

# Emerging Markets Review

## The BRIC Countries

**Anyone with an interest in the business world can hardly fail to have heard of the seemingly unending rise of the so-called BRIC countries – Brazil, Russia, India and China – which are predicted to command an increasing share of world trade in the coming years.**

The recent recession appears to have quickened that process as these emerging economic powers returned to strong growth far more quickly and easily than the traditionally dominant economies of North America and Europe. Furthermore, it is the BRIC countries that now have the lower debts and appreciating currencies that investors desire and which lead to business opportunities.

While in the past, trade with such countries primarily concerned their status as low-cost manufacturing centres, they are now growing in importance as a consumer market – for example, mobile phones are being registered in India at a rate of 12million a month! And unlike in the West, these consumer markets still have plenty of potential for expansion.

Despite this, UK trade with the BRIC countries remains at a relatively low level with fears over taxation, corruption and



bureaucracy holding potential investors and entrepreneurs back in the past. However, the growing strength of these economies means we can no longer afford to

ignore the opportunities the BRIC countries present.

We have, therefore, produced this guide with input from MGI member

firms in Brazil, Russia, India and China, introducing each country and highlighting some of the main points potential entrepreneurs and investors need to be aware of.



# Brazil

Prepared with the assistance of Claudio Wagner and Ariadine Menezes, MGI members in Sao Paulo, Brazil  
email: cw@sengerwagner.com.br • Web: www.sengerwagner.com.br

**According to projections from the International Monetary Fund, Brazil will become the seventh largest economy in the world in 2011 and it will remain in that position until at least 2015, the latest year for which there are forecasts. The Brazilian economy has surpassed in size the Canadian and Spanish economies, and in 2010 almost matched that of Italy.**

Brazil has also been named as the fourth-favourite destination for overseas investment during 2010 and 2011, with increasing numbers of foreign firms setting up operations in Brazil, or investing in existing Brazilian companies.

However, bureaucracy in the country is still seen as a major obstacle, sometimes difficult to understand for entrepreneurs and executives not familiar with Brazil. To illustrate this, after evaluating the rules for foreign investment in 87 countries worldwide, a World Bank report concluded that the opening of a company by a foreigner in Brazil takes an average of 166 days. Among the countries evaluated, only Angola (263 days), Haiti (212) and Venezuela (179), had more time-consuming procedures. This time was directly related to the paperwork for all stages, which involves about 40 kinds of documents that must be completed before the doors of the business can be opened.

Nonetheless, it is possible to reduce this timescale by using legal and tax consultants in Brazil

who understand the laws, rules and procedures in the country and are able to correctly file the necessary documents. The Brazilian government is also working to move the information, control and registration systems of companies online, which should be successful in making the registration of companies in Brazil quicker and easier.

Brazil's income tax system has a number of bands, ranging from 0 per cent to 27.5 per cent, depending on earnings, while non-residents pay a flat rate of 27.5 per cent on all income earned in Brazil. Corporate tax consists of a basic tax rate of 15 per cent, a 10 per cent surcharge on any income over 240,000 Reais (£89,556 at 1 February 2011) and a nine per cent social contribution. Capital gains are taxed at 15 per cent for individuals, while for companies they are added to their regular income.

One area where Brazil is ahead of the game is its use of the international accounting standards issued by the IASB, which have been implemented in Brazil since 2008, and from the financial year beginning 1 January 2010, their use is already fully compulsory, not only in the consolidated financial statements, but also in primary accounting, i.e. in separate statements. With the complete convergence of IASB standards in 2010, Brazil will be the first country to produce individual and consolidated balance sheets according to international standards.

# Russia

Prepared with the assistance of Svetlana Gavrilova, MGI member in Moscow, Russia email: gavrilova@delprof.ru • Web: www.delprof.ru

**Russia is the largest country in the world, with abundant natural resources and a population of around 142million people. It offers many opportunities for new overseas investors, but also presents several difficulties including a very complex tax system, a lack of English spoken outside the major cities and high levels of bureaucracy and corruption.**

Russian policies to encourage overseas investment include tax reliefs, reduced administrative barriers and developing public-private partnerships. Russia also has the lowest corporate tax rate of any G8 or BRIC country. There has been a large increase in foreign direct investment over recent years, but several sectors still restrict overseas involvement including banking, nuclear energy, natural monopolies, the military, the space industry and subsoil development.

The tax system is relatively new and many tax concepts that are standard in most market economies are only just beginning to emerge in Russia. It includes corporate profits tax, value-added tax, excise taxes, personal income tax and obligatory social insurance contributions as well as some more specific charges including mineral resources extraction tax, water tax, transport tax, gambling tax and land tax.

Corporations are taxed separately from their shareholders, with a maximum profits tax rate of 20 per cent. Dividends received by Russian legal entities are taxed at a nine per cent flat rate, except

those from companies residing in offshore zones with preferential tax regimes. Dividends paid by Russian legal entities to foreign legal entities are normally taxed at 15 per cent, unless this is reduced by a relevant double taxation treaty. The standard VAT rate is 18 per cent, and companies must pay compulsory Social Insurance contributions for their employees, normally at 26 per cent.

A simplified taxation system applies to small businesses with annual sales of less than 60million roubles (£1,259,658 at 1 February 2011). Unified tax is levied on gross receipts at six per cent or on profit before tax at 15 per cent (at the taxpayer's choice). Businesses in certain sectors – including banks and insurance – and foreign companies are not eligible for the scheme.

Russia also has some specialised tax zones for scientific projects, industrial production, tourism and ports, with firms setting up in these areas entitled to a number of tax benefits including reduced profits tax, exemption from property tax and land tax, and exemption from customs duty and VAT in some cases.

With personal taxation, tax residence is determined by the number of days a person is physically present in Russia – currently, individuals are tax residents if they spend more than 183 days in the country. The tax rate is 13 per cent for residents and 30 per cent for non-residents. Individuals do not pay any Social Insurance contributions.



# India

Prepared with the assistance of Jeenendra Bhandari, MGI member in Mumbai, India email: jbandari@mgbco.com • Web: www.mgbco.com



**India is one of the world's fastest-growing economies, enjoying a stable democracy with a common law legal system and a large English-speaking, highly educated workforce. Its burgeoning middle class, with rising disposable incomes, is fuelling domestic demand. Overseas investment in India totalled \$37.18 billion in 2009/10 but it is not all one-way traffic – Indian firms are increasingly flexing their financial muscle abroad with strategic acquisitions including such household names as Corus Steel and Jaguar Land Rover in the UK.**

Setting up or investing in India also requires conformity with the country's foreign exchange regulations. Foreign Direct Investment (FDI) is unlimited in most areas, although certain sectors do have caps on the amount of FDI allowed including banking, telecom services, civil aviation, insurance and defence. There are also sectors where FDI is prohibited

including atomic energy, lotteries, gambling and retail (except single brand or wholesale traders), while others – including non-banking financial services and construction/development – have a minimum investment requirement.

All companies, banks and financial institutions must have their accounts audited. Companies with a turnover in excess of six million rupees (£81,448 at 1 February 2011) also require a Tax Audit, while all companies also need a VAT audit, with the exact format and due date differing from state to state. Companies have to file their income tax returns by 30 September of every year for the year ended March 31.

The rupee is fully convertible for trade and current account purposes and foreign currency can generally be freely purchased. Capital Account transactions, which affect the ownership of assets, are prohibited, except for those on a 'permitted' list including investment in India by a

person resident outside India and acquisition of immovable property in India by a person resident outside the country.

Personal tax rates are 10, 20 and 30 per cent, depending on income levels, while domestic corporations are subject to tax at a basic rate of 30 per cent, plus a 10 per cent surcharge for companies where total income exceeds 10 million rupees. The rate for foreign companies is 40 per cent, with a 2.5 per cent surcharge. All companies also pay an additional three per cent educational tax.

Minimum Alternate Tax (MAT) is levied at 18 per cent (excluding surcharge and tax) of the adjusted book profits declared in a company's financial statements in the case of companies where income tax payable on the taxable income according to the normal provisions of the Income Tax Act 1961 is less than 18 per cent of the adjusted book profits. MAT credit is available for 10 years and can be adjusted

against normal tax of future years.

The Indian indirect tax system also sees Value Added Tax (VAT) levied on the movement of goods within states, Central Sales Tax (CST) on the movement of goods between states and Excise on the production of goods in India. Efforts are being made to simplify the system with a unified Goods and Services Tax (GST), originally set to be introduced in April 2012 but currently delayed.

India also levies a number of other taxes including service tax, stamp duty, luxury tax, property tax and entertainment tax.

In an effort to encourage foreign investment, the Indian government has implemented incentives for companies to invest in certain areas or industries, including Software Technology Parks for export-oriented IT zones and Special Economic Zones for export-producing industries, both offering tax holidays for investors.

# China

Prepared with the assistance of Dickson Leung, MGI member in Beijing, China email: [dleung@lehmanbrown.com](mailto:dleung@lehmanbrown.com) • Web: [www.lehmanbrown.com](http://www.lehmanbrown.com)

**China has the world's largest population and has now eclipsed Japan as the world's second-largest economy. With a growing and increasingly affluent middle class spending their earnings on cars, property and consumer goods, it is a market that Western companies are increasingly looking to be part of.**

While the economy was once closed to outside investors, there are now a number of initiatives designed to attract investment to specific sectors or locations, including Free Trade Zones, High Technology Parks/Zones, Processing Zones, Logistics Parks, Go West Policy (Western region of China), Go Central Policy (Central and North East region), Tianjin Bin Hai New Area and Shanghai Pudong New Area.

However, investors need to be aware that many restrictions on foreign investment do still exist. Some industries – including media, publishing, mining of certain non-ferrous metals, rare earth and radioactive minerals – are classed

as 'prohibited' with no overseas investment allowed, although foreign firms may become involved by providing services to Chinese owners or under a nominee shareholding. 'Restricted' industries permit overseas holdings of not more than 49 or 50 per cent (depending on the industry), 'Permitted' industries can be joint ventures or wholly foreign-owned, and those classed as 'Encouraged' also allow up to 100 per cent foreign ownership, coupled with tax concessions to encourage investment.

Companies operating in China are required to make various social security contributions for their Chinese employees, where the contribution rate varies depending on local labour regulations. For example in Beijing, firms pay a pension contribution of 20 per cent, unemployment insurance of one per cent, medical insurance of 10 per cent, maternity insurance of 0.8 per cent, housing fund of 12 per cent and work injury insurance of between 0.2 per cent and three per cent (0.5 per cent to two per cent for the initial two years for a newly-registered

company), depending on the industry.

Certain expenses incurred for employees can also be deductible against corporate income tax, including employee education costs of 2.5 per cent, a labour union fee of two per cent (if the company has a labour union) and employee welfare expenses at 14 per cent of total salaries and wages. Foreign investors currently do not have any obligation to make social security contributions for expatriate employees although this may change in future. The prevailing standard Corporate Income Tax (CIT) rate in China is 25 per cent, while a reduced rate of 20 per cent is offered to small and low-profit enterprises. Certain qualified high-technology enterprises can enjoy a 15 per cent preferential rate.

The Chinese accounting system is currently undergoing significant changes to be harmonized with international standards. The 'New System' redefines certain accounting fundamentals such as consistency, timeliness, understandability, accrual basis, matching and materiality.

China implements a Foreign Exchange control regime under which capital account nature transactions such as stock investment or loans, are prohibited or restricted. For 'current account' transactions, such as trade in service and goods, free convertibility of foreign currency is generally allowed but subject to supervision; for instance, when applying for converting foreign currency of more than US\$200,000, companies are required to obtain prior approval from the authorities. Companies not in China which need to receive revenue in yuan will need to use escrow services.



## Being part of MGI

Being part of MGI allows member firms to access the local knowledge and insight of accountants from around the world without sacrificing their independence.

The alliance has over 285 member offices in 82 countries, meaning that if an MGI firm's client needs local advice on an overseas tax or finance issue, there will be a fellow member nearby who can help.

At a time when more and more businesses are operating across international boundaries, an increasing number of accountancy firms and their clients are seeing the benefit of being able to access that global expertise.

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