Doing Deals in Brazil

Helping you to pursue business success in Brazil

Brazil is likely to become the world's fifth largest economy in less than a decade*: a fast-growing consumer market with high growth potential.

*The Economist

www.pwc.com.br
Brazil is now recognized as a mature country - both politically and economically and as one of the most attractive markets in the world for foreign investment.

The country rapidly overcame the turbulence of the 2008-2009 international economic crisis and has returned a stronger, more attractive global player. The high level of diversification in Brazil’s economy and its broad range of trading partners, coupled with a tightly regulated financial system, were central to mitigating the worst effects of the recent global crisis. Brazil has nearly two decades of political and currency stability, tight fiscal discipline, increasing international reserves, solid macroeconomic indicators and a fast expanding internal consumer market, all of which make the country one of the most promising emerging markets in the world.

Brazil’s success in a generally difficult global economic climate, its government’s aggressive infrastructure plans and an increasing awareness of the investment opportunities that the country offers, along with the discovery of the pre-salt oil fields – a rare event on the global oil scene – have attracted the attention of the world. And as the global appetite for commodities continues to grow and agribusiness gains international momentum, especially in terms of biofuels, Brazil is becoming an ever more important business destination. This in addition to Brazil’s successful bids to host the 2014 FIFA World Cup and the 2016 Olympic Games.

Despite their increasing interest and confidence in Brazil, prospective investors still find it difficult to overcome complex regulatory and legal matters as well as out-dated perceptions of the country’s strengths and weaknesses. To help you improve
We believe that this guide will help you to pursue successful and profitable business ventures in Brazil. PwC professionals are available to provide further information on the matters covered in this publication. Note that professional accounting and legal advice should be taken on relevant Brazilian laws and regulations as necessary.

Fernando Alves
Territory Senior Partner
PwC - Brazil
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Investment Drivers and Challenges in Brazil
1. **Investment Drivers and Challenges in Brazil**

### Why invest in Brazil?

Some of Brazil’s attractions and challenges are shared with its fellow BRIC countries:

**BRICs: Opportunities**
- Rapid economic growth
- High growth rate of GDP per capita
- Increasing market size across all sectors
- An expanding middle class
- Large and growing urban populations
- Burgeoning energy consumption

**BRICs: Challenges**
- Poor infrastructure
- Inefficient governance
- Ineffective law and order
- Widespread corruption
- High levels of inequality and poverty

All four of the BRICs (Brazil, Russia, India and China) are globally perceived as offering huge opportunities and potential for growth. However, the challenges for investors in Brazil are smaller than for those in other emerging economies.

Brazil is rich in natural resources, it has a young workforce and a largely unexploited domestic market: this is a country with great potential. Having constructed over the last decades a durable platform for growth on the pillars of economic and political stability, Brazil is as well placed as ever to capitalize on its potential.
Brazil’s Key Advantages

Brazil however has a number of qualities that sets it apart from other destinations for investment:

**Governance and finance:**
- Brazil is a settled democracy with well established governmental and administrative institutions
- Following the adjustment of macroeconomic fundamentals and the improved stability of political institutions, its economic climate is no longer volatile
- There is increasing international trade and globalization and the Government promotes policies favoring exports
- There are new regulations in place favoring minority shareholders, and promoting corporate governance and better accounting practices
- It has strict, modern environmental legislation
- It has a sophisticated, resilient financial and banking system
- Inflation has been under control for almost a decade and a half

**The business environment:**
- Brazil is currently the world’s sixth largest economy and the largest in South America; it is expanding its presence in world markets
- The country has large, well-developed agricultural, mining, manufacturing, and service sectors, with a broad industrial base: in short, it is a diversified economy
- Brazil has been given an Investment-Grade rating by all the major risk agencies
- Foreign investors are eligible for most available fiscal incentives, including tax deductibility of goodwill under certain conditions
• There has been significant improvement in local capital and debt markets, with an increasing number of IPOs in recent years
• There has been a significant reduction in the country risk perception over the last few years
• Brazilian business is facing a transformational period with the introduction of better corporate governance and accounting procedures followed by the convergence of local accounting and auditing standards with International Financial Reporting Standards (IFRS)
• Whilst corruption remains widespread, problems of physical security have greatly improved in recent years

Geography:
• Brazil offers a business-friendly environment for US and European investors (there are no major cultural differences affecting business)
• It is highly urbanized when compared to other emerging market countries
• The whole country speaks one language
• The country has a creative, flexible labor force
• It does not suffer from natural disasters such as earthquakes and hurricanes
• It maintains peaceful relations with neighbor countries
• From Brazil, investors have tariff-free access to the other members of the Mercosur free trade zone (Brazil, Argentina, Chile, Venezuela, Paraguay and Uruguay)
Resources:
• Brazil has immense resources in energy, minerals and raw materials
• It is self-sufficient in oil and is a world leader in the development and production of low emission fuels and biofuels, especially ethanol

The future:
• According to The Economist, Brazil will be world’s fifth largest economy in less than a decade
• Many local companies are undervalued and in need of restructuring, capital and technology
• There is a fast-growing consumer market with high growth potential, especially among the middle-classes
The main investment drivers

Brazil was the first Latin American country to emerge from the international recession. It has overcome the recent turbulence in the world economy and has emerged stronger and more attractive to investors. From approximately one year after the bankruptcy of Lehman Brothers, there was an increased awareness around the world that the actions Brazil had taken were effective in fighting the recession.

The economic impact of the recent global financial crisis and demand downturn was less severe for Brazil than for the USA, Europe and Asia. This was a consequence of a successful public-private long term commitment to growth, involving a combination of factors such as decades of political stability, fiscal discipline, strong international reserves, solid macroeconomic indicators (based on a focus on inflation control) and the strengthening of the middle class consumption power.

The government reacted promptly with the implementation of anticyclical measures to sustain the credit flow, especially to the automotive industry and households, and the level of consumption of durable goods. These measures contributed to a lower unemployment rate and economy recovery. A high degree of diversification in Brazil’s economy and trading partners, as well as a sound financial system – leveraged by active regulators and the Central Bank – have also helped to mitigate the effect of the crisis in the country.

The Rousseff administration has been closely monitoring inflation and economic growth goals. In order to boost internal consumption, the Federal Government has recently announced incentive programs especially in relation to the industrial sector, due to lower than expected growth noted in 2011.
Although the global environment remains difficult and the Brazilian export sector continues to struggle as a result - compounded by a strongly appreciated real - the size of Brazil (with 2011 GDP of approximately US$2.5 trillion) and the strength of its domestic demand has propelled its economy into recovery.

However, long term strategies and investments (including pre-salt oil exploration opportunities) are now top of the government’s agenda. This effort is expected to bring results in the medium to long term. Some regions, in particular the NorthEast, now have the challenge to reach out for opportunities that are already available for the rest of the country. The country’s social inequalities are also being addressed. The government has made significant progress in attacking poverty (including the “Bolsa Família” program).

Financial and strategic investors are seeing these opportunities and Brazil is viewed as a highly attractive investment destination. Cross-border merger and acquisitions and strong capital markets will play an important role.

Brazil deserves close attention while it prepares itself for the future. The country has huge infrastructure demands and a need for further public and private investment in education and healthcare. Top priorities on the government’s agenda include structural tax reforms and tight control on government expenses to spur the country’s economic growth.
The main investment challenges

Despite significant progress, investors still face numerous challenges. There is a complex tax and labor regulatory environment, with high taxes and social charges on payroll, sales and income. Multiple taxes and fast changing legislation can affect business plans and increase risks for contingent liabilities, potentially blocking the success of both asset and stock acquisitions. There are also complex transfer pricing and foreign capital registration rules.

Brazilian companies may not comply with corruption or anti-bribery laws, including the Foreign Corrupt Practices Act and the UK Bribery Act 2010. They may also have undisclosed off-balance sheet transactions and commitments, which can result in the loose application of accounting rules. There is a generally low quality of historical financial information of businesses and it may not fully adhere to generally accepted accounting practices. A significant number of small and/or family-owned businesses may require investment in post deal integration issues in areas such as corporate governance, internal controls, integration of IT platforms, HR related matters etc.

Brazilian companies may not be organized optimally. There may be difficulties in reorganizing companies quickly, since there are high costs for employee terminations. There is also a considerable amount of bureaucracy and regulation for certain businesses and industries. In certain regions and even in some industries, there may be nepotism: “knowing who” is often more important than “knowing how”.
In some, less industrialized, areas of the country, there is a need for further investment in distribution channels and infrastructure. Weaknesses in the education system may also impair the supply of sufficiently skilled labor. This goes hand in hand with Brazil’s social inequality and uneven distribution of wealth.

More generally, Brazil still lags behind in investment in innovation and research and development, and Brazilian firms still suffer from poor brand recognition outside the country, although this is improving.

A recent change to anti-trust regulation came into effect on May 29, 2012, with the requirement for pre-approval from CADE (Anti-trust Agency) whenever one of the parties in the transaction has revenues in Brazil equal or higher than R$ 400 million in the previous year and the other party has revenues in Brazil that’s equal or exceed R$ 30 million in the previous year (these numbers are likely to be increased to R$ 750 million and R$ 75 million, respectively).

Presented below are examples of common difficulties typically faced by investors when contemplating doing deals in Brazil (pre investment and post investment, in no particular order).
The main issues usually identified in due diligence processes involving Brazilian target companies

- Material tax, environmental and labor risks and contingencies
- A certain level of informality in the operations (e.g. unrecorded transactions, two sets of books)
- Significant related party transactions with inadequate documentation (e.g. family costs)
- A lack of or an inadequate internal controls environment (resulting in poor quality of financial information)
- Inadequate accounting practices, triggering significant accounting adjustments (to EBITDA, net income and net assets) and tax risks
- A lack of regular control account reconciliations
- Inadequate cash management

The main reasons for unsuccessful business deals in Brazil

- Unexpected tax and labor problems
- Excessive legal formalities/bureaucracy
- Low quality of available information
- Market volatility
- Insufficient due diligence prior to investment
- Underestimation of deal execution time
- Overestimated synergy/restructuring gains
- Low quality of acquired management
- Inefficient post-acquisition monitoring
The Economic Environment
2. The Economic Environment

2.1 An Overview of Brazil

Key Figures

- Population: estimated at 192 million
- 26 states and one federal district (Brasília)
- 2011 GDP: US$2.5 trillion
- Currency: Real (rate of US$1 to approximately R$1.82 as of March 31, 2012)
- Language: Portuguese

Political Organisation

- Federative Republic of Brazil
- Presidential and state elections held in October 2010
- Former president Mr Luiz Inácio Lula da Silva democratically elected his successor Mrs Dilma Rousseff (Workers Party)

Economic Overview

Facts and Figures

- Brazil is the largest economy in Latin America and the seventh largest in the world
- The GDP per capita was approximately US$12,000 in 2011
- Primary economic sectors are: agriculture, automotive, utilities, transport, industrial products, mining and energy
- Some main natural resources include bauxite, gold, iron ore, manganese, nickel, phosphates, platinum, tin, uranium, petroleum, hydropower and timber, among others
- Main agricultural products include coffee, soybeans, wheat, rice, corn, sugarcane, cocoa and citrus, among others
- Export items include iron, soybean, automobiles, soybean oil and derivates and aircraft, among others
• Import items include petroleum, vehicle parts, electronic micro parts, medicines, among others
• The main ports and harbors are Tubarão (ES), Itaqui (MA), Santos (SP), Itaguaí (RJ), São Sebastião (SP), Paranaguá (PR), Aratu (BA), Rio Grande (RS), Belém (PA), Angra dos Reis (RJ)

Population
• Brazil has the largest population in Latin America and the fifth largest in the world
• Approximately 70% of the people are concentrated in the Southeast and Northeast
• Life expectancy is approximately 72 years
• Some 27% of the population is under 14 years of age and only 6% is over 65 years
• The country is highly urbanized: only 14% of the population lives in rural areas
**Geography**

- São Paulo is one of the fastest-growing cities in the world
- Twenty other metropolitan areas of Brazil have populations of more than 1 million
- The population of the São Paulo and Rio de Janeiro states are approximately 42 million and 16 million, respectively

- The main economic regions are: São Paulo, Rio de Janeiro, Minas Gerais, Paraná and Rio Grande do Sul
- The GDP per capita in the Southeast, South and Midwest regions is much higher than in the North and Northeast regions

<table>
<thead>
<tr>
<th>Region</th>
<th>Population</th>
<th>Land Mass</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In millions</td>
<td>%</td>
</tr>
<tr>
<td>Southeast</td>
<td>80.9</td>
<td>42.1</td>
</tr>
<tr>
<td>South</td>
<td>28.4</td>
<td>14.8</td>
</tr>
<tr>
<td>Midwest</td>
<td>13.8</td>
<td>7.2</td>
</tr>
<tr>
<td>North</td>
<td>15.4</td>
<td>8.0</td>
</tr>
<tr>
<td>Northeast</td>
<td>53.6</td>
<td>27.9</td>
</tr>
<tr>
<td></td>
<td>192.1</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: IBGE – Instituto Brasileiro de Geografia e Estatística
### 2.2 A Summary of Recent Economic Activity

After a period of unstable and truly unpredictable worldwide economic activity in 2010 and 2011, Brazil is reaping the benefits of consistent policy making over the past 15 years. M&A activity is stable at record levels, with multi-sector and multi-regional activity, totaling 750 deals announced in 2011.

The global economy is facing a shock-filled period, still looking for the path to recovery and growth. Though still under political stress and with some instability in economic indicators, the US has seen growing signs of economic recovery. Europe, with its political leaders also facing challenges, still has significant financial issues remaining and the Central Banks have played decisive roles with capital injections and debt guarantees and restructurings. China has slowed down its economic drive, while events in Japan and the Middle East have impacted the global economy and related future projections. Brazil has withstood the international economic crisis and emerged as a stronger and more attractive global player. A high degree of economic diversification, combined with a strong domestic consumer market and a broad selection of trading partners, further coupled with a regulated financial system, have been key to successfully mitigating the worst effects of the crisis. The long period of domestic economic instability in Brazil has been overcome. Both politically and economically, Brazil is now a mature country and one of the most attractive markets in the world for foreign investment.
Brazil’s positive environment is the result of serious and long-term strategy programs and homework. Of course Brazil was also impacted by the international crisis and after an impressive GDP expansion of 7.5% in 2010, the country experienced more modest growth of 3% in 2011. Consistent with the international context, a steady decline in economic activity was observed throughout the year, and in the second half of 2011 growth approached almost zero. Both domestic and international factors contributed to explain this. At the domestic level, Brazil tightened its monetary policy in the last quarter of 2010 and the first half of 2011 to mitigate concerns over an overheated economy and price increases – which threatened to drive inflation out of control. Since the end of 2010, consumer prices have increased at a pace of around 7% per year - above the target inflation rate of 4.5% and above the ceiling of the inflation band of 6.5%. It was clear then that the labor market was experiencing high demand, as shown by the all-time low unemployment rate of 6% and clear real wage increases.

In this context, during 2011 the Brazilian Central Bank imposed restrictions on the capacity of the banking system to expand credit by raising required reserves on demand and time deposits and by tightening capital requirements for lending transactions. At the same time, it raised the basic interest rate from 10.75% to 12.5% in the first half of the year. The federal government also imposed a tax on the inflow of foreign capital (IOF tax) to avoid further exchange rate appreciation.

On the other hand, the extraordinary fiscal expansion inherited from the Lula administration (2003-2010) was somewhat mitigated by the Rousseff administration (started in 2011). It is true that the fiscal austerity declared by the new government was more rhetoric
than effective, since federal spending, in real terms, has continued to increase well above the growth of GDP. Rousseff’s government, however, did make efforts to preempt expenditure-increasing proposals in Congress throughout the year.

At the international level, the financial crisis in Europe and the slow recovery in the US had a dampening effect on the growth of emerging countries in general, Brazil included. As is well known, the crisis created impacts through three distinct channels: first, by deteriorating business expectations and reducing investment plans by firms; second, by making credit more difficult and more expensive to obtain in the international capital markets; and third, by limiting the expansion of exports. In the case of Brazil, these three factors became significant in the second half of the year. In fact, throughout 2011 exports expanded 27.3% largely due to the good economic performance of emerging economies, especially China – Brazil’s main trade partner today. As one of the major exporters of primary goods, Brazil depends on the continuing growth of world demand and the stability of commodities prices. The unfolding of the crisis in Europe, China’s performance and their impacts on the world economy will be important influences on the performance of the Brazilian economy in 2012.

On the financial side, Brazil’s situation has been comfortable so far. The current-account deficit of US$ 53 billion in 2011 was totally financed by foreign direct investment (FDI) of US$ 66 billion – a record level. In addition, Brazil is today a net creditor in the world economy, with reserves of US$ 352 billion and total external debt of US$ 301 billion. The structure of the balance of payments makes the country much less vulnerable than in the past, although not immune, to a temporary disruption in world financial markets, as was seen in 2008.
The economic environment in 2011 produced heterogeneous impacts on asset prices. In reaction to the worldwide uncertainty and stock markets, Brazilian companies lost value throughout the year. The BOVESPA index fell 18% in reais (R$) and 24.5% in dollar terms in 2011. The IPO market, which saw some 25 new issues during 2010 and half that amount in 2011 is now more selective and still recovering from the financial crisis. The bulk of foreign investments have been directed at exploring the opportunities offered by the growing domestic market.

But the outlook and boom of the domestic real estate market proceeded unabated, as revealed by the increasing prices of such assets and the flow of investment in the sector. A combination of factors explains this growth: repressed demand built up in the past, substantially lower real interest rates, an increase in the supply of long-term credit, and the inflow of foreign capital to the sector. Despite the recent expansion, it should be pointed out that mortgage credit in Brazil is still very low (c.5% of GDP) and still has room for expansion.

On the political front, the first year of the Rousseff administration was marked by a series of political scandals, which resulted in the replacement of six cabinet ministers. These situations result from the way political power is shared among the many parties of the alliance supporting the government in Congress. A more comprehensive shake-up of cabinet ministers is expected for the beginning of 2012. Finally, at the end of the first year of her term, President Rousseff is enjoying an even higher rate of approval than her predecessor Lula in the same period.
2.3 The Outlook for 2012

In the second half of 2011, the Brazilian Central Bank reversed its course of monetary policy, as it became clear that the economy was heading towards the stagnation of demand, despite inflation still being well above the target level. This action showed a change in the role of the Central Bank and its relationship with the government. Contrary to the previous ten years since the adoption of the inflation targeting framework, Brazil’s monetary authority is now less autonomous and more in line with overall government policy. Inflation is still a priority, but the Bank keeps an eye on growth as an equally important objective. Although this change in policy caused some mistrust in financial markets, the weakening of economic activity in the second half of 2011 proved the Central Bank was right in reducing interest rates and relaxing credit restrictions imposed in 2010. It is noteworthy that real interest rates are presently at their historical low, in the range of 4% per year (the Central Bank rate) with chances of yet further decreases, compared to the average of 8% over the past five years. Despite the more expansionist monetary policy, the economic outlook for 2012 has been reassessed in the direction of slower growth and higher inflation. At this point, and given the prospect of a weaker worldwide economy, it is believed that 2012 GDP growth will remain near 3.5%, with inflation still remaining as an area of attention and at risk of exceeding the target rates.
The economic outlook for the next few years remains positive for Brazil, although perhaps not as bright as before, given the enormous difficulties developed economies are facing to overcome the financial crisis since 2008 and return their economies to full employment and fiscal sustainability. It is feasible for Brazil to expand at long-term rates of c. 4% per year, based on the still strong domestic market and on the exploitation of the many investment opportunities. Brazil’s robust balance of payments and strong reserve position provide a guarantee that the economy will suffer only moderately from the effects of a stagnant world economy.

At the political level, Rousseff’s government will face two key challenges in 2012. The first is to use the opportunity of changes in cabinet ministers to improve the governance and administrative efficiency of sector-specific programs and policies. The federal investment program known as PAC (Programa de Aceleração do Crescimento), for instance, has been criticized for lagging far behind their targets, mainly due to poor execution of some key infrastructure projects and effective management. The fact that Brazil will host the FIFA World Cup in 2014 and the Olympic Games in 2016 requires a huge effort to implement the PACs and other investment programs on a more timely and efficient basis. The government’s second challenge is to resist the pressures from Congress and its own party (PT) to expand current expenditures, as witnessed by the annual real increases of the minimum wage and the extension of social programs. In 2012, Brazil will hold municipal elections, which are not only important in themselves, but also tend to indicate prevailing opinion and political alliances for the presidential elections in 2014.
The crisis in the developed world, especially in Europe, has opened a window of opportunity for Brazil, alongside other emerging countries, to attract foreign long-term capital, to increase its investment rate and to modernize its economy. Seizing this opportunity requires its macroeconomic foundations to be in order and a friendly and predictable investment environment to be maintained. The Brazilian government seems to be aware of that opportunity and the conditions to use it.

Finally, the outlook for the next few years is one of continuing growth at reasonable rates (4% per year), in a context of stable inflation and equilibrium in the balance of payments. Certain imbalances in the economy will have to be resolved, however, if this positive outlook is to remain. Though from a positive angle Brazil is today more predictable and stable, a number of challenges still linger, ranging from economic (federal expenditures, currency stability and investment volume) through education and skilled labor to infrastructure and fiscal challenges.
## Summary of historical economic indicators

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<tbody>
<tr>
<td>GDP (US$ billion) (1)</td>
<td>506.0</td>
<td>554.0</td>
<td>664.0</td>
<td>882.0</td>
<td>1,089</td>
<td>1,336</td>
<td>1,636</td>
<td>1,577</td>
<td>2,144</td>
<td>2,475</td>
</tr>
<tr>
<td>Real GDP growth (% per year)</td>
<td>2.7</td>
<td>1.1</td>
<td>5.7</td>
<td>3.2</td>
<td>4.0</td>
<td>5.7</td>
<td>5.1</td>
<td>(0.6)</td>
<td>7.5</td>
<td>2.7</td>
</tr>
<tr>
<td>Unemployment rate (% of labor force)</td>
<td>10.5</td>
<td>12.4</td>
<td>11.5</td>
<td>9.9</td>
<td>10.0</td>
<td>7.5</td>
<td>6.8</td>
<td>6.8</td>
<td>5.3</td>
<td>4.7</td>
</tr>
<tr>
<td>General price index - IGP-DI (% per year)</td>
<td>26.4</td>
<td>7.7</td>
<td>12.1</td>
<td>1.2</td>
<td>3.8</td>
<td>7.9</td>
<td>9.1</td>
<td>(1.4)</td>
<td>11.3</td>
<td>5.0</td>
</tr>
<tr>
<td>Consumer price index - IPCA (% per year)</td>
<td>12.5</td>
<td>9.3</td>
<td>7.6</td>
<td>5.7</td>
<td>3.1</td>
<td>4.5</td>
<td>5.9</td>
<td>4.31</td>
<td>5.91</td>
<td>6.5</td>
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<td>Exchange rate at year’s end (R$/US$)</td>
<td>3.63</td>
<td>3.08</td>
<td>2.93</td>
<td>2.44</td>
<td>2.18</td>
<td>1.78</td>
<td>2.39</td>
<td>1.75</td>
<td>1.69</td>
<td>1.84</td>
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<tr>
<td>Exchange rate change (% per year)</td>
<td>53.8</td>
<td>(19.3)</td>
<td>(7.1)</td>
<td>(15.8)</td>
<td>(5.9)</td>
<td>(16.9)</td>
<td>34.1</td>
<td>(25.3)</td>
<td>(3.96)</td>
<td>8.9</td>
</tr>
<tr>
<td>Public sector deficit (% of GDP)</td>
<td>4.2</td>
<td>4.6</td>
<td>2.3</td>
<td>6.6</td>
<td>5.2</td>
<td>2.6</td>
<td>2.0</td>
<td>3.3</td>
<td>2.5</td>
<td>2.7</td>
</tr>
<tr>
<td>Public sector debt (% of GDP)</td>
<td>50.5</td>
<td>53.5</td>
<td>48.2</td>
<td>48.0</td>
<td>45.9</td>
<td>43.9</td>
<td>38.4</td>
<td>42.8</td>
<td>40.4</td>
<td>38.0</td>
</tr>
<tr>
<td>Goods exported</td>
<td>60.4</td>
<td>73.1</td>
<td>96.5</td>
<td>118.3</td>
<td>137.5</td>
<td>160.6</td>
<td>197.9</td>
<td>153.0</td>
<td>201.9</td>
<td>256.0</td>
</tr>
<tr>
<td>Goods imported</td>
<td>47.2</td>
<td>48.3</td>
<td>62.8</td>
<td>73.6</td>
<td>91.4</td>
<td>120.6</td>
<td>173.0</td>
<td>127.7</td>
<td>181.9</td>
<td>226.2</td>
</tr>
<tr>
<td>Trade balance</td>
<td>13.2</td>
<td>24.8</td>
<td>33.7</td>
<td>44.7</td>
<td>46.1</td>
<td>40.0</td>
<td>25.0</td>
<td>25.2</td>
<td>20.3</td>
<td>27.0</td>
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<tr>
<td>Current-account balance</td>
<td>(7.6)</td>
<td>4.1</td>
<td>11.7</td>
<td>14.0</td>
<td>13.6</td>
<td>1.5</td>
<td>(28.3)</td>
<td>(24.3)</td>
<td>(47.5)</td>
<td>(53.0)</td>
</tr>
<tr>
<td>International reserves</td>
<td>37.8</td>
<td>49.3</td>
<td>52.9</td>
<td>53.8</td>
<td>85.8</td>
<td>180.3</td>
<td>206.8</td>
<td>239.0</td>
<td>288.6</td>
<td>352.9</td>
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<td>Foreign direct investment (2)</td>
<td>14.1</td>
<td>10.1</td>
<td>18.1</td>
<td>15.1</td>
<td>18.8</td>
<td>34.6</td>
<td>45.0</td>
<td>25.9</td>
<td>48.5</td>
<td>66.6</td>
</tr>
<tr>
<td>Total foreign debt (3)</td>
<td>227.7</td>
<td>235.4</td>
<td>220.2</td>
<td>188.0</td>
<td>199.4</td>
<td>240.5</td>
<td>262.9</td>
<td>277.6</td>
<td>350.4</td>
<td>400.3</td>
</tr>
</tbody>
</table>

(1) At the year-average exchange rate.
(2) Including intercompany loans.
(3) Information from web site http://www.redegoverno.gov.br
Brazil’s interest rates have historically ranked amongst the highest in the world.

Source: Diário oficial da União
Brazil’s GDP is the highest of Latin America, driven by its large and developed agricultural, mining, manufacturing and service sectors.

GDP Evolution

GDP Evolution

Source: IBGE – Instituto de Geografia e Estatística
Despite increasing pressure in the last 2 years, Brazil has kept inflation under control in the last decade.

**Brazilian Inflation Index (IPCA) evolution**

Source: ipeadata (Presidência da República - Secretaria de Assuntos Estratégicos)
Robust economic performance coupled with favourable international conditions have conveyed significant capital inflow to Brazil impacting the value of the local currency (Brazilian Real).

Exchange rate reached US$1.00 = BRL2.00 in mid May 2012 following worsening of international crisis.
There has been a significant reduction in the country risk perception over the last few years.
Total exports showed a significant increase in 2011 (27% from the prior year), despite the overappreciation of the Real caused by, among other reasons, record-breaking foreign direct investments and the significant inflow of funds attracted by the high interest rates. Note that since 2009 China has become the most significant destination of Brazil’s exports, overtaking the United States.

Main exports / imports - by country

<table>
<thead>
<tr>
<th>Country exports (US$ Millions)</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011*</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>10.749</td>
<td>16.403</td>
<td>20.191</td>
<td>30.786</td>
<td>20.044</td>
</tr>
<tr>
<td>United States</td>
<td>25.314</td>
<td>27.648</td>
<td>15.740</td>
<td>19.462</td>
<td>11.753</td>
</tr>
<tr>
<td>Netherlands</td>
<td>8.841</td>
<td>10.483</td>
<td>8.150</td>
<td>10.228</td>
<td>6.639</td>
</tr>
<tr>
<td>Germany</td>
<td>7.211</td>
<td>8.851</td>
<td>6.175</td>
<td>8.138</td>
<td>4.437</td>
</tr>
<tr>
<td>Japan</td>
<td>4.321</td>
<td>6.115</td>
<td>4.270</td>
<td>7.141</td>
<td>4.090</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>-</td>
<td>-</td>
<td>3.727</td>
<td>4.635</td>
<td>2.283</td>
</tr>
<tr>
<td>Russia</td>
<td>3.741</td>
<td>4.653</td>
<td>2.869</td>
<td>4.152</td>
<td>2.994</td>
</tr>
<tr>
<td>Italy</td>
<td>4.464</td>
<td>4.765</td>
<td>3.016</td>
<td>4.235</td>
<td>2.747</td>
</tr>
<tr>
<td>Chile</td>
<td>4.264</td>
<td>4.792</td>
<td>-</td>
<td>4.258</td>
<td>2.679</td>
</tr>
<tr>
<td>Others</td>
<td>77.327</td>
<td>96.626</td>
<td>76.072</td>
<td>90.357</td>
<td>50.199</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>160.649</strong></td>
<td><strong>197.942</strong></td>
<td><strong>152.995</strong></td>
<td><strong>201.915</strong></td>
<td><strong>118.303</strong></td>
</tr>
</tbody>
</table>

Source: Secretaria do Comércio Exterior (Brazilian Trade Balance Consolidated Data Report)

*From January to June. Total exports in 2011 reached US$256.0 billion
United States and China are historically the main providers of Brazil’s imports. Total imports in 2011 reached US$226 billion, an increase of approximately 25% compared to 2010.

<table>
<thead>
<tr>
<th>Country imports (US$ Millions)</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011*</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>18.887</td>
<td>25.810</td>
<td>20.183</td>
<td>27.249</td>
<td>15.862</td>
</tr>
<tr>
<td>China</td>
<td>12.618</td>
<td>20.040</td>
<td>15.911</td>
<td>25.593</td>
<td>14.740</td>
</tr>
<tr>
<td>Argentina</td>
<td>10.410</td>
<td>13.258</td>
<td>11.281</td>
<td>14.426</td>
<td>7.991</td>
</tr>
<tr>
<td>Germany</td>
<td>8.675</td>
<td>12.025</td>
<td>9.866</td>
<td>12.552</td>
<td>7.098</td>
</tr>
<tr>
<td>South Korea</td>
<td>3.391</td>
<td>5.412</td>
<td>4.818</td>
<td>8.422</td>
<td>4.965</td>
</tr>
<tr>
<td>Japan</td>
<td>4.610</td>
<td>6.807</td>
<td>5.368</td>
<td>6.982</td>
<td>3.956</td>
</tr>
<tr>
<td>Nigeria</td>
<td>5.273</td>
<td>6.706</td>
<td>4.760</td>
<td>5.920</td>
<td>4.632</td>
</tr>
<tr>
<td>France</td>
<td>3.525</td>
<td>4.678</td>
<td>3.615</td>
<td>4.800</td>
<td>2.559</td>
</tr>
<tr>
<td>Italy</td>
<td>3.347</td>
<td>4.612</td>
<td>3.664</td>
<td>4.838</td>
<td>2.874</td>
</tr>
<tr>
<td>India</td>
<td>-</td>
<td>-</td>
<td>2.191</td>
<td>4.242</td>
<td>2.572</td>
</tr>
<tr>
<td>Others</td>
<td>49.885</td>
<td>73.849</td>
<td>45.990</td>
<td>66.625</td>
<td>38.088</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>120.621</strong></td>
<td><strong>173.197</strong></td>
<td><strong>127.647</strong></td>
<td><strong>181.649</strong></td>
<td><strong>105.337</strong></td>
</tr>
</tbody>
</table>

Source: Secretaria do Comércio Exterior (Brazilian Trade Balance Consolidated Data Report)
(*) From January to June. Total imports in 2011 reached US$226.2 billion
Despite exporting a diversified range of products, commodity based items have historically played an important role in Brazil’s foreign sales.

### Main exports / imports - by product

<table>
<thead>
<tr>
<th>Exports (in US$ million)</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011(*)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transport material</td>
<td>27.026</td>
<td>16.160</td>
<td>21.748</td>
<td>11.827</td>
</tr>
<tr>
<td>Soybeans &amp; produce</td>
<td>17.986</td>
<td>17.251</td>
<td>17.115</td>
<td>12.717</td>
</tr>
<tr>
<td>Sugar &amp; Ethanol</td>
<td>7.873</td>
<td>9.716</td>
<td>13.776</td>
<td>5.797</td>
</tr>
<tr>
<td>Metallurgical products</td>
<td>23.047</td>
<td>11.104</td>
<td>12.948</td>
<td>8.868</td>
</tr>
<tr>
<td>Paper &amp; Pulp</td>
<td>5.834</td>
<td>5.001</td>
<td>6.769</td>
<td>3.560</td>
</tr>
<tr>
<td>Coffee</td>
<td>-</td>
<td>4.251</td>
<td>5.739</td>
<td>3.942</td>
</tr>
<tr>
<td>Electrical equipment</td>
<td>6.500</td>
<td>4.694</td>
<td>4.815</td>
<td>2.187</td>
</tr>
<tr>
<td>Footwear &amp; Leather</td>
<td>-</td>
<td>2.764</td>
<td>3.513</td>
<td>1.870</td>
</tr>
<tr>
<td>Others</td>
<td>47.568</td>
<td>35.377</td>
<td>40.284</td>
<td>21.039</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>197.942</strong></td>
<td><strong>152.995</strong></td>
<td><strong>201.915</strong></td>
<td><strong>118.303</strong></td>
</tr>
</tbody>
</table>

Source: Secretaria do Comércio Exterior (Brazilian Trade Balance Consolidated Data Report)

(*) From January to June. Total exports in 2011 reached US$ 256.0 billion.

<table>
<thead>
<tr>
<th>Imports (in US$ million)</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011(*)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital goods</td>
<td>35.929</td>
<td>29.690</td>
<td>40.995</td>
<td>22.753</td>
</tr>
<tr>
<td>Oil and fuel</td>
<td>31.466</td>
<td>16.745</td>
<td>25.344</td>
<td>16.461</td>
</tr>
<tr>
<td>Consumption goods</td>
<td>22.525</td>
<td>21.523</td>
<td>31.426</td>
<td>18.265</td>
</tr>
<tr>
<td>Intermediate goods</td>
<td>83.277</td>
<td>59.689</td>
<td>83.884</td>
<td>47.858</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>173.197</strong></td>
<td><strong>127.647</strong></td>
<td><strong>181.649</strong></td>
<td><strong>105.337</strong></td>
</tr>
</tbody>
</table>

Source: Secretaria do Comércio Exterior (Brazilian Trade Balance Consolidated Data Report)

(*) From January to June. Total exports in 2011 reached US$ 256.0 billion.
Brazil is gradually increasing its participation in global international trade.
Europe and the US have been the main foreign direct investors in the last five years with the manufacturing and services sectors being the main drivers, followed closely by agriculture. Leading countries investing in Brazil have historically been The Netherlands, USA, Spain, Germany, France and Japan. Foreign direct investors have increased significantly in recent years, peaking in 2011, when FDI totalled US$67 billion.

![Bar chart showing foreign direct investor (in US$ billion) from 2005 to 2011.]

Source: Banco Central do Brasil
M&A and Private Equity Activity
3. M&A and Private Equity Activity

3.1 2011 M&A Activity and the 2012 Outlook

During the 1990s, Brazil began to welcome increasing numbers of foreign investors, following a series of liberalizing structural changes, including moves towards a more open economy, privatization and deregulation of key sectors. The country then experienced several years of flux resulting from a number of crises in other emerging economies and high levels of foreign and domestic debt. This was combined with uncertainty over the direction of economic policy following the election of the Lula government that many commentators believed would lead Brazil back to a condition of unstable exchange rates, erratic growth and low levels of M&A activity and Foreign Direct Investment. Instead, the Lula government continued the sound economic policies of its predecessors and a period of strong growth commenced that, with the exception of the hiatus following the 2008/2009 downturn, continues until today.

Brazil saw a record 800 deals announced in 2010 and sustained this level in 2011, with 750 announced transactions. In comparison with 2010, we observed a slight decrease of 6%, but still saw an increase of some 16% over 2009 and 4% over 2007 – the previous all-time record level. The Brazilian M&A market is a testament to the strength of the country’s economic environment and prospective growth. While international market sentiment about M&A recovery this year has swung between optimism and skepticism, in Brazil there...
is a positive momentum in what looks to be sustained activity. Strategic and financial investors (Private Equity) have reached historical record levels of deal making, supported by a solid macroeconomic environment and tremendous consolidation opportunities. Confidence – a key driver for M&A activity – has been further boosted by low unemployment rates, access to credit and c.40 million new consumers. Middle-market M&A activity remains strong and is expected to drive M&A in 2012.

Majority stake transactions accounted for 56 percent of all announced transactions. Both strategic and financial investors are participating aggressively in the fast developing Brazilian economy. Growth is being accompanied by the expansion of both the type and origin of investors, as well as the nature of targeted sectors.
The 2010/2011 record in the number of announced transactions reflects the excellent state of the Brazilian economy and demonstrates the political and social maturity of the country, despite international developments in the post-crisis era.

In a period which was undermined by uncertainties about the performance of international economies, Brazil emerged stronger and more attractive to investors, largely due to its speedy recovery relative to larger and more mature economies like the USA and the Eurozone countries. Private equity players reinforce themselves as they act as an alternative for companies seeking new capital resources and opportunities to consolidate sectors. Apart from its main objective in increasing value, private equity stimulates Brazilian companies in mid and long term planning, besides continually seeking best practices in management and operations.
Additional information on the profile of the Brazilian M&A market

Buyers
- Local and multinational firms
- Private equity and buy-out funds
- Government and private pension funds
- Distressed debt conversions

Targets
- Private companies
- Family owned businesses
- Privatization
- Carve-out of acquired non-core businesses
- Non-core or distressed businesses of multinational companies

Transactions with deal value over US$ 100 million

Source: PwC Corporate Finance
Foreign and domestic capital participation in M&A activities

Brazilian investors participated in 400 business deals, representing 63% of all acquisitions (controlling and minority stake deals).

Foreign investors took part in 237 transactions, or 37% of the total business deals. The incentive to invest in Brazil is evident when one observes the level of participation of foreign investors in the total number of transactions. Such a movement should reinforce the new momentum attained, particularly in terms of stable, transparent growth, as demonstrated by the Brazilian economy.

Aquisition deals by origin of buyer (*)

Source: PwC Corporate Finance

(*) Does not include mergers, joint ventures and spin offs.
IPO activity

Thirty eight Brazilian companies came to market in 2011 (including follow ons), against thirty six in 2010 and twenty five in 2005. Brazil’s record year for IPOs was 2007, when 64 companies raised 55.6 billion Brazilian Real ($33.3 billion).
3.2 Private Equity

Private Equity in Brazil continues to gain momentum

While worldwide private equity-backed M&A activity has been severely affected over the past 3 years, Brazil’s M&A environment has been different. Private Equity activity has reached record levels. After representing 30 percent of the deals announced in Brazil in 2009, Private Equity reached 43 percent of the deals announced in 2011 (this share was 11 percent in 2006).

The Brazilian private equity market has been stimulated by a combination of several factors that have strengthened Brazil’s position not only as an emerging market alternative to China, but currently as an attractive alternative to more developed markets that have experienced a much slower return to growth. A combination of factors, such as increasingly sophisticated and liquid capital markets, new financing instruments and existing exit alternatives, along with the continuing demonstration of political and economic stability, have opened the eyes of foreign Private Equity investors to Brazil, which is now regarded as a serious player in the global market.

Capitalized and with some US$15bn available for investments, a significant part of Private Equity activity in Brazil has involved consolidation opportunities in “cash for investments” deals. The largest investors in 2011 were in the food and drink segments, along with real estate construction, consumer goods, IT, education and the financial and energy sectors. Additionally, deal size has started to increase from the small- to mid- market transactions that have historically dominated the market.
The presence of the large funds that have traditionally operated in Brazil (like AIG, Advent, GP, Banco Pátria and Gávea) has continued to grow alongside the entrance and/or confirmation of interest in the country (as published in the media) of firms including Blackstone, Carlyle, GE Capital, One Equity Partners, Morgan Stanley, Apax Partners and CVC. All these players are competing for investment opportunities with other local and international funds as well as with strategic investors.

**Brazil has a multi-sector profile in M&A**

Strengthened by the dimensions of resources and the extensive possibilities in the country, M&A activity is spread across several sectors.

A multi-sector and multi-region deal profile was observed in 2011, with the leading sectors by deal volume being IT, Consumer Products (including Food/Agribusiness & Beverages, Healthcare and Cleaning products), Mining, Services (Healthcare, Education and general services) and Chemicals/Oil & Gas. Next in significance were Financial Services, Logistics, Retail and infrastructure/construction. The largest sector holds some 10% of total deal activity in terms of volume, with the other sectors following close behind.

The approach of the Private Equity industry in Brazil is wider and funds in Brazil tend to be more flexible in terms of interest to be acquired and investment size. The typical deal size remains low, although a number of larger business deals are increasingly being seen.
Who is already investing?

Approximately 140 Private Equity and Venture Capital firms have invested in Brazil through over 230 investment vehicles. Private equity investors more than trebled their share of the Brazilian M&A market over the past four years. Some of the Private Equity investment highlights in 2011 were:

- BTG acquired 70% of Casa & Video and 37.64% of Panamericano Bank
- GP Investments acquired 65% of Fogo de Chão
- Panamericano bank and BTG acquired BRFE – Brazilian Finance for R$ 1,215 billion
- Itaú Unibanco sold 100% of Orbitall shares to Stefanini Group
- Pepsico acquired Mabel
- Fleury acquired Diagnoson
- XP Investments acquired Interfloat
- GP acquired 56% of Sascar for US$ 680 million
- Brazil Trade Show was acquired by Informa Group
- Laep acquired Daslu for R$ 65 million
- Samba Tech acquired Videolog
- Volluto Fund acquired Pássaro Marron and Litorânea for R$ 400 million
- Publics Group acquired 70% of DPZ
- BP acquired 50% of Tropical Bioenergia
- Boa Vista Serviços acquired Equifax
What to expect for the near future in the Brazilian M&A Market?

Expectations are that the Brazilian M&A and investment context will continue to mature and reach new levels. Given the continued interest of strategic and financial investors, the main sectors of investment will continue to be food and consumer goods, healthcare, education and outsourcing services, real estate, energy and finance, with consolidation in all these sectors continuing to be a key driver. Infrastructure, given Brazil’s structural deficiencies, and oil & gas are also sectors likely to see improvement in activity. Companies in Brazil are facing a transformation period. With better corporate governance and accounting procedures (IFRS has been mandatory for large companies since December 2010 and a more simplified and optional set of rules has been established for mid-size companies), most Brazilian companies are experiencing the challenges of being transformed from a local business into a regional, then a national and finally an international operation.
Culture
4. Culture

This section presents an overview of Brazil’s culture from the point of view of investment.

Language

Brazil’s official language is Portuguese. There are no significant local dialects or other derivations from the official language, but a number of words and phrases vary from those used in Portugal. English is the most used foreign language in the business community.

Religion

The predominant religion is Roman Catholicism. Many other religions are also practiced, since immigrants of different creeds have settled in Brazil. The constitution guarantees freedom of religion.

Education

The government offers free state and subsidized private educational facilities from primary school through university, with full- or part-time curricula. The government also subsidises national apprenticeship training programs as preparation for various industrial and commercial sectors, as well as an educational program to reduce illiteracy among adults. About 90 percent (2008) of the adult population is considered to be literate. The general level of education requires considerable improvement. Approximately 9.5 percent of enrolled students go on to higher education.

Improvements in the public’s education levels have been observed compared to the previous decade.
**Living standards**

The standard of living of a large proportion of the population is very low, while that of the top stratum is extremely high. Whilst improving, this income gap between the rich and poor has been a constant preoccupation of successive governments. Basic social indicators underscore the differences in regional development.

GDP per capita was approximately US$12 thousand in 2011.

**Cultural and social life in Brazil**

With its mixed background of Portuguese, Italian, German, Japanese, East European, Middle Eastern and African immigrants, Brazil offers a wide diversity of cultural and social activities depending on the region of the country. Most major cities support cultural institutions. Leisure and recreation activities are mainly outdoors, taking advantage of the favourable climate. Many social clubs in Brazil offer extensive sports and social facilities.
The attitude of the local business community towards foreign investment

In general, the attitude of local businessmen towards foreign investment is welcoming. Certain sectors have exerted strong lobbying pressure in order to protect their activities, including the imposition of trade barriers and the establishment of restrictions on foreign investment. In the past, such political pressure was quite successful but since the early nineties, the government has gradually improved this situation as it seeks to generate more efficiency and competitiveness in the business environment.

Workforce attitude towards foreign investment

If foreign investment and management can be seen to bring jobs and compete on an equal basis with Brazilian businesses, the attitude of the workforce tends to be welcoming.

Cultural perception of Due Diligence

The need for a potential investor to perform detailed analysis and due diligence has been accepted by sellers of local businesses in Brazil. However, the purposes of due diligence are not always clear in the minds of local businessmen and the staff of target companies. It is sometimes thought to be some form of audit work or to be limited to an analysis of the company’s financial, tax and legal positions.

The existence of generally less homogeneous accounting and reporting systems, and less sophisticated financial and accounting departments in medium and small sized Brazilian companies, renders the preparation of due diligence information and the execution of due diligence exercises generally more difficult and time-consuming than in more developed countries.
5. **Accounting Principles and Audit Requirements**

**Audit requirements and practices**

- Financial institutions and other entities under the jurisdiction of the Central Bank, as well as insurance companies, are required to publish annual and semi-annual audited financial statements.

- The quarterly financial information of listed corporations and financial institutions must be filed with the appropriate regulator (the CVM or Central Bank) and, in certain cases, reviewed by an independent auditor.

**Investor considerations**

- Public/listed “S.A.” corporations are required to publish their annual financial statements.

- The annual financial statements of all listed companies and all “large companies” (entities with total assets of over R$ 240 million or annual revenue over R$ 300 million) must be audited by an independent auditor registered at the Brazilian Securities Commission (CVM).

**Statutory requirements**

**Digital books and records**

In January 2007, Federal Decree 6022 instituted the Public Digital Bookkeeping System – SPED, a tool that unifies the activities of receipt, validation, storage and authentication of documents and books which integrate the taxpayer’s commercial and fiscal bookkeeping, through a single, computerized flow of information and the use of digital certification.
SPED is an integrated initiative of the federal financial administration for three different areas: the Digital Fiscal Bookkeeping (*Escrituração Fiscal Digital* - EFD), Digital Accounting Bookkeeping (*Escrituração Contábil Digital* - ECD) and the Electronic Invoice (*Nota Fiscal Eletrônica* - NF-e).

The Accounting SPED – ECD tool is intended to replace the need to issue hardcopy accounting books with softcopies. The general journal (*livro diário*), general ledger (*livro razão*), auxiliary books and the trial balances and balance sheets will be generated as part of a set of digital documents. The project includes the presentation of information for the federal, state and, hereafter, municipal tax authorities, as well as for the National Registration Department of Commerce (Departamento Nacional de Registro de Comércio), the Central Bank (BACEN), SUSEP and the Brazilian Securities Commission (CVM). These accounting books must be delivered by the current deadlines.

The Fiscal SPED - EFD tool encompasses the preparation and the delivery of comprehensive tax information to both Federal and State tax authorities, aiming to provide detailed information regarding tax computations and invoices issued/received by the Companies.

The whole SPED initiative is getting more and more sophisticated, with the inclusion of additional information which comprises PIS and COFINS information, electronic services invoices, electronic freight services invoices and the electronic taxable income control register (E-LALUR), among other relevant tax information.
**Audited financial statements**

The annual financial statements of the following entities must be audited by independent auditors registered at the CVM, the Central Bank and other government agencies, as applicable:

- Listed corporations
- “Large companies” (as defined above)
- Financial institutions and other entities under the jurisdiction of the Central Bank
- Investment funds
- Stock exchanges
- Insurance companies
- Private pension funds

Financial institutions and insurance companies must also have their semi-annual financial statements audited. The quarterly financial reports of listed entities supervised by the CVM must be reviewed by independent auditors, in certain cases.

**When a private corporation does not have independent auditors, the company’s audit committee (conselho fiscal) may appoint them at the corporation’s expense if it is believed that this is necessary for the fulfilment of its responsibilities.**

Even when not required by regulation or bylaws, banks and other financiers frequently require audited financial statements from borrowers.

The tax authorities do not require audited financial statements.

Internal auditors cannot be used as statutory auditors.
Auditing standards

Brazilian accounting and auditing standards were converged in 2010 with the International Financial Reporting Standards (IFRS) issued by the IASB and International Standards on Auditing (ISAs) issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB), respectively.

The information here is not a comprehensive source for assessing and understanding audit requirements and practices. We strongly advise you seek help from your accounting consultants when assessing these matters.

Accounting principles and practices

Investor considerations

- Law 11,638, enacted in 2007, modified the Brazilian Corporate Law and legislation regarding the Brazilian securities market and the CVM. Although the accounting professionals, standard setters and regulators were already committed to seeking convergence with International Financial Reporting Standards (IFRS), these modifications to Brazilian Corporate Law were necessary to provide the flexibility and agility to move forward in that direction.
• Several new Brazilian accounting pronouncements were issued by 2010 and full convergence with IFRS was achieved for consolidated financial statements. Individual financial statements are prepared in accordance with accounting practices adopted in Brazil. These practices differ from IFRS applicable to separate financial statements only in relation to the measurement of investments in subsidiaries, associates and jointly-controlled entities based on equity accounting, while IFRS requires measurement based on cost or fair value, and, at the transition date, the option of maintaining the balances of deferred charges as at December 31, 2008, which are being amortized.

• Financial institutions must prepare their financial statements in accordance with Brazilian Central Bank regulations. When these financial institutions are listed companies or are obliged to have an audit committee, they shall also prepare consolidated financial statements in full compliance with IFRS as issued by the IASB.

• All small and medium entities in Brazil must apply the accounting practices adopted in Brazil for Small and Medium size entities, which is in compliance with the IFRS for SMEs.

• As there may be other differences and specific considerations related to the transition noted here throughout certain industries, we strongly advise prospective investors seek assistance from accounting consultants during due diligence investigations.
Tax Issues
6. **Tax Issues**

**Preliminary comments regarding the tax environment in Brazil**

The tax system is highly regulated and extremely complex and it is difficult, if not impossible, to structure a transaction in order to avoid or eliminate succession liability.

There are also a number of other factors which increase the risk in this area, including the nature of the legislation (sometimes with an emphasis on form rather than substance of transactions), the frequency of tax audits performed by Federal, State and Municipal authorities, the incidence of relatively high penalties and interest charges in the event of non-compliance and an enforcement process which is difficult to predict (and at times arbitrary).

It is also important to consider the fact that the statute of limitations for most taxes and social charges in Brazil is of five years. In case of fraud, the statute of limitations period does not apply.

During the statute of limitation period, a company can be inspected by the federal, state and municipal tax authorities regardless of the fact that a certain tax or fiscal period has already been examined. In other words, even though a certain tax or period have been already submitted to inspections, it does not mean that the taxpayer cannot be afterwards inspected and assessed by the tax authorities, to the extent that statute of limitations period is still in place.
With respect to succession liabilities in Brazil, the responsibility to pay current and previous tax and labour liabilities, both known and unknown, generally follows the legal entity, based on the concept that the owner of the operating assets or the acquirer of the business unit retains the capacity to generate income and hence, pay the tax or labour liabilities. As a result, when structuring the transaction as a stock acquisition, the buyer steps into the shoes of the previous owner with respect to all tax and labour liabilities and contingencies.

Regarding transactions that involve asset acquisitions, as a general rule, in the case of a purchase of a set of assets which do not comprise a business unit and where the seller continues with operate, the responsibility for the past tax contingencies continues with the seller company. This is also valid for the Brazilian direct taxes.

However, if the set of assets which are envisaged to be sold comprise one or more of seller’s business units, there would be a risk of buyer being challenged/assessed by the Tax Authorities in regards to the tax contingencies generated prior to the asset acquisition, specifically related to the ICMS (State VAT) and, potentially, to the IPI (Federal Excise Tax). In addition, whether most of seller’s operational assets are transferred or sold to the buyer, there is also a risk of the tax authorities challenging the buyer for the past contingencies related to the other main Brazilian taxes (PIS, COFINS, IRPJ and CSL – taxes on revenues and corporate income taxes).

Penalties - Tax debts may be subject to penalties from 20% to 150%. For federal taxes, if the taxpayer voluntarily pays the tax debt before initiating any tax inspection, the penalties shall be imposed at 20% of the tax debt.
The penalties are increased to 75% in the case of the payer being assessed by the relevant tax authorities and to 150% in the case of fraud. Both penalties (75% and 150%) can be reduced up to 37.5% and 75%, respectively, if the taxpayer decides not to challenge the assessment made by the tax authorities and pays the tax debts assessed.

**Tax treatment for foreign investors**

As a general rule, local and foreign investors are treated equally as regards investment and tax benefits. There are no special Federal tax incentives to attract foreign investors, with a few exceptions such as the capital gain taxation and investments through private equity funds (named “FIP”).

**Stock acquisition**

The most common means used by foreign companies to invest in Brazil is through the acquisition of a Brazilian target entity through the purchase of its shares.

This acquisition method has several tax and labour implications for the buyer. From a legal standpoint, the business unit retains its identity in all respects including its taxpayer identification number. As a result, the buyer will step into the shoes of the former owner and become liable for, any known and unknown tax and labour contingent liabilities. In addition to this, the buyer will be also liable for any fines and penalties imposed by the tax authorities regardless of whether such fines or penalties relate to target activities prior to or after the transaction. When acquiring the stock of a Brazilian target company, caution must therefore
be exercised so that the major tax and labour contingent liabilities can be identified, measured and analyzed, and so that the buyer can factor the cost of the liabilities into the overall investment decision. However, this situation could be managed by the parties, by inserting a tax indemnity, and representations and warranties clauses in the Stock Purchase Agreement with proper counterguarantees given by the seller.

Provided that certain conditions are met, foreign investors can benefit from an acquisition structure according to which the tax “goodwill” paid for the acquisition of an interest in a Brazilian company is tax deductible over a five-year minimum period. For Brazilian tax purposes the tax goodwill would consist of the positive difference between purchase price and the net equity value of the acquired interest in the Brazilian company. Please see further comments over the next pages.

**Purchase of assets and assumption of liabilities**

A foreign investor may, for a variety of business reasons, structure the acquisition of a Brazilian target company as an asset purchase of the business unit (operating assets), and assume part or all of the related liabilities. As we mentioned above, unlike a stock acquisition, in the case of a purchase of a set of assets which comprises a business unit and in the case of the seller continuing to operate, the responsibility for the past tax contingencies continues with the seller company. This is also valid for the Brazilian direct taxes. However, the tax authorities may firstly audit and challenge the buyer due to the fact that, in this case, the tax register number of the acquired business unit would be owned by the buyer. In this hypothesis, the buyer would have to challenge the tax assessment imposed by the tax authorities and take all legal procedures to have the sellers recognized as the responsible party for the payment of the past tax contingencies.
In regards to the direct taxes (CIT, PIS and COFINS), the responsibility for past contingencies in the case of the sale of an entire business unit continues with the original (seller) company. In this case (direct taxes) the tax authorities would likely challenge the original company not the buyer.

**Types of investment mechanisms in Brazil**

Besides private deals, a foreign investor has typically two other alternatives when investing in a Brazilian company. They are (i) acquiring shares directly on the Brazilian stock exchange market and (ii) investing in a FIP (Equity Investment Funds). Accordingly, under certain circumstances the capital gains on the disposal of such investments made in the Brazilian companies are not subject to local taxation, provided they meet certain requirements, as per local tax and corporate legislation.

In summary, capital gains derived from sales of shares of listed companies on the Brazilian Stock Exchange (Bovespa) are not subject to taxation when the foreign investor is not located in a jurisdiction considered by the Brazilian tax authorities as a low tax jurisdiction (“tax havens”) and the investment was made in accordance with the Brazilian Monetary Council (i.e. investors qualified by the Resolution 2,689, issued by the National Monetary Council).

In regards to an foreign investment through a FIP, in summary, non-resident investors may be granted 0% taxation provided that certain conditions are met such as: (i) 90% or more of the FIP’s portfolio must consist of shares, convertible debentures or warrants issued by Brazilian companies; (ii) debt instruments cannot exceed 5% of the total FIP’s portfolio; (iii) FIP quota holders (individually or together with related parties) must not hold 40% or more of the total quotas issued by the
Brazilian FIP (iv) FIP quota holders (individually or together with related parties) cannot benefit from 40% or more of the income arising from the FIP; and (iv) a direct foreign quota holder of the FIP cannot be domiciled in a tax haven.

**CFC rules**

Brazilian resident companies are taxed on worldwide income. Foreign branch profits are taxed as earned and foreign subsidiary profits are taxed when distributed or made available to the Brazilian controlling company. Profits are considered available to the Brazilian controlling company at the time the CFC closes its financial statements at the end of its fiscal year.

The CFC’s profits are subject to Brazilian corporate income taxes at the combined rate of 34%. Double taxation is avoided by means of foreign tax credits.

There are no tax breaks to encourage the location of multinational companies’ headquarters and administrative offices in Brazil and/or the use of Brazil as a base for offshore financial operations.

**Investing directly from abroad X Investing through a Brazilian vehicle**

The advantage of investing in Brazil through a Brazilian vehicle is that this alternative may allow a potential tax deduction in Brazil of eventual tax goodwill paid upon the acquisition, which is not possible in Brazil if the acquisition is made directly from a company abroad.
Note that, in theory, the existence of an intermediary holding company is neutral from a pure tax perspective, as dividend distribution is not subject to taxation. However, it may naturally bring some additional administrative costs to the group as well as determine additional taxation of any interest on net equity paid by the operating company to the holding entity, for PIS and COFINS (two social contribution taxes on revenues levied at a 9.25% combined rate).

**Tax Goodwill Amortisation**

In order to benefit from the tax goodwill deduction for local tax purposes the acquisition of interest in a Brazilian company is made through the incorporation of a Brazilian vehicle company or through an existing Brazilian entity. For Brazilian tax purposes, tax goodwill is the difference between the purchase price and the corresponding net equity of the target company. The tax goodwill amount paid in the acquisition of an interest in a Brazilian company, after the merger of the Brazilian vehicle into the operating entity (or vice-versa), if paid as a result of the expected future profitability of the acquired company, may be deducted for local tax purposes in a 5 year (minimum) to 10 year period (maximum).

One relevant requirement that has to be observed where using the tax structure above, among others, consists of providing evidence that the acquisition structure is supported by consistent economic reasons (business purposes). Evidence that the structure was established with the only purpose of reducing the tax burden may jeopardize the tax goodwill deduction.
As from January 2008, the goodwill concept changed for local corporate and accounting purposes. For accounting purposes, the cost of the investment acquired would have to be allocated to the fair value of the assets and liabilities of the acquired company and, if part of such acquisition cost could not be allocated, the remaining amount would have to be recorded as an intangible asset, not subject to any amortization, named goodwill. Accordingly, there are rumours that the relevant authorities are discussing potential changes with respect to tax goodwill amortization for local tax purposes. Some rumours indicate that the tax goodwill amortization period would be no longer based on a 5 to 10-year period but would be in line with the accounting rules above. In this case, the benefits arising from the tax goodwill would be subject to a longer period of amortization, if any. There are also rumours indicating that the tax benefit would be simply ceased.

**Thin Cap rules**

Interest paid or credited by a Brazilian entity to a related party abroad (individual or legal entity), which was not constituted in a tax haven or in a jurisdiction with a privileged tax regime, may be deducted for income tax purposes if the interest expense is viewed as necessary for the activities of the local entity and the following requirements are met:

I. the debt amount granted by the foreign related party (which has a participation in the Brazilian entity) does not exceed twice the amount of its participation in the net equity of the Brazilian entity;

II. the debt amount granted by a foreign related party (which does not have participation in the Brazilian entity) does not exceed twice the amount of the net equity of the Brazilian entity;
III. the total debt amount granted by foreign related parties as per (i) and (ii) does not exceed twice the sum of the participation of all related parties in the net equity of the Brazilian entity; or in the case debt is only granted by related parties that do not have a participation in the Brazilian entity;

IV. the total debt amount granted by all of these related parties does not exceed twice the amount of the Brazilian entity’s net equity.

If one of the mentioned 2:1 ratios is exceeded, the portion of interest related to the excess debt amount is not deductible for Brazilian income tax purposes.

Similar provisions are also applicable to interest paid or credited by a Brazilian entity to an individual or legal entity (whether or not a related party) resident or domiciled in a tax haven or in a jurisdiction under a privileged tax regime. In this case, the interest expense is deductible for Brazilian income tax purposes if it is viewed as necessary to the company’s activities, as referenced above, and the total amount of the Brazilian entity’s debt with any foreign party resident or domiciled in a tax haven or in a jurisdiction under a privileged tax regime, does not exceed 30% of the Brazilian entity’s net equity.

The two above-mentioned limits (2 to 1 and 0.3 to 1 debt to equity ratios) also apply to cases where a guarantor, representative or any other intervening party is a related party or resident of a tax haven/privileged tax regime jurisdiction (respectively).
The Law also provides that amounts paid, credited, delivered, used or remitted under any title, directly or indirectly, to related or unrelated individuals or legal entities which are resident or domiciled in a tax haven or in a jurisdiction under a privileged tax regime are deductible for Brazilian income tax purposes if all of the following conditions are met: (i) the effective beneficiary of the payment is identified; (ii) there is evidence that the beneficiary has operational capacity (i.e., substance); and (iii) there is adequate documentation to support the relevant payments and the corresponding supply of goods, rights or utilization of services.

Brazilian Double Taxation Treaties Network

Brazil has a limited network of Double Taxation Treaties entered with other countries (around 30). It includes Austria, Belgium, Canada, China, South Korea, Denmark, Spain, France, the Netherlands, Italy, Japan, Luxembourg, Norway, Portugal and Sweden among others. Brazil does not have tax treaties entered into with the USA and the UK, but has Reciprocity Agreements entered into with such countries which allow, in theory, for the utilization of tax credits derived from the payment of income tax in the other country.

In terms of potential reductions to the withholding income taxation, the benefits allowed by the Treaties are limited. The advantage is much more related to Tax Credits allowed in one on the other country.
The adoption of a determined country to be used as a Holding Company for a Brazilian investment varies from case to case depending on the specific details of each case. However, in general terms, The Netherlands, Spain, Luxembourg and Austria are considered to be advantageous jurisdictions mostly because of the Tax treaties entered into with Brazil, vis-à-vis the specific clauses related to the availability of tax credits.

**Corporate legislation**

Brazilian corporate legislation has been changed through Federal Law 11,638/07, which significantly affected accounting practices in Brazil as and from January 1, 2008. The main goal of this new rule was to transition Brazilian GAAP to IFRS. As a consequence, such changes had tax implications as well.

In December 2008, through the Provisional Measure n° 449, the Brazilian Government introduced the Transitory Tax Regime - “RTT” in order to neutralize the potential tax effects derived from new accounting methodologies brought by Law 11.638/07. In summary, according to the RTT, corporate taxpayers would avoid any adverse tax effects derived from the new corporate legislation, i.e. ensuring that the company could be taxable as if the corporate and accounting rules valid up to December 31, 2007 were still in force (related exclusively to the tax perspective).

**Background information on the main taxes and contributions in Brazil**

The main Federal, State and Municipal taxes are as follows.
<table>
<thead>
<tr>
<th>Taxes</th>
<th>Statutory Rates</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Income taxes - Corporate Income Tax (IRPJ) and Corporate social contribution on net income (CSL)</td>
<td>25%(^1) and 9%</td>
<td>IRPJ and CSL are determined based on the calendar year, with monthly tax payments, and are generally computed on the basis of annual or quarterly taxable income.</td>
</tr>
<tr>
<td>Taxes on revenues - Contribution for the Social Integration Program (PIS) and Contribution for Social Security Financing (COFINS)</td>
<td>1.65% and 7.6%(^2)</td>
<td>PIS and COFINS are levied on gross income. Companies are entitled to PIS and COFINS credits on the acquisition of certain inputs and services (non-cumulative methodology similar to a VAT(^3)). PIS and COFINS contributions apply on the imports of goods and services from non-residents. Export revenues are tax exempt.</td>
</tr>
<tr>
<td>Federal Excise Tax (IPI)</td>
<td>Various rates(^4)</td>
<td>IPI is paid by manufacturers on behalf of their customers at the time of sale, either to another manufacturer who will further the manufacturing process or to the retailer who sells to the end user. When manufactured products are sold between producers, the IPI is imposed. However, the subsequent manufacturer is allowed a credit against its IPI liability, equal to the IPI paid to its suppliers (non cumulative tax). IPI is also imposed on the import of goods. Export revenues are tax exempt.</td>
</tr>
<tr>
<td>Import tax (II)</td>
<td>Various rates(^5)</td>
<td>Import tax is levied on the CIF price and is a cost to the company (not recoverable).</td>
</tr>
</tbody>
</table>

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\(^1\) IRPJ is charged at the rate of 15% plus a surcharge of 10% on annual taxable income in excess of R$ 240,000 (approximately US$ 120.00).

\(^2\) Higher rates are imposed in certain sectors (such as automotive).

\(^3\) Certain companies pay PIS and COFINS under the cumulative system, which imposes a lower combined rate of 3.65% but does not enable the taxpayer to record any tax credits on acquisitions.

\(^4\) The rate is defined by the product’s tax code according to the Harmonized System.

\(^5\) The rate depends on the degree of necessity and is defined by the product’s tax code according to the Harmonized System.
<table>
<thead>
<tr>
<th>Taxes</th>
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<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value-added tax on sales and services (ICMS)</td>
<td>17, or 18% internal rate(^6)</td>
<td>ICMS is a State tax calculated on the circulation of goods and on the rendering of interstate and inter-municipal transportation services, communication and on electricity, even when the transaction and the rendering of services start in another country. The tax is only assessed on the increase in the price of the product in each part of the circulation process. ICMS is also imposed on imports. Export revenues are tax exempt from ICMS.</td>
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<tr>
<td></td>
<td></td>
<td>%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Intrastate transactions 17 to 18</td>
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<tr>
<td></td>
<td></td>
<td>Interstate transactions 7 to 12</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Most imports 17 to 18</td>
</tr>
<tr>
<td>Service Tax (ISS)</td>
<td>2% to 5%</td>
<td>The ISS is a municipal tax levied on gross revenues for certain services as per the Federal Government.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>In general, the service tax is levied by the municipality in which the Company is headquartered. There are some exceptions to this rule for services involving assembly, construction, demolition, among others</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ISS also applies on the import of services.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ISS is not levied on exports of services, except when the services are rendered in Brazil or the results of these services are applied in Brazil.</td>
</tr>
<tr>
<td>Withholding Income Tax (IRRF) - Dividends</td>
<td>Not taxed</td>
<td>Dividends are not taxed no matter the location of the recipient.</td>
</tr>
</tbody>
</table>

\(^6\) ICMS internal rate corresponding to 17\%, except for the States of São Paulo, Minas Gerais and Paraná, whose tax rate is 18\% and Rio de Janeiro, whose rate is 19\%. Some products exceptionally trigger a higher rate (in the case of the cosmetics industry) or a lower rate (in the case of the automotive industry).
<table>
<thead>
<tr>
<th>Taxes</th>
<th>Statutory Rates</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Withholding Income Tax (IRRF) (Cont’d) - Interest</td>
<td>15%(^7) or 25%(^8)</td>
<td>Interest expenses payable to related parties located abroad are subject to transfer pricing and thin capitalization rules.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>In regards to the transfer pricing rules, until December 31st, 2012 the applicable rule is that the loan contracts entered with related parties located abroad should be registered with the Brazilian Central Bank. The Brazilian Central Bank usually accepts (and provides the registration of) loan contracts in which interest rates are consistent with market rates. If the loan contracts are registered and accepted by the Brazilian Central Bank, the maximum interest rate for this non-registered loan (i.e. the maximum deductible interest expenses) should not be higher than the Libor (in US Dollars, for six months) plus 3% spread rate. As from January 1st, 2013, the obligation of registering such loan contracts with the Brazilian Central Bank will be no longer exist but the maximum deductible interest rate will change from a Libor plus 3% spread rate to a Libor plus a spread rate to be determined by the Brazilian relevant authorities. If the loan is borrowed from a lender located in a low tax jurisdiction or from a lender party subject to privileged tax regimes, the thin capitalization and transfer pricing rules apply even if the lender is not a related party. Interest related to domestic loans is subject to the Brazilian withholding income tax at a 22.5% to 15% regressive rate, depending on the time when interest is paid (e.g. interest paid in less than 180 days is subject to a 22.5% tax rate, from 181 to 360 days - 20%, 361 to 720 days - 17.5% and more than 720 days - 15% tax rate). Domestic loans are also subject to the IOF (tax on financial, exchange and insurance transactions) at a 0.38% plus a 0.0041% daily rate (limited to 365 days or 1.5%), levied on the principal amount of credit still not liquidated. In other words, the IOF would be levied at a 1.88% rate if the debt consists of a long-term (more than one year) loan contract. Long-term international loans (loans which average maturity is higher than a 1,800 day period) are subject to the IOF at a 0% rate. Short-term international loans (loans which average maturity is up to a 1,800 day period) are subject to the IOF (levied only on the loan principal amounts) at a 6% rate. Please see further comments in this Section regarding the IOF taxation.</td>
</tr>
</tbody>
</table>

\(^7\) These rates are effective unless otherwise specified by a tax treaty.  
\(^8\) Payments of any type made to tax havens, defined as jurisdictions that do not tax income, or tax income at a rate lower than 20%, and classified by the Brazilian local tax authorities as a Tax Haven according to the "Blacklist", will be subject to withholding at a rate of 25%. 
<table>
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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Withholding Income Tax (IRRF) (Cont’d)</td>
<td>15%(^9) or 25%(^{10})</td>
<td>In the case of royalties, the royalty contract has to be approved by the National Institute of Industrial Property (INPI) and filed with the Brazilian Central Bank.</td>
</tr>
<tr>
<td>• Royalties and services</td>
<td></td>
<td>Deductions for royalties are generally limited up to 5% of the net sales of the relevant products or services; the percentage depends on the type of product or activity.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Royalties for the use of trade marks and trade names, for whatever type of production or activity, when the use of the mark or name does not result from the utilization of a production patent, process or formula, are deductible up to 1% of net sales.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>In addition to the withholding income tax, royalties and service fees paid to foreign parties are subject to the Contribution for Intervention in the Economic Domain (CIDE) at the rate of 10 percent and to the PIS and COFINS at a 9.25% combined rate. These are taxes borne by the Brazilian service contracting company.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fees corresponding to services provided by foreign parties are subject to the Municipal Service Tax (ISS) at a 2% to 5% rate.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Besides the withholding income tax, remittances or payments of royalties or service fees to abroad are subject to the IOF at a 0.38% rate. This taxation is imposed due to the conversion of the amount of royalties and service fees from Brazilian Reais into foreign currency. Please see further comments in this Section regarding the IOF taxation.</td>
</tr>
</tbody>
</table>

\(^9\) These rates are effective unless otherwise specified by tax treaty.

\(^{10}\) Payments of any type made to tax havens, defined as jurisdictions that do not tax income, or tax income at a rate lower than 20%, will be subject to withholding at a rate of 25%.
**Tax Consolidation**

The Brazilian Tax Laws do not contemplate the possibility of consolidated returns and/or group relief. Therefore, entities from the same group are not allowed to consolidate the income and deductions of group members in order to submit to taxation the net income of the group. Considering this, each Company of the group must separately file its annual income tax returns to the local authorities.

**Tax losses carry forward (IRPJ and CSL)**

There is no time limit for the carry forward of tax losses. However, the taxable profit of each year can only be reduced by tax losses up to a maximum of 30%. Furthermore, it is neither possible to carry back tax losses nor transfer tax losses to other Brazilian companies. Tax losses of an acquired company cannot be carried forward to be offset against the taxable income of a new activity if the following two conditions are simultaneously met:

a) modification in the ownership of the company; and

b) modification in the activity of the company.

**Interest on capital**

Entities are allowed to remunerate their shareholders by way of interest on capital payments, subject to certain limitations (i.e., limited to the TJLP - Long Term Interest Rate - and limited to 50% of current or accumulated profits). This payment is deductible for corporate income tax purposes and for social contribution on net income purposes, as well. These payments are subject to a 15% withholding tax (or 25% for a tax haven jurisdiction).

During the first quarter of 2012, the applicable TJLP rate was 6% per year.
Payments made to tax havens’ beneficiaries

Any payments made directly or indirectly to beneficiaries resident or incorporated in tax havens are not tax deductible, except when the following requirements are cumulatively observed: (i) beneficiaries are identified; (ii) the non resident has the operational capacity to perform the transaction; and (iii) payments, receipt of goods, rights and use of services are evidenced with proper documentation.

Capital gains

Capital gains derived from the sale of Brazilian assets (including shares) by non-resident shareholders are subject to the withholding income tax at a 15% rate (unless otherwise specified by international tax treaty), even if both vendor and buyer parties are domiciled abroad. In the case of the sale of shares, the capital gain will correspond to the difference between the purchase price of the shares and the amount of foreign capital, in foreign currency, registered with the Brazilian Central Bank.

As a general rule, the local buyer is responsible for withholding and paying the withholding income tax levied on the capital gain earned by a foreign vendor. When both parties, buyer and vendor, are not located in Brazil, the local attorney-in-fact representing the foreign buyer in Brazil is the responsible for withholding and paying the withholding income tax.

Capital gains earned by foreign parties located in low tax jurisdictions (tax havens) are subject to the withholding income tax at a 25% rate.

Repatriation of capital in excess of the cost of the non-residents’ investments in Brazil is subject to capital gains tax at 15% (or 25% for tax haven jurisdictions).

The capital gain derived from the sale or transfer of shares by a Brazilian resident company is subject to the Brazilian Income taxes (IRPJ and CSLL) at the 34% combined rate.
Provided that some requirements are fully met, there are capital gain exemptions in the case of the transactions being carried out by foreign investors, such as: i) in our local Stock Exchange Market; and ii) in private deals when structured through a local FIP (Equity Investment Fund).

Individuals domiciled in Brazil are taxed at the rate of 15% on capital gains.

**Financial Transactions Tax (IOF)**

As a general rule, foreign exchange transactions made in order to allow payments to non residents, considering royalties, technical services, and other payments, including the reimbursement of costs, are subject to IOF.

The regular IOF rate for foreign exchange transactions (both inbound and outbound) currently applied, corresponds to 0.38%. Investments made through the Brazilian stock market or via Equity Investment Funds (FIP) are currently taxed by the IOF at a 0% rate, regarding the inflow of foreign capital into Brazil. The return of the investment is not subject to IOF.

The IOF may not be avoided if the payment requires a foreign exchange transaction from Reais to a foreign currency, or from a foreign currency into Reais.

IOF is also levied at various rates, on loans and credit operations, securities transactions, foreign exchange transactions and insurance policies.

IOF at a 6% rate is charged on foreign loans with an average maturity of less than 1,800 days. All other long-term foreign loans are subject to IOF at a 0% rate. The average maturity is determined based on the balance of the loan relative to the number of days of the outstanding balance of the related loan.

**Other taxes on payments to non-residents**

A Brazilian company with royalty, license or service agreements with foreign entities, when related to the transfer of technology, must pay a 10% Economic Domain Intervention Contribution (CIDE) based on the amounts paid abroad.

PIS and COFINS contributions, ISS and withholding income tax also apply on the payment of services to non-residents.
**Tax Havens and Privileged Tax Regimes**

Most payments (except dividends) made to tax havens, defined as jurisdictions that do not tax income, or tax income at a rate lower than 20%, are subject to a withholding income tax at a rate of 25%. Indeed, Brazilian local tax authorities issue from time to time a “Blacklist” where the countries/jurisdictions classified as Tax Havens are set out.

The Brazilian IRS released (on June 4th, 2010) a Normative Instruction (IN 1,037/2010) changing the Brazilian tax havens Blacklist.

**Tax Havens’ Blacklist (according to IN 1,037/2010)**

Andorra, Anguilla, Antigua and Barbuda, Aruba, Ascension Island, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Brunei, Campione D’Italia, Canal Islands, Cayman Islands, Cook Islands, Costa Rica, Cyprus, Djibouti, Dominica, French Polynesia, Gibraltar, Grenada, Hong Kong, Isle of Man, Kiribati, Labuan, Lebanon, Liberia, Liechtenstein, Macau, Madeira Island, Maldives, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, Norfolk Island, Niue, Pitcairn Islands, Panama, Qeshm Island, Saint Helena, Saint Kitts and Nevis, Saint Pierre and Miquelon, Samoa, Samoa Island (American), San Marino, Seychelles, Singapore, Solomon Islands, St. Lucia, St Vincent and Grenadines, Sultanate of Oman, Swaziland, Switzerland (suspended from the list), Tristan da Cunha, Tonga, Turks and Caicos, United Arab Emirates, US Virgin Islands and Vanuatu.

A second list of “Privileged Tax Regimes” has been created. This list encompasses the following regimes/entities:

- Uruguayan SAFIs;
- Danish Holding companies which do not perform significant economic activities;
- Dutch Holding companies which do not perform significant economic activities (suspended from the list);
- ITCs (Iceland);
- Offshore KFT (Hungary);
• US State LLCs, an interest is owned by non-US residents;
• Spanish ETVEs (suspended from the list); and
• ITC and IHC (both Malta).

Before the Normative Instruction (IN 1,037/2010) there was not a Blacklist of privileged tax regimes. After the IN 1,037/2010 came into affect, some potential adverse tax consequences should be considered for parties subject to the foreign privileged tax regimes listed above.

In summary, the current understanding of the consequences of the IN 1,037/2010 is that the rules regarding the non-deductibility of payments (interest, services, royalties etc.), transfer pricing and thin cap rules are applicable to payments made to and transactions performed with companies or persons located in the jurisdictions listed in the updated tax haven Blacklist and also to foreign beneficiaries subject to the privileged tax regimes listed there-in.

For the purposes of the taxation of the Brazilian withholding income tax, only the companies or persons located in the foreign jurisdictions comprised in the tax haven Blacklist (not in the Blacklist of privileged tax regimes) would be affected. This means that the IN 1,037/2010 would not affect the existing rules regarding the withholding taxation levied on capital gains, foreign investments made via the Brazilian capital market by qualified investors (which are exempt from taxation on capital gains), etc., for foreign companies or persons subject to privileged tax regimes.
Work Force and Labour Charges
Labour Relations

Labour and management relations

Employer and employee relations are dealt with principally in the labour laws (CLT) enacted in 1943 and subsequent legislation. The labour laws are applicable to all employees in regular registered employment, except for individuals in public employment or domestic labour, who have separate regulations.

The labour laws make no distinction between skilled and unskilled workers or between those engaged in manual, office or professional work. Therefore, all types of workers are generally referred to as employees. A change in the legal structure or ownership of an employer does not affect the rights acquired by employees under the labour laws.

Extensive social security laws and labour regulations govern employer-employee relations. However, foreign investors have not experienced much difficulty in the way of labour problems, mainly because they follow local standards and practices.
**Background information on labour practices and the main social charges in Brazil**

**Employer’s payroll costs in Brazil Remuneration**

*Salary and labour rights*

Employees are entitled to monthly salary, which may be increased by overtime, night shift additional payments and unhealthy work condition additional payments, among others.

In addition to the amounts paid to employees as salary, any other amounts which are paid on a regular basis are, for all legal purposes, considered as part of the employee’s salary and are, in general, taken into account in the calculation of vacation, 13th salary and the amount that must be deposited in the FGTS, as well as termination payments.

A fringe benefit is an additional item granted to an employee in excess of the employee’s regular salary. Pursuant to the applicable labour legislation, the grant of an award or of any other benefit (such as vehicles) to an employee may be considered a fringe benefit, for the reason that any incentive award or benefit may represent an additional payment and consequently, compensation to the employee. In such cases, the total amount of the employee’s earnings (including taxable fringe benefits) shall form the taxable basis for the contributions that should be borne by the employer.

After a 12-month period, employees are entitled to a 30-calendar day paid annual vacation, which must be taken within the subsequent 12 months and compensated at an amount equivalent to 1 month salary plus 1/3 of bonus.

At the end of each year, employers must pay employees a Christmas bonus (on “13th salary”) annual bonus equivalent to 1 month’s salary.
**Taxes and contributions on payroll**

*Social Security Contribution (INSS)*

Employers’ social security contributions correspond to 20% of the gross payroll (monthly compensation paid to all employees).

Payment of insurance by employers against labour accidents is normally due at rates which vary from 1% to 3% of the total remuneration paid to employees, depending on the “level of risk” presented by the type of activity of the company.

Employers are also required to pay a monthly contribution as the “education salary allowance” equivalent to 2.5% of the total remuneration paid to employees.

Additionally, employers have also to contribute to other governmental entities, such as: Incra, SESC, SESI, among others, for which the respective contribution may reach up to 3.3%

In addition, employers are also responsible for withholding and collecting the INSS on behalf of their employees (who are also subject to INSS at lower and progressive rates).

*FGTS*

Under the FGTS system, employers must deposit on a monthly basis, on the employees’ behalf, in a blocked bank account, an amount equivalent to 8% of the remuneration of each employee. The 8% destined to FGTS is borne by the employer, without any discount from the employee’s salary.

In the case of an employee’s dismissal, the company will have an additional 50% cost calculated on the balance of the employee’s FGTS deposit.
Environmental Issues
This section discusses the environment in Brazil. In general, the rules are strict but there are significant opportunities for business.

Environmental impact on businesses

Business in Brazil has to take into account several environmental issues which may become relevant risks if not adequately managed. On the other hand, there are many environment-related aspects in Brazil that may result in real opportunities, such as the abundance and quality of natural resources, the country’s climate, the overall concern with environmental protection and the corresponding Brazilian environmental legislation, which is among the most advanced in the world.

Protecting the environment

Key “green” concerns in Brazil include the deforestation of the native and old-growth forests in the biologically rich Amazon Rain forest and other regions, and soil loss due to erosion. The main “gray” areas of attention are the lack of sewage collection, solid waste management, urban, industrial and non-point-source pollution of rivers, lakes, estuaries and the shoreline, air pollution in and around some major cities, and questions related to the recovery of mining areas.

Main legislation and regulation

Brazilian legislation extends over a wide variety of environmental issues concerning licenses, zoning, pollution prevention and control and inspection procedures.
Environmental crimes are subject to fines of up to R$ 50 million (some US$ 30 million)

The penalties might include not only the fine but also the cancellation of the operating license and the obligation for the recovery of the impacted area. Additionally, in many cases, the issue is made public, thus affecting the company’s reputation. Given this scenario, environmental due diligence prior to acquisition is highly recommended.

Projects for the construction of a new plant or production site must be submitted for approval by the Brazilian environmental authorities. The location and activity will determine the environmental license that should be obtained at federal, regional or local levels. For activities considered as having a high environmental impact, a more detailed study of environmental impacts and mitigation (named EIA-RIMA) is required before installation is allowed.

The environmental legislation was effectively introduced in 1981, when the National Environmental System - SISNAMA – was implemented, including all agencies responsible for the environmental quality. More recently, in 1998, new legislation was passed (the “environmental crimes law”) defining pollution and forest destruction as crimes punishable with heavy fines and, in some cases, jail sentences. These fines can reach amounts up to R$50 million (equivalent to more than US$ 30 million).

Furthermore, the acquirer of a Brazilian company or business might become fully or partially responsible for present and past environmental liabilities attached to the acquired asset.
Every plant in operation must obtain an environmental license issued by the Federal Environmental Agency (IBAMA). The license has to be periodically updated (the period varies according to the plant’s location).

CONAMA Resolution nº 237/97, details the projects and activities subject to licensing, as well as the respective capacity at the federal, state and municipal levels.

Also, the incorporation of the Environmental Impact Assessment and its instruments such as the EIA – RIMA in the licensing process represented a major advance in the control and supervision of projects which cause environmental degradation.

**Pollution control**

Pollution has become a serious concern in many areas and consequently it is now one of the main issues both politically and economically.

Federal and State governments have developed programs and controls aiming at preventing or reducing pollution, mainly in the more industrialized areas.

The treatment of waste with the purpose of avoiding or reducing pollution must be considered in the installation of new production sites in Brazil; or evaluated when acquiring a business.

CONAMA is the federal agency responsible for establishing federal criteria for pollution control. Other state agencies are required to take environmental regulations into account when examining applications for incentives and financing of investment projects. Non-compliance with pollution control regulations may result in the suspension of tax benefits, credit restrictions or even the closing-down of operations.
The new rules for Solid Waste

Despite the lack of resources, and the challenge of achieving and maintaining the desired quality and technological innovation in urban cleaning services, Brazil has presented a greater awareness about environmental sustainability, especially through recent legislation such as the National Basic Sanitation Policy (Law nº 11.445/07) and the National Policy on Solid Waste (Law nº 12.305/10).

The National Policy on Solid Waste Plan established that the Municipal Integrated Management of Solid Waste shall be consistent with local realities and also stimulate reduction in the volume of waste for landfill, through selective collection programs and materials reuse/recycling. Due to the preoccupation with social inclusion, this document recommends the use of cooperatives for low-income individuals.
Sustainability: a growing issue in Brazil

Good environmental management became a relevant business issue as and from the discussions held at the Rio Environmental Summit in 1992, when the concept of sustainability (i.e., the adequate integration of environmental management, social responsibility and the related economics/value added proposition) gained a higher profile in the agenda of the public and private sectors as well as for a major element of the global population.

In many sectors, good environmental management is no longer a competitive advantage but a condition on the ability to compete not only in the global market but also in the Brazilian market.

The Environmental Audit is a sustainability tool that helps a Company to have good environmental management. This mechanism is used to analyze environmental documentation, such as operational licenses, water resources documentation, and solid residues management in order to show the Company’s exposure to possible risks (legal sanctions) if they are not in compliance with legislation.

It is relevant to highlight the importance of the Environmental Audit for Companies, because it creates an incentive for them to seek out environmental adequacy and to avoid possible legal fines resulting from non compliance.
Our M&A Specialists and Post-Deal Services in Brazil
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PwC in Brazil

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Brazil is likely to become the world’s fifth largest economy in less than a decade*:
a fast-growing consumer market with high growth potential.

*The Economist

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