To G. R-Rees Windsor House

UZBEKISTAN - Tobacco Taxes

Visit by DJ Bishop and CD Dufty - 10-14 January 1994

Summary Findings

An uncontrolled market; with imported product, on which no taxes are paid to the Uzbek Government, freely available at prices giving enormous (75%-80% of selling price) margins to wholesale/retail trade. Domestic product (ex TTF) is hardly visible in the market and even after Uzbek taxes, the current selling prices give even higher trade margins (90%-95% of selling price).

The Government officials (State Taxes Ministry), who did not seem aware of the substantial revenue which it ought to be earning from those cigarette imports, are very interested in collecting revenue but really are not very sure about how to do it. We have established good contact and had preliminary discussions about how imports might be taxed and how taxes collection on domestic production can be better controlled. In the event of a BAT joint venture going ahead we could assist the Government in introducing some form of fiscal stamp system (like Hungary?) and possibly simplifying the domestic production indirect tax system later to introduce an element of specific taxation.

The wholesale/retail trade is clearly taking advantage of the current market supply/demand imbalance and the correction and establishment of reasonable/lower selling prices will be a problem with the distribution forces.

Intra - CIS trade will probably continue to be taxed in the country of supply, at least for the foreseeable future and 'dumping' tactics, particularly from Kazhakstan, will have to be controlled. (Not so much of a problem on Kazkak manufacture but as a 'cover' for third country transit).

Objectives of Visit

1. Confirm manner in which indirect taxes are applied to imported and domestic production cigarettes in Uzbekistan.

2. Make contact with relevant Government officials to ascertain whether it is realistic to make changes if necessary to indirect tax regulations so as to suit BAT brand marketing strategies.

Meeting with Dr Abdoulla M Abdoukadirov, Deputy Minister, Central State Taxation Board

A series of meetings took place with Dr Abdoukadirov who is responsible for the formulation and operation of indirect tax policy in Uzbekistan. He is young for the seniority of the position (early 30's) and one of the 'new breed' of free market thinkers, close to Mr Sultanov the Deputy Prime Minister. The conversations were open and frank and topics discussed included import duties, applications of excise and VAT to domestic production and imports, free trade agreements between CIS countries and market prices/profiteering by distributors.

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Import Duties - As part of the former Soviet bloc there is no history of levying import duties. Goods moved freely within the USSR but any third country imports would have been controlled by Moscow. However, Dr Abdoukadirov recognised the importance of levying import duties both in order to raise state revenue and protect investment in local industry. He cited the introduction of a 50% import duty on cars following joint venture agreements with Mercedes and Daewoo - a South Korean car manufacturer. He volunteered that similar protection would be granted to the cigarette industry if desired.

It is important to note, however, that any such duties would not be applicable to movements between countries where free trade arrangements existed. Either because of newly confirmed bilateral agreements (Kazakhstan/Uzbekistan) or existing trading relationships with CIS countries.

Excise Duties and VAT - are not currently levied on imported products. This again reflects the trading practices within the former USSR. Taxation was normally levied at the production stage and deemed a tax on production rather than a consumer tax. Hence once the tax had been met ex-factory the product could move freely within the USSR without being subject to further taxation.

The anomaly of this situation has been recognised and excise and VAT are to be levied on third country imports from 1 July 1994. Rates and collection and control procedures have not yet been worked out. As with import duties these taxes will not apply to trade between countries within the CIS free trade area, at this moment.

It was explained to Dr Abdoukadirov that the waiving of excise duties within a free-trade area was not common international practice. He was very interested to learn that within the EU, NAFTA, CACM and other such groupings, countries always retained the right to levy excise duties domestically for national revenue purposes. Even with a reasonable tax on imports, importation into Uzbek is profitable. An estimated US$130 million per annum taxes might be raised on an 18.5 billion import volume. This tax burden would give a tax incidence of 24%. Current market prices should not be affected by Government taxation, provided the distribution excess profits can be reduced. Dr Abdoukadirov was clearly interested at the prospect of raising such revenue.

Excise duty on domestic production is levied at four different rates (dependant on category of cigarette) on the ex-factory price plus the excise duty itself. VAT (at 25%) is also levied on this value. In 1993 a total of 1.2 billion roubles was collected in excise duty and VAT on local production. This low figure would seem to confirm the suspicion of problems at TTF since, based on our calculation of excise/VAT due on 1993 production the revenue should be nearer to Rs 2 billion - an under payment of Rs 800 million (US$650,000 at official rate).

With regard to the structure and level of taxation in Uzbekistan, Dr Abdoukadirov confirmed his complete willingness to work with BAT on an overhaul of the tax system should any joint venture go ahead. Until such time as BAT marketing and production plans are clearer the present ad-valorem base could be retained. The incidence of tax is very low primarily because of the high trade margins.

Uzbekistan/Kazakstan Bilateral Agreement

On 10 January 1994 Uzbekistan and Kazakstan initialed an agreement setting up an effective free trade zone between the two countries. There will be no import tariffs between the two and also national indirect taxes (excise and VAT) will be paid in the exporting country. Detailed legislation to give effect to this decree is still being prepared but a starting date is imminent.

The implications for the Uzbek tobacco industry are that if the local manufacturing capacity is limited, then Kazak supply will certainly come in freely if production there improves quickly. Indirect taxes in Kazak are marginally higher than those in Uzbek. On local production this agreement should not be disadvantageous to BAT, but non CIS production, brought through Kazak as a 'front' will need to be identified and taxed in Uzbek.

Although in practice free trade arrangements exist with all other CIS countries, similar bi-lateral treaties may be signed until the conceptual thinking changes.

Market Visit

Market prices of cigarettes in Uzbek cannot be controlled basically because (we are advised) the supply is substantially below demand also because the inflationary environment can easily conceal wholesale and retail trade profiteering. This latter fact is very evident: using bazaar prices on 12 January, examples are:

Imported (US$/Mille)	Cost (estimated)	Selling (actual)
Marlboro	16.0	62.5
Camel	16.0	50.0
Pall Mall (Rothmans)	16.0	62.5
Red Band	10.0	31.0
West	10.0	50.0
Beta (Russian)	4.0	25.0
Stewardess (Russian)	4.0	25.0
Peter Johnson	7.5	29.0
TU 134 (Russian)	4.0	25.0
Monte Carlo	7.5	44.0
Morven	6.0	38.0

Note - Cost on imported brands is an estimated CIF price. No Uzbek duties or taxes apply. Selling price is translated at unofficial exchange rate Som 4000/US$ 1. Either estimated CIF is very wide of the mark or the wholesale/retail trade is making a truly handsome profit! (Shop prices are generally 20% higher).

Domestic (Som/Pkt)	Cost (actual - ex factory incl. Excise/VAT)	Selling (actual)
Astra	79	800
Registon	63	1500

When we spoke with Dr Abdoukadirov he expressed concern about the high market prices, but he really did not appear to have been aware of the 'excessive' margins.

Other Matters

We discussed with Coopers (S Naunton/I Rousakova) indirect tax parts of their earlier report and also the questions raised by them with Dr Abdoukadirov on 13 January (see Coopers note dated 14 January).

DJB/CDD/JS\016

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UZBEKISTAN **Appendix I**

Rates of excise/VAT on tobacco products ex TTF

	Excise	VAT
Class 1 cigarette (Uzbekistan)	40% (66.6%)	25%
Class 2/3 Cigarette (Astra)	25% (33.3%)	25%
Class 4 cigarette (Risk)	15% (17.6%)	25%
Papriosy (Registon)	20% (25%)	25%
Smoking tobacco	-	25%

Notes

1. Above excise rates are applied to product ex-factory price, including excise, the rate in brackets is effective rate on ex-factory price. Payments made every 10 days and monthly details submitted by TTF to authorities.

2. VAT rate of 25% is applied to ex-factory price plus excise duty. System is theoretically a full multi stage tax to retail level. Tax payer entitled to deduct 6% from payment to authorities, this amount is retained in business towards employee costs. Payment is made quarterly.

3. Despite being classified as class 4 - Risk is taxed at the same rate as Astra.

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UZBEKISTAN **Appendix II**

Domestic production - Price and Tax summary

Som/Mille	Papirosy	Astra	Risk	Uzbekistan
Ex Factory	1675	2528	3053	2978
Excise (i)	419 (20%)	843 (25%)	1018 (25%)	1985 (40%)
VAT - 25% (ii)	523	848	1018	1241
	942	1686	2036	3226
'Official' Trade Margin (iii)	2617	4214	5089	6204
Selling Price	5234	8428	10178	12408
a) Tax Incidence	18%	20%	20%	26%
Market Price (iv)	60000	40000	100000	135000
b) Tax Incidence	2%	4%	2%	2%

(i) Excise levied at rates shown on ex factory price plus excise

(ii) VAT levied at 25% on ex factory price plus excise

iii) assumed 'official' trade margin of 50% of retail selling price

iv) actual market prices

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UZBEKISTAN **Appendix III**

Imports - Price and Tax Summary (Assuming application of existing indirect tax system to imports)

US$/Mille	Low	Mid	High
CIF (estimated)	4.50	7.50	16.00
Import Duty - 15% (i)	0.68	1.13	2.40
Excise (ii)	1.73 (25%)	5.75 (40%)	12.27 (40%)
VAT - 25% (iii)	1.73	3.60	7.67
	3.46	9.35	19.94
Trade margin - 50% rsp (iv)	8.64	17.98	38.34
Selling Price	17.28	35.96	76.68
Tax Incidence (v)	20%	26%	26%
Selling Price - Som per 20	1380	2875	6135
Actual Selling Price	2000	3500	6000

Notes:
(i) Import duty same as rate applied in Russia
(ii) Excise levied on CIF + import duty + excise
(iii) VAT levied on CIF + import duty + excise
(iv) Trade margin at assumed 'official' rate
(v) Tax incidence excludes import duty

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