Pensions issues in cross-border acquisitions Q&A: Brazil

by Alexandre Pessoa and Henrique Lopes, KLA Advogados

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

This Q&A provides country-specific commentary on *Practice note, Pensions issues in cross-border acquisitions: Cross-border*.

1. Is there a legal requirement on both employers and employees to make pension contributions to the government to fund some form of state retirement pension in your jurisdiction? If so, how does this requirement operate?

Yes. Article 194 of the Brazilian Federal Constitution establishes the General Public Retirement Pension (*Regime Geral de Previdência Social*). This is part of Brazil's general social security regime which is regulated by Law No. 8,212 (contributions) and Law No. 8,213 (benefits, including retirement), both dated 24 July 1991 (Social Security Regime). The regime is a mandatory, pay as you go public retirement pension scheme managed by the Brazilian National Social Security Institute (*Instituto Nacional do Seguro Social* (INSS)).

The pension scheme is funded by employers and employees. Employer contributions are 20% of payroll. Employee contributions vary from 7.5% to 14% of the employee's salary (representing a maximum total monthly amount of BRL854.15 per employee). Employee contributions are deducted from the employee's monthly pay and paid by the employer to the social security system. Other additional contributions linked to the type of business concerned and the level of safety at work may raise the total payments due by employers to up to 28.8% of the payroll.

Two additional contributions related to the Social Security Regime are required from all private legal persons:

- The programme for social integration (PIS).
- The contribution for the financing of social security (COFINS).

These are levied on gross revenue. The rates that generally apply to these contributions are 1.65% for PIS and 7.6% for COFINS (with the possibility of taking offsetting input tax credits). There are other regimes for smaller companies (0.65% PIS and 3% COFINS, with no input tax credits), and for specific activities. Payments originating from COFINS serve to finance the Social Security Regime in general, and payments originating from PIS fund specific welfare programmes.

In addition to the General Public Retirement Pension, there is a specific regime that applies to government workers, called the Pension Regime for Government Workers (*Regimes Próprios de Previdência Social* (RPPS)). This regime is also a pay as you go state retirement pension scheme, although in some cases it is pre-funded by states and municipalities. The equivalent of the PIS in the public sector is called PASEP.

2. Is supplementary (that is, non-state) pension provision available and/or legally required in your jurisdiction? If so:

- Is this provided mainly through contractual arrangements between individuals and product providers (such as insurers) or by employer-sponsored and/or industry-wide schemes?
- Is tax relief available on contributions made to such schemes for both employees and employers?

Private pensions in Brazil can be provided through:

- Pension Funds contracted by employer-sponsored or industry wide schemes managed by EFPCs.
- Private Pension Plans contracted by individuals with EAPCs (that is, *Vida Gerador de Beneficio Livre* (VGBL) and *Plano Gerador de Beneficio Livre* (PGBL)).

Yes, retirement contributions are subject to specific tax rules.

Legal entities may make income tax deductions on payments made to private pensions for the benefit of employees up to 20% of the combined salaries of employees and managers registered in those plans. However, withholding income tax (WHT) applies to payments received upon retirement.

Once the individual has chosen a private pension to participate in, the employee must choose one of the two following alternative WHT regimes to be applied on payments received from such a scheme upon retirement or withdrawal of the contributed amounts:

- Progressive tax rate regime.
- Regressive tax rate regime.

WHT on the progressive tax rate regime is the standard WHT in Brazil. The larger the income, the larger the WHT tax rate on income received. Under the progressive tax rate regime, the taxpayer will be charged up to 27.5% total WHT on income received from the private pension. Under the regressive tax rate regime, the longer the taxpayer stays in the private pension, the lower the WHT rate will be. For plans under two years' duration, the WHT rate is 35%. For plans with a duration of more than ten years, the WHT rate is 10%.

In the Brazilian market there are two kinds of Private Pension Plans most commonly contracted by individuals, which differ from each other mainly with respect to their tax treatment:

- **VGBL.** The individual takes no deductions with respect to the contributions made by them to the Private Pension Plan. In the future, they will be liable for income tax on the return from the fund investments (the principal capital invested will not be taxed).

- **PGBL.** The individual can take a deduction of up to 12% of their income in the assessment of their income tax. In the future they will be taxed on the whole amount redeemed from the funds (thus the principal capital invested, as well as the return from the investment, will be taxed).

The Private Pension Plan schemes referred to above (VGBL and PGBL) are to some extent based on the IRA (Individual Retirement Account) and 401k retirement plans in the United States.

3. Where supplementary schemes are provided, do these schemes provide pensions, the value of which:

- Is linked to the employee's salary (defined benefit)?
- Is linked to employer and/or employee contributions and investment return on those contributions (defined contribution)?

Complementary private pensions are based on an individual funding scheme (capitalisation regime), determined according to the plan contracted by the employer or the individual. In the case of a private pension offered to an employee, the employer usually makes contributions proportional to those made by the employee. The employee's contributions are usually based on a percentage of their salary.

Although there are some complementary pension plans contracted on a defined benefit system, as a result of historical losses experienced by complementary pension entities most complementary pension plans are structured as defined contribution plans. The pension benefit paid to the individual will be calculated and known only at the time such benefit is granted, based on the employer and employee contributions and the investment return on those contributions.

4. Please confirm what level of government supervision operates in respect of work-based and/or supplementary pension provision in your jurisdiction. If a specific government body exists to monitor and/or regulate such provision please confirm the scope of its powers and provide examples of its intervention (if possible).

Both the General Public Retirement Pension and private pensions are regulated, monitored and supervised by the government.

The work-based retirement scheme is granted through the General Public Retirement Pension. The rules that apply to it are set by the Social Security Secretariat of the Brazilian Ministry of Finance, and executed by the INSS. The General Public Retirement Pension is contributory and mandatory. Among the contributors are:

- Employers.
- Wage earners.
- Domestic workers.
- Self-employed workers.
- Individual taxpayers.
- Rural workers.

Private pension retirement schemes are granted through the following:

- **Pension Funds.** These are managed by EFPCs, which are regulated, monitored and supervised by the National Superintendence of Supplementary Pension (*Superintendência Nacional de Previdência Complementar*) (PREVIC), an autonomous governmental agency connected to the Brazilian Ministry of Social Security (*Pension Funds Law No. 12,154, dated 23 December 2009)*. PREVIC monitors and supervises the EFPCs and implements policies for the complementary pension scheme and market.
- **Private Pension Plans.** These are managed by EAPCs, which are regulated, monitored and supervised by:
  - the National Council of Private Insurance (*Conselho Nacional de Seguros Privados*) (CNSP), a governmental agency established under Decree Law No. 73, dated 21 November 1966 (Brazilian Private Insurance System Law). CNSP is responsible for setting the guidelines and rules for the legal entities and market under the Decree Law (insurance, reinsurance, capitalisation and private pension); and
  - the Superintendence of Private Insurance (*Superintendência de Seguros Privados*) (SUSEP), a governmental body also established under Decree Law No. 73/1966, responsible for the execution of the general rules established by CNSP.

These regulators have the power to:

- Authorise the incorporation and operation of an entity.
- Inspect an entity.
- Require administrative measures.
- Mediate disputes with the insured or participants.
- Impose penalties.
- Shut down entities in violation of their rules (*Law No. 12,154/2009* in the case of PREVIC; *Decree Law No. 73/1966* in the case of CNSP and SUSEP).

5. Where an employer elects or is required to provide a work-based pension for its employees is this commonly funded or unfunded in your jurisdiction? If unfunded, how is allowance made for the

future funding obligation, and how is this recorded in the employing company's accounts or financial records?

With respect to contributions to the General Public Retirement Pension, the employer is only required to make monthly contributions, and is not required to provide for any shortfall in the public pension.

With respect to private pensions, although most future private pension benefits are based on a defined contribution (that is, the benefit amount will be known only in the future, based on the contributions made and the return on the investment), according to the applicable law and regulation, EAPCs and EFPCs must make provision to enable and ensure future obligations (financial and economic stability). These provisions must be presented in financial statements based on the rules established in the applicable regulations.

Private pensions may or may not be sponsored by the employer. An adhesion agreement may make an employer responsible for financial shortfalls connected to Private Pension Plans managed by EFPCs. In these cases, the employer must be aware of the adhesion agreement rules, follow closely the EFPC's financial statements and make the proper financial provisions in accordance with the generally accepted accounting standards (in Brazil, close to IRFS) in order to face future obligations connected to the Pension Fund offered to the employees.

6.Are there any established customs and practices to provide pension or retirement benefits for employees in addition to any legal obligations that may already apply to an employer? If so, please explain what these are and (if possible) provide examples of their operation and provision.

Private pensions are usually offered by large employers (especially companies with thousands of employees) for the following reasons:

- They are an additional benefit of the employment contract.
- They complement the General Public Retirement Pension.
- They are a tool used as part of a talent retention strategy.

In most cases, employers offer contributions equal to those voluntarily made by the employees who decide to participate in the plan. Within certain limits, contributions by employers made directly to the plans are exempt from social security taxes.

7. If an employee is transferred as part of a business acquisition, is the transferee obliged to provide pension provision in respect of the transferring employees? If so, is the transferee required to honour existing pension rights or provide equivalent rights? If so, how is this dealt with in practice?

A private pension is considered part of an employment contract, which is protected against any detrimental changes by Article 468 of the Consolidated Labour Laws. Therefore, in the case of a transfer, the new owner or new employer is required to honour the existing pension rights, or provide equivalent rights. It is usual for private pensions previously granted to employees to be transferred from one employer to another.

8. In the scenario described under *Question 7* above, please confirm which party assumes responsibility for the provision and funding of any pension or retirement benefits that have accrued prior to the date of the transfer.

The acquiring party, or the new employer, assumes responsibility for the provision and funding of the private pension. The accrued funds are transferred to ensure the payment of the respective benefits.

9. Can employees that are working outside of their home jurisdiction, and employees of a subsidiary company in a different jurisdiction, participate in a pension scheme established by a "home" parent company? Are the same tax reliefs referred to in *Question 2* still available in these circumstances?

In Brazil there is no consolidation of legal entities for tax or social security purposes. A subsidiary and a parent company are considered separate entities, and each one is responsible for the social security of its own employees, whether the employees are working in Brazil or abroad. Under Brazilian social security laws, employees of Brazilian companies who are working anywhere in the world, and employees of foreign companies who are working in Brazil, are subject to Brazilian social security contributions and entitled to the respective benefits.

If the employee is required to make local social security payments in the country where they work, in the absence of a tax or social security convention to avoid double taxation, the employee may be required to make payments in both jurisdictions.

Employees working abroad who have an obligation to present income tax statements in Brazil will also benefit from the corresponding tax reliefs.

Nothing in the applicable law prohibits a Brazilian parent company from including employees working outside of their home jurisdiction in its private pension. It is not clear whether an employee of a subsidiary company located in an overseas jurisdiction can be included in the parent company's private pension.

Brazilian companies that contract private pensions for the benefit of their employees must offer such a plan to all employees (*Complementary Law No. 109 dated 29 May 2001*).

Where no tax or social security treaty is in place that specifically refers to private pensions, payments may be subject to WHT on the Brazilian source.

The situation can be summarised as follows:

- The fact that an employee of a Brazilian company is working abroad does not change the requirement for the employee to enter into, or be kept in, the private pension that has been contracted.
- Based on the applicable law and regulations, any individual can participate in a private pension, as long as the employee complies with the general admission requirements. However, it is important to note that some practical difficulties may arise in this scenario, including that:
  - the insurer is likely to request the identification of the foreign based individual through its enrolment with the Brazilian Tax Authorities, compelling the individual to register before the Cadastro de Pessoas Físicas (CPF); and
  - it is possible that the Brazilian Central Bank may question the remittances of funds needed to make contributions to the private pension.
- For a foreign subsidiary of a Brazilian parent company to include its employees in the private pension contracted by the parent company, it must contract or register itself with EAPC, EFPC and the supervising authority, as the case may be. The foreign subsidiary may face questioning from the Brazilian Central Bank about the funds remitted to make contributions to the private pension. In such cases, even if the foreign subsidiary and the parent company are able to enter into an inter-company arrangement to enable the payment through the parent company, this option must be fully reviewed by both companies. It can raise tax concerns and create additional costs not foreseen in a superficial analysis.

These complexities make it very unusual for a non-resident individual to hold a pension plan in Brazil, and for Brazilian employers to sponsor a Brazilian pension plan for the benefit of non-resident employees, in particular employees of a subsidiary located abroad.

10. What information would a buyer usually request about pensions and other retirement benefits in a due diligence exercise relating to a private company or an asset acquisition? Would the seller commonly provide this information?

The information usually requested varies depending on the following:

- The nature of the transaction (that is, whether it is a company acquisition, a control acquisition, a share participation acquisition, or an asset acquisition).
- The distribution of responsibilities between the parties (buyer and seller).
- The nature of the existing complementary pension plan.

The buyer should request disclosure of the following information:

- Whether a pension plan for employees exists.
- The managing entity (EAPC or EFPC).

- The nature of the pension plan.
- How the scheme is funded (by the employer and/or the employee).
- A copy of the pension plan contracts, including the pension plan statute or regulation, adhesion agreement and regulatory approval, as the case may be.
- The number of employees included in the pension plan.
- Any shortfalls in the pension plan in the past three years.
- The pension plan's financial statements regarding, at least, the last three years.
- Any provisions made by the employer to fund future obligations connected to an occasional financial shortfall in the pension plan, and a copy of the last financial statement, as the case may be.

The seller usually has no problem in responding to any queries concerning pension plans, or disclosing information, documents and evidence about such matters.

11.What provisions would commonly be inserted in a share purchase or asset purchase agreement relating to pensions and other retirement benefits (for example, would specific warranties be given by the seller?)

The contractual structure will vary according to the nature of the transaction and the information that is disclosed or detected during due diligence (for example, a financial shortfall in the pension plan, or the responsibility terms of an adhesion agreement).

It is common for specific arrangements and warranties to apply whenever a pension plan is detected in a transaction, especially if it involves a company sponsoring or funding a pension fund. In an asset acquisition, there is a lower degree of concern with regard to pension plans. In a share acquisition, the buyer must pay greater attention to pension plan matters.

Contributor details

Alexandre Pessoa, Partner

KLA Advogados
T +55 11 3799 8174
E *apessoa@klalaw.com.br*
W *www.klalaw.com.br*

Area of practice: Labour.

Henrique Lopes, Partner

KLA Advogados
T +55 11 3799 8125
E *hlopes@klalaw.com.br*
W *www.klalaw.com.br*

Area of practice: Tax.

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