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May 2007

## Foreign Investment In Brazil Via FIP Article by Ana Cecília Manente

There has been a significant increase of investment in Brazilian companies via Private Equity Funds ("FIP"), created under Brazilian Securities and Exchange Commission – CVM Instruction No. 391, dated July 16, 2003. The recent granting of fiscal benefits to foreign investors investing in FIPs is one of the reasons for this phenomenon.

The FIP may acquire shares, debentures, subscription bonds and other convertible securities of public or private companies, and is required by applicable regulation to participate in the decision-making process of the company.

As private companies are not registered with the CVM, in order to be eligible to receive investments from a FIP, they must adopt certain minimum corporate governance practices. Among other requirements, corporate disputes of the company must be resolved through arbitration and the company must submit its financial reports for audit on a yearly basis by CVM-registered independent auditors.

The FIP must have an administrator authorized by the CVM, as well as written regulations relative to investment policy, quotaholder rights, capital calls and redemptions. The FIP may issue more than one class of quotas, subject to different voting rights and fees. Thus, the same vehicle can accommodate investors of distinct particularities. Nonetheless, FIP quotaholders, regardless of the class, will always have the right to an undivided interest in the fund's portfolio, which cannot be segregated among classes of quotas.

Especially for foreign investors, the FIP receives a favorable tax treatment on the basis of recent legislation.

The withholding income tax rate applicable to earnings from FIP investments is reduced to zero when the earnings are paid to an individual or collective beneficiary domiciled abroad, as long as, cumulatively:

- i the FIP investment was made in accordance with National Monetary Council rules (Resolution No. 2.689, dated January 26, 2000);
- ii the beneficiary, individually or together with related parties, does not hold 40% or more of the quotas issued by the FIP, nor has the right to receive more than 40% of the income generated by the FIP;
- iii the FIP's portfolio does not, at any time, consist of more than 5% in bonds or fixed-rate financial instruments, except for convertible debentures and bonds issued by the Brazilian government; and
- iv the beneficiary is not domiciled in a tax haven.<sup>1</sup>

Where all such conditions are not met, earnings generated by the FIP will be subject to withholding income tax at a rate of 15%, so long as the fund meets the diversification requirements and complies with the investment rules established by the CVM and, further, has a portfolio at least 67% comprised of shares of corporations, convertible debentures and subscription bonds.<sup>2</sup>

Both the 0% and 15% rates are relatively low. Additionally, the requirements indicated in subitems (i) and (iv) above being present, the capital gains from the sale of FIP quotas will be free from income tax should the sale be made via a stock exchange or similar entity.

Thus, it is possible, depending on the particular case, to reduce to zero the Brazilian taxation on any and all return a foreign investor might have on investment in operational companies via a FIP.

<sup>1</sup> A jurisdiction that does not impose income tax or imposes income tax at a maximum rate less than 20%.

<sup>2</sup> In the case of FIPs that do not comply with the diversification requirements and other conditions established under Law No 11.312/06 and the CVM regulations, the withholding income tax applies according to the same regressive rates of 22,5%, 20%, 17,5% and 15% applicable to Brazilian fixed income funds in general.

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