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content

page	04	introduction
page	06	corporate law
page	10	labour law
page	15	tax law
page	21	foreign investment
page	25	real state

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Firm'S Profile & Description: Gallegos, Valarezo & Neira

Offers a wide range of legal services to commercial enterprises and businesses. The firm's commitment is to provide efficient and effective after-the-fact legal solutions, as well as preventive legal counsel. Starting with a relatively small practice the firm has grown and earned prestige and recognition in Ecuador and abroad. It serves a broad base of local and foreign clients with legal, accounting and tax planning services. The firm encourages participation in continuing legal-business education seminars, professional association activities and civic affairs.

Gallegos, Valarezo & Neira has participated as legal counsel in important transactions and projects in Ecuador, representing local and foreign clients, covering, among others, Corporate Deals, Mergers & Acquisitions, transactions in the Finance and Banking sectors, as well as important Trusts, Tax Law & Planning, Intellectual Property, Environmental and Telecommunications projects.

Gallegos, Valarezo & Neira firmly believes that an efficient service requires well-trained legal professionals. To this end, its members are permanently involved in legal-business educational programs, seminars, post-graduate studies, as well as training to allow our members to improve service and foreign language capabilities. The members of our boutique firm have specialized studies at prestigious institutions in Ecuador and abroad, including, Harvard Business School, Thunderbird, Yale, George Washington University, University of Salamanca, Alacel, and others.

The firm's offices are strategically located in a modern building in downtown Quito. The working areas of the firm encompass ample offices, board rooms, a library, archive area, trainee area, accounting department, reception area and administrative area. The offices display paintings from the firm's private art collection including works by both Ecuadorian and international modern artists.

Gallegos, Valarezo & Neira facilities contain a library as well as a legal archive, which is an invaluable work tool as they comprise many years of the Ecuadorian Legislation. The firm's local area network comprises state of the art computer equipment, dedicated Internet lines for rapid access and communication with clients, correspondent and involved parties.

Areas Of Expertise: Administrative law, Alternative Dispute Resolution, Banking and Financial Institutions, Bankruptcy, Business Law, Collections, Commercial Law, Company Law, Constitutional Law, Contracts, Copyrights, Corporate Law, Due Diligence (Legal and Accounting), Energy Law, Environmental Law, Franchising, General Practice, Government Contracts, Insurance, Intellectual Property, International Law & Trade, Immigration Law, Internet Law, Labor and Employment, Leases and Leasing, Litigation, Mergers, Acquisitions and

Divestitures, Offshore Structures, Patents, Privatization, Property Law, Real Estate Securities, Tax Law and Tax Planning, Telecommunication and Media Trade Secrets, Trademarks, Trusts, Unfair Competition and Utilities.

Representative Clients: Abro Industries (USA), Asociación de Empresas de Telecomunicaciones del Ecuador ASETEL (Ecuador), Belcorp (EBEL Cosmetics-Perú), CONECEL-Porta Celular (Ecuador), Corporación MARESA Holding S.A. (Ecuador), Dendrite (USA), Deutsche Bank AG (Germany), Diseños Urbanos S.A. Diursa (Spain), Ericsson Credit AB (Sweden), Etex Group (Belgium), Ecuador Bottling Company (Coca-Cola) (Ecuador), Exxon-Mobil (USA), Forests Absorbing Carbondioxide Emissions-Face (Netherlands), Galletera del Norte S.A. (Perú), Glencore AG (Switzerland); Hilton Hotels (USA), INTAS Phramaceuticals (India), ICARO Air (Ecuador), Internacional Rescue-Bridges (Switzerland), LM Ericsson Telefonaktienbolaget (publ) (Sweden), Organización Latinoamericana de Energía OLADE (Ecuador), Latin American Agribusiness Development Corp, LAAD (USA), Localiza Rent a Car (Brazil), Kawasaki Motor Corp (Japan), Nouvelle Frontiers (France), Pelikan Vertriebsgesellschaft GmbH & Co. KG (Germany), Premaman (Belgium), Repsol-YPF (Spain), Samsung Corporation (Korea), Sylvan Leaning Systems Corp. (USA), TBWA/Viteri (Ecuador), Telfinfor Advanced Telecom S.A. (Argentina), The Nature Conservancy (USA), Turavia Club S.A. (Spain).

Firm Size: 12 (total overhead 18)

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1 Dr. Juan Carlos Gallegos Happle is the managing partner and founder of Gallegos & Valarezo (now Gallegos, Valarezo & Neira). He is in charge of the corporate law area of the firm. He holds a law degree from Catholic Pontifical University of Quito and an MBA in International Business from THUNDERBIRD, the Garvin School of International Management. Ab. David Garcés Jaramillo is an Associate Attorney at Gallegos, Valarezo & Neira with extensive training and professional experience in corporate law. Among his extracurricular activities, he is a consultant at the United Nations and International Public Law Professor at San Francisco University of Quito's Law School.

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Regulations

Company Law (Official Gazette No. 389 dated 28 July 1977)

Financial Institutions Law (Official Gazette No. 686 dated 15 May 1987)

Stock Market Law (Law No 107, Official Gazette No. 367 dated 23 July 1998)

Types of Companies

There are five main types of commercial companies or corporations: partnership (en nombre colectivo), limited partnership (compañía comandita simple), limited partnership with shares (compañía comandita por acciones), limited-liability company (compañía de responsabilidad limitada), joint-stock company (compañía anónima), and companies with mixed capital (participation of the private and public sectors - economía mixta).

Register of Companies

The Company's Superintendence is the controlling entity of all the mercantile companies in Ecuador. Despite the control of the Superintendence, companies are fully registered and recorded before the Mercantile Registrar (a separate authority). There exists a different Mercantile Registrar in each canton, nevertheless in those jurisdictions where there is no such Mercantile Registrar, these records and registration procedures are conducted by the Property Registrar.

Liability of Shareholders

According to Ecuadorian corporate law, the case of limited-liability companies and joint-stock companies is the same as for their North American equivalents. Liability is limited up to the amount of shares of each shareholder has in the company. The corporate veil protects the shareholders from liability.

In partnerships there is no limitation of liability except for limited partners; each partner is liable without limit for the company's acts and obligations.

Share Capital (minimum and minimum paid in amount)

- ▶ Joint-stock companies: Minimum stated capital is USD 800. The minimum paid-in capital is 25% of the stated capital, and the balance must be paid in two years.

Limited-liability Company: Minimum stated capital is USD 400. The minimum paid-in capital is 50% of the stated capital, and the balance must be paid in one year.

Classes of shares (registered, bearer, preferred, ordinary)

According to Ecuadorian Law, there are two kinds of shares:

Ordinary shares, which allow the shareholder to exercise all company rights.

Preferred shares, which do not have voting rights but have economical rights (dividend distribution).

Corporate Governance

Corporations are usually governed by:

General shareholders meeting, this is the principal and most important governance entity of the corporations, with broad powers to decide over the company's destiny.

Board of directors or Directorate (not regulated by the law, but in the by-laws), which is a common governance entity in companies with a large shareholder structure and a must in financial institutions.

General Manager and President (legal representatives of the company, with authority as provided by law and in the by-laws of each company).

Shareholders meetings

There are two classes of shareholders meetings: ordinary and extraordinary.

Ordinary shareholders meetings must be held at least once a year, during the first quarter, in order to approve, among other items, the general manager's yearly report, the financial statements and the profit/loss distribution of the last fiscal year.

Decisions reserved to the Shareholders

Amending the by-laws

Increasing the share capital

Reducing the share capital

Assignment of interests (transfer of shares or participations)

Authority to bind the company - changing the company's legal representatives

Some acts such as selling corporate assets

Changing the corporate purpose.

Decision-making bodies

The principal corporate governance entity of the company is the general shareholders meeting. This is the only company board ruled by the Ecuadorian Company Law.

Directors are not regulated by the Company Law. Rather, they are regulated by the company by-laws or internal regulations (except for the Financial Institutions Law, which establishes that these types of legal entities must appoint a Board of Directors).

Joint-stock companies and limited-liability companies are normally run by legal representatives with the title General Manager and President.

Appointment of directors

The shareholders' meeting appoints the company's directors and legal representatives (General Manager and President).

Powers of directors

Directors are obligatory in financial institutions and common in companies with a significant number of shareholders. Generally the directors have the power to appoint the General Manager and the President of the company (most common titles for the company's representatives) and monitor their activities.

Minimum number of independent directors

Directors are not regulated by the Company Law. Directors are ruled by the by-laws or internal

company regulations. Therefore the minimum number of directors, and whether they must be independent, is established by the company statute. The Financial Institution Law provides that the board of directors of financial institutions shall have no fewer than five and no more than fifteen directors.

Term of appointment

There is no legal maximum term of appointment. The term of appointment is normally ruled by the company's by-laws.

Scope of directors' liabilities

The scope of directors' liability must be determined by the company's by-laws, except in the case of financial institutions where this issue is governed by the Financial Institutions Law.

Directors' fees

Directors' fees are not subject to special disclosure requirements or legal maximum fees. The directors' fees are established by the shareholders meeting or by the board of directors itself.

Annual accounts

According to Article 20 of the Ecuadorian Company Law, corporations are required to submit the following information to the Company Superintendence:

Annual Financial Statements.

General Manager's Report.

Internal Audit (by shareholders' representative) or Report (for joint-stock companies).

Company's General Information form.

Quoted companies

No special rules of corporate governance for public companies.



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In Ecuador the legal relationship between the employer and the worker is regulated by public law. The labor private agreement is affected by the provisions in favor of the worker.

Labor legislation is protective of the worker, whose rights cannot be waived. Therefore professional legal advice regarding labor structures to be implemented in any type of business is essential when investing in Ecuador.

Employment Contracts

There are several types of employment contracts.

In form there are two kinds of agreements, written and oral.

In duration there are two types, for a definite period or an indefinite period.

All oral contracts are considered to be for an indefinite period.

Other special classes of employment contracts are:

- ▶ Specific endeavor contract,
- ▶ Occasional works contract,
- ▶ Seasonal contract,
- ▶ Domestic services contract,
- ▶ Apprenticeship contract,
- ▶ Conditional employment contract.

In the first 90 days of the contractual relationship, all contracts are considered to be a conditional employment contract in which there is a probation period.

Cost of dismissal and wrongful dismissal

Article 188 of the Ecuadorian Labor Code establishes compensation for wrongful dismissal. The compensation for wrongful dismissal is related to the duration of the employment contract. If the worker has served for up to 3 years, the cost of the dismissal will be no less than 3 months' pay. If the worker has served more than 3 years, the cost of the dismissal will be equivalent to one month's pay for every year of services rendered.

A worker who has received during the last 24 months a monthly salary of USD 500 or more will be subject to a different calculation for compensations, according to the following scale: Up to 5 years' service, the employee will receive compensation equivalent to one month's salary; from 5 to 10 years' service, compensation equivalent to two months' salary; 10 to 15 years' service, compensation equivalent to three months' salary; and beyond 15 years' service, the equivalent of five months' salary.

Employment contracts for directors

According to Ecuadorian Labor Law there is a difference between the general administrators of a company (directors) and area managers. Directors who legally represent the company are governed by general agency provisions. The appointment is a special contract between the directors and the shareholders meeting (top authority) of the company. This is not an employment relationship but a duty regulated by good faith and civil law.

Area managers are considered employees and governed by labor laws.

Employee Representatives and Labor Unions

After the promulgation of the Ecuadorian Constitution in 1967, labor union representation was formally recognized following the principles of Agreement No. 87 of the International Labor Organization (ILO). Since then, these groups have become powerful organizations with political influence.

Labor union influence has made collective bargaining agreements more popular. In 1969 the Ecuadorian Labor Code was significantly reformed with respect to collective bargaining agreements. Thus individual labor contracts are controlled not only by law, but also by specific collective bargaining agreements.

When a union representation becomes binding

When a syndical or union organization meets the requirements established by law in order to be a legal entity which represents the workers' interests, the organization is able to negotiate collectively with the employer.

When a collective bargaining agreement is approved and signed by the employer and the union representation, the labor organization is the rightful representative of the workers inside and outside the company.

Rights and privileges of union representatives

Members of the labor union board enjoy legal protection. They cannot be fired during their term in office.

The leaders of a labor union enjoy some privileges such as permission to leave their duties because of their obligations related with the Labor Union.

Collective bargaining agreement

Collective bargaining agreements are treated as a special class of contracts. They control individual labor contracts of the members.

Wages and Other Benefits

Classes of wages

- ▶ Unified salary,
- ▶ Right to receive part of the annual net profit sharing (15%).
- ▶ Two special bonuses, the "13th salary" (Christmas Bonus) and "14th salary" (Scholar Bonus),
- ▶ Reserve fund (fondo de reserva),
- ▶ Employer pension (for retirement),
- ▶ Ordinary pension plan.

Minimum salary in 2005

The minimum monthly wage projected for 2005 is USD 143.62.

Overtime pay

Overtime up until midnight is subject to a supplement of 50% of the regular wage. Special overtime (work between midnight and 6 a.m. or on weekends or holidays) is subject to a supplement of 100% of the regular wage.

Employees in some sectors are not entitled to an overtime supplement: transport personnel, travel agents, security and surveillance personnel, managerial staff.

Employment Regulations

Labor, employers and workers' rights are ruled by the Constitution of the Republic and the Labor Code.

The Constitution provides basic guarantees for workers; for example, workers' rights cannot be waived; salaries cannot be attached; net profit sharing (15%) for workers; workers' and employers' right to form unions; workers' right to strike; employers' right to lockout.

The Labor Code contains specific regulations to enforce these guarantees for the exclusive purpose of protecting the workers. The main sections of the Code set forth rules concerning:

- ▶ Personal employment contracts;
- ▶ Capacity to contract;
- ▶ Employers' and workers' obligations;
- ▶ Duration of working day, leaves of absence, and vacations;
- ▶ Salaries and profit sharing;
- ▶ Employment of women and minors;
- ▶ Employment of apprentices;
- ▶ Termination of employment contracts;
- ▶ Old-age pensions paid by employer;
- ▶ Collective bargaining contracts;
- ▶ Provisions related to special working conditions;
- ▶ Occupational hazards, accident benefits, and compensation for occupational diseases;
- ▶ Labor unions;
- ▶ Collective labor conflicts (strikes, lockouts);
- ▶ Labor justice administration;
- ▶ Ministry of Labor organization; and
- ▶ Limitations of labor actions.

The law acknowledges and grants guarantees to labor unions created at different levels - national, provincial, local, by sector, professional, or corporate. Labor is regulated at a national level.

Social Security

The employer is required to register the worker with Ecuadorian Social Security Institute and withhold a percentage of the worker's pay (9.35%) as the worker's social security contribution, and to pay the employer's contribution (12.15%).

Labor and social security laws for Ecuadorian citizens are also applicable to foreign employees in accordance with the principle of equal treatment.

Health and Safety

Essential duties of employer

The Ecuadorian Labor Code requires the employer to provide the workers with tools and equipment related with workforce safety.

The employer is required to provide employees a secure workplace.

According to Article 317 of the Ecuadorian Labor Code, in case of an accident during working hours, the employee has the right to indemnification by the employer without the right of reimbursement.

In case of professional sickness affecting the worker, the worker may request compensation.

The employer must protect against risks related to hygiene and safety. The workplace must be illuminated, ventilated, clean and dry.

The main regulations in this respect are Arts. 353-368 and 416-433 of the Ecuadorian Labor Code, Art. 66 of the Mining Law, and by-laws for the operation of medical services enterprises.

Outsourcing

A recent Ruling has been promulgated on the subject of outsourcing, and provides that at least 25% of the work force should be hired directly, and the rest could be hired through an outsourcing scheme.



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Taxes in Ecuador may only be created by laws passed by the Congress and enacted by the President. Tax bills may only be prepared and submitted to the Congress by the President. Tax laws can be modified by tax treaties between the Republic of Ecuador and other countries. Ecuador has executed tax treaties and agreements with the Andean Nations Community (also called Andean Pact), which includes Bolivia, Colombia, Peru and Venezuela; and also with other countries such as Argentina, Belgium, Brazil, France, Germany, Italy, Mexico, Spain and Switzerland.

Corporate Income Tax

All Ecuadorian corporations as well as foreign corporations with a branch or other permanent establishment in Ecuador are subject to Ecuadorian income tax. Ecuadorian corporations are subject to income tax on their local and worldwide income. Income tax charged to foreign legal entities is based on income generated in Ecuador.

Ecuadorian corporations as well as foreign corporations with a local branch are required by law to maintain their accounts according to General Accepted Accounting Principles (GAAP). Accounting books and records necessary to support the information shown on tax returns must be maintained in the Spanish language with figures in US dollars (the official currency of Ecuador since 2001). The form of documentation required is flexible and varies according to circumstances. In Ecuador it is customary to prepare financial statements including balance sheet, income statement, statement of retained earnings, and statement of changes in financial position.

The tax administration system is based on the principle of self-assessment. Taxpayers must file a tax return annually with the SRI. On every tax return, taxpayers report their income, deductions and exemptions, and compute their tax. Tax due over the amount withheld must be paid with the return. Penalties and interest are imposed when a tax return is not filed on time or when the taxes due or to be withheld are not paid by the due date. Taxes paid in excess may be claimed through a refund process before the competent administrative body and ultimately before the fiscal court.

A corporation's gross profit for the taxable year equals gross receipts or sales, less returns and discounts (plus other income derived from interest, rents, royalties, capital gains and others), and less cost of goods or services sold. Only ordinary and necessary business expenses and costs are deductible for income tax purposes. Although subject to many special limitations, deductible business expenses and costs generally include but are not limited to salaries and wages, unrecoverable debts, taxes, interest, cost of goods or services charged to income, and depreciation. Depreciation can be straight-line or reducing, over a term based on the useful life of the asset. Unused depreciation allowances can be carried forward indefinitely.

Rate: Tax is assessed at a flat rate of 25%. If profit is reinvested through capital increases of the

company, the income tax rate is lowered to 15%.

Losses: Regarding the corporate operations, losses may be carried forward for five consecutive years to offset taxable income in those years, such offset being limited to 25% of the taxable income of the corresponding year.

Inventory valuation: Inventory is valued each year on the basis of cost, with an adjustment to market value where applicable (for finished products) or cost (for work in process and semi-finished goods). Seconds, waste, and the like are valued at their potential resale value (if any). Inventory should not be written down applying an overall percentage mark down; adjustments must be made on a line-by-line basis. Cost may be determined on first in first out (FIFO) basis, or using a weighted average. Last in first out (LIFO) valuation is also allowed.

Branch income: The Ecuadorian legal system does not make any distinction between corporations and branches in terms of income tax. There is a consolidated accounting and unique taxpayer identification. Subsidiaries of foreign corporations are considered as separate organizations in Ecuador, and thus these types of legal entities should fulfill all their tax law obligations individually.

Capital gains: Capital gains originating from assets located within Ecuadorian territory or belonging to Ecuadorian corporations are subject to income tax. Capital gains from occasional sale of shares, participations and real estate are exempt from income tax.

Depreciation and depletion: Depreciation can be straight-line or reducing, over a term based on the useful life of the asset. Unused depreciation allowances can be carried forward indefinitely.

Group taxation: There are rigorous controls imposed by the tax authorities on economic groups (enterprises owned and managed by related persons). All these companies (part of the group) should pay their taxes individually, but are compelled to make a special tax declaration regarding their relationship with the holding company or the rest of the group.

Tax incentives: It is possible for companies to designate the totality of the income tax due (25%) to non-profit charitable organizations. In the case of the city of Quito, there is a specific tax incentive created and managed by a legal vehicle called the "Life for Quito" Corporation. This organization encourages environmental protection and development of public spaces, and is authorized by law to receive, as its main source of income, donations of income tax from companies and individuals.

Withholding tax on dividends: Dividends paid by Ecuadorian corporations are exempt income for income tax purposes. Once income tax has been paid by the source there are no more tax obligation. If the shareholder of an Ecuadorian corporation is a foreign individual not domiciled in Ecuador or a foreign entity (domiciled or not in Ecuador), the income tax paid by the Ecuadorian corporation is attributed to the shareholder who may therefore use it as a tax credit in the home country (to the extent permitted by the corresponding local laws). Dividends remitted abroad after income tax is paid in Ecuador, or generated from exempt income, are not subject to any additional tax or to income-tax withholding.

Other withholding tax: Other remittances sent abroad that constitute income for the beneficiaries (i.e. royalties), whether forwarded, paid or credited in an account, are subject to a single 25% income tax rate that must be withheld at the source. The following general exceptions apply: a) Import of goods are fully exempt; b) Interest at or below the official lending rates and financial expenses related to supplier's credit or to financial credits duly registered with the Central Bank are fully exempt; c) Commissions paid for exports and for the promotion of incom-



ing tourism are exempt; in the case of exported goods the exemption is up to 2% of the price of the exported goods; d) Costs and expenses paid abroad by air and maritime transportation companies, as well as by fishing entities for high sea fishery activities are fully exempt; e) Reinsurance fees have 96% of the fee exempt; f) Aircraft and vessel lease for providing international transportation have 90% of the fee exempt; g) Lease payments of capital goods under a purchase option are fully exempt, as long as the purchase option is exercised in due time.

VAT ("IVA")

VAT applies to the transfer of ownership over movable goods, to imports of movable property and also to the rendering of services. There are some transactions and transfers that are subject to 0% VAT and other transfers and services that are subject to a rate of 12%. Moreover, the following transfers of ownership are not subject to VAT: (i) contributions in kind for capitalization of entities, (ii) transfer of businesses which include assets and liabilities, (iii) mergers, spin-offs and transformation of corporations, (iv) assignment of shares, participations and other credit instruments.

Other Business Taxes

Municipal taxes: There are two main municipal taxes levied on companies doing business in Ecuador:

The municipal "patent" tax, which is a sort of business license or permit fee that must be paid on a yearly basis in all counties (cantones) where commercial operations are carried out. The amount is not significant, but the formula for calculation is rather complex and varies from one municipality to the other.

The "1.5/1000 tax" on total assets. This is an annual tax equal to 0.15% of the total value of assets (some deductions apply). It is paid proportionally in each county (canton) where the commercial operations are carried out.

Real estate transfer tax: Transfer tax in real estate purchases and transfers in Ecuador are stated and regulated by the Municipality Regime Law and equals 8% of the declared value of the deed, some deductions apply. It is paid differently in each county (canton) where the estate transfer is carried out.

Land value tax: This is an annual property tax on real estate. The tax is strictly linked to the geographic location and is assessed based on the conditions, services, features and commercial value of the land.

Personal Income Tax

According to Ecuadorian law, an individual is subject to tax when it is registered as a contributor and holds a tax payer identification number (RUC).

Territoriality and residence: Determined by the territory and the residence. Also the legal residence of an individual determines the place where the tax returns should be filed.

Gross income:

Employee gross income

In accordance with the Ecuadorian legal system, everything is considered to be taxable which the employee receives under a labor relationship including social benefits. If the employee earns a yearly amount over the minimum legal taxed income (USD 7400), the employee is required to pay income tax.

Capital gains and investment income

Dividends duly distributed by any employer who has paid the corresponding income tax are exempt from further taxes.

Deductions:

Business deductions

Any expense caused by the administration of the business is considered to be a deductible expense of taxes.

Non-business expenses

Non-business expenses are not tax-deductible.

Withholding: Corporations act as withholding agents on any payment that represent income to their payees. Employers withhold income tax over wages and salaries of their employees.

Tax Administration

Taxes in Ecuador are administered by national and municipal governments. The Internal Revenue Service of Ecuador (SRI) is the administrative body which collects national taxes and generally provides interpretive and administrative regulations and rulings concerning the tax laws. Municipal taxes are collected by each municipality which also enacts regulations concerning such taxes.

The SRI was created by Law Number 41 published in the Official Gazette on 2 December 1997. The SRI is a technical and autonomous entity, with legal existence, ruled by public law, and holds its own assets.

Since its creation, SRI has created and encouraged the process of formalizing the tax system and broadening the tax basis.

Among the main roles of SRI are:

- ▶ enforcement of tax policies approved by the President of the Republic,
- ▶ determination, collection and control of the internal taxes of the State,
- ▶ preparation of studies and projects of reforms of tax legislation,
- ▶ resolving requests and claims presented by taxpayers,
- ▶ issuing and annulling qualifications of credit, notes of credit and collection orders of taxes,
- ▶ imposing sanctions,
- ▶ establishing and maintaining national tax statistics,
- ▶ tax investigations related to taxpayers and third parties.



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Ecuador has traditionally enjoyed a free exchange regime for more than seventy years. The system has prevailed during this time whereby Ecuadorian and foreign companies and individuals in Ecuador may freely bring foreign currency into Ecuador and remit it abroad, invest in securities in other countries, and maintain bank accounts in any foreign currency in this country or abroad without needing any authorization or registration.

Even within the legislation of the Andean Community of Nations dealing with foreign investment, ranging from the restrictive Decision 24 of 1970 to the flexible Decision 291 of 1991, Ecuadorian internal rules have always been most favorable to foreign investment, within the limits set.

The regulatory framework for foreign direct investment includes:

- ▶ Decisions No. 291 and No. 292 of March 1991 issued by the Commission of the Andean Community (same rules apply for Venezuela, Colombia, Ecuador, Peru and Bolivia),
- ▶ Law on Foreign Trade and Investments,
- ▶ Law of Promotion and Guaranty of Investments,
- ▶ Ruling of the Law of Promotion and Guaranty of Investments,
- ▶ Regulation No. 921-95 issued March 1995 and amendments from the Central Bank of Ecuador which regulate the applicable regime for foreign investment registration,
- ▶ Ecuadorian Company Law.

Article 1 of Decision No. 291, which applies to Ecuador as well, defines foreign investment as "foreign contributions by foreign individuals or corporations to the capital of a company, in the form of freely convertible currency or physical or tangible goods, such as industrial plants, new and reconditioned machinery, new and reconditioned equipment, spare parts, parts, pieces, raw materials, and intermediate goods. Also deemed to be foreign direct investment are investments made in national currency using resources that may rightfully be remitted abroad and reinvestment made under the current regime."

Government Registration and Permits

In Ecuador, the current Laws determine that the national entities competent to handle foreign investment are:

- ▶ the Ministry of Industry, Commerce, Integration, and Fisheries (MICIP), which establishes the policies and legal standards for foreign investment,
- ▶ the Central Bank of Ecuador, which is the entity responsible for registration of foreign investment brought into the country,
- ▶ Superintendence of Companies, which is responsible for the control and supervision of companies established in the country,

- ▶ Bank Superintendence, which is the control and supervisory agency for private banks, finance and insurance and reinsurance companies operating in Ecuador.

Subregional or foreign direct investment must be registered with the Central Bank of Ecuador. Registration of foreign direct investment may be requested by the foreign investor, the investor's representative, or the legal representative of the company making the investment.

Any foreign individual or corporation may resort to the foreign investment regime. No citizens or residents may resort to the foreign investment regime. Companies determined to be mixed companies because of the composition of their capital cannot make foreign direct investments.

Foreign individuals and corporations may make investments in Ecuador in all sectors of the economy, without restriction, and on equal terms with Ecuadorian individuals and corporations. In addition, Ecuadorian legislation does not consider real rights (rights over tangible goods) or intellectual property rights to be capital contributions.

The Ecuadorian economy functions through basic sectors. The public sector is comprised exclusively of State-owned enterprises. The areas of economic activity reserved exclusively for the State are:

- ▶ Nonrenewable natural resources and, in general, subsoil products and all minerals and substances that may by nature be different from the subsoil.
- ▶ Drinking water, electrical energy, and telecommunications services.
- ▶ Strategic enterprises as defined by law.

The State is active in those business sectors or economic activities which, because of their scale or scope, can have a decisive economic or political influence and which must reflect the public interest. These areas are mainly telecommunications, electrical energy, hydrocarbons, mining, national security, real property in border areas, protected forests.

Article 2 of the Telecommunications Law establishes that it is a function of the State to direct, promote, execute, regulate, and control telecommunications activities by directly providing services or taking measures in advocacy of the national interest. The State may grant authorization to other individuals or corporations to establish or operate telecommunications facilities.

The generation, distribution, and marketing of electrical energy are the responsibility of the State. (A new draft law on electrification that admits foreign investment is currently being debated in Congress.)

Article 5 of the Mining Law establishes that all substances existing in the national territory are inalienably and in perpetuity under the control of the State, irrespective of their form, origin, and physical state; whether they are to be found in or on the surface of the soil, in the seabed or sea waters. The State may authorize the conduct of mining activities by nationals or foreigners in the interest of efficient mining resource use. The reform of the Mining Law is expressly aimed at providing more attractive conditions for foreign investment.

The law provides that radio or television broadcasting channels or frequencies are national assets which the State regulates through the National Radio and Television Broadcasting Council, authorizing these services throughout the national territory. It stipulates that individuals holding concessions for these services must be Ecuadorians by birth and that the corporations must also be Ecuadorian and may have no more than 25% foreign investment.

The Fishing Law reserves this activity for national and mixed companies defined in the law. Under the law, foreign investment in companies is admissible but may not exceed 49% of the company's equity capital.

The Constitution establishes prohibitions for foreigners regarding border property, as provided in the law.

The Forestry Law also establishes restrictions in favor of the State but envisages the possibility

of granting concessions.

Transfer of Dividends, Interests and Royalties Abroad

Foreign investment may be made in freely convertible currencies or physical or tangible goods, such as industrial plants, new and reconditioned machinery, new and reconditioned equipment, spare parts, parts and pieces, raw materials, and intermediate goods.

There are no restrictions on remitting profits (dividends) and capital after payment of the relevant taxes.

Profits distributed in the country or remitted abroad and any other benefit remitted or credited to an account and derived from income exempt from the flat tax are not subject to any additional income taxes.

Recipients of profits or dividends remitted or deposited abroad are taxed at the rate of 25% of their taxable income, after deduction of tax credits.

Recipients of income other than profits or dividends remitted, paid, or deposited abroad, pay a flat rate of 25% on taxable income.

The income tax of 25% levied on corporations may be used as a tax credit for foreign corporations, branches incorporated abroad, or individuals not resident in Ecuador.

The profits earned by contractors from services in the exploration and exploitation of hydrocarbons are subject to income tax at the flat rate of 44.4%. Profits reinvested in the country are taxed at the reduced rate of 25%.

Repatriation Procedures and Restrictions

Executives or employees recruited abroad may repatriate their earnings in freely convertible currencies, without any restrictions as there is a free foreign exchange market in Ecuador.

Foreign Personnel

Under Ecuadorian legislation, there is no time limit on the status of a foreign investor. Under the current provisions, business activity is conducted in a context of free competition with access to all sectors of the economy.

The Foreign Nationals Department of the Ministry of the Interior issues Class IV immigrant visas, under Article 10 of the Law on Aliens, to persons who are to assume administrative, technical, or specialized functions in companies or institutions established in the country, whether such duties are to be performed under an employment contract, power of attorney, or legal representation.



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Real Estate law in Ecuador derives from the Napoleonic Code (the ancestor of our current Civil Code), which is drawn to a large extent from Roman law. It is also influenced by the well organized land registers, managed by several Registrars (each with Cantonal authority). Real estate transfers are considered by the Civil Code to be a solemn contract and must be executed before a notary public notary and duly registered. Costs involved in real estate transactions (notary's fees, registration, stamp and other duties) amount to approximately 10-14% of the sale price.

Types of Ownership

Title to real property can be either entire (derecho de dominio pleno), or divided into two separate rights, a) the right to the usufruct (derecho de usufructo) and b) the right of disposition (nuda propiedad).

"Entire" ownership can belong to a single person, either an individual or legal entity, or a to a group of individuals or entities such as a cooperative, or co-ownership where each individual owns a portion of the whole with no direct right over any specific part.

Land Register

Land registration in Ecuador is twofold: On one hand, there is a technical record handled by each municipality depending the location of the real estate; and, on the other hand there is a legal record which is managed by the property registrar. The municipality records, called "catastres" in Ecuador, are carefully kept by each municipality. There are specialized departments at each municipality where all the real estate assets that exist within a specific geographical area are recorded and permanently updated. On the other hand, title must be recorded before the Property Registrar. Once the title is duly registered the new owner has ownership rights.

Transfer Formalities

A transfer of title, mortgage or other change in the legal status is only enforceable against third parties as from its registration at the office of the Property Registrar, despite the fact that it may be enforceable between the parties as from the date of signature of the legal instrument enacting the transfer, mortgage or other change.

In order to be registered with the Property Registrar, the title must be executed before a notary public. In Ecuador, the judicial system appoints a specific number of notaries to act as such within a given canton until their term expires or they are legally replaced by someone else.

Exceptions to this rule exist. Not all real estate titles must be executed before a notary public; there are other public instruments such as auction titles issued by the administration, and court orders, among others, that are not subject to such requirement for recording purposes.

Mortgages

A mortgage creates a security lien over real property for the purpose of guaranteeing the performance of a principal obligation. The following rights arise out of a mortgage:

The beneficiary of a mortgage, under an event of default of the debtor, may exercise his/her legal rights before a civil judge and have the mortgaged asset sold at auction by Court order; if the debtor sells the real property without first paying his debt, the mortgage holder may seize the real property from the new owner and have it sold at auction. The mortgage holder is allowed to follow the property despite multiple transfers and seize it in the hands of the owner, whoever that may be.

According to our Civil Code, a mortgage is considered a fourth-class privileged credit, which gives its holder a right to be paid with preference over other creditors out of the sale price of the real property of his debtor. The preference overrides creditors whose rights are registered at a later date, as well as ordinary creditors.

There are three ways of establishing a mortgage:

- ▶ by operation of law, when so provided;
- ▶ by court order, when so provided; or
- ▶ voluntarily, when a debtor executes the relevant instrument before a notary public and the mortgage is recorded by the Property Registrar of the canton where the estate is located.

Preemptive Rights and Other Protection of Parties

Preemptive rights must be purged at the time of a sale of a building.

Protection of buyer/seller:

The buyer may challenge the validity of the purchase in court if buyer's consent was tainted by mistake, bad faith or misrepresentation.

The sale agreement may be challenged in court by buyer or seller on the grounds that the price was more than twice or less than half the fair market value.

The buyer may also seek to void the sale or reduce the price if a "hidden defect" makes the proper unfit for its intended use or restricts its use to such an extent that the buyer would not have purchased the property or would have offered a lower price had he been aware of the defect.

Leases

Real estate may be leased under lease agreements. The law on leases is protective of tenants, who are considered to be the weaker party to the transaction.

Residential leases and commercial leases are subject under law to minimum terms, maximum rent, regulated increases, and preemptive rights for the tenant to renew the lease unless the owner wishes to sell the property.

Zoning, Construction and Use Permits

All construction must be authorized and approved by the municipality according to the zoning and guidelines of each sector (residential, commercial, industrial, etc.) All new housing solutions as well as property to be used for commercial or industrial purposes require prior permits issued by the local municipalities in the context of zoning rules and regulations, codes and local ordinances.





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