To N.G.M. Wstring

UZBEKISTAN - INDIRECT TAX MEETING WITH MINISTRY OF FINANCE

At a meeting on 23 February 1994, Dr Abdoukadirov, Deputy Minister of Finance (the Ministry of Finance is to be given overall responsibility for indirect tax strategy), outlined their Governments indirect tax proposals for cigarettes. These proposals differ adversely from the position adopted at earlier meetings when full co-operation with BAT was promised in order to introduce a suitable indirect tax structure to support and develop domestic manufacture of cigarettes in Uzbekistan.

The Government proposals outlined were:-

Import Duty

Following Presidential decree no import duties will be levied until at least July 1995.

Excise Duty

Domestic Production - two rates to be applied on the ex factory price plus excise -

Category 1 (filter) 40%
Category 2 (plain) 25%

Imports - Single rate to be set at between 5% - 10% of the c.i.f. price plus excise.

VAT

Domestic Production - 25% of ex factory price plus excise.

Imports - Not currently levied on imports. No decision yet taken as to whether it will be in future.

Impact on Prices

If adopted total tax inclusive prices can be calculated as follows:

Net Prices

	Domestic (i)	Imports(ii)
	-$US per 1000 -	
Plain	1.77 (Astra)	
Economy	1.78 (Uzbekistan)	
VFM	4.64 (Hilton)	5.50 (TU134)
IFB3	6.42	11.00 (Viceroy)
IFB2	9.28	16.00 (Pall Mall s/longs)
IFB1	12.49	17.00 (Lucky Strike)

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(i) Projected ex factory prices as at end 1993
(ii) Current c.i.f. prices

Tax Inclusive Prices

	Domestic	Imports (Excl. VAT)	Imports (Incl. VAT)
		-$US per 1000 -	
Plain	2.95		
Economy	3.71		
VFM	9.67	5.95	7.43
IFB3	13.38	11.89	14.86
IFB2	19.33	17.30	21.62
IFB1	26.02	18.38	22.97

Excise on imports say 7.5% on c.i.f. plus excise

In the above, import price/tax projections apply to third country imports only. Imports from other C.I.S. countries e.g. Kazakhstan and Kirgizstan, with whom Uzbekistan has bi-lateral trade arrangements, do not currently pay Uzbeki taxes but pay tax in the country of production. In general this should produce tax inclusive prices from these countries more in line with those shown for domestic production.

The above shows the tax inclusive price of domestic production significantly disadvantaged vis a vis imports.

However, the potential impact of a wildly fluctuating currency exchange rate should be noted.

Example - VFM segment

Domestic Production

End 1993 Ex factory price projection	= $US 4.64 per mille
Exchange rate 3700 som = $US1.00	= Som 17,168 per mille
Current position + say 50% for $ content	= Som 25,752 per mille
Tax Inclusive Price	= Som 53,650 per mille

Imports

Current c.i.f. price	= $US5.50 per mille
Current exchange rate Som 10,000 = $US1.00	= Som 55,000 per mille
Tax Inclusive Price (Excl. VAT)	= Som 59,460 per mille
Tax Inclusive Price (Incl. VAT)	= Som 74,325 per mille

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The disappointing change in stance taken by the Ministry of Finance was justified by Abdoukadirov on the following grounds:-

Import Duty - Country's desperate need for imported products has led to an extension of an overall ban on import duties. This was likely to remain in force until such time that the supply of necessities could be more adequately met from domestic sources.

Excise Duty - Following discussions with 'black marketeers" and his own investigation of price/profit from imported cigarettes Abdoukadirov claimed to be convinced that it was not equitable to levy the same rate of tax on imports due to their higher cost base and the low level of profit attainable from them compared to domestic production!

Whilst this is clearly not true, sufficient pressure has been applied for Abdoukadirov to adopt this position.

Future Action

BAT has three courses of action following the change in position outlined by Abdoukadirov:-

i) Insist that Government reviews its position again by illustrating that the viability of the Joint venture is undermined by an indirect tax policy which not only fails to support domestic manufacture but actually disadvantages it in favour of imports (see earlier calculations). NBD must decide how far they would wish to pursue this line.

ii) Adopt a compromise position by requesting the imposition of a specific excise of x $/som per 000 cigarettes at a single rate applicable to both imports and domestic.

    This answers Abdoukadirov's charge of inequitable tax treatment of higher priced imports, whilst removing the tax disadvantage to domestic products under the Governments current proposals. However, it does not provide any degree of 'tax protection' to the JV.

iii) Accept Government proposals in the short-term but continue to lobby over the medium term for the adoption of an indirect tax structure which satisfies BAT's market requirements.

A common point to all three courses of action is the extension of VAT to imported cigarettes.

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Summary

Whilst a little uncomfortable with the change in position that he outlined, Dr Abdoukadirov continued to be open and friendly, was appreciative of the information provided by BAT on international indirect tax treatments and very keen that BAT should work with him and his officials on the drafting of indirect tax legislation and the setting up of collection and control procedures, which he admits they have neither the personnel or expertise to do.

BAT should continue to work closely with Dr Abdoukadirov, however, the level of assistance given must depend on the course of action taken by BAT and the tax structure adopted - BAT should not be instrumental in drafting a law which overtly favours imports as this will undermine our ability to lobby for change in the short/medium term.

Finally it must be recognised that whether or not a 'level playing field' in taxation is legislated for, the reality of the market is that for the immediate future large quantities of cigarettes will continue to be available upon which little or no tax has been paid. This will remain the case regardless of the control procedures adopted - the introduction of tax stamps will be difficult both on cost grounds and complications created by the non-taxable status of products from countries benefiting from bi-lateral agreements. In practice the only way in which a true 'level playing field' could be achieved in the short term would be if dispensation from excise duties on domestic manufacturer was granted until such time that the market had stabilised.

CD Dufty
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