbons, high tech electronics, distribution centers for air traffic and cargo, deep water harbors, production of agro industrial machinery and production of fuels from natural resources such as ethanol) enjoy tax holidays. For more detail see Taxation Policy, in Chapter 3.

Mergers or amalgamations

There are some income tax advantages in entering into a merger process. Exchange of shares is the most common mechanism. Profits on the occasional transfer of shares are income tax exempt. Value-Added Tax is not paid on the transfer of assets under the Tax Regime Law.

Liquidation

The repatriation of capital in case of liquidation is nontaxable and guaranteed, as is repatriation of profits, provided taxes have been paid.

Acquisitions

Acquiring assets and trademarks is normally recommended in the acquisition of going concerns.

Joint ventures

Straight joint ventures without domicile or establishment of an Ecuadorian company are not recommended, as the tax burden could not be effectively reduced.

International center

Under certain conditions an investor could use Ecuador as a base for carrying out meaningful international operations.

Tax treaties

Ecuador has signed tax treaties which provide relief from double taxation for individuals or companies with Brazil, Belgium, Chile, France, Germany, Italy, Romania, Spain, Canada, Mexico, Switzerland and the nations of the Andean Community (Venezuela, Colombia, Perú and Bolivia).

Chapter 16
Taxation of foreign corporations

Investor considerations

- Branches and wholly owned foreign subsidiaries are subject to a tax rate of 25 percent on distributable profits whether or not distributed. If profits are capitalized a 15% tax rate applies.
- Imports are not subject to taxation.
- A selling agent or distributor acting on behalf of a foreign corporation may incur exposure to Ecuadorian tax.

Tax concepts

Foreign companies doing business in Ecuador through a legally established branch are subject to the applicable laws and related regulations as subsidiaries or local entities.

Permanent establishment

A permanent establishment is the location from which an entity carries out part or all of its activities. A foreign entity is deemed to have a permanent establishment in Ecuador when it does the following.

1. Maintains a fixed location of economic activities, such as a branch, agency, affiliated company, or other office that acts on behalf of the foreign entity; or maintains operations such as the following:

    (a) Production centers;
    (b) Mines;
    (c) Construction sites;
    (d) Exhibit centers engaging in commercial activities.
    (e) Any material property, if its period of construction or set up exceeds 6 months.

2. Maintains a business office providing consultancy services or services related to the entertainment or travel industry.

3. Performs business activities in Ecuador on account of a foreign entity and can legally bind the entity it represents, pay for local services on behalf of the foreign entity or keep merchandise belonging to the foreign entity on consignment for sale within Ecuador.

The concept of permanent establishment, though relatively broad, does not include installations used for storage or exhibition (but not sale) of merchandise or information offices with no economic activity.

Imports

Apart from custom duties, VAT and other minor costs (see Chapter 8), payments for imports into Ecuador are not subject to other taxes or withholdings, provided that an import permit has been obtained from the CBE. All imports are subject to verification, at the country of origin, of quantity, quality and cost by authorized international certifying companies. The cost associated with verification is paid by the importer.

Authorized agents

According to present legislation authorized agents must file with the tax authorities copies of their representation contracts. Care should be taken to avoid maintaining inventories in consignment with such agents for sale to local clients as such situation is considered to give rise to a permanent establishment (de facto branch) and thus to all tax implications of a normal branch.

Sales subsidiary

Sales subsidiaries of foreign corporations are subject to all regulations as any entity doing business in Ecuador. Transfer pricing regulations apply for related parties transactions.

Branch operations

Income tax on branch profits is computed by following the same procedures as for local corporations; profits are taxed at the 25 percent rate when distributed; capitalized profits are taxed at a 15% rate.

In other respects, tax legislation also applies equally to subsidiaries (local corporations) and branches. Additionally, the level of asset holdings at which branches are required to engage external auditors is much lower than that for local corporations, companies and partnerships (see “Independent audits” in Chapter 11). Branch operations in all sectors of the economy are treated equally.

Administrative offices

There is no specific legislation regarding administrative offices of foreign corporations with the exception of representative offices for banks, which are not allowed to conduct banking business in Ecuador. Information offices for corporations, where no business is conducted, can also be considered non-income-generating operations and consequently not subject to tax. These are rare, as legally they could be deemed either a branch or a subsidiary expected to do business. However, arrangements can be made to maintain this type of office.

Income from Ecuadorian subsidiaries

Dividends

Dividends received from local corporations (subsidiaries) by branches of foreign corporations are tax exempt.

Other income

Other income received by a branch domiciled in Ecuador would be subject to local withholding rates by the paying entity. The amounts withheld would be treated as a tax credit toward the tax liability at year-end. If the net income is remitted abroad, it would be subject to the flat 25 percent rate. For other provisions in this area, see Chapter 15.

Portfolio investments

There are no specific regulations on portfolio investments in Ecuador. In general terms, all dividends received from local entities are tax exempt. Other income received by subsidiaries or branches in Ecuador is taxable income.

International financial center

Under certain conditions an investor could use Ecuador as a base for carrying out meaningful international operations. The country does not, however, qualify as a tax haven.

Chapter 17
Taxation of shareholders

Investor considerations

- Dividends received from domestic corporations by Ecuadorian citizens and resident aliens are free of tax.
- Ecuadorian tax law states that income tax paid locally on profits distributed to a foreign shareholder is attributable to said investor.
- Goodwill on acquisitions can be amortized.

Domestic shareholders

Dividends

Under Ecuadorian tax legislation dividend income received by resident shareholders, when the dividend-paying company has paid its corporate tax, is not subject to any further tax.

Dividends received from abroad by local corporations or branches of foreign corporations (the latter very unlikely) would be added to the tax base and taxed at the corporate rates. Taxes paid abroad on the dividend income could be taken as tax credits, up to the amount of tax due in Ecuador on such income. Tax treaties should be reviewed before applying this general rule.

Capital gains

Capital gains from the sale of shares are not taxed if occasional. Gains on the occasional sale of real estate are also tax exempt.

Foreign shareholders

Dividends

Dividends paid or credited to foreign shareholders (individual or corporate) are not subject to tax. Moreover the 25% rate paid by the distributing entity is attributable to said foreign shareholder.

Companies are allowed payments abroad for professional services at an effective tax rate of 25 percent withheld.

Capital gains

The treatment does not differ for domestic and foreign shareholders.

Reorganizations

In general, reorganizations are not common in Ecuador.

Incorporation and acquisitions

The transfer of a business (assets and liabilities) into a corporation must be carried out through a contract (deed) recorded with an official notary. The agreed-on price, if different from the net book value, will result in a gain or a loss for the seller. It is important to note that the Tax Code broadens the responsibilities of the buyer to include any tax liabilities incurred and not paid by the seller for the year in which the business was transferred and two prior years of operations. This responsibility is limited to one year when the transfer is reported to the tax authorities. In this regard it becomes very important that the buyer check carefully any pending tax liabilities and the results of recent tax audits.

Additionally, labor and social security responsibilities are also transferred to the buyer. Workers have the right not to accept a change in employer because of a transfer of a business. If employees do not accept the transfer, indemnities are due.

Differences between book value and purchase price constitute a gain or loss for the selling party. Tax losses cannot be passed on to the purchaser but may be taken as a deduction in the current year or upon liquidation if the transaction occurs in the same period. On the other hand, the gain is taxable and the tax liability will be borne by the seller.

Asset acquisitions are normally registered at the paid asset price. Depreciation of the purchased assets follows the rules for used assets. Interest expense on such acquisitions is fully deductible. Goodwill paid should be accounted for as a deferred expense and amortized.

Transferring parts of a business in separate transactions through consecutive purchase contracts for groups of business assets is allowed. If the transfer involves specific assets and not business units, there are no tax responsibilities, but certain labor and social security responsibilities could remain. In these cases certain taxes, such as VAT on inventories or real estate taxes, would be payable.

Merger or amalgamation

Mergers are regulated by the Company Law, which establishes that a merger exists when one of the following occurs.

- Two or more companies start a new enterprise that assumes the previous companies' rights and obligations; or,
- One or more companies are absorbed by a third company, which continues the existing operations.

In order to merge, a company must first execute a dissolution agreement and a transfer of net assets (stockholders' equity). The tax implications for mergers are similar to those for incorporation; that is, the continuing enterprise is responsible for the tax and other liabilities of the disappearing enterprises. Labor and social security responsibilities are also transferred in full.

In general terms, the only restrictions on the transfer of shares among shareholders apply to limited liability companies, general partnerships and silent partnerships. In these cases, a new corporate charter, a deed of assignment and the unanimous consent of the other shareholders are required.

The importance of proper valuation services and special audits of all of the disappearing company's liabilities (tax and labor) cannot be sufficiently stressed in order to avoid unpleasant surprises later.

Share acquisition

A business could be also transferred by the purchase of shares by the foreign investor. The tax, social security and labor responsibilities assumed are those normally applicable to an ongoing concern. Any gain by the seller in the sale of shares, if deemed occasional, would be tax exempt. The buyer, as a foreign investor, is required to register such investment at the CBE.

Chapter 18
Taxation of foreign operations

Investor considerations

- Profits of foreign subsidiaries are taxable upon receipt.
- Domestic corporations can claim tax credits for foreign taxes paid or accrued on foreign-source income, subject to certain limitations.
- Excess foreign tax credits for the year cannot be carried back to prior periods.
- Operations of branches of Ecuadorian companies ought to be consolidated in the local company.

Taxation of foreign income

The law grants the right to apply income taxes paid abroad on foreign-source income as a tax credit. Under no circumstances may tax credits exceed the amount of income taxes due in Ecuador on the specific foreign-source income. The law does not provide for excess (unused) foreign tax credits to be carried back or forward to other years or for the globalization of foreign-source income for purposes of applying against it global taxes paid. Losses incurred yearly in foreign operations are generally excluded (except in the case of branches) from the calculation of Ecuadorian taxable income.

For operations discussed bellow, existing tax treaties should be reviewed. See Appendix V.

Income of branches and foreign subsidiaries

Income of subsidiaries of Ecuadorian companies in other countries is subject to tax in Ecuador whenever dividends are received. The law does not cover the matter of taxes on the proceeds of liquidation, but it is presumed that reimbursements of capital would not be considered as taxable income. Documentary evidence of losses would be essential in order to obtain their deduction for income tax purposes.

Branch operations ought to be incorporated into the operations of the head office in Ecuador. As this is a new phenomenon, no specific legislation or regulations have been issued. Ecuadorian branches of foreign companies, by their very nature, are not expected to have subsidiaries or establish branches in foreign countries.

Capital gains

Gains realized from the sale of shares in foreign subsidiaries, if deemed occasional, are tax exempt.

Dividends

See “Income of branches and foreign subsidiaries” above.

Interest and royalties

Interest and royalties earned from foreign sources form part of gross income subject to normal corporate income tax. Tax treaties entered into by Ecuador provide relief from double taxation by way of tax credits. Branches of foreign corporations doing business in Ecuador will be taxed on foreign-source income.

Foreign exchange gains and losses

As a rule, foreign exchange gains are taxable when earned, and foreign exchange losses are deductible when incurred.

Double tax relief

Relief from double taxation is provided for by way of tax credits or exclusions as provided by tax treaties entered into by Ecuador.

Chapter 19

Partnerships and joint ventures

Investor considerations

- Partnerships and joint ventures are considered business entities for purposes of determining income.
- Income of foreign non-resident partners is treated as remittances for income tax purposes.

Partnerships

See Chapter 9 for a description of the kinds of partnership.

Entity or conduit

A general partnership is considered as a separate business entity for purposes of determining income generated by the partnership. Thus, they are treated in the same manner as a corporation for tax purposes. In such companies, the partners can be individuals or juridical persons (corporate entities), domiciled or not in Ecuador. (See Chapter 9 for further details.)

Taxable income

Taxable income for partnerships is determined in the same way as for corporations (see Chapter 15).

Taxation of foreign partners

Foreign resident partners are not distinguished from nationals in tax legislation; consequently, they receive equal treatment with Ecuadorian partners. Partnership income would be exempt provided that the partnership has paid 25% income tax on profits remitted.

Joint ventures

According to Ecuadorian legislation, joint ventures take the form of separate business entities for tax purposes and are treated as local corporations. Joint ventures, particularly those of branches of foreign corporations that are formed to carry out specific projects (for example, dams or other public works), normally act as a unit, and taxes are paid according to the venture's results.

Chapter 20
Taxation of individuals

Tax planning for expatriates

Resident/nonresident status

- Residence for tax purposes is established (1) by presence in Ecuador for more than six months or (2) upon arrival if in possession of a work contract that grants formal residence. The income of residents is taxed at progressive rates up to a maximum of 25 percent.

- Nonresidents performing occasional work in Ecuador (for periods of less than six months) are taxed at a flat 25 percent if paid from Ecuador. The tax is withheld at source.

- Income of non-residents if not charged to a local entity or branch is generally not taxed at personal level.

- No exclusion of income is allowed for time spent outside Ecuador.

Non-salary payments

- Residents are taxed on total compensation, which is defined to include bonuses, allowances, fringe benefits, and any other emoluments received in cash, kind or services.

Activities outside Ecuador

- Expatriate residents' temporary absences from Ecuador do not entitle them to exclude income for those periods from their taxable base.

Social security contributions

- Social security contributions borne by the employee are deducted in determining taxable income. However, under "net salary" arrangements, where the employer makes tax and social security payments for the employee, the latter cannot deduct the social security contributions.

Special tax concessions

- No special tax concessions are granted to foreign nationals as such.

Timing of arrival/departure

- Timing of arrival and departure is not a significant factor in tax planning with regard to the Ecuadorian tax burden, but in fact splits income in two periods and thus may reduce the tax liability due to the application of a lower progressive tax rate.

Territoriality and residence

Ecuador taxes its citizens and foreigners on their Ecuador-source income. Ecuador-source income is defined as any income derived from activities executed in Ecuador, regardless of where the income is received. It also taxes any income obtained abroad by individuals with residence in Ecuador.

Foreigners are subject to tax on their Ecuador-source income regardless of their domicile or place of residence. Foreigners living in Ecuador for less than six months who receive income from local sources are subject to a flat 25% income tax, which is withheld at source and need not file a return. Payments made to foreigners occasionally working in Ecuador, when not charged to an Ecuadorian company or branch, do not give rise to personal income tax.

Foreigners with resident visas are subject to income tax on all earnings and are not entitled to exclusion of income for temporary absence from Ecuador. In this context, resident foreigners are treated equally as Ecuadorians and thus have the right to take credit for any taxes on foreign source income paid abroad. Also, to apply any tax treaty provisions to avoid double taxation if their country of origin has entered in such a treaty with Ecuador.

Special provisions

Individual representatives of foreign governments who are working under international agreements are exempt from taxes in Ecuador. There are no other special provisions applicable only to foreign individuals.

Gross income

Employee services

Residents (national or foreign) are taxed on their total compensation, net of Ecuadorian social security contributions paid by the employee. Total compensation includes any payments in cash, kind or services, regardless of the place of payment. Regional, cost-of-living, car, vacation, travel, housing, utilities, and similar allowances are considered taxable. In a “net salary” arrangement where the employer pays personal income taxes and social security contributions on behalf of the employee, the income tax liability on the net salary is added once to total income to arrive at a new taxable income. Social security deduction is disallowed in this case.

Capital gains

Capital gains arising from the occasional sale or transfer of shares and real estate are exempt.

Other income

All types of income (wages, professional fees, rents, royalties, annuities, etc.) are considered taxable with the exception of the following.

1. Local dividends received by residents.
2. Interest on savings deposits.
3. Social security pensions.
4. Severance pay as contemplated in the Labor Code.

It is important to note that resident individuals are taxed on foreign-source income; consequently, income earned abroad (from non-Ecuadorian-related activities) is considered taxable. This would include dividends, pensions, interest income, etc. Salaries paid abroad for work performed in Ecuador and any other income received abroad that is paid by an entity or person domiciled in Ecuador may not be excluded and hence are taxed. As mentioned above tax paid abroad is creditable and treaty provisions applicable.

Deductions

Business

- Labor relationship

The only deduction available to individuals under a labor relationship is Ecuadorian social security contributions, when these are actually borne by the individual. The employer calculates and withholds the tax liability from remuneration for all personnel under its employ. If the employer pays the employee a net salary (free of tax and contributions) the social security deduction is disallowed.

- Self-employed Individuals

Professional fees and, in general, non-employment income can be reduced by expenses necessary in obtaining or maintaining income. In general terms, the deductions allowed correspond to those expenses needed to generate taxable income (see Chapter 15). All expenses must be properly documented, and support documentation must comply with all legally established requirements.

Non-business

There are no non-business deductions.

Personal allowances

No annual personal allowances exist. However the tax table for 2006 establishes that annual income of less US$7,680 does not give rise to tax.

Double tax relief

Tax relief legislation with regard to individual taxpayers allows for credit for taxes paid abroad on foreign source income and for the application of tax treaties. See tax treaties in Appendix V.

Tax computation

Employees

Taxable income is composed of all remuneration originating from a labor relationship, less social security contributions when borne by the employee. No other deductions are allowed. The employer on a monthly basis must withhold the applicable tax, which must be estimated yearly using the tax table for the year. If the employee receives a net salary, the social security deduction is disallowed, and the applicable tax as determined initially is added to taxable income in order to arrive at a new definite tax base. Applicable taxes are payable as if withheld, monthly in this case.

If the employee has other taxable income (of Ecuadorian or foreign source) that, together with earned salary, adds up to the an amount greater than the income tax base fixed with a 0% rate, such income must be declared along with employment income in a tax return due in the designated period (review Chapter 14). The return should show all income, the tax liability on such income, all taxes already paid (both employment and other tax withholdings) and the creditable tax to arrive at the final amount of the tax due (or refundable).

Self-employed

Professionals working independently and other self-employed individuals compute their tax base by adding all their year's income and deducting all expenses necessary to produce such income. The tax table is used to calculate the corresponding tax liability. From the liability all withholdings from payments made to them as well as any tax prepayments are subtracted to arrive at the tax due or refundable for the year.

Tax rates

When an independent professional renders services to a company, such individual is subject to monthly income tax withholdings (8% for 2006).

Income is taxed at progressive rates ranging from 0 to 25 percent. Tax rates are given in Chapter 14 and Appendix VI. A sample tax calculation is shown in Appendix VIII.

Tax credits

All local withholdings from income are treated as prepayments toward (and thus creditable against) any income tax that may be due from the beneficiary of the payments. Taxes paid on foreign source income are also creditable when the foreign source income has not been excluded by a tax treaty.

Tax Advances

Review Chapter 14 - Payment and Collection.

Other taxes

Local taxes on income

There are no provincial, county or municipal taxes on income.

Wealth tax

At present no wealth tax is levied in Ecuador.

Inheritance and gift taxes

Ecuadorian tax legislation considers all inheritances, gifts or donations of assets located in Ecuador as taxable if they increase the net equity of the beneficiary. This type of income is taxed at a flat 5 percent on said increase.

Regarding inheritances, gifts or donations the property subject to tax includes all property at the time of death. All property held by the spouse, blood relatives or in-laws that belonged to the deceased transferred to them during the six months prior to death is generally deemed part of the inheritance for tax purposes.

Lottery income

Lottery, raffle and gambling income is subject to a flat tax of 15 percent on the excess over US$ 80. Taxable lottery income is not added to the taxpayer’s income tax base.

Chapter 21
Taxation of trusts and estates

Trusts

The general rules applicable to trusts are incorporated in the Civil Code. Trusts under Ecuadorian tax legislation are considered to be a business entity and thus taxed. However, the tax liability can be endorsed to the beneficiary, in which case, if an individual person, such benefits would be taxed at personal progressive rates (i.e. less than the 25% corporate tax).

Estates

Estate income is taxed at individual tax rates until distribution is made. The inheritance resulting from a distribution is taxed at a flat 5 percent.

Chapter 22
Value-added tax

Investor considerations

- Value-added tax (VAT) is Ecuador’s most significant indirect tax.
- VAT is imposed on the transfer of all goods (both imported and produced locally) except transfers specifically excluded and on the provision of all services.
- Two VAT rates apply: 12% or 0%.
- Exporters can recover VAT incurred in export activities.
- Value-added tax represents approximately 50 percent of the country’s tax revenue.

Taxable transactions

VAT is incurred upon transfer of ownership, rendering of service or the subscription of contracts that have as their purpose transfer of ownership or the rendering of services. VAT is imposed at a flat rate of 12 percent on all goods, imported or produced locally, and on all services. Certain goods and services are taxed at a rate of 0%.

Imports

VAT is generated and is payable upon entry into Ecuador of imported goods. The tax base is the CIF value of goods plus other taxes and tariffs levied by Customs.

Local sales and services

The tax applies on the sale or transfer of ownership of all movable physical assets sold by an entity that customarily sells taxable goods.

The tax base for all local sales or services rendered is the total value of the goods or services inclusive of other taxes and costs. This does not include, however, discounts given to customers as specified in the bill of sale, the value of goods returned by the buyer and interest or other finance charges on credit sales.

Application of VAT at 0%

Among others, the following goods are taxed at a 0% rate upon either importation or local transfer of ownership.

- Most agricultural goods and foodstuffs when these remain in their natural state. Refrigeration or packaging of goods without further processing does not alter their natural state. Also included in this category are milk, meats, sugar, salt, bread, butter and margarine, flour, and cooking oil.
- Drugs, medicines and other pharmaceutical products, including raw materials for their manufacturing.
- Fertilizers, insecticides, animal foods, and similar products, including the raw materials required for processing such goods.
- Agricultural machinery and equipment.
- Goods that are exported.
- Paper, books, magazines and newspapers.

Among others, the following services are taxed at a 0% rate.

- Transportation of persons and cargo; except air transportation of persons and local air transportation of cargo;
- Health, educational, religious, funeral services;
- Book printing services;
- Rental of living quarters;
- Water, electric, sewage and other public services including garbage collection;
- Financial services;
- Exported services;
- Road tolls,
- Aerial fumigation and cold services related to the conservation of foods staples, as well as certain food processing services.

Exemptions

The following transfers are excluded from VAT:

- In kind contributions to capital of companies.
- Inheritance and assets arising from liquidations of companies.
- Transfer of business as a whole.
- Amalgamations, mergers, take-overs, and spin-offs.
- Donations to public entities and non profit organizations.
- Transfers of shares and securities.

Tax credit

Under Ecuadorian tax legislation, VAT paid on imports and local purchases can be deducted from VAT charged on sales or services rendered, as described below.

Recoverable VAT

VAT paid on the local acquisition or importation of goods destined for resale can be recovered as a tax credit on sales taxed at a 12% rate. The tax paid on new raw materials or components required in the production of goods or rendering of services are also creditable when the final product is considered taxable at 12%.

If VAT was paid on fixed assets that are required in the production and selling of taxable goods or services taxed at 12%, the tax amount can also be recovered. Finally, any VAT paid on raw materials, components or fixed assets necessary for the production of exported goods is also recoverable.

Non-recoverable VAT

VAT may not be recovered (by either tax credit or other means) on the local acquisition or importation of goods and services that are used for the productions of goods or services taxed with a rate of 0%. In these cases non recoverable VAT becomes part of the cost of the purchased goods and services.

VAT administration

Bills of sale

Taxpayers are required to issue bills or invoices on all transfers of property or rendering of services, regardless of whether the transfer involves a sale or a gratuity. VAT amounts must be listed separately on the invoices.

VAT withholdings

Certain companies qualified by the SRI are required to withhold VAT from other entities and persons as follows:

- 30% of VAT on purchases of goods taxed at the 12% rate
- 70% of VAT on the acquisition of services taxed at the 12% rate, except in the case of services rendered by professionals in which case 100% of VAT charged must be withheld.

VAT returns

Business entities must file monthly VAT returns by the date specified in the Regulations to the ITRL. All VAT charged must be listed on the return, along with VAT paid. The difference between VAT charged and VAT payable is either the tax payable or (if negative) the tax creditable the following month. These returns must include any VAT withholdings made by the filing entity as required by law. The dates in which the VAT return must be filed are presented below, and vary according to the ninth digit of the TIN.

Ninth digit	Due date
1	10 of the next month
2	12 of the next month
3	14 of the next month
4	16 of the next month
5	18 of the next month
6	20 of the next month
7	22 of the next month
8	24 of the next month
9	26 of the next month
0	28 of the next month

All supporting documentation must be kept by the taxpayer for at least six years for VAT purposes.

Fines

Late filing of VAT returns gives rise to fines which are calculated at 3% per month on the tax owed. In addition, normal interest is also applied which is based on interest rates set quarterly by the CBE.

The lack of issuance of bills of sale or invoices, as well as non payment of collected VAT or VAT withheld to the tax authorities is considered fraud, which may involve closure of the business establishment and criminal sanctions for legal representatives.

Establishments that do not file returns for three months can be closed.

Chapter 23
Other taxes

The most important of these are the following.

Special consumption tax

The special consumption tax is imposed on telecommunications, cigarettes, beer, soft drinks and alcoholic beverages, whether imported or produced locally. Also, the special consumption tax is imposed on vehicles for land transport with a weight of up to 3.5 tons; planes, executive planes and helicopters, when not utilized for commercial transport of passengers and freight; jet skies, 3-wheeled and 4-wheeled motorcycles and leisure boats and yachts.

Rates vary, depending on the product (see Appendix XII). For locally produced items the tax is charged by the manufacturer upon transfer of ownership of goods, in the case of imports the tax is charged by Customs. Regarding telecommunications this tax is charged by the provider at a 15% rate.

Municipal taxes

The following are the most important municipal taxes:

Municipal asset tax

The municipal asset tax (MAT) is levied on all individuals and companies required to keep accounting records in accordance with Ecuadorian tax legislation. MAT is levied at a rate of 1.5 per thousand (or 0.15 percent) of total assets less current liabilities and contingent liabilities as shown on the balance sheet. The tax is payable to municipalities. The financial statement submitted to the Superintendence of Companies or Superintendence of Banks, as the case may be, is the base for calculating the tax.

When a company conducts operations in more than one municipality or county, the tax paid is apportioned pro rata according to the percentage of sales in each municipality or county.

Real estate tax

The city government assesses the municipal property tax, which ranges between 0.25 per thousand and 5 per thousand of the commercial value of the property as determined by valuation carried out every five years by the city government, for both urban and rural properties (rural property is taxed at a maximum of 3 per thousand). In addition, municipalities tax capital gains resulting from the sale of urban real estate.

Transfer taxes

1. The *alcabala* tax relates mainly to the transfer through the sale of real estate and ships. It is levied at a 1% on the taxable base which is essentially contractual price; assessments may be used if so determined by the authorities.
2. The *plusvalía* tax applies to the transfer of real estate. It is 10% of profits, except in the case of first transfer after September 2004, in which case the rate is half percent.

Tax on commerce and industry

Each Municipal Council establishes municipal fees *(patentes municipales)* payable by entities engaged in commerce and industry, and it must be paid yearly. The amount is determined by rather complex formulas that vary from one municipality to the other. The criteria used to regulate this tax is based on the total value of the capital or of the assets used in the commercial activity.

Contributions to Superintendence

Corporations and financial institutions are required to contribute to their respective Superintendence according to values or tables issued yearly. Entities other than financial institutions have been charged with a 1 per thousand of total assets in the latter years.

Automobile registration tax

An annual tax is levied on the proprietorship of all vehicles for land transportation Each year, upon registration of motor vehicles, a tax is levied on the commercial value of the vehicle as determined by the Ministry of Finance. Current rates for this tax range between 0.5% and 4% of said commercial value.

Chapter 24
Introduction to PricewaterhouseCoopers

PricewaterhouseCoopers worldwide organization

PricewaterhouseCoopers (www.pwc.com) provides industry-focused accounting, auditing and related services for public and private clients. More than 130,000 people in 148 countries connect their thinking, experience and solutions to build public trust and enhance value for clients and their stakeholders.

PwC is particularly well placed to meet the changing needs of international business. It is uniquely equipped to advise in matters germane to international operations, not only in individual countries but also on a regional or global basis.

Each PwC firm is a separate entity organized in the country or countries in which it practices in accordance with local laws and regulations. Each office is staffed with professionals knowledgeable in local business procedures. PwC firms are totally committed to client service based on an understanding of the business and requirements of each client. The firm's philosophy is to provide services of the highest quality.

PwC in Ecuador

PwC in Ecuador was permanently established 37 years ago.

The firm is organized so those partners who have full professional authority make decisions affecting clients. Clients deal directly with these decision-makers. Each client has one partner in the firm who is directly responsible for coordinating all work performed for it locally and abroad. The benefits of this approach are efficient, timely and well managed services.

A long history of service has contributed to the firm's role as leaders in the profession. Our professionals in Ecuador are in constant contact with public and private sector organizations that address public policy issues and take a stand on them. For example, firm representatives frequently consult with the Internal Revenue Service (IRS) on tax issues and with the Central Bank, the Superintendence of Companies and Superintendence of Banks and other government bodies on regulatory matters. They also work with industry associations to foster our clients' interests. This has allowed the firm to offer constructive proposals regarding matters that affect clients, the profession and the regulatory environment.

Clients base their confidence on our professional capabilities, experience, tradition of independence, integrity, and commitment to the highest ethical standards. These qualities, plus the firm's worldwide service capabilities, are what enable PwC in Ecuador permanently to satisfy and exceed clients' expectations.

Appendix I
Corporate income tax rates

Corporations, companies and branches

	2005
	%
Local corporations	
On undistributed profits and profits distributed to residents and local corporations	25.0
On profits distributed to nonresident individual and corporate stockholders (includes the 25% on pre-distribution profits)	25.0
On reinvested profits	15.0
Branches of foreign corporations	
On total taxable Ecuadorian-source income	25.0
Oil companies	
On production sharing contracts	25.0
On service fees under risk service contracts	44.4
On undistributed profits (under certain investment conditions)	25.0

Appendix II

Depreciation rates for income tax

Maximum annual depreciation rates for income tax purposes are shown below.

Type of Asset	Rate per annum
	%
Buildings, ships & planes	5
Machinery, equipment and most other capital assets	10
Vehicles	20
Computers and Software	33
Preoperational expenses	20
Intangibles	5 or according to contract

Note:

Rate varies with useful life, as allowed by tax authorities on a case-by-case basis.

Appendix III
Corporate tax calculation

Fiscal Year 2005			**US$**
Income before taxes and 15% employees' statutory profit sharing (including $800 cash dividends and $3,200 of interest and capital gains received)			40.000,00
Add:			
+	Provision for depreciation in excess of amounts allowed	2.800,00	
+	Interest and fines on income tax of a previous year paid in connection with tax examination	920,00	
+	Other nondeductible items	1.760,00	
			5.480,00
			45.480,00
Less - 15% employees' statutory profit participation (ESP) (Note1)			6.822,00
			38.658,00
Deduct:			
-	Cash dividend received	800,00	
-	Loss carried forward	560,00	1.360,00
Taxable profits			37.298,00
Tax payable (at 25%)			9.324,50
Less			
-	Taxes withheld	400,00	
-	Advanced payments	3.022,40	-3.422,40
Net tax payable			5.902,10

Notes:

1. Taxable income, nondeductible items and exempt income are considered in the calculation of ESP

Appendix IV
Withholding taxes

	2005
	%
Dividends and participations paid to:	
Ecuadorian companies	0
Resident individuals	0
Non-domiciled foreign companies and individuals	25
Non-dividend payments abroad:	
Royalties, other	25
Payments for technical (professional) services	25
Non-dividend local payments:	
Payments for professional services	8
Payments between companies	1
Payments to individuals for other services	1
Transportation	1
Acquisitions of chattels	1

Appendix V
Tax treaties

Treaties in effect

Country	Date of treaty or amendments thereto	Applicable since
Belgium	December 18, 1996	April 13, 2004
Brazil	February 2, 1988	December 16, 1982
Canada	October 24, 2001	December 31, 2001
Chile	August 26, 1999	March 16, 2004
France	November 28, 1991	March 25, 1993
Germany	May 5, 1993	December 7, 1982
Italy	March 30, 1990	January 31, 1990
Mexico	December 13, 2000	March 3, 2001
Romania	September 30, 1995	January 22, 1996
Spain	August 3, 1993	April19, 1992
Switzerland	September 25, 1995	December 22, 1995
Andean Community countries: "Decision 578"	May 4, 2004	November 9, 2004

Note 1: Bolivia, Colombia, Ecuador, Peru, Venezuela

Appendix VI
Individual tax rates

2006

Taxable Income

Base	Over Base	Tax on Base	Tax on Over Base
-	7,680	-	0%
7,680	15,360	-	5%
15,360	30,720	384	10%
30,720	46,080	1,920	15%
46,080	61,440	4,224	20%
61,440	and over	6,965	25%

Appendix VII
Personal allowances

Annual personal allowances are nontaxable up to US$7,680. Individuals file their income tax returns based on a tax chart and their tax bracket starts at US$7,680.

Appendix VIII
Individual tax calculation

	2006
	US$
Income	
Salary (note 1)	12.101,80
Lease	3.784,03
Others	4.194,50
Total income	**20.080,33**
Deductibles	
Total deductibles	0,00
Taxable base	**20.080,33**
Base	15.360,00
Tax on Base (Note 2)	384,00
Excess over Base	4.720,33
Tax on Over Base (Note 2)	472,03
Income tax 2006	856,03
(-) IT advances	0,00
(-) Tax withholdings	0,00
Total tax balance in favor	0,00
Total tax payable	856,03
Interest on amounts overdue	0,00
Fines	0,00
Total payable	856,03

Notes:

1. Total salary less social security contributions
2. From the table in Appendix VI

Appendix IX
Tax on foreign nationals working in Ecuador

2006

Foreign national resident and employed in Ecuador are taxed on total compensation, including allowances and the value of fringe benefits. Social security contributions are the only deductions allowed against income arising from employment. There are no personal allowances for dependents or other reasons.

Assumptions

1. Taxpayer has resident status, and income consists solely of Ecuadorian-source employment compensation.
2. Taxpayer owns no assets in Ecuador
3. Dollars of the Unites States of America are used for all calculations.
4. A deduction of social security contributions of 9.35% of total employment income has been taken.

Income Tax

	US$
Total Compensation	**Income tax**
20.000,00	848
25.000,00	1,348
30.000,00	1,848
35.000,00	2,562
40.000,00	3,312
45.000,00	4,062
50.000,00	5,008
55.000,00	6,008
60.000,00	7,008
70.000,00	9,105
80.000,00	11,605
90.000,00	14,105
100.000,00	16,605
120.000,00	21,605

Appendix X
Social security contributions and benefits

Contributions

Social security contributions are as follows. There is no maximum salary for deductions

	%
Employee’s share withheld at source	9.35
Employer’s share	12.15
Independent professionals	17.50

Benefits

	Minimum periods of contributions	**Percentage**
Pensions (Note 1):		
Old age, male	10 years	75
Old age, female	10 years	100
Disability	5 years	75
Survivors (Note 2):		
Spouse (Note 3)		40
Child under 18		20
Sickness (Note 4)	6 months	100
Maternity (Note 4)	1 year	100

Notes:

1. Percentage of remuneration.
2. Percentage of pension.
3. Payable upon death of beneficiary.
4. Percentage of expenses.

Appendix XI
Value-added tax

VAT is incurred upon transfer of ownership, rendering of service or the subscription of contracts that have as their purpose transfer of ownership or the rendering of services. VAT is imposed at a flat rate of 12 percent on all goods, imported or produced locally, and on all services. Certain goods and services are taxed at a rate of 0%.

- Most agricultural goods and foodstuffs when these remain in their natural state. Refrigeration or packaging of goods without further processing does not alter their natural state. Also included in this category are milk, meats, sugar, salt, bread, butter and margarine, flour, and cooking oil.
- Drugs, medicines and other pharmaceutical products, including raw materials for their manufacturing.
- Fertilizers, insecticides, animal foods, and similar products, including the raw materials required for processing such goods.
- Agricultural machinery and equipment.
- Goods that are exported.
- Paper, books, magazines and newspapers.

Appendix XII
Other indirect taxes

Special consumption tax

This tax is applicable to the production of specific goods. The following tax rates apply.

	%
Cigarettes (blond tobacco)	98.00
Cigarettes (black tobacco)	18.54
Beer	30.90
Sodas	10.30
Liquors (except beer)	32.00
Telecommunications	15.00
Motorized vehicles for land transport of cargo of up to 3.5 tons of payload	5.15
Airplanes, Helicopters, Boats	10.30

Municipal taxes

Municipal asset tax

The municipal asset tax (MAT) is levied on the net assets of a company as shown in the financial statements submitted to the Superintendence of Companies or of Banks. The rate is 1.5 per thousand (or 0.15 percent), and the tax is payable to the appropriate municipality(ies).

Real estate tax

The city government assesses the municipal property tax, which ranges between 0.25 per thousand and 5 per thousand of the commercial value of the property as determined by valuation carried out every five years by the city government, for both urban and rural properties (rural property is taxed at a maximum of 3 per thousand). In addition, municipalities tax capital gains resulting from the sale of urban real estate.

Transfer taxes

1. The *alcabala* tax relates mainly to the transfer through the sale of real estate and ships. It is levied at a 1% on the taxable base which is essentially contractual price; assessments may be used if so determined by the authorities.

2. The *plusvalía* tax applies to the transfer of real estate. It is 10% of profits, except in the case of first transfer after September 2004, in which case the rate is half percent.

Tax on commerce and industry

Each Municipal Council establishes municipal fees *(patentes municipales)* payable by entities engaged in commerce and industry, and it must be paid yearly. The amount is determined by rather complex formulas that vary from one municipality to the other. The criteria used to regulate this tax is based on the total value of the capital or of the assets used in the commercial activity.

Contributions to the Superintendences

Corporations and financial institutions must contribute to the Superintendence of Companies and the Superintendence of Banks, respectively, an amount determined by tables issued annually. The maximum contribution in any case is 0.01% of total assets.

Automobile registration tax

An annual tax is levied on the proprietorship of all vehicles for land transportation Each year, upon registration of motor vehicles, a tax is levied on the commercial value of the vehicle as determined by the Ministry of Finance. Current rates for this tax range between 0.5% and 4% of said commercial value, as shown below.

From US$	To US$	Tax on Base	Tax on Over Base
0	4,000	0	0.5%
4,000	8,000	20	1.0%
8,000	12,000	60	2.0%
12,000	16,000	140	3.0%
16,000 and over		260	4.0%

Appendix XIII
Financial statements

Compañia ABC S.A.

Balance sheets
December 31, 2XX2 and 2XX1
(Expressed in US dollars)

	Reference to Notes	2XX2	2XX1
Assets			
Current assets:			
Cash		XX	XX
Accounts receivable		XX	XX
Inventories		XX	XX
Prepaid expenses		XX	XX
Total current assets		XX	XX
Long-term receivables		XX	XX
Property, plant and equipment , net		XX	XX
		XX	XX
Liabilities and shareholders' equity			
Current liabilities:			
Notes and accounts payable		XX	XX
Cash dividends		XX	XX
Related parties		XX	XX
Accrued liabilities		XX	XX
Accrued taxes		XX	XX
Total current liabilities		XX	XX
Long-term liabilities:			
Bank indebtedness		XX	XX
Accrued retirement benefits		XX	XX
Total liabilities		XX	XX
Shareholders' equity (as per accompanying statements)		XX	XX
		XX	XX

The accompanying notes are an integral part of these financial statements.

Compañia ABC S.A.

Statements of income

Years ended December 31, 2XX2 and 2XX1
(Expressed in US dollars)

	Reference to Notes	2XX2	2XX1
Net sales		XX	XX
Cost of sales		XX	XX
Gross profit		XX	XX
Operating expenses:			
Administrative		XX	XX
Selling		XX	XX
Financial		XX	XX
Other		XX	XX
		XX	XX
Operating income		XX	XX
Other income		XX	XX
Other expenses		(XX)	(XX)
Income before employees' statutory profit sharing and income tax		XX	XX
Employee's statutory profit sharing		(XX)	(XX)
Income tax		(XX)	(XX)
Net income for the year		XX	XX

The accompanying notes are an integral part of these financial statements.

Compañia ABC S.A.

Statements of changes in equity

Years ended December 31, 2XX2 and 2XX1
(Expressed in US dollars)

	Reference to Notes	Capital	Legal reserve	Capital reserve	Retained earnings	Total
Opening balances at January 1, 2XX1		XX	XX	XX	XX	XX
Capitalization of retained earnings resolved at the shareholders' meeting held on April .., 2XX2		XX	-	-	(XX)	XX
Appropriation of earnings to the legal reserve		-	XX	-	(XX)	-
Net profit for the year		-	-	-	XX	XX
Balances as of December 31, 2XX1		XX	XX	XX	XX	XX
Appropriation of earnings to the legal reserve		-	XX	-	(XX)	-
Net loss for the year		-	-	-	(XX)	-
Balances as of December 31, 2XX2		XX	XX	XX	XX	XX

The accompanying notes are an integral part of these financial statements.

Compañia ABC S.A.

Statements of cash flows

Years ended December 31, 2XX2 and 2XX1
(Expressed in US dollars)

	Reference to Notes	2XX2	2XX1
Cash flows from operations:			
Net (loss) profit for the year		(XX)	XX
Add (deduct) charges (credits) to income not representing cash movements:			
Depreciation		XX	XX
Provision for doubtful accounts		XX	XX
Provision for retirement benefits		XX	XX
Provision for inventory obsolescence		XX	XX
		XX	XX
Changes in current assets and liabilities:			
Accounts receivable		(XX)	(XX)
Inventories		(XX)	(XX)
Prepaid expenses		XX	XX
Notes and accounts payable		XX	XX
Related parties		XX	XX
Accrued liabilities		XX	XX
Accrued taxes		XX	XX
Net cash provided by operations		XX	XX
Cash flows from investing activities:			
Acquisition of property, plant and equipment		(XX)	(XX)
Increase in temporary investments		(XX)	(XX)
Net cash used in investing activities		(XX)	(XX)
Cash flows from financing activities			
Increase in bank indebtedness		XX	XX
Payment of cash dividends		(XX)	(XX)
Net cash provided by financing activities		XX	XX
Net decrease in cash		(XX)	(XX)
Cash at beginning of year		XX	XX
Cash at end of year		XX	XX

The accompanying notes are an integral part of the financial statements.

Appendix XIV
Setting up in Ecuador - A Checklist

The checklist below indicates points that investors and their advisers should consider when setting up a business operation in Ecuador.

I Investor's considerations

Market - Existing and potential

- Existing market for products/services.
- Potential market for products or services.
- Competition.
- Market surveys.
- Patents, trademarks and copyrights.

Preparation of business plan

- Determination of overall strategy.
- Assistance from professional advisers.

Form of entity to use

- Corporation.
- Branch.
- Limited liability company.
- General partnership.
- Foreign investment corporation (holding company).
- nitial capital requirements
- Importation of capital.
- Possibility of raising capital from local sources.
- Regulations on repatriation of capital and earnings.

Capital structure

- Availability of financing - local or foreign source.
- Repatriation of interest and principal of foreign-source loans.
- Bank borrowings.
- Injection of cash from parent company.
- Lease and/or purchase of assets.
- Tax implications.
- Obtaining professional advice from bankers, attorneys and accountants.

Location

- Choice of region, province or city.
- Accessibility to transportation facilities.
- Availability of development areas/enterprises—Maquila/free-trade zones.
- Tax implications.

Premises

- Type needed.
- Owned or leased.
- Current requirements.
- Expansion possibilities.
- Storage.
- Insurance requirements.
- Health and safety requirements.
- Planning restrictions.
- Approvals required.
- Tax implications.

Management - Availability and compensation

- Skills required.
- Compensation levels.
- Possibility of bringing staff from outside.
- Limitations on expatriate staff—Number and compensation.
- Visa requirements.

Labor - Availability and compensation

- Number and types needed.
- Project costs.
- Terms of employment.
- Work permits, visas for expatriates.
- Recruitment.
- Withholdings from salaries and wages.
- Employee benefit plans - Pensions, medical aid.
- Training courses.
- Payroll taxes and social security costs.
- Unions.

Production capabilities and costs

- Capacity - Current and projected.
- Capital commitments - Initial and projected.
- Raw materials - Sources and availability.
- Import restrictions.
- Adaptation of equipment/machinery to local conditions.
- Adaptation of production process to local conditions.
- Projected costs - Overall and unit.

Selling the product

- Projected costs - Salary levels.
- Promotion methods.
- Advertising methods.
- Marketing campaigns.
- Sales force.
- Exhibitions and trade shows.
- Exporting process.
- Value-added and/or excise tax requirements.
- Tax implications.

Incorporation procedures

- Appointment of professional advisers, such as attorneys, bankers, auditors, tax advisers.
- Registration of name.
- Ordering of stationery.
- Secretarial and administrative services.

II Legal counsel's considerations

- Documentation/registration requirements for type of entity selected.
- Approvals and renewals required.
- Permits and licenses required.
- Conduct of the entity.
- Models of business contracts.
- Labor contracts.
- Property evaluation and documentation.
- Business, banking and industrial regulations.

III Accountant's considerations

- Evaluation of industry.
- Tax planning.
- Management control systems (e.g., financial management systems, employee records, inventory control).
- Bookkeeping requirements.
- Financial statements preparation.
- Projections.
- Financing requirements.
- Management consulting.
- Requirements for tax purposes.

Appendix XV
Structuring an investment - A Checklist

The checklist below indicates points that an investor and advisers should consider in selecting the form of business entity through which to operate.

I Corporation

Investor's considerations

- Rules for foreign stockholders.
- Number of founder stockholders required and voting limitations.
- Advantages/disadvantages of incorporating.
- Availability of local funding, including equity issues.
- Degree to which capital must be imported.
- Extent of powers given to the board of directors.

Legal counsel's considerations

- Incorporation requirements.
- Registration requirements.
- Documentation.

Accountant's considerations

- Tax advantages of incorporating.
- Tax planning opportunities to minimize tax.

II Branch

Investor's considerations

- Impossibility of partial disinvestment by future sale of shares to local investors.
- Advantages/disadvantages of operating as a branch.
- Capital requirements.
- Repatriation of capital and profits.

Legal counsel's considerations

- Domiciliation requirements.
- Capital to be assigned to the branch for legal purposes.
- Registration requirements.

Accountant's considerations

- Taxation of a branch.
- Taxation of repatriated profits.
- Taxation of reinvested profits.
- Tax planning opportunities to minimize tax.

III Company *(compañía limitada)*

Investor's considerations

- Rules for foreign shareholders.
- Requirements of legal representation for partners.
- Advantages and disadvantages of operating as a *limitada.*

Legal counsel's considerations

- Incorporation requirements.
- Registration requirements.
- Residence and representation of shareholders.

Accountant's considerations

- Taxed as a corporation.
- Tax planning opportunities to minimize tax.

Appendix XVI
Acquiring a business enterprise - A Checklist

The checklist below indicates points that an investor and advisers should consider when contemplating the acquisition of a business enterprise in Ecuador.

I Investor's considerations

History and current status of the enterprise

- When, where and by whom established.
- Nature of what is offered for sale.
  - Entire business.
  - Controlling interest, with possible minority ownership problems.
- Kind of organization - company, proprietorship, partnership.
- Reason business is for sale.
- Evaluation of industry in which the company operates.
  - Growth potential.
  - Stability.
  - Special characteristics.
- Status of target business within its industry.
- Reputation.
- Competitive position.
- Profitability.
- Recent changes of significance.
- Regulation by government.
- History of growth, including new products.
- General nature of current operations and principal products.
- Assessment of company's overall strategy and extent to which it sets strategic objectives and monitors its performance against them.
- Corporate strategies and the extent to which these are integrated into company's overall strategy.
- Degree to which business is dependent on a few suppliers, a few clients, the government.

Capital structure

- Business ownership.
  - Closely held.
  - Many shareholders.
- Major shareholders’ involvement in business management.

Organization

- Need to restructure business.
- Best form of organization.
- Retention of present business name and reputation, employees, stock listing, etc.

Marketing and competitors

- Special trade arrangements.
- Markets and competitors.
- Markets served.
- Potential new markets and respective market shares.
- Declining-market considerations.
- Proposed new products/services.
- Life cycle and life expectancy of products/services.
- Proposed expansion.
- Principal competitors’ strengths/weaknesses.
- Effects on company’s markets of any relevant legislation, current or pending.

Capital requirements

- Purchase costs.

Location and premises

- Regional considerations.
- Accessibility to road, rail, air, or sea transport facilities.
- Planning restrictions or approvals required for developing present site.
- Main premises owned or leased.
- Space available for expansion.
- Details of any professional valuation of premises.

Management evaluation

- Management organizational chart.
- Resumes of key employees.
- Present salaries and other forms of remuneration.
- Continued employment.
- Consulting assistance.

Production evaluation

- Estimated production capacity.
- Scope for utilizing spare capacity or for increasing capacity.
- Condition of plant and equipment, including buildings.
- Nature and amount of work subcontracted.
- Details of patents and trademarks.
- Raw materials used and principal suppliers.
- Terms and conditions of purchases.
- Any significant forward purchase commitments.
- Supply position for raw materials - Past difficulties in supply by either regular vendors or alternative sources.
- Impact of technology on existing processes.
- Control of prices/materials by government departments or under trade association agreements.

Work force evaluation

- Number of employees and staff at the plant and office.
- Labor relations between management and unions.
- Present salaries.
- Holiday/vacation pay arrangements.
- Fringe benefits provided and costs thereof.
- Impact of technology on employees' future requirements.

Sales and marketing evaluation

- Sales.
  - By product.
  - By major customers.
  - By geographical market.
  - By contribution margin.
- Export methods and distribution.
- Nature and length of relationship between company and its selling agents.
- Particulars of any major contracts unfulfilled
- Likely impact of sale of business on client relationships.
- Extent to which company is involved in fixed-price and/or long-term contracts.

II Legal counsel's considerations

Corporate, statutory and regulatory documents

- Corporate documents.
- Articles of incorporation - Possibility of special restrictions on sale.
- Bylaws, contract deed.
- Certified books - Shares, journal, inventory.
- Minute book - Board and stockholders' regular and extraordinary meetings.
- Shareholder's agreements.
- Regulatory documents.
- Annual reports of the board to shareholders.
- Shareholder's approval requirements.
- Statutory auditors' report to shareholders.
- Reports to Superintendence of Companies.

Contractual obligations, other than with management or labor

- Loan agreements/guarantees.
- Government and/or long-term contracts.
- Leases.
- Licenses.
- Franchises.
- Mortgages.
- Insurance policies.
- Assignability of contractual obligations.

Management/labor obligations

- History.
- Present contract obligations.
- Prospects.
- Changes in labor picture stemming from business acquisition.
- Employee benefit plans, such as participation in profits.
- Advisability of adoption of benefit plans after acquisition (particularly if buyer has such plans in force).
    - If seller has such plans in force, effect of termination on retained employees.
    - Effect of retention on buyer.
- Employee agreements.
    - Possibility, desirability of canceling existing agreements.
    - Need for new agreements with key employees.

Property titles and liens

- Real property.
  - List and description.
  - Evaluation.
  - Title documents.
  - Surveys.
- Insurance policies.
- Tangible property.
  - List by category.
  - Valuation.
- Intangible property - List by category, useful life (e.g., patents, trademarks).
- Existing liens.
- Pending legislation.

Other

- "Doing business" requirements/qualifications.
- Regulatory agency consent for acquisition of public utilities, banks, insurance companies, etc.
- Desirability of noncompete agreements.
  - With seller's shareholders.
  - With others.

III Accountant's considerations

Past operating results

Accounting policies

- Compliance with local accounting standards and consistency of application.

Financial statements and related accounts

- Balance sheet.
  - Accounts receivable (adequacy of bad debt reserve; average period outstanding).
  - Inventory (turnover; basis of valuations; handling of slow-moving, obsolete inventory).
  - Tangible assets (real estate, buildings and equipment—cost versus appraisal and market values; taxes; depreciation rates and methods; replacement policies).
  - Intangible assets; patents, trademarks, designs.
  - Basis for writing off capital costs; technology cost policy.
  - Goodwill (method of acquisition; cost; amounts written off; current value).
  - Investments (securities; relationship and transactions with investors; restrictions on realization).
  - Short- and medium-term liabilities (amounts; payment dates; currencies; interest rates; security; conversion options).
  - Long-term liabilities (amounts; repayment dates; currencies; interest rates; security; conversion options; availability of further financing, refinancing; leasing agreements; guarantees).
  - Contingent liabilities (discounted bills; litigation pending; capital commitments; significant post-balance-sheet orders; insured values; capitalization basis for labor and materials; company car arrangements; repayment of grants upon change of ownership).
- Income statement.
  - Gross profit ratio.
  - Comparison with other companies.
  - Operating profit ratio.
  - Expense account items.
  - Nonrecurring income and expenses.
  - Executive salaries and bonuses.
  - Fluctuations in income or expense items.
  - Change in under- or overabsorbed overhead.
  - Operating income.
  - Sales.
  - Trends.
  - Order backlog.
  - Long-term contracts.
  - Other income (rentals; trade and other investments; royalties; management and technical fees; service fees).
  - Cost of sales.
  - Overhead costs.
  - Quality of management accounting and costing procedures.
  - By-products.
  - Percentage margin on sales.
  - Profit spread on long-term contracts.
  - Interest and other loan costs.
  - General and administrative expenses.

- Statement of changes in financial position.
  - Profit and cash-flow forecasts; bases of assumptions.
  - Adequacy of working capital.
  - Relationship with bankers.
- Other.
  - Material purchase commitments.
  - Deferred pension plan costs; past service costs.
  - Liability for nonqualified pension agreements.
  - Expenses agreements.
  - Severance pay liability.
  - Pension liability.

Taxation

- Reasons for high or low rates.
- Adequacy of current provision for income taxes.
- Possible additional taxes for prior years.
- Particulars of important matters in dispute.
- Comments on adequacy of overall provision, estimated deficiency or surplus.
- Details of losses available for carryforward.
- Extent to which tax planning schemes have been used in the past, and assessment of any resulting exposure.

Appendix XVII
Major events - Past and upcoming

Past

On January 31st, 2002, at the Andean's Presidents Council, the five member countries (Colombia, Venezuela, Perú, Ecuador and Bolivia) agreed to establish a free trade zone, a CET and a customs harmonization policy by January 2004. A new CET agreement established a new unified tariff schedule coming to effect at the end of January 2006.

Ecuador expressed its interest in signing a Free Trade Agreement with the United States in October 2003. One month later the United States Government informed of its intentions of starting negotiations with the members of the Andean Customs Preference Act. Negotiations were formally started in Cartagena, Colombia, in May 2004 and negotiations have been held since that date. As a result of this process, most negotiation tables have been closed, those remaining open relate to intellectual property rights, agriculture and sanitary measures.

Transfer pricing regulations were introduced by Executive Decree No. 2430, published in the Supplement to Official Gazette No. 494 dated December 31st, 2004. These regulations follow the guidelines established by the Organization for Economic Cooperation and Development (OECD).

According to these, for tax purposes the principle of Arm's Length is defined as that in which, when two related parties impose or establish conditions in their financial and commercial transactions, that differ from those which would have been established with, or between, independent parties, the profit that would have been obtained by one of the parties had such conditions not existed but that due to their application were obtained, should be quantified and registered. The enacted reforms include various methods of determining Arm's Length: Comparable Uncontrolled Price (CUP), Resale Price, Cost Plus, Profit Split, Residual Profit Split and Transactional Net Margin Method (TNMM).

The Tax Code *(Código Tributario)*, which contains general principles of taxation and establishes the ground rules for relations between the tax authorities and taxpayers, and which has been amended throughout the years, was codified on June 14, 2005. Also, the Internal Tax Regime Law (ITRL) of January 1, 1990, and also amended throughout the years, was codified on November 17, 2004.

In November 2005 Congress issued the Tax Incentives Law applicable to specific industries: hydroelectric and alternative-source generation, refining and industrialization of hydrocarbons, high tech electronics, distribution centers for air traffic and cargo, deep water harbors, production of agro industrial machinery and production of fuels from natural resources (ethanol). Incentives are granted for 10 years for the Provinces of Pichincha and Guayas and for 12 years for the rest of the country. For more detailed information, see Taxation Policy in Chapter 3.

Upcoming

Legislation regulating sole proprietorship of businesses with limited liability is expected to be enacted by Congress during the initial months of 2006. These regulations will establish the requirements to be fulfilled by individuals interested in setting up a limited-liability one-person enterprise in terms of purpose, duration, capital requirements, incorporation procedures, administration, legal representation, etc.

The next general and presidential elections are scheduled for October 2006 and the next president will take office in January 2007.

Appendix XVIII
Business information services

Government agencies

Central Bank of Ecuador *(Banco Central del Ecuador)*
Amazonas 34409 y Atahualpa
Quito
Telephone: (2) 2252-214/2252-329

State Bank *(Banco del Estado)*
Avs. Atahualpa Oe1-109 y Juan Bayas
Casilla 17-01-00373
Quito
Telephone: (2) 2260-720/2260-723

Ministry of Labor and Human Resources
(Ministerio de Trabajo y Recursos Humanos)
Clemente Ponce N15-59 y Pedrahita
Quito
Telephone: (2) 254-9849

National Council for Development
(Consejo Nacional de Desarrollo - CONADE)
Ed. Chimborazo Calle
Benalcazar y Espejo
Quito
Telephone: (2) 2286-696/2286-709

Integration Subsecretariat
(Subsecretaría de Integración)
Telephone: (2) 566-743

Ministry of Finance and Economy
(Ministerio de Finanzas y Economía)
Av. 10 de Agosto 1165 y J. Washington
Quito
Telephone: (2) 2503-853/2503-846

Ministry of Foreign Commerce, Industry and Fishing
(Ministerio de Comercio Exterios, Industrias y Pesca)
Av. Eloy Alfaro y Amazonas Esquina
Quito
Telephone: (2) 2527-887

National Directorate of Industrial Property
(Dirección Nacional de Propiedad Intelectual)
Av. República 396 y Almagro
Ed. Forum 300 PB
Telephone: (2) 508000

Chambers of Industry and commerce

Ecuadorian American Chamber of Commerce
(Cámara de Comercio Ecuatoriano-Americana)
Av. 6 de Diciembre y La Niña
Edificio Multicentro, Piso 4
Casilla 17-07-8823
Quito
Telephone: (2) 2507-450
Telecopier: (2) 250-7453

Ecuadorian-Brazilian Chamber of Commerce
(Cámara de Comercio Ecuatoriano-Brasilera)
Avs. Amazonas y Orellana
Edificio Torrealba, Oficina 207
Quito
Telephone: (2) 540-854
Telecopier: (2) 564-301

Ecuadorian-British Chamber of Industries and Commerce
(Cámara de Industrias y Comercio Ecuatoriano-Británica)
Av. Calle el tiempo 509 y el telégrafo
Quito
Telephone: (2) 2449-139

Ecuadorian-Chilean Chamber of Commerce
(Cámara de Comercio Ecuatoriano-Chilena)
Av. 6 de Diciembre y la Niña
Quito
Telephone: (2) 2232-449

Ecuadorian-German Chamber of Industries and Commerce
(Cámara de Industrias y Comercio Ecuatoriano-Alemana)
Av. Eloy Alfaro 2921 y Portugal,
Edificio Milenium Plaza, Piso 3
Quito
Telephone: (2) 3332048

French-Ecuadorian Chamber of Commerce and Industries
(Cámara de Comercio e Industrias Franco-Ecuatoriana)
Rusia 137 y Eloy Alfaro Ed. Horus
planta baja.
Quito
Telephone: (2) 2445-965

Pichincha Chamber of Industrialists
(Cámara de Industriales de Pichincha)
Av. Amazonas y República
Edificio Las Cámaras, Pisos 10-11
Apartado 2438
Quito
Telephone: (2) 2445-200
Telecopier: (2) 448-118

Quito Chamber of Commerce
Cámara de Comercio de Quito)
Avs. Amazonas y De la República
Edificio Las Cámaras, Pisos 5-6
Quito
Telephone: (2) 2449-787
Telecopier: (2) 243-5862
Telex: 22638 CCOQUI ED

Spanish Chamber of Commerce
(Cámara Oficial Española de Comercio e Industria)
Avs. Amazonas 3123 y Azuay Ed. Copladi , piso 2
Quito
Telephone: (2) 2446-833

Commercial offices

Colombia
Robles 709
Quito
Telephone: (2) 564-907

Korea, Republic of
Av. Amazonas 477 y Robles
Edificio Banco de Los Andes, Oficina 320
Quito
Telephone: (2) 525-449
Telecopier: (2) 500-975

Peru
J. Washington 718
Quito
Telephone: (2) 541-625/626

Taiwan
Av. República de El Salvador y Portugal
Quito
Telephone: (2) 459-357

Embassies

Belgium
Mansión Blanca Paris y Rep del Salvador 1082
Quito
Telephone: (2) 2270-340
Telecopier: (2) 250-9765

France
General Plaza 107 y Patria
Quito
Telephone: (2) 2560-789

Germany
Rep. Del Salvador y NNUU Ctio Citiplaza
Casilla 17-01-537
Telephone: 2970-821
Telecopier: (2) 297-0822
Telex: 22222 AAQTO ED

Italy
La isla 111 y Humberto Albornoz
Quito
Telephone: (2) 2561-077

Switzerland
Av.Amazonas 3617 y Juan Pablo Sanz
Edificio XEROX, Piso 2
Casilla 17-11-4815 CCI
Quito
Telephone: (2) 243-4948
Telecopier: (2) 244-9314

United Kingdom
Av. NNUU y Rep del Salvador
Quito
Telephone: (2) 2970-800/297-0801
Telex: 22138 PRODQT ED

United States
Av. 12 de Octubre y Patria
Quito
Telephone: (2) 2562-890

International organizations

Interamerican Development Bank
(Banco Interamericano de Desarrollo - BID)
Av. 12 de Octubre N24-528 y Luis Cordero
Edf. World Trade Center Torre B Piso 9
Telephone: (2) 256-3453/ 223-2324

Organization of American States
Gonzalez Suarez y Coruña
Ed. Canciller 1 Penthoues
2555353
Quito
Telephone: (2) 554-548

Preinvestment Organization of Latin America and the Caribbean
(Organización de Preinversión de América Latina y el Caribe - OPALC)
Av. República de El Salvador 525 y Irlanda
Casilla 4646-A
Quito
Telephone: (2) 435-125/437-801
Telecopier: (2) 402-362

United Nations
Ed. Amazonas Jardin Av. Amazonas 2589
Telephone: (2) 246-0332
Telefax: (2) 246-0328

United States Agency for International Development (USAID)
Av. Colombia 1573 y Queseras del Medio
Quito
Telephone: (2) 2232-102

World Trade Center
Av. 12 de Octubre 1830 y Cordero
Quito
Telephone: (2) 222-9226/222-9227
Telefax: (2) 222-9234

Appendix XIX
Reading list

PricewaterhouseCoopers publications

Corporate Taxes: A Worldwide Summary. New York. 2004 edition. (Revised annually.)

Individual Taxes: A Worldwide Summary. New York. 2004 edition. (Revised annually.)

2005 Global Annual Review, Perspectives on Value.

Ecuadorean laws and regulations

Agricultural development Law *(Ley de Desarrollo Agrario, codificación)*, published in the Official Registry, Supplement, 315 of April 16, 2004.

Banking Law, codified *(Ley General de Instituciones del Sistema Financiero, codificación)*, published in the Official Registry 250 of January 23, 2001.

Commerce Code, as amended, *(Código de Comercio)*, published in the Official Registry, Supplement 1202 of August 20, 1960.

Company Law *(Ley de Compañías)*, published in the Official Registry 312 of November 5, 1999.

Consumer Protection Law *(Ley Orgánica de Defensa del Consumidor)*, Law 21, published in the Official Registry, Supplement 116 of July 10, 2000.

Customs Law, codified *(Ley de Zonas Francas, codificación)*, published in the Official Registry, Supplement 219 of November 26, 2003.

Decision 291 of the Andean Community, March 21, 1991.

Decision 535 of the Andean Community, October 14, 2002.

Decision 578 of the Andean Community, May 4, 2004.

Electronic System for Obtaining Import Licenses *(Sistema Electrónico de Otorgamiento de Licencias de Importación)*, COMEXI Resolution 183, published in the Official Registry, Supplement 6 of May 5, 2003.

Environmental Law *(Ley de Gestión Ambiental)*, Law 37, published in the Official Registry 245 of July 30, 1999.

Fisheries Law, as amended *(Ley de Pesca y Desarrollo Pesquero)*, published in the Official Registry 497 of February 19, 1974.

Foreign Investment Code, *(Ley de Comercio Exterior e Inversiones)*, Law 12, published in the Official Registry, Supplement 82 of June 9, 1997.

Free Zones Law, codified *(Ley de Zonas Francas, codificación)*, published in the Official Registry 562 of april 11, 2005.

Hydrocarbons Law (*Ley de Hidrocarburos)*, published in the Official Registry 711 of November 15, 1978.

Intelectual Property Law *(Ley de Propiedad Intelectual)*, Law 83, published in the Official Registry 320 of May 19, 1998.

Internal Tax Regime Law, as amended and codified *(Ley de Régimen Tributario Interno, Codificación)*, published in the Official Registry, Supplement 463 of November 17, 2004.

Investment Promotion and Guarantee Law *(Ley de Promoción y Garantía de las Inversiones)*, Law 46, published in the Official Registry 219 of December 19, 1997.

Labor Code, as amended, *(Código del Trabajo)*, published in the Official Registry 162 of September 29, 1997.

Law for the Transformation of the Economy *(Ley para la Transformación Económica Del Ecuador)* Law 4, published in the Official Registry, Supplement 34 of March 13, 2000.

Maquila Law *(Ley de Régimen de Maquila y Contratación Laboral a Tiempo Parcial)*, Law 90, published in the Official Registry, Supplement 493 of August 3, 1990.

Mining Law, as amended *(Ley de Minería)*, Law 126, published in the Official Registry, Supplement 695 of May 31, 1991.

Modernization Law *(Ley de Modernización del Estado)*, Law 50, published in the Official Registry 349 of December 31, 1993.

Municipalities Law, codified *(Ley Orgánica de Régimen Municipal, codificación)*, published in the Official Registry, Supplement 159 of December 5, 2005.

Procedures for Obtaining Import Licenses *(Normativa que Regula el Procedimiento de Licencias de Importación)*, COMEXI Resolution 183, published in the Official Registry, Supplement 6 of May 5, 2003.

Regulations to the Internal Tax Regime Law *(Reglamento a la Ley de Régimen Tributario Interno)*, Executive Decree 2209, published in the Official Registry, Supplement 484 of December 31, 2001.

Security Market Law *(Ley de Mercado de Valores)*, Law 107, published in the Official Registry 367 of July 23, 1998.

Social Security Law, as amended (Ley de Seguridad Social), Law 55, published in the Official Registry, Supplement 465 of November 30, 2001.

Tax Benefits Law, *(Ley de Beneficios Tributarios)*, Law 20, published in the Official Registry 148 of November 18, 2005.

Tax Code, codified *(Código Tributario, codificación)*, published in the Official Registry, Supplement 38 of June 14, 2005.

Tourism Law *(Ley de Turismo)*, Law 97, published in the Official Registry, Supplement 733 of December 27, 2002.

Other publications

Central Bank Annual Bulletin *(Boletín Anuario/Banco Central)*. Central Bank.

Central Bank Monthly Statistical Bulletin *(Información Estadística Mensual/ Banco Central)*. Central Bank.

Labor Reports *(Informes Laborales)*. Ministry of Labor.

Web sites

Central Bank of Ecuador
www.bce.fin.ec

Foreign Trade and Investment Council
www.comexi.gov.ec

National Modernization Council
www.conam.gov.ec

Ecuadorian Investment and Export Promotion Corporation
www.corpei.org

National Statistics and Censuses Institute
www.inec.gov.ec

Ministry of Foreign Commerce, Industry, Fisheries and Competitivity
www.micip.gov.ec

Ministry of Finance
www.minfinanzas.ec-gov.net

Ministry of the Environment
www.ambiente.gov.ec

Internal Revenue Service
www.sri.gov.ec

Superintendence of Banks
www.superban.gov.ec

Free Trade Agreement with the United States, Official Website
www.tlc.gov.ec

Quito Chamber of Commerce
www.ccq.org.ec

Guayaquil Chamber of Commerce
http://www.lacamara.org

Ecuadorian Exporters Federation
http://www.ecuador.fedexpor.com

Andean Community
http://www.comunidadandina.org

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