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- Guide to Company Formation in Brazil - (Entering the Brazilian Market, Part I)

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Introduction

Foreign investors seeking to expand their corporate presence into Brazil, are faced with various legal questions. This article aims to outline the fundamental guidelines when choosing the most suitable corporate vehicle Brazilian law offers.

Brazil is not the only emerging market attracting foreign companies. However, Brazilian market access is less restricted than in other BRICS countries such as, for example, China. This is because the Brazilian legal framework offers one important advantage. With regard to the form of incorporation, foreign investors in Brazil are not required to choose a specific form of incorporation or to cooperate with a domestic partner. In contrast, foreign investment in China, by means of a wholly-owned subsidiary (WOS), requires a specific form of incorporation. And recourse to standard Chinese corporate vehicles is only possible in cooperation with a local Chinese partner.

Key crossroads to be considered when choosing a suitable corporate vehicle for doing business in Brazil

In particular, the foreign investor in Brazil is faced with the following key considerations:

→ Is it to be simply a branch or is it to be a legally independent Brazilian subsidiary?

→ Should the decision be in favour of a subsidiary: Which form of incorporation for a legally independent subsidiary to choose? Is a stock corporation (*sociedade anônima - S.A.*) or a private limited liability company (*sociedade limitada - Ltda.*) the best form for the Brazilian incorporation? Are there any alternative forms?

→ Should the decision be in favour of a Ltda.: Should one opt for supplementary application of *S.A.* law?

→ Should the decision be in favour of a S.A.: Should one opt for a closed or public *S.A.* (*companhia fechada* or *companhia aberta*)?

Form of Incorporation / free translation; not necessarily a legal equivalent in US or UK law)	**Acronym / Year of last introduction**
empresário individual / sole proprietorship	EI / 2003
sociedade simples / simple partnership	SS (acronym not used in practice)/ 2003
sociedade em nome coletivo / general partnership	SNC (see above)/ 2003
sociedade em comandita simples / limited partnership	SCS (see above)/ 2003
sociedade em comandita por ações/ partnership limited by shares	SCPA (see above)/ 1977
sociedade limitada / private limited liability company	Ltda. / 2003
empresa individual de responsabilidade limitada / one-person private limited liability company	EIRELI / 2012
sociedade anônima / stock corporation	S/A, AS or S.A. / 1977

Branch or Legally Independent Brazilian Subsidiary?

The very first decision that will set the future course of the new Brazilian undertaking is whether the parent company should opt for simply establish a branch of the parent company, or incorporate a fully independent Brazilian subsidiary.

While it is generally possible to establish a mere (dependent) branch of the foreign parent company, this has a series of disadvantages. Compared to the incorporation of a legally independent subsidiary, instituting a branch will involve a comparatively sophisticated and time-consuming approval procedure that includes obtaining a Brazilian Federal Government approval by decree.

The foreign based parent company will also be subject to extensive publication and disclosure obligations in Brazil and, most crucially, will not be able to rely on a limitation of its liability for its local business activities in Brazil. Moreover, Brazilian branches offer no Brazilian tax advantages compared to independent Brazilian subsidiaries.

Therefore, in the vast majority of cases, incorporating a Brazilian subsidiary is the preferred choice of investors/parent companies. However, due to specific tax and business model particularities, international airlines and foreign banks usually establish branches.

Choosing a Suitable Form of Incorporation for a Legally Independent Subsidiary

Secondly, if the decision is made in favour of an independent subsidiary, which form of incorporation is the most suitable to a specific business model?

Different forms of incorporation come with different features that must be weighed up and considered against each other. However, there are certain "must-haves" from the foreign corporate investor's perspective.

Irrespective of the form of incorporation the investor will eventually choose, it should ensure that its Brazilian company will be able to engage non-shareholding directors and offer a maximum level of shareholders' limitation of liability. It is also usually a necessity that the Brazilian company be able to have legal entities as shareholders.

In addition to these indispensable characteristics, there are other "nice-to-have" features: First, opting for a company that does not require much time or effort to incorporate and, more importantly, to operate the business, will be, of course, beneficial for the foreign investor.

Secondly, in the case of a joint venture company with a majority share, it would be advantageous to incorporate a company that gives the shareholder a maximum level of power and influence regarding future changes of directorships, appropriations of profits, corporate restructurings and exit scenarios. This will ensure flexibility and independence from minority shareholders, and thus facilitate the running and altering of the business.

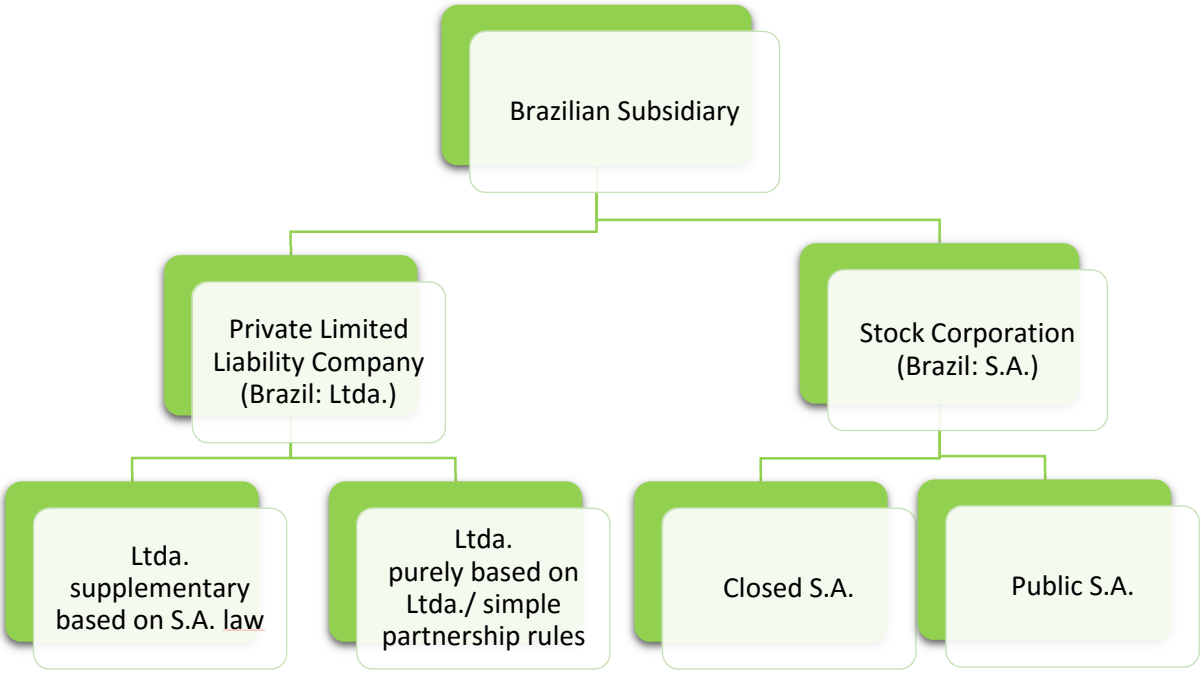
Suitability of Brazilian Corporate Vehicles for Particular Needs of Foreign Investors

In practice, the private limited liability company (*sociedade limitada, Ltda.*) and the stock corporation (*sociedade anônima, S.A.*) are the only viable options that meet the specific foreign investors' business needs appropriately. This is because only these two have the "must-have" features outlined above, such being the ability to engage non-shareholding directors, the possibility of having legal entities as shareholders, and a maximum level of shareholders' limitation of their liability.

In contrast, other forms of incorporation, such as the sole proprietorship, simple partnership, general partnership, limited partnership, partnership limited by shares and the one-person private limited liability company *(empresário individual*, *sociedade simples*, *sociedade em nome coletivo*, *sociedade em comandita*, and *empresa individual de responsabilidade limitada*) are all associated with shortcomings that make them unsuitable for foreign investors.

For example, shareholders' liability is unlimited in the *sociedade em nome coletivo*, *sociedade simples* and *empresário individual*, and only partially limited in the *sociedade em comandita*. Furthermore, neither the *sociedade em nome coletivo*, *sociedade em comandita* nor *empresário individual* allow for non-shareholding or external directors. In addition, legal entities are restricted from holding shares in the *empresa individual de responsabilidade limitada*, *sociedade em nome coletivo*, *empresário individual*, and have only a limited ability to hold shares in the *SC*.

Overview of Legal Types of Stock Corporations and Private Limited Liability Companies in Brazil



Sociedade Anônima (S.A.) or *Sociedade Limitada (Ltda.)* as Best Form of Brazilian Incorporation?

The investor faces a choice between the *sociedade limitada (Ltda.), a* private limited liability company, and the *sociedade anônima (S.A.), a* stock corporation. As will be outlined, the most suitable form of incorporation largely depends upon the investor's needs and business objectives.

In assessing the two options, one of the aspects that foreign investors should take into account are their envisaged shareholder participation scenario as significantly different statutory decision quorums apply to the stock corporation and private limited liability company.

Moreover, and of crucial importance will be the type and extent of financing the foreign investor may seek to obtain for its Brazilian business. For example, third-party finance would be easier to obtain for a public *S.A.* due to its access to debt and equity capital markets, whereas the *Ltda.* would be confined to loan finance.

The private limited liability company (*sociedade limitada, Ltda.*) is more suitable in scenarios involving wholly-owned subsidiaries (WOS) or majority shareholdings of 75% or more in a joint venture company (JVC).

In contrast, the investor should opt for the stock corporation (*sociedade anônima, S.A.*) in cases involving JVCs conducted on equal terms or in cases of minority shareholdings.

Furthermore, when it is envisaged or required that non-Brazilian residents be able to directly participate in the management of the Brazilian company (as members of the board of directors / *conselho de administração*), the stock corporation is the appropriate option.

Sociedade Anônima (S.A.) and Sociedade Limitada (Ltda.) – Their Strengths and Features at a Glance

S.A. – Stock Corporation	**Ltda. - Private Limited Liability Company**
No joint liability of shareholders if other shareholders fail to deposit their contributions to the corporate capital (in contrast to the Ltda.)	Incorporating and operating the company involves less time and effort in comparison to the S.A.
Usually no minimum capital is required	
Usually at least two shareholders are required	
Stronger protection of minority shareholders from arbitrary decisions of majority shareholders	More favourable towards majority shareholders (min. ¾ majority required for corporate control) in comparison to the S.A.
Statutory obligation to distribute profits (min. 25%)	No statutory obligation to distribute profits
Greater availability of external finance through access to capital markets (e.g. issue of bonds) in comparison to the Ltda.	More flexibility regarding configuration of by-laws in comparison to the S.A.
Non-Brazilian resident administrators can participate in company management (in contrast to the Ltda.)	Requires only one director (stock corporations require at least two directors)

Sociedade Limitada (Ltda.): With or Without Supplementary Application of *S.A.* Law?

Thirdly, and finally, if the decision is made in favour of private limited liability company (*sociedade limitada, Ltda.)*, a crucial but often neglected issue will be whether or not the *Ltda.* should be incorporated under supplementary application of *S.A.* law.

The law provides the founding shareholders with an option to have recourse to supplementary application to the law governing the stock corporation (*sociedade anônima, S.A.*). The shareholders must exercise this choice by way of express incorporation into the articles of association of the company. In such case, *S.A.* law will apply so as to supplement the law governing the *Ltda.*, but only to the extent that *S.A.* rules are compatible with the legal principles that ordinarily govern the *Ltda.* In the absence of such a stipulation in the articles of association, only the simple partnership rules (arts. 997 – 1.038 of the Civil Code) under general civil law will apply to the law governing the *Ltda.* (arts. 1.052 – 1.087 of the Civil Code) on a subsidiary basis.

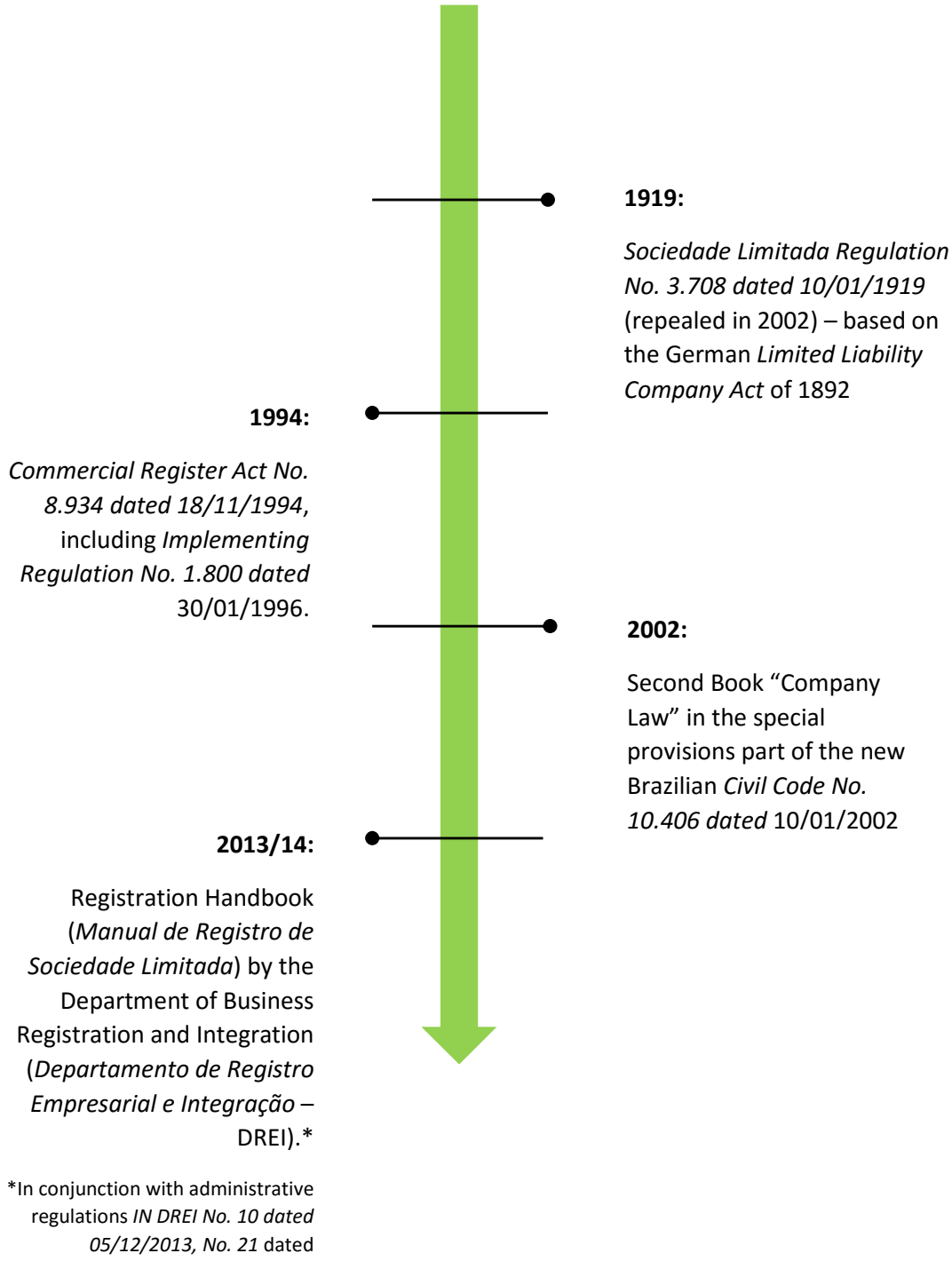
The shareholders may also opt for the application of specific parts of *S.A.* law only, such as the rules regarding the annual appropriation or minimum distribution of profits.

It is crucial that the founding shareholders properly balance the advantages and disadvantages connected with the supplementary application of *S.A.* law to their Ltda. with reference to the investor's business needs and relationships with other partners, if any. The following table provides hereto a helpful overview.

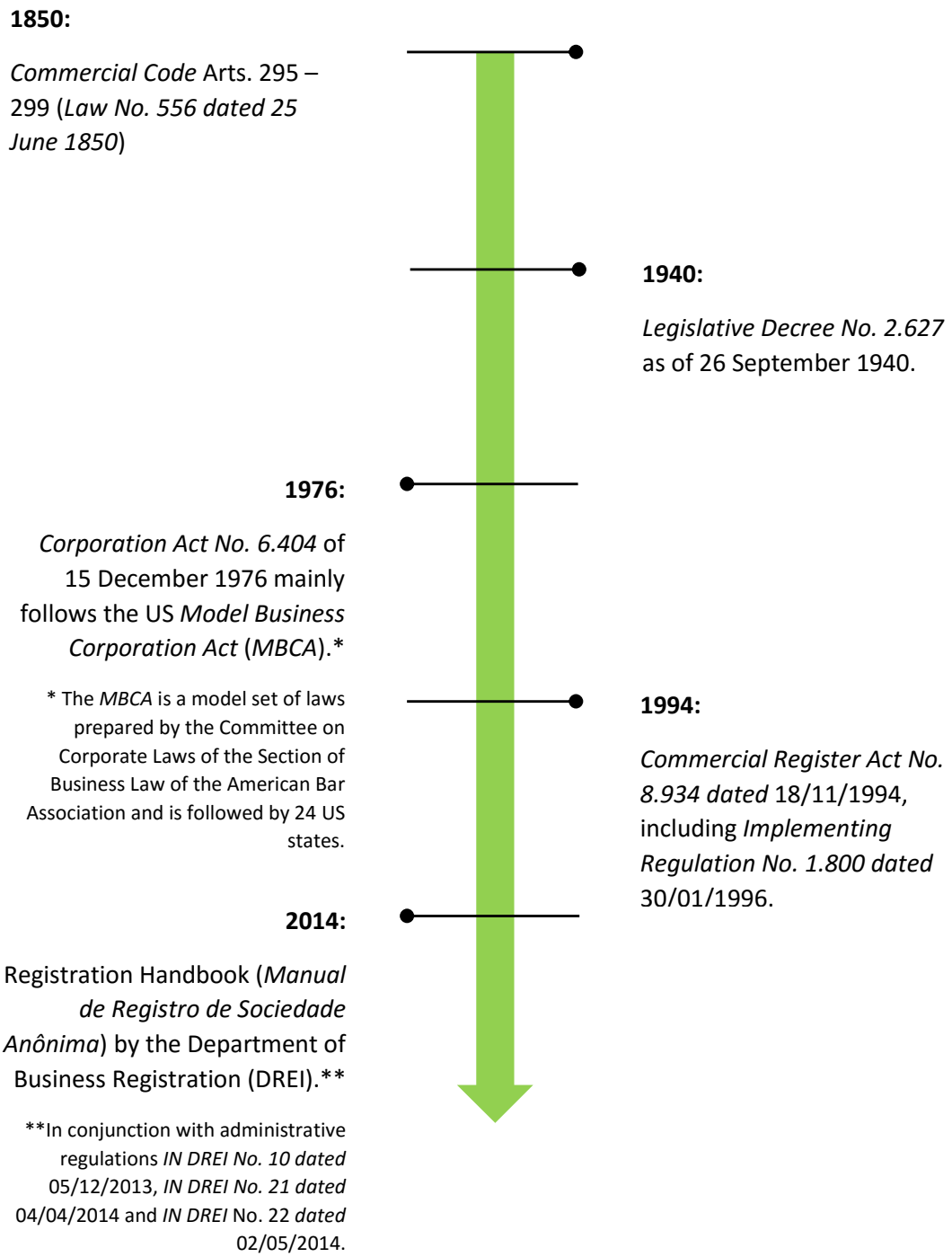
Consequences of Supplementary Application of S.A. Law to the Ltda.

	Non-application of *S.A.* Provisions	**Supplementary application of *S.A.* provisions**
Annual appropriation of profits	Decision by way of a simple majority of shareholders	Decision by way of an absolute majority of shareholders
Minimum distribution of profits	Not compulsory	Compulsory
Occurrence of a deadlock (determined by reference to the share capital)	Deadlock to be resolved by a decision on a *per capita* basis; In the event of a *per capita* deadlock, a decision by way of judicial determination will be necessary	Deadlock to be resolved by a new shareholders' meeting must be summoned and votes must be cast anew; in the event of a persisting deadlock, a third party, appointed by the shareholders, will decide; failing this, a judicial decision will be necessary
Transactions of the management unrelated to the company's business pursuant to its articles of association (*ultra vires*)	Generally invalid	Generally valid
Number of scenarios in which an individual shareholder may be compelled to surrender their shareholding	Six	Three

Annex 1: Historical Roots and Current Law Governing the *Sociedade Limitada (Ltda.)*



Annex 2: Historical Roots and Current Law Governing the *Sociedade Anônima (S.A.)*



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