

## NEW ARCHITECTURE OF THE TAX SYSTEM IN THE REPUBLIC OF UZBEKISTAN: NEW RISKS AND NEW OPPORTUNITIES

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**Abstract:** *The article discusses the methodological approaches of taxation used in the process of reforming the tax system of the Republic of Uzbekistan. These approaches were assessed from the point of view of compliance with the criteria of leading scientific schools. Proposals have been developed to improve the taxes in the context of instability.*

**Keywords:** *leading scientific schools, taxation concept, tax burden, tax system, tax classification, taxation instruments*

**JEL classifications:** *H2*

### 1 INTRODUCTION

The main goal of the tax reforms in Uzbekistan is to ensure economic stability, create favorable conditions for business and increase state budget revenues.

### 2 MAIN BODY OF TEXT

The important tasks of the Action Strategy for the further development of the Republic of Uzbekistan in 2017-2021 are to improve tax administration, continue to reduce the tax burden and simplify the tax system. This direction was not chosen by chance. In 2010-2018 the tax area had been beginning to face systemic problems stronger, including [4]:

- a significant difference in the level of the tax burden between economic entities that pay taxes under the simplified system and generally established taxation;
- the high rate of the payroll fund (payroll) taxation contributed to the concealment of the real number of employees and wages by taxpayers.

Until 2018, the national tax system was developing according to the principle: take more funds from large enterprises and use them for the needs of the state. As a result, many businesses lost incentives to grow profits, expand investment and stimulate innovation.

At the same time, small businesses often received significant “undeserved” income with tax incentives. The established tax rules disrupted the competitive environment, which often led to technological stagnation in sectors of the economy.

More than 45% of economic activity was carried out in the shadow sphere and more than 4 million employed workers out of 12 million able-bodied workers did not pay income tax and insurance premiums. This situation required the adoption of drastic measures to reform the tax system.

From 1 June 2018, in order to eliminate the existing shortcomings Uzbekistan adopted the Concept for Improving Tax Policy [1]. Since 1 January 2019, radical reforms in this area have been carried out in the country (Table 1):

- a flat personal income tax rate of 12% was introduced for all employed workers;
- for all companies the insurance payments were canceled, which calculated from the earnings of legal entities;
- enterprises with an annual turnover of more than 1 billion soums in 2018 were transferred to pay 5 taxes (previously they paid 2 taxes);
- tax incentives were optimized for legal entities and individuals.

**Table 1: Dynamics of tax rates for 2015-2020, in %**

Indicator	2015	2017	2018	2019	2020
Income tax of legal entities (Corporate income tax)	7,5	7,5	14	12	15
Tax on improvement and development of social infrastructure *	8	8			
Personal income tax (maximum rate)	23	23	22,5	12	12
Value added tax	20	20	20	20	15
Single social payment (for budget organizations)	25	25	25	25	25
Single social payment (for all other entities)	15	15	15	12	12
Single tax payment for small and private businesses	6	5	5	4	4
Property tax of legal entities	4	5	5	2	2

*\* this tax is included into the Income tax of legal entities (Corporate income tax)*

*Source: compiled by the authors based on data from the Ministry of Finance of the Republic of Uzbekistan.*

From 1 October 2019 the VAT rate was reduced from 20% to 15%. This measure reduced the diversion of working capital from enterprises and decreased the pressure of the indirect tax on the final consumer.

As a result of the reforms, the tax burden on the economy decreased from 26.5% in 2018 to 26.1% of GDP in 2019 (according to the consolidated budget). At the same time, the tax burden excluding insurance funds increased over this period from 19.4% to 21.4% of GDP. Thus, in 2019, as a result of the tax reform, the burden on large business decreased and it increased for small and medium-sized businesses.

At the end of 2019, the main source of the formation of budgetary funds continues to be receipts from indirect taxes. Despite the decline the share of indirect taxes in the structure of the state budget revenues by 10.4% for 2018-2019, indirect taxes receipts for 2019 amounted to 41.4% of budget funds.

The share of direct taxes over the same period decreased from 9.5% to 28.2%. The share of resource taxes increased from 16.0% to 17.5%.

The raise in direct taxes had the greatest impact on the state budget revenues. For 2018-2019 the value of this factor increased from 13.2% to 47.1%. This is due to the expansion of the taxable base of the income tax, an increase in the number of taxpayers and the influence of other factors.

The contribution to the formation of budgetary funds from resource payments and property tax increased from 19.7% to 20.4%, indirect taxes decreased from 50.4% to 15.9%.

Significant changes in the structure of the state budget funds are due to the directions of tax policy: *strengthening the role of receipts from direct taxes and resource payments for the state budget, and a simultaneous weakening the importance of indirect taxes.*

Certain positive results have been obtained in the process of tax reforms. In 2019 the difference between the level of taxation of legal entities using the generally established and simplified taxation system was reduced. The role of profit for large enterprises and the profit tax for the formation of state budget funds is growing.

Since 1 January 2020, in accordance with the Law of the Republic of Uzbekistan dated December 30, 2019 No.599, the Tax Code has been introduced in Uzbekistan in a new edition [2]. This document consolidated the simplification of the current tax legislation. Many changes and additions have been made to the Tax Code, in particular:

- instead of a single social payment, a social tax was introduced;
- single tax payment was replaced by value added tax;
- fixed tax was changed by a fixed amount of personal income tax.

The taxpayers of the new taxes are eligible for the benefits that they received under the previous taxes.

Sections on state duties and fees to sell certain types of goods have been removed from the Tax Code. They will be regulated by a separate law:

- bonuses for subsoil users, which are special payments of a one-off nature, have been transferred to the Law on Subsoil;
- special tax regimes for markets, agricultural producers and some other areas of activity were abolished;
- individual entrepreneurs are given the right to choose whether to pay income tax on the basis of a declaration or a fixed amount of income tax.

According to the new version of the Tax Code, significant innovations have been introduced into the *tax administration system, in particular:*

- the responsibility of the tax authorities for the untimely return of overpaid or overly collected taxes has been strengthened;
- the tax authorities have been granted the right, on the basis of risk analysis, to appoint cameral tax audits, field tax audits and tax audits;
- all business entities are divided into three segments - green, yellow and red carpet. Businesses with a low risk of tax evasion that enter the green zone will not be assigned tax audits;
- legal entities created with the attraction of direct private foreign investment are exempt from paying land tax, property tax and tax for the use of water resources;
- participants in special economic zones are provided with tax benefits in the form of exemption from property tax, land tax and tax for the use of water resources, depending on the volume of made investments.

Thus, since 2020, a new architecture of the tax system has been functioning in Uzbekistan, which covers the activities of the overwhelming number of economic entities. At the same time, the current fiscal instruments are formed on a basis of the requirements of the Concept for Improving Tax Policy.

Over recent years introduced changes in the sphere of taxation have a significant impact on the activities of legal entities and individuals, as well as on the formation of funds from the State budget. It will be possible to fully assess

the effectiveness of the implemented measures only after a sufficiently long period of time.

At the same time, currently it is possible to compare the basic principles of the tax reform and the criteria of the leading scientific schools. This will allow timely elimination of the existing shortcomings in the created architecture of the new tax system. Carrying out a high-quality "tuning" of the introduced instruments will direct the activities of enterprises to achieve the established priorities for the development of the national economy.

The need to solve these problems is confirmed by the current stage of development of the world economy in the context of the widespread spread of the coronavirus pandemic COVID-19 and the imposed forced restrictions. Practice has shown that fiscal arrangements in many countries proved to be unsuitable to act in the emergency situation.

Governments of several countries had to repeatedly intervene in the system of state regulation of the economy by introducing tax breaks, abolished or reduced tax rates, writing off debts for taxes, insurance premiums and penalties of economic entities.

The period of lifting forced restrictions and the post-coronavirus stage of development should also be accompanied by the creation of flexible fiscal incentives. They should direct economic entities towards the transition to a new type of economy. The main features of this economy should be *resource conservation, high competitiveness, environmental friendliness, safety for humans. The amount of income of employed workers for high-quality work should provide them with access to generally recognized human values (housing, food, education, culture, etc.).*

In our opinion, the methodological and practical provisions of any tax system should proceed from the established foundations and principles of taxation, as well as from the goals of the country's economic policy at the appropriate stage of its development. *The effectiveness of measures to improve the taxation system largely depends on this.*

Research on the scientific foundations of taxation has shown that over the past centuries, different concepts and approaches have been used in this area. At the same time, such approaches of leading economists as "the theory of exchange", "the theory of exchange of equivalents", "the theory of the

satisfaction of collective needs", "the theory of the satisfaction of social needs" have become more attractive. They were united by one common statement that taxes are the payment of taxpayers for state services (the total amount of taxes should be equivalent to the value of state services) [6].

In the theory of taxation, another direction has developed, in which "taxes" and "state fiscal regulation" are "evil", which should be reduced as much as possible. This area includes the modern theory of "supply economics", the tools of which were used in practice after the weakening of the Keynesian approaches.

If we choose a fair and optimal path for the country's development, then in our opinion, we need to use the mechanisms arising from the "theory of exchange" and its later versions (for example, the "theory of equivalents", etc.). The key claim of this theory is that the sum of all taxes paid by taxpayers should be equivalent to the total value of government services for taxpayers - no doubt. If this principle is observed, overwhelming majority of the taxpayers generally pay the taxes and fees due (experience of Germany).

A study on the scientific foundations of taxation and their use in carrying out tax reforms in Uzbekistan revealed the following patterns.

*Seligman B* [7], a representative of the "theory of exchange" in its later versions, suggested at the beginning of the development of the economy to use a proportional system of personal income tax, and after that - to introduce a progressive scale. Since 1 January 2019 in Uzbekistan a transition has been made to a flat scale of income tax at a rate of 12%, which, in our opinion, is quite reasonable. The premature use of the progressive scale in Uzbekistan has led to an increase in informal activity and the loss of significant budget funds.

*Ricardo D.* [5], a representative of the classical school, noted in his research papers that taxes should be imposed primarily on luxury goods and put forward the idea of a non-taxable minimum. In Uzbekistan, in course of the tax reform, from 1 January 2019, the non-taxable minimum in the calculation of income tax was abolished, and from 1 October VAT exemptions on 9 types of essential food products were canceled.

It can be assumed that the increase in prices for essential foodstuffs, which took place as result of the VAT reform, was offset by a decrease in the income tax rate to 12% and the abolition of insurance premiums of citizens from wages

in the amount of 8%. However, the removal of insurance premiums increases the risks for employed workers in the event of illness or loss of work.

The use of VAT at a rate of 15% at all stages of the technological chain inevitably leads to an increase in the cost of final consumer products. The negative effect of the effects of the growth of "price disparity" on agricultural and industrial products, the gap between the level of wages and consumer prices, is increasing. These effects do not meet the criteria for the fundamental principles of David Ricardo theory.

In our opinion, the tax system of Uzbekistan, after the adoption of the Concept for Improving Tax Policy, the Tax Code in the new edition, is still at the stage of transformation of the used mechanisms of taxation.

In order to improve the conditions for business and employed workers, it is advisable to continue adjusting the existing tax instruments. The scientific and theoretical foundations of taxation (the foundation of the system), the established development goals and the specifics of the current situation (the spread of COVID-19) should be taken into account.

All proposed measures should be grouped into several periods: the state of emergency (quarantine); lifting restrictions and gradual economic recovery; post-coronavirus development.

The action of the tax policy in the conditions of emergency and quarantine should be aimed primarily at supporting business entities, legal entities and individuals. Adhering to the principle of justice, the state needs to exempt all economic entities from property and land tax (resource taxes) for the entire period of the state of emergency and quarantine regimes. In difficult situations, it is possible to return to taxpayers the tax funds that payed to the state budget in the previous and current year, depending on the amount of damage caused by forced restrictions. For indirect taxes, you can use a mechanism to reduce their rates or deferrals. The direct tax burden can be left unchanged. This is due to fact that in the absence of activity the profit and revenue of enterprises will approach "0" and the tax will also be at the same level. If the profit grows, then the tax amount will also increase. Depending on the situation, it is recommended use the mechanism of "deferring" the payment of income tax or "tax holidays" (for legal entities and individuals, individual entrepreneurs).



The action of the tax policy in the context of the lifting of restrictions and the gradual recovery of the economy should be aimed at a gradual increase in the rates of resource taxes. If revenues and profits begin to grow, then the entrepreneur already has opportunity to pay resource taxes. In addition, "deferrals", "tax holidays" and "tax credit" for direct taxes are canceled. In this situation, it is possible to gradually bring the rates of indirect taxes to the initial level. At the same time, the VAT rate on essential consumer goods and services should be minimal, and on the rest - maximum. This will provide access to the consumer basket for low-income and medium-income citizens.

### **3 DISCUSSION AND CONCLUSION**

The action of tax policy in the period of post-coronavirus development should be aimed at expanding access of low-income and medium-income citizens to universal human values, health promotion, disease prevention, employment expansion, innovation, environmental sustainability, resource and energy conservation, widespread use of alternative energy sources and reduction of emissions pollutants.

To reduce shadow employment, it is necessary to create conditions for increasing the stimulating role of wages in the commercial sector of the economy. This can be done by expanding the practice of returning part of tax revenues to taxpayers and deductions from taxable bases of certain socially significant expenses. These tools can be compulsory insurance contributions, deductions for the diagnosis of diseases, reimbursement of expenses for dental services, performing certain surgical operations, purchasing goods for children, the elderly and the disabled, etc.

In order to implement these noble tasks, it is advisable to apply taxation instruments used in a socially oriented economy. For this, it is advisable to use methodological approaches arising from the "theory of exchange", "the theory of social needs" and other concepts that ensure the transition from the "economy of barbaric consumption" to the "green economy", "smart economy", "economy of knowledge and innovation."

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