Doing Deals in Brazil

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Investment Drivers and Challenges in Brazil

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Introduction

Brazil has pulled through the international economic crisis remarkably well, emerging as a stronger and more attractive global player. A high degree of economic diversification, a strong domestic consumer market, a broad selection of trading partners, and a robust and regulated financial system, have all been key to successfully mitigating the worst effects of the crisis. After a long period of domestic economic instability Brazil has come of age, both politically and economically: the country has had nearly two decades of political and currency stability, tight fiscal discipline, increasing international reserves, solid macroeconomic indicators and a fast-expanding internal consumer market.
All of this makes Brazil one of the most promising emerging markets in the world, and one of the most attractive markets for foreign investors.

However, despite their increasing interest and confidence in Brazil, prospective investors still harbour some out-dated perceptions of the country's strengths and weaknesses and continue to find it difficult to overcome complex regulatory and legal matters. Businesses can be challenged by the complex tax environment, bureaucracy and poor infrastructure. To help you improve your understanding of these perceived barriers and the ways to clear the path to a successful investment, we are pleased to publish the 2013 edition of this convenient pocket book guide to Doing Deals in Brazil. This guide contains information about Brazil's economic environment, financial and tax regulation and M&A activities, as well as information on Brazilian politics and culture and other subjects.
To aid your investment in Brazil, a team of PwC Brazil specialists has also identified some of the critical concerns and risks that a prospective investor may face.

Introduction

We believe that this guide will help you to pursue successful and profitable business ventures in Brazil. Obviously a guide of this kind can offer only a summary of the legal and regulatory environment in Brazil and you will want to obtain professional accounting and legal advice before embarking on doing deals here. Our experts at PwC Brazil would be delighted to provide more detailed information on any of the matters covered in this guide, to help you get started.

Fernando Alves
Territory Senior Partner
PwC Brazil

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1 Investment Drivers and Challenges in Brazil

Why invest in Brazil?

All four of the BRIC countries (Brazil, Russia, India and China) are globally perceived as offering huge opportunities and potential for growth. However, the challenges for investors in Brazil are smaller than for those in other emerging economies.

Brazil is rich in natural resources, it has a young workforce and a largely unexploited domestic market: this is a country with great potential. Having constructed, over the last two decades, a durable platform for growth made out of the twin pillars of economic and political stability, Brazil is better placed than ever to capitalize on its potential.

Some of Brazil's attractions and challenges are shared with its fellow BRIC countries:

BRIC: Opportunities

- Rapid economic growth
- High growth rate of GDP per capita
- Increasing market size across all sectors
- An expanding middle class
- Large and growing urban populations
- Increasing energy consumption

BRIC: Challenges

- Poor infrastructure
- Inefficient governance
- Ineffective law and challenges to societal order
- Widespread corruption
- High levels of inequality and poverty

Brazil's Key Advantages

However, Brazil has a number of qualities that set it apart from other destinations for investment:

Governance and finance:

- Brazil is a settled democracy with well established governmental and administrative institutions
- Following the adjustment of its macroeconomic fundamentals and the improved stability of its political institutions, Brazil's economic climate is no longer volatile
- There is increasing international trade and globalization and the government promotes policies favoring exports
- There are new regulations in place favoring minority shareholders, and promoting corporate governance and better accounting practices
- Brazil has strict, modern environmental legislation
- Brazil has a sophisticated, resilient financial and banking system
- Inflation has been under control for almost a decade and a half

The business environment:

- Brazil is currently the world's seventh largest economy and the largest economy in South America; it is expanding its presence in world markets
- The country has large, well-developed agricultural, mining, manufacturing, and service sectors, with a broad industrial base: in short, it is a diversified economy
- Brazil has been given an Investment-Grade rating by all the major risk agencies
- Foreign investors are eligible for most available fiscal incentives, including tax deductibility of goodwill under certain conditions
- There has been significant improvement in local capital and debt markets, with an increasing number of IPOs in recent years

- There has been a significant reduction in the country risk perception over the last few years
- Brazilian business is facing a transformational period with the introduction of better corporate governance and accounting procedures and the convergence of local accounting and auditing standards with International Financial Reporting Standards (IFRS)
- Whilst corruption remains widespread, problems of physical security have greatly improved in recent years

Geography:

- Brazil offers a business-friendly environment for US and European investors (there are no major cultural differences which affect the ability to do business there)
- Brazil is highly urbanized when compared to other emerging market countries
- The whole country speaks one language
- The country has a creative, flexible labor force
- Brazil is not frequently afflicted by severe natural disasters
- Brazil maintains peaceful relations with neighbour countries
- From Brazil, investors have tariff-free access to other members of the Mercosur free trade zone (Brazil, Argentina, Chile, Venezuela, Paraguay and Uruguay)

Resources:

- Brazil has immense resources in energy, minerals and raw materials
- Brazil is close to becoming self-sufficient in oil and is a world leader in the development and production of low emission fuels and biofuels, especially ethanol

The future:

- According to The Economist, Brazil will be the world's fifth largest economy in less than a decade (it is currently placed seventh)
- Many local companies are undervalued and in need of restructuring, capital and technology
- There is a fast-growing consumer market with high growth potential, especially among the middle-classes

The main investment drivers

Long term strategies and investments (including allowing overall infrastructure improvement and pre-salt oil exploration) remain on the top of the government's agenda. This effort is expected to bring results in the medium to long term. Some regions, in particular the northeast, now have the challenge of taking advantage of opportunities that are already available in the rest of the country. The country's social inequalities are also being addressed. The government has made significant progress in recent years in attacking poverty (including through the "Bolsa Família" program).

Financial and strategic investors are seeing these opportunities and are finding Brazil to be a highly attractive investment destination. Cross-border mergers and acquisitions (M&A) and strong capital markets will also play an important role in driving future investment.

Brazil deserves close attention while it prepares itself for the future. The country has huge infrastructure demands and a need for further public and private investment in education and healthcare. The top priorities on the government's agenda include structural tax reforms and tight control on government expenses, to spur the country's economic growth.

Brazil will have a unique opportunity to showcase its success when it hosts the upcoming major sporting events, the Soccer World Cup in 2014 and the Olympic Games in 2016. Strategic and financial investors (such as private equity firms) have not been established in Brazil for very long. Already, however, they are arriving in greater and greater numbers, realizing that they cannot afford to be absent from this dynamic market.

“Business as usual’ is not the key to business success. That is why investors are looking for opportunities to expand their business interests among the emerging economies. If they rely on the low long-term growth of developed economies, businesses will only stagnate. The projected annual growth rate for developed economies is only 2% p.a. in real terms. Understanding the way businesses work beyond traditional home markets is key. Brazil provides a democratically stable economic/political environment structured around mature institutions operating in/with a single market/ language comprising 200 million consumers, many of whom are new arrivals in the consumer markets. Investment grade emerging markets have long ceased to be viewed as fringe speculative investments. A well managed investment in an economy like Brazil´s is part of a formula for success.

The main investment challenges

Despite significant progress, investors still face numerous challenges when they approach Brazil. There is a complex regulatory environment with regard to tax and labor, as well as high taxes and social charges on payroll, sales and income. Multiple taxes and fast-changing legislation can affect business plans and increase risks on contingent liabilities, potentially blocking the success of both asset and stock acquisitions. Brazil also has complex transfer pricing and foreign capital registration rules.

Brazilian companies do not always comply with internationally recognised corruption or anti-bribery laws, such as the Foreign Corrupt Practices Act and the UK Bribery Act 2010. They also frequently have undisclosed off-balance sheet transactions and commitments, which can result in loose application of accounting rules.

On the whole, historical financial of businesses in Brazil information is of a generally low quality and does not always fully adhere to generally accepted accounting practices. A significant number of small and/or family-owned businesses may require post-deal investment in areas such as corporate governance, internal controls, integration of IT platforms, and HR related matters, among others.

Brazilian companies are not always organized optimally. There may be difficulties in reorganizing companies quickly, since there are high costs for the termination of a worker's employment. There is also a considerable amount of bureaucracy and regulation in certain industries and with regard to certain kinds of businesses. In certain regions, and even in certain particular industries, nepotism can be a factor: "knowing who" is often more important than "knowing how".

In some, less industrialized, areas of the country, there is also a need for further investment in distribution channels and infrastructure. Weaknesses in the education system can also impair the supply of a sufficiently skilled labor-force. This goes hand in hand with Brazil's social inequality and uneven distribution of wealth.

More generally, Brazil still lags behind in investment in innovation and research and development, and Brazilian firms still suffer from poor brand recognition outside the country, although this is improving.

Presented below are examples of the usual difficulties faced by investors when doing deals in Brazil, both (pre-investment and post-investment (in no particular order).

The main issues usually identified in due diligence processes involving Brazilian target companies

- Material tax, environmental and labor risks and contingencies
- A certain level of informality in the operations (e.g. unrecorded transactions, two sets of books)
- Significant related party transactions which have inadequate documentation
- A lack of a controls environment or inadequate controls (resulting in poor quality financial information)
- Inadequate accounting practices, triggering significant accounting adjustments (e.g. to EBITDA, net income and net assets) and tax risks
- A lack of regular control with respect to account reconciliations
- Inadequate cash management

The main factors behind unsuccessful business deals in Brazil

- Unexpected tax and labor problems
- Excessive legal formalities/ bureaucracy
- Low quality of available information
- Market volatility
- Insufficient due diligence prior to investment
- Underestimation of time needed for deal execution
- Overestimated synergy/ restructuring gains
- Low quality management
- Inefficient post-acquisition monitoring

The Economic Environment

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2 The Economic Environment

2.1 An Overview of Brazil

Key Figures

- Population: estimated at 194 million
- 26 states and one federal district (Brasília)
- 2012 GDP: US$2.3 trillion
- Currency: Real (rate of US$1 to approximately R$1.98 as at April 11, 2013)
- Language: Portuguese

Political Organisation

- Federative Republic of Brazil
- Presidential and state elections were last held in October 2010 (for a four year term)
- Current president Mrs Dilma Rousseff (Workers Party) is set to run for re-election in 2014 supported by former president Mr. Luiz Inácio Lula da Silva

Economic Overview

Facts and Figures

- Brazil is the largest economy in Latin America and the seventh largest in the world
- The GDP per capita was approximately US$12,000 in 2012
- Primary economic sectors are: agriculture, automotive, utilities, transport, industrial products, mining and energy
- Some main natural resources include bauxite, gold, iron ore, manganese, nickel, phosphates, platinum, tin, uranium, petroleum, hydropower and timber
- Main agricultural products include coffee, soybeans, wheat, rice, corn, sugarcane, cocoa and citrus
- Export items include iron, soybean, automobiles, soybean oil and derivates and aircraft
- Import items include petroleum, vehicle parts, electronic micro parts, and medicines
- The main ports and harbours are Tubarão, Itaqui, Santos, Itaguaí, São Sebastião, Paranaguá, Aratu, Rio Grande, Belém, Angra dos Reis

Population

- Brazil has the largest population in Latin America and the fifth largest in the world
- Approximately 70% of the population are concentrated in the south-east and north-east
- Life expectancy is approximately 74 years
- Some 27% of the population is under 14 years of age and only 6% is over 65 years old
- The country is highly urbanized: only 14% of the population lives in rural areas

Geography

- São Paulo is one of the fastest-growing cities in the world
- Twenty other metropolitan areas have populations of more than 1 million
- The population of the São Paulo and Rio de Janeiro states is approximately 42 million and 16 million, respectively
- The main economic regions are: São Paulo, Rio de Janeiro, Minas Gerais, Paraná and Rio Grande do Sul
- The GDP per capita in the south-east, south and mid-west regions is much higher than that in the north and north-east

Region	Population In millions	%	Land Mass %
Southeast	81.6	42.1	11.0
South	27.7	14.3	7.0
Midwest	14.4	7.4	22.0
North	16.3	8.4	42.0
Northeast	53.9	27.8	18.0
	193.9	100.0	100.0

Source: IBGE – Instituto Brasileiro de Geografia e Estatística

2.2 A Summary of Recent Economic Activity

The Brazilian economic game changing event in 2012 was the launch of the Federal government´s economic program named the “New Economic Matrix”. The basis of this new economic policy had been introduced in 2011, at the beginning of Dilma’s government, but the detail became clearer over the last year. The New Economic Matrix can be characterized by low interest rates, a devalued exchange rate, more expansionary fiscal policy and industry specific incentives.

From the monetary policy point of view, in an attempt to boost economic growth and achieve what the current government considers to be a more appropriate interest rate, in August 2011, the Central Bank began a monetary adjustment process that ended in October 2012. The benchmark interest rate was reduced from 12.50 percent to 7.25 percent in this cycle, thus declining, in real terms (net of inflation) from 4.2 percent at the end of 2011 to 1.5 percent at the end of 2012.

Although the monetary authority believed that inflation would converge towards its target, the practical result was rather different, and inflation as measured by the IPCA (consumer price index) reached 6.5 percent in 2011 and 5.8 percent in 2012. Market players seem to understand that the Brazilian Central Bank is focusing much more on growth than on inflation, which means that its goal is no longer steering inflation towards the target (4.5 percent), but preventing it from exceeding the ceiling (6.5 percent). In other words, whenever inflation threatens to overreach this ceiling, we should observe monetary policy acting to contain it.

While the interest rate was reduced, we had an important change in exchange rate controls, with the government seeking a more depreciated exchange rate to boost industrial activity and hence GDP. Accordingly, it adopted increasingly more measures intended to reverse the Real appreciation trend, such as raising taxes (IOF) on (a) foreign loans and (b) credit to exporters.

Furthermore, the Central Bank actively intervened in the foreign exchange market, purchasing dollars. As a result, the flow of US dollars to the Brazilian economy fell from US$ 65.3 billion in 2011 to US$ 16.7 billion in 2012, and the exchange rate, which reached 1.70 BRL/USD in the first quarter of 2012, ended the year at 2.04 BRL/USD. In 2012, among the fifteen most important currencies in the world, the Brazilian Real was the second most devalued one (minus 10.8 percent), just behind the Japanese yen (minus 11.5 percent).

Despite the lower volume of dollars that entered the country, Brazil enjoys a comfortable situation in terms of balance of payments. Last year, the current account deficit was US$ 54 billion, which could be financed by the FDI flow that amounted to US$ 65 billion. As a share of the GDP, our current account deficit totaled 2.4 percent.

Finally, 2012 was marked by the intense use of fiscal policy, as the government pursued the agenda of reducing some taxes in order to boost economic activity - especially consumption - and control inflation. In the same vein, the government reduced taxes on purchases of vehicles and household appliances and replaced some payroll taxes with a sales tax to reduce production costs. The latter measure was originally designed to apply only to some segments of the economy, but was ultimately extended to a greater number of sectors, including some service sectors at the end of last year.

Additionally, public banks such as the BNDES (Brazilian Development Bank), Caixa Econômica Federal and Banco do Brasil have been capitalized in order to strengthen their lending capabilities thus boosting consumption and investments. In a context of low economic growth, the result in terms of public finance was a major drop in revenue, which, together with the increased spending, kept the government from fulfilling the primary surplus target (3.1 percent of GDP). In spite of that, though, it is important to note that Brazil's solvency risk is still low.

Roughly speaking, the New Economic Matrix, for the moment, is not producing the results the government expected, i.e. high GDP growth (about 4 percent) and a relatively curbed inflation. Brazil's GDP growth in 2012 was slightly below 1 percent with an inflation rate close to 6 percent which resulted in a dangerous combination of low growth and high inflation. It should also be noted Brazil had record low rates of unemployment – although the country still seeks qualified labor.

From the political point of view, 2012 was a year of intense government intervention in terms of economic policy. In addition to shifting from the macroeconomic tripod (inflation targets, a floating exchange rate and fiscal responsibility) to the “New Economic Matrix”, the dispute with private banks to reduce interest spreads and the cut in electricity rates represented major changes.

Politically, the government faced difficulties in approving the tax changes given the dispute on federal issues in Congress. The quarrel over oil royalties caused a paralysis that prevented the government’s tax policy from being approved. The foremost change in its strategy was the reduction in payroll taxes for some sectors of the economy. The combination of economic and political instabilities will make 2013 a critical year for the remainder of President Dilma´s first term.

Brazil has withstood the international economic crisis and emerged as a stronger and more attractive global player. A high degree of economic diversification, combined with a strong domestic consumer market and a broad selection of trading partners, further coupled with a well regulated financial system, have been key to successfully mitigating the worst effects of the crisis. The long period of domestic economic instability in Brazil has been overcome. Both politically and economically, Brazil is now a mature country and one of the most attractive markets in the world for foreign investment. Challenges persist due to the maintenance of a complex tax environment and, for 2012, a low growth rate and unexpectedly high inflation rate.

2.3 The Outlook for 2013

2013 will be the year when we start to see how the world economy will look for the rest of the century. It will be the year when businesses recognize that without doubt, global growth and commodity prices are now driven primarily by developments in Emerging Economies, like China, India and Brazil (which, together will account for nearly half of world GDP growth in 2013), not the US and Europe.

Brazil is one of the world's fastest growing economies with its GDP ranking 7th worldwide in 2012 and expected to improve in the ranking over the next years.

We expect 2013 to carry a slightly better scenario for the Brazilian economy, especially in terms of GDP growth. As a result of the lower interest rate, the devalued domestic currency, the tax changes - especially those related to payroll - and the increase in the public banks' credit lines with extremely favourable terms, the expansion of the economy should be around 3.0 percent.

Under this scenario, investments are a key variable. After a reduction of about 3.6 percent in 2012, investments should gain steam, due to the above factors, the approaching World Cup and the ensuing need to complete related projects. Additionally, the government has been driving its efforts to increase investments especially considering the limitations of a growth model based on consumption. Accordingly, the government wants to offer concessions to the private sector for public services such as roads, highways, railways, ports and airports.

Whereas some of these concessions should only take place in the second half of the year, their concrete impact on the economy should be seen more clearly only in 2014, as they spur GDP growth.

On the other hand, inflation, which has been on a negative trend since late last year, remains a major risk factor. Given the economic recovery context, inflationary pressures can be greater, demanding that the central bank take action by raising interest rates. This scenario, however, is not the most likely, since the monetary authority has indicated interest rates will remain at their current levels for some time. To avoid a worsening inflation scenario, the government continues to promote tax discounts.

In the 2013 IPCA (inflation index parameter) scenario, the energy price cuts of around 30 percent for both consumers and manufacturers, promoted by the government will make a major difference. Additionally, the government is expected to announce new tax reductions on food products. Despite these initiatives, the average expectation for IPCA forecasts are 5.7 percent.

Finally, given the risk of a worsening inflationary scenario, the government is not expected to act so intensively in the exchange rate market on the devaluation of the Brazilian Real. Actually, since late last year, the government suspended some of the measures it implemented to prevent currency appreciation. Moreover, the Brazilian Central Bank sold dollars to reduce the downward pressure on the currency.

From the political point of view, the economic performance during the year will be essential to validate the government's optimism about the effects of the new balance between exchange and interest rates. The argument that low growth is a matter of time tends to become implausible. Accordingly, this year will test the efficiency of the current administration's diagnosis.

In macroeconomic terms, 2013 should bring no surprises. The trend expected is that the tax cuts will continue, in order to accommodate the inflationary pressures and boost the economy through a looser fiscal policy and greater incentives for the production sector.

The basic scenario for 2013 includes the extension of tax cuts on payroll taxes and changes in the goods and services tax (ICMS) and in social security contributions (PIS/COFINS). There is a good chance that tax cuts on staple foods will be approved, so as to minimize inflationary pressures.

The positive aspect will be an increased concern by the government on increased investments. The challenge is to introduce the ambitious investment agenda designed for the infrastructure sector, which totals more than US$ 110 billion (US$ 45 for railroads, US$27 billion for ports, US$ 21 for highways and US$ 17 billion for airports).

Government should also soften its rhetoric toward the private sector. The approach to investors is central to reversing the drop in investments. This milder tone, however, will unlikely suffice to bring about the recovery in investments expected by the government. Sound concession models, a stronger GDP growth forecast and a friendlier business environment are the key elements to attract private investors.

The year 2013 should be paramount for President Dilma in her effort to attain greater economic growth and, hence, a successful reelection project. The current political and economic challenges are quite complex. Dilma's ratings, however, are highly positive given the low unemployment rate. Nevertheless, Brazil is still struggling to find the path to higher economic growth levels.

In our view, the key message is: adapt, because 'business as usual' is changing. Emerging economies will drive global growth. Businesses based in advanced economies that want a market growing at more than 2% per annum in real terms (which is the projected per annum real trend rate of advanced economies in the long run) need to look beyond their traditional home markets. In 2013, expansion in the emerging markets will no longer be viewed as a speculative investment, but core to business growth. But it will also bring new risks that have to be assessed and managed. Brazil is a key player in this new environment.

The realization of mega events like the FIFA World Cup in 2014 and the Olympic Games in 2016 in Brazil provides a unique opportunity to promote and attract investments, leveraging the potential of the country and helping reduce the infrastructure deficit. Strategic and financial investors (private equity investors) are strongly considering investments in the area – and are supported by the BNDES.

To attract these investments requires a major organizational effort, particularly strong synergies and integration between the various public and private entities, directly or indirectly linked to the sports industry. Currently, a total of US$50 billion is estimated to be invested in the infrastructure of all cities involved in both events, creating approximately 3.5 million jobs in the country.

As the World Cup and the Olympic Games are world events, the expected gains in terms of visibility for Brazil are huge. Therefore these are considered great opportunities for the country to improve its international image. An increase of about 1 percent in Brazil's GDP is expected in the year of each event.

Summary of historical economic indicators

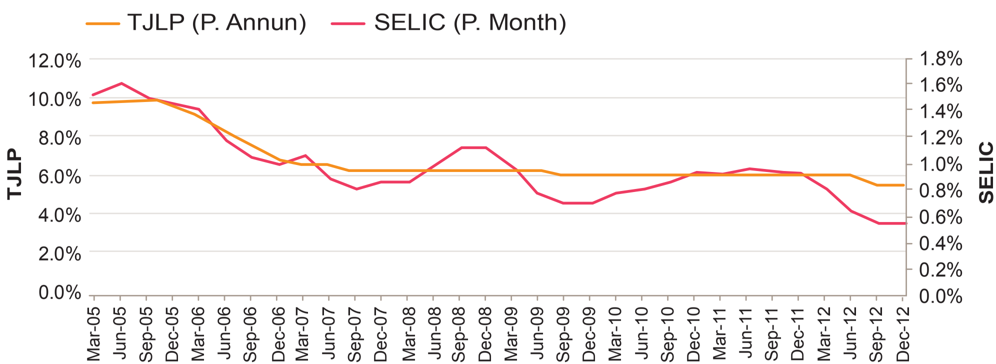
Main Economic Indicators

In US$ billion	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012[1]
GDP (US$ billion) [2]	506.0	554.0	664.0	882.0	1,089	1,367	1,651	1,626	2,144	2,475	2,253
Real GDP growth (% per year)	2.7	1.1	5.7	3.2	4.0	5.7	5.1	(0.3)	7.5	2.7	0.9
Unemployment rate (% of labour force)	10.5	12.4	11.5	9.9	10.0	7.5	6.8	6.8	5.3	4.7	4.6
General price index - IGP-DI (% per year)	26.4	7.7	12.1	1.2	3.8	7.9	9.1	(1.4)	11.3	5.0	8.1
Consumer price index - IPCA (% per year)	12.5	9.3	7.6	5.7	3.1	4.5	5.9	4.31	5.91	6.5	5.8
Exchange rate at year's end (R$/US$)	3.63	3.08	2.93	2.44	2.18	1.78	2.39	1.74	1.67	1.88	2.04
Exchange rate change (% per year)	53.8	(19.3)	(7.1)	(15.8)	(5.9)	(16.9)	34.1	(25.3)	(3.4)	13.6	9.4
Public sector deficit (% of GDP)	4.2	4.6	2.3	6.6	3.6	2.7	2.0	3.3	2.5	2.6	2.5
Public sector debt (% of GDP)	50.5	53.5	48.2	48.0	45.9	43.9	38.8	42.1	39.1	36.4	35.1
Goods exported	60.4	73.1	96.5	118.3	137.8	160.6	197.9	153.0	201.9	256.0	242.6
Goods imported	47.2	48.3	62.8	73.6	91.4	120.6	173.0	127.7	181.9	226.2	223.1
Trade balance	13.2	24.8	33.7	44.7	46.5	40.0	25.0	25.3	20.3	29.8	19.4
Current-account balance	(7.6)	4.1	11.7	14.0	13.6	1.5	(28.3)	(24.3)	(47.3)	(52.5)	(54.3)
International reserves	37.8	49.3	52.9	53.8	85.8	180.3	206.8	239.1	288.6	352.0	373.1
Foreign direct investment (3)	14.1	10.1	18.1	15.1	18.8	34.6	45.0	25.9	48.5	66.6	65.3
Total foreign debt	227.7	235.4	220.2	188.0	199.4	240.5	262.9	277.6	351.9	404.1	428.4*

(1) Based on the most recent published data.
(2) At the year-average exchange rate. IBGE.
(3) Including intercompany loans.
* Jan - Set

Brazil's interest rates have historically ranked amongst the highest in the world.

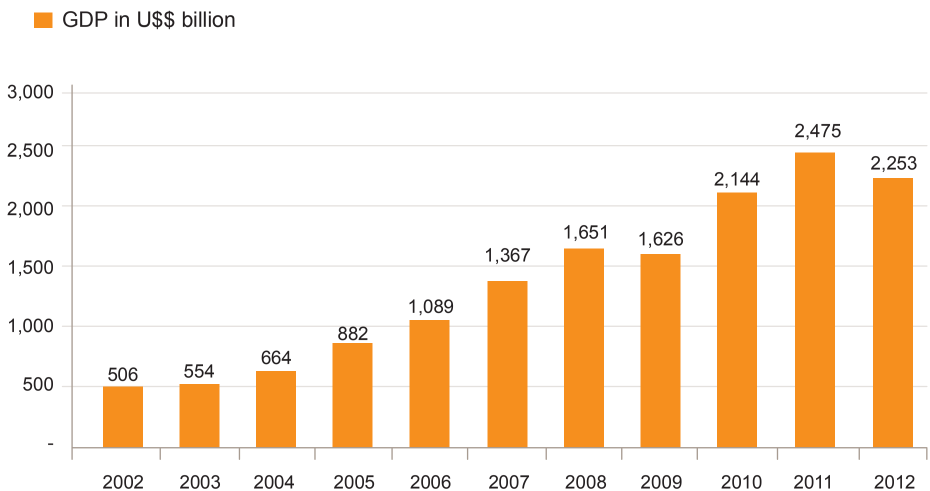
Interests Rates



Source: Diário Oficial da União

Brazil's GDP is the highest in Latin America. This has been driven by Brazil's large and developed agricultural, mining, manufacturing and service sectors.

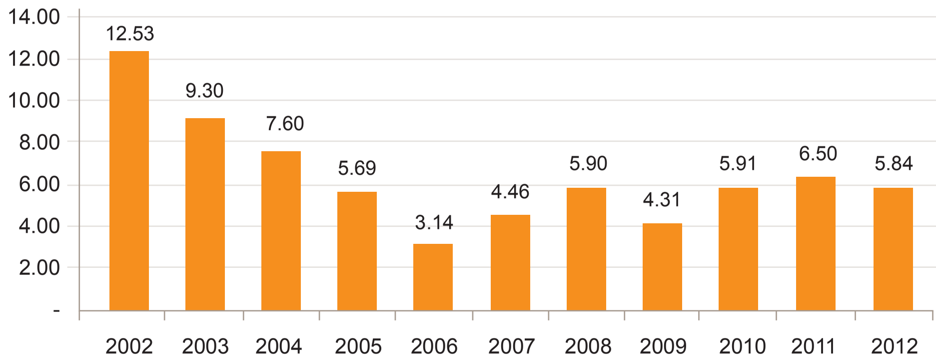
GDP evolution - in U$$ billion



Source: IBGE - Instituto de Geografia e Estatística

Despite increasing pressure in the last two years, Brazil has kept inflation under control in the last decade.

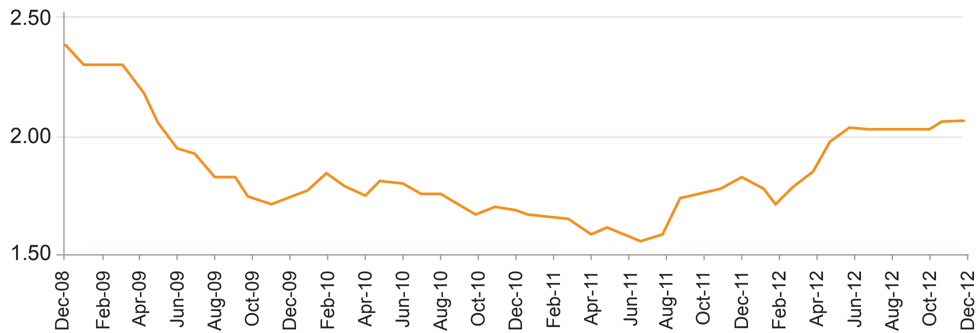
Brazilian Inflation Index (IPCA) evolution



Source: Ipeadata (Presidência da República- Secretaria de Assuntos Estratégicos)

Robust economic performance coupled with favourable international conditions have conveyed great capital inflow to Brazil, impacting the value of the local currency, the Brazilian Real.

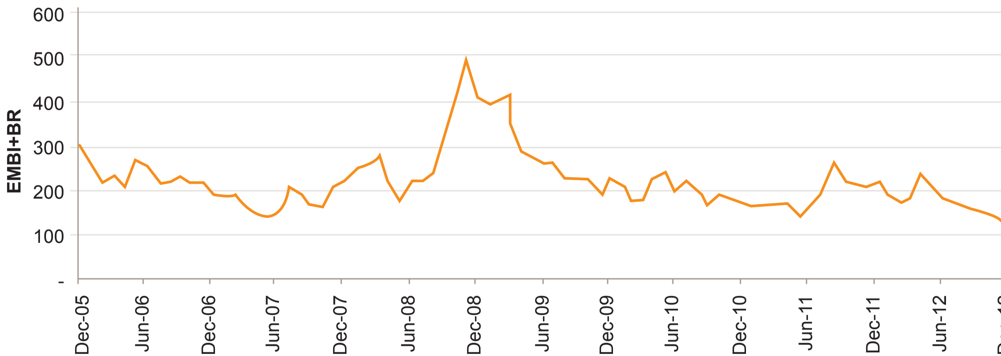
Exchange Rate Evolution



Source: Gazeta Mercantil

There has been a significant reduction in the perception of Brazil's country risk over the last few years.

Country Risk (Brazil)



Source: Bloomberg

Despite total exports showing a slight decrease in 2012 (5% from the prior year), as a result of reductions in international-based commodities prices, at $243 billion they were 20% greater than in 2010. Note that since 2009 China has become the most significant destination for Brazilian exports, overtaking the United States.

Main export destinations - by country

Country exports (US$ Millions)	2007	2008	2009	2010	2011	2012
China	10,749	16,403	20,191	30,786	44,315	41,228
United States	25,314	27,648	15,740	19,462	25,805	26,701
Argentina	14,417	17,606	12,785	18,523	22,709	17,998
Netherlands	8,841	10,483	8,150	10,228	13,640	15,041
Germany	7,211	8,851	6,175	8,138	9,039	7,227
Japan	4,321	6,115	4,270	7,141	9,473	7,956
United Kingdom	-	-	3,727	4,635	5,230	4,519
Russia	3,741	4,653	2,869	4,152	4,216	3,141
Italy	4,464	4,765	3,016	4,235	5,441	4,581
Chile	4,264	4,792	-	4,258	5,418	4,602
Others	77,327	96,626	76,072	90,357	110,754	109,582
Total	**160,649**	**197,942**	**152,995**	**201,915**	**256,040**	**242,580**

Source: Secretaria do Comércio Exterior (Brazilian Trade Balance Consolidated Data Report)

United States and China have historically been the main providers of Brazil's imports. Total imports in 2012 reached US$223 billion, approximately 1% lower than 2011.

Main import sources - by country

Country imports (US$ Millions)	2007	2008	2009	2010	2011	2012
United States	18,887	25,810	20,183	27,249	33,962	32,357
China	12,618	20,040	15,911	25,593	32,788	34,248
Argentina	10,410	13,258	11,281	14,426	16,906	16,444
Germany	8,675	12,025	9,866	12,552	15,213	14,209
Korea Republic	3,391	5,412	4,818	8,422	10,097	9,098
Japan	4,610	6,807	5,368	6,982	7,872	7,735
Niger	5,273	6,706	4,760	5,920	8,386	8,012
France	3,525	4,678	3,615	4,800	5,462	5,910
Italy	3,347	4,612	3,664	4,838	6,222	6,199
India	-	-	2,191	4,242	6,081	5,043
Others	49,885	73,849	45,990	66,625	99,512	83,894
Total	**120,621**	**173,197**	**127,647**	**181,649**	**226,243**	**223,149**

Source: Secretaria do Comércio Exterior (Brazilian Trade Balance Consolidated Data Report)

Despite exporting a diversified range of products, commodity-based items have historically played an important role in Brazil's foreign sales.

Brazilian Exports - Top Products - Descending Order (January- December 2012)

Description	FOB Prices (US$)	Share%
Grand Total	**242,579,775,763**	**100.00**
Total of the items described below	**157,288,162,600**	**64.86**
Iron ore and iron ore concentrates	30,989,292,517	12.77
Crude oil	20,305,876,591	8.37
Soybean, including soybean crush	17,455,200,216	7.20
Whole cane sugar	10,030,103,067	4.13
Frozen, fresh or chilled chicken meal (including edible offal)	6,732,381,151	2.78
Meal and residues from the extraction of soybean oil	6,595,457,488	2.72
Coffee beans	5,721,720,964	2.36
Corn	5,287,267,448	2.18
Fuel oil (diesel oil etc.)	5,039,034,073	2.08
Aircraft	4,746,598,532	1.96
Wood chemical paste	4,700,438,179	1.94
Frozen, fresh or chilled cattle meat	4,494,880,017	1.85
Semi-finished iron and steel products	3,841,699,402	1.58
Parts and spare parts for automobiles and tractors	3,777,556,020	1.56
Passenger automobiles	3,724,764,941	1.54
Tobacco leaf and surplus	3,197,303,248	1.32
Refined sugar	2,814,469,786	1.16
Ferroalloys	2,787,913,165	1.15
Semi-finished gold goods for non-monetary use	2,341,157,579	0.97
Ethanol	2,186,191,155	0.90
Earthmoving and drilling machines and equipment, etc.	2,181,322,688	0.90
Cotton	2,104,430,857	0.87
Cargo vehicles	2,082,220,453	0.86
Ethylene, propylene and styrene polymers	2,079,428,957	0.86
De-haired leather and hide, other than raw leather and hide	2,071,454,104	0.85
Other	85,291,613,163	35.14

Source: Brasil. Ministério do Desenvolvimento, Indústria e Comércio Exterior. Secretaria de Comércio Exterior (Brazilian Ministry of Development Industry and Foreign Trade), at http://www.desenvolvimento.gov.br/arquivos/dwnl_1358532852.doc

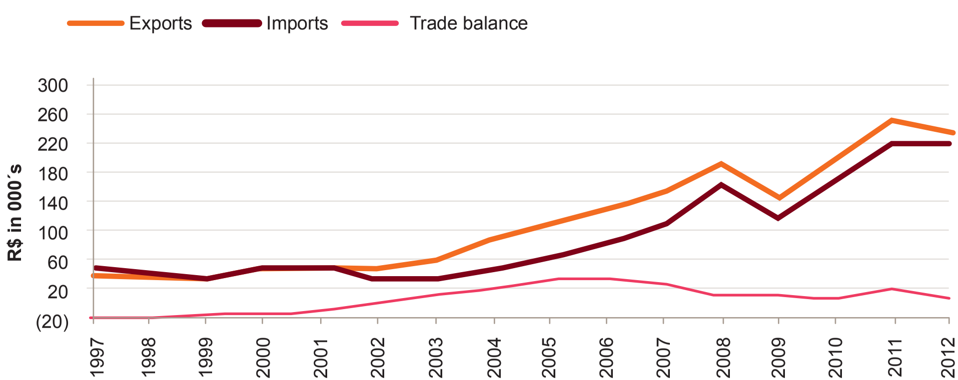
Brazilian Imports - Top Products - Descending Order (January- December 2012)

Description	FOB Prices (US$)	Share%
Grand Total	**223,149,130,318**	**100.00**
Total of the items described below	**99,918,518,190**	**44.81**
Crude oil	13,405,739,345	6.01
Passenger automobiles	9,566,747,498	4.29
Parts and spare parts for automobiles and tractors	6,771,471,931	3.03
Fuel oil (diesel oil etc.)	6,711,698,984	3.01
Drugs for human and veterinary medicine	6,113,616,532	2.74
Integrated circuits and electronic micro-assemblies	4,248,640,651	1.90
Naphthas	4,192,993,317	1.88
Transmission or receiving devices components	3,630,109,255	1.63
Potassium chloride	3,512,818,128	1.57
Natural gas	3,336,130,497	1.50
Heterocyclic compounds and related salts and sulfonamides	3,079,989,375	1.38
Gasoline	3,008,376,949	1.35
Coal, including coal powder (but non agglomerated)	3,006,339,110	1.35
Cargo vehicles	2,993,192,079	1.34
Instruments and devices for measuring, testing etc.	2,870,872,226	1.29
Electric engines, generators and transformers and related parts	2,868,901,807	1.29
Parts and components for automatic data processing machines	2,608,524,943	1.17
Bearings and gears and related parts and components	2,407,894,487	1.08
Automatic data processing machines and related components	2,406,114,206	1.08
Insecticides, formicides, herbicides and related products	2,245,806,264	1.01
Pumps, compressors, fans etc., and related parts	2,240,313,150	1.00
Aircraft engines and turbines and related parts	2,200,521,823	0.99
Machines and equipment for earthmoving, drilling etc.	2,200,001,618	0.99
Flat-rolled iron and steel products	2,154,009,791	0.97
Fertilizers containing nitrogen, phosphorus and potassium	2,137,694,224	0.96
Other	123,230,612,128	55.19

Source: Brasil. Ministério do Desenvolvimento, Indústria e Comércio Exterior.
Secretaria de Comércio Exterior (Brazilian Ministry of Development Industry and Foreign Trade), at http://www.desenvolvimento.gov.br/arquivos/dwnl_1358533197.doc

Brazil is gradually increasing its participation in global international trade.

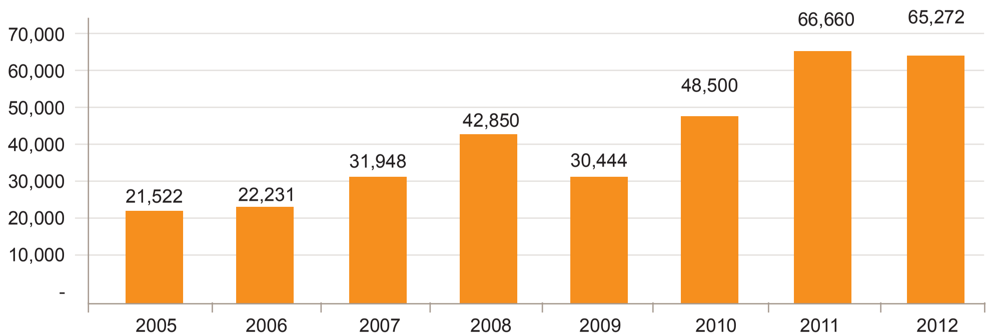
Brazilian trade balance evolution- 1997 to 2012



Source: Banco Central do Brasil

Europe and the US have been the main foreign direct investors in the last five years, with the manufacturing and services sectors being the main drivers, followed closely by agriculture. Leading countries investing in Brazil have historically been the Netherlands, the US, Spain, Germany, France and Japan. Foreign direct investors have increased significantly in recent years, peaking in 2011 at US$67 billion.

Foreign direct investors (in US$ Billion)



Source: Banco Central do Brasil

M&A and Private Equity Activity

3

3 *M&A and Private Equity Activity*

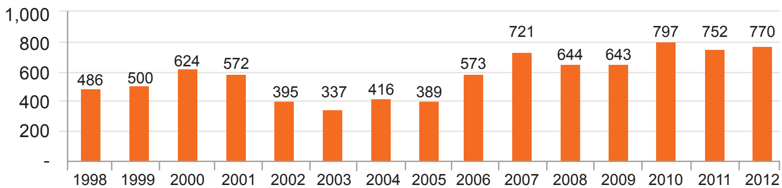
3.1 2012 M&A Activity

Brazil has, over the last three years maintained the level of M&A activity. With an all time record of nearly 800 deals announced in 2010, 2011 and 2012 had, 750 and 770 announced deals respectively. The level of activity experienced in the Brazilian M&A market is testament not only to Brazil's rebound from the global downturn started in 2008, but also to its underlying strength. While international market sentiment around M&A activity in 2012 swung between optimism and skepticism, Brazil continues to show good momentum in what looks to be sustained activity. Strategic and financial investors (private equity) have reached historical record levels of deals, supported by a solid macroeconomic scenario and tremendous consolidation opportunities. Confidence – a key driver for M&A activity – has been further boosted by low unemployment rates, access to credit and an estimated 40 million new consumers in recent years. Middle market M&A activity remains strong and is expected to drive M&A in 2013 – transactions up to US$ 100 million lead M&A activity with a 69 percent share of the announced deals.

Majority stake transactions represent around 55 percent of all announced transactions, while non-controlling positions account for 32 percent, indicating a long-term investment strategy. Strategic and financial investors are both participating aggressively in the fast developing Brazilian economy. An annual and more detailed monthly analysis of deal flows demonstrate that M&A activity in Brazil is at high levels, the monthly average number of deals having risen from 54 in 2008 and 2009 to 64 in 2012. On a monthly basis, we observe that transactions results increased with the introduction of the new format adopted by CADE (antitrust authority) in regulatory approvals, which came into effect on May 29, 2012 – in that month we recorded one of the highest levels of M&A activity, with 88 announced transactions.

A multi-sector and multi-region deal profile has been observed in 2012, with the leading sectors by deal volume being IT, Retail, Consumer Products (including Food/Agribusiness & Beverages, Healthcare and Cleaning products), Mining, Services (Healthcare, Education and general services) and Chemicals/Oil & Gas. Next in significance are Financial Services, Logistics and infrastructure/construction. It should be observed that the largest sector holds some 10% of total deal volume with other sectors following close behind.

Number of M&A transactions



Source: PwC Corporate Finance

Strong and sustained growth emerged in 2012 across multi-sectors and regions, with a particularly strong performance in IT, Retail, Consumer Products (including Food/Agribusiness and Beverages, Cleaning products), Mining, Services (Healthcare, Education and general services) and Chemicals/Oil and Gas.

These were followed closely by Financial Services, Logistics and Infrastructure/Construction. The top preferred sector (IT) accounted for some 10% of the total deal volume.

Additional information on the profile of the Brazilian M&A market

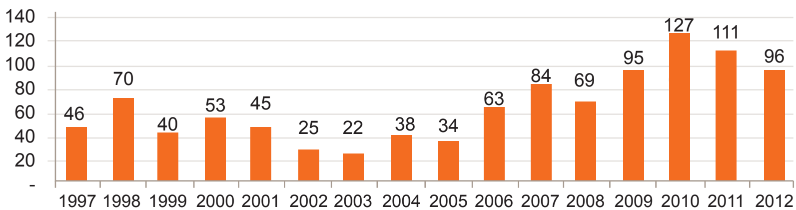
Buyers

- Local and multinational firms
- Private equity and buy-out funds
- Government and private pension funds
- Distressed debt conversions

Targets

- Private companies
- Family owned
- Privatization
- Carve-out of acquired non-core businesses
- Non-core or distressed businesses of multinational companies

Transactions with deal value over US$ 100 million



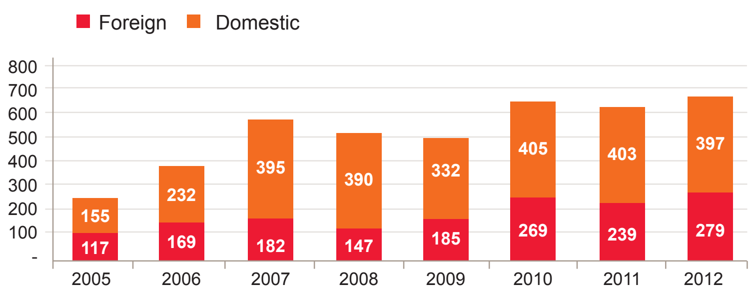
Source: PwC Corporate Finance

Foreign and domestic capital participation in M&A activities

Brazilian investors participated in 397 business deals in 2012, 59% of these being acquisitions (controlling and minority stake deals). This represents a slight fall from 2011 (403 transactions).

Foreign investors took part in 279 transactions (a record number for foreigners), or 41% of all business deals. With a notable increase in transaction volume, foreign investors maintained their focus on the M&A market in Brazil. Signs of the financial crisis appear less pronounced over time: there has been a 90% increase in the volume of deals involving foreign buyers, compared to 2008.

Aquisition deals by origin of buyer

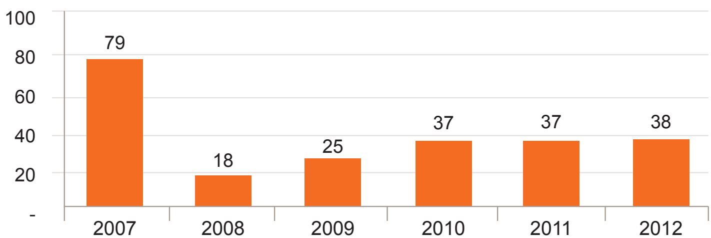


Source: PwC Corporate Finance

IPO activity

38 Brazilian companies came to market in 2012 (including follow-ons), against 37 in 2011. Brazil's record year for IPOs was 2007, when 79 companies raised R$55.6 billion ($33.3 billion).

IPO´s by year



Source: BMF/Bovespa

Private equity in Brazil continues to gain momentum

While worldwide private equity-backed M&A activity was severely affected since October 2008, Brazil is experiencing a different scenario. Private equity activity maintains a high level of activity, being present in 38 percent of the deals announced in 2012. This share, which was 15 percent in 2007 and 20 percent in 2008, reflects aggressive private equity investment strategies and consolidation of various sectors.

Capitalized with some US$ 15bn available for investments, a significant part of private equity activity in Brazil has involved consolidation opportunities in "capital for growth" deals. The largest investments this year are in the segments of food and beverage, retail, consumer goods, IT, education and financial and energy sectors. Additionally, deal size has started to increase from the small- to mid- market transactions that have historically dominated the market.

The Brazilian private equity market has been stimulated by a combination of several factors that have strengthened Brazil's position not only as an emerging market alternative to China and India, but currently as an attractive alternative to more developed markets that have experienced a much slower return to growth. A combination of factors, such as increasingly sophisticated and liquid capital markets, new financing instruments and existing exit alternatives (such as sale to a strategic player, capital markets/ IPO or sale to another PE or funds), along with the continuing demonstration of political and economic stability have opened the eyes of foreign private equity investors to Brazil, which is now regarded as a serious player in the global market. We do expect a much more active equity and debt market in 2013, leading to new records in those markets, as well as, overall M&A activity and new PE entrants.

Brazil has a multi-sector profile in M&A

Strengthened by the dimensions of resources and the extensive possibilities in the country, M&A activity is spread across several sectors in Brazil.

The main sectors for investment will continue to be IT, retail, food and consumer goods, healthcare, education, general business services, energy and finance, with consolidation in all these sectors continuing to be a key driver. Infrastructure, given Brazil's structural deficiencies, and oil & gas are also sectors likely to see improved activity.

Companies in Brazil continue to face a transformation period. With better corporate governance and accounting practices (IFRS has been mandatory for large companies since December 2010) in place, most companies are experiencing the challenges of having a local company that is being transformed into a regional, then national and finally international operation.

Who is already investing?

Approximately 140 private equity and venture capital firms have invested in Brazil, through over 230 investment vehicles. Private equity investors more than trebled their share of the Brazilian M&A market over the past four years. Some of the private equity investment highlights in 2012 were:

- Tarpon Investimentos purchased, for an undisclosed value, 7.23% of the common shares of Cremer SA
- The private equity Axxon Group announced the acquisition of 50% of BR Marinas and Marina Verolme
- Carlyle bought, for $200 million, a 24% stake in Orguel, a manufacturer of heavy equipment
- Actis Capital made an investment of R$ 135 million in CNA, a language teaching network
- Patria Investimentos bought, for an undisclosed sum, a majority stake in MDT
- Kinea bought a minority stake in Grupo Delfin
- GP Investments purchased two thousand transmission towers
- Black Rock acquired shares in engineering company MRV

What to expect in the Brazilian M&A market in the near future?

Expectations are that the Brazilian M&A and investment context will continue to mature and will reach new levels. Given the continued interest shown by strategic and financial investors, the main sectors of investment will continue to be food and consumer goods, healthcare, education and outsourcing services, real estate, energy and finance. Consolidation in all these sectors will continue to be a key driver. Infrastructure, given Brazil's structural deficiencies, and oil and gas, are also sectors likely to see increased activity.

Companies in Brazil are facing a transformational period. With better corporate governance and accounting procedures (IFRS has been mandatory for large companies since December 2010 and a more simplified and optional set of rules has been established for mid-size companies), most Brazilian companies are facing the challenges of transforming from being a local business to being a regional, national or finally international operation. Equity and debt markets in 2013 will likely remain weak but prospects for the midterm are encouraging. As Brazil shifts gears to a more investment-led approach to growth, M&A activity may certainly benefit from it.

Brazilian Culture

4

4 *Brazilian culture*

This section presents an overview of Brazil's culture, from the point of view of investment.

Language

Brazil's official language is Portuguese. There are no significant local dialects or other derivations from the official language, but a number of words and phrases vary from those used in Portugal. English is the foreign language most commonly used by the business community.

Religion

The predominant religion is Roman Catholicism. Many other religions are also practiced, since immigrants of different creeds have settled in Brazil. The constitution guarantees freedom of religion.

Education

The government offers free state and subsidised private educational facilities, from primary school through university, with full- or part--time curricula. The government also subsidises national apprenticeship training programs as preparation for various industrial and commercial sectors, as well as an educational program to reduce illiteracy among adults. About 90 percent (2008) of the adult population is considered to be literate. The general level of education requires considerable improvement. Approximately 9.5 percent of enrolled students go on to higher education.

Improvements in the education levels have been observed in the last decade.

Living standards

The standard of living of a large proportion of the population is very low, while that of the top stratum is extremely high. Whilst improving, this income gap between the rich and poor has been a constant preoccupation of successive governments.

Basic social indicators underscore the differences in regional development.

GDP per capita was approximately US$12 thousand in 2012.

Cultural and social life in Brazil

With its mixed background of Portuguese, Italian, German, Japanese, East European, Middle Eastern and African immigrants, Brazil offers a wide diversity of cultural and social activities, depending on the region of the country. Most major cities support cultural institutions.

Leisure and recreation activities are mainly outdoors, taking advantage of the favourable climate. Many social clubs in Brazil offer extensive sports and social facilities.

The attitude of the local business community towards foreign investment

In general, the attitude of local businesses towards foreign investment is welcoming. Certain sectors have exerted strong lobbying pressure in order to protect their activities, including the imposition of trade barriers and the establishment of restrictions on foreign investment. In the past, such political pressure was quite successful but since the early nineties, the government has gradually improved this situation as it seeks to generate more efficiency and competitiveness in the business environment.

Workforce attitude towards foreign investment

If foreign investment and management can be seen to bring jobs and to be competing on an equal basis with Brazilian businesses, the attitude of the workforce tends to be welcoming.

Cultural perception of due diligence

The need for a potential investor to perform detailed analysis and due diligence is accepted by sellers of local businesses in Brazil. However, the purposes of due diligence are not always clear in the minds of local business people or of the staff of target companies. It is sometimes thought to be some form of audit work or to be limited to an analysis of the company's financial, tax and legal positions. The existence of generally less homogeneous accounting and reporting systems, and less sophisticated financial and accounting departments in medium and small sized Brazilian companies, renders the preparation of due diligence information and the execution of due diligence exercises generally more difficult and time-consuming than in more developed countries.

Accounting Principles and Audit Requirements

5

5 *Accounting Principles and Audit Requirements*

Audit requirements and practices

Investor considerations

- Public/listed "S.A." corporations are required to publish their annual financial statements.
- The annual financial statements of all listed companies and all "large companies" (entities with total assets of over R$ 240 million or annual revenue over R$ 300 million) must be audited by an independent auditor registered with the Brazilian Securities Commission (CVM).
- Financial institutions and other entities under the jurisdiction of the Central Bank, as well as insurance companies, are required to publish annual and semi-annual audited financial statements.
- The quarterly financial information of listed corporations and financial institutions must be filed with the appropriate regulator (the CVM or Central Bank) and, in certain cases, reviewed by an independent auditor.

Statutory requirements

Digital books and records

In January 2007, Federal Decree 6022 instituted the Public Digital Bookkeeping System – SPED, a tool that unifies the activities of receipt, validation, storage and authentication of documents and books which integrate the taxpayer's commercial and fiscal bookkeeping, through a single, computerized flow of information and the use of digital certification.

SPED is an integrated initiative of the federal financial administration across three different areas: Digital Fiscal Bookkeeping (*Escrituração Fiscal Digital - EFD*), Digital Accounting Bookkeeping (*Escrituração Contábil Digital - ECD*) and Electronic Invoices (*Nota Fiscal Eletrônica - NF-e*).

The Accounting SPED – ECD tool is intended to replace the hardcopy accounting books with softcopies. The general journal (*livro diário*), general ledger (*livro razão*), auxiliary books and the trial balances and balance sheets will be generated as part of a set of digital documents. The SPED tool includes the presentation of information for the federal, state and, hereafter, municipal tax authorities, as well as for the National Registration Department of Commerce (*Departamento Nacional de Registro de Comércio*), the Central Bank (BACEN), SUSEP and the CVM. These accounting books must still be delivered in accordance with the current deadlines.

The Fiscal SPED - EFD tool encompasses the preparation and the delivery of comprehensive tax information to both Federal and State tax authorities, aiming to provide detailed information regarding tax computations and invoices issued/received by the Companies.

The whole SPED initiative is becoming increasingly sophisticated, with the inclusion of additional information such as PIS and COFINS information, electronic services invoices, electronic freight services invoices and the electronic taxable income control register (E-LALUR), among other relevant tax information.

Audited financial statements

The annual financial statements of the following entities must be audited by independent auditors registered with the CVM, the Central Bank and other government agencies, as applicable:

- Listed corporations
- "Large companies" (as defined in investor considerations above)
- Financial institutions and other entities under the jurisdiction of the Central Bank
- Investment funds
- Stock exchanges
- Insurance companies
- Private pension funds

Financial institutions and insurance companies must also have their semi-annual financial statements audited. The quarterly financial reports (ITR) of listed entities supervised by the CVM must be reviewed by independent auditors.

When a private corporation is not required to have, and does not have, independent auditors, the company's audit committee (conselho fiscal) may appoint them at the corporation's expense if it is believed that this is necessary for the fulfilment of its responsibilities.

Even when not required by regulation or bylaws, banks and other financiers frequently require audited financial statements from borrowers.

The tax authorities do not require audited financial statements.

Internal auditors cannot be used as statutory auditors.

Auditing standards

In 2010, Brazilian auditing standards were converged with the International Standards on Auditing (ISAs) issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB).

The information we provide here is not a comprehensive source for assessing and understanding audit requirements and practices in Brazil. We strongly advise you seek help from your accounting consultants when assessing these matters.

Accounting principles and practices

Investor considerations

- Law 11,638, enacted in 2007, modified the Brazilian Corporate Law of 1976 and legislation regarding the Brazilian securities market and the CVM. Although the accounting professionals, standard setters and regulators were already committed to seeking convergence with IFRS, these modifications to Brazilian Corporate Law were necessary to provide the flexibility and agility to move forward in that direction.
- Several new Brazilian accounting pronouncements were issued in 2010 and full convergence with IFRS was achieved for consolidated financial statements. Individual financial statements are prepared in accordance with accounting practices adopted in Brazil. Nowadays, these practices differ from IFRS applicable to separate financial statements only in relation to the measurement of investments in subsidiaries, associates and jointly-controlled entities, which are based on equity accounting while IFRS requires measurement based on cost or fair value. Early adoption of new or revised standards and interpretations is usually not allowed in Brazil.

- Financial institutions must prepare their financial statements in accordance with Brazilian Central Bank regulations. When these financial institutions are listed companies or are obliged to have an audit committee, they must also prepare consolidated financial statements in full compliance with IFRS as issued by the IASB.
- All small and medium sized entities in Brazil must apply the accounting practices adopted in Brazil for small and medium sized entities, which are in compliance with the IFRS for SMEs. Alternatively they may apply the accounting practices adopted in Brazil, which have now converged with IFRS.
- As various industries are undergoing individual transitions, we strongly advise prospective investors to seek for help from accounting consultants during due diligence investigations.

Tax Issues

6

6 *Tax Issues*

Preliminary comments regarding the tax environment in Brazil

The tax system is highly regulated, complex and therefore requires attention to structure a transaction in order to mitigate succession liabilities.

There are also a number of other factors which affect the tax risk companies in Brazil are subject to, including the nature of the legislation, the frequency of tax audits performed by Federal, State and Municipal authorities (a company can be audited by the relevant authorities more than once during the statute of limitations), the incidence of relatively high penalties and interest charges in the event of non-compliance and an enforcement process which is difficult to predict.

The statute of limitations for most taxes and social charges in Brazil is five years (as a result of the starting date for counting the statute of limitations period it can reach six years under certain conditions). During the statute of limitations period, a company can be inspected by the federal, state and municipal tax authorities regardless of the fact that there has already been an audit or examination of a given tax or fiscal period. Even though a certain tax or period may have been already submitted to inspections, a taxpayer can still be inspected and assessed by the tax authorities, to the extent that the statute of limitations period is still in place.

With respect to succession liabilities in Brazil, the responsibility to pay current and previous tax and labor liabilities, both known and unknown, generally follows the legal entity, based on the concept that the owner of the operating assets or the acquirer of the business unit retains the capacity to generate income and, hence, pay the tax and labor liabilities. As a result, regardless of whether or not the transaction is structured as a stock acquisition, the buyer steps into the shoes of the previous owner with respect to all tax and labor liabilities and contingencies.

Unlike the situation regarding a stock acquisition, in the case of an asset deal, if the company from where the assets are sold/transferred continues to operate (or ceases its operations and restarts them up to six months after the deal), the responsibility for the past tax liabilities remains with the seller. The buyer may be considered as responsible for paying the contingences which originated prior to the deal only if the seller party has no financial resources to liquidate its tax liabilities (and this conclusion is reached after an execution process). If the seller ceases its operations after the deal, the buyer will be primarily liable for all past tax contingencies of the seller company.

Also, in the case of an asset deal, if the set of assets which are envisaged to be sold or transferred comprises one or more of the seller's business units, there would be a risk of the buyer being challenged/ assessed by the Tax Authorities in regards to the tax contingencies generated prior to the asset acquisition, specifically in regards to the ICMS (State VAT) and, potentially, to the IPI (Federal Excise Tax). In addition, whether or not most of the seller's operational assets are transferred or sold to the buyer (i.e., a share deal is presented as an asset deal, in order to avoid the succession risks), there is still a risk of the tax authorities challenging the buyer for the past contingencies and considering it to be subsidiarily liable for all past tax contingencies of the seller company.

Penalties

Tax debts may be subject to penalties of between 20% to 225%. For federal taxes, if the taxpayer voluntarily pays the tax debt before any tax inspection is initiated, the penalties will be 20% of the tax debt, and under certain circunstances and provided that specific requirements are met, may even be 0% in case of self assessment. The penalties are increased to 75% in cases where the payer is assessed by the relevant tax authorities and to 225% in cases of fraud. Both penalties (75% and 150%) can be reduced to 37.5% and 75%, respectively, if the taxpayer decides not to challenge the assessment made by the tax authorities and pays the tax debts assessed. There is a 225% penalty in the case of fraud where the tax payer does not submit the required information to the tax authorities.

Tax treatment for foreign investors

As a general rule, local and foreign investors are treated equally as regards investment and tax benefits. There are no special Federal tax incentives to attract foreign investors, with a few exceptions such as with regard to the taxation of capital gains and investments through the Brazilian stock market and through private equity investment funds ("FIP").

Stock acquisition

The most common means used by foreign companies to invest in Brazil is through the acquisition of a Brazilian target entity through the purchase of its shares.

This acquisition method has several tax and labor implications for the buyer. From a legal standpoint, the business unit will retain its identity in all respects including its taxpayer identification number. As a result, the buyer will step into the shoes of the former owner, and become liable for any known and unknown tax and labor contingent liabilities. In addition to this, the buyer will also be liable for any fines and penalties imposed by the tax authorities, regardless of whether such fines or penalties relate to target activities prior to or after the transaction. When acquiring the stock of a Brazilian target company, caution must therefore be exercised so that the major tax and labor contingent liabilities can be identified, measured and analyzed, so that the buyer can factor the cost of the liabilities into the overall investment decision. The parties can also manage this situation by inserting a tax indemnity, and representations and warranties clauses in the Stock Purchase Agreement - with proper counter–guarantees being given by the seller.

Due to tax and labor succession risks, the statute of limitations and the tax and labor exposures, transactions in Brazil, particularly stock acquisitions, usually demand that buyers seek stronger protections (strong guarantees and retention of part of the purchase price through escrow accounts).

Provided that certain conditions are met, foreign investors can benefit from an acquisition structure which means that the tax "goodwill" or premium paid for the acquisition of an interest in a Brazilian company is tax deductible over a five-year minimum period. For Brazilian tax purposes the tax goodwill would consist of the positive difference between the purchase price and the net equity value of the acquired interest in the Brazilian company.

Types of investment mechanisms in Brazil

Besides private deals, a foreign investor has two other major alternatives for investing in a Brazilian company, which are often used. These are: (i) acquiring shares directly on the Brazilian stock exchange market and (ii) investing in an FIP (Equity Investment Fund). The capital gains on the disposal of investments made in Brazilian companies in this way are not subject to local taxation.

Capital gains derived from the sales of shares of listed companies on the Brazilian Stock Exchange (Bovespa) are not subject to taxation when the foreign investor is not located in a jurisdiction considered by the Brazilian tax authorities to be a low tax jurisdiction (a "tax haven") and when the investment was made in accordance with the rules of the Brazilian National Monetary Council.

This exemption is valid only for foreign qualified investors registered with the Brazilian Central Bank under the rules of the Resolution 2,689, issued by the National Monetary Council.

In regards to foreign investment through a FIP, non-resident investors may be granted a 0% capital gain taxation rate, provided that certain conditions upon the redemption of FIP quotas are met. These include: (i) 90% or more of the FIP's portfolio must consist of shares, convertible debentures or warrants issued by Brazilian companies; (ii) debt instruments cannot exceed 5% of the total FIP's portfolio; (iii) FIP quota holders (individually or together with related parties) must not hold 40% or more of the total quotas issued by the Brazilian FIP; (iv) FIP quota holders (individually or together with related parties) cannot benefit from 40% or more of the income arising from the FIP; and (iv) a direct foreign quota holder of the FIP cannot be domiciled in a tax haven.

CFC rules

Brazilian resident companies are taxed on their worldwide income. Foreign branch profits are taxed as earned and foreign subsidiary profits are taxed when distributed or made available to the Brazilian controlling company. Profits are considered available to the Brazilian controlling company at the time the CFC closes its financial statements at the end of its fiscal year.

The CFC's profits are subject to Brazilian corporate income taxes at the combined rate of 34%. Double taxation is avoided by means of foreign tax credits.

There are no tax breaks to encourage the location of multinational companies' headquarters and administrative offices in Brazil and/or the use of Brazil as a base for offshore financial operations.

Investing directly from abroad versus investing through a Brazilian vehicle

The advantage of investing in Brazil through a Brazilian vehicle is that this may allow a potential tax deduction in Brazil of the tax goodwill or premium paid upon the acquisition. This is not possible in Brazil if the acquisition is directly from a company abroad. Note that, in theory, the existence of an intermediary holding company is neutral from a pure tax perspective, as dividends distribution is not subject to taxation.

However, such an arrangement may naturally incur additional administrative costs for the group as well as determine an additional taxation of any interest on net equity paid by the operating company to the holding entity for the PIS and COFINS (two social contributions on revenues levied at a combined rate of 9.25%).

Note that the Complementary Law I 104/01 (still pending regulation) allows administrative authorities to “disregard” legal acts or transactions effected with the objective of dissimulating the occurence of a taxable event or the nature of the elements that constitute the tax obligation.

Tax goodwill amortisation

In order to benefit from tax goodwill deduction for local tax purposes, the acquisition of an interest in a Brazilian company must be made through the incorporation of a Brazilian company or through an existing Brazilian entity. For Brazilian tax purposes, tax goodwill is the positive difference between the purchase price and the net equity value of the acquired interest in the Brazilian company.

The tax goodwill amount paid in the acquisition of an interest in a Brazilian company, after the merger of the Brazilian acquiring company into the acquired /operating entity (or vice-versa), if paid due to the future profitability of the acquired company, may be deducted for local tax purposes over a five year (minimum) to ten year period (maximum).
One relevant requirement that has to be observed where using this kind of tax structure is that of providing evidence that the acquisition structure has been chosen for consistent economic reasons (business purposes).

Evidence that the structure was established for the sole purpose of reducing the tax burden may jeopardize the tax goodwill deduction.

From January 2008, the definition of "goodwill" changed for local accounting purposes as a result of the Brazilian new accounting rules[1] , issued in 2007 and valid as from January 2008. According to these new rules, the cost of the investment acquired has to be allocated to the fair value of the assets and liabilities of the acquired company and, if part of such acquisition cost cannot be allocated only this remaining amount would be recorded as "goodwill", an intangible asset not subject to any amortization.

[1] The Brazilian corporate and accounting legislation was changed in 2007, through Federal Law 11,638/07, and became effective as from January, 1st 2008. The main goal of these new accounting rules was to align the Brazilian GAAP to the IFRS ("International Financial Reporting Standards").

Given these new accounting rules, currently there are rumors that the relevant authorities are discussing potential changes with respect to the goodwill amortization for local tax purposes. Some rumors suggest that the tax amortizable goodwill amount and the period for its amortization will be changed in order to be in line with the accounting rules above, i.e., in a way that the available amount of the tax amortizable goodwill should be consistent with the accounting allocation of the purchase price paid for the acquired company's shares and with their depreciation or amortization periods. If this is the case, it is possible that the benefits arising from the tax amortizable goodwill will be lower; subject to a different period of amortization; or even be no longer available.
The rumors indicate that the changes in the legislation could become effective from 2014. At this point, however, it is still uncertain as to how and when these changes will become effective.

Thin cap rules

Interest paid or credited by a Brazilian entity to a related party abroad (an individual or a legal entity), which was not constituted in a tax haven or subject to a privileged tax regime, may be deducted for income tax purposes if the interest expense is viewed as necessary for the activities of the local entity and the following requirements are met:

I. the debt amount granted by the foreign related party (which has a direct participation in the Brazilian entity) does not exceed twice the amount of its participation in the net equity of the Brazilian entity;

II. the debt amount granted by a foreign related party (which does **not** have a direct participation in the Brazilian entity) does not exceed twice the amount of the total net equity amount of the Brazilian entity;

III. the overall debt amount granted by foreign related parties as per (I) and (II) does not exceed twice the sum of the participation of all related parties in the net equity of the Brazilian entity; and

IV. in case the foreign related parties do not have a direct participation in the Brazilian borrower entity, the overall debt amount granted by all of these related parties does not exceed twice the amount of the Brazilian entity's total net equity amount.

If one of the mentioned 2:1 ratios is exceeded, the portion of interest related to the excess debt amount is not deductible for Brazilian income tax purposes. Similar provisions are also applicable to interest paid or credited by a Brazilian entity to an individual or legal entity (whether or not this entity is a related party) resident or domiciled in a tax haven or in a jurisdiction which has a privileged tax regime.

In this case, the interest expense is deductible for Brazilian income tax purposes if it is viewed as necessary to the company's activities and the total amount of the Brazilian entity's debt with any foreign party resident or domiciled in a tax haven or in a jurisdiction with a privileged tax regime does not exceed 30% of the Brazilian entity's net equity.

The two above-mentioned limits (2:1 and 0.3:1 debt to equity ratios) also apply to cases where a guarantor, representative or any other intervening party is a foreign related party or resident of a tax haven / privileged tax regime jurisdiction (respectively).

The Brazilian Legislation also provides that amounts paid, credited, delivered, used or remitted under any title, directly or indirectly, to related or unrelated individuals or legal entities which are resident or domiciled in a tax haven or in a jurisdiction under a privileged tax regime are deductible for Brazilian income tax purposes if all of the following conditions are met: (i) the effective beneficiary of the payment is identified; (ii) there is evidence that the beneficiary has operational capacity (i.e., substance); and (iii) there is adequate documentation to support the relevant payments and the corresponding supply of goods, rights or utilization of services.

Brazilian Double Taxation Treaties Network

Brazil has a limited network of double taxation treaties which it has concluded with other countries (around 30 treaties). These include Austria, Belgium, Canada, China, South Korea, Denmark, Spain, France, the Netherlands, Italy, Japan, Luxembourg, Norway, Portugal and Sweden, among others. Brazil does not have tax treaties with the USA and the UK, but the Reciprocity Agreements with these countries allow, in theory, the utilization of tax credits derived from payment of income tax in the other country.

In terms of potential reductions on the withholding income taxation, the benefits allowed by the treaties are limited. The advantages relate instead to the tax credit allowed in one and the other country.

The adoption of a determined country to be used as the location of a holding company for a Brazilian investment varies from case to case, depending on the specific details of each case.

However, in general terms, the Netherlands, Spain, Luxembourg and Austria are considered to be advantageous jurisdictions mostly because of the tax treaties between them and Brazil and the specific clauses related to tax credits availability.

Corporate legislation

Brazilian corporate legislation was changed by Federal Law 11,638/07. This made significant changes to accounting practices in Brazil which have been applicable from January 1, 2008. The main goal of this new Law was to move the Brazilian GAAP towards the IFRS. The change had tax implications as well.

In December 2008, the Brazilian Government introduced the Transitory Tax Regime (RTT) in order to neutralize the potential tax effects derived from new accounting methodologies brought into effect by Law 11, 638/07. The RTT allowed corporate taxpayers to avoid any adverse tax effects derived from the new corporate legislation, i.e. ensuring that the company could be taxable as if the corporate and accounting rules valid up to December 31, 2007 were still in force (related exclusively to tax matters).

Background information on the main taxes and contributions in Brazil

The main Federal, State and Municipal taxes are as follows:

Taxes	Statutory Rates	Comments
Corporate Income taxes - Corporate Income Tax (IRPJ) and Corporate social contribution on net income (CSL)	25%[1] and 9%	IRPJ and CSL are determined based on the calendar year, with monthly tax payments, and are generally computed on the basis of annual or quarterly taxable income.
Taxes on revenues - Contribution for the Social Integration Program (PIS) and Contribution for Social Security Financing (COFINS)	1.65% and 7.6%[2]	PIS and COFINS are federal taxes levied on gross income. Companies are entitled to PIS and COFINS credits on the acquisition of certain inputs and services (non-cumulative methodology similar to a VAT[3]). PIS and COFINS contributions apply on the imports of goods and services from nonresidents. Export revenues are tax exempt. Currently, there are some tax incentives (such as the "RECAP" and "REIDI") which grant PIS and COFINS exemptions, or PIS and COFINS credits, on the importation or acquisition of fixed assets, such as machinery, equipment, consumer material and instruments (i) for manufacturing companies of which 75% or more of their total revenues are derived from exportations for specific products this 75% threshold is reduced to 50% (RECAP) and (ii) for companies which are involved in infra-structure projects (REIDI).
Federal Excise Tax (IPI)	Various rates[4]	IPI is paid by manufacturers on behalf of their customers at the time of sale, either to another manufacturer who will further the manufacturing process or to the retailer who sells to the end user. When manufactured products are sold between producers, the IPI is imposed. However, the subsequent manufacturer is allowed a credit against its IPI liability, equal to the IPI paid to its suppliers (non cumulative tax). IPI is also imposed on the import of goods. Export revenues are tax exempt. Some IPI tax breaks have been recently granted to certain industries and their products such as automotive, household appliances, furniture and real estate.
Import tax (II)	Various rates[5]	Import tax is levied on the CIF price and is a cost to the company (not recoverable).

1 IRPJ is charged at the rate of 15% plus a surcharge of 10% on annual taxable income in excess of R$ 240,000 (approximately US$ 120,000)
2 Higher rates are imposed in certain sectors (such as automotive).
3 Certain companies pay PIS and COFINS under the cumulative system, which imposes a lower combined rate of 3,65% but does not enable the taxpayer to record any tax credits on acquisitions.
4 The rate is defined by the product's tax code according to the Harmonized System.
5 The rate depends on the degree of necessity and is defined by the product's tax code according to the Harmonized System.

Taxes	Statutory Rates	Comments
Value-added tax on sales and services (ICMS)	17 to 19% internal rate	ICMS is a State tax calculated on the circulation of goods and on the rendering of interstate and inter-municipal transportation services, communication and on the sale of energy even when the transaction and the rendering of services start in another country. The tax is only assessed on the increase in the price of the product in each part of the circulation process. ICMS is also imposed on imports. Export revenues are tax exempt from ICMS. % Intrastate transactions 17 to 19 Interstate transactions 7 to 12 Most imports 17 to 19 Interstate transfers or the sale of imported products, or products for which local content is not higher than 60%, are subject to the ICMS at a 4% rate, rather than the 12% or 7% interstate ICMS rate above.
Service Tax (ISS)	2% to 5%	The ISS is a municipal tax levied on gross revenues for certain services as per the Federal Government. In general, the service tax is levied by the municipality in which the Company is headquartered. There are some exceptions to this rule for services involving assembly, construction, demolition, among others ISS also applies on the import of services. ISS is not levied on exports of services, except when the services are rendered in Brazil or the results of these services are applied in Brazil.
Withholding Income Tax (IRRF) - Dividends	Not taxed	Dividends are not taxed no matter the location of the recipient.

6 ICMS internal rate corresponding to 17%, except for the States of São Paulo, Minas Gerais and Paraná, whose tax rate is 18% and Rio de Janeiro, whose rate is 19%. Some products exceptionally trigger a higher rate (in the case of the cosmetics industry) or a lower rate (in the case of the automotive industry).

Taxes	Statutory Rates	Comments
Withholding Income Tax (IRRF) (Cont'd) - Interest	15%[7] or 25%[8]	Interest expenses payable to related parties located abroad are subject to transfer pricing and thin capitalization rules. Recently published Brazilian transfer pricing rules cap the maximum deductible interest expenses to a spread (yet to be set by the Finance Minister) above the following average rates: 1. Brazilian sovereign bonds in US dollars issued outside Brazil for loans entered in US dollars; 2. Brazilian sovereign bonds in Brazilian Reais issued outside Brazil for loans entered in local currency, and; 3. Libor for six months in all the other cases not mentioned above. If the loan is borrowed from a lender located in a low tax jurisdiction or from a lender party subject to privileged tax regimes, the thin capitalization and transfer pricing rules apply even if the lender is not a related party. Interest related to domestic loans is subject to the Brazilian withholding income tax at a 22.5% to 15% regressive rate, depending on the time when interest is paid (e.g. interest paid in less than 180 days is subject to a 22.5% tax rate, from 181 to 360 days - 20%, 361 to 720 days - 17.5% and more than 720 days - 15% tax rate). Domestic loans are also subject to the IOF (tax on financial, exchange and insurance transactions) at the following rates, levied on the principal amount of credit still not liquidated: 1. For loans with a fixed term - 0.38% one shot rate plus a 0.0041% daily rate, limited to 365 days or 1.5% (in other words, the IOF would be levied at a 1.88% rate if the debt consists of a more than one year loan contract); 2. For loans without a fixed term - 0.38% one shot rate plus a 0.0041% daily rate, without the 365 days or 1.5% limitation (the IOF in this case would be levied at a 1.88% rate in the first year and 1.5% in the following years). Long-term international loans (loans for which the average maturity is higher than a 360 day period) are subject to the IOF at a 0% rate. Short-term international loans (loans for which the average maturity is up to a 360 day period) are subject to the IOF (levied only on the loan principal amounts) at a 6% rate. Please see further comments in this Section regarding the IOF taxation.

7 These rates are effective unless otherwise specified by a tax treaty.

8 Payments of any type made to tax havens, defined as jurisdictions that do not tax income or tax income at a rate lower than 20%, and classified by the Brazilian local tax authorities as a Tax Haven according to the "Blacklist", will be subject to withholding at a rate of 25%.

Taxes	Statutory Rates	Comments
Withholding Income Tax (IRRF) (Cont'd) • Royalties and services	15%[9] or 25%[10]	In the case of royalties, the royalty contract has to be approved by the National Institute of Industrial Property (INPI) and filed with the Brazilian Central Bank. Deductions for royalties are generally limited up to 5% of the net sales of the relevant products or services; the percentage depends on the type of product or activity. Royalties for the use of trade marks and trade names, for whatever type of production or activity, when the use of the mark or name does not result from the utilization of a production patent, process or formula, are deductible up to 1% of net sales. In addition to the withholding income tax, royalties and service fees paid to foreign parties are subject to the Contribution for Intervention in the Economic Domain (CIDE) at the rate of 10 percent and to the PIS and COFINS at a 9.25% combined rate. These are taxes borne by the Brazilian service contracting company. Fees corresponding to services provided by foreign parties are also subject to the Municipal Service Tax (ISS) at a 2% to 5% rate. Besides the withholding income tax, remittances or payments of royalties or service fees to abroad are subject to the IOF at a 0.38% rate. This taxation is imposed due to the conversion of the amount of royalties and service fees from Brazilian Reais into foreign currency. Please see further comments in this Section regarding the IOF taxation.

9 These rates are effective unless otherwise specified by tax treaty.

10 Payments of any type made to tax havens, defined as jurisdictions that do not tax income, or tax income at a rate lower than 20%, will be subject to withholding at a rate of 25%.

Tax Consolidation

The Brazilian tax laws do not contemplate the possibility of consolidated returns and/or group relief. Therefore, entities that are part of the same group are not allowed to consolidate the income and deductions of the members in order to submit to taxation the net income of the group. Each company of the group must separately file its annual income tax returns with the local authorities.

Tax losses carry forward (IRPJ and CSL)

There is no time limit for the carry forward of tax losses. However, the taxable profit of each year can only be reduced by tax losses up to a maximum of 30%. Furthermore, it is neither possible to carry back tax losses nor transfer tax losses to other Brazilian companies.

Tax losses of an acquired company cannot be carried forward to be offset against the taxable income of a new activity if the following two conditions are simultaneously met:

a. modification in the ownership of the company; and
b. modification in the activity of the company.

Interest on capital

Entities are allowed to remunerate their shareholders by way of interest on capital payments, subject to certain limitations (i.e., limited to the Long Term Interest Rate - TJLP - and limited to 50% of current or accumulated profits). This payment is deductible for corporate income tax purposes and in relation to social contributions on net income. These payments are subject to a 15% withholding tax (or 25% for tax haven jurisdictions).

During the first quarter of 2013, the applicable TJLP rate was 5% per year.

Payments made to beneficiaries in a tax haven

Any payments directly or indirectly made to beneficiaries resident or incorporated in tax havens are not tax deductible, except when the following requirements are cumulatively observed: (i) the beneficiaries are identified as beneficiaries; (ii) the non-resident has the operational capacity to perform the transaction; and (iii) payments, receipt of goods, rights and use of services are evidenced with proper documentation.

Capital gains

Capital gains derived from the sale of Brazilian assets (including shares) by non-resident shareholders are subject to the withholding income tax at a rate of 15% (unless otherwise specified by an international tax treaty), even if both vendor and buyer parties are domiciled abroad.

In the case of the sale of shares, the capital gain will correspond to the difference between the purchase price of the shares and the amount of foreign capital, in foreign currency, registered with the Brazilian Central Bank.

As a general rule, the local buyer is responsible for withholding and paying the withholding income tax levied on the capital gain earned by a foreign vendor. When both parties, buyer and vendor, are not located in Brazil, the local attorney-in-fact representing the foreign buyer in Brazil is responsible for withholding and paying the withholding income tax.

Capital gains earned by foreign parties located in low tax jurisdictions (tax havens) are subject to withholding income tax at a 25% rate.

Repatriation of capital in excess of the cost of the non-residents' investments in Brazil is subject to capital gains tax at a rate of 15% (or 25% for tax haven jurisdictions).

Capital gains derived from the sale or transfer of shares by a Brazilian resident company is subject to Brazilian Income taxes (IRPJ and CSLL) at a combined rate of 34%.

Provided that some requirements are fully met, there are capital gain exemptions in cases where the transactions are carried out by foreign investors, such as: i) in the Brazilian stock exchange; and ii) in private deals when these are structured through a local FIP (equity investment fund).

Individuals domiciled in Brazil are taxed at the rate of 15% on their capital gains.

Financial Transactions Tax (IOF)

As a general rule, foreign exchange transactions made in order to allow payments to non-residents, including royalties, technical services, and other payments, including the reimbursement of costs, are subject to IOF.

The regular IOF rate for foreign exchange transactions (both inbound and outbound) currently applied is 0.38%.

Equity contributions to Brazilian companies (except those made through the Brazilian stock market) are subject to IOF at 0.38%. The 0.38% IOF is also imposed on the return of equity from Brazil.

Investments made through the Brazilian stock market or via FIP are currently taxed at a 0% IOF rate, only on the inflow of foreign capital into Brazil. The return of investment, in this case, is not subject to IOF.

The IOF may not be avoided if the payment requires a foreign exchange transaction from Brazilian Real to a foreign currency, or from a foreign currency into Real.

IOF is also levied at various rates, on loans and credit operations, securities transactions, foreign exchange transactions and insurance policies.

IOF at a 6% rate is charged on foreign loans with an average maturity of less than 360 days. All other long-term foreign loans (more than a 360 days average maturity loan) are subject to IOF at a 0% rate. The average maturity is determined based on the balance of the loan relative to the number of days of the outstanding balance of the related loan.

Other taxes on payments to non-residents

A Brazilian company with royalty, license or service agreements with foreign entities, where these relate to the transfer of technology, must pay a 10% Economical Domain Intervention Contribution (CIDE), based on the amounts paid abroad.

PIS and COFINS contributions, ISS and withholding income tax also apply on the payment of services to non-residents.

Tax havens and privileged tax regimes

Most payments (except dividends) made to tax havens, which are defined as jurisdictions that do not tax income or which tax income at a rate lower than 20%, are subject to a withholding income tax at a rate of 25%. Brazilian local tax authorities periodically issue a “Blacklist”, listing countries/jurisdictions which are classified as tax havens.

The Brazilian IRS released (on June 4th, 2010) a Normative Instruction (IN 1,037/2010) changing the Brazilian tax havens Blacklist.

Tax Havens Blacklist (according to the IN 1,037/2010)

Andorra, Anguilla, Antigua and Barbuda, Aruba, Ascension Island, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Brunei, Campione D'Italia, Canal Islands, Cayman Islands, Cook Islands, Costa Rica, Cyprus, Djibouti, Dominica, French Polynesia, Gibraltar, Grenada, Hong Kong, Isle of Man, Kiribati, Labuan, Lebanon, Liberia, Liechtenstein, Macau, Madeira Island, Maldives, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, Norfolk Island, Niue, Pitcairn Islands, Panama, Queshm Island, Saint Helena, Saint Kitts and Nevis, Saint Pierre and Miquelon, Samoa, Samoa Island (American), San Marino, Seychelles, Singapore, Solomon Islands, St. Lucia, St Vincent and Grenadines, Sultanate of Oman, Swaziland, Switzerland (suspended from the list), Tristan da Cunha, Tonga, Turks and Caicos, United Arab Emirates, US Virgin Islands and Vanuatu.

A second list of "Privileged Tax Regimes" has been created. This list encompasses the following regimes/entities:

- Uruguayan SAFIs;
- Danish holding companies which do not perform significant economic activities;
- Dutch holding companies which do not perform significant economic activities (these Dutch holding companies were suspended from the "Privileged Tax Regimes" list in 2010. Therefore, currently the tax rules derived from this list are not applicable to these);
- ITCs (Iceland);
- Offshore KFT (Hungary);
- US State LLCs, where interests are owned by non-US residents;
- Spanish ETVEs (suspended from the list); and
- ITC and IHC (both Malta).

Before the Normative Instruction (IN 1,037/2010) there was no Blacklist of privileged tax regimes. After the IN 1,037/2010 it has been necessary for parties subject to the foreign privileged tax regimes listed above to consider certain potential adverse tax consequences.

In summary, the current understanding of the consequences of the IN 1,037/2010 is that the rules regarding the non-deductibility of payments (interest, services, royalties etc.), transfer pricing and thin cap rules are applicable to payments made to and transactions performed with companies or persons located in the jurisdictions listed in the updated tax havens Blacklist and also to foreign beneficiaries subject to the privileged tax regimes listed.

For the purpose of the taxation of the Brazilian withholding income tax (including the withholding income tax levied on capital gains), only the companies or persons located in the foreign jurisdictions included in the Blacklist (not the privileged tax regimes) would be affected.

Work Force and Labour Charges

7

7 Work Force and Labor Charges

Labor Relations

Labor and management relations

Employer and employee relations are dealt with principally under the labor laws (CLT) enacted in 1943 and subsequent legislation. The labor laws are applicable to all employees in regular registered employment, except for individuals in public employment or domestic labor, who have separate regulations. The labor laws make no distinction between skilled and unskilled workers or between those engaged in manual, office or professional work. Therefore, all types of workers are referred to as employees. A change in the legal structure or ownership of an employer does not affect the rights acquired by employees under the labor laws.

Extensive social security laws and labor regulations govern employer-employee relations. However, foreign investors have not experienced much difficulty in the way of labor problems, mainly because they follow local standards and practices.

Background information on labor practices and main social charges in Brazil

Salary and labor rights

Employers are entitled to a monthly salary, which may be increased by additional payments for overtime or night shifts and unhealthy working conditions, among others.

After a 12-month period, employees are entitled to a 30-calendar day paid annual vacation, which must be taken within the subsequent 12 months and compensated at an amount equivalent to one month's salary plus 1/3 bonus.

At the end of each year, employers must pay employees a Christmas bonus (called "13th salary") annual bonus equivalent to one month's salary.

In addition to the amounts paid to employees as salary, any other amounts which are paid on a regular basis are, for all legal purposes, considered as part of the employee's salary and are, in general, taken into account in the calculation of vacation, 13th salary and the amount that must be deposited in FGTS (the Mandatory Severance Indemnity Fund for Employees), as well as termination payments.

A fringe benefit is an additional item granted to an employee in excess of the employee's regular salary. Pursuant to the applicable labor legislation, the grant of an award or of any other benefit (such as the provision of a vehicle) to an employee may be considered a fringe benefit, for the reason that any incentive award or benefit may represent an additional payment and, consequently, compensation given to the employee. In such cases, the total amount of the employee's earnings (including taxable fringe benefits) shall form the taxable basis for the contributions that should be borne by the employer.

Taxes and contributions on payroll

Social Security Contribution (INSS)

Employers' social security contributions usually correspond to 20% of the gross payroll (monthly compensation paid to all employees).

Since December 2011, the Social Security Contribution for certain industries (such as IT and call centre companies, passenger transportation companies, hotels and companies in the automotive sector, among others) has been paid at a 1% and 2% rate levied on the company's net revenues (the precise rate depends on the type of product manufactured and type of services provided by the company), and not through a 20% rate on the company's payroll amount.

The INSS payment through this regime (the 1% and 2% rate on the company's net revenues) should be calculated proportionally to the company's net revenues related to the sale of products and services listed in the Law 12,715 (the Law which introduced this regime). If not all the company's revenues are related to products and services included in this list, the 20% INSS contribution levied on the payroll amount should still be paid considering the same percentage of net revenues not encompassed in the list above.

Payment of insurance by employers against labor accidents is normally due at rates which vary from 1% to 3% of the total remuneration paid to employees, depending on the "level of risk" presented by the type of activity the company undertakes.

Employers are also required to pay a monthly "education salary allowance", equivalent to 2.5% of the total remuneration paid to employees.

Additionally, employers have also to contribute to other governmental entities, such as: Incra, SESC, SESI, among others. Respective contributions may be up to 3.3%.

In addition, employers are also responsible for withholding and collecting the INSS on behalf of their employees (who are also subject to INSS at lower and progressive rates).

FGTS

Under the FGTS system, employers must make monthly deposits, on the employees' behalf, in a blocked bank account, of an amount equivalent to 8% of the remuneration of each employee. The 8% FGTS is borne by the employer, without any discount in respect of the employee's salary. In case of an employee's dismissal, a company must bear an additional 50% cost calculated on the balance of the employee's FGTS deposit.

Environmental Issues

8

8 *Environmental Issues*

This section discusses the environment in Brazil. In general, environmental rules are strict but there are significant opportunities for business.

Environmental impact on businesses

Business in Brazil has to take into account several environmental issues. These may become relevant risks if they are not adequately managed. On the other hand, there are many environment-related aspects in Brazil that offer real opportunities, such as the abundance and quality of natural resources, the country's climate, the overall concern with environmental protection and the corresponding Brazilian environmental legislation, which is among the most advanced in the world.

Protecting the environment

Key "green" concerns in Brazil include the deforestation of the native and old-growth forests in the biologically rich Amazon rain forest and other regions, and soil loss due to erosion. The main areas of attention are the lack of sewage collection, solid waste management, urban, industrial and non-point-source pollution of rivers, lakes, estuaries and the shoreline, air pollution in and around some major cities, and questions related to the recovery of mining areas.

Main legislation and regulations

Brazilian legislation extends over a wide variety of environmental issues concerning licenses, zoning, pollution prevention and control and inspection procedures.

Environmental crimes are subject to fines of up to R$50 million (some US$30 million)

Doing deals and carrying out business in Brazil has to take into account several environmental issues, which may become relevant risks if not adequately managed.

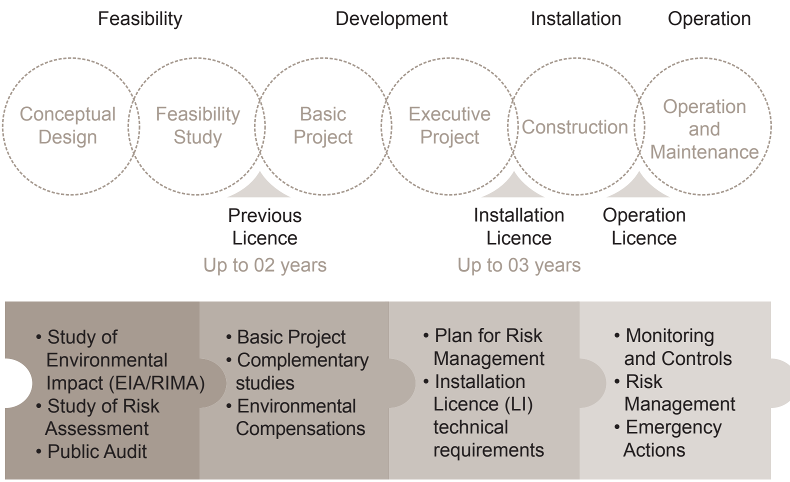
Environmental legislation was effectively introduced in 1981, with the National Environmental System. This established the responsibility of natural and juridical persons in the civil, criminal and administrative sphere for environmental illegalities. In 1988, the Federal Constitution established that present and future generations have a right to a healthy environment.

More recently, in 1998, new legislation was passed (the "Environmental Crimes Law") defining pollution and forest destruction as crimes punishable with heavy fines and, in some cases, jail sentences. Furthermore, an acquirer of a Brazilian company or business might become fully or partially responsible for present and past environmental liabilities attached to the acquired asset. Penalties can include not only fines but also the cancellation of operating licenses and obligations for the recovery of an impacted area. Additionally, in many cases, environmental issues are made public, thus affecting a company's reputation. Given this scenario, environmental due diligence prior to acquisition is highly recommended.

Projects involving the construction of a new plant or production site must be submitted for approval to the Brazilian environmental authorities. The location and activity will determine what environmental license(s) should be obtained at federal, regional or local levels. For activities considered as having high environmental impact, a more detailed study of environmental impacts and mitigation (an EIA-RIMA) is required before installation is allowed.

Every plant in operation must obtain an environmental license issued by the competent environmental agency. The license has to be periodically updated and also the company must comply with the technical conditions established in its license.

CONAMA Resolution nº 237/97 details the projects and activities which are subject to licensing at the federal, state and municipal levels. According to the rules of this Resolution, the Environmental Licensing Process includes the following activities and deadlines:



Also, the incorporation of an Environmental Impact Assessment and, instruments such as the EIA – RIMA, in the licensing process demonstrate regulatory control and supervision in respect of projects which cause environmental degradation.

Pollution control

Pollution has become a serious concern in many areas and consequently it is now one of Brazil's main issues, both politically and economically. Federal and State governments have developed programs and controls aimed at preventing or reducing pollution, mainly in the more industrialized areas.

The treatment of waste, with the purpose of avoiding or reducing pollution, must be considered in the installation of new production sites in Brazil or evaluated when acquiring a business.

CONAMA is the federal agency responsible for establishing federal criteria for pollution control. Other state agencies are required to take environmental regulations into account when examining applications for incentives and financing of investment projects. Non-compliance with pollution control regulations may result in the suspension of tax benefits, credit restrictions or even the closing-down of operations.

The new rules on Solid Waste

In the face of a lack of resources in respect of urban cleaning services, Brazil's recent National Basic Sanitation Policy (Law nº 11.445/07) and National Policy on Solid Waste (Law nº 12.305/10) represent strong steps on the part of the government to tackle the problem of pollution in Brazil's cities.

The National Policy on Solid Waste Plan established that the Municipal Integrated Management of Solid Waste must be consistent with local realities and also stimulates reduction in the volume of waste for landfill, through selective collection programs and reuse/recycling of materials. Due to Brazil's preoccupation with social inclusion, this document recommends the use of cooperatives in cases involving low-income individuals.

Sustainability: a growing issue in Brazil

After the Rio Environmental Summit in 1992, good environmental management became a major business issue. The concept of sustainability (i.e., the adequate integration of environmental management, social responsibility and the related economic factor/ added value) gained a higher presence in the agenda of the public and private sectors, as well as of a major part of the global population.

In many sectors, good environmental management is no longer a competitive advantage but a pre-requisite for being able to compete not only in the global market but also in the Brazilian market.

An environmental audit is a sustainability tool that helps a company ensure it has good environmental management.

This mechanism is used to analyze environmental documentation (such as operational licenses, water resources documentation, solid residues management) in order to show the company's exposure to possible risks (legal sanctions) if they are not in compliance with legislation.

Our M&A Specialists and Post-Deal Services in Brazil

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9 Our M&A Specialists and Post-Deal Services in Brazil

PwC in Brazil

The Brazilian firm of PwC was formed in 1915. Since then, we have been the leading professional services organization in the country, with over 180 partners and approximately 5,000 professionals, operating out of 17 offices across the whole country.

- Our Deals (Transaction Services and Corporate Finance) group comprises nearly 250 professionals, including approximately 30 partners and directors.
- Our partners, directors and staff specialise in various industry sectors: Financial Services, Consumer and Industrial Products, Agribusiness, Telecom, Media, Technology, and Government Services.
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