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"An Analysis of Value-Added Taxes in Russia and Other Countries of the Former Soviet Union" by Victoria P. Summers and Emil M. Sunley

Since the end of 1991, Russia and the other transition countries that were part of the Soviet Union have adopted value-added taxes (VATs). The VATs in Russia and in all the other countries except Estonia, Latvia, and Lithuania (referred to in the paper as "the other transition countries") were originally almost identical to the VAT adopted by the Soviet Union in December 1991, upon the eve of its dissolution. Although the laws of the various countries have diverged over the past two and a half years, most of them still share certain features derived from the 1991 Soviet model.

In principle, the VAT is an efficient, neutral revenue source at the national level. And, in fact, these new taxes now generate a very significant portion of total tax revenues in Russia and the other transition countries. But large and growing arrears in the payment of interenterprise obligations correlate closely with declining revenue performance. This correlation arises in part because interenterprise arrears give rise to liquidity problems, which lead directly to tax arrears, and in part because timing asymmetries resulting from the unique structure of the Russian VAT reduce VAT liabilities (but not VAT credits) in the presence of interenterprise arrears.

The large number of exemptions and preferences found in the Russian VAT causes both a loss of revenue and economic distortions. The major structural anomalies found in the Russian VAT and in many of the laws of the other transition countries include (1) accounting for VAT liability on sales on a cash basis while allowing credit on inputs at the time the inputs are put into production; (2) calculating the tax at the manufacturing and production level on the credit/invoice method, and in the wholesale, retail, and service sectors based upon the taxpayers' gross margins; and (3) denying or delaying credits for the acquisition of capital inputs. The paper recommends that all taxpayers ultimately use an accrual basis for both credits and liabilities. The credit/invoice method should be extended through final sales to consumers in all sectors. In Russia, credit is now permitted for capital inputs, taken in installments over a six-month period. The paper recommends that the countries that have not yet allowed any capital input credits should begin to do so. Ultimately, all countries should give immediate, full crediting for capital inputs. Excess credits should be either refunded or, if carried forward, adjusted for inflation.

These transition countries must also decide how they will apply the VAT to trade among themselves. The paper discusses the effects of adopting an origin-method versus destination-method VAT as well as the issues raised by using the VAT at the subnational level. It analyzes how, since the inception of the Russian VAT, the approach to the problem of interstate trade has evolved. The paper concludes that although administrative considerations play a key role in how the VAT is applied, the basic choice between the origin or destination method must depend upon the sort of economic relationship the countries decide to establish among themselves.

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