

## FRIENDLY ENVIRONMENT FOR THE PRIVATE EQUITY INDUSTRY IN BRAZIL

The Brazilian private equity and venture capital industry has been essentially based on foreign investment. For the last 25 years, two-thirds of the resources raised by *Fundos de Investimentos em Participações* – FIP (Brazilian private equity funds) were in US Dollars. Recent changes in legislation and on the pipeline rendered the environment more advantageous yet.

The tax friendly legal environment for the foreign Private Equity industry is well established. As a rule, the Brazilian Withholding Income Tax (“WHT”) rate levied on income distributed by FIP to foreign-resident investors, as well as on capital gains earned by such investors upon the sale and amortization of FIP shares, is zero, subject to the following conditions:

- (i) The foreign-resident investor, individually or together with related parties, shall hold less than 40% of the fund’s total equity and be entitled to no more than 40% of the fund’s total income;
- (ii) the fund shall not at any time hold/invest more than 5% of its net asset value in debt instruments, except for public bonds, stock-convertible debentures, and subscription bonuses;
- (iii) the foreign investment in the FIP is made in accordance with the rules and conditions set forth by the National Monetary Council;
- (iv) the foreign-resident investor cannot be resident or domiciled in a low taxation (tax haven) jurisdiction;
- (v) the FIP must comply with diversification limits and investment rules issued by the CVM and
- (vi) at least 67% of the FIP’s net assets should be composed of stock of corporations, stock-convertible debentures, and subscription bonuses. In case any of such conditions are not met, the FIP’s shareholders shall be taxed at the general rate of 15%.

The Brazilian government intends to incentivize foreign investments. An example of this intention is a recent Bill eliminating limits to foreign holdings in Brazilian companies exploiting aviation services.

President Jair Bolsonaro also enacted the “Economic Freedom Rights Declaration” Provisional Measure (MP 881), which allows investment funds to be organized with limited liability, among other innovations. Until now, Brazilian funds could not limit the liability of investors. In addition, the activism of Brazilian courts, as well as complex tax, labor, environmental legal frameworks, among others, always represented a threat to entrepreneurs and investors.

As a result of these changes, MP 881 is likely to promote a significant boost to the local investment fund industry. The MP is already effective but shall be voted by Congress by August 28 or it will

lapse. Additional regulations are to be issued by the Brazilian Securities Commission (*Comissão de Valores Mobiliários* – CVM) but they are also pending.

All these recent changes create conditions for a vigorous and sustainable growth of the private equity industry in the next few years. The expected recovery of the Brazilian economy and privatizations to be carried out in Federal and State levels can add even more fuel to the market. In any scenario, the FIP must always be on the table as a tool for private equity investments in Brazil. Risks must be made clear, but opportunities are more than ever outstanding.

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