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THE FISCAL IMPACT OF THE PROPOSED VAT CHANGES MAY NOT MEET BUDGET EXPECTATIONS

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The increase in the tax burden in 2026 has sparked lively debate, particularly regarding the increase in the VAT rate to 22% and the reduction in the threshold for the simplified tax system and patent from January 1, 2026. However, the forecast for VAT revenue growth, estimated by the Russian Ministry of Finance at Rb 1.4 trillion, may not be achieved in our view, as it assumes not only the best possible dynamics of key macroeconomic variables, but also steady growth in VAT collection. According to our estimates, there is a risk of a shortfall of approximately Rb 0.6 trillion in VAT revenue in 2026. Moreover, this measure can lead to a reduction in other budget revenues in 2026 due to the negative consequences of a decline in the purchasing power of business and household income, including a reduction in income tax revenues to the federal and regional budgets, as well as insurance contributions and personal income tax due to a reduction in the wage fund, and a slowdown in the pace of key rate cuts by the Central Bank, which will increase the cost of new borrowing for the Russian Ministry of Finance.

Among the legislative initiatives of the Russian Government accompanying the submission of the draft law on the federal budget for 2026–2028 (hereinafter referred to as the Draft Law) to the State Duma of the Russian Federation on September 29 of this year, proposals to change the collection of value-added tax stand out in particular. In particular, in order to balance the state budget, it is planned to increase the VAT rate from 20% to 22%, and to prevent taxpayers from splitting their businesses, the maximum income threshold for exemption from VAT calculation and payment will be reduced from Rb60 mn to Rb10 mn for both the simplified taxation system (STS)¹ and the patent taxation system.² In other words, from 2026, the ranks of VAT taxpayers may be joined

1 From 2025, STS payers will have to pay VAT if their income for the previous year or during the current year exceeded Rb60 mn. From 2026, it is proposed to reduce this limit to Rb10 mn. If the law is adopted and published before the beginning of December this year, the tax burden for most small businesses will increase significantly, and tax administration will become more complicated (quarterly reporting to the Federal Tax Service will be required).

2 Lowering the income threshold to Rb10 mn, which allows individual entrepreneurs to apply for a patent, means that from the beginning of 2026, they will have to switch to either the basic taxation system or the simplified taxation system with VAT payments. Moreover, the bill provides for the abolition of the possibility of applying the patent for freight transportation and virtually all retail trade.

Monitoring of Russia's economic outlook

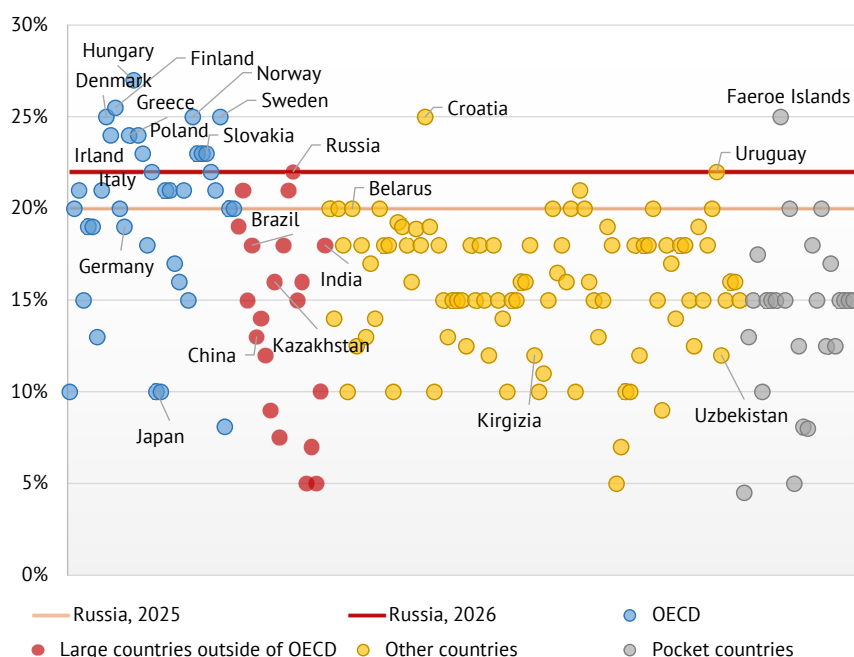


Fig. 1. VAT rate in 173 countries in early 2026

Source: own compilation.

by companies and individual entrepreneurs with annual income exceeding Rb10 mn. According to estimates by the Russian Ministry of Finance, these innovations alone could generate a total increase in VAT revenues of Rb1.4 trillion. Let's try to analyze how realistic this forecast is.

As is well known, VAT is characterized by a high but slightly “lagging” (lag) correlation with GDP dynamics, which predetermines its “restrained” procyclicality, making the tax an important element of budget revenue stability in any country.¹ In particular, about 40% of all Russian federal budget revenues in the current year are generated by VAT. Moreover, among non-oil and gas revenues, the importance of VAT as the main source of revenue will only increase after the innovations under consideration, according to estimates by the Russian Ministry of Finance: its share in the total volume will increase from 52% in 2025 to almost 58% in 2028.

As we have already noted, the main fiscal innovation in relation to VAT is the increase in the tax rate to 22% from 2026. As a result, Russia will enter the top 20 countries in the world with the highest VAT rates (Fig. 1).

Most countries with high VAT rates are members of the European Union or the EU single market (such as Norway). Among the other countries that apply VAT, Russia will share first place in terms of rate size only with Uruguay. This circumstance clearly affects the assessment of the competitiveness of the Russian tax system in comparison with other countries of the world (outside Europe and North America), primarily from Asia (Fig. 2).

It should be admitted that, given the recent increase in income tax,² personal income tax, and other taxes, tax environment in the country as a whole is

1 Belyov S.G., Sokolov I.A., Suchkova O.V. Stability of VAT revenues to the budget: myth or reality? // Russian Economic Development. 2020. Vol. 27. No. 12. Pp. 60–69.

2 According to the Trading Economics summary table for 163 countries, Russia is in the top half, i.e., among the 80 countries with the highest income tax rates.

The fiscal impact of the proposed VAT changes may not meet budget expectations

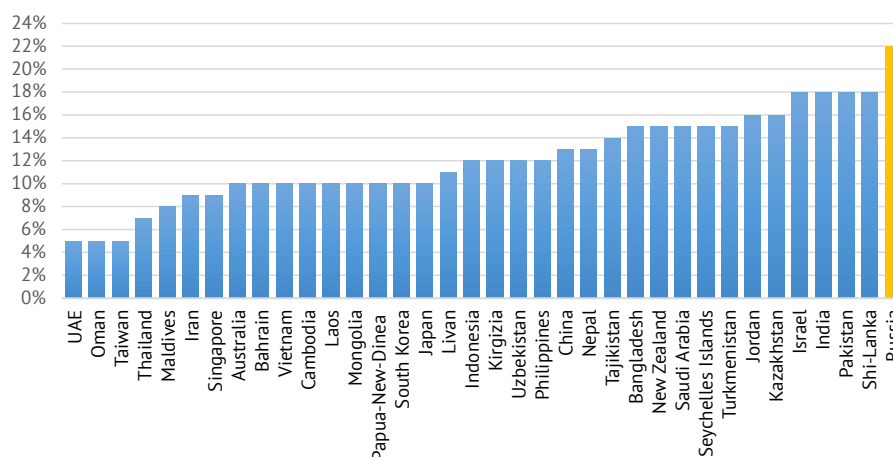


Fig. 2. VAT rates in Russia and Asia-Pacific countries as of early 2026

Source: own compilation.

becoming much tougher. While the increase in direct taxes has already had a restraining effect on supply in the economy (due to a contraction in investment in fixed assets), the VAT increase will affect consumer demand, including imports of final goods.

In particular, the VAT increase will result in a short-term increase in consumer prices and a contraction in consumer demand amid existing credit constraints. In turn, lowering the VAT payment threshold from Rb60 mn to Rb10 mn for those using the simplified tax system and patent holders will negatively affect the profitability of small businesses and will have a clear pro-inflationary effect. The decline in sales and margins will have a negative effect on both taxable income and output indicators. At best, the decline in business profitability will affect the amount of dividends paid, and at worst, it will require the budget to provide financial support to systemically important organizations.

The medium-term socio-economic forecast presented by the Russian Ministry of Economic Development in its baseline scenario assumes the realization of virtually the best expected dynamics of key macroeconomic variables, while the Russian Ministry of Finance's assessments of the quality of VAT administration based on this forecast predict continuous growth in tax collection. At the same time, as our econometric calculations show, all other things being equal, a 1 pp increase in the tax rate leads to a 2 pp decrease in tax collection (estimates made for CIS countries). This effect may be amplified by an economic slowdown. There are well-founded doubts that lowering the threshold for the simplified tax system can compensate for this effect, given that the administration of small businesses is a fairly costly process. The assumption that the collection rate for domestic VAT will remain unchanged is far from indisputable, and in the short term it is reasonable to expect some decline in collection.

And while the Russian Ministry of Finance's forecast for VAT revenues on imports seems quite realistic, it will be much more difficult to collect VAT on domestic consumption in the amounts specified in the draft law for 2026 – we forecast domestic VAT revenues to be almost Rb0.6 trillion less than official expectations (Table 1).

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Table 1

VAT revenue forecasts, Rb bn

	2024	2025	2026
Russian Finance Ministry forecast			
VAT on domestic consumption	8 733.6	10 243.1	12 149.1
VAT on imports	4 789.0	4 276.0	5 369.7
Own forecast			
VAT on domestic consumption	8 733.6	10 379	11 519
VAT on imports	4 789.0	4 461	5 509

Sources: Federal Treasury, Draft Law, own calculations.

In addition to the risks of losing part of the VAT revenue, there are other circumstances that could reduce the overall fiscal effect of the VAT tax reforms. It is clear that the increase in the VAT tax burden from January 1, 2026, will lead to an increase in VAT revenues to the budget only starting from Q2 2026, since VAT is paid in three months (in tranches) based on the turnover of the previous quarter. However, in addition to the growth in VAT revenues, it is necessary to take into account the likely decline in other budget revenues. In particular, against the backdrop of a decline in domestic consumption, there can be a slight decrease in revenues from other indirect taxes, primarily customs duties on goods imported from abroad and excise taxes.

A decrease in income tax revenues can also be significant. Thus, with an increase in VAT and a subsequent increase in final prices, the purchasing power of business and household incomes will decline somewhat, which in turn will lead to a reduction in:

- Income tax revenues to federal and regional budgets;
- Dividend payments, both to individuals and legal entities and directly to the budget (for companies with state participation);
- STS revenues credited to regional budgets (however, this may be offset by an increase in the number of STS payers due to reduced opportunities for individual entrepreneurs to apply for patents);
- The wage fund, which will affect insurance contributions and personal income tax revenues.

It is clear that the decline in regional budget revenues will require either an increase in transfers from the federal budget or easing of restrictions on commercial borrowing. Moreover, some businesses will record losses, which will necessitate additional subsidiary support from the federal government.

However, a much more important long-term factor in VAT changes will be the slowdown in the pace of key rate cuts by the Central Bank (according to estimates by the Russian Ministry of Economic Development, this effect will last for two quarters), which will force the Russian Ministry of Finance to place OFZ bonds at a higher yield than would be possible in the absence of the pro-inflationary effect of all the tax innovations related to VAT. Consequently, higher interest expenses will also reduce the net fiscal effect of the VAT rate increase. ▲