TAX PERSPECTIVE
DeAlmeida International & M&A Tax Law

Businesses Models
Software Companies adopt in Brazil
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Nonresident companies engage in businesses in Brazil when they acquire an existing entity or set up thei subsidiary. The local presence has commercial impact on the relationship with local clients. This strategy allows nonresidents to understand the dynamics of the Brazilian market, one of the world´s largest consumer markets of tech solutions. The business model of start-ups is often based on cost-plus arrangements. The Brazilian company receives an arm´s length commission fee for marketing, sales and technical support. Nonresidents license their products to local clients who pay royalty fees.

A second group is made of local subsidiaries that are licensees of their parent companies and sublicense the software to local clients. They typically have marketing & sales activities. From a tax standpoint, the "resale function" based on the sublicense of the software attracts additional direct and indirect taxation at the level of the Brazilian subsidiary and the structure becomes more expensive. On the other hand, if the software company offers standard software solutions to clients and obtains favorable rulings from Federal and State tax authorities, the typical tax burden can be substantially reduced.

The third group of nonresident software companies enters into commercial arrangements with exclusive and non-exclusive local distributors. Commercial aspects derived from this relationship have to be weighted. Distributors will typically charge the nonresident all its tax and non-tax costs. As they are generally small business that pay corporate income taxes based on gross revenues rather than adjusted net income, they will transfer the indirect and corporate income tax costs, and payroll costs as well. This practice may lead to a certain level of controversy between the partners. Under these arrangements, distributors sublicense software and/or provide services to local clients. Exclusivity requires transfer pricing analysis in Brazil as if the distributor were a subsidiary. This group is less representative.

The cons of a local presence regard the high costs of doing business in Brazil (tax, labor and social security costs). The corporate income and turnover taxation imposed on the business could be minimized depending on the regime of taxation. The overall tax compliance obligations, including the Brazilian transfer pricing policy (that is different from the U.S. transfer pricing and OECD guidelines), also have an impact on costs. All these aspects are discussed below.

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