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GLOBAL TRANSFER PRICING SERVICES

Global Transfer Pricing Review

Ecuador

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TAX



Ecuador

KPMG observation

Since 2005, the tax administration, Servicio de Rentas Internas (SRI), has increased the compliance requirements for transfer pricing. Taxpayers need to prepare a transfer pricing study. This has resulted in an increase in the number of transfer pricing audits, and by the end of 2011 the SRI had collected around 200 million United States dollars (USD) in tax from audits.

Basic information

Tax authority name

Servicio de Rentas Internas (SRI).

Citation for transfer pricing rules

- unnumbered Article following Article 4 of the Internal Tax Regime Law (LRTI)
- second section of Chapter 4 of the LRTI
- unnumbered Article following Article 22 of the LRTI
- Articles 4 and 84 to 91 of the Ruling for Application of the Internal Tax Regime Law (RALRTI)
- General Resolution of the SRI No. NAC-DGER 2008–0464
- General Resolution of the SRI No. NAC-DGERCGC 09–00286
- supplementary regulations
- Update of General Resolution of the SRI No. NAC-DGER 2008–0464, by resolution NAC – DGERCGC 13 - 00859.

Effective date of transfer pricing rules

1 January 2005.

What is the relationship threshold for transfer pricing rules to apply between parties?

The following, among others, are considered related parties:

- the head office and its subsidiaries, affiliates or permanent establishments
- the branches, subsidiaries or permanent establishment among them
- the parties in which the same natural person or society, participate indistinctly, directly or indirectly in the management, administration, control or capital of such parties
- the parties in which the decisions are made by governing entities consisting of mostly the same members
- the parties in which the same member group, partner or stockholder, participate indistinctly, directly or indirectly in the administration, management, control or capital of these
- members of governing bodies of the companies in respect of the same, as long as it is established among

them that those relations are non-inherent to their position

- the administrators and commissioners of the society in respect of the same, as long as it is established among them that relations are non-inherent to its position
- a society in respect of the spouse and relatives until the fourth degree of blood relation, or second degree of affinity of the executives, administrators, or commissioners of the society
- a natural person or society, and trusts in which they have rights
- when a natural person or society is a direct or indirect holder of 25 percent or more of the social capital or equity capital in another society
- the societies in which the same partners, stockholders or their spouses/husbands or their relatives until the fourth degree of blood relation or second degree of affinity participate directly or indirectly in at least 25 percent of the social capital, or own funds or have commercial transaction, provide services or are in a dependent relationship

- when a natural person or a company is a direct or indirect holder of 25 percent or more from the common stock or own funding in two or more companies
- when a natural person or a society, whether domiciled or not in Ecuador, performs 50 percent or more of its sales or purchases of goods, services or another type of operations, with a natural person or society, whether domiciled or not in the country.

The tax authority may presume there is a relationship between the parties when their transactions do not follow the arm's length principle. Related parties are also considered to include those parties carrying on transactions with companies located in low-tax jurisdictions or tax havens.

What is the statute of limitations on assessment of transfer pricing adjustments?

The SRI can determine transfer pricing adjustments: i) up to 3 years from the return date, or ii) up to 6 years from the due date in which the tax return should have been filed, where the return has only been partially filed or not at all.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be prepared or submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes, taxpayers who have cross-border or domestic transactions with related parties, for an accumulated amount exceeding USD3 million during the fiscal year under analysis, must prepare and submit to the tax administration a Transfer Pricing Appendix. If the accumulated amount exceeds USD6 million during the fiscal year under analysis, the taxpayer must instead prepare and submit both a transfer pricing appendix and transfer pricing report.

What types of transfer pricing information must be disclosed?

The following information must be disclosed:

- taxpayers must include in their annual income tax return the total amount of transactions performed with related parties abroad differentiated between fiscal haven and other regimes disaggregated as follows: assets, liabilities, income, and expenses
- in addition, the amount of transactions with local and foreign related parties must be included in the compliance tax report that is submitted to the tax authorities
- transfer pricing report
- transfer pricing appendix.

What are the consequences of failure to prepare or submit disclosures?

If the taxpayer does not submit either a transfer pricing appendix or a transfer pricing report, the Internal Tax Regulations state that a penalty of USD15,000 will be assessed.

Transfer pricing study overview

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

If the taxpayer does not prepare transfer pricing documentation, they incur a penalty of approximately USD15,000.

Yes, for all transactions. Taxpayers who perform operations with related parties inside or outside the country have to prepare or submit a transfer pricing study.

On 24 January 2012, the SRI amended the rules concerning compliance with transfer pricing formal requirements:

- Transfer pricing appendix: taxpayers performing cross-border or domestic transactions with related parties, for an accumulated amount exceeding

USD3 million during the fiscal year under analysis.

- Transfer pricing report: taxpayers performing cross-border or domestic transactions with related parties, for an accumulated amount exceeding USD6 million during the fiscal year under analysis.

The reform takes effect immediately, and applies for the submission of the transfer pricing report and appendix related to intra-group transactions carried out in the fiscal year 2012.

Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?

Mitigate risk of tax authority making adjustments using secret comparables.

To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?

The transfer pricing appendix and the transfer pricing report must be filed within 2 months after the return's filing date (the corporation's income tax returns are due between 10 April and 28 April, depending on the 9th digit of the tax identification number).

When a transfer pricing study is prepared, should its content follow Chapter V of the OECD Guidelines?

Yes.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

Transfer pricing methods

Are transfer pricing methods outlined in Chapter II of the OECD Guidelines acceptable?

Yes, with some exceptions. In import and export transactions involving products traded on transparent markets, stock markets or the like, there is

a presumption that prices on such markets would be used in comparable uncontrolled price (CUP) analysis, except where it could be shown they are not appropriate. This also applies to imports and exports transactions involving brokers.

Is there a priority among the acceptable methods?

Yes, the application ruling to the LRTI sets forth the following order:

- CUP
- resale price
- cost plus
- profit split
- residual profit split and
- transactional net margin method.

If there is no priority of methods, is there a “best method” rule?

Not applicable.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer’s transfer pricing documentation, how long does the taxpayer have to submit its documentation?

Normal practice is to expect documentation within 20 days of request.

If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?

Yes, a taxpayer may challenge the adjustment in the respective fiscal court.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

Yes, 20 percent of the income tax payable, as determined by the tax authority.

To what extent are transfer pricing penalties enforced?

To the extent that the company did not submit, or submitted an erroneous, appendix or transfer pricing report.

What defences are available with respect to penalties?

The only defense available is to have proper documentation of the transactions performed.

What trends are being observed currently?

Since the transfer pricing regime came into force, the tax authority has primarily focused on controlled transactions of international business groups dedicated to exports, such as bananas, flowers, pharmaceutical companies, automotive companies, importers, etc.

Special considerations

Are secret comparables used by tax authorities?

Yes.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

No, due to the lack of local information.

Do tax authorities have requirements or preferences regarding databases for comparables?

No, the tax administration uses Compustat North America and global databases but it is not required in practice because other databases can also be used.

What level of interaction do tax authorities have with customs authorities?

High, since customs provide information to the SRI when it is required by this organization.

Are management fees deductible?

Yes, provided the fees are used to obtain, maintain, and improve income of an Ecuadorian source. Additionally, and with the purpose of ensuring the expense deductibility, the SRI demands the existence of the economic substance and clear confirmation that the service was provided.

Are management fees subject to withholding?

Yes, 24 percent in 2011, 23 percent in 2012 and 22 percent in 2013 and thereafter, withholding tax is generally imposed on management fees paid abroad. Certain bilateral tax treaties provide for a reduced rate. There are treaties to avoid double taxation with countries such as Belgium, Canada, France, Chile, Italy, Romania, Switzerland, Spain, Germany, Brazil, Mexico, Uruguay and the Andean Community. Sanctions for not withholding include disallowing deductions for the expense, and also the obligation to withhold the withholding not performed to the payment beneficiary.

Additionally, payment of the omitted withholding tax could be required including the interest related to the omission.

Are year-end transfer pricing adjustments permitted?

No.

Other unique attributes?

Safe harbor – taxpayers that carry out operations with related parties will be exempt from the application of the transfer pricing regulations provided that:

- the tax incurred is greater than 3 percent of total taxable income
- they do not carry out operations with residents in fiscal havens or preferential fiscal regimes
- they do not maintain an agreement with the State for exploration or exploitation of non-renewable resources.

Additionally, regulations allow the tax authority to use secret comparables for the establishment of the arm's length principle. The tax authority could use all of its information, as well as from third parties, as set forth in the tax code and the LRTI.

Other recent developments

In 2012, the SRI has begun more intensive audits, requesting supporting documentation on methodology used, comparability analysis, and comparable information and in most cases one or all comparables have been challenged. For this reason, it is now much more important that the company has adequate support for its transfer pricing policies, as evidenced by a transfer pricing study and other documentation to support the completion of transactions with foreign related parties.

In 18 December 2013, the SRI modified Resolution NAC - DGER 2008-0464, published in Official Register 324 of 25 April 2008. According to the RES the reports for the fiscal year 2013 must include:

"Detail search in the respective database for obtaining comparable to be used. Such detail should include each of the search screens used, corresponding to each of the steps followed sequentially from the beginning of the process to obtaining comparable with who transfer pricing analysis will continue. Bidders must also attach the details of the selected for the application of the method used comparable."

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Extensive.

If extensive, is the competent authority effective in obtaining double tax relief?

Frequently.

When may a taxpayer submit an adjustment to competent authority?

This depends on the timeframe allowed by the tax treaty.

May a taxpayer go to competent authority before paying tax?

No.

Advance pricing agreements

What Advance Pricing Agreement (APA) options are available, if any?

It is possible for taxpayers to consult with the tax authorities so that a determination can be reached with regard to the correct value of transactions carried out between related parties prior to actually carrying out the transactions.

Is there a filing fee for APAs?

Not applicable.

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

No.

Please provide some information on how successful the APA program is and whether there are any known difficulties?

Local regulations allows taxpayer to negotiate an APA with the tax authorities, nevertheless the tax authority haven't provided any guidelines to the taxpayer for their practical application. Due to the lack of guidelines, taxpayers haven't relied on APAs.

Language

In which language or languages can documentation be filed?

Spanish.

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