



**BRAZIL**

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In the meantime, German industry can look back on a considerable tradition in Brazil which has developed organically. In Latin America, German companies and their products have an exceptionally good reputation. The first large companies arrived from Germany at the end of the 19th century and beginning of the 20th century, first of all with trading offices and later with production facilities. Many companies – especially Mittelstand companies – followed and today all industrial sectors are represented.

When Brazil in 2010 reported a GDP of USD 2,143 billion, the country – at least in terms of figures – had become an economic power. Despite considerably corrected estimations and forecasts for growth in the following years, Brazil has in total performed well. Recently, however, the country has been characterised by a rather weak economy and is also undergoing political upheaval. In particular, in 2013 the currently growing middle class for the first time expressed clearly their deep-rooted anger and disappointment in public regarding the political reality. These strong feelings seemed to be directed at almost everything including extensive corruption which at least in relation to the authorities and large companies influenced by the state continues to be a daily experience, a complex tax system with a high burden and not much service in return from the state which primarily but not only affects the health system, education (schools and universities) and public transport which continues to be a challenge for employees on a daily basis in combination with a patronising and patriarchal leadership style of the currently dominant PT worker's political party which obviously does not recognise that Brazilians are politically mature citizens.

Notwithstanding this, Brazil remains a stable investment location with positive prospects. Just the expected investments in connection with the soccer world cup in 2014 and the Olympic Games in 2016 are estimated to be three figure billion amounts. But the most important driver of growth by far in Brazil continues to be domestic consumption which is growing steadily. Economists forecast average annual GDP growth of 3.6 % over the next 50 years.

Entrepreneurial success here depends on many different factors. The Brazilian market is complicated, demanding and in many ways is very different to Germany. Adjustments are necessary and investors partly have to dismiss cherished expectations. Yet with all the differences, quality and reliability also pays for itself in Brazil.

## Cultural differences

One of the most significant challenges for a German entrepreneur in Brazil is the Brazilian mentality which is even more different to the German mentality than expected. In addition, the reality of life in Brazil is totally different to the stereotypes which “we” usually have in our heads when we think of Brazil. São Paulo is the economic heart of the country. No beach in sight. No samba in the air.

## Language

Without Portuguese it is even difficult in São Paulo. English (not to mention German) is usually not enough. Claimed knowledge and actual knowledge of language in fact partly diverges to a great extent. In the southern part of the country there are a number of German “enclaves”. But the greater majority of German companies are based around São Paulo.

## Management and relationship of the boss to employees

The hierarchical element is very marked. Brazilian employees expect comprehensive and detailed guidelines. Independent original thinking is not really encouraged. The “ideal” boss is a kind, wise patriarch who never loses his cool.

## Financial accounting

Taxes must in principle be declared every month. The means in practice a closing date for the financial accounting on the day 25 of each month (for example, to enable “dynamic” reporting deadlines) is not possible. In addition to standard tax returns which must all be submitted by the internet, the financial authorities receive a comprehensive monthly overview of all bookings included in the general ledger. In addition, numerous auxiliary calculations and explanations must be submitted with the aim of enabling an automated plausibility inspection.

Personnel expenses are often booked locally as a distribution or appropriation of net income as the local law basically allows this. This practice must be taken into consideration when assessing the economic situation.

The annual financial statement must be prepared by April 30 of the following year.

## Tax law

Brazilian tax law is surprisingly complex and has more than 80 different taxes and contributions which are the responsibility of different tax authorities. In total in relation to the gross domestic product the tax and contribution ratio are roughly comparable to that of Germany.

Remarkable special points in particular exist in the area of commercial taxes. A seemingly simple question such as “How high is the sales tax rate in Brazil?” with regard to an import of goods into Brazil requires the answers to at least the following information:

- › Customs tariff number for the imported goods
- › Value of the goods (CIF)
- › Import port
- › Headquarters of the importing company
- › Headquarters of the end customer
- › Use of the goods at the end customer

Then it is possible to calculate the commercial taxes incurred by the import. These are in total six taxes on transactions each with a different basis for assessment and parties entitled to collect the respective tax: II (customs), IPI (industrial product tax), PIS and COFINS (social contributions), ICMS (sales tax) and IOF (financial transaction tax). II and IOF are always costs. With PIS and COFINS it depends on among other things according to which method the importing companies determine their corporation tax.

ICMS is a state tax with the result that there are 27 turnover tax laws each with a number of rates and different exemptions.

## Transfer of foreign exchange

This is fully transparent. All movements of foreign exchange between Brazil and abroad are subject to control through the Brazilian central bank. If the money is correctly declared in the import process, an export at a later point in time is not a problem.

## Financing

The current interest rates for company financing are between 3 % to 5 % per month if they are at all available for companies. The bureaucratic hurdles are partly considerable.

As a result the German companies finance themselves here either through equity or via shareholder loans. Concerning the tax deductibility of the interest on the shareholder loans the following limits must be complied with:

- › The relationship between equity and the shareholder loan must not exceed 1:2.
- › The maximum permissible interest rate is currently 3.5 % plus LIBOR (here: six month LIBOR in USD – independent of the life of the loan and the currency of the loan)
- › If the limits are exceeded, the interest rates can only be deducted within the described limits.

## Labour law

Due to its extremely one-sided orientation on the employee side the Brazilian labour law constitutes an enormous burden for companies. Originally conceived to protect illiterate farmhands from their brutal masters, it is today with a shocking matter of course attitude even directed at managing directors and therefore naturally leads to results which are difficult to comprehend.

This is all not made easier by the fact that the jurisdiction is not willing to adequately take into account the current legislative difficulties. In fact the reverse is true.

Although this investment obstacle is today the subject of political discussion, it is nevertheless not foreseeable that this will result in corresponding measures.

## Founding a company / principles of company law

The forms of company which exist here are basically comparable with the forms of company known in Germany. However, as the taxation is based on the legal form, more complex structures are not required. In entrepreneurial practice the company with limited liability (Sociedade Limitada, abbreviated to Limitada) is almost exclusively used. This form is relatively easy to manage.

Foreign nationals can found a company in Brazil without restrictions or hold an interest in Brazilian companies provided their activity is not involved in an area which the state protects against foreigners such as the press, broadcasting, television and air traffic.

## Share capital

In contrast to the German GmbH with the founding of a Brazilian Limitada there is no obligation to bring in a minimum share capital. The only exception to this is for companies who have import or export as their company purpose. In this case "sufficient" capital must be available. A fixed rule as what this might mean has not existed up to now. Foreign capital must be registered as an investment at the Brazilian central bank. This ensures that imported capital can later be re-exported.

## Shareholders

A Limitada must be founded by at least two shareholders who can be domestic or foreign legal entities or natural persons. A foreign shareholder, however, has to have a legal representative (Procurador) who must be resident in Brazil and must represent the foreign shareholder with regard to the Brazilian tax authorities and assumes corresponding liability.

## Company purpose

Difficulties with the founding of the company are frequently concerned with the definition of the company purpose in the contract. The company must be able to prove it has business premises where the company can pursue and actually realise exactly this company purpose (e.g. also storage capacity). This is inspected in practice.

## Formalities

As Brazil has not yet ratified the corresponding international agreements, legal transactions – for example the submission of important documents necessary for founding a company (power of representation, commercial register extracts, company contracts, etc.) to the authorities – still require a supplementary attestation for notarial authentication and legalisation through Brazilian representation in Germany (embassy, consulate). Before submission in Brazil the documents must first of all be translated into Portuguese by a certified translator.

## Managing director

The company can have one or more managing directors, whereby their appointment is made in the articles of association or by resolutions. If the managing director is not a shareholder, his appointment requires the approval of two thirds of the shareholders and if not all of the share capital is paid in then even unanimous approval is required. Managing directors can only be appointed if they are Brazilian or have an unlimited residence permit and have a Brazilian tax

number for natural persons (CPF). If a foreigner is appointed, a minimum investment of BRL 600,000 has to be proven to the Brazilian central bank. The managing director can also then receive a permanent visa which is coupled to a period of office for the managing director of five years.

### Amendments to the articles of association

Amendments to the articles of association require a qualified majority of 75 % of the share capital. Companies with more than ten shareholders are subject to stricter requirements for the formalities for calling a shareholders' meeting, whereby this requires timely publication in an official communication organ and three formal announcements in a daily paper with a good circulation.

### Liability of shareholders and the managing directors for certain liabilities

Each foreign shareholder of a Brazilian company requires a legal representative (Procurador) who is resident in the Brazil. The Brazilian financial authorities regularly apply pressure through access to this person's private and business assets if tax, labour law or social security related obligations of the company are not settled. Similar rules apply to managing directors.

# Practical examples

## Auditing

### Background facts:

A German company from the premium consumer sector wanted to acquire a Brazilian family owned company to simplify and accelerate entry to the domestic market. The target company had been active on the market for many decades, had a strong brand and approx. 120 employees in one plant. In commercial terms, this seemed plausible.

In the course of a tax due diligence it was established that on the liabilities side the formally overindebted target company consisted more or less completely of liabilities relating to the areas of tax, social security and labour law. The possibility made available at regular intervals by the Brazilian tax authorities through the Federal Tax Amnesty Program (REFIS) to provide non-declared and/or previously unpaid tax liabilities with a generous discount provided the black sheep would turn into a white sheep had already been exploited on the balance sheet without the existence of the required formal conditions.

In a clarifying, personal meeting with the owner of the target company we were informed that for decades the target company had either not paid taxes and social contributions or paid these after they were due for payment and that this was justified to counteract government corruption.

### What can be done now?

We examined whether it makes sense within the framework of the acquisition to separate the target company from the questionable liabilities in order to even enable the acquisition to take place.

This was unfortunately not possible in Brazil as according to the instrument of the *Trespasse* (similar to the transfer of an undertaking), the acquiring party assumes liability with an asset deal for liabilities in the areas of tax, social security and labour law, backdated by five years plus interest plus penalties.

In such a case a contract designed to reimburse expenses will have practically no effect. The usual procedure to retain part of the purchase price in an escrow account was not possible here as the liabilities and the risks not yet registered from the underlying facts constituted a multiple of the discussed purchase price.

### What should one have done differently from the beginning?

Trust. Observe. Who?

This example brings starkly into contrast the subjects of corruption and tax evasion in the environment of Brazilian family-owned companies. We know from other projects that historically and culturally speaking there is often a different understanding to that pursued by the current compliance standard. This risk can be addressed and qualified through execution of a tax due diligence. Usually – but not always – a practical solution can be found which both sides can agree to.

## Taxes

### Background facts:

An internationally successful company in the field of medical engineering at the premium end of the market has been working for many years together with a distributor in the Brazilian state of São Paulo. In order to further push sales in Brazil, an own subsidiary was founded and the co-operation with the previous sales partner maintained.

With the primary objective of achieving the hoped for growth as quickly as possible without excessive costs, the previous sales partner was formally appointed as managing director of the own subsidiary and the imports were processed through his company. In practice that means his import permit (RADAR) and his approval for the products were used with the health authority ANVISA.

Subsequently the sales targets were mainly met, but with a margin which was considerably below expectations.

### What can be done now?

We examined the previous arrangements and established that the linking of the two companies for the import led to an unnecessary accumulation of trading tax which in turn reduced the margin. Contrary to what one might expect, the accumulation of commercial taxes in Brazil is by no means merely a cash flow theme.

The question of whether for example PIS and COFINS are costs or transitory items depends on the method of the determination of taxable income of the purchasing company. Under some circumstances companies here can choose between *Lucro Real* and *Lucro Presumido*, whereby *Lucro Real* mainly corresponds to a balance sheet determination of income. With *Lucro Presumido* the basis for the assessment is determined simply on the sum of the outgoing invoices and a defined percentage applied to calculate the presumed profit.

This method naturally makes sense when the actual profit is higher than the presumed profit. The more so as loss carried forward can then not be used. Companies in the start-up phase seldom meet these business requirements.

Nevertheless the *Lucro Presumido* is relatively popular with Brazilian family-owned companies as the financial accounting obligations are then markedly lower.

## What should one have done differently from the beginning?

A market entry will often not be successful without checking the business model in advance from a tax point of view. In Brazil even the simplest entrepreneurial practices should be examined to establish whether they make sense.

The reason for these unexpected barriers is mainly the complex Brazilian commercial tax law with a host of taxes (and more than one sales tax) which despite a certain similarity on a meta level in fact when it comes to the details often functions in a way which is different to the way one might expect. European sales tax law does not serve as a blueprint for the Brazilian tax system.