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FOREIGN INVESTMENT IN BRAZIL

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During the last years, Portugal has shown to be an important investor in Brazil and it is under this scope that a major effort has been verified in the relationship between the two Countries. In the first semester of 2004, Portuguese companies have invested US$ 252 million, Portugal being the 6th largest foreign investor in Brazil, with approximately 4,5% of the total investment received during that period.

It is estimated that more than 400 companies with Portuguese capital exist in Brazil, guaranteeing approximately 100 thousand jobs. The sectors covered include mobile telecommunications, energy, road, water and sanitation concessions, car parts, textiles, agglomerated wooden chips, cements and distribution, among other segments, many of which occupy a leading position.

It is important to emphasize that Portuguese investments, particularly in the areas of infrastructures, may intensify under the scope of the PPP – Public Private Partnerships -, with the Federal Law edited at the end of 2004. The aim of the Brazilian Government is to stimulate the creation of joint-ventures between that Government and private companies interested in investing in public structures.

It is gratifying to observe that Brazil is considered as an important and extremely advantageous market for Portugal with excellent business opportunities. In this context we believe that this Edition, setting forth legal aspects for foreign investment in Brazil, may be of relevance.

Sao Paulo, February, 2005

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NEWSLETTER – FOREIGN INVESTMENT IN BRAZIL

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To become a leading emerging market, Brazil has undergone a remarkable transformation from economic isolation to global integration in the last 15 years. Milestones in this development include the privatization program started in 1990, extensive import tariff reform from 1991 to 1993, and the external debt re-negotiation completed in 1994. Control of inflation, however, was perhaps the single most important development contributing to Brazil's recent economic and political stabilization. By containing chronic inflation and promoting fiscal reform, the Brazilian Government inspired domestic and foreign investor confidence and spurred internal consumption and foreign investment levels. Extensive legal reforms consequently followed suit to help Brazil's legal framework keep pace with rapidly changing economic realities, particularly enhanced foreign investment opportunities.

A key legal reform was the 1995 Amendment to the 1988 Federal Constitution, which removed foreign investment restrictions in certain economic sectors, including petroleum, mining, domestic transportation and local gas service activities, by revoking provisions which distinguished between a *Brazilian company* (any company incorporated in Brazil) and a *Brazilian company of national capital* (a company incorporated in Brazil that was effectively controlled, directly or indirectly, by persons physically domiciled or resident in the country or by Brazilian public entities). Foreign investment restrictions remain in certain areas, however, such as nuclear energy, rural property ownership, border activities, mail and telegraph, domestic aviation and aerospace. In addition, foreigners cannot hold more than 30 percent of Brazilian press and broadcasting companies.

Foreign investors have responded favorably to Brazil's market and legal reforms, establishing domestic market presence through a variety of investment structures. Distribution and sales representation agreements with Brazilian individuals and/or companies may be used as preliminary investment vehicles to survey the Brazilian market and often precede the establishment of a direct local presence. Where market conditions support a local presence and associated investment costs, many foreign investors establish a Brazilian subsidiary. Alternatively, foreign investors may seek to conduct activities through a joint venture with, or acquisition of, all or part of, a knowledgeable, experienced and connected local company to complement their strengths. This paper will briefly review each of these investment alternatives and other key foreign investment considerations.

• PRELIMINARY INVESTMENT VEHICLES

Cost savings, among other factors, usually motivate the election of distribution and sales representation activities as a means to survey and participate in the Brazilian market without establishing a direct local presence. Opportunities for cost savings presented by these vehicles, however, should be carefully weighed against the loss of direct control over the manner in which the product is introduced and placed in the market and the resulting market penetration.

In distribution agreements, a Brazilian distributor will be appointed to purchase the products from the foreign supplier and sell the products in the Brazilian market. In sales representation agreements, the sales representatives do not acquire products in their own name, but merely act as intermediaries in the sale of products. In exchange, sales representatives are entitled to commissions based on the total value of products sold by the supplier through the sales representative.

• ESTABLISHMENT OF A BRAZILIAN SUBSIDIARY

Foreign investors often establish a direct local presence through a Brazilian subsidiary, which provides them direct control over activities, management and personnel. In addition to market and management considerations, foreign investors may choose to establish a Brazilian subsidiary alone, rather than enter into a joint venture with or acquire an existing local company, to avoid labor and tax succession concerns associated with such transactions.

Brazilian laws provide for several types of company forms, of which the *Sociedade Limitada (Limitada)* and the *Sociedade Anônima (S.A.) are most commonly used. Other* company forms have enjoyed virtually no acceptance in practice, especially because most of them provide for unlimited liability of their partners.

The election of the company form most suited to the proposed activities should take into account the desired ownership structure, legal flexibility, cost and confidentiality considerations, among other factors, as specific circumstances may warrant. For instance, a *Limitada* may not be adequate in the case of a joint venture, since certain fundamental matters affecting the company require approval from partners representing at least 75% percent of its

capital. On the other hand, and in contrast to the *S.A.*, *the Limitada is not required to publish financial records and* statements, which results in cost savings and confidentiality benefits for the *Limitada. Unlike the Limitada, however, the S.A. may issue securities and other* negotiable instruments. The *Limitada and S.A. are accorded the same treatment* under Brazilian tax legislation; however, the home tax jurisdiction of investors may treat *Limitada and S.A. company profits and losses* differently.

• JOINT VENTURES AND MERGERS AND ACQUISITIONS

The selection of joint ventures and mergers and acquisitions as alternatives to the exercise of activities through a newly created, wholly-owned Brazilian subsidiary is primarily motivated by business factors. From a legal perspective, the decision to establish a joint venture with or acquire an existing Brazilian company should be made only after due diligence investigations and an assessment of the legal risks associated with the relevant business, particularly tax and labor.

Joint ventures are normally structured through the establishment of a company, taking the form of a *Limitada or privately-held S.A.* In the establishment of a joint venture, the preliminary understandings of the parties on various aspects of the proposed business venture and its structure may be recorded in a preliminary agreement *(usually* referred to as a memorandum of understanding). Upon the successful completion of negotiations, the joint venture company is created.

Merger and acquisition transactions commence with preliminary negotiations between the parties on purchase terms and conditions, representations and warranties, non-compete and indemnification provisions, which may be reflected in a memorandum of understanding. As a preliminary, although important, discussion point, the parties to the transaction should consider whether to effect it through an asset or share acquisition, at which time it should be noted that the outcome of due diligence investigations may determine the most cost-effective alternative. Upon the successful completion of negotiations, the manner in which the acquisition is effected will depend on the company form of the target company, as provided by Brazilian laws.

• ANTITRUST PROVISIONS

In general terms, Brazilian law follows the U.S. competition law model, but in Brazil there is no bar on closing and no mandatory waiting period, thereby allowing the parties to close the transaction at their own risk. It is important to note that, although transactions may be closed and implemented before clearance, the Administrative Council for Economic Defense (CADE) has the discretionary power to impose whatever measures it deems necessary to remedy any anti-competitive impacts resulting from a given transaction.

All kind of mergers, acquisitions and associations, including joint ventures, are affected by the Brazilian Competition Law, provided they produce effects in Brazil and certain thresholds established by the law are met. Notifications must be submitted to the authorities within 15 business days as of the execution of the first transaction document by the parties.

• FOREIGN CAPITAL REGULATIONS

The Central Bank of Brazil (BACEN) administers a system for registration of foreign capital, which includes foreign direct investments in Brazilian companies and foreign loans to Brazilian debtors.

The registration of foreign capital with BACEN allows remittances abroad, through the commercial rate exchange market, of capital repatriations and profits with respect to direct investments, as well as payments of principal, interest, fees and commissions in connection with loan transactions.

• VISA REGULATIONS

Except in the case of a member of the board of directors of a corporation, a foreign individual may only act as manager of a Brazilian company when holding a permanent resident visa.

Any Brazilian company may apply for a visa for a foreign individual who is to hold a managerial position in the company if (i) it proves that it has received a foreign investment of at least US$ 50,000, coupled with an undertaking to create at least 10 new jobs in the following 2 years, or (ii) it proves that it has received a foreign investment of at least US$ 200,000, in which case the obligation to create new jobs is waived.

• TAXATION

As a general rule, capital gains earned by non-Brazilian residents are subject to income tax at the rate of 15 percent, to be withheld and paid by the Brazilian source, unless the beneficiary is resident in a tax haven jurisdiction, in which case a 25 percent rate will apply. Capital gains realized outside Brazil in transactions involving assets located in Brazil are subject to Brazilian income tax, even if the transaction only involves non-Brazilian residents.

Dividends payable by a Brazilian company to its shareholders, in and outside of Brazil, are not subject to Brazilian withholding taxes.

Payments of interest made by a Brazilian party to a resident outside of Brazil with respect to loan transactions are subject to withholding tax at a rate of 15 percent, which rate is increased to 25 percent if the beneficiary is resident in a tax haven jurisdiction.

Brazil has entered into treaties to avoid double taxation with several European countries, including Portugal. However, the provisions of the Brazil/Portugal Treaty do not apply to those residents in Madeira and Santa Maria (Açores) Islands who benefit from certain income tax incentives provided by law. In relation to African countries, Brazil has only entered into a treaty to avoid double taxation with South Africa, which is not yet in force since it is pending approval of the Brazilian National Congress.

• INTELLECTUAL PROPERTY

The protection of intellectual property in Brazil was significantly enhanced by recent statutory reforms, including the enactment of a new intellectual property law in 1997.

Under Brazilian law, inventions and utility models are patentable. To obtain a patent for an invention, the inventor must prove its novelty, industrial applicability and the inventive activity involved. Additionally, the invention must not fall into one of the categories prevented from being patented under Brazilian law, such as scientific theories, computer software, surgical techniques, and nuclear-derived compounds, among others. To obtain a patent for a utility model, the object in question or a part thereof must have a functional use and industrial application. It should also present a new shape or arrangement and must involve an inventive process resulting in a functional improvement in its use or its production.

A trademark is defined by law as a visually perceptive distinctive sign which serves to identify the origin of goods, thereby avoiding confusion, deception or mistake as to origin. Trademark rights may only be obtained through registration.

Trade secrets are protected under legal provisions covering unfair competition. Trade secret protection does not require registration and is not subject to any time limitation. The protection accorded to trade secrets will continue as long as its owner can preserve secrecy. The disadvantage of a trade secret, however, is that once it is generally publicly disclosed it will no longer be a *secret and anyone may have access to it.*

In Brazil, non-patented technology or know-how is transferred and not licensed. A long-standing principle in Brazilian law with respect to unpatented technology is that the act of effecting payment for unpatented technology is equivalent to the acquisition of such technology. Therefore, recipients should always be free to continue to use transferred technology after expiration of the term of the agreement. In addition, the recipient should be free to use the technology after any applicable secrecy period has elapsed.

Copyright law in Brazil protects original works of authorship, expressed by any means or fixed in any tangible medium of expression. Following the Berne Convention, registration of copyrights in Brazil is optional and therefore not necessary for the enforcement of rights against third parties.

Software is considered to be a copyrightable subject matter in Brazil. Software is protected for fifty years following its publication, release or creation. Registration is not required for the protection of software copyrights, although the registration of computer programs may be effected. ■

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