

Tax Aspects of M&A Transactions and Direct Investments in Brazil

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São Paulo – Brazil

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How to Invest in Brazil

- Direct foreign investments:
 - Equity participation
 - Loan
- With few exceptions, there is no restriction on nonresident investments in Brazilian companies
- Nonresident direct investments are generally afforded the same treatment as local capital (from a commercial and legal perspective)

How to Invest in Brazil

Equity Participation

- Electronic registration with the Central Bank of Brazil
 - Registration is essential for offshore remittances, capital repatriation and reinvestments of profits.
- Most commonly used types of business entities:
 - *Limitada* (limited liability company)
 - *Sociedade Anônima* (corporation)

Income Tax upon Investments in Brazil

- Taxation of the Repatriation of Capital:
 - Free of tax up to the amount of the capital registered, in foreign currency, with the Brazilian Central Bank
 - Capital in excess of the registered is subject to 15% capital gains withholding income tax (25% if the investor is domiciled in so-called “tax havens”)
- Dividends paid to nonresidents are not subject to any withholding tax.

Financial Transactions Tax upon Direct Investments in Brazil

- Financial Transactions Tax (IOF) is levied at a 0.38% rate upon the foreign exchange transactions related to:
 - Inflow/Outflow of capital in Brazil to invest directly in Brazilian companies, and
 - Outflow related to payment of dividends abroad.

Financial Transactions Tax upon Portfolio Investments and Depositary Receipts

- In order to reduce the appreciation of the BR Real in view of the inflow of international funds, the IOF is levied:
 - Since October, 2009, at a 2% rate upon foreign exchange transactions related to investments in Brazilian Capital Markets (Portfolio Investments), and
 - Since November, 2009, at a 1.5% rate upon certain transactions involving Depositary Receipts.

Instruments for M&A transactions in Brazil

- Merger
- Corporate Consolidation (*Fusão*)
- Spin-Off (*Cisão*)
- Drop-Down
- Transfer of Assets

Corporate Consolidation and Merger

- Corporate Consolidation (Fusão): not frequently used:
 - Both entities lose tax credits and corporate tax deferred assets
- Merger: very frequently used
 - Direct merger
 - Reverse Merger (tax purposes)
 - Merger of shares (indirect control change, alternative to avoid tag along effects. Example: BR Foods - Perdigão and Sadia)

Spin-Off and Drop-Down

- Spin-off (Cisão) is allowed by Brazilian legislation, but requires compliance with the following rules:
 - Appraisal report of the transferred assets
 - 60 to 90 days term for creditors
- Drop-Down is a simplified way to separate businesses:
 - Mitigation of risk of succession of tax liabilities (in the spin-off is certain)
 - Appraisal is mandatory only if NEWCO is a corporation
 - No need to turn public the corporate documents, nor to wait for a 60 to 90 days period

Asset Transfer

- Allowed in Brazil, including transfer of establishment
- Tax inefficient (taxes levied on the transfer and loss of credits)
- Succession of tax liabilities, although less likely, is possible. Purchaser of the assets may be liable for the contingencies related to the “establishment” transferred
- Bureaucratic problems (transfer of permits and taxpayer enrollments)

Antitrust Aspects

- Brazilian antitrust law dates from 1994
- Acts or agreements that may limit or restrict competition are subject to antitrust law, including corporate reorganizations
- Transactions that require antitrust authorities' approval:
 - acquisition of control of more than 20% of a relevant market segment, or
 - transactions in which the gross turnover of any of the companies involved exceed R\$ 400mm (approximately USD 220mm)

Relevant M&A Taxes

- In principle, M&A transactions in Brazil affect only Corporate Taxes (taxes levied on net profits and capital gains), except for the transfer of assets, which may impact other taxes
- Since 1998, goodwill paid for the acquisition of corporate interest can be deducted from Corporate Taxes (amortization in 60 months and benefit of up to 34% of the goodwill paid)
- Goodwill: difference between the amount paid for the corporate interest and the company's net worth (or proportion of such net worth)

Example: Acquisition of Banespa by Santander

- In year 2000, Santander Bank (through its subsidiary in Brazil) purchased Banco Banespa S/A (public bank)
- Amount paid for Banespa was of R\$ 7.05 billion (approx. USD 3.9 billion)
- Banespa net worth equity was of R\$ 4.175 billion (approx USD 3.2 billion)
- Premium registered was of R\$ 2.875 billion (approx USD 1.6 billion)

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