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Doing business in Brasil

The tenth largest economy in the world, the largest in South America and the third largest in the Americas, Brazil is an historically attractive country for investors, but the challenges are also great. To navigate the multiple questions about doing business in the country, we invited some of the best lawyers from ten different practices to discuss the Brazilian market and understand the best ways to enter it

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Introduction

Brazil is the largest country in South America. With a growing population of over 210 million, it is the sixth-largest country in the world, and it has the world's ninth-largest economy.

While most of the BRICS countries have issues with dependence on Oil&Gas, ethical or religious problems, and are not democratic, Brazil is a full democracy, is the only country in the world with a 100% electronic election system since 1996 and does not have such issues as these other emerging nations.

The country is an attractive market for international investors due to several factors: a big domestic market, a diversified economy, and international reserves totaling (USD 343.5 billion in May 2023) which are less vulnerable to international crises.

Brazil's central bank improved the 2023 GDP growth forecast to 2.0%, and the annual inflation rate in Brazil receded to 3.16% in June of 2023. This is the lowest since September 2020 and broadly in line with market forecasts. However, investment in Brazil remains risky because of some negative factors, including cumbersome and complex taxation, bureaucratic delays, and heavy and rigid labor legislation.

For this reason, it is important to understand the **rules** and the **business environment**.

Also, being an emerging country allows it to attract FDI and foreign direct investment, such as the European Union, which is the first investor with 560 Billion USD, more than China and the United States.

Brazil is a federal republic, and its legal system is based on

civil law.
The Brazilian Federation comprises the federal government, states, federal districts, and municipalities. Each entity competently legislates on matters defined by the Federal Republic of Brazil (Constitution).

Brazil offers a wide variety of federal, regional, and local **incentives** to national and foreign investors, for example:

- Tax exemptions and deductions apply to sectors the government considers strategically important.
- Incentives for developing infrastructure projects in several sectors (including energy, telecommunications, oil and gas, logistics, and transportation), for example, through public bidding processes and public-private partnerships.
- Tax incentives are applicable in Tax-Free Areas (for example, the Zona Franca de Manaus) and Export Processing Zones.
- Funding from public banks, particularly the Brazilian Development Bank.
- Lower taxation on investment by non-residents in capital markets.
- Dividends paid to foreign individuals or companies are not subject to income or withholding tax. At the same time, interest or royalties remitted abroad are generally subject to a 15% withholding tax (25% if remitted to a low-tax jurisdiction).

Regarding **resources and sectors**, Brazil is a rich country in natural resources, an important and major commodity-producing nation.
Brazil has a thriving mining industry and is also an important energy producer. Their largest commodity output being the agricultural sector, with soybeans as the top export, is understandable as the climate in Brazil puts the nation in a unique position and makes the country the largest producer in the world of several important agricultural staples. Also, it is the world's largest producer and exporter of sugar cane and the leading coffee bean producer. These are just a few of the agricultural commodities that Brazil produces. Pineapples, cashews, oranges, papayas, tobacco, beef, chicken, corn, and palm are major agricultural products.

Brazil's electricity matrix is one of the cleanest in the world, and Brazil is committed to continuing its support for renewable energy projects. Continued investments are expected in wind, solar, and hydropower capacity. Also, Brazil can become a global leader in the carbon credit market via projects associated with conservation (REDD+) and forest restoration.

But Brazil is also Latin America's top oil producer. The country owns the world's largest recoverable ultra-deep oil reserves, with 96.7% of Brazil's oil production produced offshore. It is the world's tenth-largest producer of crude oil, and, due to its position in terms of sugar production, Brazil is a significant producer of sugar-based ethanol. Most opportunities for U.S. oil and gas suppliers are related to pre-salt projects with great development potential.

The emerging sectors of Aerospace, Wellness, Pet Industry, and Fintech are interesting where European investors collect opportunities.

In a very practical way, we will detail below the main **ways to do business in Brazil** which can be summarized as using a sales representative, using a distributor, making a JV, or opening a branch.

The use of a commercial agent/representative is very common as the first approach to a foreign market. In Brazil, this practice is also frequently used by foreign companies due to the special characteristics of the market. Considering that both countries are considerably distant – flying time is around 12 hours – it is relatively complex to manage sales directly from Europe. Depending on the sector, some sales will demand several trips to Brazil per year; this could significantly increase the cost of client acquisition and require extended time for sales personnel.

Another important aspect is also related to the cultural side of Brazil: in some cases, personal contact is key for sales. Brazilians tend to prefer business relations that are constructed upon personal contact and for that, personal meetings are essential for keeping this relationship. Speaking Portuguese, in some cases, can also be a determinant for client acquisition due to the country's relatively poor level of foreign language.

These are all advantages of having a sales agent /representative in the country. On the other hand, it is essential to pay attention to some points to avoid having a bad experience with this instrument. It is necessary to align expectations in both parts. Brazilians tend to be sometimes over-optimistic and foreign will take for granted the promises of the local agents. The foreign company should provide complete technical training for the sales agent, and it is critical to align the values of the company; after all, this professional will be the face of the company in Brazil.

Having an agent/representative might bring faster commercial results with a more minor financial impact as the remuneration might be based on sales. Nevertheless, it is important to consider that the foreign company will likely have to cover the expenses of promoting the product.

Traveling costs inside Brazil can be high considering the country's continental dimensions and foreign companies should not expect the agent /representative to cover these expenses only based on sales commissions. Representation schemes can be based in a fixed monthly payment and sales commissions.

Sales representation can be a good option for smaller businesses but does not work as well on a larger scale. For large businesses unwilling to hire an entirely new sales force, distribution agreements are one of the best options. Unlike in an agency agreement, the company will sell the goods to a distributor under a **distribution agreement**. The main difference between such structures would be the fact that the agent does not purchase the title over the goods before selling them to final clients,

and the distributor's earnings are based on the difference between the purchase price from the supplier and the price for which it sells the goods to the final clients.
Agent or distributor? Often, the decision between appointing an agent or distributor will depend on the sophistication of the buyers (and their willingness to deal with the stresses of importing goods into Brazil) and the taxes applicable to the product, service, or IP right being supplied to Brazil.

Companies seek distributors that are willing to take all risks. While that may sound ideal from the supplier's viewpoint, due to the heavy taxes that apply to importing goods and services, sales volumes are invariably affected as distributors' margins generally price the products or services out of the market.

In addition to the problems involving Brazil's mandatory laws applicable to agents, appointing an agent places the commercial risk on the final customer, which they seldom welcome. Furthermore, it leaves all problems of dealing with the bureaucracy to clear customs (in the case of goods) or make foreign international payments and withhold the relevant taxes (in the case of services). Hence, appointing an agent is only suitable in specific cases, and the preferred option will be the distributor.

It is important to notice that due to the high import costs, there is always tremendous financial pressure upon the distributor as they have to commit and invest considerably in inventory, especially in a country with high-interest rates like Brazil.

When you enter a distribution agreement, you give the distributor sole rights to resell your goods in a particular territory and agree not to sell your goods to any other distributors in that area. Appointing a distributor in Brazil does not require formal steps, and parties have great freedom to decide on the terms of their distribution arrangements. Nevertheless, some precautions have to be taken to avoid problems.

Brazil has laws dictating how contracts involving parties from different countries should be interpreted. It would be best if you did not assume that because your agreement says the law of a specific country should be adopted, the Brazilian courts will automatically support such a law. While Brazilian laws allow some of the provisions to be freely chosen by the parties, other provisions will only be addressed if they contradict the rules of law related to contract performance enacted by the Brazilian legislation. Companies with agents worldwide frequently have standard contracts to appoint distributors in different jurisdictions. Due to Brazil's particular rules relating to distributorships, Brazilian lawyers must review distributorship agreements before they are presented to the distributor. Relying on a choice of law and court (including arbitration) provision will do little to avoid the mandatory nature of some Brazilian laws that will apply to the distribution relationship. Thus, having a well-drafted agreement customized to the Brazilian legal environment and following

its terms throughout the agency relationship will go a long way to minimize the exposure of the foreign company to undesired risks.

If Brazilian law governs the distribution agreement, then the Civil Code will apply to its termination and provide its rules. According to Brazilian law, this may lead to higher compensation payments as the distribution is entitled to damages if the foreign company tries to force them out of the contract. The purpose of this provision is to protect distributors where suppliers push distributors to terminate the agreement by controlling the supply of goods or services.
Using a distributor may also increase the risk of copying or counterfeiting your product. Some large agents and distributors may manage so many product lines that more attention should be given to yours.

Another business model to operate in Brazil is through Joint Ventures. Joining forces with a Brazilian partner can be beneficial if you wish to sell directly to the Brazilian domestic market. You will be able to take advantage of the Brazilian partner's contacts and local knowledge while they benefit from technology transfer or your company's expertise in other areas. However, the primary concern with joint ventures is finding a partner you can work with. Many joint ventures fail where, for example, due regard has yet to be given to Brazilians' importance to personal relationships in business.

Selecting a JV partner who complements you is often better than a potential competitor. Plan for your exit from a joint venture from the outset - joint ventures are rarely permanent, and it is better to have a "pre-nuptial agreement" than a messy divorce. If you decide to go down this route, you must conduct thorough due diligence checks on your potential partner.

While no specific Brazilian law governs JVs, they are usually classified under two types - contractual joint ventures and corporate joint ventures. The JV itself does not have a legal identity, as it is effectively only a type of association used by parties to implement the development of a new business and to combine their various interests. JVs are, broadly, agreements between parties that establish the basis on which they associate.

Opening a local subsidiary in Brazil can bring your business to a higher level because it might boost your presence in the market and optimize tax aspects caused by the heavy import taxes. Nevertheless, this action is surrounded by challenges that foreign companies have to overcome, like the famous Brazilian bureaucracy and the difficulties of managing a structure in another country, especially regarding tax compliance.

Planning the structure and the business model of the new entity is key to the project's success, and it is highly advisable to count on the professional

help of skilled consultants like lawyers, accounting firms, and tax experts. The tax issues can vary significantly according to the type of business and the operations involved, meaning that each operation should be analyzed from a case-by-case perspective.

Calculating the tax the subsidiary will pay is challenging, considering the highly sophisticated Brazilian tax system. Foreign entrepreneurs should take into account this critical step.
If this is the way chosen by the foreign company, there are some measures to be taken. Establishing a corporation to hire employees, open a bank account, and carry out several other tasks is necessary. Brazilian law doesn't allow any representative office. Therefore, there is a need to establish a company in the country.

The vast majority of investors in Brazil adopt the subsidiary model since their shareholders are not responsible for the subsidiary's debts except for specific provisions set forth by specific rules. The investor could also acquire an existing company or assets, which would require a due diligence project. The main decisions will be around incorporating or acquiring a company.

Another issue concerns which format is more appropriate for the business: Ltda. or S.A. There are other types of legal entities. However, they do not apply to companies with foreign Capital. Therefore, the majority of legal entities incorporated in the country are either Limitada" or "S.A.": the Limitada type of business (Sociedade Limitada or Ltda.) is a limited liability company, and a S.A. (Sociedade Anônima) is similar to a corporation.

The Ltda. is usually the preferred vehicle for a wholly owned subsidiary, as formally, the liability of the shareholders is limited to their capital contribution. It is recommended to use this format because a S.A. demands stricter governance rules.

The Ltda. is a legal entity under private law and is defined as Limitada because the responsibility of each partner is limited to the number of shares they own. The power of each partner is limited and bound by approvals defined in the Civil Code. Thereby, the autonomy of each partner is also limited. It is the best option for a small business owner or a startup.
In a Limited company, the costs for establishment and maintenance are generally lower; however, minority quota holders are equally financially responsible. There are no impediments regarding the nationality of the investors. A company can be 100% foreign-owned, but these owners should appoint a local representative, and the company will need a legal representative (manager) who has residency in Brazil (can be a Brazilian or a foreigner with legal residence in the country). Other option doesn't work well even if provided by law.

M&A

Doing Business in Brazil

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Structuring investments The proportion of voting rights and capital contributions

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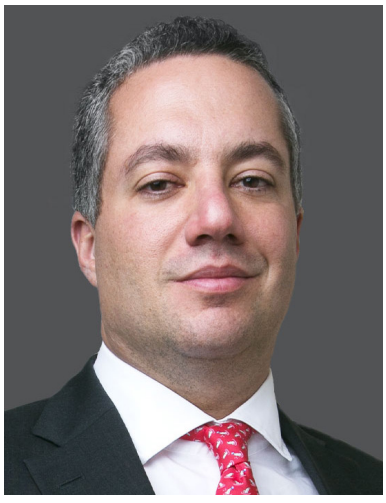

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When structuring a new investment in Brazil, we frequently face the challenge on how to conciliate economical aspects of such investment and the intended governance structure.

It is very usual that, in a brand-new investment structure, the parties have agreed that some will make larger contributions but will be minority shareholders when it comes to voting rights. A common example are private equity investors frequently might make the largest contributions but want an experienced controlling shareholder handling day-to-day business.

However, it is just as usual that both lawyers and financial consultants see it as natural (if not necessary under the law) that there is a certain proportionality between the amount invested by and investor and the voting rights that such investor will hold.

That is so because Brazilian law contains very strict rules on voting rights, even if all shareholders are in agreement on the conditions under which the shares will be issued.

The first and probably most important rule about voting rights is the restriction of number of shares with restricted voting rights. Such shares may only represent up to half of the total shares issued by a company. Moreover, until very recently, Brazilian law adopted unwaveringly the one share one vote principle regarding voting capital stock.

Brazilian law recently allowed for multiple voting shares, an innovation seen by many as a solution to finally stray from the quasi-proportionality between voting rights and capital contributions. Nevertheless, it is important to highlight that such proportionality was never imposed by the law, which already contained some mechanisms which allowed for changing the proportionality between voting rights and capital contributions.

Moreover, the legal restrictions on multiple voting shares make it clear that they were designed for a very specific purpose: companies which have not entered the capital market and which are in the early stages of development, where the controlling shareholder is strategic, but who might lose its relevance as the companies develop.

For that reason, the multiple voting right is not eternal. The ramped up voting rights may only last up to seven years. After the end of the initial term, the shareholders who do not hold such shares would have to approve the renewal of such multiple voting right. The ephemerality of the of multiple voting right is extremely undesirable in structures which will require a stable corporate governance over a long period of time, due to its long investment cycle.

We further highlight that the Brazilian multiple voting shares do not fully stray from the proportionality principle, though. It only allows that each share grants right to up to 10 votes. In the scenario where all shares grant voting rights and issued at the same time, for the same price, this requires that an investor makes at least 9,1% of the capital contributions in order to hold control though multiple voting shares.

Although this seems reasonable, it might render impossible to achieve the aimed governance structure if the capital contributions agreed upon are extremely disproportionate to the voting rights and poses a relevant obstruction to contractual freedom of the parties.

Lastly and probably most importantly, the law imposes that the multiple voting right is automatically terminated in case the shareholder who holds such shares executes voting agreements or transfers their shares. Such limitation not only significantly reduces the

value of such shares, but also renders practically impossible to adopt the mechanism in new investment structures. After all, relevant minority investors will certainly decline not having the usual protective vetoes and appointment rights of a shareholders' agreement with the controlling shareholder.

Since the multiple voting mechanism poses such relevant limitations, as mentioned, other mechanisms should always be considered in new investments.

A strategy which has been proved as extremely flexible is what the Brazilian have coined as the "super preferred share", i.e., a preferred share which grants right to an extremely high dividend and which is issued at an equally high issuance price.

The super preferred shares mechanism was first used as a way to comply with the cap on the number of shares with restricted voting rights whilst raising an high capital contribution. By increasing the dividend rights of the super preferred share and consequently their issuance prices, it is possible to issue a much lower number of shares without limiting the amount of capital which might be raised.

If extrapolated, this shifts drastically the usual assumption that there is a proportion between voting rights and capital contributions.

After all, Brazilian law does not regulate the number of shares which might be issued by a company, only the prices for which such shares will be issued (based on their book, market or economic value). Thus, in an intended structure with extreme disproportion between aimed economic and voting rights, a simple solution is to issue shares so as to finetune the number of votes each party should have and their economic rights.

Example: Investors A, B and C intend to make 90% of all capital contributions and must have proportionate economic rights, but wish to have only 20% of the voting rights; meanwhile, investor D wishes to make 10% of the contributions and have 80% of the voting rights.

An effective way of achieving that would be creating two types of preferred shares, one to be held by A, B and C and a second one held by D. Type 1, held by investors A, B and C, would have to grant economic rights and have an issuance price equivalent to 36 times respectively of the rights and price of the type 2, held by D. That way, the number of type 1 shares - and consequently number of votes - would be shrunk significantly, while maintaining their economic aspects.

In new investment structures, this strategy might be a convenient alternative to multiple voting shares, since it does not pose the challenges addressed above, such as restrictions of voting agreements and cap on votes per share. Instead of modifying the number of votes each share grants, it uses the legal flexibility on the number of shares which might be issued so as to achieve the desired structure.

Whilst this may provide investors with intended disproportionality between voting and economic rights, the paradigm shift proposed by this strategy might face resistance of investors and consultants. Moreover, this strategy is most suitable and easily applicable in new investment structures, as mentioned above, since it might face challenges in existing structures where shareholders are not aligned.

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