Distributing Funds from Companies by Dividend (Brazil)

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Practice notes | Law stated as of 01-Feb-2024 | Brazil

A Practice Note explaining how to distribute funds from limited liability companies (*sociedade empresária limitada* (Ltda)) and stock corporations (*sociedade anônima* (SA)) in Brazil by way of dividends. Issues addressed include determining if a Brazilian company can pay a dividend, the amount that can be paid, the approval process for declaring a dividend, and related duties and liabilities of directors in the context of dividends.

When shareholders invest in a company, they expect to receive returns on their investment. Companies deliver these returns to their shareholders through various means, but the main and widely favored method in Brazil is by distributing dividends.

This Note explains what dividends are and discusses the legal procedure and practice surrounding the declaration and payment of dividends of limited liability companies (*sociedade empresária limitada* (Ltda)) and stock corporations (*sociedade anônima* (SA)) in Brazil. For more information about the key corporate features of Ltdas and SAs, see Practice Note, Trading Vehicles: Overview (Brazil).

Outside the scope of this Note are:

- Dividends in kind, which are dividends satisfied by the distribution of assets rather than in cash or stock dividends (satisfied by the issue of shares).
- Other forms of distributions and returns of funds to shareholders such as share buybacks, royalty payments, reduction of share capital, and loans.
- The accounting treatment of dividends in Brazil.

Unless otherwise stated, a reference in this Note to:

- A "company" means both a Ltda and an SA.
- A "share" includes the capital stock of an SA, which is divided into shares, as well as the capital stock of a Ltda, which is divided into quotas.
- A "shareholder" means both a shareholder in an SA and a quotaholder (partner) in a Ltda.
- The Brazilian Civil Code (*Código Civil Brasileiro*) means Law No. 10,406/2002.
- The Corporations Law (*Lei das Sociedades por Ações*) means Law No. 6,404/1976.
- The Penal Code (*Código Penal*) means Decree-Law No. 2848/1940.

What Is a Dividend?

A dividend is a distribution of a company's post-tax profits to its shareholders. The profit of a company is in principle for the benefit of its shareholders, meaning that every shareholder has the right to receive dividends on the profits of the company in which they invest (see Right to a Dividend).

Dividends are, by nature, derived from shares (in stock corporations) or quotas (in limited liability companies).

Articles 201 to 205 of the Corporations Law govern the distribution of dividends by stock corporations. Most of the provisions of the Corporations Law regarding dividends also apply to limited liability companies, with the main exceptions explained throughout this Note.

In Brazil, it also possible to remunerate the shareholders through a mechanism known as distribution of "interest on equity capital" (*juros sobre o capital próprio* (JCP)) (Article 9, Law No. 9,249/1995).

The main difference between these two types of profit distribution relies on their tax and accounting treatment:

- In the company's accounting, JCP is booked as an expense and is deductible from the Corporate Income Tax (*Imposto sobre a Renda das Pessoas Jurídicas* (IRPJ)). Shareholders who receive JCP are subject to withholding income tax of 15% on the amount received (or 25% if the shareholder is resident in a tax haven jurisdiction).
- Dividends are booked in the company's accounts as profit distributions. Dividends are exempt from income tax for the receiving shareholder, while the company pays (at least) 25% in IRPJ and 9% in Social Contribution on Net Profit (*Contribuição Social sobre o Lucro Líquido* (CSLL)).

Dividends and JCP also differ in their calculation basis. Dividends are based on the company's net profit, accumulated profits, or profit reserves and their amount is not limited by law. JCP is calculated based on the company's net equity and their amount is limited. (Article 9, Law No. 9,249/1995.)

Stock corporations must pay a compulsory dividend as may be stipulated in the company's by-laws. If the by-laws are silent, the compulsory dividend distributed to the shareholders must be in the amount equivalent to at least half of the company's net profit as adjusted (Article 202, Corporations Law). However, the compulsory dividend is limited to the net profit for the year, which is the basis for its calculation (see Amount of the Dividend).

As for limited liability companies, there is no compulsory dividend or legal requirement for a minimum distribution of profits. Payment of dividends or reinvestment of profits depend on a shareholders' resolution.

The distribution of JCP is fully optional for both stock corporations and limited liability companies.

As a rule, dividends must be paid in cash since this is the normal way of payment. Payment made by a means other than cash corresponds to a payment in kind and, consequently, should require agreement from any creditor shareholder.

Any dividend paid out by a company is either an annual dividend, an intermediate dividend, or an interim dividend (see Annual Dividends vs Intermediate and Interim Dividends). The dividend may be a normal dividend paid periodically during the company's financial year as a reflection of its ongoing performance, a one-off special dividend, or a fixed dividend that is paid to the holders of preferred shares.

Why Pay a Dividend?

Companies pay dividends to:

- Reward their shareholders for making capital available to the company.
- Provide shareholders with a return on their investment.
- Maximize shareholder value.

Many private subsidiary companies of multinationals use dividends to repatriate local profits up to their parent companies.

Determining if a Company Can Pay a Dividend

The distribution of dividends is contingent on the presence of company profits.

A Brazilian company can only pay dividends from the net profit for the year, accumulated profits, and the profit reserve account (Article 202, Corporations Law). In the case of preferred shares with priority in the distribution of cumulative dividends, dividends can also be paid from the capital reserve account when the profit for the year is insufficient to pay it and if provided by the by-laws (Article 201, Corporations Law).

In addition to the compulsory dividend, Brazilian law allows for a priority dividend. While the compulsory dividend is restricted to the net profit for the year, the priority dividend encompasses the profit for the year and profit reserves, retained earnings, and capital reserves (subject to the fulfillment of the conditions in the Corporations Law).

After determining the annual profit and deducting the legal reserve, the company must, as a first step, allocate the priority dividend (fixed or minimum) of any outstanding preferred shares. This dividend cannot be affected by other profit reserves or the compulsory dividend, ensuring its priority (Article 203, Corporations Law). (See Amount of the Dividend.)

When deciding on dividend distribution, the general shareholders' meeting (*assembleia geral*) encounters two limits:

- The minimum amount, represented by priority and compulsory dividends.
- The maximum amount, represented by the sum of the following accounts:
  - net profit for the year;
  - accumulated profits; and
  - profit reserves.

Whenever the maximum limit equals zero, the minimum limit is adversely affected.

For annual dividends, the financial statements for the period, including the proposal for the allocation of profits, must be drawn up in the four months following the end of the company's financial year under the responsibility of the company's management bodies. The financial statements must be submitted for approval of the general shareholders' meeting (for stock corporations) or the partners' meeting (for limited liability companies).

For interim or intermediate dividends, balance sheets must be drawn up evidencing the existence of profits within the respective periods (see Annual Dividends vs Intermediate and Interim Dividends).

Declaring a Dividend

If distributable profits are present, the second prerequisite for dividend distribution is the resolution determining their distribution.

Board Approval

As a rule, limited liability companies do not have a Board of Directors (*Conselho de Administração*) and their management is incumbent on the individuals (managers) appointed under the articles of association or by a resolution of the partners, as applicable.

The management bodies of stock corporations are comprised by the Board of Directors, which is optional for closely held stock companies, and the Board of Officers (*Diretoria*).

The management of both limited liability companies and stock corporations is responsible for recommending or not recommending the distribution of dividends to shareholders. However, as a rule:

- For limited liability companies, the declaration of annual, intermediate, or interim dividends falls under the responsibility of the partners through a partners' meeting (Article 1,071, Brazilian Civil Code).
- For stock corporations, the declaration of annual dividends falls under the responsibility of the general shareholders' meeting (Article 132, item II, Corporations Law).

- For interim or intermediate dividends, the by-laws of stock corporations may authorize the Board of Directors (or, if the company does not have a Board of Directors, the Board of Officers) to declare interim dividends, to the account of accumulated profits or profit reserves existing in the last annual or half-yearly balance sheet (Article 204, Corporations Law).

(See Annual Dividends vs Intermediate and Interim Dividends.)

Shareholders' Resolution to Declare a Dividend

The annual distribution of dividends must be deliberated by the general shareholders' meeting, which holds the prerogative to deliberate and approve management's accounts and declare dividends.

The approval of the resolution for dividend distribution requires a simple majority of the shareholders present at the meeting (Article 129, Corporations Law; Article 1,076, item (b), Brazilian Civil Code). A higher quorum may be established under the company's by-laws (or, in case of limited liability companies, articles of association) or shareholders' agreement.

Closely held stock corporations that are not controlled by publicly held stock corporations may choose to distribute dividends in a lower amount than the mandatory one, or even retain the entire net profit, if no shareholder attending the meeting objects.

The minutes of the dividend distribution resolution taken by the general shareholders' meeting, or by the management bodies of stock corporations authorized to declare interim dividends, must be submitted for registration with the Board of Trade (*Junta Comercial*) of the state where the company's headquarters are located.

Directors' Duties and Liabilities in Context of Dividends

Officers and shareholders may face liability for disregarding corporate rules on the accounting and distribution of dividends (Article 201, Paragraphs 1 and 2, Corporations Law). Officers who distribute dividends using funds other than net profit or applicable reserves may be:

- Held civilly responsible, jointly and severally.
- Ordered to reimburse the amounts improperly attributed to the company.
- Subject to criminal action (Article 117, Paragraph 1, Penal Code) and administrative action if the company is publicly traded (Article 11, Law No. 6,385/1976).

To avoid this liability, officers and shareholders must diligently adhere to corporate rules on the determination and distribution of dividends, as outlined in the Corporations Law, especially concerning origin and approval of the dividend distribution. Transparency in communicating and documenting dividend-related deliberations also plays a crucial role in mitigating legal risks.

Officers and shareholders should seek specialized legal counsel to ensure all practices are compliant to avoid the civil, criminal, and administrative liabilities stipulated in the applicable regulations.

Provisions in By-Laws, Articles of Association, and Shareholders' Agreement

Before declaring and paying a dividend, the company's constitutional documents should be reviewed for any express provisions on dividends. Provisions related to dividends and their distribution are quite common under the company's by-laws (or articles of association) and any applicable shareholders' agreement, and may include:

- For both stock corporations and limited liability companies:
  - voting and quorum requirements in respect of shareholders' or partners' resolutions to approve and pay dividends; and
  - a provision authorizing the company to declare intermediate or interim dividends.
- For stock corporations:
  - a provision authorizing another corporate body, such as the board of officers, to declare intermediate or interim dividends;
  - the percentage of the compulsory dividend; and
  - the description of dividends attributable to preferred shares issued with priority in the distribution of dividends.

Amount of the Dividend

A company can only pay dividends from:

- The net profit for the year, accumulated profits, and the profit reserve account (Article 202, Corporations Law).
- The capital reserve account in the case of preferred shares with priority in the distribution of cumulative dividends, when the profit for the year is insufficient to pay it and so provided by the by-laws (Article 201, Corporations Law).

Reserves and dividends are calculated based on the net profit for the year, in the following order:

- 5% for creating the legal reserve, capped at 20% of the share capital (Article 193, Corporations Law).
- Fixed or minimum dividends prioritized for preferred shareholders, including delayed payments, if cumulative (Article 203, Corporations Law).
- Contingency reserves, if applicable (Article 195, Corporations Law).
- The tax incentive reserve, if applicable. The general shareholders' meeting may, on the management bodies' proposal, allocate to the tax incentive reserve the portion of net profit derived from government grants or subsidies for investments, which amount may be excluded from the calculation of the compulsory dividend (Article 195-A, Corporations Law).
- The compulsory dividend, as the allocation of profits to the creation of statutory reserves (Article 194, Corporations Law) and the retention of profits (Article 196, Corporations Law) cannot be approved each year to the detriment of the compulsory dividend (Articles 198 and 202, Corporations Law).
- Statutory reserves, if applicable (Article 194, Corporations Law).
- Retained profits, following the terms of the capital budget previously approved by the general shareholders' meeting, if applicable (Article 196, Corporations Law).

If there is a remaining balance of the net profit for the year after these allocations, it must be distributed as dividends (Article 202, Paragraph 6, Corporations Law).

Right to a Dividend

Participating in company profits is considered a fundamental shareholder right in Brazil. The primary purpose of the company is to generate profits and distribute them among its shareholders. The exercise of the right to dividends depends on the existence of profits, which are a necessary precondition for their distribution.

If the company's financial situation does not permit the distribution of dividends, and the shareholder cannot exercise its right to share in the profits during that period, the right to dividends remains intact. Dividends become payable when there are profits, even for periods in which it has been suspended (Article 202, Paragraph 5, Corporations Law).

In limited liability companies, all quotas entitle their holders (partners) to profits proportionally to the number of quotas held (Article 1,007, Brazilian Civil Code). However, the articles of association may authorize distributions of profits disproportionate to the equity held by each of the partners.

Similarly, in stock corporations, each share confers on its holder certain rights relating to it, such as the right to share in the company's profits, which are distributed subject to statutory provisions (Articles 191-205, Corporations Law) and in proportion to each shareholder's stake in the share capital.

Distribution of dividends by stock corporations must be made proportionately to the equity participation held by the shareholder, except for closely held stock corporations that have ascertained an annual gross revenue of up to BRL78 million. These closely held companies may approve disproportionate dividend distributions if the rights of the preferred shareholders to receive fixed or minimum dividends are preserved.

Annual Dividends vs Intermediate and Interim Dividends

Any profit paid out by a company is either an annual dividend, an intermediate dividend, or interim dividend:

- Annual dividends are paid once a year and are calculated after the annual accounts have been drawn up and the company's profits have been determined.
- Intermediate profits (*lucros intermediários*) can be paid as dividends based on profits recorded in previous years (destined to profit reserves, as was done by the company when establishing the unrealized profit reserves). In this case, the by-laws must contain a provision authorizing the management bodies to declare these intermediate dividends.
- Interim profits (*lucros intercalares*) are profits distributed semesterly or in shorter periods, if the total dividends paid in each semester of the fiscal year do not exceed the amount of capital reserves provided by the company (Article 204, Corporations Law).

Capital reserves are financial resources that companies set aside for specific purposes. They are created from profits or other sources defined by the company's by-laws. There are different types of reserves, such as legal reserves, which are mandatory and aim to protect the company's financial stability.

For limited liability companies or stock corporations to pay an interim or intermediate dividend, the same requirements must be met as for the payment of an annual dividend, including:

- A balance sheet evidencing the profit to be distributed (see Determining if a Company Can Pay a Dividend).

- A partners' or shareholders' resolution (see Declaring a Dividend).
- Board approval, if applicable (see Board Approval).
- Minutes of a partners' or shareholders' resolution submitted for registration with the local Board of Trade (see Shareholders' Resolution to Declare a Dividend).

Currency

Dividends distributed by limited liability companies or stock corporations residing in Brazil must be paid in Brazilian Reais.

Method of Payment

Most dividend payments in Brazil are done by electronic transfer of funds to the shareholders' bank accounts. The company may also make these payments through a registered check sent by mail to the address provided by the shareholder.

Recent Developments

Complementary Law No. 182/2021 (known as the legal framework for startups) introduced significant changes, including the authorization for closely held stock corporations to approve disproportionate dividend distributions, which was previously prohibited for this type of company. Closely held stock corporations with an annual gross revenue of up to BRL78 million may approve disproportionate dividend distributions if the rights of preferred shareholders to receive fixed or minimum dividends are preserved. (See Right to a Dividend.)

Resolving and Paying a Dividend: Summary

The process of declaring and paying a dividend in Brazil can be summarized as follows:

- The officers or Board of Directors:
  - prepare and sign either the annual accounts or the balance sheets; and
  - ascertain from the balance sheets whether there are distributable profits (with final decision by the partners or the general shareholders' meeting).
- The partners' or general shareholders' meeting (and other management body, if applicable):
  - resolve to declare and pay dividends; and
  - approve the declaration and payment of dividends.
- The officers:
  - submit the resolution for registration at the local Board of Trade; and
  - pay the dividends.

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