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# *Doing Deals in Brazil*

*Helping you  
pursue business  
success in Brazil*



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Over the last three years, Brazil has faced its worst economic crisis. During this period, the country has been involved in a profound discussion around its ethical values and business practices. Hopefully it will pave the way for Brazil to become a much more important global player.

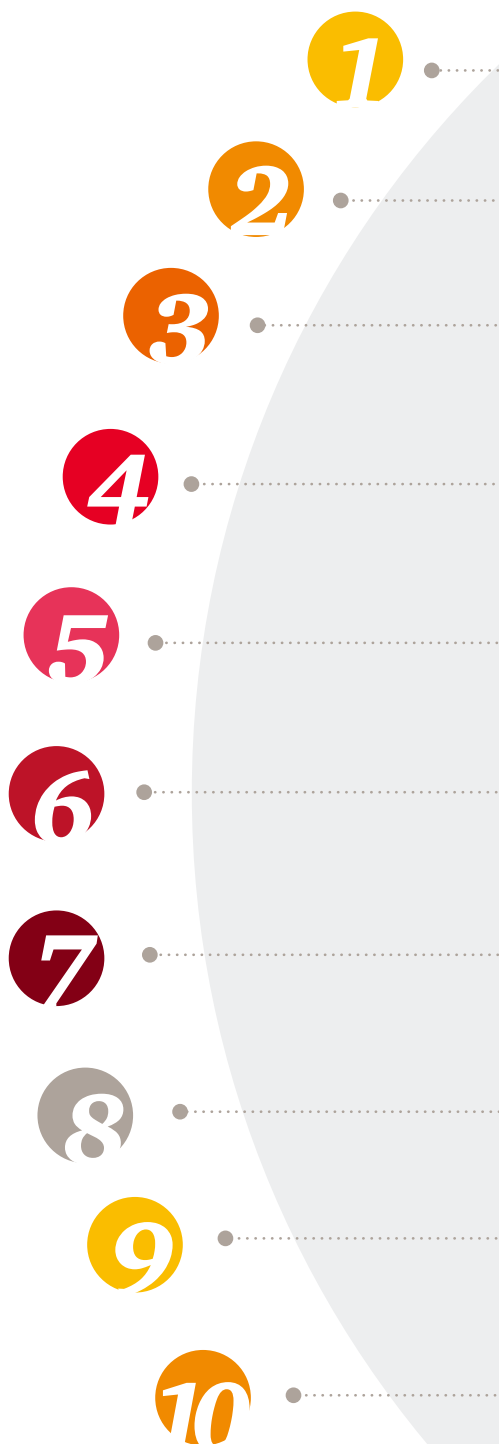
So, yes, Brazil is regaining its momentum to grow. Businesspeople are more confident with the economic scenario. This favors investment and employment, two strong generators of economic expansion. Our publication *The World in 2050* forecasts that Brazil will jump from 7<sup>th</sup> to 5<sup>th</sup> largest economy by 2050, with an average growth of 2.6% p.a.

Forecasts apart, Brazil has a diversified economy with strong companies in the agricultural, commodities, industrial and service sectors; it has one of the biggest middle classes – which will continue to expand; with a solid democracy and improving institutions.

We hope 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  
*CEO*  
PwC Brazil

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# Investment Drivers and Challenges in Brazil







# 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, Brazil might be considered extremely well positioned among the BRIC countries due to its richness in natural resources, its young workforce, and largely unexploited domestic market. Brazil has constructed over the last decades a well-established – and improving – institutional ecosystem consisting of free press, independence among the executive, legislative and judicial branches of government and enhanced transparency and regulatory agencies. Brazil is a country with great potential.

### Opportunities

- Economic growth potential
- Increasing market size across all sectors
- An expanding middle class
- Large and growing urban populations
- Increasing energy consumption

### Challenges

- Poor infrastructure
- Inefficient governance
- Ineffective law and challenges to corruption societal order
- 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, Brazil's economic climate is less volatile
- There is increasing international trade and globalization and the government promotes policies favouring exports

- There are new regulations in place favouring 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 two decades
- Whilst corruption remains a concern for investors, problems of physical security have greatly improved in recent years
- The recent introduction of the Brazilian anti-bribery law has raised awareness within the business community of very legitimate concerns related to governance, transparency in business, risk mapping, internal controls, and internal investigations, etc

### *The business environment:*

- Brazil is currently the world's ninth 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
- 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
- Brazilian business is facing a transformational period with the introduction of better corporate governance
- Local accounting and auditing standards converged to International Financial Reporting Standards (IFRS)

### *Geography:*

- Brazil offers a business-friendly environment for United States 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 labour 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, Paraguay and Uruguay are permanent members and Chile, Bolivia, Colombia, Ecuador, Peru, Suriname and Guyana are associated countries)

### 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:

- Despite the recent lack of growth, Brazil is still a significant market for foreign companies to be present in, due to its more than 200 million population and its fast-growing consumer market with high growth potential, especially among the middle-classes
- Many local companies are undervalued and in need of restructuring, capital and technology

### The main investment drivers

Long term strategies and investments (including related to overall infrastructure improvement) remain on the government's agenda, even though this has been postponed due to recent economic and political challenges. The top priorities on the government's agenda include structural tax and pension reforms and tight control on government expenses, to spur the country's economic growth

The long term investment initiative 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, the poverty alleviation cash transfer program that raised the living standards of millions).

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.

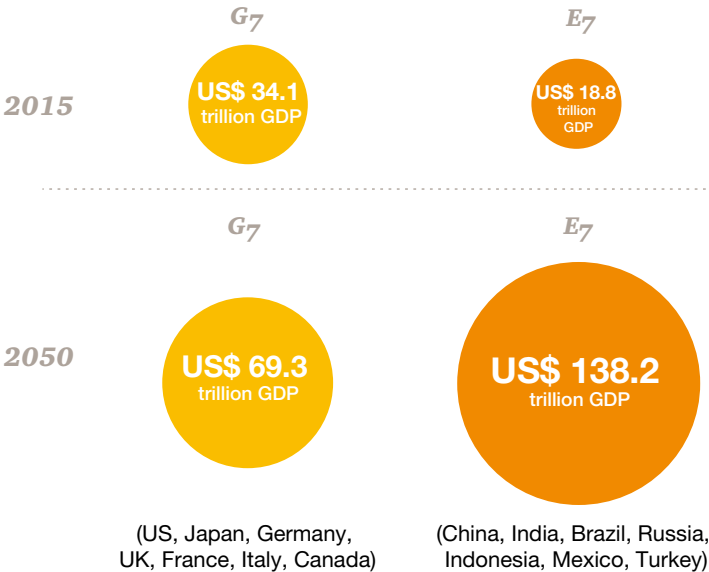
Brazil had the opportunity to host the FIFA World Cup of football in 2014 and the Olympic Games in 2016. The legacy of these events was not only the infrastructure and construction works but also the projected image of Brazil that delivered the events with excellence.

“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 1.5% p.a. Understanding the way businesses

work beyond traditional home markets is key. Brazil provides a democratic environment structured around mature institutions operating in/with a single market/ language comprising 205 million consumers, many of whom are new arrivals in the consumer markets. A well-managed investment in an economy like Brazil’s is part of a formula for success.

*Investors are looking for opportunities in the emerging markets to benefit from the expected higher long-term growth from these economies*

**Number of transactions Monthly in 2016**



Source: PwC analysis

## 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 labour, 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. However, the Brazilian regulatory system has shown significant improvements in this area with the implementation of Law Nº. 12,846/2013 which penalizes companies involved in corruption schemes. Companies also may have undisclosed off-balance sheet transactions and commitments, which can result in loose application of accounting rules.

On the whole, historical financial information of businesses in Brazil is generally of a 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 labour-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 labour risks and contingencies
- Significant related party transactions which have inadequate documentation
- Poor environment or, inadequate controls, resulting in poor quality in financial information
- Inadequate accounting practices (mainly for small and privately owned companies), triggering significant accounting adjustments (e.g. to EBITDA, net income and net assets) and tax risks
- Inadequate cash management

- A certain level of informality in the operations (e.g. unrecorded transactions, two sets of books) which has reduced substantially in the last several years following the introduction of specific tax legislation requiring companies to deliver accounting and tax books through an electronic public system named SPED

### **The main factors behind unsuccessful business deals in Brazil**

- Unexpected tax and labour 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







## 2.1 An Overview of Brazil

### Key Figures

Population: estimated at

**206.1**  
million



### Currency: Real

(rate of US\$ 1  
to R\$ 3.26 as at  
December 30<sup>th</sup>, 2016)

Language: Portuguese

### Political Organisation

Federative Republic of Brazil

**Presidential and state elections were last held in October 2014** (for a four year term)

**Current president Mr. Michel Temer** (Brazilian Democratic Movement Party) took office in August 31<sup>st</sup> 2016 after the impeachment of former president Mrs. Dilma Rousseff

**26**

*states and one federal district (Brasília)*

**2016 GDP:**  
**R\$ 6.27 trillion**  
(US\$ 1.8 trillion)

## Economic Overview

### *Facts and Figures:*

- Brazil is the largest economy in Latin America and the ninth largest in the world
- The GDP per capita was approximately R\$ 30,407 (US\$ 8,730 in 2016)
- Primary economic sectors are: agriculture, aerospace, automotive, oil & gas, energy, mining and technology products. 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, rice, corn, sugarcane, beef, pork, cocoa and citrus
- Export items include minerals, soybean, automobiles, meats, chemicals, soybean oil and derivatives, sugar & ethanol, coffee and aircraft
- Import items include petroleum, vehicle parts, mechanical equipment, electronic micro parts, iron & steel and chemicals
- The main ports and harbours are Tubarão, Itaquí, Santos, Itaguaí, São Francisco do Sul, Paranaguá, Rio Grande, Vila do Conde, Suape, Rio de Janeiro and Pecém

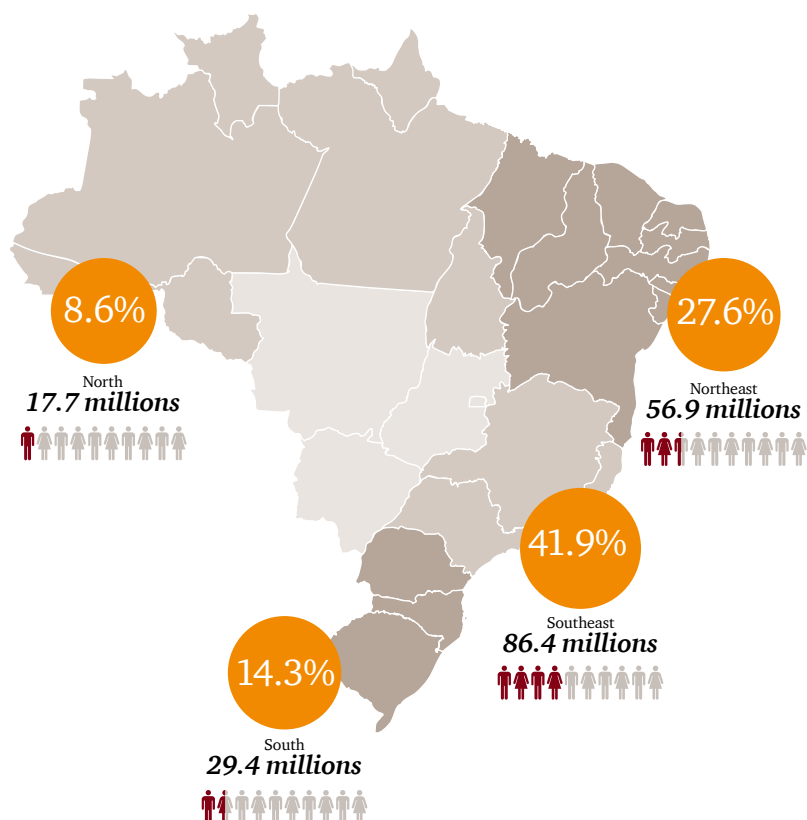
### *Population:*

- Brazil has the largest population in Latin America and the fifth largest in the world
- Approximately 70% of the population are concentrated in the Southeast and Northeast
- Life expectancy is approximately 75 years
- Some 24 % of the population is under 14 years of age and only 7 % is over 65 years old
- The country is highly urbanized: only 16 % of the population lives in rural areas

### *Geography:*

- São Paulo is one of the fastest-growing cities in the world. Twenty six other metropolitan areas have populations of more than 1 million
- The population of the São Paulo, Minas Gerais and Rio de Janeiro states is approximately 45 million, 21 million and 17 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 Southeast, South and Midwest regions is much higher than that in the North and Northeast

## Brazilian population per region



Region	Population in millions	%	
			Land Mass %
Southeast	86.4	41.9	11.0
South	29.4	14.3	7.0
Midwest	15.7	7.6	22.0
North	17.7	8.6	42.0
Northeast	56.9	27.6	18.0
Total	206.1	100.0	100.0

Source: IBGE - Instituto Brasileiro de Geografia e Estatística (July, 2016)

## 2.2 Brazil: Overview of Recent Economic Performance



The past 30 months have been marked as a period of abundant bad news vis-à-vis Brazil's economic and political challenges. But one must pay special attention to the country's upside potential – whose rewards far exceed current problems. Brazil is, in many ways, its own natural market.

It is true Brazil's political crisis weighs heavily on the country's short-term GDP performance. As 2016 drew to a close, Brazil's economy accumulated two years of recession.

Today, the economic model that produced fast growth only a few years ago has come to a point of exhaustion. Privileging consumption over investment, sectorial policies over structural reforms, and the domestic market over global trade has reached a dead end.

The path out of the current stalemate in Brazil must address urgently-needed pensions, tax and labour reforms.

In 2016, Brazil's economy headed towards a painful contraction of 3.5%. This comes on top of disappointing numbers throughout the last several years, with the economy averaging less than 2% annual growth in 2011-2016. Unemployment is very high (10.5%) and inflation in 2016 was far North of the government's 4.5 % target.

The government has adjusted the concession-privatizations into a larger scale package and has brought in well-known and highly-regarded executives to lead Brazil's government-controlled operations in oil & gas, development banking and the energy sector. This has produced major performance gains in institutions such as Petrobras, BNDES (Brazil's Development Bank) and Eletrobras. A new macroeconomic team also took its place and has shifted the economic course for Brazil through major policy changes.

They have opted for large doses of orthodoxy and increased transparency in macroeconomic management.

Overall, Brazilian economic policy is more market-oriented, fostering a pro-business environment. As a result, the government's pro-markets actions can definitely bring Brazil back into the appreciation of investors and partners around the world.

## 2.3 Brazil Outlook

It is not difficult to be caught up in the “short-termism” surrounding Brazil’s economic and political challenges. However, Brazil continues to offer significant potential for growth and development which outweigh such issues. Brazil is, in many ways, one of the world’s few “critical” growth markets.

Many define the notion of “critical” as being related largely to a transitional period. This is exactly what Brazil is going through – a phase when that which was old is not yet gone and that which will be new has not yet arrived. This is at the core of economic opportunities arising during the transitional year of 2017.

The principal factors that lead to Brazil being considered a critical growth market should be highlighted:

- Brazil is moving in between growth models and a number of companies will benefit greatly from what’s ahead
- Although short of its potential, Brazil’s recent GDP growth (over the past 10 years) is second among the world’s top 10 economies. The country has indeed experienced a two-year recession (2015-16), but growth will resume in 2017
- No country in the Western Hemisphere grew as much as Brazil in the past 20 years
- Brazil’s income per capita has risen constantly for 18 years leading up to 2014. It will resume its ascension in 2017
- Brazil is the world’s fourth primary destination for FDI;
- FDI into Brazil in 2017 may exceed US\$ 60 billion
- There is general consensus that inflation will be within target in 2017 (centered at 45%)
- Brazil is approving budget control measures that will signal long term fiscal balance
- Brazil already has the ball rolling on social security, labour market and tax reform
- Brazil is adopting a new, more liberal approach to international trade negotiations, whilst some developed countries are now going in the opposite direction

Brazil also presents relevant upsides when compared to other countries that can also be termed as “critical” for contemporary global affairs. Unlike China, Brazil presents a well-established – and improving – institutional ecosystem consisting of free press, independence among the executive, legislative and judicial branches of government, ideological diversity of political parties, corporate compliance rules and practices, an active branch of public prosecutors, enhanced Transparency and Accountability and regulatory agencies. Unlike other emerging markets Brazil does not present cultural hindrances, such as the caste system, to its socioeconomic ascension. And, also stands in a region where peace with its neighbours is a century-old characteristic and no geopolitical strifes are expected.

In 2017, furthering the adoption of sound macroeconomic policies, a more modern, interdependent global economic policy and at least the promise of reform, have to be pursued by Brazil within the reshifting alignment of global economic forces.

Ongoing investigations into corruption seem to have made Brazil a “prisoner of the short run”, where it is difficult to see past the crisis of the day. But the potential is there and it is desperately seeking to be unlocked.

Brazil has taken a breather but will resume its growth trajectory, especially once it is able to close the chapter on corruption and consequently improves governance at all levels and – on a broader level – enacts much needed pro-business reforms.

## Summary of historical economic indicators

Main Economic Indicators In US\$ billion	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
GDP (US\$ billion) <sup>1</sup>	892.0	1,107.1	1,396.8	1,693.1	1,672.6	2,209.8	2,614.5	2,463.5	2,468.5	2,454.8	1,797.6	1,799.1
Real GDP growth (% per year)	3.2	4.0	6.1	5.1	(0.1)	7.5	3.9	1.9	3.0	0.1	(3.8)	(3.6)
Unemployment rate (% of labour force) <sup>2</sup>	9.9	10.0	9.3	7.9	8.1	6.7	6.0	7.4	7.1	6.8	8.5	11.5
General price index - IGP-DI (% per year)	1.2	3.8	7.9	9.1	(1.4)	11.3	5.0	8.1	5.5	3.8	10.7	7.2
Consumer price index - IPCA (% per year)	5.7	3.1	4.5	5.9	4.3	5.9	6.5	5.8	5.9	6.4	10.7	6.3
Exchange rate at year's end (R\$/US\$)	2.3	2.1	1.8	2.3	1.7	1.7	1.9	2.0	2.3	2.7	3.9	3.3
Exchange rate change (% per year)	(11.8)	(8.7)	(17.2)	31.9	(25.5)	(4.3)	12.6	8.9	14.6	13.4	47.0	(16.5)
Public sector deficit (% of GDP)	3.5	3.6	2.7	2.0	3.2	2.4	2.5	2.3	3.0	6.0	10.2	8.9
Public sector debt (% of GDP)	47.9	46.5	44.6	37.6	40.9	38.0	34.5	32.2	30.5	32.6	35.6	45.9
Goods exported	118.5	137.8	160.6	197.9	153.0	201.9	256.0	242.6	242.0	225.1	191.1	185.2
Goods imported	73.6	91.4	120.6	173.0	127.7	181.8	226.2	223.2	239.7	229.2	171.4	137.6
Trade balance	44.9	46.5	40.0	25.0	25.3	20.1	29.8	19.4	2.3	(4.1)	19.7	47.7
Current-account balance	13.5	13.0	0.4	(30.6)	(26.3)	(75.8)	(77.0)	(74.2)	(74.8)	(104.2)	(59.5)	(23.5)
International reserves	53.8	85.8	180.3	193.8	238.5	288.6	352.0	373.1	358.8	363.6	356.5	365.0
Foreign direct investment	21.6	22.2	34.3	44.5	31.7	52.6	69.5	60.5	49.3	56.1	57.9	53.7
Total foreign debt <sup>3</sup>	188.0	199.4	240.5	262.9	277.6	351.9	404.1	455.4	486.8	560.6	540.5	552.3

Source: Banco Central do Brasil.

<sup>1</sup> Accumulated value in the year.

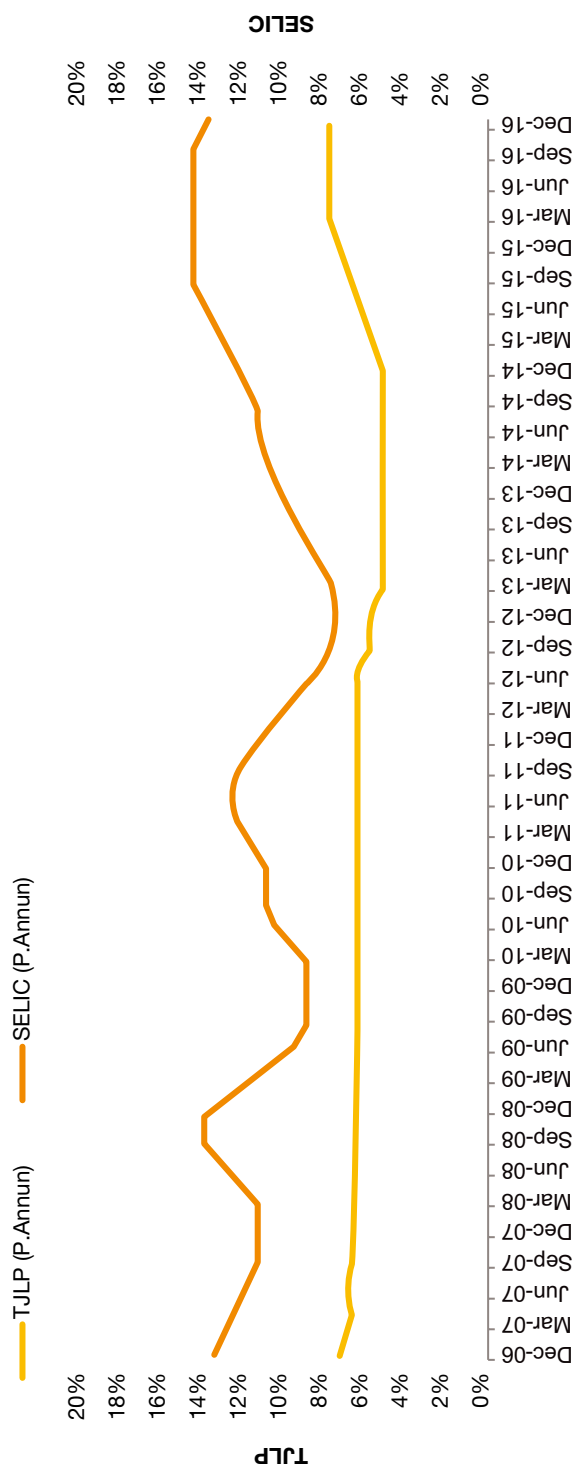
<sup>2</sup> IBGE changed the methodology of calculation in 2016 (retroactively to 2012).

<sup>3</sup> Including intercompany loans.



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

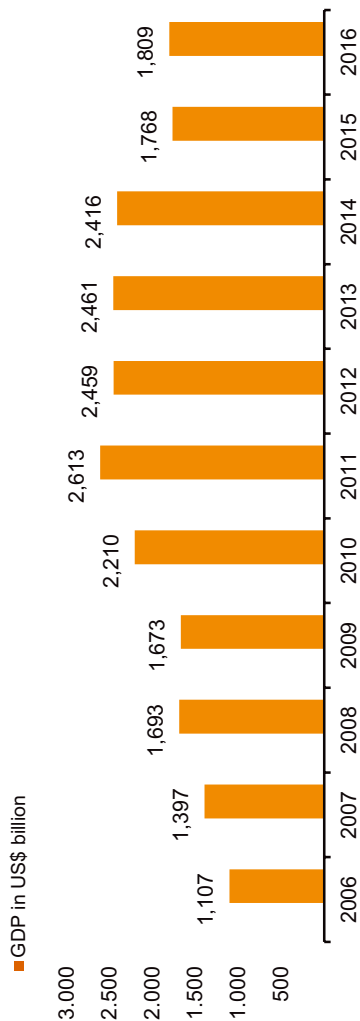
# Interest rates



Source: Diário Oficial da União

*Brazil's GDP is the highest in Latin America. GDP growth is expected to be back on positive ground by 2017 after the approval of budget control measures and at least the promise of structural pro-business reforms*

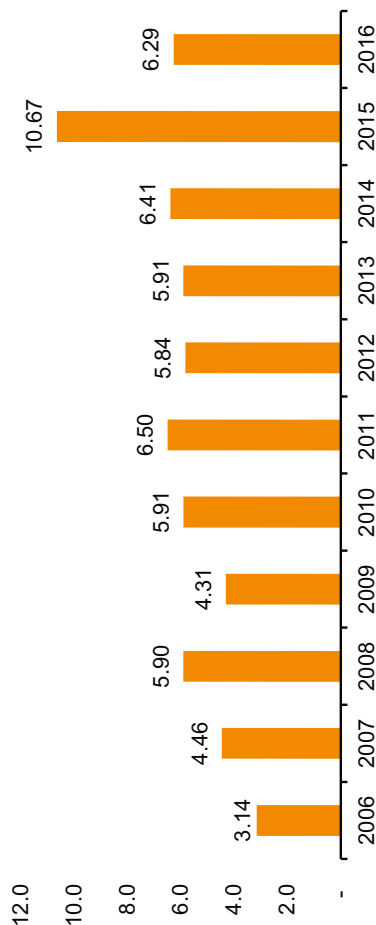
### **GDP evolution - in US\$ billion**



Source: IBGE - Instituto de Geografia e Estatística.

Consumer inflation has ended 2015 at 10.7%, far higher than the government's target ceiling of 6.5%. However, in 2016, inflation has already reduced to 6.29% following the shift in economy policy after the new government took place in late August

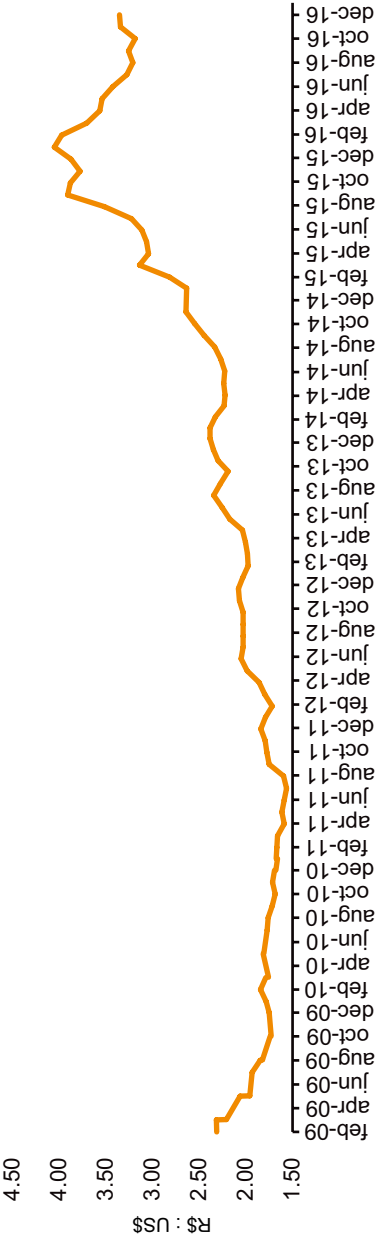
### Brazilian Inflation Index (IPCA) evolution



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

The recent substantial devaluation of the Brazilian currency follows the strengthening of the US dollar in the global markets and the deterioration of Brazilian terms of trade and the high current account deficit

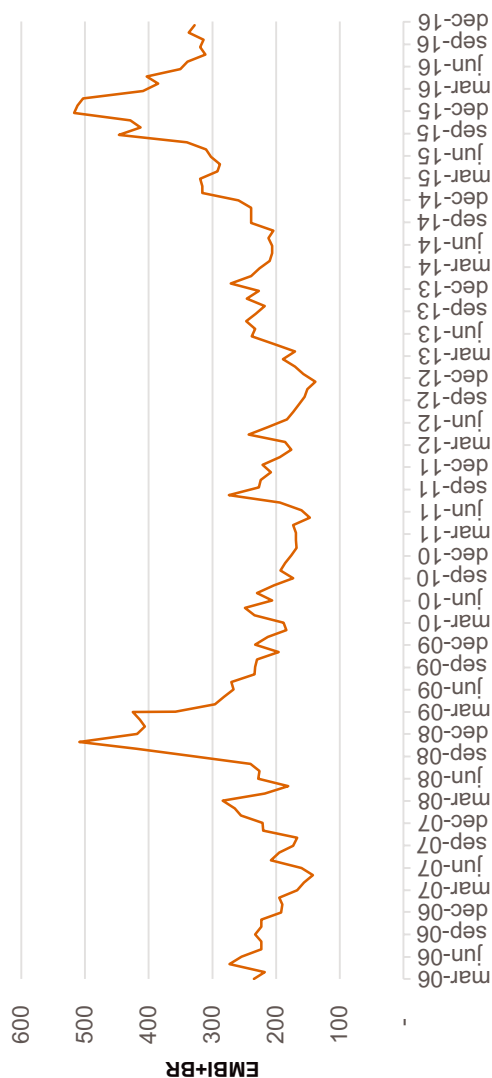
Exchange Rate Evolution



Source: Gazeta Mercantil

*The recent economic recession and political instability increased significantly the perception of Brazil's country risk over the last two years*

### Country Risk (Brazil)



Source: Bloomberg

*Total exports have decreased since 2012 by about 24% to US\$185 billion in 2016, as a result of reductions in international-based commodities prices as well as a strong local currency.*

*Since 2009 China is 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	2013	2014	2015	2016	CAGR % 2007-2016
China	10,749	16,403	20,191	30,786	44,315	41,228	46,026	40,616	35,608	35,134	14.06%
United States	25,314	27,648	15,740	19,462	25,805	26,701	24,653	27,028	24,080	23,156	-0.99%
Argentina	14,417	17,606	12,785	18,523	22,709	17,998	19,615	14,282	12,800	13,418	-0.79%
Netherlands	8,841	10,483	8,150	10,228	13,640	15,041	17,333	13,036	10,044	10,323	1.74%
Germany	7,211	8,851	6,175	8,138	9,039	7,277	6,552	6,633	5,179	4,861	-4.29%
Japan	4,321	6,115	4,270	7,141	9,473	7,956	7,964	6,719	4,845	4,604	0.71%
Others	89,796	110,836	85,684	107,637	131,059	126,378	119,890	116,788	98,579	93,740	0.48%
<b>Total</b>	<b>160,649</b>	<b>197,942</b>	<b>152,995</b>	<b>201,915</b>	<b>256,040</b>	<b>242,578</b>	<b>242,034</b>	<b>225,101</b>	<b>191,134</b>	<b>185,235</b>	<b>1.59%</b>

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 2016 reached US\$ 138 billion*

#### Main import sources - by country

Country imports (US\$ Millions)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	CAGR % 2007-2016
United States	18,887	25,810	20,183	27,249	33,970	32,363	36,019	35,018	26,471	23,803	2.60%
China	12,618	20,040	15,911	25,593	32,791	34,251	37,304	37,345	30,719	23,364	7.08%
Germany	8,675	12,025	9,866	12,552	15,214	14,212	15,183	13,838	10,380	9,131	0.57%
Argentina	10,410	13,258	11,281	14,426	16,906	16,444	16,463	14,143	10,285	9,084	-1.50%
South Korea	3,391	5,412	4,818	8,422	10,097	9,099	9,492	8,526	5,421	5,449	5.41%
Italy	3,347	4,612	3,664	4,838	6,223	6,202	6,719	6,312	4,675	3,703	1.13%
France	3,525	4,678	3,615	4,800	5,465	5,910	6,499	5,700	4,457	3,679	0.47%
Japan	4,610	6,807	5,368	6,982	7,872	7,735	7,081	5,901	4,877	3,566	-2.81%
Mexico	1,979	3,125	2,784	3,859	5,131	6,075	5,795	5,363	4,378	3,528	6.63%
Chile	3,483	4,162	2,616	4,091	4,547	4,166	4,325	4,013	3,411	2,882	-2.08%
Others	49,692	73,055	47,617	68,957	88,029	86,727	94,868	92,995	66,375	49,364	-0.07%
<b>Total</b>	<b>120,617</b>	<b>172,985</b>	<b>127,722</b>	<b>181,768</b>	<b>226,247</b>	<b>223,183</b>	<b>239,748</b>	<b>229,154</b>	<b>171,449</b>	<b>137,552</b>	<b>1.47%</b>

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 Product categories

Main exports - by product

Exports (in US\$ million)	2009	2010	2011	2012	2013	2014	2015	2016	CAGR % 2009-2016
Soybeans & prod	17,251	17,115	24,154	26,122	30,965	31,408	27,959	25,422	5.70%
Transport material	16,199	21,817	25,156	24,606	32,178	21,739	21,517	25,402	6.64%
Mineral (Ores)	14,453	30,839	44,217	33,244	35,083	28,402	16,693	15,816	1.30%
Meats	11,471	13,292	15,357	15,266	16,272	16,891	14,393	13,921	2.80%
Oil and fuel	15,146	23,033	31,008	30,986	22,398	25,175	16,520	13,477	-1.65%
Chemicals	10,902	13,510	16,268	15,222	14,661	15,079	13,465	12,710	2.22%
Metallurgic products	11,197	13,058	17,498	15,663	13,329	14,493	13,433	11,608	0.52%
Sugar & Ethanol	9,716	13,776	16,432	15,031	13,711	10,357	8,522	11,332	2.22%
Machines and equipments	6,280	8,193	10,469	10,581	8,984	8,675	7,397	7,490	2.55%
Paper & Pulp	4,995	6,761	7,179	6,657	7,156	7,219	7,623	7,446	5.87%
Coffee	4,251	5,739	8,700	6,439	5,248	6,616	6,122	5,430	3.56%
Footwear & Leather	2,764	3,513	3,659	3,467	3,870	4,287	3,487	3,313	2.62%
Electrical equipments	4,965	4,817	4,812	4,600	4,290	3,967	3,432	3,040	-6.77%
Others	23,404	26,454	31,131	34,695	33,889	30,793	30,573	28,828	3.02%
<b>Total</b>	<b>152,995</b>	<b>201,915</b>	<b>256,040</b>	<b>242,578</b>	<b>242,034</b>	<b>225,101</b>	<b>191,134</b>	<b>185,235</b>	<b>2.77%</b>

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



## Brazilian Imports - Top Product categories

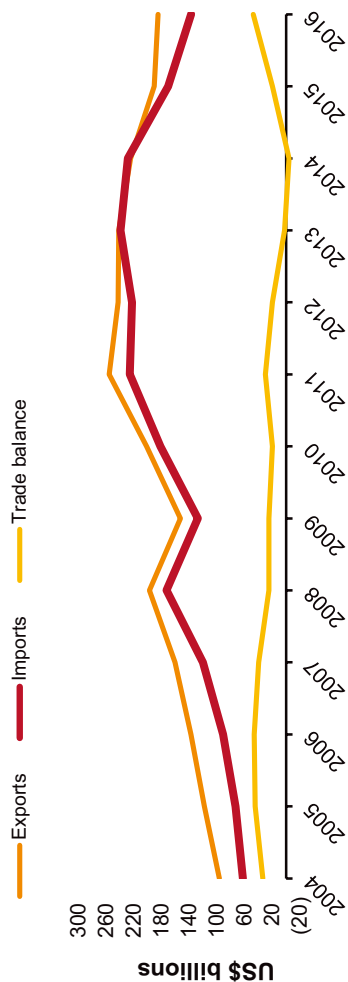
Key import items include petroleum, vehicle parts, electronic micro parts, and chemicals. The overall decrease in imports over the last two years reflect the impact of the adverse economic environment and as weaker local currency

Imports (in US\$ million)	2009	2010	2011	2012	2013	2014	2015	2016	CAGR % 2009-2016
Fuel and oil	21,022	28,537	33,703	34,674	35,758	31,874	24,813	21,124	0.07%
Mechanical equipment	15,581	22,246	26,395	25,489	28,274	27,013	20,383	16,942	1.20%
Electrical and electronic equipment	18,865	29,958	41,968	40,187	45,694	45,040	24,919	15,142	-3.09%
Motor vehicles and parts	8,631	10,235	11,765	12,441	13,111	12,834	11,233	10,053	2.20%
Organic and inorganic chemicals	11,456	17,276	22,621	21,309	22,419	19,470	13,569	9,955	-1.99%
Plastics and its products	4,478	6,093	6,499	6,841	7,420	7,427	6,463	6,389	5.21%
Fertilizers	3,903	4,943	9,138	8,584	8,849	8,443	6,602	6,002	6.34%
Iron, steel and its products	4,790	6,521	8,104	7,968	8,885	8,849	7,121	5,916	3.06%
Pharmaceuticals	4,874	6,093	6,302	6,467	7,137	6,761	5,545	5,757	2.41%
Optical and precision equipment	4,592	7,882	7,583	7,573	7,805	7,468	5,662	3,495	-3.82%
Rubber and its products	2,538	2,785	3,245	3,224	4,751	3,183	2,149	2,979	2.32%
Cereals and milling products	2,294	3,990	5,103	4,540	4,971	4,091	2,975	2,475	1.09%
Airplanes and its parts	1,512	1,949	2,342	2,409	2,870	2,503	1,947	1,774	2.31%
Synthetic and Artificial filaments and fibers	2,213	2,293	2,516	2,893	3,831	2,571	2,329	1,664	-3.99%
Copper and its products	1,314	2,464	2,775	2,683	2,454	1,986	1,695	1,108	-2.41%
Others	19,584	28,384	36,184	35,867	35,392	39,547	34,494	26,777	4.57%
<b>Total</b>	<b>127,647</b>	<b>181,649</b>	<b>226,243</b>	<b>223,149</b>	<b>239,621</b>	<b>229,060</b>	<b>171,449</b>	<b>137,552</b>	<b>1.07%</b>

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

Despite the economic recession, Brazil recorded a trade balance surplus over the last two years, following the decrease in imports

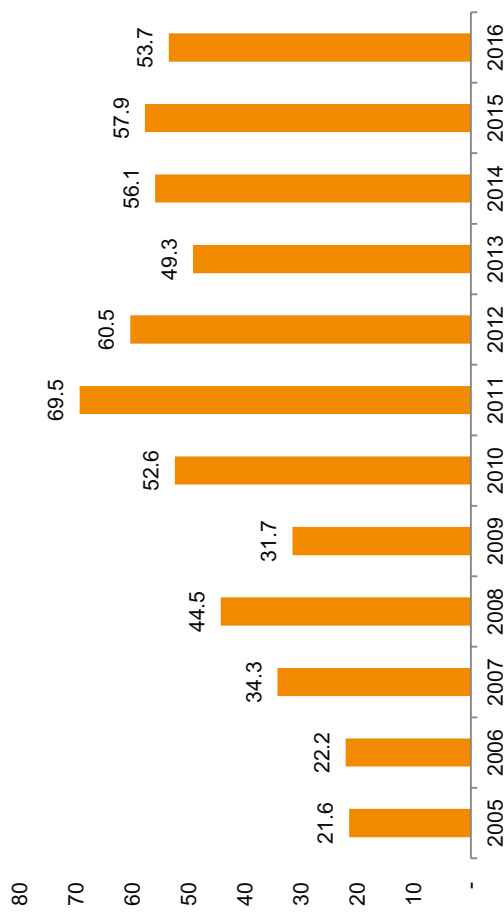
### Brazilian trade balance evolution - 2004 to 2016



Source: Banco Central do Brasil - Secretaria do Comércio Exterior

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

### Foreign direct investment (in US\$ Billion)



Source: Banco Central do Brasil



## M&A and Private Equity Activity





### 3.1 2016 M&A Activity

As the year of 2016 passed by, the Brazilian M&A Market glimpsed new levels in the number of deals closed as compared to previous years.

Numbers since 2010 had an average of 793 deals until 2015, with an all-time record of deals in 2014 with 879 transactions. Nevertheless, this level had decreased in 2015 with 742 transactions, and again in 2016 with 597 deals (with an average of 50 deals per month, 19% lower than 2015).

Marked by the Olympics, Brazil had a year of greatness in showing to the world how South America would host such a major event, all the while having political credibility uncertainties and internal economic issues. Since 2015, Brazil has been suffering from these uncertainties, this clearly seen in the decreasing level of M&A activity.

In 2016, financial investors had a participation of 20% of total M&A activity in Brazil (121 deals with financial investors within 597 deals in 2016), 45% less when compared to 2015 (221 deals within 742 total deals).

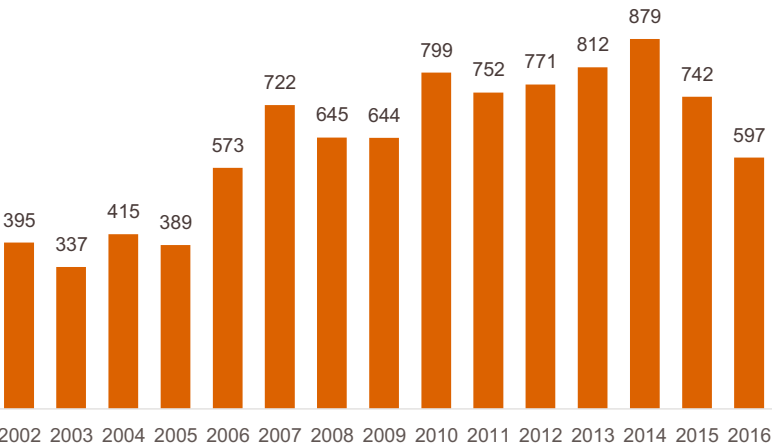
As the focus of Brazilian M&A activity continues to related to middle market deals, transactions up to US\$100 million represented 69% of the total deals announced.

The Southeast of Brazil has attracted the majority of the investment interest (290 deals in 2016), this is now followed by the South of Brazil (with an increasing participation from 86 deals in 2014, to 90 deals in 2015, reaching 95 deals in 2016).

A relevant shift more towards majority stake transactions occurred in 2016, representing 59% of all announced deals in 2016 (when compared to the previous year with 49% represented by 342 majority stake negotiations), while non-controlling positions accounted for 34% (versus 44% in 2015). Both levels indicate a continued trend towards long-term investment strategies.

Multi-sector and multi-region deal characteristics initially observed in 2014, continued through 2015 and 2016. In 2016, the leading sectors by deal volume were IT, services (marketing, advisory, consulting and general services), financial services, chemical and mining. Next in relevance were retail, food, public services, logistics and agribusiness. IT holds 17% of total deal volume, followed by general services at 12% and financial services with 9%.

Number of transactions



Note: The number of transactions includes joint ventures, mergers and spin offs.  
Source: PwC Corporate Finance



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

### *Buyers:*

- Local and multinational firms
- Private equity and buy-out funds
- State owned companies and private pension funds
- Distressed debt conversions

### *Targets:*

- Private companies
- Family owned businesses
- Carve-outs of acquired non-core businesses
- Non-core or distressed businesses of multinational companies
- Public concessions

## Foreign and domestic capital participation in M&A activities

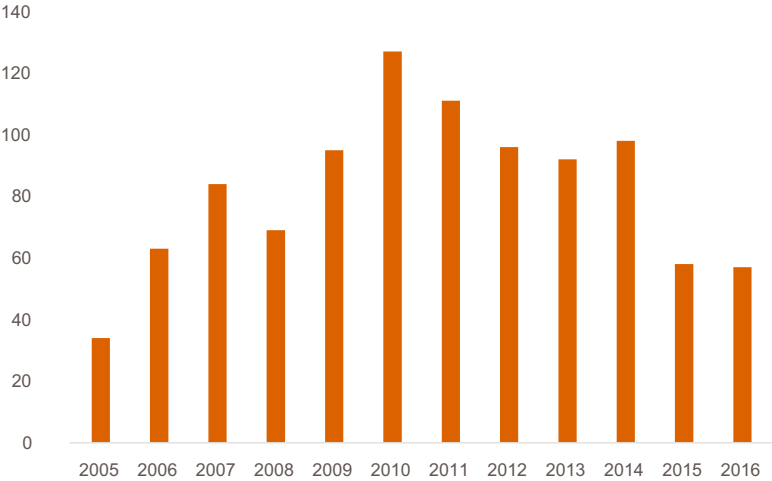
Foreign investors had an important role in 2016, with the United States, France and UK accounting for 52% of the total volume of foreign investment deals in 2016. Whilst 2016 had a volume of 265 total foreign deals, this number is 26% lower than 2015 (360 deals), indicating some hesitation among foreign investors in 2016, the year Brazil was known worldwide for the impeachment suffered by President Rousseff.

Brazilian investors participated in 300 transactions in 2016. These acquisitions accounted for 54% of the total deals transacted (both majority and minority stake deals).

Foreign investors partook in 265 transactions in the same period.

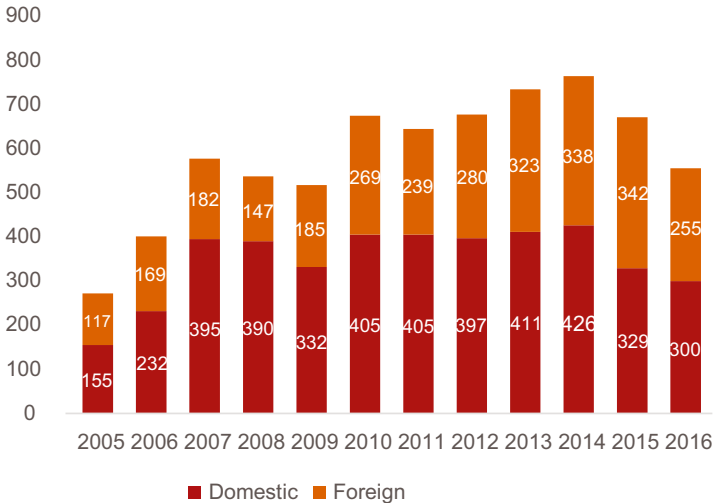
The decline in the number of such deals has become more pronounced over time: this represents a 26% decrease in the volume of such deals since 2015.

### Transactions with deal volume over US\$ 100 million



Source: PwC Corporate Finance

### Aquisition deals by origin of buyer



Source: PwC Corporate Finance

## 3.2 Private Equity

**A decrease in investments from Private Equity firms has been seen in 2016. Privatizations, the recent changes in the health care regulation and the continuing consolidation in certain industries should boost investments in 2017.**

Contrasted with the previous four years with a high level Private Equity investments activity in Brazil, such as in 2015 when 30% of deals had the participation of Private Equity, the year of 2016 seems to have presented some pause with respect to investments in Brazil, with only 20% of deals including Private Equity participation. Along with a decrease in the investment levels seen in Brazil, 2016 appears to have been a year of increased caution and prudence with respect to overall global economic perspectives.

Once Brazil was a shining star among emerging economies, but this brightness has been dimmed due to the political issues presented by Brazil in 2015, these more pronounced in 2016. This perspective appears to have also gotten the eye of Private Equity, which has been less aggressive and less confident with respect to the economic perspective in Brazil, leading to less private equity investments in 2016.

Nonetheless, it is worth considering what market conditions are expected to push middle market M&A activity in 2017, as set out below.

### **Brazil has a multi-sector profile in M&A**

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

The largest investments in 2016 have been in IT, financial services, general services, retail and logistics, with consolidation in all these sectors continuing to be a key driver for deals into 2017.

The new law introduced in 2015 which extinguishes the limitation of stake holdings of foreign companies investing in certain healthcare sectors (such as hospitals and medical plans) drove the recent increase in the interest of Private Equity firms in this sector.

Education has also been attracting solid investments, historically in college and more recently in primary and secondary education.

Privatizations are also expected to boost investments opportunities related to the companies in distress due to the financial crisis and the opening of tenders for infrastructure concessions.

### Who is already investing?

Approximately 120 private equity and venture capital firms have invested in Brazil. Some private equity investment highlights of recent years were:

- GP Investments, acquired 57.8% of the Brazilian real estate company BR Properties, for the amount of R \$ 1.9 billion (2016)
- Southern Cross completed the acquisition of 100% of a Petrobras subsidiary in Chile - Petrobras Chile Distribution, for US\$ 490 million (2016)
- The Samambaia Master investment fund made the acquisition of the power distribution group headquartered in Minas Gerais - Energisa, for the amount of R\$ 618 million (2016)
- Jaguar Real Estate Partners purchased up to 30% of the shares of Tenda, for a total amount of R\$ 539 million (2016)
- Permira made a contribution in the amount of R\$ 500 million into Mutant - a Brazilian company providing software and services for call centers (2016)

**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 92% of the adult population is considered to be literate. Approximately 13.5% of the working population have attended higher education.

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

## **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 GDP per capita  
was R\$ 30,407  
(US\$ 8,730 in 2016)



### **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.





## Accounting and Audit Requirements

5



### *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, independent of their legal format) 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 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:

The Public Digital Bookkeeping System – SPED is a tool that unifies the activities of receipt, validation, storage and authentication of documents and books which integrates the Brazilian taxpayer's commercial and tax records, through a single, computerized flow of information and the use of digital certification. It covers and integrates three different areas: Tax Records (*Escrituração Fiscal Digital - EFD*), Digital Accounting Records (*Escrituração Contábil Digital - ECD*) and Electronic Invoices (*Nota Fiscal Eletrônica - NF-e*).

The Accounting SPED – ECD tool is intended to replace the hard copy accounting books with soft copies. The general journal (*livro diário*), general ledger (*livro razão*), auxiliary books and the trial balances and balance sheets are generated as part of a set of digital documents. The SPED tool includes the presentation of information for the federal, state and, municipal tax authorities, as well as for the National Commerce Registration Department (*Departamento*

*Nacional de Registro de Comércio*), the Central Bank (BACEN), the Private Insurance Superintendence (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 corporate taxpayers.

The whole SPED initiative is becoming increasingly sophisticated, with the inclusion of additional information such as information on revenue taxes (PIS and COFINS), electronic service invoices, electronic freight invoices and the electronic taxable income control register (E-LALUR), among other significant 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 including all listing segments
- “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), if present, 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 directly require audited financial statements, although companies must provide the name of their independent auditor in the annual tax form, particularly in the case where the financial statements are required to be audited as above.

Internal auditors cannot be used as statutory auditors.

### ***Auditing standards:***

Since 2010, Brazilian auditing standards are fully 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). As a result, from 2016 the new auditor’s report, which includes the Key Audit Matters section for listed companies, has also come into force in Brazil.

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 (BR GAAP), which requires the measurement of

investments in subsidiaries, associates and jointly-controlled entities using the equity method. Despite the fact that individual financial statements are supposed to be converged with IFRS, the application of the equity accounting in accordance with the BR GAAP may, in practice, differ from the equity method under IFRS. This difference is due to the fact that under the BR GAAP the one-line consolidation method must be applied (i.e. the amount of shareholders equity and net profit for the year in the individual financial statements must be the same as shareholders equity and net profit for the year attributable to the parent's shareholders in the consolidated financial statement). This method may not end up with the same results as applying the equity method as set out in IFRS (IAS 28)



- 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
- Small and medium sized entities in Brazil may 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 “full” accounting practices adopted in Brazil, which are converged with IFRS
- Despite some years of IFRS application in Brazil, its implementation for certain entities may have a legacy GAAP bias. We strongly advise prospective investors to seek help from their accounting consultants during due diligence investigations



Tax  
Issues





## ***Preliminary comments regarding the tax environment in Brazil***

The tax system is highly regulated and complex in Brazil. Therefore, it requires attention when structuring a transaction in order to mitigate succession liabilities.

A number of factors affect the tax risks which companies in Brazil are subject to, including: the complex legislation; the frequency of tax audits performed by Federal, State and Municipal authorities (e.g.: a company can be audited by the relevant authorities more than once during the statute of limitations); the high penalties and high interest charges in the case 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 (under certain circumstances, the statute of limitations can reach six years). During the statute of limitations a company can be inspected by the federal, state and municipal tax authorities regardless of the fact that there might already have been an audit or examination of a given tax or fiscal period. Even though a certain tax 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 is still in place.

With respect to succession liabilities in Brazil, the responsibility to pay current and previous tax and labour 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, to pay tax and labour 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 past tax and labour liabilities and contingencies.

Unlike the situation of 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 but 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 tax contingencies which originated prior to the deal only if the seller party has no financial resources to settle 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 that are sold or transferred to the buyer company 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 relation to the tax contingencies generated prior to the asset acquisition. This assessment should specifically involve the past tax liabilities related to the ICMS (State VAT) and, potentially, the IPI (Federal Excise Tax).

If most of the seller's operational assets are transferred or sold to the buyer (i.e. if a share deal is carried out 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, considering the buyer subsidiarily liable for all past tax contingencies of the seller company.

## New Tax Rules

On November 12, 2013, the Brazilian government published Provisional Measure (PM) 627, which amended important aspects of the tax law. During the extensive legislative approval process, several amendments were made to PM 627 before it was converted into the Law 12,973, on May 14, 2014.

Two of the key provisions of Law 12,973 were the new treatment of tax goodwill amortization generated from company's acquisitions and also controlled foreign companies' rules (CFC rules). The new law also contemplated other important changes to the Brazilian tax laws related to the Brazilian Corporate Income Taxes ("IRPJ" and "CSLL") and the taxes levied on revenues ("PIS" and "COFINS"). These changes and the new tax rules essentially aimed to align the Brazilian tax rules with the Brazilian accounting standards (which are almost 100% aligned with IFRS since 2007).

Amongst others, the main issues specifically addressed by the tax rules changed or introduced by Law 12,973 include the tax treatment for:

- business combinations and the fair value adjustments derived from them
- present value adjustments
- amortization of intangibles
- interest expenses and financial instruments
- depreciation rules (subject to different periods and rules since 2007)
- stock options and share based payments
- impairment effects
- operational and financial leasing contracts and concessions

In general, the changes introduced by Law 12,973 provide that the legal and contractual nature of transactions must prevail for tax purposes, irrespective of their formal treatment and classification. The law specifically provides and regulates conditions for tax neutrality and tax deferral in connection with the Brazilian accounting standards and the exceptions that may apply.

In this context, the new law imposes additional obligations on taxpayers in respect of their tax and accounting reporting and compliance obligations, such as requiring taxpayers to maintain sub-accounts in their balance sheets and books where adjustments derived from any differences between tax and accounting rules must be recognized and controlled.

Such tax rules are effective since January 1<sup>st</sup>, 2015.

## Penalties

Tax debts may be subject to penalties ranging from 20% to 150%.

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. Under certain circumstances and if specific requirements are met, these penalties may even be 0% in the case of voluntary payment (self-assessment).

The penalties increase to 75% in cases where the taxpayer is assessed by the relevant tax authorities and to 150% in cases of fraud. These penalties 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 assessed debts. There is a 225% penalty in the case of fraud in the situation where the taxpayer does not submit the required information about the fraud 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 the taxation of capital gains and investments through the Brazilian stock market and through private equity investment funds (named “FIP”).

## **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 a FIP (Equity Investment Fund).

The capital gains on the disposal of investments made in Brazilian companies through these options are not subject to local taxation.

Capital gains derived from the sale of shares of listed companies are not subject to taxation when the foreign investor is not located in a jurisdiction considered by the Brazilian tax authorities as 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 Resolution 4,373 (former Resolution 2,689).

### **Equity Investments' Funds ("FIP")**

A FIP ("Fundo de Investimento em Participações") is a fund that provides foreign investors with an efficient vehicle for investing in the Brazilian Private Equity Market.

A FIP is not a legal entity, rather it is a closed-end investment fund incorporated by investors as a co-ownership vehicle aimed at investing in securities. The FIP can only invest in shares, debentures and warrants issued by a Brazilian Corporation (S/A) and, under certain conditions and limits, issued by "Brazilian Limitadas" (or "Ltda.").

FIPs are subject to the Brazilian SEC ("CVM") rules and available in most cases to qualified investors with a net worth greater than R\$ 300 thousand (approximately US\$ 100 thousand).

The FIP is not subject to income taxes on interest and on capital gains. The taxation of the income generated by the FIP portfolio is deferred to the moment that the FIP income is paid to its shareholders.

Although the FIP is transparent for Brazilian Tax purposes, the Brazilian companies below the FIP will continue to be subject to normal 34% corporate tax in Brazil.

There are no IOF (a tax on financial, exchange and insurance operations) charges on the FIP investment or divestment by foreign or local shareholders.

To the extent that a foreign investor holds less than 40% of the FIP (economic, political and governance rights), any income (dividends, capital gains, interest etc.) arising from the FIP should be exempt from Brazilian taxes.

There are a number of conditions that a FIP needs to fulfil in order to be exempt from Brazilian taxes. In summary, they include:

- 90% or more of the portfolio must consist of shares, convertible debentures or warrants issued by Brazilian companies

- FIP quota holders (individually or together with related parties) must not hold 40% or more of the total quotas issued by the FIP
- A direct foreign quota holder of the FIP cannot be located or domiciled in a tax haven (please refer to our comments on the new rules for ultimate beneficial owners on page 83)

As mentioned above, if investments of the FIP are sold there is no immediate tax charge. Tax is only potentially triggered when the quotas are amortized or liquidated (at the rate of 15% on quota holders not qualifying for the FIP benefits above).

If the capital gains are reinvested effectively in the FIP, the 15% taxation is deferred. The by-laws of the FIP however would need to allow for reinvestment.

Since 2014, a 0% (zero per cent) Brazilian capital gains tax (CGT) applies on the direct sale or amortization of FIP quotas by foreign investors that hold no more than a 40% interest in a FIP, amongst the other requirements stated above.

Prior to this, such 0% taxation was limited to transactions involving the withdrawal of the FIP income; with any gains involving the direct sale of FIP quotas being subject to the Brazilian CGT at a 15% rate.

More recently, on August 30<sup>th</sup>, 2016, the CVM (Brazilian Securities Exchange Commission) issued the Instruction 578, providing new rules for the Brazilian FIPs. The main changes introduced by the new regulation (amongst others) are:

- i. the possibility that the FIP invest in “Brazilian Limitadas” (before this change the FIP could invest or own stakes only in Brazilian Corporations or “S.A.”);
- ii. the possibility for the FIP to invest, directly or indirectly, in foreign entities (up to 20% of its net equity), which shall allow its use as an investment hub<sup>1</sup>; and,
- iii. the possibility that 33% of the FIP portfolio consist of non-convertible debentures (except for Infrastructure FIP and FIP-PD&I, where there is no limitation).

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<sup>1</sup> The total amount of the fund's capital invested in foreign entities varies according to the type of FIP. For instance, for the most sophisticated type of FIP, available for qualified investors, (“multi-strategy” FIP) 100% of the FIP net equity could comprise foreign investments (i.e., companies located abroad).

Regarding the possibility of a FIP holding Brazilian Limitadas instead of only Brazilian Corporations (or S.A.), this may create an opportunity for US investors to consider the FIP as a vehicle for investments in structures subject to the “check the box election”.

In spite of the new FIP rules, the tax legislation still provides that at least 67% of the FIP portfolio should consist of Brazilian (not foreign) corporations’ shares (S.A.), convertible debentures, or S.A.’s subscription bonds.

This means that FIPS that decide to invest, for instance, more than 67% of their portfolio in Brazilian Limitadas or in foreign companies should not be considered by the tax authorities as a FIP and therefore not eligible to the tax exemption granted to foreign investors. In other words, FIP investors must comply with the tax rules above before deciding to invest in a portfolio that does not consider the 67% minimum threshold above.

## Private stock acquisition

The most common means used by foreign companies to invest in Brazil is the acquisition of a Brazilian target entity through the purchase of its shares. This has several tax and labour 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 labour 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 therefore must be taken so that the major tax and labour contingent liabilities can be identified, measured and reviewed and 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 given by the seller.

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

### **Investing directly from abroad versus investing through a Brazilian vehicle**

The main advantage of investing in Brazil through a Brazilian entity is that this may allow a potential tax deduction in Brazil of the goodwill (or premium) paid upon the acquisition. This is not possible if the acquisition is made directly from a company abroad.

Note that, in theory, the existence of an intermediary acquisition company is neutral from a pure tax perspective, as dividends distributions are not subject to taxation in Brazil.

However, such an arrangement should be justifiable from a business perspective and may naturally imply additional administrative costs for the acquiring party. The use of an intermediary acquisition company may also determine an additional taxation of any interest on net equity (INE) paid by the operating company to the intermediary company as the INE is subject to the PIS and COFINS taxes (two taxes on revenues), levied at a combined rate of 9.25%.

## Tax goodwill amortisation

The tax benefit related to the deductible goodwill was created in 1997 as an incentive for foreign and local investments in the Brazilian privatization program.

Even after the privatization program, this tax incentive consisted of an efficient way to attract more investments to local companies and for this reason, was not eliminated by the Brazilian government to date.

Under the current tax rules (Law 12,973/14, effective since January 1<sup>st</sup>, 2015), which are consistent with current Brazilian accounting standards based on IFRS, the acquisition cost of investments must be separated into:

- i. the net equity of the acquired company
- ii. the fair market value of the net assets
- iii. the goodwill derived from future profitability, which is the remaining balance after deducting items (i) and (ii)

The goodwill amount, following a merger between the acquiring and acquired entities, can continue to be amortised for tax purposes over a period of five years.

The main requirements that enable the goodwill tax deduction are:

- an independent report must be prepared and filed with the Tax Authorities or with the Register of Deeds and Documents to support the fair value of the net acquired assets
- the transaction be carried out among unrelated parties and,
- stated business purposes

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 is set for the sole purpose of reducing the tax burden may jeopardize the goodwill tax deduction.

## **CFC rules**

The taxation of undistributed profits generated by foreign controlled or affiliated companies of Brazilian resident entities (CFC rules) has been introduced to Brazilian tax legislation in 2001. The Brazilian CFC rules differ from CFC legislation in other jurisdictions.

The old Brazilian CFC rules imposed the taxation of the Brazilian Corporate Income Taxes on undistributed profits earned by foreign controlled or affiliated companies that were available to the Brazilian parent company (irrespective of whether the profits were actually distributed or not) on December 31<sup>st</sup> of each calendar year.

The new rules keep the same general treatment of imposing taxes over undistributed profits from controlled and affiliated foreign companies. However, they make an important distinction when profits are considered to be made available.

## **Controlled companies**

For controlled companies, the profits should be considered to be made available based on the controlled company's local corporate legislation and should be made available to the Brazilian entity on 31<sup>st</sup> December of the year the profits are accrued. Other provisions have been set forth by the current tax legislation determining when the profits should also be considered as available, such as in the case of liquidation and merger of the company.

The new law applies to both directly and indirectly controlled entities (i.e. the "top-down look-through approach").

## **Affiliated companies**

The current law imposes a tax charge only on actually distributed profits of affiliated companies.

Profits earned by a Brazilian entity through a foreign affiliate therefore will be taxable in Brazil only on December 31<sup>st</sup> of the year in which they were actually distributed to the Brazilian entity, provided that the affiliate satisfies certain conditions set forth in the new law. In respect of foreign affiliates, profits should be considered available to the Brazilian company when actually credited or paid.

## **Consolidation of foreign profits and losses**

Taxpayers are allowed to consolidate profits and losses until 2022. Taxpayers that do not choose to consolidate their foreign profits and losses may offset losses only against future profits of the same foreign entity.

Also, taxpayers may choose to postpone income tax payments levied on foreign profits to when the profits are actually distributed to the Brazilian parent or affiliated entity. In the first year, however, even when there is no distribution of profits, 12.5% of the profits will be deemed to be distributed to the Brazilian parent. If no further profits are distributed, the remaining profits need to be deemed to be distributed in the eighth year.

Taxpayers choosing to postpone income tax payments should consider the impact of interest rates and foreign exchange fluctuations on their tax liabilities.

Under the old CFC rules, taxpayers normally mitigated double taxation through the use of foreign tax credits granted in Brazil for income tax paid on the foreign entities' profits. The law expressly extends such foreign tax credits to withholding income tax paid abroad on profits distributed to the Brazilian parent, with no time limitation.

## **Other aspects**

The CFC rules do not apply to activities related to oil and gas exploration in Brazil undertaken by directly or indirectly controlled foreign entities and affiliates.



### 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 located in a tax haven or subject to a privileged tax method or condition, may be deducted for corporate income tax purposes if the interest is viewed as necessary for the activities of the local borrower company.

In addition, the following requirements need to be met:

- i. the debt amount granted by the foreign related party (which has a direct participation in the Brazilian entity) should 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) should not exceed twice the amount of the total net equity amount of the Brazilian entity; and,
- iii. the overall debt amount granted by foreign related parties as per (I) and (II) should not exceed twice the sum of the participation of all related parties in the net equity of the Brazilian entity

If one of the ratios above is exceeded, the portion of interest related to the excess debt amount is not deductible for Brazilian corporate 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 method or condition.

The interest expense is deductible for Brazilian CIT purposes if it is viewed as necessary to the company's activities and if the total amount of the Brazilian entity's debt with any foreign party located in a tax haven, or in a jurisdiction with a privileged tax regime, does not exceed 30% of the Brazilian entity's net equity (a 0.3:1 debt to equity ratio).

The 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 in a tax haven/privileged tax condition (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 condition are deductible for the purpose of the Brazilian corporate income taxes 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 interest, goods or service payments and the corresponding supply of goods, rights or utilisation of services

### **Transfer pricing on intercompany loans**

Interest expenses payable to related parties outside Brazil are subject to transfer pricing deduction limits, apart from the thin capitalization rules above as of January 2013. If the recipient is located in a tax haven or privileged tax regime jurisdiction, thin capitalization and transfer pricing rules apply even if the lender is not a related party.

For transfer pricing purposes, interest paid or credited to a related party located abroad will be deductible up to an amount that does not exceed the rate determined based on the following rules, plus a 3.5% spread:

- in the case of a loan denominated in US dollars and subject to a fixed interest rate: the rate corresponding to the Brazilian sovereign bonds issued in US dollars in foreign markets
- in the case of a loan denominated in Brazilian Reais and subject to a fixed interest rate: the rate corresponding to the Brazilian sovereign bonds issued in Reais in foreign markets
- in all other cases, LIBOR for the period of six months

## **Brazilian Double Taxation Treaties Network**

Brazil has a limited network of double taxation treaties which it has entered into 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 United States and the UK, but the Reciprocity Agreements with these countries allow, in theory, the utilisation of tax credits derived from the 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 credits 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 usually considered to be advantageous jurisdictions mostly because of the tax treaties between them and Brazil and the specific clauses related to tax credits availability.

## Background information on the main taxes and contributions in Brazil

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

Tax	Rate	Description
Corporate Income taxes – Corporate Income tax (IRPJ) and Social Contribution on Net Income (CSL)	25% and 9%	<p>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.</p> <p>IRPJ is charged at a rate of 15% plus a surcharge of 10% on annual taxable income in excess of R\$ 240 thousand.</p> <p>The Presumed Profit Methodology can be used alternatively to the Taxable Income, for companies with annual revenue of less than R\$ 78 million/year.</p>
Taxes on revenues - Contribution for the Social Integration Program (PIS) and Contribution for Social Security Financing (COFINS)	1.65% and 7.6% (higher rates are imposed in certain sectors)	<p>Levied on gross income. Possibility of PIS and COFINS credits on the acquisition of certain inputs and services (non-cumulative methodology similar to a VAT).</p> <p>Also apply on the imports of goods and services to non-residents.</p> <p>Export revenues are tax exempt.</p> <p>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.</p> <p>PIS and COFINS levied on financial revenues - earned by companies subject to the non-cumulative method - are subject to a 0.65% (PIS) and 4% (COFINS) tax rate accordingly. These taxes apply over any sort of financial revenues, including those derived from hedging transactions.</p>

Tax	Rate	Description
Federal Excise Tax (IPI)	Various rates	<p>Paid by manufacturers on behalf of their customers at the time of sale.</p> <p>Sale of manufactured products between producers - IPI is imposed, but there is an IPI tax credit equal to the IPI paid to the respective suppliers (non-cumulative tax). IPI is also imposed on the import of goods. Export revenues are tax exempt.</p>
Import tax (II)	Various rates	<p>Levied on the CIF price and is a cost to the company (not recoverable).</p>
Service Tax (ISS)	2% to 5%	<p>Municipal tax on gross revenues for certain services (listed by the Federal Government).</p> <p>ISS is payable to the municipality where the Company is headquartered. Some exceptions apply and the tax will be due to the municipality where the services are performed.</p> <p>ISS applies on the import of services but 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.</p>

Tax	Rate	Description
Value-added tax on sales and services (ICMS)	17% to 19% internal rate	<p>State tax on the circulation of goods and on the rendering of interstate and inter-municipal transportation services, communications and on energy (even where the services start in another country).</p> <p>The ICMS internal rate corresponds to 17%, except for the States of São Paulo, Minas Gerais and Paraná, for which the tax rate is 18% and Rio de Janeiro, for which the 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).</p> <p>The tax is only assessed on the increase in the price of the product in each part of the circulation process.</p> <p>ICMS is also imposed on imports. Export revenues are tax exempt from ICMS.</p>
		%
		Internal transactions 17 to 18
		Interstate transactions 4 to 12
		Most imports 17 to 18

Tax	Rate	Description
Financial Transactions Tax (IOF)	Various rates	<p>Foreign exchange transactions considering royalties, technical services, interest, dividends or any other payment, including the reimbursement of costs, are subject to IOF.</p> <p>The regular IOF rate for foreign exchange transactions (both inbound and outbound) currently applied corresponds to 0.38%.</p> <p>IOF is also levied at various rates, on loans and credit operations, securities transactions, foreign exchange transactions and insurance policies.</p>
Economic Domain Intervention Contribution (CIDE)	10%	Levied on royalty, license or service agreements payments to foreign entities.
Withholding Income Tax (IIRF)	15% or 25%	WHT is levied on various payments such as interest, royalties and services. General rate is 15%, but is 25% if recipient is located in a tax haven.

## **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 for taxation purposes, 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%. 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:

- modification in the ownership of the company and,
- modification in the activity of the company

Furthermore, it is neither possible to carry back tax losses nor transfer tax losses to other Brazilian companies, except in the very specific scenario below.

According to Law 13,043 from November 13, 2014, there is the possibility of using tax credits derived from tax losses for the purpose of the early settlement of tax debts that were previously included in special payment instalment processes resulting from tax amnesty programmes. In this situation, those NOL credits could also be transferred between controlling and controlled companies or among entities that are directly controlled by the same company. Note that there are some requirements that must be met, such as both companies being domiciled in Brazil; maintaining this condition up to the date of the early settlement of the debts, among other requirements.



### **Interest on net equity (INE)**

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% when paid to tax haven jurisdictions).

During January to December 2016, the applicable TJLP rate was 7.5%.

### **Payments made to beneficiaries located in tax havens**

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 to 22.5% (unless otherwise specified by an international tax treaty), even if both vendor and buyer parties are domiciled abroad. The Brazilian tax legislation provides that non-residents should be subject to the same rules as Brazilian individuals.

As from January 1st, 2017, new capital gain taxation rules for individuals/non-residents will be in force and the new rates will be as follows:

- 15% on the portion of the gain not exceeding R\$ 5 million
- 17.5% on the portion of the gain exceeding R\$ 5 million but not exceeding R\$ 10 million
- 20% on the portion of the gain exceeding R\$ 10 million but not exceeding R\$ 30 million and,
- 22.5% on the portion of the gain that exceeds R\$ 30 million

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 cost basis of the shares, based on available documentation, or 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 certain 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).

### **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 a FIP are currently taxed at a 0% IOF rate, only applicable on the inflow

of foreign capital into Brazil. The return of the 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 180 days. All other long-term foreign loans (more than a 180 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% Economic 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 conditions**

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 4<sup>th</sup>, 2010) a Normative Instruction (IN 1,037/2010) changing the Brazilian tax havens Blacklist.

## **Tax Havens Blacklist (according to 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, Curaçao, Cyprus, Djibouti, Dominica, French Polynesia, Gibraltar, Grenada, Hong Kong, Ireland, Isle of Man, Kiribati, Labuan, Lebanon, Liberia, Liechtenstein, Macau, Madeira Island, Maldives, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, 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, Sint Maarten, Solomon Islands, St. Lucia, St Vincent and Grenadines, Sultanate of Oman, Swaziland, Tristan da Cunha, Tonga, Turks and Caicos, United Arab Emirates, US Virgin Islands and Vanuatu.

A second list of “Privileged Tax Conditions” 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)
- US State LLCs, where interests are owned by non-US residents
- Spanish ETVEs (suspended from the list)
- ITC and IHC (both Malta)
- Swiss holding companies, domiciliary companies, auxiliary companies, mixed companies and administrative companies paying taxes with rates lower than 20%
- Austrian holding companies

After 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 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.

## **BEPS and Ultimate beneficial owners**

As the recipient of significant foreign investment, Brazil has been engaged in the OECD's work and the Brazilian Revenue Service has expressed publicly its intention to adopt BEPS recommendations. Few references have been formally made to BEPS in Brazilian legislation – e.g. a formal indication of compliance with Action 5 in the reasoning for the issuance of Normative Instruction N°. 1,634, as follows:

This new Normative Instruction (NI 1,634/2016) requires the disclosure of information with respect to “ultimate beneficial owners.” Such owners include individuals and certain entities that, directly or indirectly, hold, control, or “significantly influence” an entity, as well as individuals and certain entities on whose behalf a transaction is undertaken.

Under the NI, “significant influence” is deemed to exist when the individual or other investor, directly or indirectly, holds 20% or more of the entity's stock or has exercised or exercises “preponderance” — that is, power over decisions, or to elect the majority of the entity's executives — despite not controlling the entity.

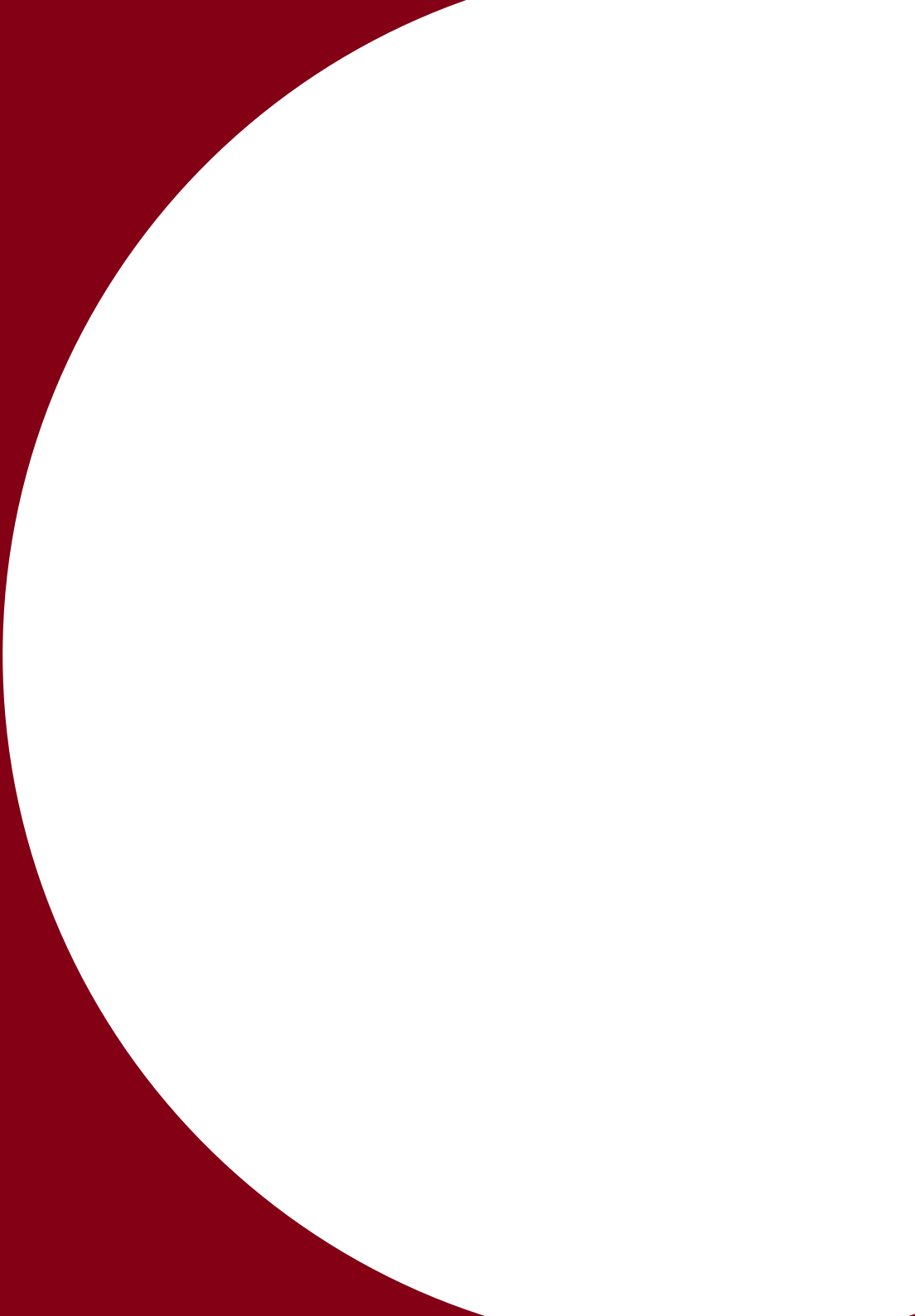
The information must be disclosed upon enrolment in the CNPJ, or upon request from the tax authorities, depending on the investor's profile — for example, a trust must disclose upon enrolment but a pension fund must disclose upon request — and whether the investor has “significant influence” over the Brazilian entity.

One of the main concerns and current discussions over this new NI is in relation to the investments through FIPs as FIPs owners would need to disclose their ownership structure. A key question for both the holding entities and the Brazilian companies (i.e., either the portfolio company or Brazilian companies under the FIP) will be how high in the structure do they need to disclose.

This new rule is applicable as of January 1<sup>st</sup>, 2017 and investors already registered with the CNPJ must provide the ultimate beneficial owners' information by December 31<sup>st</sup>, 2018, or earlier if an event occurs that warrants an update of the existing CNPJ registration.

## Work Force and Labor Charges







### *Labour and management relations*

Employer and employee relations are dealt with principally under labour laws (CLT) enacted in 1943 and subsequent legislation. The labour laws are applicable to all employees in regular registered employment, except for individuals in public employment or domestic labour, who have separate regulations.

The labour laws make no distinction between skilled and unskilled workers or among 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 labour laws.

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

### **Background information on labour practices and the main social charges in Brazil**

#### *Salary and labour rights*

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

After a 12-month period, employees are entitled to a 30-calendar days 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 "13<sup>th</sup> salary") equivalent to one month's salary.\*

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\* See the appendix A.

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, 13<sup>th</sup> salary and the amount that must be deposited in the FGTS (the Mandatory Severance Indemnity Fund for Employees), as well as for 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 labour legislation, an award or any other benefit (such as vehicle) to an employee may be considered a fringe benefit, for the reason that any incentive award or granting 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, construction, passenger transportation companies, hotels and companies in the automotive sector, among others) has been paid at a 1% to 4.5% 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. In the last five years, there have been some other types of activities and their corresponding revenues which were included and/or excluded from this taxation method as well as rates which have been changed.

The INSS, under the gross revenues method, should be calculated proportionally to the company's net revenues related to the businesses and the companies' activities listed in legislation.

The regular 20% INSS contribution must be proportionally paid on the company's payroll except for the company's revenues derived from the incentivised activities. The calculation on the not consisting of incentivised revenues should be made based on a proportion between the company's incentivised revenues and the company's total net revenues.

Payment of mandatory insurance against labour accidents by employers is normally due at rates, which vary from 0.5% to 6% of the total remuneration paid to employees, depending on the "level of risk" of each type of activity the company undertakes.

Employers have also to contribute to other governmental entities, such as FNDE, Incra, SESC, SESI, amongst others. Respective contributions may reach up to 5.8%. In addition, the employer is also responsible for withholding and collecting the INSS on behalf of its employees. The INSS rates range from 8% to 11% up to a given limit (the limit varies each year).

### ***FGTS***

Under the FGTS rules, 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 the case of an employee's dismissal, a company must pay an additional of 50% calculated on the total amounts of FGTS paid by the company during all the employment relationship period with the employee.



**Brazilian Clean Company  
Act Highlights**





## ***Brazilian Clean Company Act Highlights***



Brazil implemented an anti-bribery and corruption act (Law n.12.846/2013) that came into force in January 29, 2014 better known as the “Clean Company Act”. The law does not have a criminal perspective for companies, as the FCPA or the UK Bribery Act, but provides for severe civil and administrative responsibility and consequences for a company who is found to have committed or been involved in acts of fraud or corruption involving a public official in Brazil or abroad. Additionally, the law includes a successor liability clause in which an acquiring company can be responsible for the misdeeds of an acquired company.

On March 18<sup>th</sup>, 2015, the Brazilian federal authorities also enacted the Clean Company Act regulation through Decree nº 8.420/2015, Ordinances nº 909 and 910 and Regulatory Instructions nº1 and 2. Among other aspects, these rules:

- Detail the administrative procedure to investigate and determine the responsibility and penalties of companies
- List the expected elements of an effective so called Programa de Integridade (Integrity Program), or anti-bribery and corruption compliance program
- Establish criteria to evaluate the effectiveness of Integrity Programs
- Set leniency agreement rules for companies and,
- Define the aspects that are going to be considered when deciding to include a company on the federal government’s black lists – Cadastro de Empresas Inidôneas e Suspensas (CEIS) and Cadastro Nacional das Empresas Punidas (CNEP), available at the Transparency Portal

This new law and regulation, as well as high profile corruption probes, have raised awareness within the Brazil business community of very legitimate concerns related to governance, transparency in business, risk mapping, internal controls, hotlines, internal investigations and several other elements that together represent effective compliance programs, as required by internal regulators, such as the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) in the US and the Serious Fraud Office (SFO) in the UK. More and more Brazilian companies are implementing anti-bribery and corruption compliance programs in accordance with international standards and guidance as well as the new Brazilian regulation. On the other hand, there are companies that are still in the very early stages as it pertains to understanding the requirements of the law/ regulation and taking the necessary steps to ensure compliance.

Naturally, what is of most concern to companies is the potential for high fines, reputational damage, and other sanctions. There have been significant increases in law enforcement against economic crimes, in close cooperation with other international regulatory agencies, with severe impacts on companies and individuals, and this is a trend that is set to continue as the high profile corruption probes move forward.

Given the requirements of the (relatively) new law and even newer regulation and the occurrence of post-deal compliance problems, companies are starting to place more emphasis on the compliance aspect of their pre-transaction due diligence.



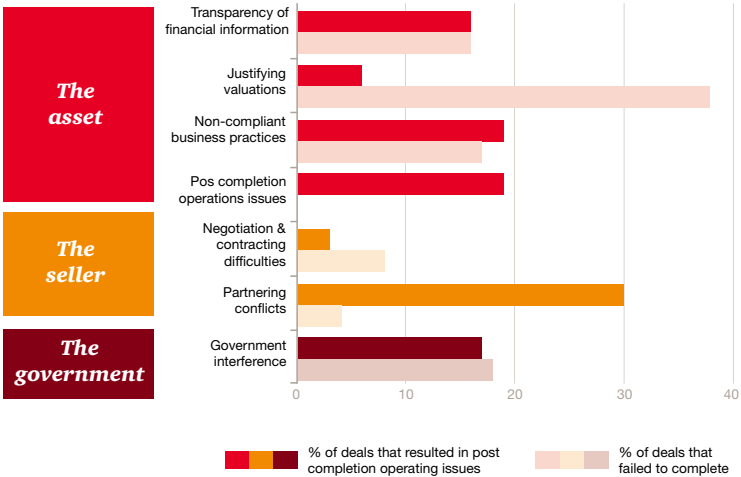
## Heatmap: The root causes of failed deals across BRIC

	China	Russia	India	Brazil	Av.
Justifying valuations					39%
Transparency of financial information					15%
Non-compliant business practices					15%
Negotiation and contracting difficulties					11%
Partnering conflicts					11%
Government interference					8%
Post completion people issues					2%

■ Greater than average +0.5 x standard deviation  
■ Within +/- 0.5 x STDV of average  
■ Lower than average -0.5 x STDV

Note: Based on a sample of 240 failed deals across BRIC

## Assessment of deal issues in emerging markets



Source: PwC publication "Getting on the right side of the delta", January 2012





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. 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 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.

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.

### 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.

## Main legislation and regulations

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.

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

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. Environmental crimes are subject to fines of up to R\$ 50 million (approximately US\$ 16 million).

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.

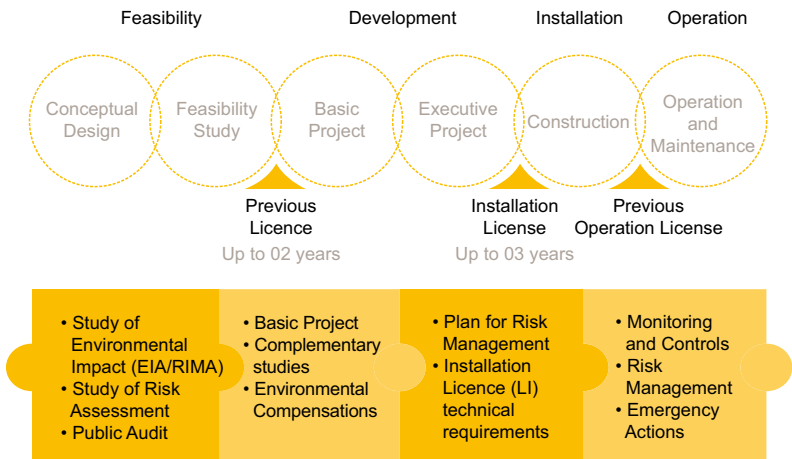
Penalties can include not only fines but also the cancellation of operating licenses, embargo and obligations for the recovery of an impacted area. Additionally, in many cases, environmental issues are made public, thus affecting a company’s reputation. Given this scenario, environmental due diligence prior to acquisition is highly recommended.

The environmental due diligence involves a review of certain environmental aspects of the target, prior to its acquisition, focusing on the identification of potential and/or existing contingencies, which could require significant costs. The work is based initially on environmental documentation analysis (such as operational licenses, water resources documentation, solid waste management) and a site visit in order to better understand the company’s exposure to possible risks (legal sanctions) if they are not in compliance with legislation.

**Licensing process – installing a new project**

Projects involving the construction of a new plant or production site or the expansion of an activity 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 a high environmental impact, a more detailed study of environmental impacts and mitigation (an EIA-RIMA) is required before installation is allowed.

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.









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





## 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 200 partners and approximately 4,500 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
- On the Post-Deal side, we have a team of over 150 M&A pre and post-deal professionals who provide solutions to all the critical aspects involved in an integration process. Our Synergy Track and 100-Day plan methodologies allow us to help our clients to capture deal value with the lowest cost and in the shortest timeframe

### Who to contact for M&A services in Brazil

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# Appendix

## Brazil Labor Reform Approved

### Overview

The Law 13,467/2017 amended the Consolidation of Labor Laws (CLT), approved by the Decree-Law 5,452/1943, beside the Laws 6,019/1974 (Temporary Working and Service Agreements), 8,036/1990 (FGTS) and 8,212/1991 (Social Security Funding Plan), adjusting the current legislation to the new labor relations.

### Specifics

The overhaul of Brazil's labor laws brought remarkable changes in several aspects of labor relations in Brazil. Considering the extent of these changes, we are presenting them as it follows:

### *Economic group*

this institute, a very particular one when compared to other fields of law, is now clearer and, consequently, brings a greater legal certainty since: an economic group no longer shall be characterized merely by the matching identities of the shareholders, now it will require (i) the demonstration of integrated interest, (ii) the effective communion of interests and (iii) the concerted action of its member companies. It should be noted that the conditions listed above are cumulative and must not be considered individually;

### *Effective working hours*

it will not be considered as working hours or employee availability when employees on their own free will decide to stay in the workplace for private activities, such as (i) religious practices; (ii) rest; leisure; (iv) study; (v) meal break; (vi) social engagements; (vii) personal care; (viii) changing clothes or uniform when it is not required by the employer. The law only presents some examples and as a consequence other activities may also be considered in here;

### *Former partner responsibilities*

partners who does not belong to the corporate structure of the company are only responsible for the company labor obligations regarding the period in which they were partners and as long as lawsuits are claimed up to 2 years after the registry of the modifications in the company contract. It should also be respected the following order of preference for charges: (i) the first to be charged must be the debtor company; (ii) in a second moment the current partners can be charged; and (iii) only then the former partners may be charged. A joint liability will exist if it is verified fraud on the company structure arising from changes in the contract;

### *Employment relationship*

the employer who maintain an employee without the proper formal registration is subject to a fine of BRL 3,000.00 per each unregistered worker, this fine will double to BRL 6,000.00 in case of recurrence. The referred fine may be reduced to BRL 800,00 to each unregistered worker when the company is a small-sized company and microbusiness. Any registration without the information required by MTPS Interministerial Ordinance, may subject the company to a fine of R\$600,00 per employee. The fines may be applied from the first visit of the tax auditor from the Ministry of Labor and Social Security - MTPS (exception to the criteria of double visitation);

### *Itinere hours*

the time employees takes from home to their place of work, including their return, either on foot or by any transportation (public or private), even if provided by the employer, will not be consider as part of the regular working hours;

### *Remote work (home office)*

remote work occurs when employees work predominantly out of the workplace, using information technologies and communication that, by their nature, do not constitute external work, even in case of specific activities that require employees to be on their workplaces. The remote work information must be disclosed in the working contract and must also provide details of the activities that will be performed by employees. Moreover, Pre-existing employment contracts may be amended as long as there is mutual agreement between employer and employee. On the other hand, when the remote work is changed to presential work, it is guaranteed a transition term of 15 days, besides the consequent contractual amendment. Other issues such as acquisition, support or supply of technological equipment and the necessary infrastructure of remote work, as well as the reimbursement of the expenses incurred by the employee, shall be stated in a written contract and will not be in incorporate to the employee's salary;

### *Succession of employers*

if there is succession of employers (change of ownership, even partial, or change in the legal structure of the company), the labor obligations, including the ones incurred by the time the employees worked for the prior company, will be considered as responsibility of the successor company;

### *Salary*

the amounts paid as (i) allowances; (ii) meal allowance; (iii) daily travel allowance; (iv) awards; and (v) bonuses are not included in the employee's remuneration (even if they are paid with frequency), not incorporated in the working contract and not considered for labor and social security tax bases. Awards are liberalities granted by the employer in the form of goods, services or cash corresponding to the outstanding performance of regular working activities;

### *Salary (2)*

the amounts paid to health or dental assistance, including the reimbursement of expenses with medicines, glasses, orthopedic appliances, prostheses, orthoses, medical-hospital care and any other costs, even when granted in different categories of health insurance plans, do not integrate the employee's payment for any purpose, not even the contribution salary (calculation basis for social security contributions - 'INSS');

### *Salary Equalization*

the rule for matching employees salary will not prevail whether the employer provide a career plan or apply, through internal standards or collective bargaining, the plan of careers and salaries, regardless of approval or public registry;

### *Union contribution*

the amounts due by participants of economic categories (companies), professional categories (workers) or liberal professional will be paid and collected when previously and expressly authorized. In other words, the union dues that were mandatory are now voluntary;

### *Termination of working contract*

the working contract may be terminated by a mutual agreement between the employer and the employee. In that case, the dismissal notice, if indemnified; and (ii) the indemnification over the FGTS balance amount (40% fine) will be paid for half of the original value, whereas (iii) the other labor related payments will be completely paid. This modality of termination allows the banking movement of the FGTS account up to 80% of the deposits amount, but it will not allow the entry into the Unemployment Insurance Program;

### *Agreements over the law*

Collective Bargaining Agreement and Union Agreements will prevail over the law in the following situations:

- working hours, respecting the constitutional limits;
- annual bank of hours (already allowed by an individual written agreement, as long as the compensation occurs within 6 months);
- break for meal and rest, considered the minimum of 30 minutes for working hours that exceed 6 hours;
- career and salary plan, and positions compatible with the employee's personal condition, as well as the identification of the positions considered as office of trust;
- company regulation;
- workers representation in the workplace;
- remote work (home office), on-call work and intermittent employment;
- productivity compensation, including tips perceived by the employee, and compensation for individual performance;
- working hours categories;
- occupational hazard degree classification;
- overtime in hazardous environments, without prior approval from the competent authorities;
- incentive bonuses in goods or services, eventually granted in incentive programs;
- profit sharing plans.

### *Outsourcing*

it is considered as a third-party service agreement the transfer of activities of the service taker, including its main activity (core business), to the provider of services that has an economic capacity compatible with the execution of the activity;

### *Outsourcing (2)*

the provider of services will not be a legal entity whose partners or owners have worked for the service taker in the last 18 months, whether as an employee or as a worker without employment relationship, unless such partners or owners are retired. Similarly, the employee who is dismissed cannot be a provider of services for the company he used to work before the period of 18 months from the date of the termination;

### *Social security contribution ('INSS')*

it will not be considered as part of the social security calculation basis, also known as contribution salary, (i) daily travel allowances (even when higher than the repealed limit of 50%); (ii) medical or dental assistance values from the company or agreed, including the reimbursement of expenses with medicines, glasses, orthopedic appliances, prostheses, orthoses,

### *Contin.*

medical-hospital care and any other costs; and  
(iii) awards and bonuses.

The law 13,467/2017 brings several more modifications about contract modalities, women's work, extra patrimonial damages, procedures of the labor claims, among other issues, that will be explored in due course.

### *Implications*

Indeed, the Labor Reform brings a lot of issues to the daily routine of the companies, requiring corrections from November 2017, the beginning date of validity of the Law 13,467/2017.

This means that routines, processes, amendments, revisions, systems and even the eSocial and EFD-REINF environments must be analyzed and revaluated according to the new rules.

The Labor & Social Security area from PwC Brazil is ready to help you in all of those evaluations.



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