

How to Invest in Real Estate in Brazil





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HOW TO INVEST IN REAL ESTATE IN BRAZIL

Brazil's economic growth during the past decade significantly boosted the country's real estate market. Tauil & Chequer in association with Mayer Brown has years of in-depth real estate experience, including in the areas of real estate finance, structured transactions and real estate tax.

Our full-service law firm offers clients comprehensive legal counsel in the handling of real estate transactions in Brazil, including investments by foreign-based entities and individuals.

Following are answers to some of the questions we consider most important when contemplating a real estate transaction in Brazil.

1. What does the real estate investment market in Brazil look like today?

The Brazilian economic boom that began in the mid-2000s greatly eased access to credit and sharply increased consumer buying power in the country. These factors, combined with a reliable legal framework that offers simple, straightforward rules for real estate funding (as well as sophisticated financial products that use real estate properties as underlying assets) have produced a vibrant real estate market.

Today, commercial, residential and rural land real estate transactions are all popular investment options in Brazil. The market has attracted many investors seeking tailored transactions (e.g., sale and lease-back on logistic centers and warehouses) on behalf of large multinational clients. Meanwhile, other investors have

turned to Brazil seeking new real estate frontiers (e.g., investments in farms or suburban residential areas) in a country that covers a vast territory.

Hence, during the past decade, Brazil saw the formation and consolidation of a market with a unique profile. Longstanding challenges, such as underdeveloped mass transportation infrastructure in Brazil's largest cities, have made the exploitation of suburban areas more challenging.

Notwithstanding these weaknesses, real estate in the core urban areas has not declined in value. On the contrary, the challenges confronting Brazil's cities have brought about a wave of renovations of old commercial facilities and the retrofitting of many residential buildings. Moreover, many AAA commercial buildings are under construction in new commercial areas in the inner parts of Brazil's largest cities, such as Av. Faria Lima in São Paulo and Porto Maravilha in Rio de Janeiro.

Brazil's real estate market has also benefited from efficient funding mechanisms, such as real estate funds, referred to in the industry as *Fundo de Investimento Imobiliário*, (FIIs), which are regulated and overseen by the Brazilian Securities and

Exchange Commission, and by a solid legal framework that secures investors with sound collateral, such as the *alienação fiduciária*, which permits the seizure of a property in the event of default.

Nevertheless, poor GDP growth in the past several years, coupled with an unprecedented rise in real estate prices, is causing many to speculate about a possible real estate bubble. Experts, on the other hand, point out that nothing in the Brazilian real estate markets resembles the characteristics of the American or the Spanish bubble but that prices on properties are expected to decline in certain areas, mostly because of a surplus of properties on offer.

2. What are the usual steps for purchasing and conveying real estate in Brazil?

Acquiring real estate in Brazil typically starts with a non-binding offer addressed to the seller/owner of the property, followed by due diligence. Real estate acquisitions must always include due diligence on the property and on the sellers of the property. This is true regardless of the property's value.

However, the type of property (e.g., commercial, residential, urban or rural) may dictate the extent of the due diligence. This is because certain types of liabilities of the seller and of the property may fall to the property after a transfer of ownership. Brazilian real estate taxes—either *Imposto Predial e Territorial Urbano (IPTU)* or *Imposto sobre a Propriedade Territorial Rural (ITR)*—are one example of a liability associated with the property that may fall to the purchaser. Environmental liabilities may also be imposed upon the purchaser. In some cases, the property may be judicially arrested to secure certain obligations of the seller. For that reason, it is imperative to investigate whether the seller is creditworthy and in good legal standing.

Prospective buyers should also seek assistance from a real estate consulting firm to evaluate technical aspects of the property, such as the potential for construction and the required city permits, as well as other licensing requirements.

Once the buyer has completed all due diligence, the parties can reach a binding commitment for the purchase and sale of the property or the final deed of purchase and sale. A binding commitment is generally used whenever there are conditions to be met by the parties prior to the definitive transfer of title to the acquirer.

3. What are the common forms of real estate investment?

The answer depends on the profile of the investor. There are mainly two types of investors: those who rely on the efforts of another to obtain financial gains over a real estate asset and those who manage the real property themselves to extract its surplus.

The former invest in securities of which the underlying assets are a real estate property (or real estate receivable). The latter are asset management houses that manage the property themselves through a holding company or other corporate vehicles.

Investment in securities occurs most commonly through *FII*s (See Section 1), which are funds that promote return on capital through the acquisition and future lease of real estate. *FII* investors enjoy certain tax benefits that make *FII*s a very popular investment alternative. *Certificados de Recebíveis Imobiliários (CRIs)* are a special type of security issued by real estate securitization houses that also hold a real estate receivable as the underlying asset.

Real estate holding companies may distribute the return on investment in the form of tax-exempt dividends.





4. What is involved in taking ownership of a property?

Taking ownership of a real property in Brazil is accomplished by filing a Public Deed of Purchase and Sale of Property (*Escritura Pública de Compra e Venda de Imóveis*) with the Real Estate Registry, known as *Cartório de Registro de Imóveis (RGI)*. The Public Deed is executed in the presence of a notary public. The buyer must present certain clearance certificates (e.g., tax, severance fund contribution) and pay a real estate transfer tax known as *Imposto sobre Transmissão de Bens Imóveis (ITBI)*. While the *ITBI* can legally be paid by either the purchaser or the seller, it is standard practice in Brazil for the purchaser to cover this expense.

A property may also be purchased indirectly through the purchase of stock in a legal entity that holds title to the property. The use of this structure is most common in purchases of commercial properties (e.g., warehouses, office buildings), particularly when the purchasers are sophisticated investors seeking to avoid *ITBI* and other registry expenses.

5. Are there restrictions on foreigners holding title to property in Brazil?

Foreigners are free to acquire property in Brazil, with the exception of rural properties and land near Brazil's national borders.

Federal Law No. 5,709 imposes certain limitations on the acquisition of rural properties by foreigners. Such limitations are also applicable to Brazilian companies whose partners, individuals or legal entities, residing or established abroad, hold the majority of the capital stock.

The Federal Constitution of 1988 eliminated the distinctions between legal entities with domestic

capital and legal entities with foreign capital.

Therefore, a company organized in Brazil with its head office and principal place of business in Brazil is deemed a Brazilian company, regardless of the nationality of its partners.

Opinion AGU/LA-04/94 issued by Brazil's attorney general (but not approved by the Brazilian president) supported that understanding, and therefore no limitations were imposed due to the terms set forth in Law No. 5,709.

Several years later, the attorney general issued another opinion (Opinion AGU GQ-181/1997) confirming that the above-mentioned restriction to foreign companies was not incorporated by the Federal Constitution of 1988.

Then, on August 23, 2010, the attorney general issued Opinion LA-01, changing the prior opinion and setting forth that Law No. 5,709 should apply to Brazilian companies controlled by foreigners. In addition, the new opinion stated that the concept of a "majority of capital stock" must be interpreted according to the broader concept of "corporate control" set forth in the Brazilian Corporation Law.

The concept of control is defined in Article 116 of the Corporation Law as "an individual or a legal entity, or a group of individuals or legal entities by a voting agreement or under common control, which: (a) possesses rights which permanently assure it a majority of votes in resolutions of general meetings and the power to elect a majority of the corporation officers; and (b) in practice uses its power to direct the corporate activities and to guide the operations of the departments of the corporation."

In summary, the attorney general's most recent opinion maintains that the restrictions for acquisition of rural lands by Brazilian companies controlled by foreign entities, set forth by Law No. 5,709/1971



and its regulation (Decree No. 74,965/1974), are still valid. On the basis of this opinion, Brazilian companies controlled by foreigners (either natural or legal) are restricted from (i) acquiring rural properties, except in case of a legitimate succession; (ii) leasing a rural property and (iii) acquiring rural properties by means of a merger or acquisition of companies that results in control by a foreign entity.

Thus, Brazilian companies controlled by foreign entities are now subject to the following restrictions:

- Acquisition or leasing of rural properties by foreign legal entities or by Brazilian legal entities controlled by foreign legal entities in excess of 100 indefinite exploitation modes, in continuous or discontinuous areas, is subject to prior authorization by the Brazilian Congress.
- Regardless of the size of each individual property, the sum of the rural areas owned or leased to foreign individuals, foreign legal entities or Brazilian legal entities controlled by foreign legal entities cannot exceed 25 percent of the total surface of the municipality where such areas are located.
- The sum of the rural areas owned or leased to foreign individuals, foreign legal entities or Brazilian legal entities controlled by foreign legal entities of the same nationality cannot exceed 10 percent of the total surface of the municipality where such areas are located.
- Foreign legal entities or Brazilian legal entities controlled by foreign legal entities may only acquire or lease rural properties destined for the development of agricultural, cattle raising, forestry, industrial, touristic or colonization activities, in accordance with their corporate purposes, upon approval of the relevant project by the Ministry of Agrarian Development.

Please note that the definition of the area equivalent to a rural mode is determined by each municipality. As a general rule, this information is contained in the Rural Property Registry Certificates, or *Certificado de Cadastro de Imóvel Rural (CCIR)*.

Certain lawsuits have been filed challenging the legality of the attorney general's most recent opinion and seeking court orders to permit acquisition of rural land by foreigners. These court orders are not final but preliminary decisions that have permitted foreigners to acquire rural land.

To purchase non-rural properties, foreigners must first obtain a federal tax I.D. in the form of a *Certificado Nacional de Pessoas Jurídicas (CNPJ)* or a *Certificado de Pessoa Física (CPF)*. Either one can be obtained online.

6. What is the safest way to acquire title to a property?

The safest way to acquire title to a property is to execute a public deed of purchase and sale and to register the deed with the *RGI* after completing proper due diligence. Notary public officers and their records are considered highly reliable. Thus, once the transfer of ownership is registered with the *RGI*, the purchaser is assured of having secure ownership of the property. Moreover, from a purely legal standpoint, it is the registration with the *RGI* that establishes property ownership. The real property's files with the *RGI* contain its entire record, including prior owners, registration of building overland, incumbency over the property and any other relevant information.



7. What are the approximate costs of a real estate transaction?

Financial expenditures include due diligence costs, notary registration fees, transfer taxes and brokerage fees.

The extent of the due diligence carried out on the property will influence the transaction costs associated with the purchase. A large part of the background investigation is made through various clearance certificates. Some of these can be obtained online, but most must be requested directly from the appropriate notary office (e.g., tax, labor, real estate). In general, however, costs for obtaining the certificates are not excessive, and the largest portion of the expenses is related to the investigation of hidden liabilities, such as environmental and urban liabilities, which are not in the certificates.

Notary registration fees vary from state to state and are generally calculated based on the value of the property, up to a maximum fee of US\$2,000. An equivalent fee is due on the registration of the deed of purchase and sale with the *RGI*.

Real Estate transfer taxes (*ITBI*) also vary depending on the location of the property. The taxes generally range from 2 percent to 3 percent of the total property value.

Brokerage fees are negotiated among the parties, but are usually between 5 percent and 10 percent on the sale price, depending on the value and characteristics of the property.

It is common practice for the purchaser to pay all of the above fees.

Other potential expenses in completing a real estate transaction in Brazil depend on the type of property and its intended use. In the case of a farm or

allotment, for example, geo-referencing expenses and notary registration expenses will be incurred.

8. How can the purchase of a property be financed?

For many decades, loans for the purchase of residential properties were scarce in Brazil. With the recent advancement of the economy and lower tax rates, a large portion of the population has gained greater access to credit.

Many banks offer financing to both performing and non-performing real estate development projects. The structure usually adopted is the use of the property as collateral—through either mortgage or, more commonly, fiduciary sale (*alienação fiduciária em garantia*)—with a repayment term of more than 20 years.

Entrepreneurs seeking funds for commercial projects (e.g., office buildings or logistics centers) can turn to vibrant capital markets with a special interest in real estate projects. *FIIs* (See Section 2) are commonly set up with the purpose of raising funds in the capital markets with accredited investors aiming to apply those funds to specific projects.

9. What tax rules apply?

Tax rules applied to real estate transactions in Brazil comprise a universe of their own with many particularities and intricacies. For that reason, it is imperative to obtain a specialist's opinion when considering a real estate transaction.

To illustrate this point, bear in mind that taxes levied on real estate transactions can vary greatly depending on whether there is a legal entity or a natural person involved, the place of residency of such persons, the tax regime applied to the legal entity

(*lucro real or lucro presumido*), the corporate purpose of the legal entity (e.g., real estate development) or the tax regime of the investment fund. Hence, the myriad tax implications of a real estate transaction in Brazil must be considered on a case-by-case basis.

Nevertheless, there are some general aspects of real estate tax law that a practitioner must be aware of to better navigate the business environment in Brazil.

As mentioned above, real estate transfer taxes, or *ITBI* (See Section 7), vary depending on the municipality in which a property is located but are usually between 2 percent and 3 percent and may not exceed 8 percent.

Brazil allows direct acquisition of real property by individuals and corporate entities, irrespective of nationality or residency in Brazil (except for rural land). Profits from such investments may come from income (lease of the property) or capital gains (sale of property).

Capital gains and rents received by legal entities (with the exception of real estate development companies) are considered “income” or “non-operational income” and are added to the basis used to calculate Brazilian corporate income tax, known as *Imposto de Renda Pessoa Jurídica (IRPJ)*, and Brazilian social contribution on net profit, or *Contribuição Social sobre Lucro Líquido (CSLL)*. If taxes are assessed by the taxable income method, capital gains may be offset by operational or non-operational losses incurred during the tax year or with “accumulated non-operational losses” from previous periods (up to 30 percent). The combined rate of taxation is 34 percent (25 percent *IRPJ* + 9 percent *CSLL*).

For natural persons resident in Brazil, rents are calculated using the Progressive Chart of the Brazilian Individual Income Tax (*Tabela Progressiva de Imposto de Renda de Pessoa Física - IRPF*). If the rent is paid by a corporate entity, Brazilian income tax must be withheld. If rent is paid by an individual, income tax must be paid by way of an *IRPF* booklet (*Carnê-Leão*). In either event, the maximum tax rate is 27.5 percent (co-proprietors may divide their respective income bases *pro rata*).

Natural persons resident in Brazil are exempt from capital gains should (i) the property sold be the only real estate property of that person; or (ii) the proceeds from the sale be used to purchase another property within 180 days after the sale took place.

For legal entities not resident in Brazil, capital gains and rents are assessed at a tax rate of 15 percent (25 percent for entities resident in designated “tax haven” countries adjudged to have favorable taxation rates, which comprise less than 20 percent of the total).

Investing in the equity of a so-called real estate development company (i.e., a company whose purpose is to develop commercial real estate projects) presents a number of benefits. Natural persons and legal entities resident in Brazil investing in a real estate development company are exempt from taxation on dividends and are taxed at a rate of 15 percent on capital gains on the sale of stock.

*FII*s also provide a favorable tax regime for investors. *FII* real estate trades are exempt from *IRPJ* and *CSLL*. Any income derived from an *FII* investment is exempt from taxation if the investor holds less than a 10 percent interest in the *FII*, the income from the investment corresponds to less than 10 percent of the total income distributed by the fund and the fund has more than 50 participating investors. ♦





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