Acquisition structures Q&A: Brazil

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Country Q&A | Law stated as at 31-Mar-2021 | Brazil

This Q&A provides country-specific commentary on *Practice note, Acquisition structures: Cross-border*.

Acquisition structures

1. What are the most common corporate entities involved in a private acquisition? Is a formal offer procedure required for the acquisition of any of these?

The most common corporate entities involved in a private acquisition are limited liability companies (*Limitadas*) and corporations (S.A.). The capital stock of *Limitadas* is divided into quotas, while the capital stock of an S.A. is divided into shares. The terms and conditions of the purchase of equity interests are provided in a share/quota purchase agreement. The transfer of shares is made through the execution of a transfer term in the corporation's shares transfer book and the transfer of quotas is made upon the execution of an amendment to the articles of association of the company.

2. Are there any restrictions (under corporate law) on the transfer of shares in, or of assets by, a private company (that is, any restrictions on acquisitions by foreign buyers)?

There are no general restrictions, but there are restrictions on foreign persons investing in some industries or acquiring rural properties.

Although it cannot be considered as a restriction, the following requirements must be met by any foreign investor before acquiring any shares issued by a private company:

- Register with the Federal Revenue (the Brazilian tax authority) and obtain a taxpayer registration (CPF for individuals and CNPJ for entities).
- Indicate an attorney in fact resident in Brazil with powers to receive services of process based on corporate claims.

3. What are the most common ways to acquire a private company? How common are asset purchases (that is, the purchase of an entire business or a substantial part of a business rather than the purchase of its shares)?

The most common way to acquire a private company is a straightforward purchase and sale of quotas/shares. The acquisition may involve all of the quotas/shares, a controlling block of quotas/shares or a minority stake.

Another way to acquire a private company is through a subscription of quotas/shares, in which case the seller remains a minority shareholder/partner. A combination of direct purchase and subscription may also be used.

Asset purchases that involve an entire business or a substantial part of it are not that common, because they may cause increased bureaucracy (such as the issuance of new licences to operate the business and transfer of employees) and do not necessarily avoid the succession of liabilities or contingencies which arose from the previous operation conducted by the sellers (see *Question 4*). Note that the acquisition by foreign investors of an entire business through an asset deal must be performed by a Brazilian subsidiary (a company incorporated, and with head offices in Brazil, and governed by Brazilian law), which may be incorporated by the foreign investor prior to closing.

An asset purchase is common, though, in relation to real estate properties or specific equipment or machinery.

4. What are the main advantages and disadvantages of a share purchase (as opposed to an asset purchase)?

Share purchases advantages in relation to asset purchases

The biggest advantages of a share deal over an asset deal are:

- Speed and simplicity of the process.
- Smooth transition of clients, different kind of assets, employees and contracts to the indirect ownership of the buyer.

A share deal may also allow the buyer to use the target's tax benefits and tax losses, if any.

Share purchases disadvantages in relation to asset purchases

In a share deal, the buyer acquires the company and all assets and liabilities owned by it.

From a tax and labour perspective, the acquisition of an entire business through an asset deal will be treated as a share deal. In an asset deal, however, the agreements may establish that the seller will remain directly liable for its debts and obligations, but that the buyer may be held liable before the tax authorities and employees if the company does not comply with its obligations.

5. On an asset purchase (of an entire business as a going concern), are there any assets and/or liabilities that are automatically transferred and cannot be excluded from the purchase, for example, employees and tax liabilities?

The parties are free to contractually exclude certain assets and liabilities from an asset purchase. However, from the perspective of the tax authorities and employees, an asset purchase involving the entire business is treated similarly to a share purchase agreement. As such, the buyer may be liable for such tax and labour liabilities and contingencies if the seller fails to comply with its obligations.

6. On an asset purchase (of an entire business as a going concern), do creditors need to be notified or their consent obtained to the transfer?

No, except if the target has executed any agreement making the disposition of assets subject to the creditor's prior consent. This is very common in public contracts and financial contracts.

7. What are the most common forms of consideration offered on a private company share purchase or an asset purchase?

The most common forms of consideration are the same as in other jurisdictions, being cash and other assets (shares, real estate properties and others). The purchase price can comprise a fixed amount, an amount to be determined according to future developments of the business (earn-out) or a combination of both, and can be paid on closing or in instalments.

8. How common are sales of companies by auction?

Sales by auction are common in the acquisition of assets, such as real estate, in judicial proceedings.

It is very common to sell a company through a private bid procedure which aims to maximise the value of the company. Private bid procedures are usually organised by sellers, and the potential buyers are invited to participate and present non-binding indicative proposals. The buyers that have presented the more attractive proposals are allowed to perform full due diligence of the company and submit a binding proposal. In these procedures, the sellers may choose to whom they want to sell the company, at their sole discretion.

9. Are there more complex structures (than a simple transfer of shares or assets) that are commonly used for the acquisition of shares in, or assets of, a private company by a foreign company?

Yes, there is a broad range of complex structures that can be used in private mergers and acquisitions transactions, depending on the issues and conditions of the deal. The transaction may involve the merger or spin-off of the involved companies, swaps of shares or assets, performance of initial public offers, and many other things, such as a two-stage hive-down of the cross-border assets into a subsidiary of the seller (Newco) followed by the sale of the shares in Newco to the ultimate buyer. Another alternative would be an umbrella agreement governed by Brazilian law regulating the cross-border deal in its entirety, leaving the transfer for completely separate documents to be prepared by local counsel, but is not so common in Brazil.

10. Is there any difference in the accounting treatment of share purchases and asset purchases?

The purchase of assets of a business or the purchase of 100% of the shares of the relevant company do not cause different accounting treatments when it comes to the consolidated financial statements of the buyer. However, relevant differences arise in the individual financial statements of the companies.

Brazilian accounting regulations were entirely revised in the past few years in order to converge with the International Financial Reporting Standards (IFRS) and these regulations are mandatory for all types of companies, large or small, listed or not, including subsidiaries of foreign companies. Listed corporations, large sized companies (with total assets over BRL240 million or annual gross revenue over BRL300 million), financial institutions and insurance companies must follow the complete set of IFRS (full IFRS), while medium and small-sized companies are subject to a slightly different and more simple set of rules labelled as "IFRS-SMEs".

The focal point of these regulations has always been the consolidated financial statements, where the accounting for asset or share sales does not deviate. In both cases the initial recognition is based on the fair value of the assets acquired. The acquirer recognises separately the identifiable assets, liabilities and contingent liabilities that exist at the date of acquisition. Goodwill is recognised as an intangible asset and is subject to impairment (full IFRS) or amortisation over its useful life or ten years (IFRS-SMEs). Transaction costs are capitalised (IFRS-SMEs) or treated as expenses (full IFRS).

In the individual financial statements, the treatment will be different since Brazilian corporate law requires the use of the equity method to measure investments in subsidiaries (as well as in joint ventures and associates). IFRS was also adapted in 2014 to reinstate the option to use the equity method in separate/individual financial statements (IAS 27).

For that reason, the accounting of an asset deal versus a share deal will render different results at the level of the individual financial statement. In asset deals, the cost of acquisition of assets and liabilities acquired will be allocated to each individual item of asset/liability acquired. In share deals, the cost of acquisition will be accounted for as an investment in a subsidiary at the transaction price. The difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as goodwill, and it is included in the carrying amount of the investment. Amortisation of this goodwill is not permitted.

11. Have you experienced any change in how cross-border share or asset acquisitions are structured as a result of Brexit, if relevant?

We have not noticed any change in how cross-border share or asset acquisitions are structured as a result of Brexit.

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