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OAKRIDGE HOLDINGS

# DOING BUSINESS IN Ecuador

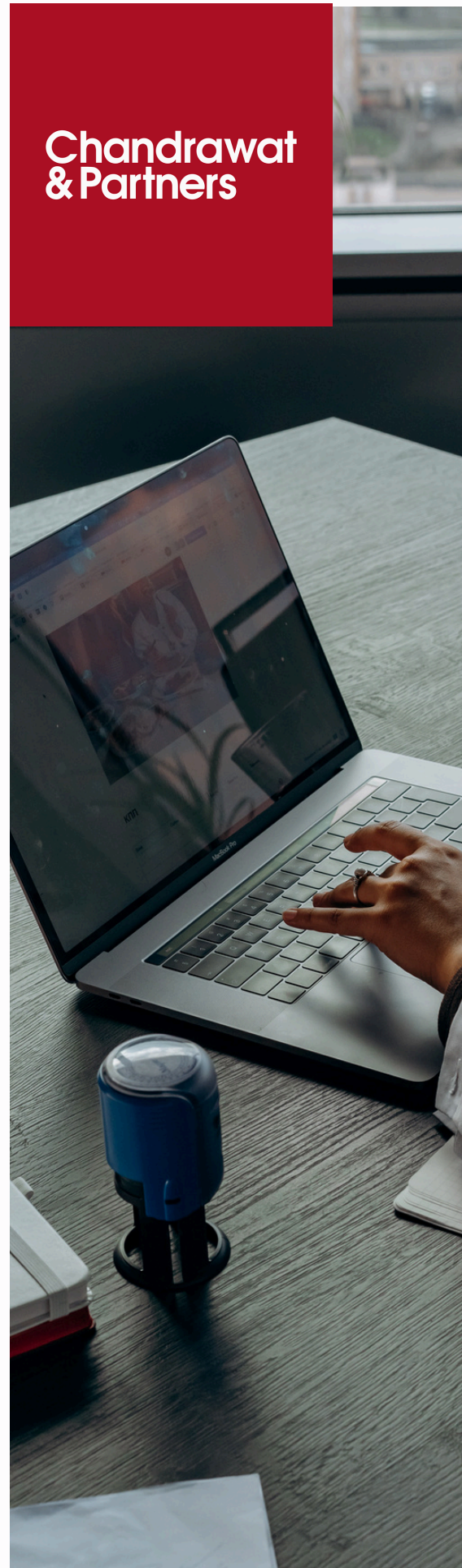
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# TABLE OF CONTENTS

• Introduction	02
• Economic overview	03
• FDI policy	04
• Key sectors	05
• Advantages	06
• Types of business	07
• Minimum eligibility Criteria.	08
• How to set up a business?	09
• Taxation	10
• Accounting standards	11
• Employment and labor laws	12
• Employment Policies	12
• How we can help?	13

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# INTRODUCTION



Ecuador, nestled in South America's heart, offers a captivating mix of natural beauty, diverse resources, and strategic location. This attracts international businesses seeking expansion. Fertile soil yields bananas, flowers, and other crops, while oil and minerals like gold and copper present development potential. Affordable energy, transportation, and labor add to the appeal.

But Ecuador's potential goes beyond physical assets. Its location makes it a gateway to the Andean Market, reaching millions of customers in Colombia, Peru, and Bolivia. Adopting the US Dollar in 2000 simplified transactions and stabilized the economy, attracting foreign investment.

However, navigating the market requires understanding the legal and political landscape. The Roman law-based system offers familiarity, but local regulations require expert guidance. The democratic system has a complex history with transitions between civilian and military rule. Staying informed about current political developments is crucial.

In conclusion, Ecuador presents a unique and promising market. Its diverse resources, strategic location, and stable currency create fertile ground for investment. However, success hinges on navigating the cultural, legal, and political landscape with a nuanced understanding. Careful consideration and a nuanced approach are key to unlocking the full potential of this captivating nation.

# ECONOMIC OVERVIEW

The Ecuadorian economy is best described as a relatively open, mixed-market system, where certain key sectors like non-renewable natural resources, utilities, defense, and strategic industries are under state control, allowing private investment through state-granted concessions. Other industries are primarily managed by the private sector, enjoying high public confidence. Ecuador heavily relies on the production and export of a few primary products, with over half of export revenues coming from crude oil. Additional significant sources include bananas, coffee, shrimp, and flowers. Despite being a major global supplier of bananas and shrimp, these industries have not surpassed oil as the primary revenue source. Ecuador exhibits promising prospects across various economic activities, leveraging its diverse climate, rich soil, cultural diversity, and biodiversity. The country's potential for agro-industrial and tourist investments is particularly attractive. While Ecuador has a high growth potential, success hinges on avoiding lax fiscal policies, flawed development strategies, and political instability, while effectively managing its oil resources amidst high global prices. The economy is vulnerable to external shocks due to its reliance on limited export revenue sources, such as oil, bananas, shrimp, cacao, tuna, and flowers.



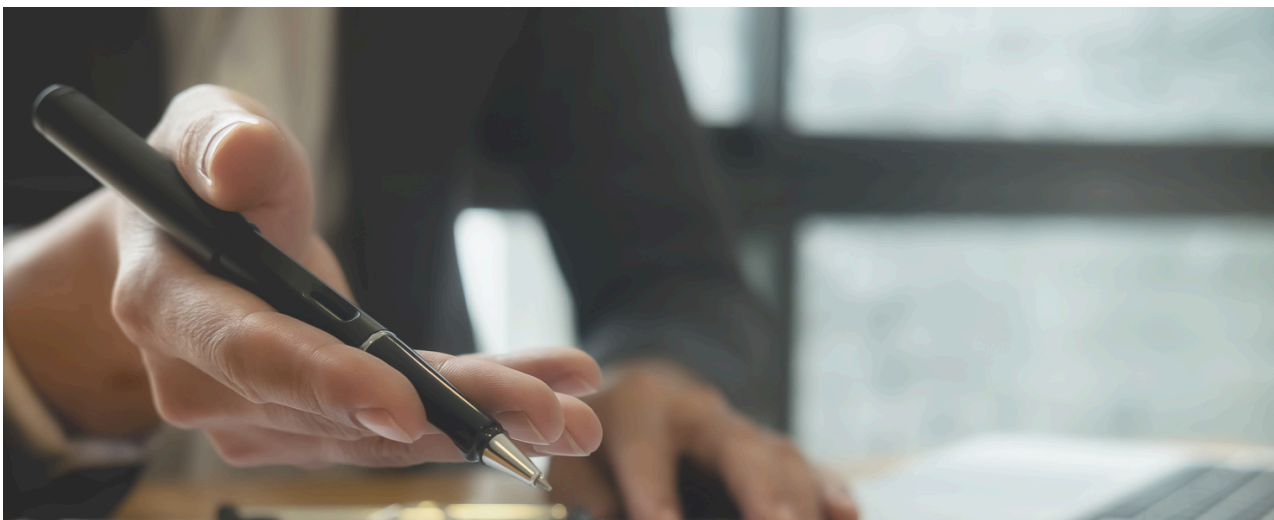
# FOREIGN DIRECT INVESTMENT POLICY

Ecuador extends a warm welcome to Foreign Direct Investment (“FDI”) across diverse sectors, implementing measures to facilitate this, such as streamlined approval processes and incentives for strategic industries.

Government approach to foreign investment:

The Andean Foreign Investment Code, a guiding document for the region, has undergone significant changes over the years. Decision 24 in 1971 was restrictive, leading to Chile's withdrawal. Subsequent liberalization occurred with Decision 220 in 1987 and Decision 291 in 1991, lifting most restrictions on foreign investment and providing member countries greater flexibility. Recognizing the need for foreign investment, the current government not only welcomes it but has also reduced tax rates. The encouragement of foreign investment is particularly notable in mining and tourism. Legal frameworks, including Decision 291 of the Andean Community, the Foreign Trade, and Investment Law (June 1997), and the Investment Promotion and Guarantee Law (December 1997), safeguard the rights of foreign investors, treating them similarly to Ecuadorian nationals.

Tax incentives, granted in November 2005 by the Tax Benefits Law, aim to foster specific industries. Foreign individuals conducting business in Ecuador, with the appropriate visa and compliance with business registration requirements, enjoy legal protections like property ownership, profit transfer abroad, negotiation freedom, access to tariff preferences, financial system access, and more. Business entities, including foreign investors, must be officially constituted in Ecuador before valid contracts. They receive the same benefits and incentives as Ecuadorian investors, gaining access to Andean markets and trade agreements. Investment types, defined by Decision 291 of the Andean Community, encompass the transfer of capital in freely convertible currency, physical or tangible property, and intangible technological contributions covered by agreements with the Ministry of Foreign Trade, Industrialization, and Fishing.



## KEY SECTORS

Ecuador's economic structure is characterized as a mixed-market economy with specific sectors under state control. The key sectors include:

**Energy and mineral resources** - The oil industry plays a crucial role, contributing about one-fourth to the country's economy. Ecuador heavily relies on oil exports. Petroecuador, the state's oil holding company, manages oil production and commercialization, collaborating with private companies for exploration and exploitation. The mining sector, with significant untapped potential, is attracting foreign investment opportunities.

**Agriculture and fisheries** - Agriculture, an important sector, has seen growth, particularly after the lifting of price controls in the mid-1980s. The Andean Community's free trade zone benefits agriculture, but dollarization poses challenges, impacting cost competitiveness. Traditional and non-traditional agricultural products, along with fishing (focused on shrimp, tuna, and other species), contribute to exports.

**Manufacturing** - Historically protected industries, ranging from textiles to automobile assembly, have developed diversely. However, many industries lack integration and depend on foreign raw materials. The Andean Community's free trade zone is expected to reshape industrial production, providing potential for growth in textiles, footwear, leather goods, and electronic goods.

**Service industries** - Contributing about 37% to GDP, the service sector is a vital part of the economy. Growth potential exists in various service industries, particularly in business services. However, specific requirements must be met in banking, financial services, electricity and water, and telecommunications.

**Tourism** - Ecuador boasts diverse attractions due to varied climatic and geographic conditions. The Galapagos Islands are a renowned tourist destination. Tourism has steadily grown, driven by natural beauty, biodiversity, history, and cultural background. Foreign investment in this sector is limited, but the government aims to develop it further, particularly in ecological, endurance, and adventure tourism. In summary, Ecuador's economy presents a mix of opportunities and challenges across these key sectors, with the government actively working to attract foreign investment and foster sustainable growth.

# ADVANTAGES

Ecuador offers a strategic location, competitive labour costs, and a growing consumer market, making it an attractive destination for businesses. The government's commitment to economic reforms and infrastructure development further enhances the appeal of conducting business in the country.

**Tax incentives** - Both foreign and local investors are eligible for standard income tax exemptions, deductions, and discounts. Basic income tax rates are moderate, standing at 25 percent for branches of foreign corporations, local companies (including subsidiaries of foreign corporations), and low progressive rates with a maximum of 25 percent for individuals. Oil companies under production sharing contracts face a 25 percent tax rate, while those under risk services contracts are taxed at 44.4 percent, with a reduced rate of 25 percent upon reinvestment in the same operation or other activities.

**Non-tax incentives** - Non-tax incentives include a simplified documentation process for exporters. Foreign investors have the legal right to access foreign currency in a free market, remit profits, and repatriate investments in currencies other than the US Dollar. Participation in regional agreements like the Andean Community, ALADI, and potentially the FTA with the United States is also available.

**Regional and industrial incentives** - Development laws' exemptions, deductions, and preferential income tax treatments were phased out in 1994. The Tax Incentives Law of November 2005 focuses on specific industries, such as hydroelectric, industrialization of hydrocarbons, high-tech electronics, air traffic and cargo, deep-water harbors, industrial machinery, and fuel production from natural resources.

**Free trade zones** - The Free Trade Zone Law since 1991 promotes exports, foreign investment, and employment. Within approved areas, any entity can freely import, store, manufacture, and trade merchandise according to zone regulations.

**International financial centre operations** - Ecuador can serve as a base for meaningful international operations under certain conditions. However, it does not qualify as a tax haven.

**Export incentives** - Exporters benefit from reduced paperwork requirements, and the creation of CORPEI promotes export by providing information and assistance in foreign trade and investment. Efficient transactions in US Dollars are a positive aspect, although credit facilities may have limitations.

# TYPES OF BUSINESS

In Ecuador, businesses can adopt various structures, such as limited liability companies, partnerships, and branches of foreign entities. Each type adheres to its specific regulatory framework, providing adaptability based on the nature and scale of operations. Business entities in Ecuador operate under the jurisdiction of the Commercial Code, the Company Law, and diverse regulations. The prevalent forms of business organization include:

**Corporation** (compañía anónima or sociedad anónima) - Preferred by large enterprises and foreign investors, this organization is characterized by shares of stock, with owners referred to as "stockholders." Their liability is restricted to the amount of their stock ownership.

**Company** (compañía limitada) - The second most common entity, companies can engage in various commercial and industrial activities, excluding banking, insurance, and savings. Owners are termed "shareholders," and their liability is confined to their investment in the company.

**General Partnership** (sociedad colectiva) - An association of two or more individuals with a written partnership agreement, participants are recognized as partners.

**Limited Partnership** (sociedad en comandita) - In this structure, some general partners bear unlimited liability, while limited partners have liability up to their capital contributions. In Ecuador, these organizations may also issue shares.

**Joint Venture** (sociedad de riesgo) - Ad hoc organizations where risks and profits are shared by multiple parties. In Ecuador, formal joint ventures are contract-based, particularly when associations of companies, local or foreign, engage with the state for specific projects.

**Branch of a Foreign Corporation** (sucursal)- Corporations legally established abroad can establish a presence in Ecuador by incorporating a branch.

**Mixed Economy Company** (compañía de economía mixta) - In this structure, private investors, state, provincial, or municipal governments, and autonomous government agencies may contribute capital and participate in management.

**Sole Proprietorship** (propietario) - Legislation for sole proprietorship with limited liability is anticipated to be enacted by Congress in the initial months of 2006. These regulations will outline the requirements for individuals interested in establishing a one-person enterprise with limited liability concerning purpose, duration, capital requirements, incorporation procedures, administration, legal representation, etc.



# MINIMUM ELIGIBILITY CRITERIA FOR COMPANY REGISTRATION

## **Incorporation Procedures -**

The formation of a limited liability company in Ecuador is governed by the Company Law, necessitating the execution of a public deed or agreement in which all shareholders must be participants. The approval of this deed by the Superintendence of Companies is mandatory, and it should include the following minimum information:

- Details of shareholders (individuals or legal entities), including names, addresses, nationalities, and civil status.
- Company specifics such as name, purpose, domicile, and a defined term (which cannot be indefinite).
- Total capital amount, individual contributions, and amounts paid by each shareholder.
- Administration and financial control methods, roles of executives serving as legal representatives.
- Procedures for calling and conducting shareholders' meetings and decision-making processes.

## **Capital Structure**

- Minimum capital is \$400.
- At least 50% of each participation must be paid at the company's formation, with the balance due within a year.
- Each shareholder's participation must be in multiples of \$1.
- A minimum of 3 and a maximum of 15 shareholders are allowed.

Capital contributions can be in cash or property, with certificates indicating the number of participations held by each shareholder. Shareholders' liability is limited to their capital contributions. Share transfers require unanimous consent, a public deed, and issuance of a new certificate. Capital increases can occur through reserves, retained earnings, new contributions, but reductions are only allowed when excluding an existing shareholder.

**Entity Conduct:** The company's deed designates shareholders for administration and the legal representative. In their absence, operations adhere to general commercial law. Shareholders have access to records and may participate in management, with extraordinary meetings held as needed. Annual meetings are mandatory, and each capital contribution grants one vote. Profits and Legal Reserve: Profits are distributed as dividends in proportion to capital contributions unless stated otherwise. A 5% annual profit allocation to a legal reserve is required until it reaches 20% of capital. This reserve cannot be distributed as cash dividends but can be capitalized.

**Books, Records, and Statutory Audit:** The same principles for corporations apply to limited liability companies regarding books, records, and statutory audits, though the law doesn't mandate statutory auditors. However, a vigilance committee may be formed when there are more than ten shareholders, and independent auditing is required under certain conditions.

# HOW TO SET UP A BUSINESS



Setting up a business in Ecuador involves several steps, including company name registration, obtaining a tax identification number, and securing necessary licenses. A step-by-step guide is available through the local commerce chambers or government agencies. Entrepreneurs contemplating the establishment of a business in Ecuador should carefully take the following factors into consideration:

**Select the right company type:** It is imperative to identify the most suitable company type that aligns with your business requirements before establishing operations in the country. Ecuador offers various company structures, including joint-stock companies, limited liability companies, and simplified stock companies.

**Appointment of a Trustworthy Legal Representative:** Designating a legal representative in Ecuador is a critical step, as this individual will be responsible for representing the company and executing legal documents related to labour and civil matters. It is essential that the appointed representative resides in Ecuador.

**Timely Registration with Tax Authorities:** Every business in Ecuador must register with the Internal Revenue Service (SRI) and fulfil tax obligations on a monthly or semi-annual basis. Engaging a local and reliable advisor during the business initiation phase is crucial to ensure complete compliance with tax regulations.

**Adherence to Labor Regulations:** Understanding the monthly and annual responsibilities towards employees is essential for employers in Ecuador. These obligations encompass social security payments per employee, mid-year and year-end bonuses, vacation entitlements, pregnancy leave, disability benefits, and severance payments.

**Intellectual Property Protection:** To safeguard your company's identity, including its name and logo, it is imperative to implement protective measures. Awareness of the available options for intellectual property protection is advisable to prevent potential imitation by competitors.

# TAXATION

Ecuador employs a progressive income tax system for corporations, and understanding the tax framework and compliance requirements is essential for businesses operating in the country.

**Corporate Taxation Investor Considerations-** Interest payments abroad enjoy tax exemption under specified conditions. Distributed dividends are tax-exempt. Payments on imports are exempt from taxes. Non-dividend remittances abroad are subject to a 25% tax. Lease instalments are deductible. Losses incurred in a fiscal year are deductible with limitations, without carry-back provisions.

**Corporate Tax System-** As per current regulations, the income tax rates are as follows: 15% on earnings allocated for capitalization, to be completed by December 31 of the following year. 25% on distributable earnings, irrespective of whether the recipient is a local or foreign investor. 25% on all non-dividend payments abroad (e.g., royalties, technical fees). Branches of foreign companies receive tax treatment equivalent to local entities. Additionally, the law stipulates that the corporation's income tax is attributed to non-resident shareholders.

**Taxation of Foreign Corporations-** Branches and wholly owned foreign subsidiaries face a 25% tax rate on distributable profits, whether distributed or capitalized (a 15% tax rate applies if profits are capitalized). Imports are exempt from taxation. A selling agent or distributor representing a foreign corporation may be subject to Ecuadorian tax exposure.



# ACCOUNTING STANDARDS

Ecuadorian Accounting Standards generally align with International Accounting Standards (“IAS”) and were implemented in July 1999 to regulate the accounting registration of operations and the preparation and presentation of information in financial statements. While the use of IAS is optional, it is typically employed in instances where Ecuadorian Accounting Standards do not address specific transactions or reporting requirements. Discrepancies in accounting practices primarily stem from tax regulations, which may dictate standards that differ from Ecuadorian Accounting Standards. Financial institutions also adhere to specific regulations outlined by the Superintendence of Banks, leading to variations from international accounting treatment. Currently, the differences include:

**Deferred Taxes:** - Comprehensive tax allocation is not applied in Ecuador. Leases: Lease transactions are generally treated as operating leases by lessees and as financing leases by lessors.

**Income Tax and Statutory Profit Sharing:** Certain regulated entities, such as insurance companies, incorporate the income tax provision as part of profit distribution rather than as a component in the income statement.

**Deferral of Start-up Costs:** The deferral of start-up costs is less restrictive compared to international accounting practices. Investments,

**Foreclosed Assets, Past-Due Accounts Receivable, Certain Income and Expenses, and Reserves Carried by Banks:** These are classified and valued based on specific standards mandated by the Superintendence, deviating from Ecuadorian Accounting Standards.



# EMPLOYMENT POLICIES AND LABOR LAWS

Running a business in Ecuador involves understanding and complying with the country's employment and labor laws outlined in the 1938 Labor Code. The Ministry of Labour oversees these regulations, which cover various aspects such as working hours, employment contracts, leave entitlements, and tax implications.

## Working Hours:

- Standard working week is 40 hours, with a daily limit of 8 hours.
- Extra hours are allowed but must be compensated proportionally.
- Ecuador observes 11 to 12 national holidays annually.

## Employment Contracts:

- There are 16 types of contracts, but three main types are commonly used.
- Indefinite contracts are the most prevalent, with a minimum monthly wage of \$450 in 2023 and a trial period not exceeding 90 days.
- Temporary contracts, often for maternity or sick leave, have a maximum duration of 180 days and convert to indefinite if continued.
- Occasional contracts for emergent needs last up to 30 days within a year, converting to indefinite if continued.

## Vacations, Leave, and Absences:

- Workers with one year of service are entitled to 15 days of consecutive leave, increasing with years of service.
- Payment for accrued vacation days is given if an employee leaves before completing a year.

## Sick Leave:

- Employers must grant sick leave authorized by a registered doctor.

## Maternity and Paternity Leave:

- Women are entitled to 12 weeks of paid maternity leave, extended in case of multiple births.
- Fathers get 10 days of paid paternity leave, extended for multiple births or caesarean sections.

## Statutory Contributions:

- Employee deductions include 9.45% for social security and progressive income tax.
- Employer contributions are 11.5% of an employee's salary towards social security.
- Companies must share 15% of net annual profits with employees, and this is tax-deductible.

Understanding these key points is crucial for businesses to operate legally and foster a positive work environment in Ecuador



# HOW CAN WE HELP?



Navigating the dynamic legal landscape of Ecuador can be daunting, but you don't have to go it alone. Our law firm serves as the trusted partner, offering a comprehensive suite of services tailored to the specific needs. Our team of seasoned attorneys, deeply versed in Ecuadorian business law, provides personalized consultations to understand the unique challenges and goals.

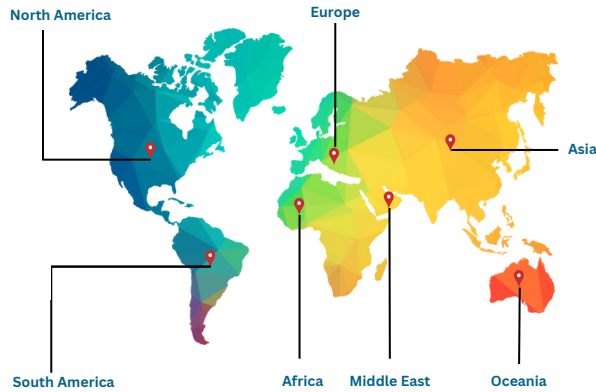
**Contractual Confidence & Clarity:** Ensure airtight agreements with meticulously crafted and reviewed contracts. We protect your interests and inject clarity, preventing future legal roadblocks.

**Compliance Simplified:** Ecuador's regulations can seem like a maze. We simplify compliance in areas like employment, labour, and business operations, freeing you to focus on growth.

**Safeguarding Your Innovations:** Protect your intellectual property with robust legal strategies and comprehensive due diligence. We empower informed decision-making and give you a competitive edge.

**Proactive Insights for Success:** Stay ahead of the curve with regular updates on legislative changes and emerging legal trends. Our proactive approach helps you minimize risks and maximize opportunities.

## SERVING CLIENTS WORLDWIDE



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