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Ecuador and Its Fight Against Tax Havens*

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"In a globalized world, if there is any pocket of secrecy, funds will flow through that pocket. That is why the system of transparency has to be global."

- Joseph Stiglitz, 2001 Nobel Prize in Economic Sciences

1. MACRO SITUATION IN ECUADOR

Ecuador has a population of 16 million, with a gross domestic product (GDP) in 2016 of around US$ 100 billion. As in Latin America as a whole, wealth is poorly redistributed in the country, although significant improvements have been made in recent years: in 2007 the country had a Gini coefficient of 0.551, and ten years later the figure had dropped to 0.466. This indicates a clear improvement in equality, although there is still a real need to keep working towards equality. The graph below shows the change in the Gini coefficient over the last ten years.

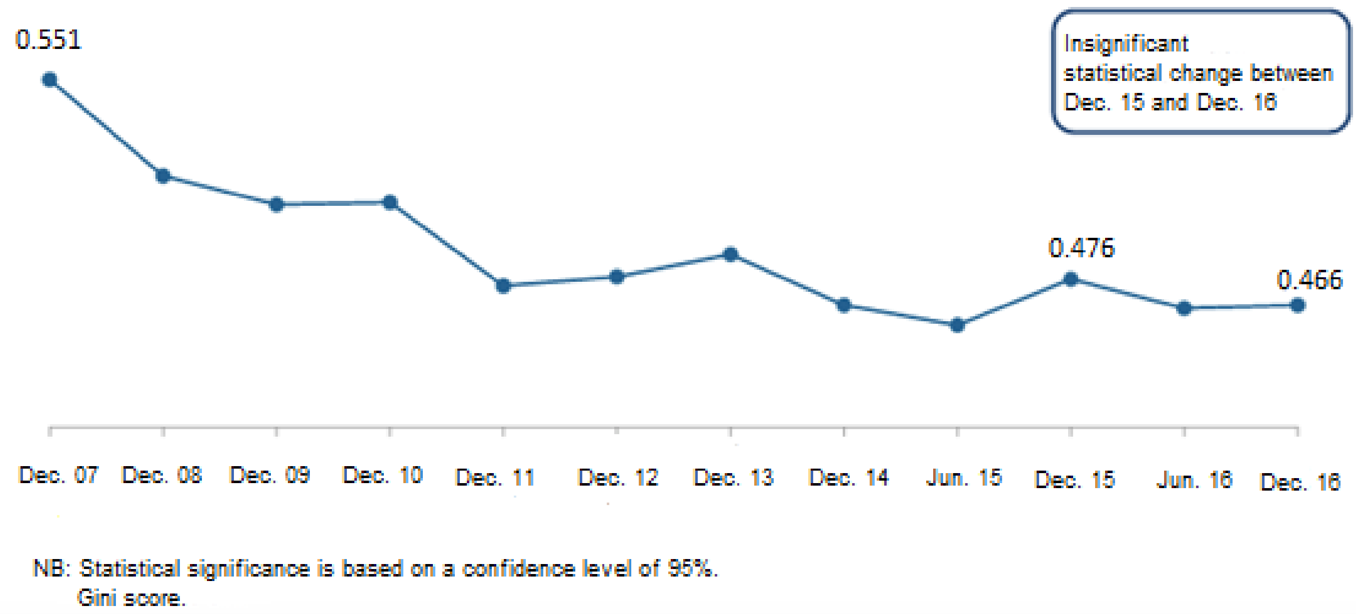
Taxation has been a key tool in improving the country's coefficient. Ecuador has improved how it manages tax collection and implemented domestic anti-fraud regulations and international mechanisms concerning aspects such as transfer pricing and tax havens. These measures have helped to increase the tax base, which has had a positive impact on the redistribution of wealth and equality. The increase in the tax base has also led to more social investments in health care, education, the road infrastructure, etc.

2. THE MONETARY SYSTEM IN ECUADOR AND THE IMPORTANCE OF THE MONEY SUPPLY FOR THE COUNTRY'S ECONOMY

The money supply is essential to the economy of any country. However, it is all the more so for Ecuador because the country does not have its own currency and has used the U.S. dollar as its currency since 2000. This means that it cannot use foreign exchange policies to make its currency more competitive and to help generate exports and restrict imports.

Dollarization relies heavily on the country's capacity to attract capital and prevent it from leaving the economy. However, this requires great effort, given the unfair competition from tax havens. Their attractiveness causes capital

Figure 1: Gini coefficient over the last ten years



Source: INEC http://www.ecuadorencifras.gob.ec/documentos/web-inec/POBREZA/2016/Diciembre_2016/122016_Presentacion_Pobreza.pdf

* The views contained in the policy brief are personal to the author and do not represent the institutional views of the South Centre or its Member States.

flight, which decreases domestic wealth, restricts domestic investment and reduces the money supply in the economy, which is the foundation of a dollarized system. This renders the economy of Ecuador and its financial system more fragile. Without monetary sovereignty,[1] the economy is more vulnerable to international capital markets and the "advantages" offered by tax havens.

3. TAX HAVENS IN FIGURES

Tax havens are harmful to global transparency; they also draw capital away from and damage countries that produce real wealth. They represent unfair competition because their attractiveness is based on secrecy and opacity, making them accomplices to actions such as tax evasion, corruption and money laundering.

Tax havens essentially represent an ethical and moral issue that has repercussions on the economies of other nations. Indeed, the money hidden in tax havens would be enough for 32 million people to be lifted out of poverty.[2] According to the United Nations Economic Commission for Latin America and the Caribbean (UN ECLAC), around US$ 320 billion in taxes are lost to tax havens on the income of individuals and companies in Latin America[3].

There are many estimates of the impact of tax havens, but they are just that: estimates. It is difficult to access more accurate data. And some data that have been accessed have been obtained through leaks such as Swiss Leaks[4] and the Panama Papers.[5] Below are some more figures:

- It is estimated that 8% of the world's financial wealth – or US$ 7.6 trillion – is located in tax havens. It is also estimated that around US$ 700 billion belonging to people in Latin America is located in tax havens, representing 22% of the region's total financial wealth, and that most of this amount (on average around 80%) has not been declared to the relevant tax authorities.[6]

- Offshore companies hold 22% of the world's wealth, which prevents States from investing in health care and education.[7]

- The World Bank estimates that more than €8 trillion are located in tax havens, which the International Monetary Fund (IMF) says represents a quarter of global private wealth.[8]

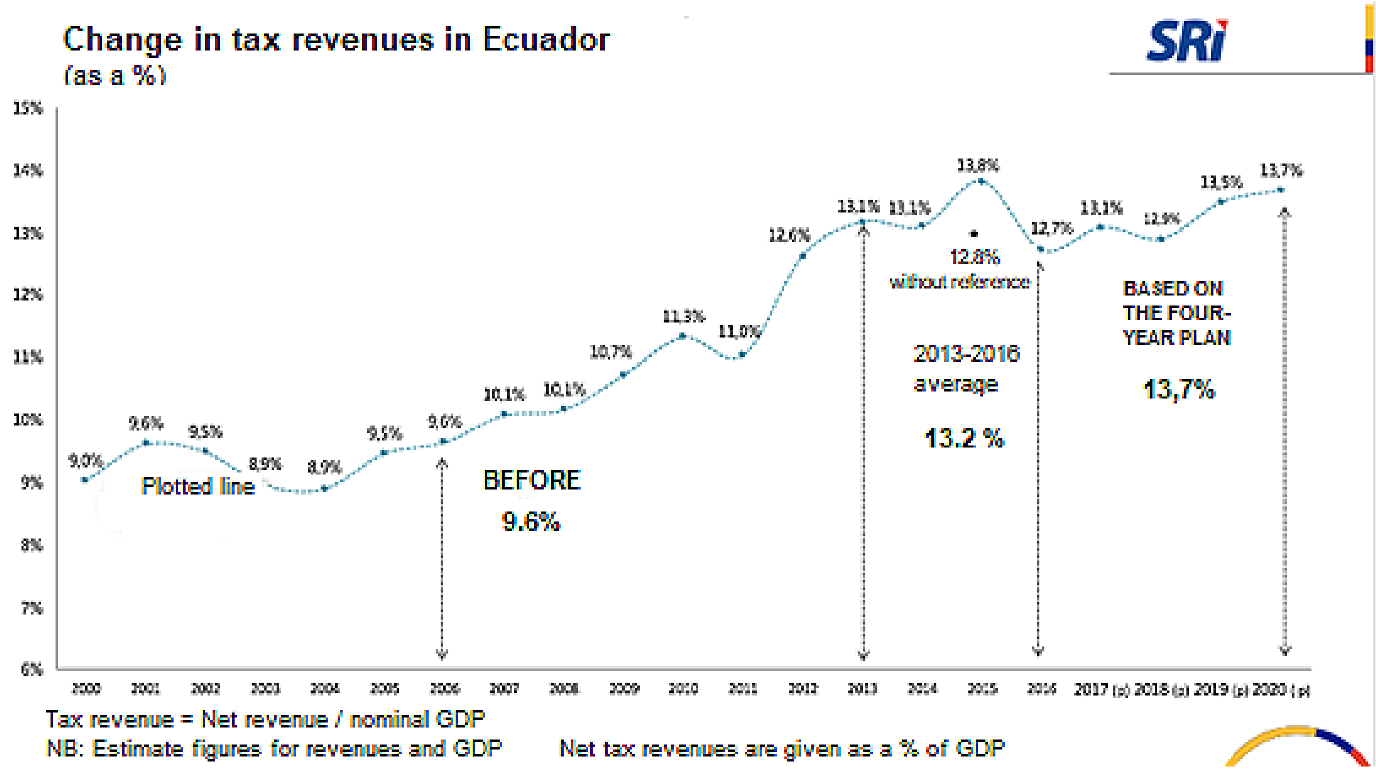
- Based on Organisation for Economic Co-operation and Development (OECD) data, some sources have estimated that the value of the wealth of high-net-worth individuals in offshore territories is US$ 5.7 trillion, while Oxfam estimated in May 2013 that the figure amounted to US$ 18.5 trillion.[9]

- The OECD's Secretary-General, Angel Gurría, said in 2008 that developing countries are estimated to lose to tax havens almost three times what they get from developed countries in aid.[10]

- In a July 2012 study, the non-profit organization Tax Justice Network estimated that the offshore sector was worth between US$ 21 and 32 trillion.[11]

Large multinationals use a series of mechanisms to reduce their tax bill. According to Zucman, they misuse bilateral treaties to generate undeclared income (what is

Figure 2: Change in tax revenues in Ecuador



Source: Servicio de Rentas Internas del Ecuador known as treaty shopping), manipulate transfer prices and shift profits. In this context, stress has been laid on the importance of practices involving the transfer of profits or costs between subsidiaries of a single multinational company, from countries or States with high tax levels or administrative constraints on capital flows to jurisdictions with systems applying relatively low or zero taxation (tax havens), via the manipulation of transfer prices.[12]

These figures are alarming and call for a reflection on the actions to be taken to address tax havens and the "advantages" they offer – such things cannot be considered an advantage if they come at a cost, above all, to the most vulnerable members of society because States' resources become limited, which reduces investment in health care, housing, education and other public development policies. In Ecuador, despite recent efforts, social investment is still below the average for Latin America and the Caribbean; spending on education and health care per capita represent just 57.5% and 26.5% of the average for Latin America and the Caribbean, respectively.[13]

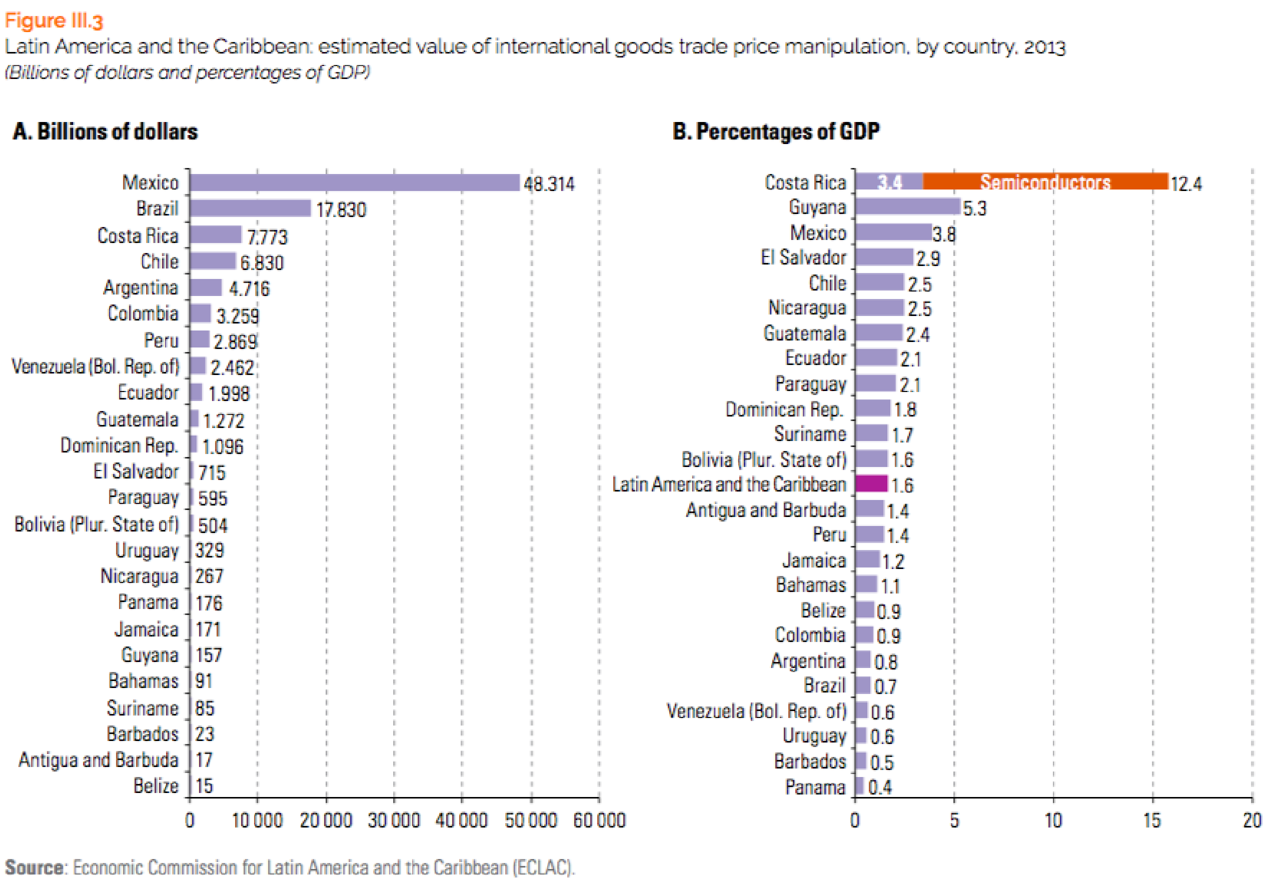
We cannot wait any longer to take decisions, especially since international and domestic initiatives to eliminate such behaviour are perceived to have been ineffective. Yet every action should be considered in the same way as those described by José Luis Prieto in *Estrellas de mar*, in which the apparently insignificant actions of a child saved so many starfish. Although many thought that the efforts of the child were insignificant, it was worth it for every starfish he saved. This is the same for every action taken by every country: they may seem insignificant to many people, but the funds that they manage to recover are worth it for each person who gains access to health care and education and increases their standard of living. In other words, even the smaller action can contribute to someone's wellbeing.

Countries are responsible for fighting these evasive and elusive practices in an integral and coordinated manner. As part of these efforts, the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) has taken on a greater role as the multilateral body leading international actions in the area of transparency and the exchange of tax information. However, every joint or individual effort will be effective only if there is a real desire to eliminate these harmful practices. This could be achieved through a public register of financial information that is available to all tax authorities worldwide.

This fight is not easy, as there are many factors that have encouraged and facilitated evasive and elusive practices, as indicated by Diaz Corral in the fourth edition of the training "Nociones de Fiscalidad Internacional", which highlights factors that have contributed to the increase in this type of practices over the last 20 years. These include:

- the increased mobility of people and capital;

Figure 3: Transfer pricing and GDP



- financial innovation;
- the internet;
- the existence and use of offshore financial centres to hide assets and income;
- tougher competition, which puts pressure on companies to reduce their effective tax rate;
- the existence of aggressive tax planning strategies;
- the globalization of the economy;
- the lack of fiscal awareness in the global population;
- the lack of coordination between national legislation and tax competencies between States.

These factors are difficult to address, especially since in States like Ecuador, tax evasion and avoidance are unfortunately not yet considered socially unacceptable. The population is indifferent to tax-related offences, despite the major progress made in making taxation a civil responsibility and fostering a tax culture in recent years. While this has improved the tax-related behaviour of citizens, there is still a lot of work to do until this type of behaviour is considered socially unacceptable and strictly punishable by law, as these are actions that not only affect the economy of a society but also blur its culture and values.

4. TAX HAVENS AND THE 1999 BANKING CRISIS IN ECUADOR

It is important to remember that the adverse effect that tax havens have on Ecuador's economy is nothing new. It dates back many years and helped to trigger one of the most difficult periods for Ecuador's economy. This period is known as the "banking crisis", and was one of the reasons why Ecuador gave up its currency.

In March 1999, a "banking holiday" was declared and financial institutions closed their doors for a week. This resulted in deposits being frozen, companies going bankrupt, higher rates of suicide, older people losing their life savings, and increased unemployment, which in turn led to greater poverty and destitution. It also prompted the biggest wave of migration in the country's history.

The economic loss amounted to US$ 8 billion, which was almost 40% of GDP, and the social losses were even greater.[14]

In 1999, international audit firms revealed that some of the biggest banks used offshore arms to carry out certain inappropriate practices. Banco Popular, for instance, "sold bad loans on the last day of the month to a non-banking subsidiary to hide its portfolio of non-performing loans". Banco La Previsora "used its offshore offices to invest in properties but classified the investments as loans".[15]

Permissive regulations had led to financial deregulation and liberalization, incentivizing inappropriate behaviour by the financial system and moral hazard, and legalizing offshore banking in tax havens on the argument that there was a need for greater financial integration in the international markets. This created the ideal environment for tax avoidance and evasion, generating "creative accounting" methods through pyramiding and making it easy to bypass regulations. Offshore banks were used to avoid regulations concerning transactions within a financial group and adjust the figures reported for technical capital. Offshore banking reached major proportions (two thirds of onshore assets,[16] which means that a large part of the country's wealth was invested in tax havens.

"As a result of greater activity and growing market uncertainty, offshore deposits grew rapidly during this period, rising by around US$ 1 billion, as shown in the graph below."

"After the crisis, the percentage of impaired loans in the offshore arms of closed banks reached 90% and a large proportion of these loans were lost because of a lack of appropriate collateral and because of ghost borrowers".[17] All of these bad practices were possible thanks to the secrecy, discretion and opacity offered by tax havens.

5. TAX HAVENS AND THEIR IMPACT IN ECUADOR

Fighting tax havens is a moral and ethical duty, and Ecuador must ensure that its wealth does not leave the country and this does not cause another economic and financial crisis. As such, Ecuador has made fighting tax havens a policy of the State and not just of the Tax Authority.

The Ecuadorian Tax Authority defines tax havens as jurisdictions that protect and promote harmful tax competition, attracting capital regardless of its origin, offering little or no transparency and having no other requirements of substance that need to be met for a company or transactions to be covered by its tax regimes.

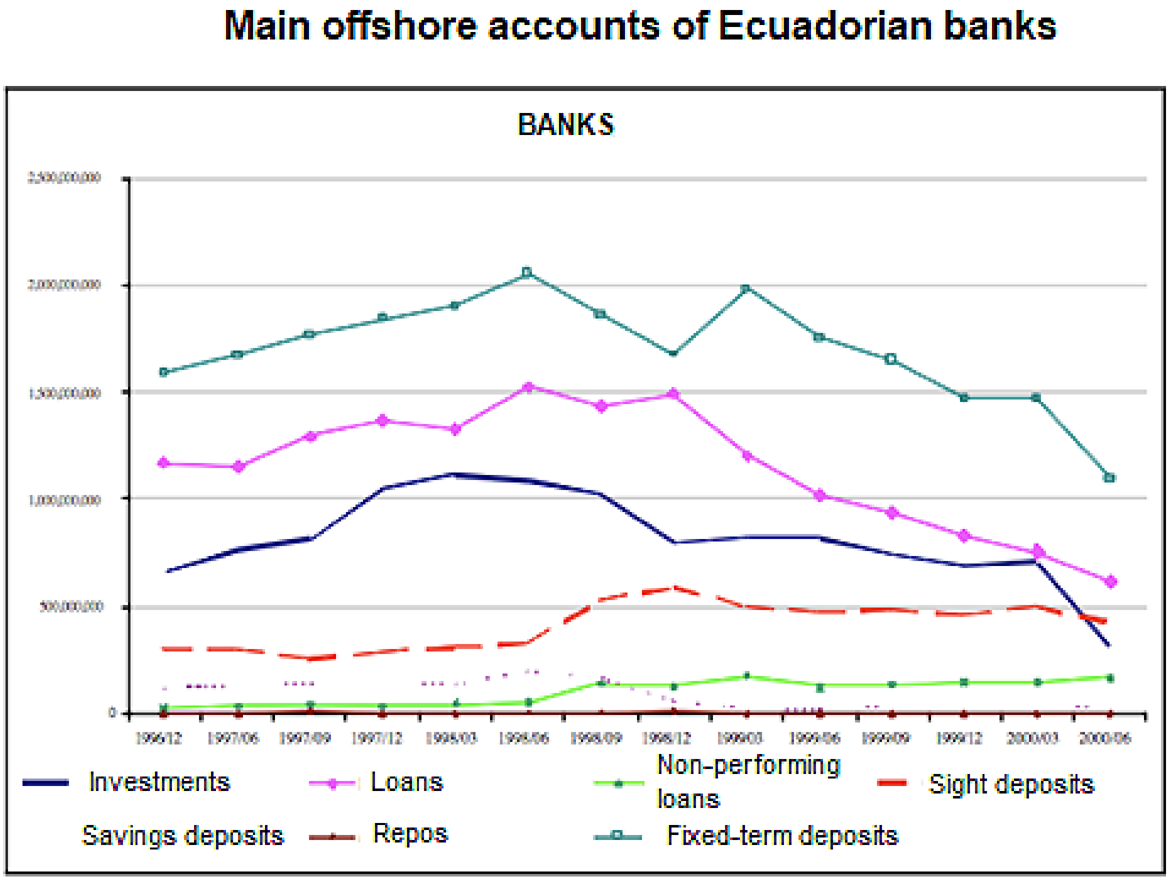
In Ecuador, according to figures from 2016 tax returns, 50% of the share capital of companies considered as major taxpayers came from outside the country. In reality this is not a foreign investment but domestic investment that comes from outside the country, with 70% of this amount coming through tax havens.

The tax havens in which the largest numbers of shareholders in domestic companies are registered are: Panama, the Virgin Islands and Barbados.

According to information from the country's Inland Revenue Service, business groups based in Ecuador accounted for 37% of total sales in 2016. Out of these business groups, 76% have foreign shareholders, of which 49% are located in tax havens, primarily Panama, the Virgin Islands and Barbados.

According to information from the Tax Authority, between 2014 and April 2017, US$ 5,224 million left the country for tax havens. This does not include the money belonging to Ecuadorians that was already abroad and moved countries. This affects our economy, not only be-

Figure 4: Main offshore accounts of Ecuadorian banks



Source: Banco Central del Ecuador

cause taxes are not paid on a large part of these funds but also because it weakens the structure of the economy, as we live in a dollarized economy that needs to be able to keep a certain amount of dollars in the economy.

Strangely, the main reasons why money leaves the country are to pay down loans, to repay loans early and for collections outside the country. Regulations concerning the financial system are explained in section 6.7 below. Financial entities in tax havens can no longer use the do-

Table 1: Ranking of assets held by shareholders domiciled in tax havens

Ranking	Tax havens	Proportion of total wealth in tax havens	Total for companies
1	Panama	54.7%	1,316
2	British Virgin Islands	13.0%	196
3	Barbados	12.3%	2
4	Cayman Islands	9.9%	31
5	Bahamas	4.0%	100
6	Bermuda	2.5%	23
7	Luxembourg	1.0%	19
8	Curaçao	0.9%	11
9	Belize	0.7%	31
10	Others	1.0%	111

Source: Servicio de Rentas Internas del Ecuador mestic financial system to grant loans, and so outflows for these reasons should decline.

Based on information from the Tax Justice Network, Ecuador's tax authorities estimated that Ecuador lost US$ 30 billion dollars in funds that ended up in tax haven between 1970 and 2010.[18]

It is not surprising that, even though it is a relatively small economy, Ecuador was ranked ninth in the top ten countries with intermediaries that operated with Mossack Fonseca,[19] based on information from the International Consortium of Investigative Journalists (ICIJ). Based on this information, there are 1,852 offshore entities connected to Ecuador. However, after further analysis the ICIJ revised this figure up to 2,114, with almost 60% of these offshore entities based in Panama.

We have these figures thanks to the leak. Otherwise, the discretion and secrecy offered by tax havens would have been maintained. Tax havens are accomplices in multiple cases of corruption and abuse that have come to light as well as in crimes such as tax evasion, corruption, money laundering, etc. They also lead to cuts in government budgets that so need these resources to develop health care, education, justice, etc. Furthermore, tax havens contributed to the economic and social crisis and have shirked their responsibilities, leading to another crisis – the ethical crisis.

From the controls that Ecuador's tax authorities have implemented for years now, it came to light that tax havens were being used to erode the tax base through

Table 2: Offshore entities connected with Ecuador and created by Mossack Fonseca by country of domicile

Offshore country	Number of offshore entities created	% of holding
Panama	1,258	59.51%
British Virgin Islands	307	14.52%
Nevada	210	9.93%
British Anguilla	153	7.24%
Bahamas	66	3.12%
Seychelles	36	1.70%
Samoa	23	1.09%
Niue	18	0.85%
United Kingdom	11	0.52%
Costa Rica	8	0.38%
New Zealand	8	0.38%
Belize	5	0.24%
Uruguay	4	0.19%
Hong Kong	2	0.09%
Cyprus	1	0.05%
Unknown	4	0.19%
Total	**2,114**	100.00%

the use of practices such as transfer pricing, undercapitalization and the simulation of transactions. Such practices have generated more than US$ one billion in fines.

6. CHANGES IN REGULATIONS IN ECUADOR

Despite the adverse effects on the country's economy; and the difficulty of establishing fines for using tax havens, it was not until 2007 that Ecuador began tackling tax havens head on. The country made major regulatory and administrative changes that covered taxation as well as the financial – and even the political – system, with a view to discouraging capital flight and tax evasion through tax havens and limit the harmful effects it has on both the economy and society.

Under Ecuadorian law, all regulations concerning income tax, which is paid annually, come into effect in the year following publication of the amendment.

In late 2007, the first regulatory amendments were made with the adoption of the Tax Equality Act, which allows the tax authorities to strengthen their control processes and implement regulations that make it easier to control the misuse of tax havens. These changes came into effect in 2008.

The main changes in terms of anti-tax-haven regulations are analyzed below and can be grouped as follows:

6.1 List of tax havens, jurisdictions with low tax rates, and preferential tax regimes

6.2 Exemptions not applicable to tax havens, jurisdictions with lower tax rates and preferential tax regimes

6.3 Non-deductible expenses relating to tax havens, jurisdictions with lower tax rates and preferential tax regimes

6.4 Income tax rate

6.5 Treatment of oil, bananas and minerals

6.6 Tax withholding for payments to tax havens

6.7 Financial system regulations

6.8 Ethical pact

6.9 Other regulations: Residence, closely related parties, aggressive tax planning strategies, and lifting banking secrecy

6.1 List of tax havens, jurisdictions with low tax rates, and preferential tax regimes

In the Tax Equality Act (*Ley Reformatoria para la Equidad Tributaria*) published in December 2007, the tax authority is given the power to issue a list of countries deemed to be tax havens.

As a result, in February 2008, resolution 182 was issued. This resolution has since undergone several amendments, but nevertheless has three key parts:

6.1.1 List of countries deemed to be tax havens;

6.1.2 Jurisdictions with low tax rates; and

6.1.3 Preferential tax regimes.

6.1.1 List of countries deemed to be tax havens

The Tax Authority drew up an initial list in 2008. It included 90 countries and jurisdictions considered to be tax havens or to have preferential tax regimes. This list draws on and complies with comparable legislative experiences in other countries and common practices at the global level.

Countries can be removed from the list if they enter into an effective double taxation agreement with Ecuador that contains clauses on the exchange of information and if their domestic legislation does not allow for banking, stock-market or any other type of secrecy regarding requests for information from the Inland Revenue Service and if they change their legislation to bring income tax rules in line with international guidelines. This would mean they are no longer classified as tax havens or preferential tax regimes.

Subsequently, the rules were changed so that a country can be removed from the list if it enters into a specific agreement on the exchange of information even if it does not have a double taxation agreement with a clause on the exchange of information.

The list has been changed since it was first implemented in 2008. Firstly, Uruguay was removed from the list of tax havens in 2009 and the Canary Islands Special Zone in 2011. A double taxation agreement with an exchange of information clause was entered into with Uruguay. As for the Canary Islands Special Zone, it forms part of Spain, a country with which Ecuador already had a double taxation agreement with an exchange of information clause, and it was demonstrated that this zone was covered by the provisions of this agreement.

In 2015, resolution 052 was issued, which replaced resolution 182 issued in 2008 and recorded 87 countries and jurisdictions as tax havens. Amendments were made to remove Qatar, the Pacific Islands and Hong Kong from the list and to correct the reference to the now dissolved Netherlands Antilles.

In 2016, Trieste was removed from the list, as it is part of Italy, a country with which Ecuador has a double taxation agreement with a clause on the exchange of information and which does not have any harmful regulations.

Finally, in August 2017, a new resolution was issued to include Hong Kong[20] once again in the list, as talks with the Chinese territory to sign and effectively implement a specific agreement on the exchange of information did not come to anything. As a result, the current list contains 88 countries and jurisdictions, the details of which can be found on the Tax Authority's website:http://www.sri.gob.ec/BibliotecaPortlet/descargar/558c426d-570a-4655-8313-a59cc46db267/Listado%20de%20Paraisos%20Fiscales.pdf .

This mechanism has made it easier for taxpayers to apply rules concerning tax havens, since they have a list and any doubt concerning the countries and jurisdictions that should be treated as tax havens has been removed. In addition, the experience of the list was positive because once it had been issued, countries like Spain (Canary Islands) and Uruguay came forward and provided information, making it possible to make changes to the list.

6.1.2 Jurisdictions with low tax rates

Many territories that are part of a country have different tax regimes to the rest of the country. This means that the country as a whole cannot be considered a tax haven, but the territory in question can. As a result, and considering that the tax framework can change every day at a global level, resolution 182 issued in 2008 stipulated that tax havens were those countries and jurisdictions with an effective rate of income or similar tax below 60% of the rate applied in Ecuador, i.e. those countries and jurisdictions with a tax rate of below 15% up to 2010 and as follows since 2011:

Table 3: Income tax rates to classify countries and jurisdictions as tax havens

Year	Corporate Income Tax Rate in Ecuador*	60% of tax rate
2010	25%	15.00%
2011	24%	14.40%
2012	23%	13.80%
2013	22%	13.20%

The Production Code issued in December 2010 reduced the corporate income tax rate by one percentage point a year, reaching 22%, which is the rate currently in force.

This approach allowed for some flexibility, since control processes could be used to treat transactions with jurisdictions with low tax rates as with tax havens without having to issue a new list of tax havens.

This approach remained practically unchanged in resolution 052, issued in 2015.

6.1.3 Preferential tax regimes

Preferential tax regimes are legal forms and as such are independent of the territory itself.

In resolution 182, issued in 2008, preferential tax regimes were considered tax havens and were therefore included in the countries and jurisdictions listed in these regulations.

Later on, in 2015, resolution 052 distinguished between these two concepts in different articles, setting as the criteria for being considered a preferential tax regime the lack of substantial economic activity or a low tax rate (less than 60% of the rate in effect in Ecuador).

In 2016, through resolution 440, the definition of a preferential tax regime was changed. It now sets out both specific preferential tax regimes and general conditions for regimes to be deemed as such.

The following types of **specific** regimes are included:

1. Those granted only to foreigners and not to nationals, which is known as "ring fencing";

2. Those that allow companies to have bearer shares or nominee shareholders without the identity of the beneficial owner being known;

3. Those that make tax-exempt any income from activities developed outside the country involving goods that do not originate in or are not destined for the territory where the tax regime is established. In other words, when the economic activities are not conducted in that location.

4. Those where it is possible to legally create a company without any obligation to declare the company to the tax authority in that country.

In terms of **general** criteria, at least two of the following conditions must be met for a regime to be classified as a preferential tax regime and deemed to be a tax haven:

a) lack of economic substance;

b) effective rate of income or similar taxes below 60% or unknown;

c) lack of transparency and no effective mechanisms for exchanging information;

d) companies are allowed to have bearer shares or nominee shareholders.

Finally, in August 2017, resolution 433 was issued, which replaces resolution 052, amending the article relating to preferential tax regimes and expressly including regimes identified in the Netherlands, the UK, New Zealand and Costa Rica.

In conclusion, Ecuador treats as tax havens:

- **Tax havens themselves**: 88 countries in the list available at the Tax Authority's website: www.sri.gob.ec;
- Those **jurisdictions** that it considers to have a low tax rate, i.e. a rate that is less than 60% of the income tax rate in effect in Ecuador;
- Specific **preferential tax regimes** and those regimes that meet two of the four general criteria, such as those identified in the Netherlands, UK, New Zealand and Costa Rica, as mentioned above.

6.2 Exemptions not applicable to tax havens, jurisdictions with lower tax rates and preferential tax regimes

In the Tax Equality Act issued in December 2007, an amendment was made to how income from outside the country is treated. Up to that fiscal year, income from other countries had been included in overall income and a tax credit was recognized for the income tax paid abroad, up to a maximum amount corresponding to the tax paid on the income earned abroad. Since 2008, such income has been considered tax-exempt income subject to tax in another country. However, this does not apply to income earned in tax havens, and even when tax has already been paid in the tax haven, the income is considered part of the taxable income in Ecuador and no tax credit is recognized for the tax paid in the tax haven.

In addition, Ecuador has an overseas remittance tax, which, as its name suggests, is a tax (5%) on funds that leave Ecuador. This was adopted to prevent dollars from exiting the economy and to strengthen the dollarization of Ecuador. This tax is levied on any funds leaving the country, except for certain transactions stipulated by law. One type of transaction that was exempt from this tax until 2007 was the payment of dividends. However, from 2008, this was limited to dividends that are sent to countries not considered to be tax havens, jurisdictions with low tax rates or preferential tax regimes. Dividends transferred to tax havens are subject to this 5% overseas remittance tax.

Following a series of cases involving the misuse of trusts, the tax benefits for trusts were restricted in the reform that was issued in 2014 and came into effect in 2015. Under this reform, income from trusts that do not develop business activities or have ongoing business operations are exempt from tax. However, this does not apply when one of the founders or beneficiaries is a natural person or company that resides or is based in a tax haven or a juris-

Table 4: Preferential tax regimes by country, pursuant to resolution 2015-52

DESCRIPTION	Investment companies not paying income tax	Tax rulings	Innovation box	Companies with nominees and where the beneficial owner is not known	Trusts	Not registered with the tax authorities
NETHERLANDS	X	X	X			
UK			X	X		
NEW ZEALAND					X	
COSTA RICA						X

diction with a low tax rate.

6.3 Non-deductible expenses relating to tax havens, jurisdictions with lower tax rates and preferential tax regimes

Under the 2007 reform, payments relating to international commercial leasing arrangements are not tax-deductible if they are made to natural persons or companies that reside in tax havens. It is important to note that both national and international commercial leasing arrangements had been misused to create tax deductions and to take advantage of accelerated depreciation without needing to request authorization from the tax authorities. Under Ecuadorian regulations, it is possible to deduct the value of the maximum depreciation accepted for taxable property relative to commercial leasing. However, when payments are made to tax havens, the expense cannot be deducted even if the other conditions are met.

There are also restrictions on tax deductions relating to interest paid on loans outside the country and granted by non-financial institutions,[21] indirect expenses[22] and bonuses[23] when they are made with closely related parties (see section 6.9.2).

6.4 Income tax rate

In the reform made in late 2014, which came into force in 2015, the income tax rate was set at 25% for companies with shareholders, partners, participants, founders, beneficiaries or equivalent residing or established in tax havens or jurisdictions with a low tax rate and with a direct or indirect joint or individual holding at or above 50% of the share capital. If the holding is less than 50%, the rate of 25% is applied to the proportion of the tax base that corresponds to the shareholders with a holding in tax havens, jurisdictions with low tax rates and preferential tax regimes.

It is worth noting that the Production Code issued in late 2010 reduces the corporate income tax rate by one percentage point a year, reaching 22%. The rate at the time was 25%. Under the reform, companies with shareholders domiciled in tax havens pay a higher rate.

The rate of 25% is also applied when companies have not made inquiries as to the name of the natural person who is the beneficial owner of the company.[24]

6.5 Treatment of oil, bananas and minerals

Oil, bananas and minerals are important products for the country's economy and together represent around 50% of total exports and are the source of major inflows of funds into Ecuador.

Given their importance, the Tax Authority issued resolution 531 in 2016, which sets out technical measures and methods to prevent the abuse of transfer pricing. These measures involve determining the comparable non-controlled price as a method for determining the transfer price, as well as the conditions, periods, intermediary margins and adjustments that have to be considered for these prices in order to be used for the comparison.

These measures are applied when transactions are conducted with related parties domiciled in tax havens, jurisdiction with low tax rates and preferential tax regimes, or when an international intermediary is used and that intermediary does not reside in Ecuador or in the country to which the goods are being exported.

6.6 Tax withholding for payments to tax havens

Tax withholding has been used to discourage the use of tax havens.

The table below shows how payments to countries considered to be tax havens, jurisdictions with low tax rates or preferential tax regimes are treated compared with countries that do not fall within these categories. It clearly shows Ecuador's intention to levy taxes on income that is sent to tax havens at a higher rate than that paid by natural persons in the country (35%). This is based on the assumption that in the tax haven there is an Ecuadorian who should be paying tax in Ecuador.

6.7 Financial system regulations

In 2012, further efforts were made to fight tax havens and discourage financial institutions from investing in tax havens. A tax on assets held abroad had already been introduced in 2009; it must be paid by all financial institutions

Table 5: Comparative rates of withholding tax

COMPARISON OF WITHHOLDING TAX PAID ON PAYMENTS FROM ECUADOR TO TAX HAVENS, JURISDICTIONS WITH LOW TAX RATES AND PREFERENTIAL TAX REGIMES AND TO COUNTRIES NOT CONSIDERED AS SUCH

PAYMENT TYPE	TAX HAVEN	NOT TAX HAVEN
Dividends (when issuing entity does not apply exemptions)	10%	0%
Dividends (when issuing entity applies exemptions)*	35%	0%
Insurance premiums	35%	22% ***
Foreign remittance withholding tax**	35%	22%

*Not applied to those with agreements with a public-private association. 10-year exemption

**Except countries with an agreement that applies the provisions of said document

***22% applied to 25-50% of the value, while the rate is 100% for tax havens on investments made outside the country. The tax rate was then increased from 0.08% to 0.25% for investments made abroad and 0.35% for investments in tax havens. This measure clearly encourages financial institutions to repatriate funds to Ecuador, and was supported by other measures taken by the Monetary and Financial Regulation Authority.

The Financial Code was also issued; it sets out certain rules for financial institutions and limits their relations with tax havens as follows:

• The main domicile of foreign financial entities cannot be a tax haven.

• Financial entities cannot be shareholders in financial entities domiciled in tax havens.

• Shareholders with an interest in financial entities (more than 6% of the capital) cannot be shareholders in financial entities domiciled in tax havens or jurisdictions with low tax rates.

The Monetary and Financial Regulation Authority has issued various resolutions that set out the following rules:

• Direct and indirect shareholders in private financial entities cannot be located in tax havens.

• Resolution 335 of 23 February 2017 stipulates that financial institutions in Ecuador must end any agreement that allows foreign financial institutions to grant credit or raise funds. It is important to point out that most transactions from outside the country were conducted through tax havens, which is why the possibility of using banks in tax havens for investment or credit operations through domestic banks has been limited by law.

• Regulation 371 prevents public and private financial institutions from conducting credit operations with and buying lending portfolios granted to natural and legal persons domiciled in tax havens or jurisdictions with low tax rates.

These provisions were implemented to help keep funds in the country's economy. The Monetary and Financial Regulation Authority stipulated that financial entities must meet a 60% domestic liquidity ratio, which means that 60% of the financial resources of financial institutions must be held in the country. Only investments – and not loans – made outside the country were included in this ratio, which meant that various financial entities used loans to other entities located in tax havens to circumvent the provisions and hold funds outside the country. Through this mechanism, loans were passed onto subsidiaries held outside the country by financial entities located in Ecuador.

Loans granted before the regulation was issued cannot be renewed, refunded or restructured and have to be cancelled on the original terms of the transaction.

6.8 Ethical Pact

The "Ethical Pact" is a pioneering initiative, as it was the first referendum in a western democracy on the issue of tax havens. The people were asked the following question:

"Do you agree that those wishing to stand for election or serve as a public official should be prohibited from holding assets or capital of any type in tax havens?"

In response to this question, 55.12% replied yes, and on 8 September 2017 the "Act implementing the popular vote held on 19 February 2017" (*Ley Orgánica para la Aplicación de la Consulta Popular Efectuada el 19 de Febrero del 2017*) was issued. It prohibits anyone holding or standing for an elected position or serving as a public official in the public sector if they directly or indirectly own assets or capital in jurisdictions or regimes considered to be tax havens.

Those holding assets in such jurisdictions were given until 6 March 2018 to transfer them to unrelated third parties. The transfer is not valid if it is to relatives within the fourth degree of consanguinity or second degree of affinity or to related third parties.

This initiative made international news, such as the article by Marcelo Bustos for BBC World on 20 February 2017 entitled "Ethical Pact: three reasons why the referendum on tax havens in Ecuador is important for other countries".

"It's an idea that should be repeated in other countries. It will help to prevent public officials from hiding the money they receive in bribes and also makes it difficult for them to be part of a government if they have undeclared assets in a tax haven", Bustos told BBC World.

Although a ban at this level now exists for those in the public sector, this does not guarantee that it will be effective. However, it is a major step forward in addressing corruption and its means and raising social awareness regarding the role of public officials.

It is important to highlight that there are exceptions to this law for officials posted in a country or jurisdiction that is considered to be a tax haven, for students and interns in these jurisdictions that wish to stand for an elected position, and for candidates or members of parliament that represent foreign voters and reside in a country or jurisdiction considered to be a tax haven.

6.9 Other additional regulations: Residence, closely related parties, aggressive tax planning strategies, and lifting banking secrecy, and the Global Forum

6.9.1 Residence

Important rules were adopted in 2014 and came into effect in 2015 concerning the tax residence of natural persons, as prior rules could be easily bypassed. The following rules have now been set out:

a) Anyone who spends one hundred and eighty-three (183) calendar days or more, in a row or otherwise, in Ecuador or on board an Ecuadorian ship during a fiscal year, including sporadic absences (i.e. not exceeding 30 days), is considered a tax resident of Ecuador.

b) The 183 days can be spread over two fiscal years unless the person's tax residence for the corresponding period is in another country or jurisdiction.

If the tax residence is declared to be in a tax haven or jurisdiction with low tax rates, the individual must prove that they stayed in that country or jurisdiction for at least one hundred and eighty-three (183) calendar days, in a row or otherwise, during the fiscal year in question. Otherwise, the individual remains a tax resident of Ecuador for the following four fiscal years.

c) An individual is considered a tax resident of Ecuador when the majority of their assets and income is directly or indirectly recorded in Ecuador.

d) Finally, to remove any doubt, an individual is considered to be a tax resident of Ecuador if they do not spend more than one hundred and eighty-three calendar days, in a row or otherwise, in any other one country or jurisdiction during the fiscal year, and their closest family ties remain in Ecuador.

6.9.2 Closely related parties

The Act issued in late 2008 included a definition of closely related parties. Among other factors, it states that shareholders and directors are considered closely related parties of companies with which transactions are conducted and that are domiciled, founded or located in a jurisdiction with low tax rates or a tax haven. This definition is crucial because it provides for a series of rules that limit and restrict tax benefits and deductions when transactions and operations are conducted with closely related parties, as is the case with debt limits, indirect expenses and bonuses.

6.9.3 Aggressive tax planning strategies and lifting banking secrecy

In 2016, following the discovery of certain cases of fraud published by the ICIJ, known as the Panama Papers, and the role played by tax advisors and major law firms in these cases, legal reforms were made to lift the secrecy surrounding information that helps to identify ownership and operations of residents of Ecuador with third parties located in tax havens, as well as aggressive tax planning practices and the advisors, promoters, designers and consultants involved in these practices.

Under these regulations, information on business groups' tax behaviour concerning offshore entities is published on the internet.

In addition, promoters, advisors, consultants and law firms are required to inform under oath the Tax Authority of the creation, use and ownership of companies that have Ecuadorian beneficial owners and are located in tax havens or jurisdictions with low tax rates. If this provision is not complied with, a fine equivalent to up to ten times the basic amount not subject to income tax (for 2017, the amount would be up to US$ 112,900) is charged, without prejudice to the criminal liability that may have been incurred.

Based on this article, a series of requests were made to the main law firms that create offshore companies, and the information served as the basis for the Tax Authority's planning and execution of control processes.

6.9.4 Lifting banking secrecy for the Tax Authority

Another important step was that on 23 December 2009, banking secrecy was lifted for the Tax Authority, which means that financial institutions are required to report bank information on transactions conducted between Ecuador and tax havens.

6.9.5 Global Forum

While the actions taken by our country are important, they need to be combined with essential and timely information if we are to truly fight tax havens. This is why Ecuador requested to be part of the Global Forum, which is currently in the peer review stage concerning compliance with international standards by countries and jurisdictions.

All countries have a duty to transform words into action in order to change the view that measures taken at the international level have been timid, superficial and with little impact. Ecuador has set a clear example. Our action can be compared to that of the story of the boy who put the starfish back in the sea – although not all of the starfish could be saved, it was worth it because of the ones he did save.

Endnotes:

[1] The capacity of a State to issue its own currency, control aspects of its exchange rate with other currencies, the exchange-rate regime and interest rates for its currency, as well as other money-related aspects within the territory in which it exercises national sovereignty. (Caixa)

Table 6: Use of offshore entities based on information from law firms

Use of offshore entities	**Total offshore entities created**
Holding (shares or other assets)	160
International trade	72
Inactive or liquidated (never used)	43
Wealth	25
Foundation	2
Business administration	1
Sending money	1
Legal representation	1
Total	**305**

[2] Winnie Byanyima, “Fighting inequality in Latin America: The road ahead,” 8 December 2014. Available from https://blogs.oxfam.org/es/node/24205.

[3] Susana Ruiz Rodríguez, Rosa Cañete Alonso, Michael Hanni, Ricardo Martner, Daniel Titelman, *Time to tax for inclusive growth* (Santiago, UNECLAC, Oxfam, March 2016). Available from https://www.cepal.org/en/publications/39950-time-tax-inclusive-growth.

[4] Swiss Leaks is the name of a journalistic investigation into a tax evasion scheme allegedly operated with the knowledge and encouragement of the British multinational bank HSBC via its Swiss subsidiary.

[5] Panama Papers is the name given to the major leak of financial information managed by tax havens with help from the fourth largest law firm in the world, Mossack Fonseca.

[6] ECLAC, *Economic Survey of Latin America and the Caribbean, The 2030 Agenda for Sustainable Development and the challenges of financing for development* (Santiago, 2016).

[7] “Registro Oficial Publica Ley Contra Paraísos Fiscales En Ecuador,” 8 September 2017. Available from https://www.confirmado.net/registro-oficial-publica-ley-paraisos-fiscales-ecuador.

[8] Fundacion Melior, " Paraísos fiscales o el fraude a escala planetaria ", 8 February 2012. Available from http://www.fundacionmelior.org/content/tema/para%C3%ADsos-fiscales-o-el-fraude-a-escala-planetaria.

[9] Oxfam International, "Tax on the “private” billions now stashed away in havens enough to end extreme world poverty twice over", 22 May 2013. Available from https://www.oxfam.org/en/pressroom/pressreleases/2013-05-22/tax-private-billions-now-stashed-away-havens-enough-end-extreme.

[10] Angel Gurria, “The Global Dodgers”, *The Guardian*, 27 November 2008. Available from https://www.theguardian.com/commentisfree/2008/nov/27/comment-aid-development-tax-havens.

[11] James S. Henry, “The Price of Offshore Revisited - New estimates for “missing” global private wealth, income, inequality, and lost taxes” (Tax Justice Network, July 2012). Available from https://www.taxjustice.net/wp-content/uploads/2014/04/Price_of_Offshore_Revisited_120722.pdf.

[12] ECLAC, *Economic Survey of Latin America and the Caribbean, The 2030 Agenda for Sustainable Development and the challenges of financing for development* (Santiago, 2016).

[13] ECLAC, *Social Panorama of Latin America* (Santiago, 2012).

[14] “Tras las huellas de un atraco, Ecuador, 1999”. Available from www.memoriacrisisbancaria.com.

[15] Pedro Páez Pérez, “Liberalización financiera, crisis y destrucción de la moneda nacional en Ecuador,” *Cuestiones económicas*, Vol. 20, 2004. Available from https://www.bce.fin.ec/cuestiones_economicas/images/PDFS/2004/No1/Vol.20-1-2004PedroPaez.pdf.

[16] Pedro Páez Pérez, “Liberalización financiera, crisis y destrucción de la moneda nacional en Ecuador,” *Cuestiones económicas*, Vol. 20, 2004. Available from https://www.bce.fin.ec/cuestiones_economicas/images/PDFS/2004/No1/Vol.20-1-2004PedroPaez.pdf.

[17] Pedro Páez Pérez, “Liberalización financiera, crisis y destrucción de la moneda nacional en Ecuador,” *Cuestiones económicas*, Vol. 20, 2004. Available from https://www.bce.fin.ec/cuestiones_economicas/images/PDFS/2004/No1/Vol.20-1-2004PedroPaez.pdf.

[18] James S. Henry, “The Price of Offshore Revisited – Appendix III – Key Charts” (Tax Justice Network, July 2012). Available from https://www.taxjustice.net/cms/upload/pdf/Appendix%203%20-%202012%20Price%20of%20Offshore%20pt%201%20-%20pp%201-59.pdf.

[19] Mossack Fonseca is the fourth largest law firm in the world. It provided advice on how to use tax havens for financial management purposes. Information on the firm was leaked in what is known as the Panama Papers.

[20] This region is a special administrative region of China with a separate legal and tax system to that of China. Its tax system is based on territorial criteria, which means that only income from local sources is subject to tax. Factors such as residence and nationality are not relevant for tax purposes. Tax rates in Hong Kong are among the lowest in the world, which is why numerous foreign companies choose the city as the head office for their Asian operations (ICEX).

[21] For interest payments to be deducted, the external debt must not exceed 300% of total assets when the borrower is a company and 60% of total assets when the borrower is a natural person. Interest payments on amounts exceeding this threshold are not deductible, although 22% of the total interest paid must be maintained. There is no limit if the debt is with financial entities, even if they are located in tax havens.

[22] Up to 5% of the income tax base plus the value of such expenses can be deducted. 5% of total assets in the preoperative period. A corresponding amount must be withheld at source.

[23] Up to 20% of the income tax base plus the value of such expenses can be deducted. 10% of total assets in the preoperative period. A corresponding amount must be withheld at source.

[24] Under resolution 536, issued on 28 December 2016, listed companies are not required to provide details of shareholders that own less than 2% of the share capital. For non-profit organizations and investment funds, minimum holdings subject to reporting are also set out. The requirements to report to the end level applies to those entities whose owners or beneficiaries with voting rights or members of governing bodies are companies that are not permanently based in Ecuador.

SOUTH CENTRE
South Unity, South Progress.

The South Centre is the intergovernmental organization of developing countries that helps developing countries to combine their efforts and expertise to promote their common interests in the international arena. The South Centre was established by an Intergovernmental Agreement which came into force on 31 July 1995. Its headquarters is in Geneva, Switzerland.

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