
Ecuador makes significant tax law changes

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In brief

Ecuador published a law on August 21, making significant tax changes to the country's income tax (IT), value added tax (VAT), and remittance tax (ISD) rules (Ley Orgánica para el Fomento Productivo, Atracción de Inversiones, Generación de Empleo, y Estabilidad y Equilibrio Fiscal (Ley de Fomento Productivo) in Spanish). The new law includes various tax incentives for certain industries and a tax amnesty.

Except for the tax amnesty and other non-annual liquidation taxes, the changes generally are expected to apply as of January 1, 2019.

In detail

Income tax (IT) changes

The main IT changes are as follows.

Distributions

Dividend payments and profits are exempt from withholding tax on distributions to domestic and foreign companies and to individuals not resident in Ecuador. The exemption will not apply if the beneficiary is an individual resident in Ecuador or when the company that distributes the dividends does not disclose the beneficial ownership chain to the tax authorities.

Under prior law, dividends paid to tax havens (or similar) were subject to 10% withholding tax.

Under the new law, dividends to all non-residents are exempt to the extent there is disclosure of the beneficial ownership and the beneficial owner is not an individual Ecuadorian tax resident.

Corporate tax rate

The IT rate for companies remains 25%. However, there is an increase of 3% (i.e., a total rate of 28%) that applies to companies that have not appropriately reported their beneficial ownership chain to the tax authorities and companies whose direct or indirect shareholders are resident in a tax haven, low-tax jurisdiction, or subject to a preferential tax regime, and the beneficial owner is resident in Ecuador.

Transfer of shares/participations

Gain on the sale of shares, participations, or other rights that represent capital or allow exploitation/exploration of companies resident in or with permanent establishments (PEs) in Ecuador is subject to IT at a progressive rate on the gain amount (in USD) as follows:

Up to \$20,000 - 0%.
From \$20,001 to \$40,000 - 2%
From \$40,001 to \$80,000 - 4%
From \$80,001 to \$160,000 - 6%
From \$160,001 to \$320,000 - 8%
Above \$320,001 - 10%

Under prior law, the gain was subject to IT at a rate of 25% or 28%.

No direct or indirect transfer is deemed to exist when the transfer of shares, participations, or other capital rights in an Ecuadorian entity takes place in the context of a corporate restructuring, merger, or demerger, provided the effective beneficiaries of the shares, participations, or rights representing capital are the same before and after the transactions.

The term 'corporate restructuring' is not defined in the new law.

IT advance payment

Companies may request a refund of any IT advance payment that exceeds the taxpayer's IT liability for the following year.

VAT updates

VAT tax credits paid with respect to local acquisitions and imports of goods and services and VAT withholdings may be used up to five years from the date of payment. Under prior law, there was no time limit on the use of VAT credits.

A VAT refund may be requested for the following activities:

- Audiovisual, television, and cinematographic productions (50% VAT paid with respect to pre-production and post-production development expenses). It does not cover programming and transmission activities;
- Housing construction projects of social interest; and
- Exportation of services under terms to be defined by regulations and under conditions established by the Tax Policy Committee.

5% remittance tax (ISD)

The law provides new ISD exemptions for:

- Payments to foreign parties with respect to principal and interest on loans granted by public or private financial intermediaries or other types of institutions that operate in international markets (subject to various requirements); and
- Payments to foreign parties for the maintenance of shipyards and ships.

IT incentives

The new law provides incentives to invest in certain 'prioritized' sectors, including additional sectors added in the law, such as: agriculture sector; oleochemicals; cinematography, audiovisuals, and international events under certain conditions to be defined; exports of services under certain conditions to be defined; biotechnology and software services, production and development of technological hardware, digital infrastructure, cyber security, digital products and content and services online; energy efficiency; sustainable construction materials and technology industries; industrial, agro-industrial, and agro-social sectors under conditions to be defined; and sectors of strategic substitution of imports and promotion of exports (determined by Executive Decree).

The incentives also apply to various mining industry activities related to copper, aluminum, flat steel, hydrocarbons, petrochemicals, cellulose, and navy ships.

The investment incentives are valid for 24 months beginning when the new law is published in the Official Registry. The benefit can be extended for an additional 24-month period. The investment activity must start during this period.

The incentives consist of the following:

- Exemption from IT (as long as the investment generates net employment increases). The number of years for which this exemption applies depends on the location of the activities;
- Subject to certain conditions, exemption from remittance tax for new productive investments that subscribe investment contracts with respect to importation of capital goods and raw materials, and dividends; and
- Exemption from remittance tax with respect to dividends for companies that reinvest at least 50% of the profits in new productive assets.

Tax amnesty

The tax amnesty provides 100% forgiveness of interest, fines, and surcharges with respect to taxes administered by the Tax Authority. It does not apply to 2017 income tax returns or to unpaid obligations after April 2, 2018.

The new law also provides 100% forgiveness of interest, fines, and surcharges with respect to customs duties as a result of a tax audit determined up to April 2, 2018 (taxes administered and/or collected by the Customs Service).

Finally, the new law provides a reduction of interest, fines, and surcharges with respect to employer's social security obligations due up to April 2, 2018. The amount of the reduction depends on when the taxpayer seeks the reduction.

To benefit from the amnesty, taxpayers must meet various conditions, including that taxpayers may not initiate any administrative, judicial, constitutional, or arbitrator appeals.

Amendments to the mining law

The new law eliminates the windfall tax (extraordinary tax calculated on the difference between the sales price of the extracted mineral and the fixed price of the mining exploitation contract).

The new law also changes the percentages and calculation of mining royalties from 5% to between 3% and

8% of sales (calculation will be progressive based on volumes of production of the mining concessionaire and type of extracted mineral).

The takeaway

Multinationals with Ecuadorian subsidiaries should evaluate how changes to the income tax, value

added tax, and remittance tax may affect their operations.

Companies also should consider whether they can take advantage of the tax amnesty.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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