Guide to Company Formation in Brazil: Crossroads in choosing a suitable corporate vehicle

Foreign investors seeking to expand their corporate presence into Brazil shall consider the following key crossroads in choosing the most suitable form Brazilian law offers:

- → 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 available in Brazil?
  - → 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)?

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 the application to obtain 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.

Form of Incorporation for a Subsidiary in Brazil

Secondly, if the decision is made in favour of an independent subsidiary, which form of incorporation is the most suitable in view of specific business models and particular needs of foreign investors? Different forms of incorporation come with different features that must be weighed up and considered against each other.

Overview of Brazilian Corporate Vehicles

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

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.

Shareholders' liability is unlimited in the *sociedade em nome coletivo* (general partnership), *sociedade simples* (simple partnership) and *empresário individual* (sole proprietorship), and only partially limited in the *sociedade em comandita* (limited partnership). Furthermore, neither the *sociedade em nome coletivo*, *sociedade em comandita* (partnership limited by shares) nor the *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* (one-person private limited liability company), *sociedade em nome coletivo*, *empresário individual*, and have only a limited ability to hold shares in the *sociedade em comandita*.

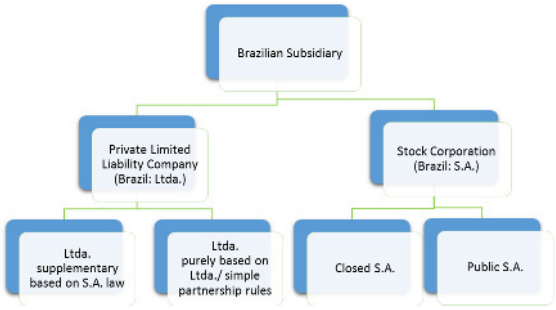
Since these forms of incorporation are all associated with shortcomings they are rather unsuitable for foreign investors. In practice, the Brazilian private limited liability company (sociedade limitada or Ltda.) and the Brazilian stock corporation (sociedade anônima or S.A.) are the only viable options 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.

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 Brazilian private limited liability company, and the sociedade anônima (S.A.), a Brazilian 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,

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



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

Sociedade Anônima (S.A.) and Sociedade Limitada (Ltda.) – The

S.A. – Stock Corporation	
No joint liability of shareholders fail to deposit t to the corporate capital (in c Ltda.)	
Us	
Stronger protection of minor from arbitrary decisions of m shareholders	
Statutory obligation to distrib 25%)	
Greater availability of extern through access to capital ma bonds) in comparison to the	
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)

Side Note:
Chinese and Brazilian Situation Compared

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. In addition, recourse to standard Chinese corporate vehicles is only possible in cooperation with a local Chinese partner.

In contrast, the investor should opt for the Brazilian stock corporation in cases involving JVCs conducted on equal terms or in cases of minority shareholdings. The same applies, 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).

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

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

Brazilian law provides the founding shareholders with an option to have recourse to supplementary application to the law governing the stock corporation. 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, on a subsidiary basis, to the law governing the Ltda. (arts. 1.052 – 1.087 of the Civil Code).

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

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 decisive 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.

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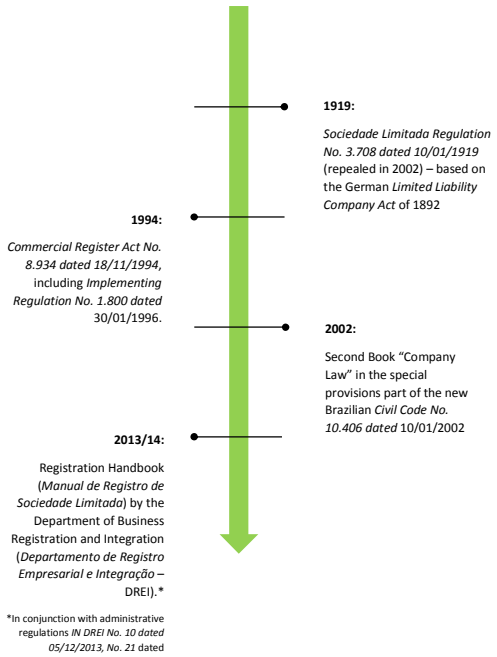
Legal Graphics: Digitorney, www.digitorney.com

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.)*