

## Corporate Aspects of Trading and Investing Brazil

### 1. INTRODUCTION

This article is an overview of the most common ways of entering into the Brazilian market and its consequences. It is important to contact a lawyer if you are planning to invest in Brazil.

The legal system adopted in Brazil is codified, with its laws edited by the federal government, States and Municipalities, with due regard for their individual spheres of authority determined by the Federal Constitution.

Therefore, all types of investments follow specific laws that should be observed by the parties involved.

All foreign capital must be registered with the Brazilian Central Bank. Foreign capital is considered to be any goods, machinery and equipment that enter into Brazil for the purpose of production and creation of any goods and services, as well as any capital brought into the Country to be invested in economic activities, provided that they belong to individuals or companies resident or headquartered abroad.

### 2. METHODS OF MARKET ENTRY IN BRAZIL

#### 2.1 DISTRIBUTION AND AGENCY

##### **Distribution Agreement**

The distribution agreement is governed by the Brazilian Civil Code. In accordance with the law that regulates this type of agreement, the distributor acquires the product that will be resold. By this type of agreement, the distributor has exclusivity in determined areas to represent the company in accordance with the contract. The company that is being represented may determine that such distributor cannot represent another company for the sale of the same or equivalent products in the same territory.

The company that is being represented may establish the rules of marketing and commercialization that shall be observed by the distributor in the territory. The risks of the business are on the account of the distributor that imposes to the products a profit margin for resale, in accordance with the rules of the agreement. The distributor must be organized as a legal entity.

Pursuant to article 713 of the Civil Code, the distributor enjoys independence and autonomy to carry out the business. The contracting parties are free to regulate their relationship in the agreement, only observing the restrictions imposed by the Civil Code. However, in some cases (for instance, automotive vehicles), there are specific laws and restrictions imposed by the represented company or by the government that must be observed by the distributor.

## **Agency Agreement**

The Federal Law n° 4.886 of December 9<sup>th</sup>, 1965, amended by Law n° 8.420 of May 8<sup>th</sup>, 1992, has established the agency agreement in Brazil. These laws have the character of public order law, which means that they are cogent rules, so they shall be applied notwithstanding volition of the parties and cannot be countered. This type of agreement is also ruled by the Brazilian Civil Code of 2002.

In this kind of agreement the agent intermediates the business on behalf of a company or several companies. The agent will perform gathering proposals of buying companies and send them to the represented company for the approval.

The law that rules the agency agreement has as its main characteristic the protection of the agent imposing indemnifications in case of rescission. In agreements with effectiveness term, the indemnification to be paid to the agent in case of rescission without just cause shall be equivalent to the monthly average payments received by the agent until the rescission date, multiplied by half of the resulting months of the contract stated period. On the other hand, the indemnification in agreements with indeterminate period shall not be lower than one-twelfths of the total amount received by the agent during the effective time of the contract.

It is important to note that Brazilian Labour Law is very strong in Brazil. Therefore, the represented company should observe carefully the rules before contracting an Agent, taking into account the risk of a labour claim due to this relationship. This does not occur if the Agent is a legal entity.

## **2.2 BRANCH**

It is established in the Brazilian Civil Code that foreign companies need governmental authorization to act in Brazil. The Brazilian government will decide about the authorization and restrictions based on the Brazilian economy. This is a very unusual situation in Brazil. There is a very small number of companies in this Country under this condition, since this is a process that does not present any advantage, is very bureaucratic and takes time to be terminated, given that it needs to be approved by Presidential Decree.

The company cannot start its activities in Brazil before having such Presidential authorization. To support such application the company must present, among other documents:

- evidence of its regular incorporation in its country of origin;
- the company's Article of Association or By Laws;
- list of the members of all administrative bodies;
- the company's act which approved the opening of the branch in Brazil;
- the company's act which defined the share capital in Brazilian currency that the parent company assigns for the Brazilian operation;
- proof that the company appointed a legal representative in Brazil with full powers to accept the conditions determine by the authorization; and
- the last financial statement.

All these documents must be notarized and registered by the nearest Brazilian Consulate, translated by a Brazilian sworn public translator and registered with the Registry of Deeds before being presented to the authorities. Brazil is not party of the Hague Legalization Convention and therefore an apostille certificate cannot be used. Apart from France, with whom Brazil has an Agreement discharging the registration before a consulate, all other countries must follow the mentioned legalization steps. Furthermore all these documents must also be published in the Official Gazette and in a major newspaper.

If all is in order and according to the Brazilian policies interest, the President will by Decree, approve the creation of the foreign branch in Brazil.

By President Decree number 5.664 of January 10<sup>th</sup>, 2006, it is now from the Minister of Development, Industry and Foreign Trade the power to authorize the incorporation of foreign companies in Brazil.

This branch is considered as an extension of the foreign company. Therefore, the Brazilian law establishes that the liability is not limited to its own amount, but to all capital of the company. The foreign company is accountable in Brazilian courts for the acts of its branch in Brazil.

The company must always have a legal representative in Brazil with full powers to represent it.

Any amendment to the company's Articles of Association, Agreement or By-Laws shall depend on the prior government approval to be enforced in Brazil.

The parent company must every year publish its financial statements and its branch's financial statements in the Official Gazette and widely circulated newspaper in Brazil.

## **2.3 CORPORATIONS ("S.A.")**

Corporations are ruled by Law 6.404 from December 15<sup>th</sup>, 1976 and its amendments. As determined by the Brazilian Law a corporation is always a business/commercial company.

The property of a S.A. is represented by shares that can be common, preferred or fruition shares. The amount of preferred shares without voting right cannot exceed 50% (fifty per cent) of the total amount of shares.

Corporations can be (i) a public held company obtaining funds through public offers, or (ii) a closed corporation, obtaining its funds directly from its own shareholders or subscribers, having a simple accounting and administration system. If is a public held company, it shall be supervised by the Securities Commission ("CVM") and will be able to negotiate its shares and papers both in the Stock Market and in the bond market.

### **Formation of a Corporation**

The S.A. is incorporated through a General Assembly held by its shareholders that shall approve the conditions of the incorporation, as well as the By-laws, its administration, company's capital and all other matters involving the S.A. The Minutes of the General Assembly of Incorporation of the S.A. and the By-Laws shall be registered with competent State Board of Commerce and published in a major newspaper and in the State Official Gazette to inform third parties.

These companies must have at least two shareholders. In the act of constitution, the down payment shall represent at least 10% (ten per cent) of the issuance price of the subscribed capital and its payment must be through a deposit in a special account in a Brazilian bank, which is authorized to receive down payments for the purpose of the incorporation of an S.A.

The shareholders shall also approve during the General Assembly the subscription list. This document informs the shareholders of the S.A., the amount and the type of its shares. The subscription list shall also be registered as an attachment of the General Assembly and By-Laws.

The S.A. shall have certain books of registers established in Law 6.404/76, which includes but are not limited to Books of Shares, Books of Transfer of Shares, Books of General Assembly, and others.

It is important to note that the transfer of shares' property is made through its register both in the Book of Shares and in the Book of Transfer of Shares.

Equally the corporate acts of the S.A. must be registered at the Board of Commerce and published in a major newspaper and in the State Official Gazette.

The S.A. also needs to arrange at least an annual assembly, to (i) approve the administrator's accounts; (ii) deliberate about the destination of the net profits and dividends' distribution; and (iii) appoint administrators and members of the Fiscal Council if it's the case. However, the shareholders meetings in an S.A. must, all of them, be published in a major newspaper and in the Official Gazette. If the S.A. has more than 10 shareholders and its net worth is more than R\$ 1.000.000,00 (one million of Reais), the balance sheets of the company must be published in the Official Gazette and in a major newspaper at least 30 days prior to the annual shareholders meeting and also be registered with the Board of Commerce.

The company's capital is composed by shares. The liability of the shareholders is limited to the value of the shares they subscribed or acquired.

The shareholders may sign a Shareholders Agreement establishing the rules for the sale of its shares, vote rights, and other matters, in accordance with the law. The rules established in such document may be subject to specific performance as established in Law 6.404/76.

## **Management of a Corporation**

The corporation shall be formed as follows:

- General Assembly;
- Board of Directors, not obligatory for closed capital corporations. It shall be formed by at least three members. The members of the Board of Directors must be shareholders of the S.A. with at least one share and shall be appointed by the General Assembly. The members can be foreign individuals provided that duly represented in Brazil by an attorney with the powers established in laws;
- Executive Board. It shall be formed by at least two members, which must be Brazilian residents, or if a foreigner, he/she must have permanent visa in Brazil. The members shall be appointed by the Board of Director if it established, or by the General Assembly. Not more than 1/3 of the members of the Board of Directors can be elected as member of the Executive Board; and

- Board of Auditors, not obligatory in cases foreseen in law.

It is important to note that this is a very simple memorandum regarding the rules of the Corporations. The Law 6.404/76 determines specific rules for each case. Besides this Law, there are several laws and regulations of the Securities Commission that must be observed.

## **2.4 BRAZILIAN LIMITED LIABILITY COMPANY**

Limited Liability (*Sociedade Limitada*, "Ltda.") and Corporations (*Sociedade Anônima*, "S.A.") companies are the most common types of association in Brazil.

Beginning with the Limited Liability Companies (Ltda.), these were regulated by a Decree of 1919 until 2002. Since then, a new Civil Code is in force in Brazil, establishing specific rules for these companies.

First of all it is important to mention that a Ltda. is not allowed to negotiate its quotas or other papers neither in the Stock Market nor in any other kind of bond market.

In a limited liability company, the capital is divided into quotas and must have at least two quota holders (two partners). This type of company may be constituted by a foreign individual or legal entity, provided that they are duly represented by an attorney resident and domiciled in Brazil.

The liability of the quota holders is limited to the amount of their quota part in the capital of the company. However, if the capital subscribed is not fully paid, all quota holders respond for the entire capital.

The quota capital can be subscribed and paid by the partners in money, goods, credits or rights at the moment of the signature of Articles or Association, or within certain limit of time established by the same document.

The quotas are not physically represented. The quota part of each partner is represented in the Articles of Association of the company.

The foreign investment must be registered with the Brazilian Central Bank. Any Brazilian company held by foreigners is only allowed to send dividends abroad once this company has its foreign investments properly registered with the Central Bank of Brazil.

Another important aspect is that if one or more quota holders, representing the majority of the company's capital understand that the minority quota holder is a risk for the company, if duly justified, they may exclude this quota holder of the company.

## **3. FORMATION OF A LIMITED LIABILITY COMPANY**

The Ltda. is incorporated with an Article of Association that shall be registered with the Board of Commerce within the State in which the company has its headquarter and branches or with the Civil Registry of Legal Entities, in accordance to the company's purpose. It is important to note that all corporate acts - such as quota holders meetings, openings of branches and others - must be registered with the Board of Commerce to be valid before third parties.

The corporate bodies of the company are the (i) General Meeting and/or quota holders Meeting, (ii) Management, and (iii) an Audit Committee which is not obligatory, all of them established in the Articles of Association through deliberation of the quota holders. We emphasize that if the Ltda. has more than ten quota holders, there will be some changes imposed by the Civil Code regarding the administration, for instance, instead of annual quota holders meeting, a Ltda. with more than ten partners must hold an annual quota holders assembly.

#### **4. MANAGEMENT OF A LIMITED LIABILITY COMPANY**

The company can be managed by one or more Administrator(s) that shall be individuals resident and domiciled in Brazil. The Administrator cannot be a legal entity. This person can be a quota holder or a third party and will be appointed by the quota holders in the Articles of Association or in a side document. The company may be managed by a foreigner with permanent visa and domiciled in Brazil.

The Administrator can be removed at any time through the quota holder's decision observing the legal quorums established in the Brazilian Civil Code or in the Articles of Association.

#### **5. OFFICERS' LIABILITY OF A LIMITED LIABILITY COMPANY**

The administrator of the Limited Liability Companies shall act in accordance with the law and with the Articles of Association, and the side documents that appointed him/her as administrator, with the By-laws, and any other document that imposed the limits for the administration.

If the administrator exceeds such rights or acts against the laws he/she can be personally liable under civil and criminal law.

#### **6. TAXATION OF PROFITS**

To discuss the Brazilian taxation system, one must first understand the political structuring of Brazil. The Federative Republic of Brazil is made up of twenty-six states and the Federal District. These states together have 6,000 municipalities. These three levels of organization (Federal Government, States and Municipalities) have, in terms of the Federal Constitutions, competencies to legislate on different taxes.

Firstly, the Federal Government is competent to institute and collect among others Income Tax, Taxes on Industrialized Products, Import Tax and Contributions (such as social security, taxes on financial activity, intervention in the economic domain). It is the entity with the most elastic competency to create and collect taxes in Brazil.

The main due taxes to the States are Tax on Circulation of Goods (ICMS) and Tax on Motor Vehicles (IPVA).

Finally, the municipalities collect taxes on Services and Urban Property.

As one can imagine, it is a complex taxation system, widely regulated by the Federal Constitution, as well as by the Federal Legislation, which has the role of not only regulating tax collection under the Federal Government's competency, but also of providing on the general themes concerning taxes under competency of the States and Municipalities, aiming at preventing conflicts between said political entities.

The dividend system follows the basic table of Income Tax in Brazil, whose maximum percentage for calculation of the tax is 27.5%. There is a series of exceptions and rules especially applicable to companies, depending on the form of taxation specific to them or that they choose. In certain cases, taxation on dividends does not even exist.

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