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**ANALYSIS OF INTERNATIONAL TRADE TRANSACTIONS AMONGST
RELATED MULTINATIONAL ENTERPRISES
IN ECUADOR IN 2016.**

**GRADUATION PROJECT PRIOR OBTAINING THE UNDERGRADUATE
DEGREE IN INTERNATIONAL STUDIES WITH EMPHASIS IN FOREIGN
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DEDICATED TO:

My parents, siblings, family and friends, who have been part of my daily behalf.

*I WANT TO THANK PROFESSOR LUIS PINOS
LUZURIAGA FOR PROVIDING HIS TRUST AND
SUPPORT DURING THIS INVESTIGATION, AND TO JOSÉ
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BEGINNING OF THIS PROJECT.*

CONTENTS

TABLES AND GRAPHICS INDEX	6
RESUMEN.....	8
ABSTRACT	9
INTRODUCTION.....	10
CHAPTER I:	12
TRANSFER PRICING DESCRIPTION	12
1.1. ORIGINS AND DEVELOPMENT OF TRANSFER PRICING.....	12
1.1.1. TRANSFER PRICE	12
1.1.1.1. MULTINATIONAL ENTERPRISES (MNEs)	14
1.1.1.2. TAX HAVEN (TH)	16
1.1.1.3. RELATED PARTIES	18
1.1.2. HISTORY	18
1.2. THE TRANSFER PRICING ISSUE FOR MULTINATIONAL COMPANIES AND LOCAL TAX ADMINISTRATIONS	20
1.3. OECD GUIDELINES	23
1.3.1. ARM'S LENGTH PRINCIPLE	23
1.3.1.1. COMPARABILITY	25
1.4. TRANSFER PRICING METHODS	26
1.4.1. TRANSACTION-BASED METHODS (TRADITIONAL)	27
1.4.1.1. COMPARABLE UNCONTROLLED PRICE (CUP).....	27
1.4.1.2. RESALE PRICE METHOD (RPM).....	29
1.4.1.3. COST PLUS METHOD.....	30
1.4.2. PROFIT-BASED METHODS	31
1.4.2.1. PROFIT SPLIT METHOD	32
1.4.2.2. TRANSACTIONAL NET MARGIN METHOD	32
1.5. CONCLUSIONS	33
CHAPTER II	35
MULTINATIONAL ENTERPRISES SUBJECT TO THE TRANSFER PRICE REGIME IN ECUADOR AND ITS MAIN CHARACTERISTICS	35
2.1. HISTORY AND CONTEXT OF THE TRANSFER PRICING REGIME IN ECUADOR ..	35
2.2. CURRENT NORMS	37
2.2.1. ORGANIC LAW OF INTERNAL TAX REGIME	37
2.2.2. REGULATION FOR THE APPLICATION OF THE LAW OF INTERNAL TAX REGIME	38

2.2.3. RESOLUTIONS	40
2.3. MULTINATIONAL ENTERPRISES SUBJECT TO THE TRANSFER PRICING REGIME IN ECUADOR AND ITS MAIN CHARACTERISTICS	41
2.3.1. FORMULARY 101	42
2.3.1.1. COLLECTION OF INFORMATION AND PREPARATION OF DATABASE	42
2.3.1.2. DETERMINATION OF THE SAMPLE USED IN THE STUDY	42
2.3.2. CLASSIFICATION OF MNEs SUBJECT TO THE REGIME.....	43
2.3.2.1. SECTOR IN WHICH THEY OPERATE	43
2.3.2.2. MOTHER COUNTRIES	45
2.3.2.1. MAIN FINANCIAL ACCOUNTS	50
2.4. CONCLUSIONS	52
CHAPTER III	54
QUANTITATIVE ANALYSIS OF THE INTRA-GROUP OPERATIONS OF MULTINATIONAL COMPANIES SUBJECT TO THE TP REGIME IN ECUADOR	54
3.1. CLASSIFICATION OF INTRA-GROUP OPERATIONS	54
3.1.1. ANALYSIS OF TOTAL OPERATIONS.....	54
3.1.2. ANALYSIS OF THE ASSETS OPERATIONS	56
3.1.3. ANALYSIS OF THE LIABILITIES OPERATIONS	63
3.1.4. ANALYSIS OF INCOME OPERATIONS.....	68
3.1.5. ANALYSIS OF THE EXPENSES OPERATIONS	74
3.1.6. ANALYSIS OF ROYALTIES, TECHNICAL, ADMINISTRATIVE, CONSULTING AND SIMILAR SERVICES (S-R).....	79
3.1.7. ANALYSIS OF CAPITAL OUTFLOWS	83
3.2. CONCLUSIONS	85
CONCLUSIONS AND FINAL RECOMENDATIONS	86
BIBLIOGRAPHY	88
ANNEX	91
ANNEX 1.....	91
ANNEX 2.....	92

TABLES AND GRAPHICS INDEX

Table 1: Sector	44
Table 2: Countries of origin of the multinationals of the study	46
Table 3: Top 10 countries and their OPRE share.....	47
Table 4: Top 12 Ecuadorian based MNEs according to their patrimonial contribution	49
Table 5: Main Financial Accounts based on the amount generated in 2016	50
Table 6: Main financial accounts divided by sectors	51
Table 7: Total transactions with related parties in relation to each segment	54
Table 8: Assets operations divided by sector	56
Table 9: Top 10 companies with the most assets operations with THs and related parties from abroad.	58
Table 10: Liabilities operations divided by sector	63
Table 11: Top 10 companies with the largest liabilities operations with THs and related parties abroad	65
Table 12: Income Operations divided by sector	68
Table 13: Top 15 companies with the largest Income Operations with THs and related parties abroad	70
Table 14: Expenses Operations divided by sector	74
Table 15: Top 10 companies with the largest Expense Operations with THs and related parties abroad	76
Table 16: Operations of (S-R) divided by sector	79
Table 17: Top 10 companies with the largest (S-R) operations with THs and related parties abroad	81
Graphic 1: Horizontal and Vertical FDI.....	16
Graphic 2: Resale Price	29
Graphic 3: Related Parties.....	39
Graphic 5: Sector (USD Millions)	44
Graphic 6: Concentration of Patrimonial Contributions by Country	47
Graphic 7: Comparison of the assets operations with companies in THs and related parties abroad, versus the total reported in 2016.....	61
Graphic 8: Comparison of liabilities operations with companies in THs and related parties abroad, versus the total reported in 2016.....	66

Graphic 9: Comparison of the income operations with companies in THs and related parties from abroad, versus the total reported in 2016..... 71

Graphic 10: Comparison of the expenses operations with companies in THs and related parties abroad, versus the total reported in 2016..... 77

Graphic 11: Comparison of the (S-R) operations with companies in THs and related parties abroad, versus the total reported in 2016..... 82

RESUMEN

Desde la perspectiva del comercio internacional y los negocios internacionales, podemos identificar a las empresas multinacionales como uno de los principales actores en el ámbito del intercambio de bienes y servicios. Teniendo esto en cuenta, nace la necesidad de un control de precios bajo los cuales se realizan dichos intercambios entre empresas de un mismo grupo comercial. Debido al tamaño y poder que tienen en el mercado mundial, las grandes empresas encuentran más fácil poder manipular los precios de compra y venta de bienes y servicios entre sus subsidiarias. Dada la influencia que tienen estas empresas en el comercio internacional y a nivel interno, nace la necesidad de una explicación de esta problemática, que para muchos es desconocida.

ABSTRACT

From the perspective of international trade and international business, we can identify multinational enterprises as one of the main actors in the field of the exchange of goods and services. Taking this into account, the need arises for a price control under which such exchanges are made between companies of the same commercial group. Due to the size and power that they have in the world market, large companies find it easier to manipulate the prices of buying and selling goods and services among their subsidiaries. Given the influence of these companies in international and local trade, the need arises for an explanation of this problem, which for many is unknown.

INTRODUCTION

The main motivation and interest in international transfers, derived from trade practiced by multinational enterprises (MNEs), is given by the existent curiosity to understand the problems that arise from the prices in which trade amongst related parties is carried out, a problem that has repercussions mainly in the attempts of large companies to reduce tax payments, taking special consideration at the level of foreign trade, and the exchange of products and services at prices suggested by the market, and understand how this problem derives in the regime of transfer pricing.

This study aims to be a contribution to the understanding of international trading operations and for international business, seeking to address the issue from a perspective of multinational enterprises, with operations in Ecuadorian territory. This study involves the economic and commercial trend of Ecuador and focuses on the need for an investigation and description of a subject for many unknown.

The first element that must be taken into consideration is the reason why external economies are created, that is, what leads companies to expand their market and internationalize their operations. It will also take into account the patterns that lead companies to make direct foreign investment, and how all this leads to the emergence of multinational enterprises, and the consequences that the existence of such cause.

The study of the economic power of multinational groups, their business models and the impact of price policies on the geographical distribution of income has occupied the interest of researchers and academics within international development organizations and private centers. The Organization for Economic Cooperation and Development (OECD) is a specialist in this area and since 1999 publishes the guidelines for transfer pricing (OECD, 2013). This document has been adopted totally or partially by several countries in the world in its local regulations in order to require companies to prove compliance with the arm's length principle.

To carry out this research, firstly, the existing literature will be reviewed to formulate the theoretical bases necessary to understand transfer pricing and the base regulations, the local regulations, and the transfer pricing study methods. Among the literature consulted to develop the conceptual bases of this research are; the OECD 2017 guidelines, the Organic Law of the Internal Tax Regime (LORTI for its Spanish

acronym) and its respective regulations, the SRI resolutions on transfer pricing and transfer pricing studies of national authors.

The second part of this investigation corresponds to the elaboration of a sample that contains all of the multinational enterprises with business activities in Ecuador, and that have registered more than 15 million dollars in commercial operations with related parties. For this, it will be used the last database of financial information available from the Superintendence of Companies, Securities and Insurance corresponding to 2016.

It will be reviewed that each company meets the proposed criteria and local companies will be excluded, so the stock tree of each company will have to be reviewed in order to confirm that it actually belongs to an international multinational group. Subsequently, the characteristics of the sample obtained, the sectors to which these companies belong and the economic particularities that can be identified will be analyzed.

Finally, a quantitative analysis of the intra-group transactions of the companies in the sample will be carried out in order to determine which the MNEs that carry out most international trade with their own economic group are. Likewise, the intra-group transactions will be related to the ordinary operations of the company.

CHAPTER I: TRANSFER PRICING DESCRIPTION

1.1. Origins and Development of Transfer Pricing

1.1.1. Transfer Price

"Transfer Price" can be defined, in simple terms as "the amount charged by a segment of an organization, for a product or service that supplies another segment of the same organization" (Horngren & Sundem, 2008). That is, the prices that the related parties charge each other for the goods and services that are transferred between them.

From an economic point of view, the reason for accepting the transfer pricing regime is to be able to evaluate the performance of the entities of the group involved. By charging the prices of the goods and services transferred within a commercial group, the managers of the group entities can make the best decision about whether to buy or sell goods and services inside or outside of the commercial groups.

Approximately half of the most important commercial groups in the world transfer goods and services valued internally under a cost-based system. Some multinational companies use only variable costs, others use total costs and others use total costs plus a profit margin. Some use standard costs, other real costs (UNPAN, 2001). In other words, transfer pricing determines the correct price for transactions between subsidiaries of the same business group.

These prices can be used to transfer profits to jurisdictions that favor companies in terms of tax; if in a transaction between a subsidiary that is in a jurisdiction with high taxes and another in a jurisdiction with low taxes, the subsidiary with high taxes charges a price lower than the "real" price, some of the profits of the group are then transferred to the subsidiary with low taxes.

Obviously, taxpayers (companies) would like to be part of this type of behavior because it would help them significantly to reduce their taxes. If there were no limitations on the aforementioned, the total income of multinational corporations would be taxed at the lowest tax rate in the world, that is, at a zero tax rate if possible, usually in tax havens.

It is for this reason that lots of countries have adopted a set of tax rules that regulate prices that related companies can charge each other.

According to several organisms that propose guidelines in this matter, if there is a competitive open market for the products or services transferred internally, the best solution from a business economics point of view is to use the market price as a transfer price. The market price may be derived from published price lists for similar products and services, or it may be the price charged by a group entity to its customers (unrelated or independent companies) (UNPAN, 2001).

However, for companies to achieve optimal prices can be very difficult. An apparently simple approach is to apply market prices to intra-group transactions, as explained in the previous paragraph. In any case, those prices may be inapplicable, or even non-existent, to the realities of the operations of MNEs.

First, profit centers may not be free to purchase inputs from the open market. Second, the relevant inputs may not be available on the open market. Indeed, the specialized productive technology or managerial know-how of a given MNE may be unique to the enterprise. The very advantage that the firm possesses may negate any alternative source. Thus an internally determined transfer price may be the best approximation of the value of the input concerned (UNCTAD, 1999).

Apart from the cost-based methods and transfer prices based on open market prices, another approach may be distinguished. In various MNEs, group entities negotiate with each other like independent parties because they have their own profit responsibility. The transfer price resulting from such negotiations is equally acceptable from a business economics point of view (UNPAN, 2001).

Tax legislation may have an impact on commercial transfer pricing approached. If the commercial system is in conflict with the pertinent tax rules, companies may either adopt the fiscally correct system or, if allowed, maintain two systems, one for commercial purposes, the other for tax purposes (UNPAN, 2001). The above definition of transfer pricing is also valid for tax purposes.

However, sometimes it is used incorrectly, to mean the shifting of taxable income from a company, belonging to an MNE, located in a high taxing jurisdiction to a company

belonging to the same group in a low taxing jurisdiction through incorrect transfer prices in order to reduce the overall tax burden of the group.

Which means that trade between related parties is not a form of tax evasion, as is commonly thought, it can become so if they do not have a correct support and valuation, but to avoid this, transfer price studies are carried out by the companies.

Paragraph 3 of the Preface to the OECD Report on Transfer Pricing and Multinational Enterprises of 1979 explains that the term "transfer price" is neutral: "consideration of transfer pricing problems should not be confused with the consideration of problems of Tax evasion, even though transfer pricing policies can be used for such purposes." The OECD reports further clarify this from its title "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" (OECD, 2017).

In fact, transfer prices provide opportunities for multinational companies to transfer profits from a high-tax country to a country with a low corporate tax rate or with tax incentives for certain activities. However, one must realize that tax planning is just one of a series of considerations that are relevant to multinationals (UNPAN, 2001).

Most multinationals prefer to maintain a good relationship with the tax authorities of the countries where they are active. Certainty about the amount of taxes payable is a priority for large companies and they generally operate with a well-documented and direct transfer pricing system, which is, as explained above, a requirement for an efficient commercial economy (UNPAN, 2001).

1.1.1.1. Multinational Enterprises (MNEs)

The term multinational is widely used in OECD reports. But, what is a multinational?

- The multinational corporation is a business organization whose activities are located in more than two countries and is the organizational form that defines foreign direct investment (FDI). This form consists of a country location where the firm is incorporated and of the establishment of branches or subsidiaries in foreign countries. Multinational companies can, obviously, vary in the extent of their multinational activities in terms of the number of countries in which they operate. A large multinational corporation can operate in 100 countries,

with hundreds of thousands of employees located outside its home country (Columbia Business School, 2001).

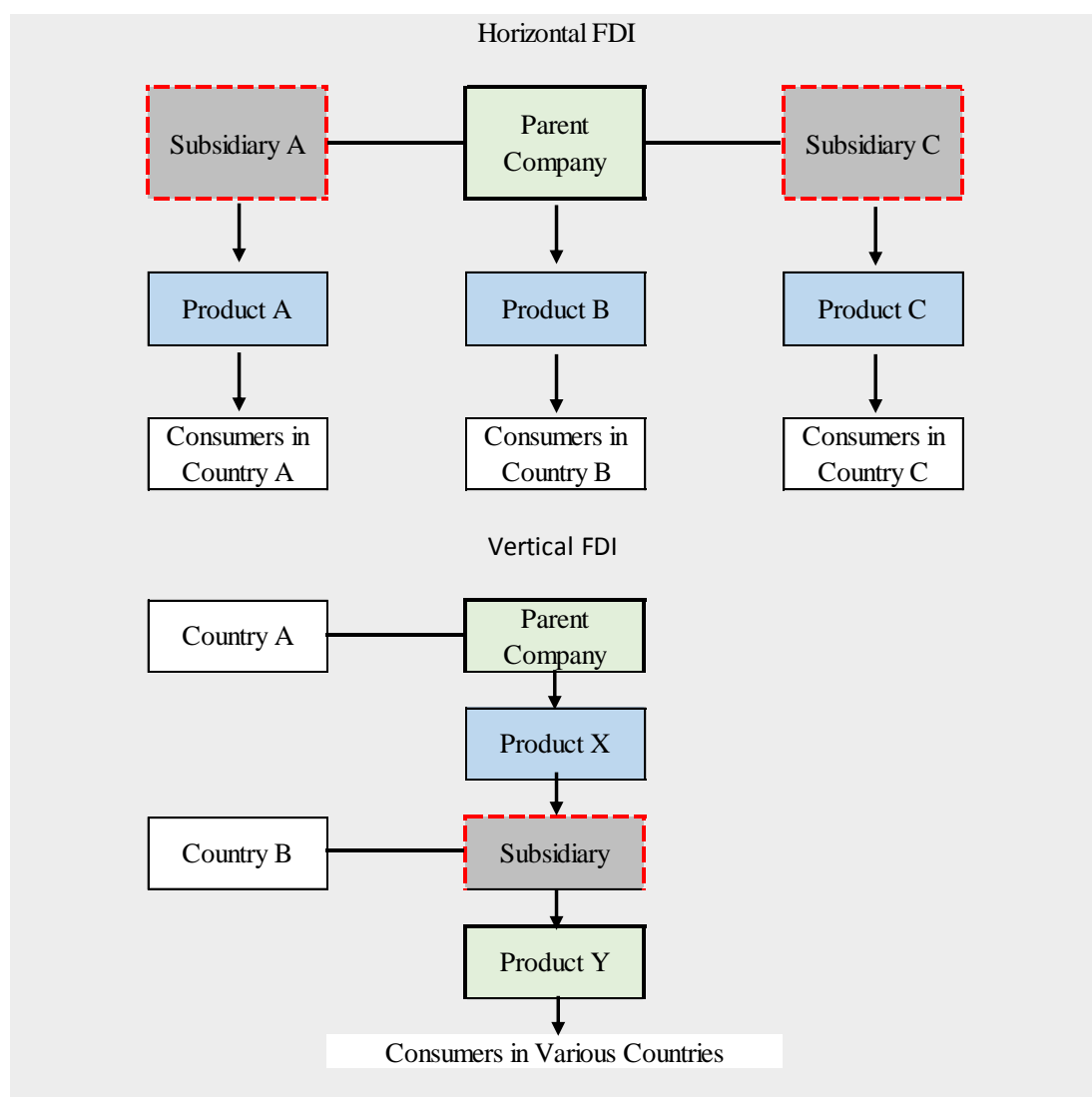
On a different approach, Paul Krugman states; when is considered that a corporation is a multinational??

- "According to US statistics, it is considered that a US company is controlled by foreign companies and, therefore, is a subsidiary of a multinational company based abroad, if a foreign company has 10% or more of its shares; The idea is that 10% is enough to give effective control. Similarly, it is considered that a company based in the United States is a multinational if it owns more than 10% of a foreign company. The controlling company (owner) is called the parent, while the "controlled" companies are subsidiaries of the multinational." (Krugman, Obstfeld, & Melitz, 2012). It should be noted that for purposes of this thesis is considered 25% or more of shares, according to Ecuadorian regulations.

Foreign investment flows are denominated Foreign Direct Investment (FDI); and from this the following question arises, why do companies decide to make this investment and have a subsidiary abroad?

Krugman argues that this response depends, in part, on the production activities carried out by the foreign subsidiary. These activities fall into two fundamental categories, which are those integrated horizontally and vertically (Krugman, Obstfeld, & Melitz, 2012):

Graphic 1: Horizontal and Vertical FDI



Source: (Krugman, Obstfeld, & Melitz, 2012)

Elaboration: González, David

1.1.1.2. Tax Haven (TH)

This term is often repeated within intra-group commercial exchanges between MNEs, since this term refers to countries with low or non-existent tax rate, they are the main objective of MNEs to reduce their tax expenditures.

In this way it can be said that a tax haven is a country that offers little or no tax to foreign individuals and companies in terms of politics and economy. Tax havens also have the characteristic of offering little or no financial information to foreign tax authorities, and do not require residence or commercial presence for individuals and companies to benefit from their tax policies (UNPAN, 2001).

According to the Internal Revenue Service of Ecuador (SRI), in its section "International Taxation" it defines in the following manner the conditions considered to include a country within the list of tax havens.

(*) Unnumbered article, added after Article 4 of the Internal Tax Regime Law:

"Art. (...).-Tax havens, preferred tax regimes or jurisdictions of lower taxation. Those tax regimes or jurisdictions in which at least two of the following conditions are met will be considered as tax havens:

1. Have an effective tax rate on income or taxes of an identical or analogous nature lower than sixty percent (60%) to the corresponding one in Ecuador or when the tax rate is unknown.
2. To allow that economic, financial, productive or commercial activities does not develop substantially within the respective jurisdiction or regime, in order to benefit from tax benefits of the jurisdiction or regime.
3. Absence of an effective exchange of information in accordance with international standards of transparency, such as the availability and access to information by the competent authorities on the ownership of companies, including legal owners and beneficial owners, reliable accounting records and information on bank accounts, as well as the existence of mechanisms that imply an effective exchange of information (SRI, 2017).

On the other hand, the organization for the cooperation and the economic development of the nations-OECD, in an official document issued in 1998, called "COUNTERING OFFSHORE TAX EVASION"; establishes four key factors to identify tax havens:

- 1) No or nominal tax on the relevant income;
- 2) Lack of effective exchange of information;
- 3) Lack of transparency;
- 4) No substantial activities.

No or nominal tax is not sufficient in itself to classify a country as a tax haven. The fourth factor above “no substantial activities” was not considered when determining whether a jurisdiction was cooperative. Thus, in order to avoid being listed as an uncooperative tax haven, jurisdictions which met the criteria were asked only to make commitments to implement the principles of transparency and exchange of information for tax purposes (OECD, 2009).

1.1.1.3. Related Parties

Related companies refers to all the entities that operate within the same commercial group, whether it is a branch or subsidiary, or companies linked economically, which means that it is its sole supplier or its sole client.

Article 9¹ of the "OECD Model Tax Convention", refers to the taxation of profits of companies and their associated companies. First, certain conditions must be met to be considered as a related company. There must be a control relationship between a parent company and its subsidiaries, either directly or indirectly, or two companies must be controlled by a common third party.

According to the aforementioned article, the related parties are defined as follows:

- a. A company of a Contracting State participates directly or indirectly in the management, control or capital of a company of the other Contracting State or;
- b. The same persons participate directly or indirectly in the administration, control or capital of an enterprise of a Contracting State and a company of the other Contracting State... (OECD, 2010).

However, the regulations of each country in relation to what is considered as a related party may vary.

1.1.2. History

The transfer pricing regime was introduced for the first time in the United Kingdom in 1915, where it has had an integral regime based on the arm's length principle to apply

¹ To review article 9 refer to annex 1.

transfer pricing methodologies to transactions between companies under common control (Gardner & Palmer, 2017).

The United States is the next country to adopt a transfer pricing regime. For this, the Internal Revenue Service (IRS), was authorized in 1917 to allocate income and deductions among related corporations, and request that they make their tax returns on a consolidated basis (UNPAN, 2001).

The predecessors of its current Internal Revenue Code (IRC) section 482, where it is determined whether intra-group transactions comply or not with the Arm's Length Principle, date from 1921 and 1928. Since 1935, regulations have used the arm's length principle as a basis for its provisions on this subject (CLA (CliftonLarsonAllen): Tax, Audit, Outsourcing, Wealth Advisory, 2013).

The arm's length principle was formulated for the first time in Article 6 of the League of Nations draft Convention on the Allocation of Profits and Property of International Enterprises in 1936. However, some countries had already relied in this principle for their regulations.

Until the 1960s, it was mainly the developed countries that adopted measures in terms of transfer prices in their legislations, although it was not very generalized, due to the fact that there was not a large amount of international trade during this period, and also due to the military conflicts that aroused during this period, between 1915 and 1960 (UNPAN, 2001)

In 1979, the OECD undertook an in-depth analysis of the transfer pricing provisions and published a report on "Transfer pricing and multinational companies". This report reaffirmed the arm's length principle, not only in the context of the treaties but also as a general rule. Before 1979, administrative guidelines on the application of legal provisions regarding transfer prices were very scarce. In addition to the OECD, the United States had played a decisive role in the development of transfer pricing guidelines until this year (OECD, 2009).

In 1999 guidelines were issued to carry out price agreements in advance. During this period, the role of multinational companies in world trade had increased considerably. As such, a large number of developed countries began to pay more attention to transfer

pricing problems and introduced comprehensive legislation in the field of transfer pricing (UNPAN, 2001).

Based on these new guidelines, new reforms are made in Latin American countries, these are applied from the nineties. Ecuador, despite not being a member of the OECD, accepts its guidelines from the year 2005, its neighboring countries Colombia and Peru do so since 2004 and 2001 respectively.

1.2. The Transfer Pricing Issue for Multinational Companies and Local Tax Administrations

As the world economy turns global, more multinational companies are considering new or greater direct foreign investments and the creation of subsidiaries abroad. This expansion requires the transfer of tangible and intangible assets, and even services, between the parent companies and their foreign subsidiaries. One issue that arises in this context is how to set the prices of these cross-border transfers.

While obstacles to international trade are reduced, large companies find easier ways to take their activities to foreign territories, and thus increase the amounts of their transactions.

This creates conflicts with local tax administrations, since multinational companies when doing intra-group trade involve two territories, or two countries; for that reason tax regulations must be taken into account in a broad international context, and not only in isolation in the country of origin or in the recipient.

Transfer pricing frameworks can, in principle, promote reasonable tax revenues for the countries involved and, at the same time, establish a fair tax liability on corporations. For these reasons, transfer pricing issues raise important and often contentious policy questions for host and home governments, as well as for MNEs, as transfer pricing methods directly affect the amount of profit reported in host countries by corporations, which in turn affects the tax revenues of both host and home countries (UNCTAD, 1999).

To understand transfer pricing, it is important to describe the use of the same by MNEs. Only in this way the meaning of the regulatory standards used in international agreements and national laws can be fully understood.

First, the transfer pricing regime is understood as a tax rate at the international level, and it is considered a declaration before the tax agency of each country; which makes it a tax, which is defined as "a mandatory contribution by a person to the government to cover expenses incurred in the common interest of all, without reference to the special benefits conferred" (Edwin R & Seligman, 1895) It is a government need to cover its obligations.

In this sense, perhaps the biggest tax problem that the international system faces is the transfer prices between related parties, local or international. This is because the price charged by one commercial entity to another for the provision of goods, services or intangibles is the easiest way to redistribute the income and expenses between the entities.

In this case, one way for MNEs to evade taxes is by manipulating the prices of intra-group exchanges. The main objective of this behavior, is that enterprises prefer to maximize the general income after taxes of the company against the individual income of its subsidiaries.

Parent companies of larger groups usually have sub-holdings and intermediary holdings in several countries; research and service activities may be concentrated in centers operating for the whole group or specific parts; intangibles, developed by group entities, may be concentrated in centers operating for the whole group or specific parts; intangibles, developed by group entities, may be concentrated at certain group members; finance companies may operate as internal banks; production of parts and assembly of final products may take place in many different countries. From a decision making perspective groups may range from highly centralized, important decisions being made centrally, to structures with a high degree of decentralization and profit responsibility allocated to individual group members (UNPAN, 2001).

The transfer pricing regime has gained more attention in recent years. There are several reasons for companies to do this:

- One of them is the concentration of functions within multinational companies.
- They prefer to set up a base in foreign countries, and try to do their operations so that they carry out the activities that generate more income in the country with less tax rates.

- They seek to reduce different costs, such as production costs, infrastructure, taxes, etc.
- The on-going (re)location of the production of final products and components to appropriate territories.
- The relatively new phenomenon of global, 24 hours per day, trading in commodities and financial instruments, which was made possible by modern means of communication (UNCTAD, 2013).

Political reasons, in particular in the United States, have also played a role. American politicians alleged (and continue to allege) that foreign enterprises active in the United States paid substantially lower amounts of income tax than comparable U.S. groups. Although the reason for tightening transfer pricing legislation in 1986 was a domestic American one tax planning by American groups involving the transfer of intangibles developed in the United States to related companies in tax havens such as Puerto Rico, the political emphasis has shifted to foreign held American companies, although no clear evidence has been provided that foreign groups manipulate transfer pricing more than U.S. based groups do (UNCTAD, 2013).

In this context, the most important problem regarding local tax administrations is that, each of the countries expect to have a legitimate percentage of taxes derived from the functions of each company within their territories, since these exploit the resources that the country provides, so that countries have the power to collect taxes derived from the cost of the resources that their territories make available to companies, so each country wants to collect taxes from the profits generated in its territory. Therefore, the tax administrations of each country argue that the rent must be taxed in the place where it was generated.

MNEs and commercial groups of companies play a dominant role in international commerce and business. These multinational corporations can carry out intra-group trade with their related companies in different countries with the same or different tax systems.

This way companies can transfer goods and services at prices that are not based on the market, or supply and demand; but impose the prices to their liking. It happens exactly the same also at a local level, between commercial groups that operate within a given

territory. Therefore, the importance given to transfer pricing by all countries, due to their impact on tax revenues, and the importance of their economic activity.

Taking into account that the administrations of the commercial groups seek to maximize their income, and that one way to achieve this is by reducing the paid taxes, their fiscal strategies have countries and jurisdictions with low or zero tax rates as their targets.

1.3. OECD Guidelines

The Organization for Economic Cooperation and Development has turned into the entity with the most responsibility over the transfer pricing regime, and its guidelines, which are the basis for tax regulations in most countries, have become a standard within this problem. As mentioned before, the OECD is the starting point for almost all regulations on this subject. For this reason it is inevitable to talk about the principles of transfer pricing without mentioning the OECD.

As can be seen from the history of the transfer pricing regime, the OECD is the initiator in terms of regulations, and its guidelines have become a standard to be taken into account by countries that wish to include this section in their legislations.

Its mission is to promote policies that improve the economic and social well-being of people around the world. To do so, the OECD provides an environment where governments can compare policies, seek answers to common problems, identify good practices and coordinate national and international policies. One of these international policies is the Transfer Pricing Guidelines for Multinational Companies and Tax Administrations. These guidelines have been published since 1999, and the latest available version was published in 2017.

The guidelines are widely accepted as a framework for the interpretation of Article 9, mentioned above, and to establish and analyze the prices and conditions of the arm's length principle, as well as to solve international tax problems.

1.3.1. Arm's Length Principle

The Principle of Full Competition is the international transfer pricing standard accepted by all OECD member countries for tax purposes of MNEs, it is used to avoid

double taxation between countries. It has its origin in article 9 of the OECD Model Tax Convention, this principle is defined as follows:

“(When) two companies, in their commercial or financial relationships, are united by accepted or imposed conditions that differ from those that would be agreed by independent companies, the profits, which would have been obtained by one of the companies in the absence of such conditions, and that, in fact, they have not been made because of the same, they may be included in the profits of said company and be subject to taxation accordingly.” (OECD, 2010).

That is, the arm's length principle means that in an intra-group business transaction, the two related companies operate as independent, and the transaction is carried out at market price, without benefit of the commercial relationship.

The OECD's main reason for supporting the application of the arm's length principle is stated in its 1995 report. It argues that this principle promotes the growth of investment and international trade, since this principle considers that the related parties are in equal positions as independent parties for tax purposes, thus maintaining competitiveness (Mulyani, 2010).

In addition, the 1995 OECD report argued that the arm's length principle has been found to work effectively to resolve most cases of transfer pricing. A large number of countries believe that this principle is the most appropriate method to deal with transfer pricing problems. However, although the principle itself can be seen as simple, its application has proven difficult (Mulyani, 2010).

If independent companies do business with each other, it is the market that decides the financial or commercial relationship between them. If companies do intra-group business, the market does not affect in the same way. The arm's length principle is, in these transactions, the best way to bring them into an independent relationship. The tax advantages and disadvantages are eliminated using this principle.

Sometimes, when it is easy to collect comparable information from transactions in independent corporations, the arm's length principle is useful. But in some cases it is difficult or not the best option to use this principle. If information is missing or the information available is incomplete, then you do not have enough material to compare

the information. If there is a special or unique service, a product or intangible property, it can be difficult to find transactions to compare and the arm's length principle is difficult to use (United Nations, 2017).

To make sure that the independent transaction is useful, as a basis of comparison, it is necessary to use a comparable analysis. To ensure that it is a comparable independent transaction, it is important that the conditions being analyzed affect the transaction. If there are important differences, adjustments must be made to ensure that you have a basis for comparing these transactions (United Nations, 2017).

There are two problems when deciding if an operation is a comparable independent transaction:

- It is not easy to find identical or similar comparable transactions to determine the arm's length price or market price, especially for transactions involving intangibles.
- Sometimes taxpayers and tax authorities have different interpretations of which is the best method to determine the arm's length price.

The use of different methods can result in a significant difference between arm's length prices (OECD, 2017).

1.3.1.1. Comparability

Comparability has to do with the comparison of a related transaction to one or several unrelated. These two types of operations are comparable if:

- There is no difference that can significantly affect the factor that has been examined in the methodology (for example, the price or the margin) or;
- If it is possible to make necessary precise adjustments that eliminate the substantial effects of any difference (OECD, 2010).

This means that, the transactions do not necessarily have to be identical, but similar enough to be compared. Adjustments are made when there are material differences, so these differences can be considered when determining the full price.

Comparability can be determined by five factors:

1. The characteristics of the goods or services transferred.
2. The analysis of the functions or activities performed, including the assets used and the risks assumed in the operations.
3. Contractual terms or not, with which transactions between related and independent parties are actually carried out.
4. Economic or market circumstances.
5. Business strategies, including those related to entrance, permanence and expansion of the market, among others (RLORTI, 2015).

1.4. Transfer Pricing Methods

The most common problem faced by multinationals when determining the prices charged between related companies is that there is a possibility that two or more tax jurisdictions have a different approach to determining the arm's length price.

This can lead to economic double taxation, which consists of paying taxes twice for a single transaction in two jurisdictions of two different countries. This will not only increase the tax expenditures of companies, but also requires a lot of time. The OECD transfer pricing guidelines recommend that the methodologies established in the 1979 report be used to determine the arm's length price. All members of the OECD have adopted these methods. (OECD, 2017)

However, as Rohatgi points out, there is no method that adapts to each situation. (Rohatgi, 2002). As a result, taxpayers (companies) try to choose the method that gives them the best estimate of the arm's length price. The methods proposed by the OECD are based directly or indirectly on comparable prices, information on profits or margins of similar transactions in similar circumstances (UNPAN, 2001).

Several countries have adopted these methods, even without being members of the OECD, as in the case of Ecuador. However, its application varies depending on the territory in which the company is located.

The OECD does not have the power to oblige countries to adopt its guidelines, unless:

- The country is a member and has adopted these guidelines in its domestic law.

The differences of the preferred methods result in different arm's length prices, which can lead to a different allocation of income in the countries where the multinationals are located.

To choose the most appropriate method, it is not necessary to analyze each method for the transactions. However, it is recommended that taxpayers keep always the transfer pricing documentation always in their hands.

The transfer pricing documentation may contain information about the establishment of the transfer price, the reason why a particular transfer pricing method is chosen or rejected, basic information about the business line and the reason for preferring transactions with related parties.

To determine arm's length, the OECD Guidelines recommend the use of various methods to establish whether or not the conditions imposed by related parties are consistent with the arm's length principle. (OECD, 2017). There are five different methods, divided into two categories, Transaction Based methods (gross profit) and Profit Based methods (net profit).

The Regulation for the Application of the Internal Tax Regime Law (Decree No. 374) establishes that companies with activity in Ecuador can use any of the five methods recommended by the OECD.

1.4.1. Transaction-based methods (Traditional)

Part II of Chapter II of the OECD Guidelines describes the three traditional methods of transfer pricing: the Comparable Uncontrolled Price (CUP) method, the Resale Price Method (RPM) and the Cost Plus Method (C+ or CP).

1.4.1.1. Comparable Uncontrolled Price (CUP)

This method "allows to establish the arm's length price for the goods or services transferred in each of the transactions between related parties, with the invoiced price

of the goods or services transferred in transactions with or between independent parties in comparable operations.” (RLORTI, 2015).

This method compares the price charged for the property or for the services in a transaction between related parties, with the agreed price in a comparable transaction between unrelated companies. The differences between the two prices may indicate that the first price is not arm’s length price and that it must be replaced by the second price.

The OECD Guidelines state that, when a comparable uncontrolled transaction can be found, this method is the most direct and reliable way to apply the arm's length principle. This method is preferable to all other methods in such cases.

If there are differences between the transfer prices of the transactions, adjustments can be made to reach arm’s length price.

According to the OECD guidelines, that are included in Ecuadorian regulation, an uncontrolled transaction is comparable to a controlled transaction for purpose of the CUP method if one of two conditions is met:

- a. None of the differences (if any) between the transactions being compared or between the enterprises undertaking those transactions could materially affect the resale price margin in the open market.
- b. Reasonably accurate adjustments can be made to eliminate the material effects of such differences (OECD, 2010).

The issue with this method arises when within the same organization exist transactions only between related companies, there are no comparable operations. In addition, "it can be difficult to find an operation between two independent companies sufficiently similar to a linked operation so that there are no differences that have a significant effect on the price” (OECD, 2010).

1.4.1.2. Resale Price Method (RPM)

This method takes into account a product that has been acquired by a company B of its related company A and that has then been resold to an independent company C. This price (the resale price), then, is reduced by an appropriate gross margin (the "resale price margin" or "resale margin") representative of the amount by which reseller "B" would seek to cover its sales costs and operating expenses and, depending on the tasks performed (considering the assets used and the risks assumed), obtain an appropriate profit. Once this is done, what remains of the resale price after subtracting this gross margin can be considered as an arm's length price for the original transfer between the related A and B (OECD, 2010).

Graphic 2: Resale Price



Arm's length price = Resale price - (Resale price x Gross profit margin)

For example:

Resale Price	=	\$4
Gross Profit Margin (10%)	=	\$0,40
Arm's length price	=	\$3,60

Source: (United Nations, 2017)

Elaboration: González, David

An example of the use of this method is the following: "A" is a Swiss parent company that has a distributor in Ecuador which distributes its products (chocolates) to Ecuadorian customers. Under this method, the transfer price of "A" to their distributor in Ecuador should be calculated as: the retail price for Ecuadorian customers minus the gross margin of the independent distributor in Ecuador. Suppose that the retail price of a chocolate in Ecuador is \$ 4 and the gross margin obtained by an independent distributor is 10%, then the transfer price is: \$ 4-10% (\$ 4) = \$ 3.60.

Thus, this method is used primarily to determine the arm's length price of a supplier and its related resellers, including distributors, retailers and wholesalers. Which means that the distribution companies use it most, and it works by comparing the sale price of the goods between the parties related to the price at which it is resold to an unrelated one. Unlike the aforementioned method, the assumed functions and risks are taken into account, but not the physical similarity of the good, however, if there is more physical similarity of goods, this method will have more confidence.

The equation to calculate this method is found in the Ecuadorian Regulation for the Application of the Law of Internal Tax Regime, which translated states for Reglamento para la Aplicación de la Ley de Régimen Tributario Interno (RLORTI).

$$PA = PR (1-X\%)$$

PA = Precio de Adquisición (Purchase Price)

PR = Precio de Reventa (Resale Price)

X% = Percentage of gross profit applied with or between independent parties.

1.4.1.3. Cost Plus Method

This method, compared to the resale price method, starts by looking at the costs incurred by the company supplying goods or services A when selling these to its associated company B. Then at this cost is added an appropriate cost-plus mark up to obtain an appropriate profit for company B. This cost plus mark-up, added to the incurred cost mentioned above, is considered to be the arm's length price. This method is probably the most useful among related companies that have joint facility agreements, long-term purchase and supply agreements or sell semi-finished products together (OECD, 2010).

The formula for calculating this method is found in the RLORTI as follows:

$$PV = C (1 + X\%)$$

PV = Precio de Venta (Sale Price)

C = Costo del bien (Product cost)

X% = Percentage of gross profit applied with or between independent parties.

This method is best used to determine the arm's length price of a manufacturer only if the data provided by the manufacturer is more complete than that of the distributor. For example, 'A' is an Ecuadorian manufacturer that is a subsidiary of a Swedish parent company that produces T-shirts. Suppose the cost of making a shirt is \$ 30 and the margin to design the shirt is 15% of the cost. Under the Cost Plus Method, the price will only be considered as arm's length if the surcharge of unrelated parties in the same circumstances also represents 15% of the cost.

According to the OECD, the similarity of this method with the resale price method is that the functions and risks assumed are also taken into account more than the physical similarities of the goods. This method is more useful for manufacturers or service providers, where valuable or unique intangible assets are not added to the goods that are sold or to the services that are provided.

1.4.2. Profit-based Methods

In cases where Traditional Transaction methods are not appropriate to establish the transfer price due to the absence of comparability or reliability, Part III of Chapter 2 of the OECD Guidelines may be used, where the use of the "Transactional methods of operating income" is recommended, which "analyze the profits derived from certain operations between related companies." (OECD, 2010) These are; profit split method and transactional net margin methods.

These methods study the profits that are derived from certain related operations. "It is very rare for companies to carry out operations where utility is a 'established or imposed' condition in operations ... companies rarely use profit-based methods to set their prices ... However, the profit derived from a related operation may be an important indicator to know if the operation has been affected by conditions other than those established by independent companies in comparable circumstances. Therefore, in those exceptional cases in which the complexity of the business world makes it difficult in practice to apply traditional methods, the application of profit-based methods can provide a consistent approach to transfer pricing with the arm's length principle." (OECD, 2010)

1.4.2.1. Profit Split Method

This method is used in cases in which comparability does not exist due to the fact that intra-group transactions are closely related, so it is not possible to evaluate transactions independently; or in cases where both related parties have contributed unique or valuable intangible assets to the transactions (OECD, 2010).

It consists in calculating the overall profit of the set of transactions between related companies, which is then distributed to each of the related parties in a proportion equal to that of independent companies. Subsequently, the profit that should be distributed among the related companies by the intra-group operations is identified. This distribution of profits must be done as if a full-fledged agreement had been made that reflects this distribution (OECD, 2010; United Nations, 2017). “In similar circumstances, independent companies could decide to set up a partnership of shareholders and agree on a formula for the distribution of profits” (OECD, 2010)

According to RLORTI, this method "Determines the price through the distribution of the Global Operational Profit obtained in the operations with related parties, in the same proportion that it would have been distributed with or between independent parties, in comparable operations, according to the following statements:

- a. The Global Operational Profit of the operations with related parties will be determined by the sum of the operational profit obtained by each one of them; and,
- b. The obtained Global Operational Profit will be distributed to each of the related parties, considering, among others, the individual contribution of each party in assets, costs and expenses used in the operations between said parties.” (RLORTI, 2015)

1.4.2.2. Transactional Net Margin Method

This method consists on setting the price through the determination of the operating profit in intra-group transactions in the same way that independent parties would have obtained in comparable operations, based on profitability factors that take into account variables such as assets, sales, costs, expenses or cash flows.

It is implemented in a similar way as the cost plus and resale price method, since they use financial margins in the analysis, the difference is that this method uses net margins while the other methods mentioned above use gross margins.

One of the advantages of the transactional net margin method is that net margins (for example, the return on assets, the relationship between operating profit and sales and other possible indicators of net profit) are less sensitive to differences that affect operations, which is not the case with the price, as it was used in the CUP method (RLORTI, 2015; OECD, 2010).

1.5. Conclusions

After finishing the analysis of this first section, it can be concluded that the transfer pricing regime plays a fundamental role in the tax field of intra-group multinational trade. It has been established that these is not only a tool to reduce taxes of large corporations, but also serve them as a decision-making tool when establishing the costs of goods, and to assess if it is convenient to perform intra-group operations.

However, it cannot be ignored that the control of the same is done to avoid that the profits that will be subject to taxes in a certain tax regime, are diverted by prices that are not according to the arm's length price or market price, towards tax regimes with lower tax rates or directly towards tax havens.

For this reason, and based on history, we can see the effort made by developed countries, together with the OECD, to establish transfer pricing guidelines that over the years have become globally accepted, and that make up a clear standard at the time of establishing the intra-group exchange prices.

For this, the OECD has established the various methods of analysis, whether traditional, which use the principle of comparing comparable transactions with independent companies. Or non-traditional for cases where it is difficult to find a price in accordance with the market, which are methods based on profit margins.

Finally, it can be said that transfer prices make up the largest tax problem in terms of international taxation, and that it is the decision of the tax administrations of each country to adopt or not the standards established by the OECD, since the latter is the main organization international focused on establishing guidelines on this subject,

which based on this first section prove to be very complex and to which each country should pay special consideration.

CHAPTER II

MULTINATIONAL ENTERPRISES SUBJECT TO THE TRANSFER PRICE REGIME IN ECUADOR AND ITS MAIN CHARACTERISTICS

2.1. History and context of the Transfer Pricing Regime in Ecuador

It should be taken into account that approximately "50% of Ecuadorian exports are made to related companies or through them. Likewise, it has been calculated that around 25% of Ecuadorian imports have been made between companies or related companies and that around 1,500 Ecuadorian companies would have carried out some type of operations with related companies." (Cevallos Landeta, 2012)

Under this context, the importance of having a regulation applicable to the transfer pricing regime is evident, with a base on international regulations, which helps facilitate tax management in Ecuador.

This country, despite not being a member of the OECD, bases its internal regulation on the guidelines of this organization since 2005. The Ecuadorian Internal Revenue Service (SRI) is the regulator of the transfer pricing regime and does so through the Organic Law for the Internal Tax Regime (LORTI) and the Regulations for the Application of the same (RLORTI).

It is important to emphasize that before 1999 the only reference to the transfer pricing regime was that parties considered to be related were identified. This was determined with the publication of the Regulation for the Application of the Internal Tax Regime Law (Supplement to the Official Registry (R.O.) No. 601 of December 30, 1994).

Thus, the first regulation that is included in Ecuador in terms of transfer pricing, takes place in 1999 through the "amendment to Article No. 91 of the Tax Code, replaced by Art. No. 4 of Law 99-24 (Supplement to R.O. No. 181, of April 30, 1999)" (Cevallos Landeta, 2012), through this, the tax administration could regulate the prices at which the intra-group operations were carried out.

The aforementioned article was "reformed by the Reform Law for Equity in Ecuador published in R.O. 242 of Saturday, December 29, 2007, in this law, everything related to the transfer prices contained in this article was suppressed, but a Transfer Pricing Section was included in the Organic Law of the Internal Tax Regime." (Ayala Romero, García Guamán, & Chalén Aguas, 2015)

One of the most important changes in the Ecuadorian regulation on transfer pricing is given by the publication of Executive Decree No. 2430, (Supplement to R.O. No. 494 of December 31, 2004), which modifies the Regulation for the Application of the Internal Tax Regime Law, which incorporates substantial aspects that allow to carry out the controls on transfer prices. (Cevallos Landeta, 2012) Among the most important aspects, the following stand out:

- SRI is designated as the regulator of transfer pricing, in its international taxation section.
- It is determined which will be considered as related parties.
- It is established that the prices of the transfers must agree with the arm's length principle, otherwise adjustments will have to be made.
- Comparability criteria are included in addition to the methods of analysis.

The most important resolutions in terms of transfer pricing are; "The resolution NAC-DGER2005-640 and NAC-DGER2005-0641 published in the R.O. "188 of January 16, 2006, the first resolution refers to the content of the Annexes and the Integral Transfer Pricing Report and the second to the parameters to determine the median and the arm's length range" (Ayala Romero, García Guamán, & Chalén Aguas, 2015)

Finally, by resolution of the Internal Revenue Service No. NAC-DGER2008-0464 published in R.O. No. 324 of April 25, 2008, the Internal Revenue Service modified the amounts, and established the contents of the Annex and the Integral Transfer Prices Report. (Cevallos Landeta, 2012) Within this resolution it was determined that the taxpayers who made intra-group trade with foreign related companies, had to present the annex of transfer prices for operations exceeding one million dollars, and to exceed the five million dollars should be presented additionally the Integral transfer prices report. These amounts would be modified later.

Thus, the most important resolution in this investigation and that repealed all the aforementioned was published in the Supplement to R.O. dated May 29, 2015, through Resolution No. NAC-DGERCGC15-00000455, whose objective is to establish the content of the Annex of Transactions with Related Parties and the Integral Transfer Pricing Report that must be presented to the Internal Revenue Service by Taxpayers (SRI, 2015)

The current modifications that are used for the elaboration of this thesis are found in the Official Registry Supplement 463 of November 17, 2004, which includes reforms until December 28, 2015 (LORTI, 2004).

2.2. Current Norms

The regulations regarding the transfer pricing regime are found in the international tax section of the SRI, within which are the observations, considerations and the most relevant legal basis for the regime, which must be taken into account by the taxpayers. The current regulations, applicable to taxpayers subject to the transfer pricing regime in Ecuador, is established below.

2.2.1. Organic Law of Internal Tax Regime

This law stands for Ley Orgánica de Régimen Tributario Interno (LORTI) in Spanish. It contains the most relevant definitions mentioned throughout this investigation, which are found as innumerable articles from the second section after Article 15 within this law:

***Art. (...).- Transfer Pricing.-** The transfer pricing regime is established for tax purposes to regulate transactions that are made between related parties, in the terms defined by this Law, so that the considerations between them are similar to those made between independent parties (LORTI, 2015).*

***Art. (...).- Arm's Length Principle.-** For tax purposes, the arm's length principle is understood as one in which, when conditions are established or imposed between related parties in their commercial or financial transactions, which differ from those that 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 that, because of the application of those conditions were not obtained, will be subject to taxation (LORTI, 2015).

***Art. (...). - Comparability Criteria.** - The transactions are comparable when there are no differences between the relevant economic characteristics of the transactions, which significantly affect the price or value of the consideration or profit margin referred to in the methods established in this section, and in the event of differences, that its effect can be eliminated by reasonable technical adjustments (LORTI, 2015).*

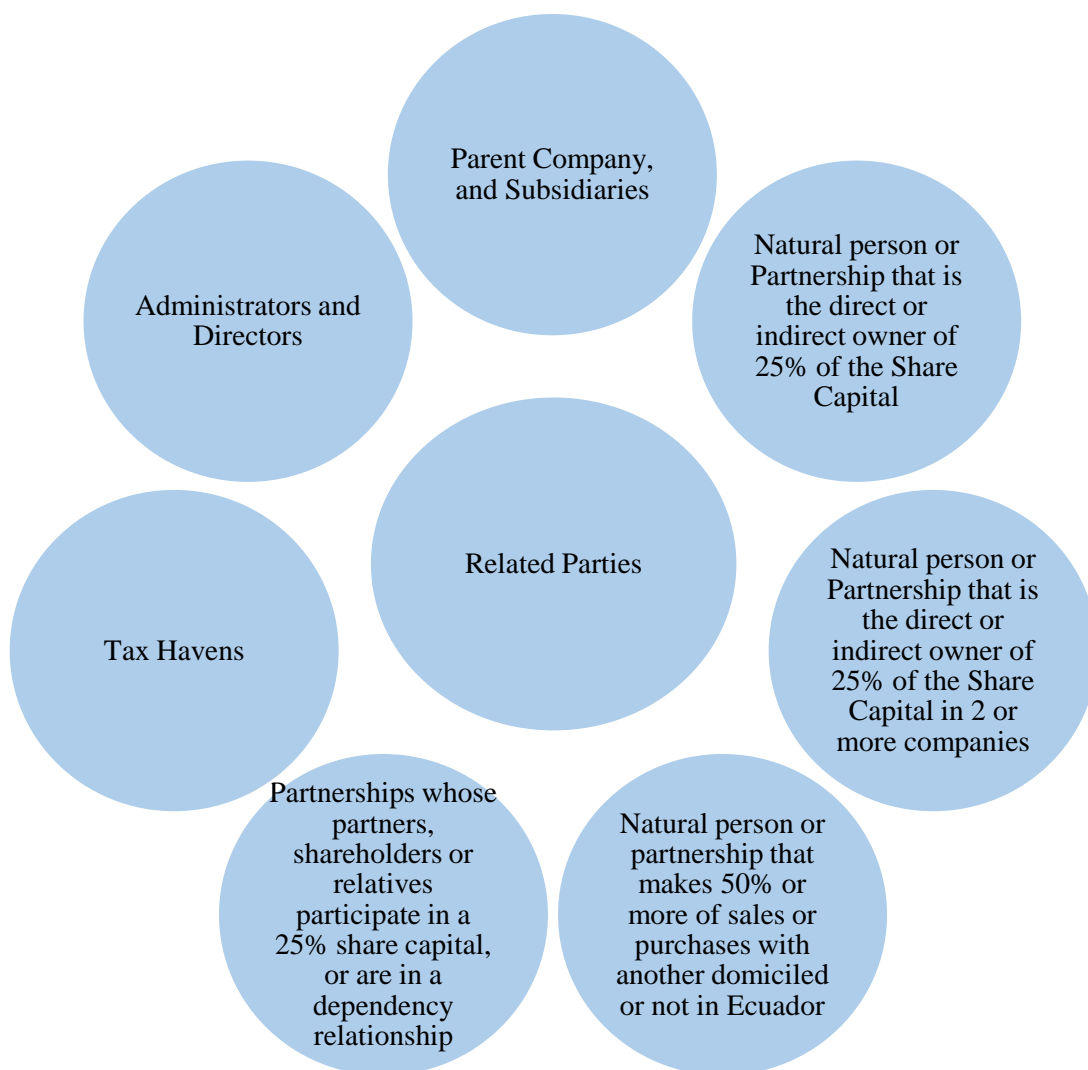
Later, within the article numbered after Article 22, it is established that the companies that carry out intra-group operations, have the obligation to present to the tax administration the annexes and required documentation. This includes determining their income, costs and deductible expenses, just as if the prices of these operations had been agreed with or between independent companies in comparable operations. The fine for not presenting this information on time, or if there are errors or differences with the income tax declaration, can reach up to \$ 15,000. It should be noted that this information is reserved (LORTI, 2015).

Below is the innumerate article after Art. 23, which enables the tax administration to determine, among other things, "the income, costs and deductible expenses of taxpayers, establishing the price or value of the consideration in transactions held between related parties, considering for these operations the prices and values of considerations that would have used independent parties in comparable operations, it also allows the tax authorities to "establish the necessary norms to regulate the transfer prices in transactions on goods, rights or services for taxing effects." (LORTI, 2015).

2.2.2. Regulation for the Application of the Law of Internal Tax Regime

This regulation stands for Reglamento Para Aplicación De Ley De Régimen Tributario Interno (RLORTI) in Spanish. Within this, specifically in Article 4, can be found the regulations regarding related parties, here is identified the cases in which a company will be considered as related a related party for tax purposes in Ecuador, the following chart contains each of the cases established by the Law and its Regulation:

Graphic 3: Related Parties



Source: (RLORTI, 2015)

Elaboration: González, David

Next, the following article to take into account is Art. 84, which refers to the information that taxpayers must present for transactions with related parties, this includes the Integral Transfer Pricing Report and the established annexes by the SRI, this is in addition to the annual declaration of income tax, and will have a term of no more than two months (RLORTI, 2015).

Finally, the five methods of analysis applicable to intra-group operations are established, these were explained in chapter one and are found in article 85 of the regulation.

2.2.3. Resolutions

The Resolution to be taken into account is No. NAC-DGERCGC15-00000455, mentioned above, which establishes that taxpayers who, within the same fiscal period, have carried out transactions with related parties in an accumulated amount exceeding three million dollars (USD 3,000,000.00) must submit the Annex of Transactions with Related Parties. If such amount is greater than fifteen million (USD 15,000,000.00), said taxpayers must submit, in addition to the Annex of Transactions with Related Parties, the Integral Transfer Pricing Report (SRI, 2015).

Thus, this resolution establishes that the Integral Transfer Pricing Report must be prepared as established in the technical specifications for the standardization of transfer pricing analysis. This file includes the presentation format, the content, the formulas for the calculation, and the analysis that must be carried out in order to have a correct and standardized calculation of transfer prices (SRI, 2018).

According to the technical sheet for the standardization of the transfer pricing analysis, the Integral Transfer Pricing Report must be presented on a non-rewritable CD, in PDF-text format, and must contain the following information:

- I. Executive Summary:
 - a. Scope and Objective
 - b. Content
 - c. Conclusions
- II. Inter-company transactions: Each of the transactions detailed in this section must have a description of the economic support or reasonableness of the transaction. In each operation, its type must be identified.
- III. Characteristics of the operations: Consider the relevant characteristics that significantly affect the price, value of the consideration or profit margin.
- IV. Functional analysis: This includes the information of the local company that is being analyzed and of its commercial group. It covers issues such as background of the multinational group, functions performed by the group, background of the local company, functions performed by the local company, assumed risks, assets used, etc.

- V. Contractual terms: It includes information on relevant characteristics that significantly affect the price, or that have significantly affected the business activity of the analyzed year.
- VI. Market analysis: The behavior and evolution of the industry in the world and local areas should be detailed. In addition to an analysis of the Ecuadorian economic environment that includes such aspects as economic, political, legal, etc.
- VII. Economic Analysis: Where should be described such information as: related parties, operations to be analyzed with the selected method, the existence of comparable internal operations, description of comparable operations and/or search of comparable uncontrolled companies that perform similar operations, financial information of the company analyzed, financial and descriptive information of the comparable companies used for the realization of the interquartile range, statistical tools used, sources of information, and a conclusion on whether the arm's length principle was met or not (SRI, 2018).

2.3. Multinational enterprises subject to the Transfer Pricing regime in Ecuador and its main characteristics

In this chapter, all the companies that exceed the 15 million dollars with related parties have been selected, whose of not being exempt, would be obliged to present the integral report of transfer prices according to the Ecuadorian regulations. In this way, a database has been prepared that will be used as an input to describe the main characteristics of the entities that report transfer prices to the Ecuadorian tax administration.

Information regarding transactions of a company with its related parties can be obtained, since these amounts must be reported to the Ecuadorian tax administration on the income tax declaration form named “Form 101”. The following is a description of the process of obtaining the sample.

2.3.1. Formulary 101

Form 101 is the Income Tax declaration form and presentation of balances form unique partnerships and permanent establishments, in force since 03/12/2016 (SRI, 2017).

Among the form boxes that are reported to the tax administration, the total of operations with related parties and the breakdown by type of operation are found. Three large groups are presented:

- From box 003 to 007 operations with local related parties are shown
- From box 008 to 012 with related parties in tax havens or preferred regimes
- From box 012 to 017 with related parties abroad

2.3.1.1. Collection of information and preparation of database

Next, it is detailed the process that has been followed to obtain the database, the filters used, and the criteria applied to the base to obtain the sample of companies that will be analyzed in this study.

On the website of the “Superintendencia de compañías valores y seguros”, in the information portal section, statistical information, you can obtain a complete database with the breakdown of the form 101 accounts of all companies in the corporate sector that report tax information to “SRI” and the “Superintendence of Companies”.

At the time of the analysis, the last available database was for the fiscal year 2016.

2.3.1.2. Determination of the sample used in the study

In the obtained base there is information of more than 70 thousand companies with functions in the Ecuadorian territory. Among the information contained in this database corresponding to the fiscal year 2016, data of transfer prices are recorded in the boxes, or accounts, which are numbered from 003 to 017 where the amount of operations in American dollars with related parties is reported. Filters have been applied to the entire database to obtain the information required by this study.

First, the total of transactions with related parties, hereinafter OPRE, was obtained from all the companies in the sample. For this research, focused on the analysis of intra-group business operations of multinational companies, it was necessary to filter

the companies that meet the criteria on which this research focuses, with special attention on the analysis of intra-group operations of MNEs.

For this reason, were selected all companies whose total amount of transactions with related parties exceeded 15 million dollars. Then, it was decided to eliminate all the companies in the database with revenues of less than 1 million dollars, since it was considered illogical for companies to report more than 15 million in operations with related parties and whose income does not exceed one million, this could indicate that the company has assets or liabilities exceeding 15 million, but it may be inactive or in the process of liquidation. The companies that meet these criteria in 2016 are 312.

Within these 312 companies are included local and multinational companies. In order to determine only the multinational companies, they were reviewed one by one, choosing only those that have foreign shareholders with legal status. This process resulted in a sample of 201 companies.

Finally, from those 201 companies, only those companies that report operations with foreign related or tax havens were selected, and those that only report intra-group transactions locally were discarded.

Applying the aforementioned criteria, the resulting number to be used in the sample is 163 companies. The list with the respective amount is presented in Annex 4.

2.3.2. Classification of MNEs subject to the regime

In this section I proceed to describe the main characteristics regarding the companies of the sample.

2.3.2.1. Sector in which they operate

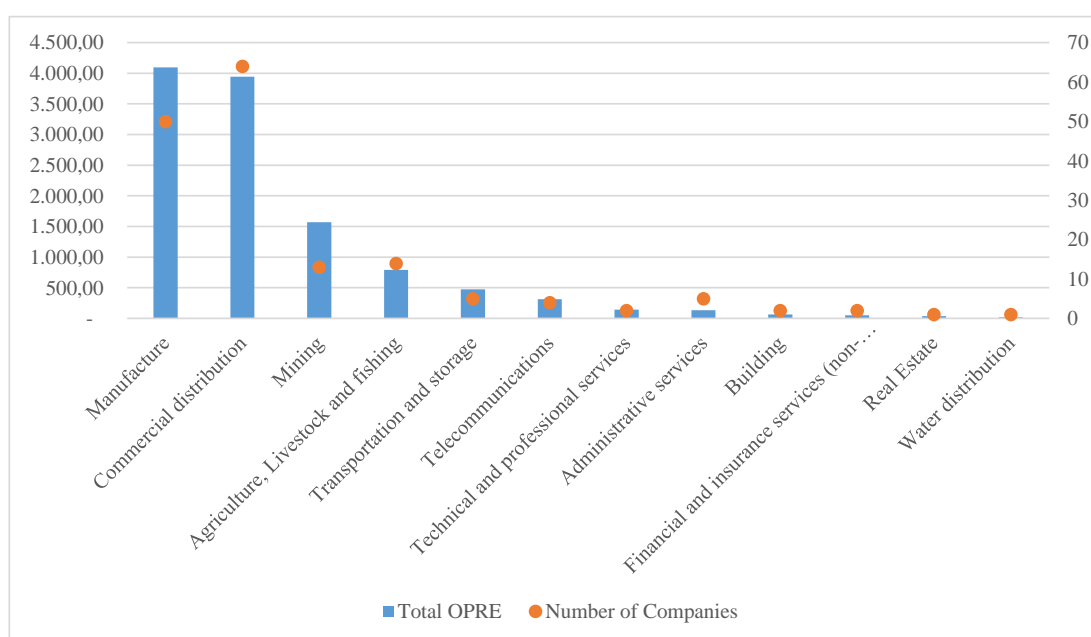
A summary table of the sector to which the 163 companies belong can be found in the sample below:

Table 1: Sector

Sector	Total OPRE	Number of Companies	Participation OPRE	Companies Participation
Manufacture	4.096.134.549,20	50	35,17%	30,67%
Commercial distribution	3.945.351.117,60	64	33,87%	39,26%
Mining	1.569.739.511,20	13	13,48%	7,98%
Agriculture, Livestock and fishing	793.090.571,60	14	6,81%	8,59%
Transportation and storage	476.158.629,40	5	4,09%	3,07%
Telecommunications	312.634.626,80	4	2,68%	2,45%
Technical and professional services	142.412.585,40	2	1,22%	1,23%
Administrative services	134.855.751,70	5	1,16%	3,07%
Building	67.027.748,10	2	0,58%	1,23%
Financial and insurance services (non-banking)	50.996.460,60	2	0,44%	1,23%
Real Estate	38.705.662,10	1	0,33%	0,61%
Water distribution	20.472.369,40	1	0,18%	0,61%
Total	11.647.579.583	163	100,00%	100,00%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Graphic 5: Sector (USD Millions)

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Table 1 and graphic 5 above show the distribution by sector of the analyzed sample of 163 companies. Regarding the most important sectors, the multinationals that operate in the sector of manufacturing of materials or products, and in distribution, are the most significant.

It can be seen that manufacturing and distribution together represent approximately two thirds of the sample. This makes sense because, in the supply chain of a

multinational economic group, it is common to find a company dedicated to the elaboration of the product and another that is responsible for marketing it.

Concentration can also be observed in both the number of companies and OPRE amounts in the following segments, which are important and include mining and agriculture, livestock and fishing. This is consistent with the main economic activities, characteristic of Ecuador.

2.3.2.2. Mother Countries

This section of the investigation refers to the country where most of the shares or participations of a company with a presence in Ecuador are concentrated, but not of the country of foundation or origin of the commercial group.

Below is a table with each of the countries where the holdings or companies that own most of the shares are located. In addition, this table shows the number of companies concentrated by country.

It is evident that the United States is the country where the majority of multinationals reside, and it is not a novelty, considering that it is Ecuador's main trading partner.

In addition, it is important to emphasize that there is a considerable number of multinational companies resident in tax havens, among which Panama stands out.

Table 2: Countries of origin of the multinationals of the study

Country	Number of Companies	OPRE Total
GERMANY	5	193.320.617,80
ARGENTINA	1	70.896.707,60
BAHAMAS	2	54.962.080,20
BERMUDA	4	149.895.651,60
BRAZIL	1	28.334.461,90
CANADA	1	63.125.210,10
CHILE	7	402.840.618,70
CHINA	3	385.852.591,90
COLOMBIA	6	178.032.480,00
SCOTLAND	1	15.874.897,40
SPAIN	23	1.461.833.959,20
UNITED STATES OF AMERICA	32	2.586.866.564,80
FRANCE	1	28.414.590,00
HOLLAND	15	1.600.182.482,40
HONG KONG	2	90.299.885,10
ENGLAND	7	1.203.491.448,70
GRAN CAIMAN ISLANDS	1	180.039.453,00
BRITISH VIRGIN ISLANDS	2	51.807.707,10
ITALY	1	166.147.927,00
JAPAN	2	91.581.131,30
SWEATER	1	138.070.644,00
LUXEMBOURG	1	68.623.771,80
MALAYSIA	1	17.325.723,20
MEXICO	5	342.665.206,40
NEW ZEALAND	2	77.616.613,40
PANAMA	8	488.234.928,30
PERU	4	334.758.665,00
SINGAPORE	4	280.792.010,60
SWITZERLAND	9	463.181.378,90
URUGUAY	8	360.583.712,70
VENEZUELA	3	71.926.463,00
Total	163	11.647.579.583,10

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

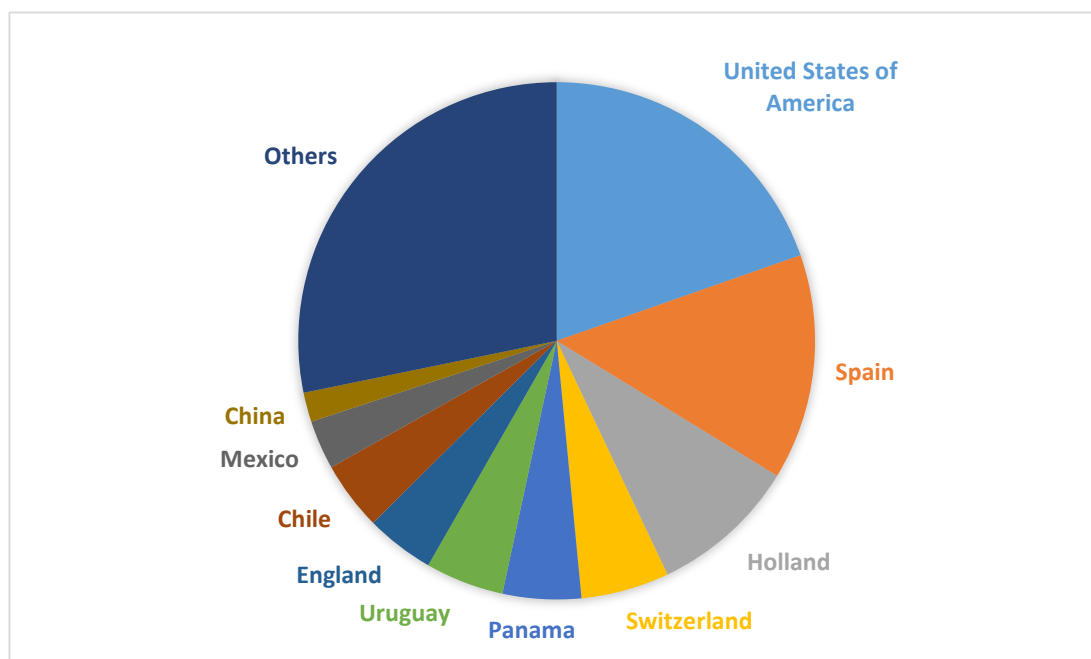
Table 3: Top 10 countries and their OPRE share

Country	Number of Companies	% Companies	OPRE Total	% OPRE
United States of America	32	16%	2.586.866.564,80	19%
Spain	23	11%	1.461.833.959,20	11%
Holland	15	7%	1.600.182.482,40	12%
Switzerland	9	4%	463.181.378,90	3%
Panama	8	4%	488.234.928,30	4%
Uruguay	8	4%	360.583.712,70	3%
England	7	3%	1.203.491.448,70	9%
Chile	7	3%	402.840.618,70	3%
Mexico	5	2%	342.665.206,40	3%
China	3	1%	385.852.591,90	3%
Others	46	38%	2.351.846.691,10	41%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Graphic 6: Concentration of Patrimonial Contributions by Country



Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

As it can be seen in graphic 6 and table 3, the relevance of United States is evident, as the country where most of the companies, in which the largest shareholdings of the multinationals operating in Ecuador, are located. In addition, there is evidence of the great presence of the European Union in terms of multinational trade whit Ecuadorian companies.

Finally, after analyzing each of the countries, it can be found the countries that own shares of certain companies. Below is listed 12 highest patrimonial contributions on companies with a presence in Ecuador.

Table 4: Top 12 Ecuadorian based MNEs according to their patrimonial contribution

Country of the Shareholder	RUC	Patrimonial Contribution	Company
United States Of America	1790016919001	\$ 427.788.906	Corporacion Favorita C.A.
Spain	1790319857001	\$ 369.663.200	Procesadora Nacional De Alimentos C.A. Pronaca
Spain	1791256115001	\$ 365.771.478	Otecel S.A.
United States Of America	992819065001	\$ 328.195.036	Skyvest Ec Holding S.A.
Holland	1792634318001	\$ 284.001.000	Shaya Ecuador S.A.
United States Of America	1790319857001	\$ 253.633.600	Procesadora Nacional De Alimentos C.A. Pronaca
Venezuela	1792133505001	\$ 207.321.000	Pdvsa Ecuador S.A.
Mexico	1792411149001	\$ 200.871.312	Bebidas Arcacontinental Ecuador Arcador S.A.
Uruguay	1791844416001	\$ 198.000.000	Corporacion Quiport S.A.
United States Of America	1790598012001	\$ 189.206.244	General Motors Del Ecuador Sa
Colombia	1791314379001	\$ 179.098.475	Productos Familia Sancela Del Ecuador S.A
United States Of America	990004196001	\$ 158.750.124	Corporacion El Rosado S.A.

Ruc: ID number of the company

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

In table 4 can be found companies that are popular in the national market and can be seen that a large part of their assets belong to legal entities with fiscal domicile in foreign countries.

Among these appear such companies as La Favorita Corporation, Pronaca, and El Rosado Corporation; which started their business within the Ecuadorian territory, and which currently have an important equity in different countries abroad, and whose shares have been acquired by multinational groups.

2.3.2.1. Main Financial Accounts

To better understand the importance of this analysis, the main financial accounts for the entire sample were totaled.

The 163 companies analyzed reported revenues of 24,500 million dollars, while the total amount of operations with related parties totals 11,600 million dollars. On the other hand, the net profit of the sample is of 2,300 million dollars, which corresponds to a profitability margin of 9.5%. It is striking that the total income tax paid in 2016, of all the companies analyzed, totals 262 million dollars and represents only 1.1% of the income generated by the sample.

The following table presents the summary of the aforementioned:

Table 5: Main Financial Accounts based on the amount generated in 2016

Main accounts	Amount	% (Revenue)
Total revenue	24.504.441.864	-
Total Assets	23.758.486.835	96,96%
Total Liabilities	14.715.151.867	60,05%
Total OPRE	11.647.579.583	47,53%
Total Equity	9.043.884.435	36,91%
OPRE with Exterior and Tax Havens	6.507.682.085	26,56%
Profit reported	2.522.929.687	10,30%
Net profit reported	2.338.848.823	9,54%
Income tax paid	262.400.598	1,07%
Losses reported	184.080.865	0,75%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

On the other hand, the table presented below contains the detailed information of each one of the accounts, divided by sectors.

Table 6: Main financial accounts divided by sectors

Sector	Total OPRE	OPRE Abroad & TH	Total Revenue	Profit	Losses	Net Profit	Income Tax Paid	Assets	Liabilities	Equity
Administrative services	134.855,75	96.324,94	89.827,86	3.534,19	2.146,22	1.387,97	1.283,41	94.978,68	81.476,52	13.502,17
Financial and insurance services (non-banking)	50.996,46	26.305,25	47.986,06	6.966,97	1.313,54	5.653,44	1.063,32	33.559,07	25.805,03	7.754,04
Real Estate	38.705,66	2.920,76	15.221,99	1.397,46	-	1.397,46	-	232.459,54	222.742,89	9.716,65
Technical and professional services	142.412,59	20.441,60	259.753,15	94.631,25	-	94.631,25	6.269,24	913.660,20	562.531,77	351.128,44
Agriculture, Livestock and fishing	793.090,57	657.075,55	1.210.823,49	36.460,41	9.231,55	27.228,86	255,02	1.045.265,73	756.861,51	288.404,22
Commercial distribution	3.945.351,12	2.230.629,28	10.150.903,99	588.286,19	21.183,17	567.103,02	56.037,32	6.150.971,64	3.341.756,97	2.809.214,67
Building	67.027,75	8.744,91	202.769,64	43.697,17	-	43.697,17	4.340,44	359.372,81	329.768,22	29.604,58
Water distribution	20.472,37	10.007,95	142.183,40	22.347,24	-	22.347,24	3.325,34	302.690,20	171.854,25	130.835,94
Mining	1.569.739,51	941.890,99	2.267.818,99	493.317,99	126.227,89	367.090,10	43.477,63	5.075.482,43	3.116.581,37	1.958.901,06
Manufacture	4.096.134,55	1.932.069,00	7.209.138,62	814.379,60	9.659,04	804.720,57	83.643,59	6.080.382,40	3.184.830,73	2.896.101,14
Telecommunications	312.634,63	299.670,72	2.317.336,02	349.430,17	1.170,70	348.259,47	56.394,44	2.526.509,53	1.865.093,76	661.415,77
Transportation and storage	476.158,63	281.601,13	590.678,67	68.481,06	13.148,76	55.332,30	6.310,84	943.154,61	1.055.848,85	-112.694,24
Total	11.647.579,58	6.507.682,08	24.504.441,86	2.522.929,69	184.080,86	2.338.848,82	262.400,60	23.758.486,84	14.715.151,87	9.043.884,43

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Table 6 shows the main accounts together with the financial situation of each of the sectors.

It was interesting to segregate the paid income tax from the sample, where the sector that contributes the most after manufacturing is the telecommunications sector.

The manufacturing companies, distributors and those dedicated to mining have considerable amounts with related parties abroad and tax havens and their income tax paid is very similar to the telecommunications sector.

In the next chapter, the most important accounts of Form 101 will be reviewed separately and in detail.

2.4. Conclusions

To conclude this chapter, it has been possible to demonstrate that transfer pricing regulations in Ecuador are a relatively new subject, but that they already have clear regulations based on the OECD guidelines, of which organization, it should be emphasized, are not an active member.

It can be seen, if the first chapter is compared with the latter, that the way in which the transfer pricing regulations are established by the OECD and by the Ecuadorian tax administration are very similar, and the latter adapts the globally accepted standards for local needs within the LORTI, the regulations for the application of the same and the resolutions that have been established to achieve better control.

It is important to emphasize the importance that should be given to the presentation of the reports and annexes on transfer prices, and the minimum amounts that the Ecuadorian tax administration has set for the presentation of the same, which highlight a great importance for the correct control of intra-group multinational operations in the country.

This chapter has also made it possible to demonstrate the ease that Ecuadorian regulations grant to access certain information, in this case referring to companies with activities in Ecuadorian territory, and thanks to this it has been possible to identify which are the companies that surpass the 15 million dollars in intra-group operations

with tax havens and related parties abroad, requirement of the sample used in this investigation. In addition to facilitating access to the detail of shareholders of each company, through the superintendence of companies.

Based on the above, it has been possible to classify the companies in the sample, in addition to identifying the sector in which they operate and the countries where their shareholders reside. With this in mind, its concentration could be seen in countries such as the United States, countries of the European Union and tax havens. Finally, the main financial accounts were identified, which are reported in form 101 to the Internal Revenue Service. This led to the research base that demonstrates the importance of a control over multinational operations for the amounts that this sample indicates these manage.

CHAPTER III **QUANTITATIVE ANALYSIS OF THE INTRA-GROUP** **OPERATIONS OF MULTINATIONAL COMPANIES SUBJECT TO** **THE TP REGIME IN ECUADOR**

3.1. Classification of Intra-Group Operations

3.1.1. Analysis of Total Operations

Table 7: Total transactions with related parties in relation to each segment

Sector	Total Local	% Local/ OPRE	Total TH	% TH/ OPRE	Total Abroad	% Abroad/ OPRE	Total OPRE
Manufacture	2.164.065.549	52,83%	435.820.969	10,64%	1.496.248.033	36,53%	4.096.134.551
Commercial distribution	1.714.721.838	43,46%	656.860.819	16,65%	1.573.768.460	39,89%	3.945.351.118
Mining	627.848.520	40,00%	326.160.835	20,78%	615.730.156	39,22%	1.569.739.511
Agriculture, Livestock and fishing	136.015.025	17,15%	152.773.389	19,26%	504.302.157	63,59%	793.090.572
Transportation and storage	194.557.495	40,86%	34.108.925	7,16%	247.492.210	51,98%	476.158.630
Telecommunications	12.963.902	4,15%	63.042.879	20,17%	236.627.846	75,69%	312.634.627
Technical and professional services	121.970.983	85,65%	11.455.878	8,04%	8.985.725	6,31%	142.412.585
Administrative services	38.530.814	28,57%	8.254.735	6,12%	88.070.203	65,31%	134.855.752
Building	58.282.839	86,95%	-	0,00%	8.744.910	13,05%	67.027.748
Financial and insurance services (non-banking)	24.691.209	48,42%	-	0,00%	26.305.251	51,58%	50.996.461
Real Estate	35.784.907	92,45%	2.920.756	7,55%	-	0,00%	38.705.662
Water distribution	10.464.419	51,11%	59.677	0,29%	9.948.274	48,59%	20.472.369

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

In the previous table it can be seen the total of each of the segments of related parties, within this can be found the total aggregate of the 5 operations (assets, liabilities, income, expenses, technical services) in each of the 3 segments presented in the table (operations with local related companies, operations with Tax Havens (TH), operations with related companies abroad). It draws attention to notice that Technical services is the only one that has more trade with companies in tax havens than with companies from abroad.

The 5 types of accounting operation with related parties are detailed below:

- **Asset Operations:** Corresponds to amounts of transactions with related parties that directly involve the assets account of the reporting company. It mainly constitutes imports or purchases of related products or materials that are

recorded as inventory either for distribution or for production. Loans granted to related parties can also be found in the assets. It should be noted that when it comes to loans, only the borrowed capital is recorded since the interest received is part of the income.

- **Liabilities Operations:** In this type of transactions, only credit transactions or loans granted by a related party are recorded.
- **Income Operations:** Corresponds to all the income generated by an operation with a related party. For example: sale of inventories, administrative services, commissions, fees, interest on loans, etc.
- **Expense Operations:** Unlike income, this operation constitutes all the costs and expenses derived from a transaction with a related party. For example: payment of administrative services, commissions, fees, interest on loans, etc.
- **Royalty, technical, administrative, consulting and similar services operations:** As of 2016, the Ecuadorian tax administration requires the segmentation of these expense operations. The aforementioned operations in this category are recorded separately since they are susceptible to different tax deductibility charges (UNPAN, 2001; SRI, 2017).

Below are each of the accounts with their respective operations, divided by sector and by the main companies. It should be noted that each of the tables presented from table 8 and on are ordered on a descendent way based on the sum of its operations with related parties on tax havens and abroad (e). The numbers correspond to amounts in American dollars, whose sign has been omitted for its representation in tables.

3.1.2. Analysis of the Assets Operations

Table 8: Assets operations divided by sector

Sector	# Of Companies	Local	Tax Havens	Abroad	Abroad + TH	Total Assets	Share/ Assets
		a	b	c	e = (b+c)	f	e/f
Commercial distribution	64	1.097.732.693	374.198.393	1.135.219.325	1.509.417.718	6.150.971.644	24,54%
Manufacture	50	469.749.924	197.585.595	777.416.313	975.001.908	6.080.382.401	16,04%
Mining	13	140.464.882	290.673.478	165.946.077	456.619.555	5.075.482.427	9,00%
Agriculture, Livestock and fishing	4	-	62.441.699	12.194.530	74.636.229	2.526.509.531	2,95%
Telecommunications	5	4.980.000	8.254.735	47.295.503	55.550.238	94.978.680	58,49%
Administrative services	14	93.078.605	10.252.299	10.455.874	20.708.172	1.045.265.735	1,98%
Financial and insurance services (non-banking)	2	19.111.021	-	15.487.000	15.487.000	33.559.070	46,15%
Transportation and storage	5	2.363.520	867.500	3.302.611	4.170.111	943.154.605	0,44%
Building	2	2.670.769	-	2.823.313	2.823.313	359.372.806	0,79%
Real Estate	2	221.271	1.044.461	464.641	1.509.102	913.660.204	0,17%
Water distribution	1	3.096.432	17.902	4.729	22.631	302.690.197	0,01%
Technical and professional services	1	3.215.942	-	-	-	232.459.536	0,00%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

In table 8 can be noted that in the telecommunications sector there are important asset operations with related companies from tax havens and abroad that represent 58% of their own assets, which means that this sector was subject to a commercial operation with related parties, and it is the account that excels in assets. After this, the financial services, distribution and mining sectors follow.

As in the previous tables, the distribution sector is maintained as one of the main ones, these amounts make sense since the related companies dedicated to the distribution import goods that are recorded in the accounting as an inventory, this is an asset transaction with related parties, and this explains its share of 24% of the total assets reported in 2016.

The telecommunications sector reports 58.5% of its total assets in operations with related parties in tax havens and abroad, through this research it has been possible to verify that, this is due to the fact that all the infrastructure that the companies that are part of this sector are bought as assets to related parties, these are specialized assets, and it is only their related parties from abroad that are able to provide this technology (Combariza, 2012).

Table 9: Top 10 companies with the most assets operations with THs and related parties from abroad.

Company	Local	Tax Havens	Abroad	OPRE Assets	Abroad + TH	Company Assets	Share/ Total Assets
	a	b	c	i = a+b+c	e = (b+c)	f	e/f
Andes Petroleum Ecuador Ltd.	9.755.599,71	219.277.058,00	0,00	229.032.657,71	219.277.058,00	940.500.240,00	23%
Omnibus Bb Transportes Sa	21.112.364,00	0,00	153.396.820,00	174.509.184,00	153.396.820,00	263.917.775,00	58%
General Motors Del Ecuador Sa	0,00	0,00	115.854.288,00	115.854.288,00	115.854.288,00	208.025.004,00	56%
Glaxosmithkline Ecuador S.A.	0,00	23.724.286,20	77.977.178,20	101.701.464,40	101.701.464,40	34.210.298,50	297%
Schlumberger Del Ecuador S.A.	82.000,00	57.518.098,30	34.288.783,00	91.888.881,30	91.806.881,30	681.623.410,00	13%
Agip Oil Ecuador B.V.	2.533.713,87	0,00	80.290.758,40	82.824.472,27	80.290.758,40	386.076.436,00	21%
Roche Ecuador S.A.	0,00	0,00	80.232.548,80	80.232.548,80	80.232.548,80	91.444.081,40	88%
Intcomex Del Ecuador S.A.	0,00	3.956,30	73.935.806,50	73.939.762,80	73.939.762,80	26.463.234,80	279%
Toyota Del Ecuador S.A.	0,00	0,00	71.923.433,00	71.923.433,00	71.923.433,00	60.700.444,10	118%
Ipac S.A	0,00	0,00	70.366.980,60	70.366.980,60	70.366.980,60	180.000.003,00	39%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Table 9 shows that among the companies that most assets transactions had with related parties abroad, it is the oil companies that top the list.

So, Andes Petroleum, Agip Oil, and Schlumberger can be found on this list, the latter known as the largest oilfield service company (Schlumberger, 2018), among the 10 companies with the most asset operations with tax havens and related companies abroad.

In positions 2 and 3 of this list are two companies that are related, Omnibus BB and General Motors del Ecuador, which are the largest vehicle assembler and distributor in the country. Its assets are mostly imported as inventories, mostly machinery for assembly, automotive parts and vehicles ready for commercialization (GM Ecuador, 2018; GM OBB, 2015).

The share over the total assets is 58% and 56% respectively. This indicates that most of its asset operations were with a related company from abroad, or that this asset was acquired from a company that resides in a tax haven. It should be noted that Omnibuss BB is remarkable on local assets since it owns assembling plants (GM OBB, 2015).

This follows GlaxoSmithKline (GSK), which is a multinational company in the pharmaceutical sector. It can be seen that its assets from foreign operations and PF exceed in relation to the total assets reported in 2016 by 297%.

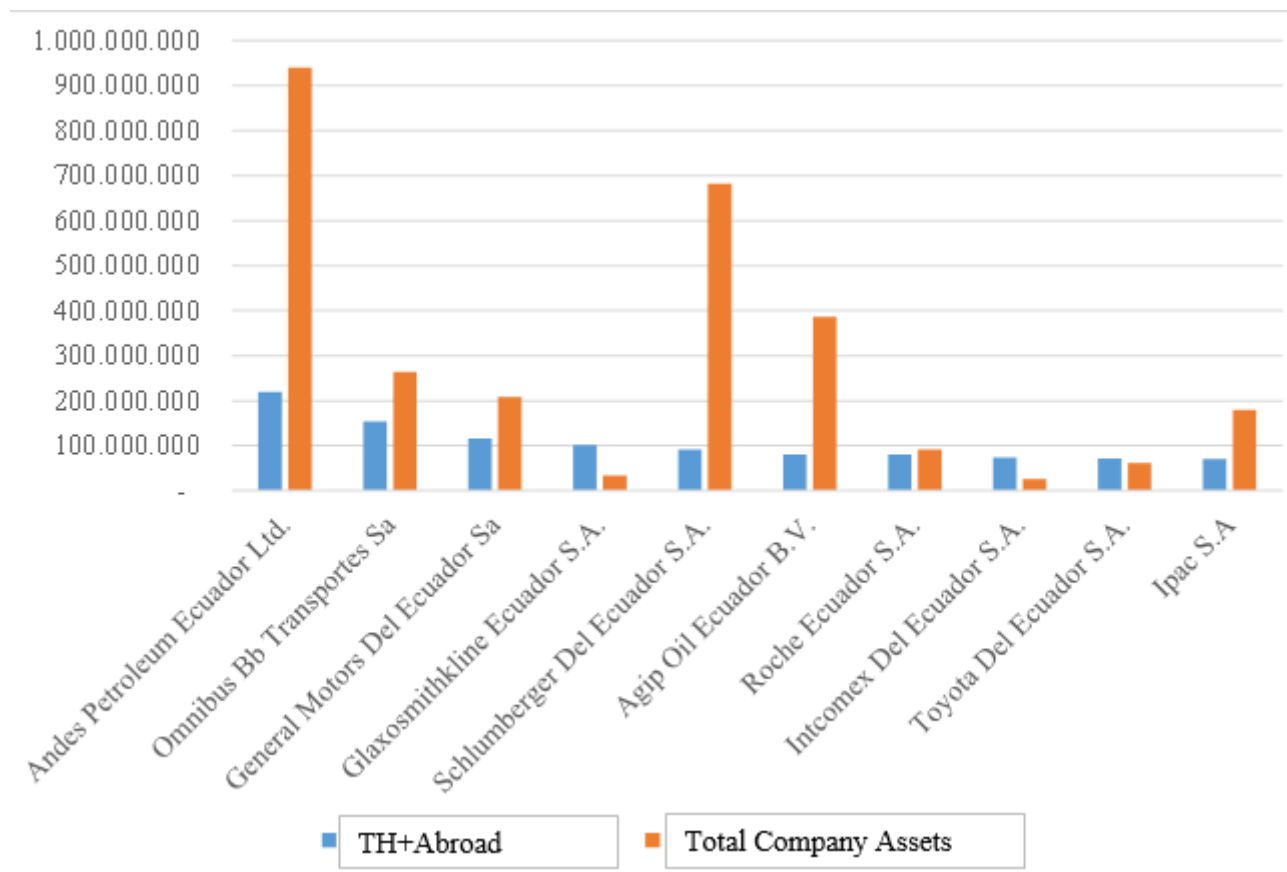
It may be noted that this occurs because both the assets and the liabilities that are recorded in the OPRE boxes of Form 101 correspond to movements or transactions and not to balances. This means that the account registered in box "f" corresponds to the final balance recorded in the balance sheet but not to all the liabilities that were involved in transactions with related parties. For this reason, the ratios of the pharmaceutical companies draw attention in the accounts of assets and liabilities, as well as the company that is reviewed up next.

In this way we have Intcomex, which is one of the best examples inventories importation. It is the leading platform in the distribution of technologic products and value-added solutions in Latin America and the Caribbean. It is unavoidable to observe that the total assets reported in the form 101 are due to operations with related companies abroad, mainly with companies in Central America. This is why 39% of its

total assets have been made through intra-group multinational operations (Intcomex Corp., 2016).

On the other hand, it is worth mentioning Toyota of Ecuador, which has the distribution of Toyota nationwide, and is another case of automotive companies that import finished goods in the form of inventories, in this case cars ready for commercialization, which in Ecuador is mainly held by Importadora Tomebamba, Toyocosta and Casabaca (Toyota Ecuador, 2018).

Graphic 7: Comparison of the assets operations with companies in THs and related parties abroad, versus the total reported in 2016



Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Finally, in graphic 7 it is shown the relation between the assets of the company. In orange are the assets reported in 2016, and in blue the assets that were subject to a transaction with related parties. There is a similar pattern among the assets reported by the oil companies, which are very active in assets, and a large part of their assets correspond to intra-group activities. We can also observe that there are companies whose reported assets, almost all correspond to related operations.

3.1.3. Analysis of the Liabilities Operations

Table 10: Liabilities operations divided by sector

Sector	# Of Companies	Local	Tax Havens	Abroad	Abroad + TH	Total Liabilities	Share/ Liabilities
		a	b	c	e = (b+c)	f	e/f
Mining	13	27.298.935	390.658.073	17.379.009	408.037.082	3.116.581.369	13,09%
Commercial distribution	64	49.330.309	27.443.166	178.906.770	206.349.936	3.341.756.973	6,17%
Agriculture, Livestock and fishing	14	410.072	73.620.228	7.605.341	81.225.569	756.861.513	10,73%
Manufacture	50	59.958.587	24.210.287	12.038.589	36.248.876	3.184.830.728	1,14%
Telecommunications	4	-	24.000.000	-	24.000.000	1.865.093.764	1,29%
Water distribution	1	3.205.000	6.795.000	-	6.795.000	171.854.253	3,95%
Administrative services	5	3.200.000	3.159.931	-	3.159.931	81.476.515	3,88%
Real Estate	1	21.903.792	-	1.000.000	1.000.000	222.742.886	0,45%
Transportation and storage	5	25.863.600	-	133.124	133.124	1.055.848.846	0,01%
Financial and insurance services (non-banking)	2	-	-	-	-	25.805.028	0,00%
Technical and professional services	2	-	-	-	-	562.531.769	0,00%
Building	2	-	-	-	-	329.768.223	0,00%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

When analyzing the liability account, it can be determined if the multinationals are financed by related parties from abroad, or companies in tax havens.

Table 9 indicates the operations of liabilities by sector, where mining and agriculture are the ones that are financed most by related from abroad.

It can be seen that among the 13 companies that make up the "Mining" sector, 13% of their obligations correspond to obligations with related parties from abroad. More specifically, \$ 390 million dollars in the liabilities account correspond to obligations with entities located in tax havens.

On the other hand, in the case of the sector that reported the most liabilities with related companies from abroad, there is the "Commercial Distribution" sector, whose obligations reach \$ 178 million dollars.

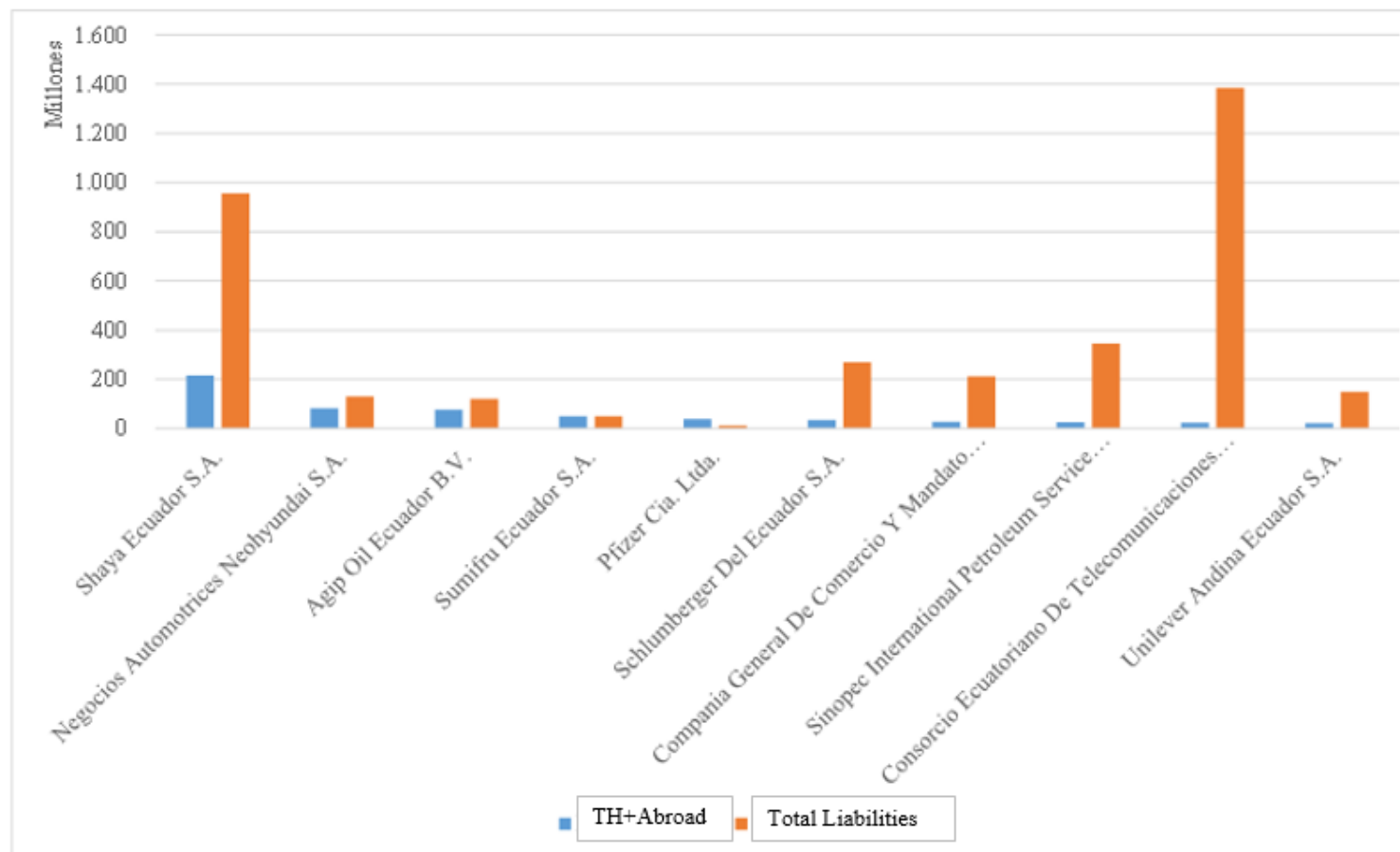
Table 11: Top 10 companies with the largest liabilities operations with THs and related parties abroad

Company	Local	Tax Havens	Abroad	OPRE Liabilities	Abroad + TH	Company Liabilities	Share/Total Liabilities
	a	b	c	i = a+b+c	e = (c+d)	f	e/f
Shaya Ecuador S.A.	0,00	0,00	216.000.000,00	216.000.000,00	216.000.000,00	954.996.632,00	22,62%
Negocios Automotrices Neohyundai S.A.	0,00	82.369.230,60	0,00	82.369.230,60	82.369.230,60	128.723.412,00	63,99%
Agip Oil Ecuador B.V.	0,00	0,00	76.336.730,30	76.336.730,30	76.336.730,30	120.704.787,00	63,24%
Sumifru Ecuador S.A.	0,00	0,00	49.293.649,90	49.293.649,90	49.293.649,90	50.795.842,30	97,04%
Pfizer Cia. Ltda.	27.962,00	38.423.403,20	0,00	38.451.365,20	38.423.403,20	11.405.850,80	336,87%
Schlumberger Del Ecuador S.A.	0,00	0,00	35.000.000,00	35.000.000,00	35.000.000,00	269.023.284,00	13,01%
Compania General De Comercio Y Mandato Sociedad Anonima	46.732.346,70	26.930.164,60	0,00	73.662.511,30	26.930.164,60	211.936.010,00	12,71%
Sinopec International Petroleum Service Ecuador S.A.	0,00	0,00	25.500.000,00	25.500.000,00	25.500.000,00	345.746.588,00	7,38%
Consortio Ecuatoriano De Telecomunicaciones S.A. Conecel	0,00	0,00	24.000.000,00	24.000.000,00	24.000.000,00	1.385.176.667,00	1,73%
Unilever Andina Ecuador S.A.	0,00	0,00	20.000.000,00	20.000.000,00	20.000.000,00	149.266.413,00	13,40%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Graphic 8: Comparison of liabilities operations with companies in THs and related parties abroad, versus the total reported in 2016



Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Table 11 and graphic 8 indicate that it is very common for companies to turn to their related parties or entities in tax havens as their main sources of financing.

Pfizer's liabilities ratio is striking. This company registers 38 million dollars in liabilities operations with related parties from abroad, while its liabilities operations in the balance from 2016 records only 11 million. As well as happened with assets operations, these amounts correspond to movements and not to balances.

Finally, it is clear that MNEs report higher amounts in terms of liabilities operations with related parties abroad and tax havens than with local related parties. In addition, graphic 8 shows that in several cases almost all of the liabilities reported in 2016 correspond to these segments.

3.1.4. Analysis of Income Operations

Table 12: Income Operations divided by sector

Sector	# Of Companies	Local	Tax Havens	Abroad	Abroad + TH	Total Income	Share/ Income
		a	b	c	e = (b+c)	f	e/f
Manufacture	50	1.590.636.906	204.237.716	455.631.483	659.869.199	7.209.138.620	9,15%
Agriculture, Livestock and fishing	14	29.896.261	134.684.728	417.136.890	551.821.617	1.210.823.487	45,57%
Commercial distribution	64	438.301.531	95.051.069	342.616.502	437.667.572	10.150.903.986	4,31%
Transportation and storage	5	160.261.433	32.802.696	128.471.302	161.273.998	590.678.671	27,30%
Telecommunications	4	176.786	207.887	37.675.805	37.883.692	2.317.336.017	1,63%
Administrative services	5	23.002.270	0	36.991.549	36.991.549	89.827.860	41,18%
Mining	13	286.745.339	17.349.004	17.982.856	35.331.860	2.267.818.986	1,56%
Financial and insurance services (non-banking)	2	5.580.189	0	0	0	47.986.058	0,00%
Real Estate	1	970.263	0	0	0	15.221.990	0,00%
Technical and professional services	2	102.236.003	0	0	0	259.753.150	0,00%
Building	2	38.495.006	0	0	0	202.769.642	0,00%
Water distribution	1	9.989	0	0	0	142.183.397	0,00%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

In the income operations report, the cumulative total is recorded throughout the year, unlike the assets and liabilities operations report where only balances are recorded. For this reason you do not have a percentage higher than 100% because in this case the percentage is part of a same "cake".

Table 12 shows that the sectors of "Agriculture, Livestock and Fishing", "Transport and Storage" and "Administrative Services" are the ones that report the highest income corresponding to sales or given services to foreign related companies and in tax havens, in relation to the total of their reported income of 2016 (f).

It can be seen that the agricultural sector has the highest exports rate after "manufacturing". It means that, 45% of the income of the multinationals belonging to this sector sell their product to its related parties. In addition, it shows that there are multinational companies in Ecuador that are engaged in agriculture, livestock or fishing and that sell these primary goods or commodities to companies abroad. For this reason it becomes the sector that stands out in operations with tax havens and related companies abroad.

Most of the companies found in the administrative services sector perform services without added value, such as accounting, auditing services, etc.

Transportation and storage is a sector in which there are multinationals that are engaged in transportation activities and provide services mostly to related parties abroad. It has been observed based on the sample that the companies that excel in this sector are air transport companies.

In addition, this table indicates that most of the goods derived from the manufacturing sector are commercialized with local related companies, compared with the operations carried out with tax havens and related companies abroad. However, it is still the sector with the highest trading numbers among all sectors with these last two segments. This indicates the great presence of multinationals that are dedicated to the elaboration of finished products in Ecuador.

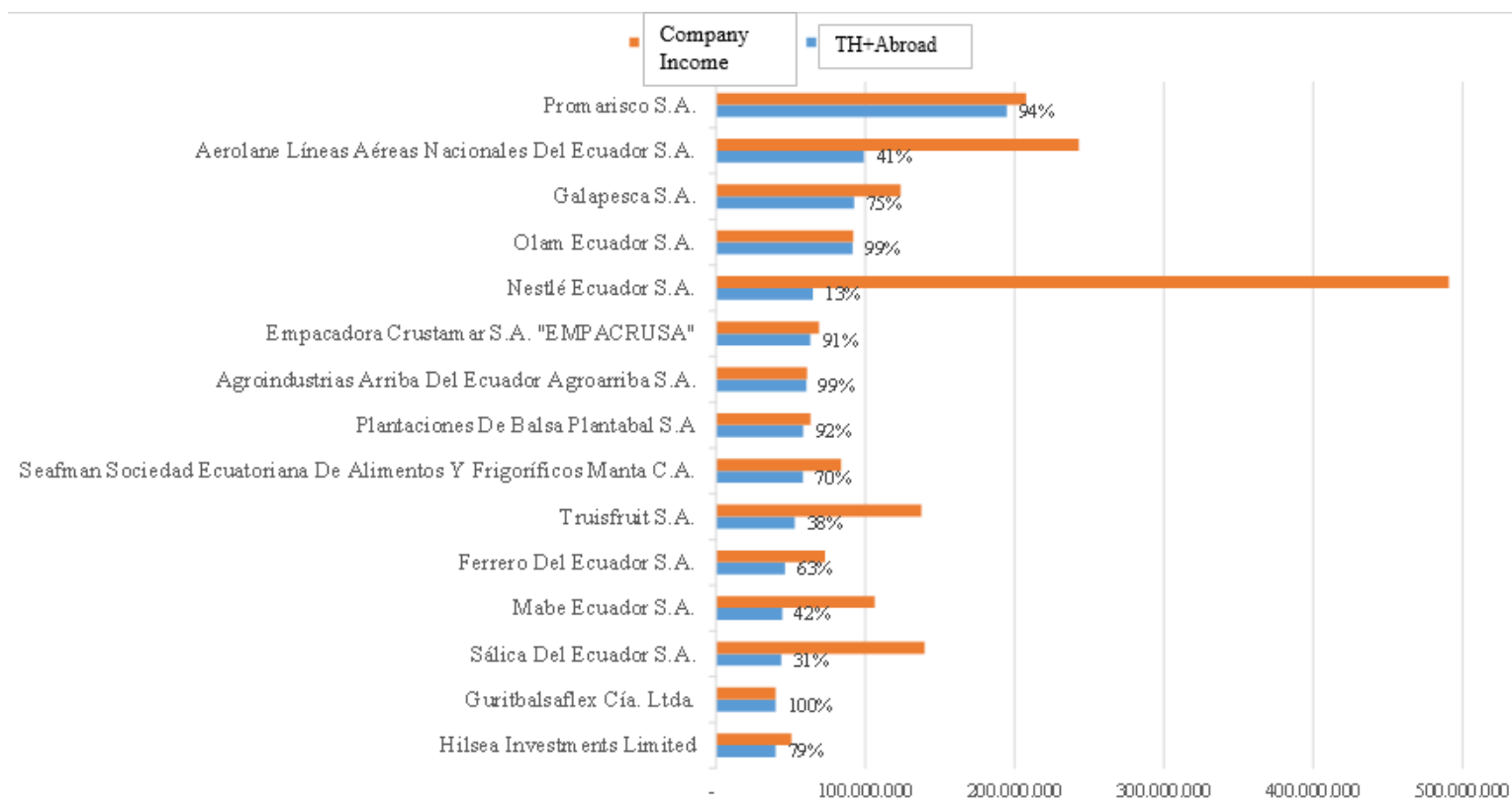
Table 13: Top 15 companies with the largest Income Operations with THs and related parties abroad

Company	Local	Tax Havens	Abroad	OPRE Income	Abroad + TH	Company Income	Share/Total Income
	a	b	c	i = a+b+c	e = (c+d)	f	e/f
Promarisco S.A.	1.022.710	0	194.739.534	195.762.244	194.739.534	207.873.849	93,68%
Aerolane Líneas Aéreas Nacionales Del Ecuador S.A.	0	0	99.066.763	99.066.763	99.066.763	243.114.415	40,75%
Galapesca S.A.	0	440.002	92.093.589	92.533.591	92.533.591	123.674.080	74,82%
Olam Ecuador S.A.	0	0	91.458.440	91.458.440	91.458.440	91.911.568	99,51%
Nestlé Ecuador S.A.	0	54.899	64.837.508	64.892.407	64.892.407	490.854.206	13,22%
Empacadora Crustamar S.A. "EMPACRUSA"	0	63.125.210	0	63.125.210	63.125.210	69.032.430	91,44%
Agroindustrias Arriba Del Ecuador Agroarriba S.A.	0	0	60.619.998	60.619.998	60.619.998	60.966.710	99,43%
Plantaciones De Balsa Plantabal S.A	1.430.381	0	58.386.912	59.817.293	58.386.912	63.409.411	92,08%
Seafman Sociedad Ecuatoriana De Alimentos Y Frigoríficos S.A.	2.755.010	57.811.342	492.718	61.059.071	58.304.060	83.891.354	69,50%
Truisfruit S.A.	4.000	52.682.635	0	52.686.635	52.682.635	137.472.619	38,32%
Ferrero Del Ecuador S.A.	0	7.251.452	39.084.689	46.336.141	46.336.141	72.990.304	63,48%
Mabe Ecuador S.A.	0	0	44.329.938	44.329.938	44.329.938	106.344.625	41,69%
Sálica Del Ecuador S.A.	424.848	163.977	43.484.810	44.073.635	43.648.787	139.736.424	31,24%
Guritbalsaflex Cía. Ltda.	202.357	0	40.042.727	40.245.084	40.042.727	40.058.796	99,96%
Hilsea Investments Limited	287.862	35.691.223	4.257.098	40.236.183	39.948.321	50.530.548	79,06%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Graphic 9: Comparison of the income operations with companies in THs and related parties from abroad, versus the total reported in 2016



Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Based on Table 13, the above is corroborated, since it can be seen that approximately 94% of the revenues reported by Promarisco, the number one in operations with foreign related companies and tax havens, which is a company dedicated to fishing, are controlled by its related parties abroad. This is a trend among the companies in the agricultural sector included in this table, such as:

- Galapesca (seafood exporter)
- Olam (cacao exporter)
- EMPACRUSA (shrimp exporter)
- Agroarriba (cacao exporter)
- Plantabal (balsa exporter)
- Seafman (tuna exporter)
- Truisfruit (exporter of bananas)
- Sálica (seafood exporter)
- Guritbalsaflex (wood exporter)
- Hilsea (Flowers exporter)

This is consistent with the characteristics of Ecuadorian exports, as these are mainly primary goods, mostly agricultural products.

On the other hand, among the companies analyzed is Aerolane, whose registered name is LATAM Ecuador, the main airline in this territory. It should be noted that almost 41% of its income comes from its related abroad (Bloomberg, 2018).

In the case of the manufacturers, there are recognized companies such as Nestlé and Ferrero, dedicated to the production of confectionery and food. And Mabe, company dedicated to the production of household appliances. Their operations are reported as follows:

- In the case of Nestlé, it is evident that it produces goods to market them with related parties mainly abroad, however, this represents only 13% of its total income. In other words, their income does not depend on intra-group operations.
- Ferrero's case is different, this company manages a line of products similar to that of Nestlé, and its transactions with tax havens and related parties abroad

represent 63%, that is, almost two thirds of its income depends on intra-group trade.

- The third is Mabe, which depends on 40% of intra-group operations.

Based on table 13 and graphic 9 can be noted that there are multinational companies that can control even 100% of the income of a company domiciled in another tax regime. That is to say, there are companies with a presence in Ecuadorian territory controlled almost entirely by outsiders.

To conclude, it should be noted that income is not the main concern for the local tax administration, since it is capital that is entering to the country.

3.1.5. Analysis of the Expenses Operations

Table 14: Expenses Operations divided by sector

Sector	# Of Companies	Local	Tax Havens	Abroad	Abroad + TH	Total Expenses	Share/ Expenses
		a	b	c	e = (b+c)	f	e/f
Transportation and storage	5	5.588.942	305.605	114.420.709	114.726.314	535.346.376	21,43%
Manufacture	50	36.371.780	14.227.624	67.256.090	81.483.714	6.404.418.055	1,27%
Telecommunications	4	6.305.165	322.277	43.511.171	43.833.447	1.969.076.546	2,23%
Commercial distribution	64	114.810.691	8.553.005	20.064.921	28.617.925	9.583.800.966	0,30%
Mining	13	153.554.789	709.846	16.393.903	17.103.749	1.900.728.886	0,90%
Technical and professional services	2	19.513.709	10.411.416	1.416.295	11.827.711	165.121.901	7,16%
Financial and insurance services (non-banking)	2	0	0	9.184.751	9.184.751	42.332.622	21,70%
Building	2	15.378.623	0	4.603.644	4.603.644	159.072.474	2,89%
Agriculture, Livestock and fishing	14	12.500.905	231.022	1.726.868	1.957.890	1.183.594.629	0,17%
Real Estate	1	9.694.910	1.920.756	0	1.920.756	13.824.534	13,89%
Water distribution	1	3.937.997	41.774	1.296.588	1.338.363	119.836.158	1,12%
Administrative services	5	7.348.544	0	623.220	623.220	88.439.894	0,70%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Table 14 has the inverse logic to that of income, since everything that companies in the Ecuadorian territory spend is because payments are being made to foreign companies. The expense is what most interests the local tax administration in this case, because this means that the capital is leaving the country, and is being directed to related companies abroad or tax havens. For this reason emphasis is placed on the operations being carried out at market prices without affecting the tax bases at a local level.

In the expenses table, if the companies are paying a price higher than the market price or than the arm's length price to their related abroad or company established in tax havens or preferred regimes, it means that the utility will be lower in Ecuador; If this happens, the tax base will be lower, therefore the tax contribution will also be lower.

Contrary to income. It is very rare that a related company controls 100% of the expenses, since this account not only corresponds to the cost of sales but its composition also corresponds to expenses that could hardly be provided by a related company. For example; payroll accounts, basic services, depreciation expenses, fines, taxes, etc.

In this table, it can be seen that the sectors in which Tax Havens and related parties outflows are higher, are transportation, manufacturing and telecommunications. In the same way, the transportation sector is the one that had the most expenses abroad and in tax havens compared to the total of its income, with 21%; this is followed by the financial services and real estate sectors.

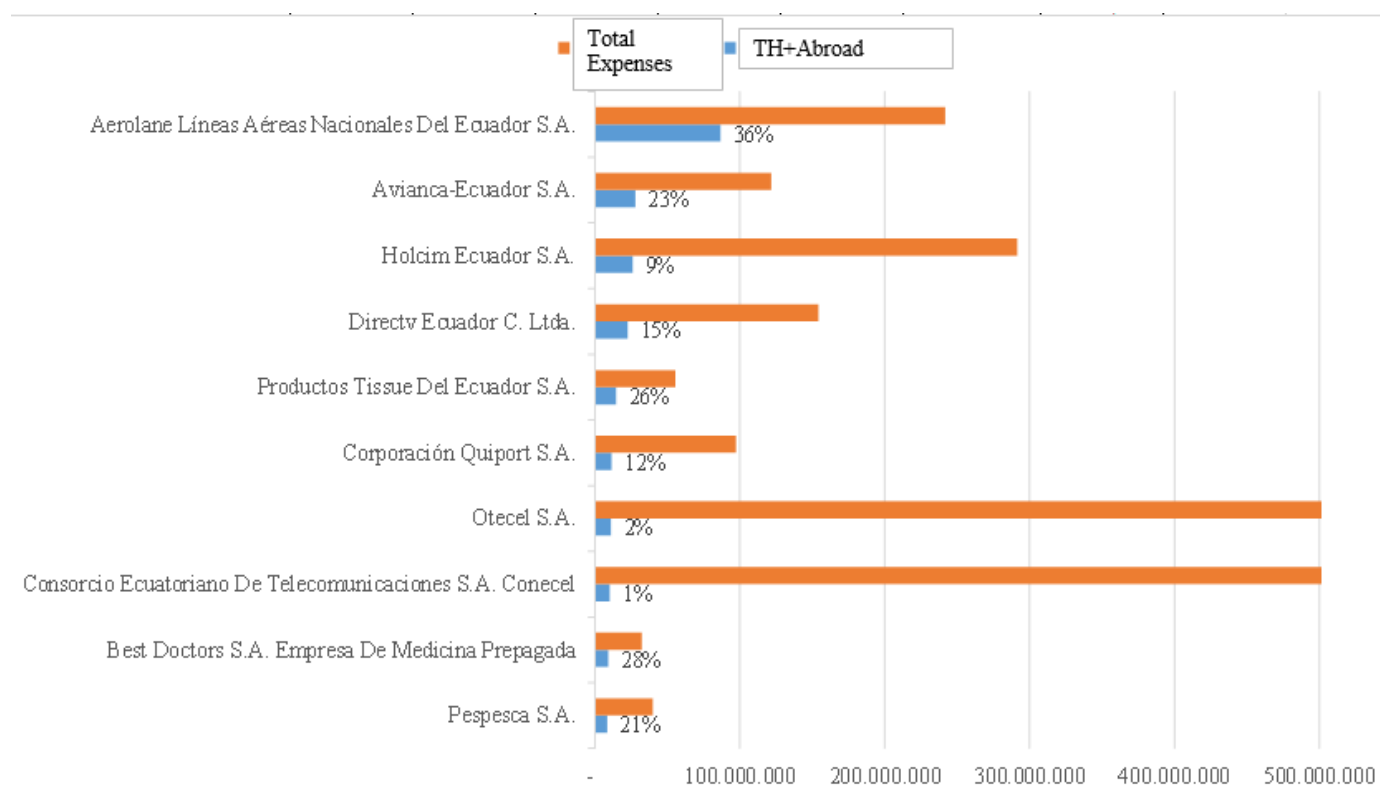
Table 15: Top 10 companies with the largest Expense Operations with THs and related parties abroad

Company	Local	Tax Havens	Abroad	OPRE Expenses	Abroad + TH	Company Expenses	Share/Total Expenses
	a	b	c	i = a+b+c	e = (c+d)	f	e/f
Aerolane Líneas Aéreas Nacionales Del Ecuador S.A.	0	0	86.666.317	86.666.317	86.666.317	241.769.373	35,85%
Avianca-Ecuador S.A.	2.577.021	172.481	27.754.392	30.503.893	27.926.872	121.536.285	22,98%
Holcim Ecuador S.A.	471.119	0	26.068.305	26.539.424	26.068.305	291.426.696	8,95%
Directv Ecuador C. Ltda.	0	0	22.663.913	22.663.913	22.663.913	154.322.602	14,69%
Productos Tissue Del Ecuador S.A.	0	0	14.495.954	14.495.954	14.495.954	55.469.458	26,13%
Corporación Quiport S.A.	17.432.014	10.257.106	1.328.543	29.017.663	11.585.649	97.326.020	11,90%
Otecel S.A.	6.305.165	29.992	11.009.795	17.344.953	11.039.787	569.773.665	1,94%
Consortio Ecuatoriano De Telecomunicaciones S.A. Conecel	0	292.285	9.837.462	10.129.747	10.129.747	1.169.297.864	0,87%
Best Doctors S.A. Empresa De Medicina Prepagada	0	0	9.184.751	9.184.751	9.184.751	32.348.546	28,39%
Pespesca S.A.	59.520	8.541.409	0	8.600.929	8.541.409	40.018.427	21,34%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Graphic 10: Comparison of the expenses operations with companies in THs and related parties abroad, versus the total reported in 2016



Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

To conclude the expense operations, table 15 and graphic 10 that can be found, which indicate the main companies that make up this account. In this way it can be seen that most of the expenses of aviation companies have to do with complex services or products. For this reason Aerolane and Avianca are in the first places, where 25% and 22% of their total expenses correspond to outflows of money to tax havens and related parties.

In this top 10, it can be seen that most of these companies services providers, whether they provide transportation such as the aforementioned airlines; or telecommunications such as DIRECTV, OTECEL or CONECEL, the last two correspond to the telephone operators Movistar and Claro respectively.

The services they provide are very specialized and have to do with technological services. These services are provided by their foreign related parties. New technological services, especially in the field of telecommunications, are highly specialized and unique, which is why it is hard to put a price on them. There is not a clear or defined market in which the price of these services can be observed (Combariza, 2012).

For example, it is not the same to determine the market price of a primary good that is quoted in public markets, than to determine the market price of a technical service. Finally, it should be considered that companies such as DIRECTV, OTECEL or CONECEL are companies that, among very few companies, dominate the national market, which are practically oligopolies that have control over the price at which they transact. This is evidenced by the weight of their expenses with related parties.

3.1.6. Analysis of royalties, technical, administrative, consulting and similar services (S-R)

Table 16: Operations of (S-R) divided by sector

Sector	# Of Companies	Local	Tax Havens	Abroad	Abroad + TH	Total Expenses	Share/ S-R
		a	b	c	e = (b+c)	f	e/f
Manufacture	50	7.348.352	7.731.445	171.733.860	179.465.305	6.404.418.055	2,80%
Telecommunications	4	6.481.951	71.016	119.246.340	119.317.357	1.969.076.546	6,06%
Commercial distribution	64	14.546.615	151.581	48.424.547	48.576.128	9.583.800.966	0,51%
Mining	13	19.784.576	49.497	24.749.248	24.798.745	1.900.728.886	1,30%
Technical and professional services	2	0	0	7.104.789	7.104.789	165.121.901	4,30%
Water distribution	1	215.000	0	1.851.956	1.851.956	119.836.158	1,55%
Financial and insurance services (non-banking)	2	0	0	1.633.500	1.633.500	42.332.622	3,86%
Agriculture, Livestock and fishing	14	129.182	0	1.362.298	1.362.298	1.183.594.629	0,12%
Building	2	1.738.440	0	1.317.952	1.317.952	159.072.474	0,83%
Transportation and storage	5	480.000	0	1.297.587	1.297.587	535.346.376	0,24%
Administrative services	5	0	0	0	0	88.439.894	0,00%
Real Estate	1	0	0	0	0	13.824.534	0,00%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

As Table 16 shows, royalties are concentrated in related companies from abroad, very little in tax havens.

The sectors that stand out are: manufacturing, telecommunications and distribution that are remarkable in intangibles, the use of these go hand in hand with payment of royalties. Among these goods, the following stand out:

- Patents
- Copy Rights
- Know-How
- Digital Content
- On-line Content

An important part of the expenditure of several sectors is recorded in this account, for that reason it can be seen that there is a similarity with the expenses operations, especially with the telecommunications sector which is the one that most represents in operations of royalties with related parties abroad and tax havens, compared to the total of its expenses with 6%. It is a tax strategy of the multinational groups that a company is the holder of the intangible asset and in general this is domiciled in a tax haven. Companies pay for the use of the intangible and the income is taxed in a regime of lower taxation or a tax haven (OECD, 2017).

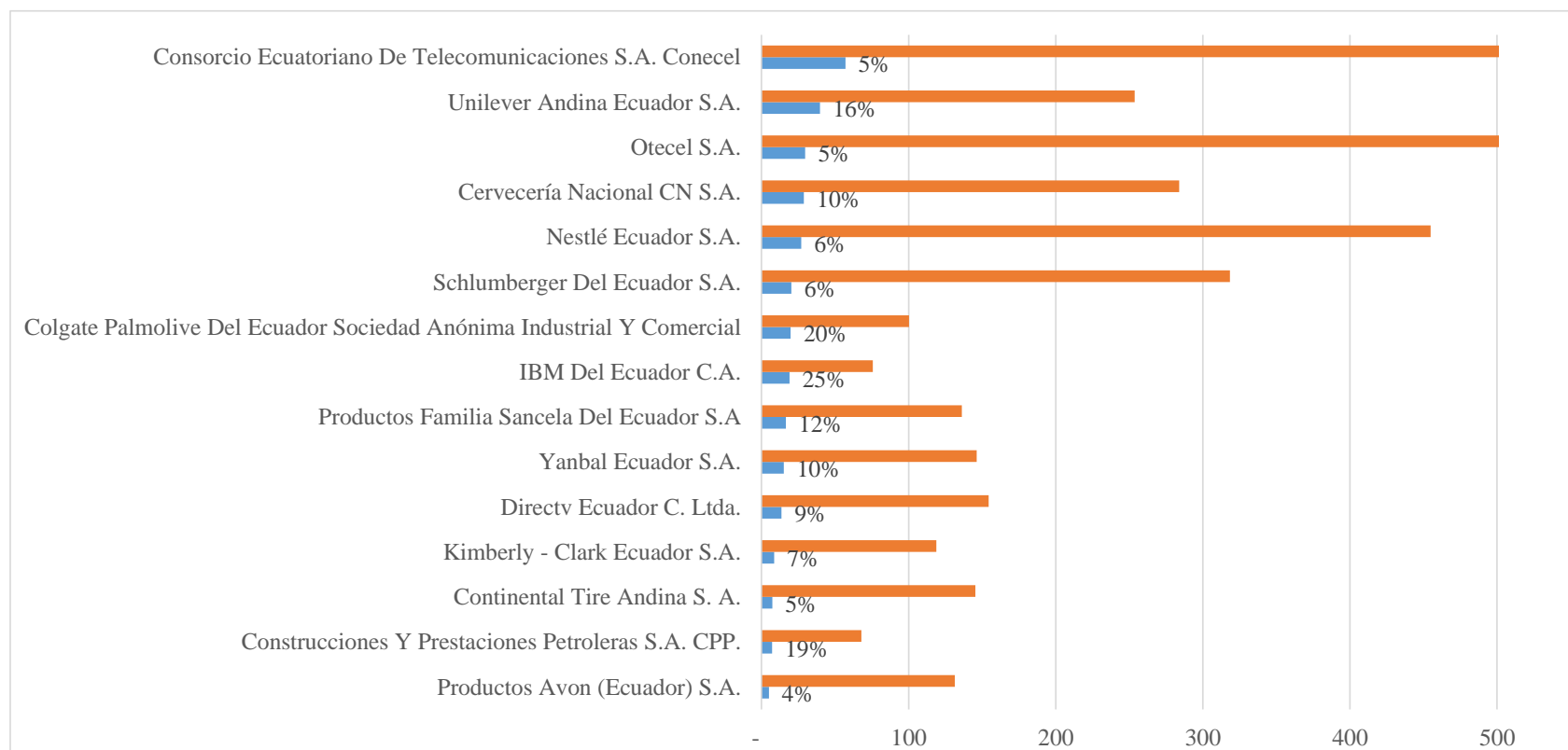
Table 17: Top 10 companies with the largest (S-R) operations with THs and related parties abroad

Company	Local	Tax Havens	Abroad	OPRE S-R	Abroad + TH	Company Expenses	Share/Total Expenses
	a	b	c	i = a+b+c	e = (c+d)	f	e/f
CONSORCIO ECUATORIANO DE TELECOMUNICACIONES S.A. CONECEL	0	0	57042220,6	57042220,6	57.042.221	1169297864	4,88%
UNILEVER ANDINA ECUADOR S.A.	0	2177402,29	37523184,5	39700586,79	39.700.587	253602888	15,65%
OTECEL S.A.	6481950,84	65253,25	29628505,1	36175709,19	29.693.758	569773665	5,21%
CERVECERIA NACIONAL CN S.A.	0	0	28761216,6	28761216,6	28.761.217	283893707	10,13%
NESTLE ECUADOR S.A.	0	12752,07	26928930,4	26941682,47	26.941.682	454907837	5,92%
SCHLUMBERGER DEL ECUADOR S.A.	0	0	20318376	20318376	20.318.376	318378241	6,38%
COLGATE PALMOLIVE DEL ECUADOR SOCIEDAD ANONIMA INDUSTRIAL Y COMERCIAL	0	0	19779882,9	19779882,9	19.779.883	100271189	19,73%
IBM DEL ECUADOR C.A.	0	5763,06	18982687,2	18988450,26	18.988.450	75682414,9	25,09%
PRODUCTOS FAMILIA SANCELA DEL ECUADOR S.A	0	0	16481781,2	16481781,2	16.481.781	136203405	12,10%
YANBAL ECUADOR S.A.	0	0	15132939,2	15132939,2	15.132.939	146197866	10,35%
DIRECTV ECUADOR C. LTDA.	0	0	13592927,3	13592927,3	13.592.927	154322602	8,81%
KIMBERLY - CLARK ECUADOR S.A.	0	0	8660073,57	8660073,57	8.660.074	118855365	7,29%
CONTINENTAL TIRE ANDINA S. A.	0	0	7267838,88	7267838,88	7.267.839	145294601	5,00%
CONSTRUCCIONES Y PRESTACIONES PETROLERAS S.A. CPP	0	0	7104788,89	7104788,89	7.104.789	67795880,6	10,48%
PRODUCTOS AVON (ECUADOR) S.A.	0	0	5124059,06	5124059,06	5.124.059	131474383	3,90%

Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

Graphic 11: Comparison of the (S-R) operations with companies in THs and related parties abroad, versus the total reported in 2016



Source: (Superintendence of Companies, Securities and Insurance, 2018)

Elaboration: González, David

As can be seen in table 17 and graphic 11, the companies that appear on the list are from well-known brands worldwide or companies that are intensive in the use of intangibles such as OTECEL and CONECEL; in addition to Avon and Yanbal, the latter dedicated to the distribution of cosmetics.

Continental Tire appears as a clear example, a company whose operations with related parties abroad has a royalty expense for use of the brand, know-how transmission for the manufacture of tires with German technology, etc. In other words, the parent company makes an expenditure on research and development and transmits this knowledge to its subsidiary in Ecuador in exchange for an amount stipulated in the intra-group operation, these movements in form 101 are recorded in the royalties and technical services account (S-R) (Bank Watch Ratings S.A., 2010).

IBM also appears, which is a company that is dedicated to the creation and distribution of software, 25% of everything they spend corresponds to royalties paid abroad (tax haven or foreign companies). This mostly corresponds to digitized content or that is distributed online.

Unilever and Cervecería Nacional are included in this list since they produce products for personal hygiene or food products; In this case, patented recipes are needed, which are used to make these products in Ecuadorian territory.

Finally, it should be noted that the goods whose arm's length price is harder to determine are the technical services and royalties. Because it is difficult to value an intangible, and determine its market price; since the price of the intangible is handled by the multinational commercial group and for this reason no one else has it, no brand is equal to the other. That is, there is no such thing as a brands market where one brand can be compared with another (UNPAN, 2001).

3.1.7. Analysis of capital outflows

Taking into account the capital expenditures that have been demonstrated are held by intra-group international operations, it has been considered necessary to analyze the outflows of money that are derived from dividends and distributed profits.

This way we find that Ecuador is a country that practically does not make foreign investment, so it does not account for income received by it in the balance of payments. While the income paid from direct investment was \$ 433.1 million in 2016, \$ 598.1 in 2015 and \$ 663.3 in 2014 (Banco Central del Ecuador, 2018).

Within this area, it can be seen that the dividends and profits, commonly distributed by subsidiaries of Ecuador abroad, reached \$ 187.4 million dollars in 2016; and in 2015 and 2014 were \$ 257.2 and \$ 267.3 million, respectively. This causes a deficit in the balance of national income, and makes it possible to show that the profits of companies with activities in Ecuadorian territory, especially multinational companies, are not being reinvested in the country (Banco Central del Ecuador, 2018).

As we have seen throughout this analysis, the largest companies in the country are multinationals, and they are also the ones that transact the most money. Not only foreign companies belong to different multinational business groups, but it has been seen that the shareholders of the largest national companies belong to foreign holdings.

Consequently, this implies that most of the dividends, or even all of their dividends, are leaving the country. For this reason it is necessary to encourage reinvestment, and that the money stays in the country.

Thus, the alternative that can be generated based on this analysis to boost the economy and increase liquidity in the country, preventing the dollars from going out, would encourage the reinvestment of profits and dividends by large companies through benefits and reductions in taxes, mainly the income tax.

Another alternative to avoid the exit of money through dividends and profits, would be to encourage the reinvestment of the same in the local stock market, thus that money could be reinvested in local debt. To achieve this, the State could guarantee part of the debt and thus ensure the multinationals their money, it would be inviting companies and shareholders to invest their dividends in local debt in exchange for a reduction or even elimination of income tax. In this way there would be more demand for debt so that smaller companies could benefit from this financing.

3.2. Conclusions

To end up the third and final section of this research, it can be concluded by emphasizing the importance of control over transfer pricing by the Ecuadorian tax administration, as it can be seen in the graphs and tables obtained from the 2016 report, the amounts deriving from intra-group multinational operations represent millions of dollars and a large part of Ecuador's international trade.

It can be seen that evidently there are accounts that represent a capital outflow to which more attention is given by the local tax administration, since it has been seen that through these transactions the companies can take money out of the country to different jurisdictions in intra-group operations.

It is also important to emphasize that there are companies in Ecuador that could apparently be considered national, but based on this research it is evident that they can become totally controlled by multinational corporations abroad. It is curious to find that in several cases the companies that report the most intra-group activities have a business based on primary goods, products related to agriculture, a detail that agrees with the characteristic of this commodities exporter country.

In addition, the importance of the creation of the technical services and royalties account should be emphasized, it highlights that the Ecuadorian tax administration is monitoring certain companies' expenditures, with which it is often difficult to establish an arm's length price.

Finally, this chapter allows us to see the importance of reinvesting capital within the country to avoid the large outflows of money that are derived from multinational trade.

CONCLUSIONS AND FINAL RECOMENDATIONS

Conclusions:

After having concluded these three chapters and the subsequent analysis of intra-group international business operations of multinational companies in Ecuador, I have reached the following conclusions:

1. The main international organization in charge of regulating transfer pricing is the Organization for Economic Cooperation and Development, and the country that has contributed the most in the development of this regime is the United States.
2. The transfer pricing regime is the most important in terms of international taxation, and to which countries must pay special attention in order to avoid tax evasion.
3. Transfer prices should not be confused with a multinationals tax evasion tool, since these also help corporations on establishing the cost of goods and services, in addition to serving as an evaluation on whether performing intra-group operations or independent operations.
4. The prices in which the intra-group transactions are carried out must be at market prices (arm's length price).
5. The analysis methods play an important role when comparing the price of intra-group operations with independent comparable operations.
6. The regulations on transfer pricing in Ecuador have a clear and well-established basis, this follows the guidelines suggested by the OECD.
7. In Ecuador there are 163 companies that carry out intra-group international trade, and whose operations exceed 15 million dollars.
8. More than two thirds of the intra-group multinational operations are carried out by the manufacturing sectors and distributors.

9. The United States is the country where most of the MNEs are established, and to which the companies that operate in Ecuador belong, with a total of 32. This country is followed by Spain with 23 and the Netherlands with 15.
10. Much of Ecuador's international trade is derived from intra-group multinational operations.
11. The sample indicates an exit of more than 317 million dollars in operations with related companies from abroad and with tax havens.
12. Emphasis is placed on the importance of the technical services and royalties account when representing additional expenses.
13. It is evident that expenditures are higher than revenues, one of the main factors that influence this item is the high percentage of income taxation in the country.

Recommendations:

1. Special attention should be given to foreign regulations on transfer pricing and to organizations that suggest guidelines for their correct use.
2. The operation of national regulations must be evaluated.
3. The government should encourage the reinvestment of capital generated by large companies, in order to prevent this money from leaving the country and going to subsidiaries abroad and in tax havens.

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ANNEX



Annex 1

B. Statement of the arm's length principle

i) Article 9 of the OECD Model Tax Convention

1.6 The authoritative statement of the arm's length principle is found in paragraph 1 of Article 9 of the OECD Model Tax Convention, which forms the basis of bilateral tax treaties involving OECD member countries and an increasing number of non-member countries. Article 9 provides: [Where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly. By seeking to adjust profits by reference to the conditions which would have obtained between independent enterprises in comparable transactions and comparable circumstances (i.e. in “comparable uncontrolled transactions”), the arm's length principle follows the approach of treating the members of an MNE group as operating as separate entities rather than as inseparable parts of a single unified business. (OECD, 2010).

Annex 2

 FORMULARIO 101 <small>RESOLUCIÓN N° NAC-DGERCGC18-00000157</small>		DECLARACIÓN DEL IMPUESTO A LA RENTA Y PRESENTACIÓN DE ESTADOS FINANCIEROS FORMULARIO ÚNICO DE SOCIEDADES Y ESTABLECIMIENTOS PERMANENTES										 SUPERINTENDENCIA DE COMPAÑÍAS VALORES Y SEGUROS			
100 IDENTIFICACIÓN DE LA DECLARACIÓN															
102 AÑO												104 N° DE FORMULARIO QUE SUSTITUYE		No.	
200 IDENTIFICACIÓN DEL SUJETO PASIVO															
201 RUC		0 0 1										202 RAZÓN O DENOMINACIÓN SOCIAL		203 EXPEDIENTE	
OPERACIONES CON PARTES RELACIONADAS LOCALES Y/O DEL EXTERIOR															
CON PARTES RELACIONADAS LOCALES	OPERACIONES DE ACTIVO	003	+		CON PARTES RELACIONADAS EN PARAÍSO FISCAL, JURISDICCIÓNES DE MENOR IMPOSICIÓN Y RÉGIMENES FISCALES PREFERENTES	OPERACIONES DE ACTIVO	008	+		CON PARTES RELACIONADAS EN OTROS RÉGIMENES DEL EXTERIOR	OPERACIONES DE ACTIVO	013	+		
	OPERACIONES DE PASIVO	004	+			OPERACIONES DE PASIVO	009	+			OPERACIONES DE PASIVO	014	+		
	OPERACIONES DE INGRESO	005	+			OPERACIONES DE INGRESO	010	+			OPERACIONES DE INGRESO	015	+		
	OPERACIONES DE EGRESO	006	+			OPERACIONES DE EGRESO	011	+			OPERACIONES DE EGRESO	016	+		
	OPERACIONES DE REGALÍAS, SERVICIOS TÉCNICOS, ADMINISTRATIVOS, DE CONSULTORÍA Y SIMILARES	007	+			OPERACIONES DE REGALÍAS, SERVICIOS TÉCNICOS, ADMINISTRATIVOS, DE CONSULTORÍA Y SIMILARES	012	+			OPERACIONES DE REGALÍAS, SERVICIOS TÉCNICOS, ADMINISTRATIVOS, DE CONSULTORÍA Y SIMILARES	017	+		
TOTAL OPERACIONES CON PARTES RELACIONADAS												029	=		
¿SUJETO PASIVO EXENTO DE APLICACIÓN DEL RÉGIMEN DE PRECIOS DE TRANSFERENCIA?												030	=		

