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Investing In... 2022

Ecuador: Law & Practice
and
Ecuador: Trends & Developments

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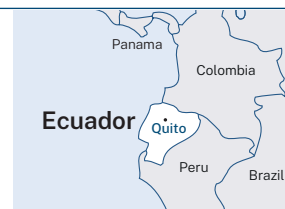
Law and Practice

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1. LEGAL SYSTEM AND REGULATORY FRAMEWORK

1.1 Legal System

Ecuador has a presidential, unitary and republican system, with open and democratic elections. It also has a National Assembly (Congress) that acts as the legislative body. The legal system is based on the supremacy of the Constitution, on the basis of which all other laws and regulations must be aligned.

Civil law is the legal system in force in Ecuador.

It has a civil judicial system with two ordinary courts, the first at the cantonal level (Judicial Units), the second at the provincial level (Provincial Court). It also has a court of cassation (National Court of Justice); however, there is also a Constitutional Court, which is the highest body of constitutional control, constitutional interpretation and the administration of justice in constitutional matters.

Public sector entities of the central government – such as ministries, agencies and secretariats – have the capacity to issue secondary and regulatory norms, as well as the different forms of decentralised autonomous governments (GADs), such as rural parish councils, municipal councils, metropolitan councils, provincial councils and regional councils.

Therefore, when conducting business, individuals and companies must apply both national and local regulations.

1.2 Regulatory Framework for Foreign Direct Investment (FDI)

The Constitution provides that the state shall encourage domestic and foreign investment, and shall establish specific regulations depending on the types of investment. Investments shall be made based on diversification of production,

technological innovation, and striking a balance between regions and sectors. Foreign direct investment shall be supplemental to domestic investment.

Foreign investment will have a direct role in complementing the strategic sectors of the economy requiring investment and financing to achieve the objectives set forth in the National Development Plan, such investments will need a formal delegation granted by the state. In the other sectors of the economy, not considered strategic, foreign investors may participate directly without any prior delegation.

Investment Protection

Foreign investors are protected by the Constitution, which provides that private ownership shall be respected in all cases, in addition, domestic and foreign investors and their legally established investments shall have equal treatment and will be treated equally with respect to the management, operation, expansion and transfer of their investments, and will not be subject to arbitrary or discriminatory measures. Foreign investment and investors shall enjoy full protection and security, and so will receive the same protection as Ecuadorians within the national territory.

According to the Organic Production Code (COP-CI), investor property will be protected under the terms and conditions established in the Constitution and further relevant laws. The Constitution prohibits all forms of confiscation. Therefore, the confiscation of national and foreign investments shall not be decreed or executed. However, the state may declare, under exceptional cases and in accordance with the laws, the expropriation of real estate with the sole objective of executing social development plans, sustainable management of the environment and collective wellbeing. In all cases, expropriation shall abide by the defined legal procedure, in a non-discriminatory

manner and shall be subject to appraisal, and the owner shall receive the corresponding payment of fair and adequate compensation. The execution of investment protection agreements is allowed in order to stabilise the tax regime and in certain cases to stabilise the regulatory regime.

In general terms, new investments will not require authorisation of any kind, except for those expressly indicated by law, such as concessions, delegations and authorisations for the provision of public services (ie, transport or banking) or that take advantage of any state-owned resource (ie, mining, oil and gas, energy or telecommunications).

According to the Constitution, the following are considered strategic sectors: energy in all its forms, telecommunications, non-renewable natural resources, transportation and refining of hydrocarbons, biodiversity and genetic heritage, radio electric spectrum, water, and others determined by law.

Likewise, public services are understood as potable water and irrigation, sanitation and sewage, electric power, telecommunications, roads, port and airport infrastructure, and others determined by law. In general terms, private participation in strategic sectors or the provision of public services will be exceptional, as established in the respective sectorial law.

2. ECONOMIC/POLITICAL/ BUSINESS CLIMATE

2.1 Outlook and FDI Developments

The Growing Role of the Private Sector in the Ecuadorian Economy

In recent years, Ecuador has undertaken a series of actions to modernise its economy based on a scheme defined by international trends, the

globalisation of the economy and the opening of markets. Ecuador is modernising its legal structures to facilitate private companies in becoming concessionaires of public services. The Constitution, enacted in 2008, promotes private investment and contains rules for protecting private property. Ecuadorian legislation does not impose any restrictions or limitations on inbound investment.

Pursuant to the Constitution, the state has the exclusive right to manage, regulate, and control strategic sectors. In exceptional cases when it is necessary and proper to satisfy public, collective, and general interests, and when the technical or financial ability would not otherwise be available, or when the demand for a service cannot be satisfied by state-owned or partially state-owned companies, the state or its institutions may delegate the management of strategic sectors and the provision of electric, road, port infrastructure and airport services, railroads, and other services to the private initiative.

This delegation may be made in the form of concessions, associations, strategic alliances, or other contractual methods, in accordance with the law, while observing the procedures for public tenders determined by the regulation for the selection of the delegated party, except when delegation is made to a state-owned company of a country forming part of the international community, in which case, the delegation may be made directly.

Investor Rights

In addition to the above, investors have the following rights:

- the freedom to produce and commercialise lawful, socially desirable and environmentally sustainable goods and services, as well as free pricing, except for those goods and ser-

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- VICES for which production and marketing are regulated by the law;
- access to administrative procedures and control actions established by the state to avoid any speculative practices or private monopoly or oligopoly or abuse of market dominance and other unfair competition practices;
 - the freedom to import and export goods and services, except for those limits established by current regulations;
 - free transfer to foreign countries of currency, periodic profits or dividends derived from registered foreign investment, once the obligations with regard to employee participation, tax obligations and other corresponding legal obligations have been fulfilled, as established in the law as appropriate;
 - free transfer of the resources obtained by the total or partial liquidation of the companies in which the registered foreign investment was made, or by the sale of the shares, or rights acquired due to the investment, once the corresponding tax obligations have been fulfilled;
 - freedom to acquire, transfer or dispose of shares or proprietary rights to third parties, within Ecuador or abroad;
 - free access to the national financial system and the stock market to obtain short, medium and long-term financing;
 - free access to promotion, technical assistance, co-operation, technology and other equivalent mechanisms; and
 - access to the other general benefits and incentives included in the applicable laws and regulations of the specific sector.

Inbound investment planning must take into consideration fixed costs and taxes. Fixed costs include salaries and other annual payments to be made in favour of public entities. Other payments may include taxes and fees varying depending on the specific activity of the investor.

Although there are no specific restrictions on outbound investment, its planning must take into consideration the capital outflow tax, as per the Tax Equity Law all payments remitted abroad are subject to a capital outflow tax at a rate of 5% of remittances exceeding USD5,000.

The government is currently working on the Investment Development Law, which seeks to update Ecuador's legal and regulatory framework, particularly in strategic sectors, in order to create better conditions for the development of concession projects and public-private partnerships. Regarding the latter, at the end of November, the PPP Technical Secretariat (National PPP Unit) was also created to promote the development of delegation projects in favour of the private sector.

COVID-19 Response

As one of the measures to aid the recovery of the economy, the President of the Republic presented a tax reform bill called the Organic Law for Economic Development and Fiscal Sustainability, after the COVID-19 Pandemic, which came into effect on 29 November 2021. Among the main changes introduced are the following.

- It is established that the financial activity will no longer be focused only on the financial system as such but will be extended to the securities market and insurance system, thus broadening the concept of financial group.
- Direct application of double taxation treaties (DTT) without any limitation or threshold.
- A 0% VAT rate is levied on:
 - (a) batteries, chargers and charging stations for hybrid and electric vehicles intended for public transportation and cargo;
 - (b) the import of fuels derived from hydrocarbons, biofuels and natural gas, intended for domestic consumption in the country; and
 - (c) the import of fuels derived from hydrocar-

bons, biofuels and natural gas, intended for domestic consumption in the country.

- The Simplified Regime for Entrepreneurs and Popular Businesses - RIMPE: entrepreneurs and popular businesses are considered as taxpayers under this regime, whose income tax tariff is 0–2%
- Certain income tax exemptions are eliminated for new productive investments made by new and existing companies.
- Companies incorporated as from the effective date of the new law, new companies incorporated, or lines of business created by existing companies, as well as new investments in existing companies, will enjoy a reduction of three percentage points on the income tax rate applicable for up to 15 years; the income tax rate may be increased by up to five percentage points, provided that they enter into an investment agreement for the term of the investment agreement in force.
- Tax obligations may be the object of settlement between the tax administration and the taxpayer, which is expected to reduce the burden of administrative or judicial proceedings; this settlement can be executed by means of a transactional act, order or judgment, provided that it is issued by the competent authority.
- Payments made abroad for the import of capital goods and raw materials made by companies that enter into investment protection agreements (IPAs) are exempted from the tax on the exit of foreign currency up to the amounts and terms established in such investment contracts.
- Once the IPA is approved, the regulatory entities that issue the permits, authorisations or any enabling document for the execution of the investment will have a term of 30 days to issue such enabling document.
- The Internal Revenue Service (IRS) will maintain a Registry of Beneficial Owners that will have the purpose of collecting, filing, pro-

cessing, distributing, disseminating and registering the information that allows the identification of the beneficial owners and members of the chain of ownership of the companies.

3. MERGERS AND ACQUISITIONS

3.1 Transaction Structures

Most companies in Ecuador are privately held, particularly family-owned companies. Very few companies are listed on a local stock exchange, on which the majority of securities are short and long-term debts. Private share purchase agreements (SPAs) are the most common acquisition structures. It should be noted that there is an Antitrust Agency in the country, which has the power to review all merger or acquisition transactions that occur and that have effects in Ecuador.

In general, transactions that meet at least one of the following conditions must be mandatorily notified to and obtain prior approval from the Antitrust Agency.

- That the total turnover in Ecuador of all the participants exceeds, in the accounting period prior to the transaction, the amount established by the Regulatory Board:
 - (a) in transactions involving institutions of the national financial system and the securities market, in excess of USD1.28 billion;
 - (b) in operations involving insurance and reinsurance entities USD85.6 million; and
 - (c) in all other transactions in excess of USD80 million.
- In the case of concentrations involving economic operators engaged in the same economic activity, and that as a consequence of the concentration a share equal to or greater than 30% of the relevant market for the product or service is acquired or increased at

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the national level or in a defined geographic market within the national market.

Among the latest decisions adopted by the Anti-trust Agency, it was established that the use of fiduciary structures such as trusts does not constitute an exception to the prior and mandatory notification process and is considered to be gun-jumping. The Agency also determined that the relevant market of an economic operator may be the canton in which it is located and not only at the provincial or national level.

However, there is still no pronouncement regarding the use of sophisticated mechanisms such as leveraged buy-outs, or similar, which are being used more and more frequently. The local stock market is not very well developed and its current regulation does not allow the use of instruments such as special-purpose acquisition companies (SPACs).

3.2 Regulation of Domestic M&A Transactions

Mergers and acquisitions in companies that have concessions or delegations in strategic sectors or that provide a public service are subject to prior notification and approval by the delegating entity (ie, municipality, ministry or delegating agency).

In addition, the terms and conditions established in each concession or delegation contract must be observed in order to determine the limitations or prohibitions that may have been included. There are cases in which the shareholder may only transfer up to 75% of its participation in the special purpose vehicle (SPV), and must maintain a minimum participation for a specific period of five to ten years (lock-up period).

Finally, it should be noted that in Ecuador, shareholders' agreements are recognised by current

legislation and are therefore valid and enforceable before arbitration tribunals or courts.

4. CORPORATE GOVERNANCE AND DISCLOSURE/REPORTING

4.1 Corporate Governance Framework Duties and Powers of the Shareholders' Meeting

The Companies Act in Ecuador provides that the general meeting of shareholders formed by the shareholders or partners legally convened and gathered is the supreme governmental body of a corporation (*sociedad anónima*) or a limited liability company (*compañía de responsabilidad limitada*). In the simplified stock company, this body is called the shareholders' meeting.

The corporation and the limited liability company

Apart from exceptions provided in the law or in the by-laws of the company, the decisions of the general meetings are taken by a majority of votes of the paid capital attending the meeting.

Simplified stock companies (SAS)

Resolutions are adopted with the favourable vote of one or more shareholders representing, at least, half plus one of the shares with voting rights, present at the respective meeting, unless the by-laws provide a higher deciding majority for some or all decisions.

The companies in Ecuador are generally governed by the general shareholders' meeting (where appropriate), which is the supreme decision-making body of a company in Ecuador, but they also usually have a board of directors, which is the body that manages the company and executes the decisions made by the shareholders or board members.

All companies must have a legal representative, who is generally the general manager of the company or the chairman of the board. This depends on how it is provided by the by-laws.

Commonly Used Corporate Forms

In accordance with Ecuadorian legislation, the most common commercial legal entities or companies may be limited liability companies, corporations and SAS, all of which are private entities.

A public company in Ecuador, whose stocks are listed in a stock exchange can only adopt the form of a corporation. On the other hand, state-owned companies are governed by the Public Enterprises Act (*Ley de Empresas Públicas*).

Key Considerations when Selecting a Corporate Form

The obligations and responsibilities of foreign investors in any type of company are the same. This means that they are responsible only up to the amount of their share capital. However, if it is determined that the company was used as a means to commit any type of crime the shareholders will be held liable. This includes crimes such as tax fraud and commercial fraud.

Foreign companies may be partners of any type of local company if their share capital is represented exclusively by participations, shares, or registered corporate shares, meaning shares issued in favour of or on behalf of their partners, shareholders or members, but by no means to the bearer. Nevertheless, the most common types of companies used by foreign investors are corporations and the SAS. In some specific cases, limited liability companies are the type of company provided/requested by the applicable regulations, and should therefore be considered (eg, security companies and transportation companies).

4.2 Relationship between Companies and Minority Investors

In general, decisions of companies in Ecuador are taken by half plus one of the shareholders; however, the shareholders are entitled to establish other types of majorities in the by-laws.

Notwithstanding the above, the law establishes the following main guarantees for minority shareholders.

- According to Ecuadorian legislation, stockholders who represent at least 25% of the stock capital of a corporation, may challenge the resolutions taken by the majority as long as said resolutions may be deemed negative for the company.
- In a limited liability company, shareholders who represent at least 25% of the share capital can challenge the resolutions taken by the majority as long as said resolutions may be deemed negative for the company.

4.3 Disclosure and Reporting Obligations

Foreign shareholders of Ecuadorian companies have the following obligations.

- to appoint and maintain an attorney-in-fact in Ecuador (this must be Ecuadorian citizen or a foreigner with residency);
- to annually report (through the company) to the IRS the list of its entire shareholders' chain, identifying each shareholder up to the ultimate beneficial owner (UBO), or to submit a certificate stating that the company is listed and registered in any stock exchange;
- in Ecuador, foreign shareholders that are based or domiciled in a jurisdiction that is considered by the IRS as a tax haven have a differentiated treatment in tax matters and the payment of dividends (higher withholding rates) and a higher tax burden (28% income tax tariff).

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Disclosure Obligations

No additional disclosure or reporting obligation must be performed other than the above-mentioned.

5. CAPITAL MARKETS

5.1 Capital Markets

Capital markets are regulated in Ecuador through the Securities Market Act and the Companies Act. Local financing is expensive in comparison to other countries in the region; this is due to a fixed interest rates scheme that is managed by the government. However, access to foreign financing is possible, although foreign loans must go through a registration process before the Central Bank.

5.2 Securities Regulation

There is one stock exchange in Quito and one in Guayaquil. Only companies that are registered and listed in any stock exchange can trade their stocks. Foreign investors are allowed to invest in listed companies. For that purpose, it is mandatory to hire a local broker (*casa de valores*), which are the only entities authorised to carry out trading activities.

Local companies, as well as foreign companies, are able to issue debt securities such as *papel comercial* (short-term debt, less than 359 days), and *obligaciones* (long-term debt, more than 360 days).

Even though the trading of debt securities has significantly grown in Ecuador in recent years, bank loans are still the main source of funding for local companies.

5.3 Investment Funds

Foreign investment funds can participate in Ecuador as shareholders of local companies, as well as lenders in financing transactions.

Acting as shareholders they must comply with the same compliance obligations as any other foreign entity, with the exception that instead of providing a complete list of all its partners, shareholders or members, they shall submit a certificate that accredits the status of an investment fund, issued by the competent authority of the country of origin.

6. ANTITRUST/COMPETITION

6.1 Applicable Regulator and Process Overview

Ecuador has a merger control regime. The Organic Law for Market Power Control (Antitrust Act) has been in force since 2011. The Superintendence of Market Control (Antitrust Agency) is the competent authority to whom a merger notification has to be made when the thresholds in a transaction have been met.

For thresholds details please refer to **3.1 Transaction Structures**.

A merger notification shall be filed within eight calendar days from the date of the agreement of the transaction. Only companies incorporated, or that have any type of presence or perform any type of economic activities in Ecuador, are considered when calculating the applicable threshold.

The seller's turnover in Ecuador need to be disclosed together with the turnover of the target. Thresholds are calculated on a group-wide basis, which is defined using concepts such as "joint ownership" and "joint control".

6.2 Criteria for Review

Only transactions that involve the acquisition or taking of control of one or several companies or economic operators – through acts such as a

merger between companies or economic operators, the transfer of all assets and liabilities, the acquisition of shares or any equity titles, joint administration, any other act that generates transfer of assets of an economic operator or generates control of material influence in the decision-making of an economic operator – are subject to a mandatory concentration notification.

Internal restructuring or corporate reorganisations generally do not need to be notified, neither the existence of shareholders agreements nor any changes or amendment of articles of association or by-laws.

For description purposes, control is defined as the possibility, depending on the circumstances of each case, of having a substantial or determining influence over a company or economic operator.

There is also the concept of a “de minimis” rule, by which the acquisition of a minority stake or any other type of activity that does not take the control of the company or the economic operators are generally not subject to reporting obligations.

6.3 Remedies and Commitments

The Antitrust Authority has the ability to approve the transaction, subject to the fulfilment of certain conditions (conditional approval). These conditions are usually imposed on economic operators that by virtue of their status have or may exercise significant market power.

The conditions may vary and are subject to the Authority’s discretion, depending on the nature of each transaction.

6.4 Enforcement

The Antitrust Agency has the capacity to investigate any transaction even if it does not meet

the applicable thresholds. However, it cannot impose any sanctions for not notifying if the thresholds were not met at the time the transaction was closed.

However, other sanctions may apply at any time if anti-competitive practices or unfair competition is detected. The Antitrust Agency can order the following sanctions if the transaction has not been notified: (i) reverse the transaction, (ii) impose structural or conditional measures, and/or (iii) impose penalties of up to 12% of the prior year’s turnover in Ecuador of the participants of the economic concentration.

There have been some recent cases in which the authority has imposed sanctions on economic operators due to lack of notification or failure to comply with the conditions stipulated. However, to the best of our knowledge most of the transactions that have met the thresholds have been notified.

Third parties are allowed to request the Antitrust Agency to perform an investigation for lack of notification.

The decision of the Antitrust Agency can be challenged before the administrative courts (*Tribunales Contencioso-Administrativos*).

7. FOREIGN INVESTMENT / NATIONAL SECURITY

7.1 Applicable Regulator and Process Overview

Ecuador does not have a foreign investment/national security review regime applicable to FDI. Any foreign investment is accepted regardless of its origin, as long as it complies with anti-money laundering and anti-bribery international standards.

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7.2 Criteria for Review

For national security issues, foreign individual or legal persons and local legal persons formed by one or more foreign individuals or legal persons are prohibited from owning, acquiring and granting land in the border security zones and in the reserved security areas, with the exception of populated and urban areas located in said zones.

7.3 Remedies and Commitments

Exceptions are applicable for land acquisitions and concessions made by:

- legally recognised marriages and de facto partnerships, of Ecuadorians and Ecuadorians with foreigners, whose marriages and de facto partnerships have lasted at least five years; and
- national legal entities whose foreign partners are domiciled in the country for at least five continuous and uninterrupted years.

7.4 Enforcement

In general terms, FDI is not blocked in Ecuador for national security reasons; however, obtaining a favourable report from the Minister of Defence is established as a mandatory requirement for the execution of plans, programmes and projects in security zones.

8. OTHER REVIEW / APPROVALS

8.1 Other Regimes

It is important to note that the legal tender in Ecuador is the US dollar and therefore there are no money exchange issues, nor exchange rate risks to consider.

9. TAX

9.1 Taxation of Business Activities

The Ecuadorian legal tax regime may be approached from three different standpoints. National taxes regulated by the Organic Tax Code, the Organic Law of Internal Tax Regime (LORTI), the Regulations for the Application of the LORTI (RALORTI). The national tax authority is the IRS.

For another part, local taxes, fees and/or special contributions will also be applicable to the company. Local taxes are established by law and are compiled in the Territorial Organisation Code (COOTAD). However, fees and special contributions may be set by the local governments and are determined in local legislation.

Foreign trade taxes (custom duties) are regulated by the Production Code and the Regulations of the Application of Book IV of the Production Code. The national customs authority is the Ecuadorian Customs Service (SENAE).

Additionally, there are other types of contribution that have the practical effect of a tax. Social security contributions, employee's participation in the company's profits and corporate contributions are among the most important ones.

The tax year begins on January 1st and ends on December 31st. Under normal circumstances, income tax is settled and paid in April of the following year.

There are two different types of taxes, which in turn have different categories.

National

The Income Tax taxes the overall disposable income of legal and physical persons. It is calculated and paid annually after deducting all expenses deemed necessary for the generation

of that income, whose net amount is the taxable matter. The general tax rate is 25%; however, a 22% rate is applicable for corporations incorporated and new business started after the enactment of the Organic Law for Economic Development and Fiscal Sustainability. It may be increased by 3% if the foreign ownership chain is not disclosed or if the beneficial owner is an Ecuadorian resident and part of the chain is domiciled in a tax haven.

The VAT tax rate is 12%. The tax is transferred to the final consumer. There are some transactions that are exempt from this tax.

The ISD (Capital Outflow Tax) applies to any transfer, delivery or exit of currencies from the Ecuadorian territory abroad. Imports may also be taxed with ISD if they are paid from abroad. The tax rate for ISD is currently 5% but is expected to reduce 1% per year during the next five years.

Local

The following are the key local taxes.

- Tax on total assets: this taxes regular economic activity on a yearly basis; payment is made to the city in which the company has its domicile and the tax base corresponds to the total amount of assets – the rate is 0.0015%.
- Municipal operative tax: this taxes regular economic activity on a yearly basis; the tax rate differs depending on the economic activity, from USD10,00–25,000.
- Real Estate Taxes: this taxes the transfer of real estate; there are several taxes, fees and special contributions related to real estate ownership or transfer.

Please note the tax benefits and incentives applying to new investments introduced in November 2021, as described in **2.1 Outlook and FDI Developments**.

9.2 Withholding Taxes on Dividends, Interest, Etc

Income tax withholding is another source of tax credit. Tax laws and regulations determine withholding agents, cases and rates. In the case of dividends and interest paid to the foreign investor, the company acting as payor is the withholding agent.

There is a single income tax on the dividends distributed from companies domiciled in Ecuadorian territory to foreign shareholders, which has a single rate of 25% over 40% of the dividend distributed, with a net effect of 10% of the amount of the remittance which is considered tax credit by the foreign shareholder in its country of origin.

In regard to payment interest from loans granted by foreign shareholders and duly registered with the Central Bank, if these payments are higher than 20% of the income tax basis of calculation, the excess is not considered as a deductible expense. On the other hand, interest on loans exceeding 365 days and under the maximum interest rates applicable are not subject to withholding taxes, to the extent that the lender is an international financial institution or a non-financial institution duly registered with the Superintendency of Banks, otherwise payments of interest would be subject to 25% withholding, regardless of whether the loan is registered with the Central Bank, unless any applicable DTT provide different.

International instruments regarding the tax regime subscribed to by the Ecuadorian government mainly comprise treaties to avoid double taxation.

Ecuador has signed several tax treaties for the avoidance of double taxation and prevention of tax fraud. The following are the international treaties currently in force: Andean Community,

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Argentina, Belgium, Brazil, Canada, Chile, China, France, Germany, Italy, Korea (South), Mexico, Qatar, Romania, Russia, Singapore, Spain, Switzerland and Uruguay. Treaties to avoid double taxation include an information-sharing clause.

9.3 Tax Mitigation Strategies

According to the tax regulations, income that has been subject to taxation in a foreign jurisdiction (except tax havens) shall not be subject to taxation in Ecuadorian territory because it becomes exempt income. In order to apply this rule, the taxpayer must inform the authorities of such income in their annual income tax declaration; such information may be subject to further investigation or audit by the IRS.

It is important to consider that applying for an investment agreement will reduce the income tax tariff by 5% for the term of the investment agreement and the dividends distributed abroad will not be subject to ISD.

It should be emphasised that according to current legislation, the use of aggressive tax planning mechanisms may be considered as a form of evasion, so it is recommended to be cautious and act conservatively.

9.4 Tax on Sale or Other Dispositions of FDI

In general terms, capital gains are part of the taxpayers' income tax base and must be taxed accordingly. Nevertheless, it is important to note that capital gains are exempt in the case of fixed deposits for periods longer than 360 days, both for physical and legal persons. Exceptionally, income tax for capital gains on the transfer of shares, based on the Law of Productive Promotion is subject to following rates.

- Up to USD20,000: 0%.
- 20,001–40,000: 2%.
- 40,001–80,000: 4%.

- 80,001–160,000: 6%.
- 160,001–320,000: 8%.
- More than USD320,001: 10%.

Local law does not contain general exemptions to the applicability of capital gains tax, so they may be exempted or not subject to payment in the event that any applicable DTTs contain provisions specific to the treatment of capital gains or income tax on the sale of shares or rights representing capital. The recent tax reform included a direct application of DTTs without limitation or any threshold.

9.5 Anti-evasion Regimes

In Ecuador, tax planning with regard to income tax is very limited because the legislation on such tax is rigorous and taxes, in general, every type of income received by national corporations, as well as every type of income from Ecuadorian sources, received by foreign corporations, is taxable. Regulations on deductible expenses are equally rigorous, with very few possibilities to access corporate schemes that may have particularly profitable results.

In order to avoid double taxation, Ecuadorian legislation provides that income received abroad by local companies that have initially paid income tax in the country of origin of such income shall be considered exempt from income tax payment in Ecuador.

The current legislation establishes the transfer pricing regime aimed at regulating – for tax purposes – the transactions carried out between related parties, in the terms defined by the law, so that the considerations between them are similar to those carried out between independent parties.

The “arm’s length principle” standard applies, whereby, when conditions are established or imposed between related parties in their com-

mercial or financial transactions that differ from those that would have been stipulated with or between independent parties, the profits that would have been obtained by one of the parties in the absence of such conditions but which, by reason of the application of those conditions, were not obtained, will be subject to taxation.

In this sense, transactions are comparable when there are no differences between their relevant economic characteristics that significantly affect the price or value of the consideration or the profit margin referred to in the methods established in this section, and, in the event of differences, their effect can be eliminated by means of reasonable technical adjustments.

Consideration is given to:

- the characteristics of the transactions;
- the analysis of the functions or activities performed, including the assets used and risks assumed in the transactions, by related parties in related transactions and by independent parties in unrelated transactions;
- the contractual terms and whether the transactions between related and independent parties actually comply with them;
- the economic or market circumstances, such as geographic location, size of the market, level of the market, wholesale or retail, level of competition in the market, competitive position of buyers and sellers, availability of substitute goods and services, levels of supply and demand in the market, purchasing power of consumers, government regulations, production costs, transportation costs and the date and time of the transaction; and
- business strategies, including those related to market penetration, permanence and expansion, among others.

10. EMPLOYMENT AND LABOUR

10.1 Employment and Labour Framework

The main laws that rule private individual and bargaining labour relations in Ecuador are the Labour Code, the Social Security Law and the Constitution.

The government has proposed to make some changes to the labour laws in Ecuador. The bill seeks to amend the labour regime in order to grant employers more flexibility with respect to the different forms of employment.

The minimum legal wage for 2022 is USD425. However, there are minimum sectorial wages depending on specific sectors and activities.

The employees also receive additional benefits, such as paid leave, thirteenth remuneration, fourteenth remuneration and reserve funds. Furthermore, the employees also receive 15% of the profit earned by the employer during each fiscal year.

In Ecuador, labour unions are provided in the law, although is not a common practice. Labour unions may be formed by at least 30 employees.

10.2 Employee Compensation

In the case of a dismissal, the employee is entitled to receive a severance payment, which includes the following.

- Up to three years of services, with the amount corresponding to three months of salary – and, when the employment relationship has lasted more than three years, with the amount equivalent to a monthly salary for each year of services – the total amount cannot exceed 25 months of salary and a portion of a year will be considered a full year.

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- Eviction, which corresponds to the 25% of the last salary multiplied by the years of work completed; in this case the fraction is not considered full year.
- In the case of the employee who has been working for 20 years, and less than 25 years, continuously or uninterruptedly, they will be entitled to receive retirement benefits, calculated pro rata temporis.
- The legal benefits such as paid leave, thirteenth remuneration, fourteenth remuneration, are calculated proportionally.

In an event of a merger or acquisition scenario, the employees remain under an employment relationship with the target company and their employment rights remain in force, including seniority.

In cases where the employment relationship is modified, or where the employer will be a new company, the employees must sign a new employment contract with the new entity, considering that they have to receive their severance payment calculated according to the law.

10.3 Employment Protection

In cases of acquisitions, the employer has two alternatives:

- termination of the labour relationship due to dismissal – under such scenario, the employee is entitled to receive compensation corresponding to one monthly salary for each year of service (minimum three salaries), in addition to eviction and proportional holidays, tenths, as detailed in **10.2 Employee Compensation**; or
- to continue the employment relationship, with the new employer – under this scenario the employees maintain their seniority, which is used to calculate all the employment benefits, including employer retirement.

There is no obligation for the employer to transfer the employee to the acquired company.

Ecuadorian legislation recognises the right of association of workers, as well as the right to strike. In the case of acquisitions, the conditions of the transfer or dismissal of employees will depend also on the provisions stated in each bargaining agreement.

11. INTELLECTUAL PROPERTY AND DATA PROTECTION

11.1 Intellectual Property Considerations for Approval of FDI

Intellectual property is constitutionally and legally recognised as a right and is an important aspect in any foreign direct investment process, considering the tangible and intangible assets involved, and the relevance that these may have for the transfer of technology and knowledge that is contractually agreed, both between private parties and also when there is state participation.

Although there is no specific review process or criteria required for carrying it out, the Organic Code of the Social Economy of Knowledge, Creativity, and Innovation (COESCCI or the IP Act), provides that investment contracts in which the state participates must include, as a requirement, technology transfers in which, logically, intellectual property rights may be compromised. In this same context, Article 83 of the COESCCI determines that investment contracts in which the state participates must also include technological unbundling processes.

There are no sectors or industries subject to rules or to a more rigorous scrutiny, although the acquisition and exercise of intellectual property rights, by express mandate of the law (Article 96, COESCCI), must be subject to the gen-

eral limitations of the Constitution and relevant laws, especially regarding access to biogenetic resources, traditional knowledge, consumer protection, environmental protection, and practices that restrict free and unfair competition.

11.2 Intellectual Property Protections

Protection of intellectual property has been strengthened in the last 25 years, during which time a unified national regulatory regime has been consolidated. In accordance with the particular legislation of the Andean Community, especially that contained in Decisions 345, 351, 391 and 486, and with TRIPS regulations in the framework of the WTO. In this sense, the rights recognised for nationals and foreigners, as well as the corresponding exclusions and limitations, are, in general, the same as those recognised by global legislation.

There are rules on compulsory licences in the field of copyright and patent law. In the first case, against practices contrary to free competition and others related to the availability and accessibility of works in the market. In the second, due to lack of use or for reasons of public interest. In general terms, the guidelines are according to the conditions generally established and recognised by the universal law.

However, industries such as biotechnology could face an important obstacle in Article 402 of the Constitution, which prohibits the granting of rights, including intellectual property rights, for nationals and foreigners, derived or synthesised products, obtained from collective knowledge associated with biodiversity.

Some recurring institutional deficiencies, such as the lack of specialised technical staff, have had a direct impact on the delay in granting rights, specifically in the area of invention patents, where processes may last several years.

11.3 Data Protection and Privacy Considerations

On 26 May 2021, the Personal Data Protection Act was enacted. The scope of its provisions is territorial, except in the case that the accountable person or the one in charge of the processing of personal data (individual or legal person, public or private, public authority, or another entity that alone or jointly with others treats personal data on behalf of a person responsible for the processing of personal data), not domiciled in Ecuador, is bound by the national legislation by virtue of a contract or by the provisions of public international law.

Considering that it is a relatively new law, and that as the date of preparation of this document the authority has not yet been designated, there are no precedents or cases in which the criterion regarding violations of legal provisions can be determined.

Likewise, the issuance of regulatory norms is pending, which should cover different day-to-day operational aspects of companies and individuals that use personal data.

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Trends and Developments

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Rising Domestic and International Investment in Ecuador

The second semester of 2021 was very active for Ecuador. Processes for accession to different regional trade agreements were initiated, which has re-established confidence in the country's productive and commercial sectors.

In addition, several business and investment events were held with significant participation from national and international attendees, in which a pipeline of more than 30 projects valued at more than USD30 billion were presented. The sectors in which these projects will be developed are diverse, including energy, hydrocarbons, infrastructure, real estate, mining, telecommunications, environment and health.

Most of the projects will be concessions and delegations under the public-private partnership model. The aim is for the private party to take charge and manage the entire process, from design, construction, financing, and operation through to maintenance. At the end of the contract, the assets will revert to the state.

There are also brownfield projects that are currently being operated by the state, but which will be delegated to the private sector for their operation and maintenance. In this way, the aim is to ensure the efficient administration of public assets by reducing their operating expenses, as well as to generate new sources of income for the country.

It is also expected that by 2022 several large mining projects will enter the exploitation phase, which will generate jobs and boost the country's

export supply. Mining exports currently represent the third largest source of income for the country, surpassing exports of traditional commodities such as cocoa and coffee.

Legislative reform

In legislative matters, a notable recent development was the introduction of a tax reform that eliminated certain tax incentives and benefits, with the purpose of increasing tax revenues. However, this was combined with a general reduction of 3% in the income tax tariff (the normal rate is 25%). For companies that sign an investment agreement an additional 2% reduction (for a total of 5%) was also established.

The income tax base was also modified, with the purpose of having more individuals pay this tax. In addition, the reform also eliminated obstacles for the execution of double taxation treaties, which will now be of direct application and without limit.

Pursuant to further legislative matters, it is expected that by the first quarter of 2022, the following bills at least will be submitted to the Assembly for discussion.

- The Organic Law for the Attraction of Investments: this seeks to update the entire legal and regulatory framework in order to create better conditions for the development of public-private projects; aspects of bankability and legal certainty will be introduced, which will be based on international standards.
- The New Labour Code: the current law has been in force since 1938 and has made very little progress in terms of hiring and the crea-

tion of conditions that promote a dynamic labour market; the new law will seek to improve such conditions in order to promote the insertion of more people into the formal labour market. The President has intimated that he will not discard a people's consultation (*consulta popular*) to decide on the labour reforms.

Public-private partnerships

Significant progress has been made in the area of public-private partnerships (PPPs). In November 2021, the Technical Secretariat for Public-Private Partnerships and Delegated Management was created, which will act as the National PPP Unit. It is an entity attached to the office of the President. Likewise, the regulations for PPPs were modified, reconfiguring the composition of the Inter-Institutional Committee, which will be led by the Technical Secretariat.

This entity will be the highest executive authority in PPP matters. It will be in charge of proposing the issuance of regulatory norms, as well as carrying out the entire project cycle. It will also have the capacity to monitor, supervise and audit PPP projects during their execution.

With this new entity, the public sector is strengthened by having a specialised PPP agency, which will have trained personnel, as well as its own budget. In this way, it is expected that the pipeline of projects will grow in an orderly manner, in addition to being able to act as an interlocutor with the different public sector entities, such as the municipalities and provincial governments, which, according to the Law, may develop projects under the PPP model at the sectional level.

Public tenders for electricity projects

Finally, in mid-December 2021, the call for the Public Selection Process for three large electricity projects worth around an estimated USD1.8 billion was officially announced.

The Non-Conventional Renewable Energy Block, with a capacity of 500 MW, has four sub-blocks equipped with non-conventional technologies (hydroelectric, photovoltaic, wind and biomass) and will be located in different geographic areas of the country based on the primary resource, environmental and logistical conditions of the area. The selection of the projects in each sub-block will be based on the lowest price offered, until the respective power allocation is completed. The concession term will be from 20 to 30 years, depending on the technology.

The 400 MW Natural Gas Combined Cycle Block contemplates the implementation of a generation plant and its associated transmission system up to the point of connection to the National Transmission System. The plant will use gas-fired thermoelectric generation units, based on conventional combined cycles with gas turbines or internal combustion engines. It will be the responsibility of the awarded bidder and subsequent concessionaire to ensure the supply of natural gas in the quantity and quality required for the operation of the plant. The concession will be for a term of 25 years.

The North-eastern Transmission System will provide transmission infrastructure to connect the National Interconnected System with the Oil Interconnected Electric System, located in north-eastern Ecuador, which will provide clean energy to the oil industry. The concession term will be 30 years.

It is also expected that the international bidding process for the studies, designs, financing, permits, procurement, construction, operation and maintenance of two of the largest hydroelectric power plant projects, Santiago and Cardenillo, will be officially announced in the first half of 2022. With investments that will exceed USD5 billion with concessions of more than 30 years,

ECUADOR TRENDS AND DEVELOPMENTS

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these projects are currently being structured by international firms.

This way, Ecuador seeks to join the global trend of decarbonising its electricity generation, with a strong commitment to renewable, conventional and non-conventional energies. There are also several private projects to promote the electrification of both public and individual transport.

As detailed above, the country is emerging as an attractive investment destination for both public and private projects.

All these projects are expected to be conducted in a framework of high environmental standards. The current government has actually expressed its commitment to environment protection and to reduction of the national carbon footprint and has sent a strong message to the international community by expanding, to 192,000 km², the marine reserve of the Galapagos Islands, creating together with Coco Island of Costa Rica, Coiba Island of Panamá and Malpelo Island of Colombia, the largest marine reserve in the world.

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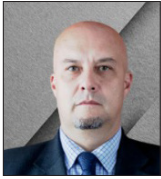
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