Cross-Border M&A can be intimidating at best. At worst, it can be laden with foreign regulations, unfamiliar customs, and countless opportunities for miscommunication and failure. Until now, there has been little in the way of reference for those undertaking such a task. With this in mind, The Alliance of M&A Advisors has called on experts around the world to develop a helpful guide for cross border M&A in their country.

These guides are replete with information on local government regulations, labor laws, tips on compliance, and much more. Each paper includes strategies for navigating local customs; such as making introductions, communicating, and showing respect to your foreign business partners. The Alliance believes that peer to peer sharing of information is our greatest resource. With the information and resources in this paper, we aim to shed light on Cross Border M&A in Brazil and to provide the tools necessary to launch a successful deal.
Cross Border M&A: Brazil

Members of the Alliance of M&A Advisors provided the research and context for the Cross Border M&A white papers. At the Alliance, we know that our members are among the best in their field. We are excited to facilitate this peer to peer sharing of knowledge. Carlos Junqueira Erich Schmid, Patricia Freitas Fuoco, Juliana Meyer Gottardi, Neil Jacobs and Jorge Claudio drew on years of specialized experience with cross border M&A in order to provide the insight in this paper. If you are interested in contributing to a Cross Border paper, please contact the Alliance of M&A Advisors at:

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Background

Brazil is the world’s seventh-largest economy, South America’s largest economy, and the United States’ ninth-largest merchandise trading partner. It is projected to pass both the U.K. and France before 2020, to become the world’s 5th largest economy. The United States and Brazil are working together on key global, multilateral, and regional issues such as climate change and defense. Brazil’s main imports from the United States are petroleum products, machinery, aircraft, electronics, and optical and medical instruments. Brazilian investment in the United States more than doubled to $14.9 billion from 2009 to 2013. The United States is Brazil’s second-largest export market. The primary products are crude oil, vehicles, electronics, and machinery. The United States is also the leading foreign investor in Brazil, with an accumulated foreign direct investment stock of $78 billion in 2013. The United States had a $12 billion trade surplus with Brazil in 2014. By October of 2015, the balance was $4 billion due to the devaluation of the Real.1

1 https://www.census.gov/foreign-trade/balance/c3510.html
Population:

The population of Brazil was 204,561,088 million people in 2014.

Size of the lower middle market:

According to the classification adopted by the Brazilian National Development Bank (BNDES), middle size companies have gross annual revenue greater than R $16 million (equivalent to US $6 million). The middle market is composed by companies with revenues between US $15 to 250 million per year.

Main Challenges in Cross Border M&A in Brazil:

Conducting business in Brazil requires an intimate knowledge of the local business environment and culture, including direct and indirect costs, the so-called "Custo Brasil". These costs are related to distribution, government procedures, employment benefits, environmental laws, and tax structure.

Positive aspects of conducting business in Brazil:

Brazil offers a stable government, a large population, and a respect for the rule of law and private property rights. It is also a large producer of low priced commodities.

Brazilian Culture:

Brazil is one of the world’s most varied and diverse multicultural nations due to its melting pot of nationalities including Africans, Europeans, and Japanese, among others. People are open-minded and tolerant, warm, creative, and rather affectionate.

Personal relationships are important in developing trust. Brazilians need to meet and get to know those they will be working with. There has to be chemistry and that requires several meetings and often a dinner or two. From an American perspective, this can seem slow paced. As to language, local deals are done in Portuguese and international deals in English.

Brazil’s territory covers a significant portion of the South American continent, bordering all countries except Ecuador and Chile. The country’s South and Southeast regions are
significantly more economically and industrially developed than its North and Northeast regions. This is due to a large concentration of industries, which include universities, companies, and financial institutions.

**Communication:**

Brazil’s official language is Portuguese, although communication is not as difficult as one might assume. Many young Brazilian businessmen speak English. If you are dealing with the older generation, their children usually speak English. Also, many of the younger generation have spent time in the U.S. either as a foreign exchange student attending high school or attending college and some have graduate degrees for U.S. colleges.

There is a good telecom system throughout the entire country. Although cellular use is widespread, Internet speed can be spotty in certain parts of the country. WiFi is common in major urban areas. Brazilians are very well connected with new technologies, especially social media (email, mobiles, Skype, Whatsapp, LinkedIn, Facebook, and Instagram).

**Dealing with misunderstandings due to different business norms or different management styles:**

Brazilians are cooperative, informative, laid back (rather than rigid) and generally have little difficulty integrating with other cultures, especially with Europeans and Americans. Brazilian business culture has historically been both hierarchical and patriarchal, leading to a concentration of decision-making power in the hands of a few. In family-held companies, the owners are likely to strongly identify with the business on a personal level.

Upfront agreement on expectations and demands is highly recommended.

**Government and Legal Issues:**

**Government:**

Brazil is a democratic federal republic consisting of 26 states and the federal district where the capital, Brasilia, is located. It has a bicameral legislature (a senate and a chamber of deputies), a fairly strong presidency and an independent judiciary. Brazil has had this form of government since 1889, with a brief period of military dictatorship. Since the return to democratic rule in 1985, it has had national governments consisting largely of center-left parties.
Brazil’s foreign policy, by and large, is neutral politically, owing in part to the fact that it borders 11 other countries.

Brazil is a founding member of the Mercosur regional trade alliance

**Corporate Governance:**

Private companies are not obliged to be audited or to use US GAAP. Traditional Brazilian accounting principles are much stricter than US GAAP. The use of IFRS by private companies is increasing significantly.

**Setting up business in Brazil:**

**Jurisdiction:** From a legal standpoint, Brazil protects private property and respects the rule of law through a codified legal system. As noted, the government consists of the Federal government, states, municipalities and the Federal District and each one of these has the power and autonomy to create its own laws, albeit subject to a hierarchy of authority. Thus, when thinking of investing and creating companies in Brazil, one of the most important things to understand is which public entity is responsible for each matter, so you will know to whom you should address your requests and to whom you should report.

The setup of a business in Brazil can be made in several ways including incorporation of a local company, commercial and/or corporate joint venture, distribution or sales agency contract, direct sales (exportation) to Brazilian customers and other possibilities.

When a company is set up in Brazil, the most frequent form is to incorporate a subsidiary/branch company as a Limitada (“LTDA”). The LTDA is the Brazilian limited liability company, which is easiest to create, since it requires fewer documents and corporate approvals to be incorporated and the partners/shareholders have more flexible rules to adopt with regards to the decision making process. Another type of corporate entity that is used is the Sociedade Anonima (“S/A”), which is the share company that can be privately or publicly held. This form is more often used for corporate joint ventures or larger companies that wish to get funding either through financial institutions or through the securities market.
Stability and protection: The benefits of investing and establishing a business in Brazil, in addition to market and strategic reasons, are a legal system that is stable, and that democracy and protection of private property are indeed realities. No retention or confiscation or seizure will be made by the Brazilian government, as long as all taxes and debts of the business are duly paid. Government approval is not need to repatriate foreign investments to the place of origin. Companies must follow some procedures, such as registering incoming capital with the Brazilian Central Bank. The procedures are clear and very well stated in the laws and lower administrative regulations.

Restrictions: Few restrictions apply to foreigners investing in Brazil. Where there are restrictions, they are usually related to strategic fields of governmental interest. Forbidden or highly controlled industries include: nuclear energy, power supply, ownership of rural areas on frontier zones, post office and telegraph services, aerospace industry, television and news channels.

Taxation Overview

The Brazilian Federal Constitution defines the authority of the Federal Government, States and Municipalities to regulate and levy each of the different existing taxes, while complying with the basic principles established in the Constitution. For State and Municipal regulated taxes, there is usually Federal legislation which must be complied with as well.

Other points to consider about taxation include:

- The Federal Corporate Income Taxes are:
  - Corporate income tax (IRPJ);
  - Social Contribution on Net Profit (CSLL);
- Profits, income and capital gains earned worldwide are subject to Brazilian corporate income taxes.
- Branches of foreign companies, although rare, are generally taxed in the same manner as standalone subsidiaries.
- There are three main methods provided by legislation to calculate corporate income tax and social contribution tax due on profits, the actual profit, the presumed profit and the arbitrated profit.
• Main tax exemptions from taxable income include dividends received from other Brazilian entities.
• Main inclusions are related to non-deductible accounting provisions and non-deductible expenses.
• Tax losses may be carried forward indefinitely. There is no statute of limitations. The offset is limited to a maximum 30% of the annual taxable income.
• The system presumes profit. Companies may elect to compute corporate tax based on presumed net profits, provided they do not:
  o have total revenue in the preceding year higher than BRL 72 million;
  o be financial institutions, similar entities of factoring companies;
  o earn foreign profits, income and gains.
• The selection of a Presumed Profit or Actual Profit basis is made annually at the beginning of the year and may be changed each year.
• Gross Revenue Taxes: The PIS or Programa de Integração Social tax is a social contribution tax payable by corporations to finance unemployment insurance and allowances for low paid workers. COFINS or "Contribuição para o Financiamento da Seguridade Social" is the federal contribution tax. Both are based on revenues and charged on a monthly basis, including income on financial transactions, under two methods: cumulative and non-cumulative.
• There are other indirect taxes including IPI, the Imposto Sobre Produtos Industrializados, a federal sales tax on domestic and imported manufactured products; the ICMS, Imposto Sobre Operações Relativas à Circulação de Mercadorias e Serviços de Transporte Interal e Intermunicipal e de Comunicações a state tax that varies by State and industry; and ISS, the Imposto sobre Serviços, a tax on services provided to a third party by a company or professional that is paid by the service provider.
• Other federal taxes are withheld on income. These apply on certain domestic transactions, such as payment of fees to some service providers, payment of salary and financial income resulting from banking investments.
• CIDE ("Contibuição de Intervenção no Domínio Econômico") is a special contribution levied on payments due to nonresidents for technical services and technical assistance, among others, remitted as royalties.

**Tax Treaties:**

Brazil has signed double taxation treaties with various countries. The main method of tax relief under these treaties is the foreign tax credit. The existing treaties offer very limited opportunities to reduce or eliminate withholding tax payments abroad. Tax sparing clauses are also found in most treaties in force.
Brazil has double taxation treaties with the following countries: South Africa; Argentina; Austria; Belgium; Canada; Chile; China; Korea; Denmark; Ecuador; Spain; Philippines; Finland; France; Hungary; India; Israel; Italy; Japan; Luxemburg; Mexico; Norway; Netherlands; Peru; Portugal; Slovak Republic; Czech Republic; Sweden; Trinidad and Tobago; Turkey; Ukraine; and Venezuela.

**Foreign Exchange Control:**

The Brazilian Central Bank guidelines allow legal entities and individuals to purchase and sell foreign currency and perform international transfers in Brazilian Reals (BRL), regardless of the nature of the operation, with no restriction with respect to the amount involved therein. However, all cross border currency transactions such as transfer of capital, imports, exports, repatriation, payment of dividends, interests and royalties must be performed solely through market agents authorized by the Brazilian Central Bank for such purpose, for example, through banks, exchange brokers, customs brokers and others.

**Labor Laws:**

An advantage of acquiring a Brazilian company, compared to a startup, is that all the legal issues have already been addressed.

Brazil’s labor laws are notoriously restrictive. It is extremely expensive for companies and protective for employees. Salaries cost almost double because of mandatory benefits established in the Federal Constitution and in the Consolidation of Labor Laws (C.L.T.). The existence of a large informal sector is the result. Prospects for significant reform are questionable.

There are four major sources of labor and employment rights in Brazil: the Federal Constitution; the Brazilian Labor Act (Consolidação das Leis do Trabalho, or “CLT”); collective bargaining agreements; and employment contracts (including companies’ common practices).

The Brazilian Labor Code (CLT) provides for a 1/3–2/3 ratio between foreign and national employees, applicable to both payroll and headcount. In other words, a Brazilian company with three or more employees can have a maximum of 1/3 foreign employees and pay a maximum of 1/3 of its total payroll to foreign citizens. Foreign
citizens can be counted as Brazilian for the purposes above if they are Portuguese citizens; foreign citizens with authorization to live in Brazil on a permanent basis, valid for a minimum 10 years; and foreign citizens with Brazilian children or a Brazilian spouse.

As a general rule, an employment relationship is subject to Brazilian Labor Law if the work is performed in Brazilian territory. This general rule is applicable regardless of the employees’ nationality and of the location of admission and signature of the employment agreement. However, there are some scenarios in which a labor relationship governed by Brazilian Law could also be governed by the labor laws of other jurisdictions.

Statutory labor rights include:
- a national minimum wage of approximately US$300 per month
- 30 days of vacation per year
- a vacation bonus (1/3 of the vacation payment)
- a 13th salary (see below under “Employee Rights”)
- Guarantee Severance Fund (FGTS) at 8 per cent of the monthly compensation
- a prior notice for termination of minimum 30 days
- indemnity for unfair termination equal to 50 per cent of FGTS account balance;
- overtime payment
- enrollment in Social Security
- shared payment of transportation costs
- weekly rest

Individual circumstances may also trigger other additional pay (for example, for occupational hazard, unhealthy work conditions and night shifts). In addition, there are also collective labor agreements that are applicable according to the business and location. They are mandatory regardless of union affiliation and valid for up to two years. Employment statutory costs are generally considered to be ‘operational costs’ and therefore subject to income tax deduction, depending on classification by tax law and compliance with the legal conditions applicable.
Employee rights
Established working hours

According to the Federal Constitution, working hours in Brazil should not exceed 44 hours per week and preferably, 8 hours a day. In this case, the employee would have to work 4 hours on Saturday, so what happens in many companies is that employees work an extra 48 minutes every day in order to take Saturday off.

Depending on the job, there are conventions between companies and unions, under which employees will work more than 8 hours a day. This is the case for nurses, guards and other professionals whose job is essential to society. Despite legal determinations, establishing that working hours cannot exceed 44 hours a week and overtime cannot surpass 2 hours a day, it is not uncommon to hear of people who work 10, 12, 14 or even 16 hours a day. Supervision is not very strict when it comes to this and in some cases, workers choose to accept such working conditions and then sue the company once they are gone.

Paid vacations

Every employee working under the CLT regulation has the right of a 30-day rest every 12 months of work. If by the time an employee is dismissed he or she has not taken vacations, then the employer is obliged to pay the employee 1/3 extra of the total vacation’s value.

13th salary

The 13th salary is a gratification equivalent to a month salary and paid in two installments. In Brazil, it is paid in November and December. It is the equivalent of a Christmas bonus in countries like Germany, Argentina and Portugal.
FGTS – Fundo de garantia por tempo de service

Every month 20% of the employee’s salary is deducted by FGTS. This percentage is split between the employee and the employer and varies according to the salary. The percentage paid by the employee goes from 8% (for those who earn up to BRL 1,106.90) to 11% (for those who earn from BRL 1,106,91 to BRL 3,689.66). Those who earn more than BRL 3,689.66 pay a fixed amount of BRL 405.86. The employer undertakes the rest.

Aviso Prévio

Aviso prévio is a notification that must be given by both employee and employer when they are no longer willing to work together. This notification must be given one month prior to the dismissal.

What happens in many companies is a practice called “aviso indenizado”, meaning that the company would rather pay the employee an extra 30 days of work without the employee working or on the premises, rather than having the employee working for 30 days, aware that they are going to be fired.

“Brazilian employers are obliged to cover their employees’ transportation costs and provide a meal for those working 8 hours a day.”

This measure is adopted because employees who are aware that they will be fired within 30 days can cause several problems to the company and be a negative influence among other workers. By law, the employee who quits should also reimburse the company for his leave, but employers rarely charge this.

Leave

The Federal Constitution establishes that pregnant women can take 120 days of leave. Also, with the exception of those working on trial period, they cannot be fired once the pregnancy has been discovered until five months after the baby is born. Fathers have the right of taking five days off when their children are born as well.

Transportation and meals

Brazilian employers are obliged to cover their employees’ transportation costs and provide a meal for those working 8 hours a day. But as with working hours, supervision
is not very efficient and many companies do not offer any meal for its employees, and in some cases, the space provided for them to prepare/heat their meals is precarious.

Regulatory Compliance:

Almost all productive sectors have a regulatory agency that determines the rules specific to its sectors.

The most important ones are:

- ANEEL – Brazilian Electricity Regulatory Agency - http://www.aneel.gov.br/
- INMETRO – National Institute of Metrology Standardization and Industrial Quality - http://www.inmetro.gov.br

Additional agencies and links include:

- Foreign capital registration: www.bacen.gov.br
- Public traded companies: www.cvm.gov.br
- Competition concentration: www.cade.gov.br

“Triggers for cross border acquisitions include the desire for better financial organization, increased access to markets and a great adoption of globally acceptable management routines.”

Triggers for cross border mergers and acquisitions in the middle market:

Brazilian companies can benefit from better financial origination, increased access to international markets and greater adoption of globally acceptable management routines.

For international companies, a large amount of raw material can be acquired and processed in the country with competitive pricing. Brazil is one of the largest producers of commodities, and has prices lower than its competitors. Examples of commodities are sugar, ethanol, coffee, soy, iron, nickel, and others.
There is also an advantage in that the Brazilian middle class is growing, leading to increased domestic consumption and a larger internal marketplace.

The size of the Brazilian internal market makes it a “can’t miss” portion of the global economy. Brazil is the world's 7th largest economy, South America's largest economy, and is projected to pass both the U.K. and France before 2020, to become the world's 5th largest economy.

Other advantages are that Brazil has:
- New anti-bribery law similar to the USA and UK Bribery Law
- Reasonable legal security
- A sophisticated and solid financial market
- Any opportunities in infrastructure, services. TI, foods, etc.
- Several international companies already established in the country.

**Ideal framework for success of cross border acquisitions:**

To successfully execute an acquisition in Brazil a team of professional advisors must be assembled. Just as in doing an in-country acquisition, a duplicate team needs to be established in Brazil. Yes, the costs of due diligence will double (approximately), but this is a necessary expense.

Collaboration and access to both internal and external markets are very important, as well as access to practical information and players.

**Current sector opportunities:**

Information, technology, and internet companies led M&A sectors in Brazil in the first half of 2014, followed by energy companies, services, food, beverage and tobacco, telecommunications and media, and financial institutions according to [KPMG](http://www.kpmg.com/BR/PT/Estudos_Analises/artigosepublicacoes/Documents/Fusoes%20e%20Aquisicoes/2014/FA-2-trim2014.pdf).
Suggestions on building successful post integration strategies in the cross border environment:

Holding frequent seminars and webinars is highly suggested, and an international certification program would be beneficial. It is also useful to create a platform where people can publish opportunities, deals, relevant information, pertinent articles, and related material. Groups on LinkedIn or the company website are not very efficient.
Our Contributors

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