



TAX REFORMS IN THE REPUBLIC OF UZBEKISTAN AND THEIR IMPACTS ON SOCIAL AND ECONOMIC CONDITIONS OF CITIZENS

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Abstract

Needless to say taxes play a very important role in the economic development of a certain country, because they account for the majority share of national revenue. Therefore, all countries do pay a lot of attention to their tax system. Some governments try to get revenue through taxes as much as possible while other countries consider the influence of taxes or tax reforms in the life conditions of citizens. Because of taxes, there may be inequality among people. Thus tax reforms should be implemented taking into consideration of social and economic conditions of citizens. This paper studies the role and impact of current tax reforms in the economy and people's life in Uzbekistan. According to results these reforms are more beneficial to people who earn more, however people who receive little income need to pay more than they used to pay.

Keywords: Tax, Tax reforms, Personal income tax, Budget, Uzbekistan



INTRODUCTION

In the past, tax systems were used in developing countries to serve multiple objectives. These included, in addition to mobilization of resources to finance government expenditure, promoting savings and investment; inducing savings in particular forms to facilitate the process of channeling savings into investment; directing investment into desirable activities. (Islam June 2001). Although current tax systems seem developed and improved there is still a necessity for tax reforms, because the tax system that was very good 10 years ago may not give an expected result now. In the Republic of Uzbekistan for 27 years of independence there have been many changes and reforms in the tax system of the country. Especially in 2018, in Uzbekistan there were many discussions about future tax reforms in the country, policy-makers and economists argued a lot on different topics. Finally, current president of the Republic of Uzbekistan, Shavkat Mirzizoev signed a decree “The Concept of Improving the Tax Policy of the Republic of Uzbekistan” on June 29, 2018. The accepted concept of tax reform is a huge step forward in creating a favorable business climate in the country.

Changes and their impacts

In short, the essence of the changes is as follows. Five key tasks are solved:

- 1) The reduction of taxes on labor - they are very high, which is one of the important reasons for dropping the economy into a “shadow”;
- 2) The elimination of a significant gap in the tax burden between the generally established and simplified tax regimes - this gap forces enterprises to disaggregate, makes it difficult to scale up production, often condemning the business to lack of competitiveness and going into the "shadow";
- 3) Eliminating (where possible) or reducing the scope of taxes from revenues (these are 3.2% of mandatory contributions to state trust funds for enterprises of a general regime and a single tax payment for enterprises of simplified regime), which kill the social division of labor and do not allow long value chains, condemning our economy to the role of a raw materials appendage of the world economy;
- 4) Reducing the overall tax burden on the economy (30–35% of GDP in recent years, not counting various forms of hidden taxation), which makes our products uncompetitive and the economy unattractive for investment;
- 5) Improving the system of tax administration, which is currently very inefficient and significantly increases the costs of doing business.

For this purpose it is supposed:(Mirziyoev June 29, 2018)

- The abolition of 8% of insurance contributions of citizens in the extra-budgetary Pension Fund, withheld from wages;
- The introduction of a “flat” income tax rate of 12% instead of a progressive scale with a maximum tax rate of 22.5%;
- Reduction of the unified social payment rate to 12% - instead of 15% for the simplified mode and 25% for the general tax regime (except for budget organizations and state enterprises - for them the rate is set at 25%);
- The abolition of mandatory contributions to state trust funds for enterprises of general regime (3.2% of revenue);
- Reduction of the corporate income tax rate from 14% to 12% (for commercial banks - from 22% to 20%, for cellular companies - increase from 14% to 20% with the abolition of excess profit tax, which they paid in excess of a certain level of profitability);
- Reduction of the tax rate on dividends from 10% to 5%;
- A reduction in the tax rate on the property of legal entities from 5% to 2% with the introduction of the obligation to pay it, as well as the payment of tax for the use of water resources by all legal entities without exception;
- Granting the right to deduct the amount of value added tax (VAT) on the acquired fixed assets, construction in progress and intangible assets that are currently included in their value (which reduces the tax burden on VAT);
- Transfer of enterprises that have an annual turnover (revenue) at the end of the previous year more than 1 billion soums or reached the established threshold during the year to pay general taxes (at the end of 2017 it is about 10% of small businesses);
- Setting for taxpayers with an annual turnover (revenue) of up to 1 billion soums, the possibility of paying (instead of VAT and income tax) turnover tax with a rate of 4% (instead of 5% of the single tax payment now);

Wherein:

- The current VAT rate is maintained at 20% with a subsequent reduction in the size of the rate in 2019;
- Taxation procedure is maintained for single land tax payers;
- It is planned to reduce the number of activities allowed for individual entrepreneurs;
- A program of measures should be developed to drastically improve tax administration;
- Measures should be developed to simplify tax reporting and ensure its integration with software products; on the introduction of automated accounting; to improve the skills of

state tax service employees and taxpayers; on the introduction of a personalized accounting of the accrued wages necessary for calculating pensions;

- Before November 1, 2018, proposals should be prepared for the abolition of ineffective tax and customs privileges and preferences;
- Before December 1, 2018, a new draft Tax Code should be developed.

What could not be implemented?

In my opinion, the planned changes are a huge step forward in creating a favorable business climate in our country. The new model of taxation is more attractive than the tax systems of most of the former Soviet republics.

Although the approved concept retained the overwhelming majority of the principal provisions of its initial draft, it was still not possible to defend two important points of the original version of the concept during discussions and agreements.

1. It was assumed reduction of VAT from 20% to 12%. Nevertheless, they decided to keep 20% (albeit with plans for reductions after 2019). As far as I understand, the desire to protect the budget from the risk of budget revenue shortfall due to a sharp decrease in tax rates and the abolition of certain types of taxes has prevailed.

I am afraid that maintaining such a high VAT rate (our neighbors in Kazakhstan and Kyrgyzstan - 12%) will put a heavy burden on enterprises, which will switch from a simplified to a general regime. It is because of the 20% VAT rate for them that the tax burden may increase. This is especially true of service enterprises for the population, where the share of value added in revenue is very large. But it is not possible to significantly reduce the taxable base at the expense of offsets or shift some of the burden to the next link in the payment of VAT - the buyer of services (the population does not pay VAT). This will lead to a reduction in incentives for the voluntary transition of small enterprises to the general regime and disaggregation or concealment of the revenue of enterprises with an annual turnover of more than 1 billion soums.

As a result:

- Legalization of the business and the transition to the general tax regime or the voluntary payment of VAT will not be as extensive as expected,
- Some types of our goods and services will be uncompetitive compared with neighboring countries,
- The budget may be short of income due to the reduction of the taxable base.

2. In the initial draft of the concept, it was proposed to introduce a tax on distributable income instead of income taxes and dividends. The objectives of this transition:

- Reduction of tax burden for enterprises of the general tax regime, and, therefore, for enterprises that will switch to general regime in the future (since not all profits are taxed, the taxable base decreases);
- Investment promotion (investment expenses are not subject to tax on distributable profits, therefore, it is beneficial for an entrepreneur not to “eat up”, but to invest his profit);
- (and most importantly!) A radical simplification of tax administration. The fact is that the income tax is the most controversial and difficult to calculate among all taxes. It is for him that the most controversy arises between business and tax specialists. For obvious reasons, tax officials do not want to recognize the “unjustified” expenses of a business and seek to include them in the taxable base, while the business has exactly the opposite tasks - to withdraw as much money as possible (by increasing expenses) from taxable income. As a result: a) tax authorities receive a powerful lever of administrative intervention in business affairs; b) enterprises sometimes artificially inflate their costs in order to reduce the taxable base. When switching to a tax on distributable profits, taxation business costs will not be of interest (with the exception of a small group of expenses for personal needs of entrepreneurs who, apart from dividends, include distributable profits), and the entrepreneurs themselves will significantly reduce the incentives to inflate these costs. Tax administration is extremely simplified for both parties.

COMPARATIVE ANALYSIS

But, in spite of everything, the planned reform is a breakthrough. As a result of its implementation, we will get a much better tax model than the one we have now. And it should be noted the courage of the government and the president who agreed to such drastic measures to reduce the tax burden and revise the existing tax rules. I think this is the second most important step in our economy after the liberalization of the foreign exchange market in 2017. The main thing is not to change your mind, not turn off the chosen path and realize the plan.

I will try to more clearly present the degree of radical change planned. The most successful tax reform in the post-Soviet space is considered to be reform in Georgia in 2005–2009, during which the number of taxes was reduced (from 22 to 6), and tax rates were reduced for the remaining taxes (Georgian way of tax reforms (Gvindadze 2017)).

Table 1 Main indicators of tax system in Georgia (2004-2011)

	First stage			Second stage			Third stage	
	2004	2005	2006	2007	2008	2009	2010	2011
Number of taxes	22	7	7	7	6	6	6	6
VAT (%)	20	20	18	18	18	18	18	18
Personal income tax (%)	12-20	12	12	12	25	20	20	20
Social payment (%)	33	20	20	20				
Tax on profit (%)	20	20	20	20	15	15	15	15
Tax on dividends and other interest incomes (%)	10	10	10	10	10	5	5	5

Source: Ministry of Finance in Georgia

At the same time, tax revenues to the budget began to grow as early as 2005–2006 on average by 30.61% per year. In the four years since the start of the reform, tax revenues increased 2.7 times in real terms. In 2009, the country ranked 4th in the world in the Forbes Tax Fear rating (Tax Misery & Reform Index) after Qatar, UAE and Hong Kong. In 2017, reform was continued, and instead of taxes on profits and dividends, a tax was imposed on distributable profits.

The authors of the initial version of the concept were guided by the final taxation model of Georgia (2017). The parameters of the signed version were closer to the first year of the Georgian reform (2005). Moreover, in some positions we went further than the Georgian government in 2004–2005. In particular, in 2019, taxes on labor and income (including dividends) will be lower than similar taxes in Georgia in 2005.

Table 2 Comparative analysis of the main taxes during the reform period in Georgia and Uzbekistan

	Georgia				Uzbekistan	
	2004	2005	2017	2018	Initial concept	Accepted concept
VAT, %	20	20	18	20	12	20
Personal income tax, %	12-20	12		7,5-22,5		12
Social tax/single social payment, %			20	15-25		12
Insurance payments, %	-	-	-	8	25	
Tax on profit, %	20	20	20	14		12
Tax on dividends and other interest incomes (%)	10	10	10	10	25	5

Source: Ministry of Finance in Georgia and Tax Committee of Uzbekistan

According to table 2 we can say that tax system of the Republic of Uzbekistan was simplified very much. Decreasing some tax rates is expected to increase government revenue by taxes. So there is a question

TAX REFORM IN UZBEKISTAN. WHAT WILL IT CHANGE?

Economists and businessmen say that the implementation of a “revolutionary document” will make Uzbekistan a country with one of the best tax systems in the world.

Will there be a “white” salary?(Center 1 2018)

The project provides for a significant reduction in payroll taxes. Now employers are obliged to deduct up to 22.5% in the form of personal income tax (PIT), as much and even more - social and insurance payments.

High tax burden forces them to pay salaries in envelopes, and to indicate small amounts in tax returns.

The concept proposes to combine these payments into a single personal income tax with a flat tax rate of 25%. The amount of income will not affect the percentage. Now the country has a progressive tax system in which people with high salaries pay more taxes than people with low incomes.

Will import become cheaper?

Uzbekistan gradually abolishes or reduces excises and customs duties on goods not produced in the country. This, as one of the factors stimulating consumer demand, is stated in the draft concept of tax reform.

For example, in the first quarter of 2018, due to this, some food categories became cheaper. In particular, vegetable oil - by 3.2%, flour - by 2.2%, potatoes - by 6.2%.

Since May 1, duties on live fish, bananas, watches, precious metals, bicycles, printed books, ice cream and other goods are completely abolished. For example, now a kilogram of bananas in Uzbekistan costs 30 thousand soums (almost \$ 4). For comparison: in Kazakhstan - twice or three times cheaper.

Excises on alcohol, tobacco, clothing, dishes will be reduced several times. At the same time, privileges will be abolished when importing certain categories of goods.

Bottom line: there is every reason to wait for the decline in prices for certain imported goods and services ... but with an eye on the dollar rate.

THE IMPACT OF REFORMS ON PEOPLE

All working Uzbeks pay personal income tax - a tax on personal income. According to the current procedure, they are not subject to salary in the amount of up to 184,300 soums (1 Minimum wage from July 15, 2018). Further, the rate depends on the amount of income:

- From 1 to 5 Minimum wages - 7.5%;
- From 5 to 10 Minimum wages - 16.5%;
- Over 10 Minimum wage - 22.5%. (Tax Committee of Uzbekistan 2008)

PIT is not the only income tax. There are still compulsory insurance contributions to the Pension Fund and a single social payment, which the employer pays for employees from the total amount of all wages. This year, premiums are charged at the rate of 8%. A single social payment - at a rate of 25% on a general basis and 15% on preferential terms (small business, farms and others).

And there are mandatory deductions for individual savings pension accounts: 2% of the salary accrued. However, these deductions are in the composition of personal income tax and are listed on the "pension book" of citizens.

Imagine how salary would be taxed and compulsory payments if the new order had the same procedure and the same rates as in this:

Table 3 Salary taxation

Salary Amount - accrual	PIT	Mandatory insurance premiums	Salary Amount - "on hand"	Tax burden
600 000	31 178	48 000	520 823	13,2%
1 300 000	117 743	104 000	1 078 258	17,1%
2 400 000	332 663	192 000	1 875 338	21,9%
4 500 000	805 163	360 000	3 334 838	25,9%

Source: Author's calculations

It turns out that salary is growing - the tax burden is growing. From 1,300,000 soums, the employee will pay 221,742 soums, and from 2,400,000 soums - 524,662 soums.

In Uzbekistan there are beneficiaries who pay personal income tax from the amount of wages minus 4 minimum wages. If the salary is less than 4 minimum wages, then it is fully exempt from the income tax of individuals.

How workers will pay after tax reform

From January 1, 2019:

The personal income tax rate is the same for all employees - 12%.

Pension deductions are equal to 0.1% and are also deducted from the personal income tax amount.

No more insurance premiums to the extra-budgetary Pension Fund.

The unified social payment is 25% for budgetary and state organizations.

The single social payment is 12% for private organizations.

Table 4 Employees of budget and government organizations

Salary Amount - accrual	PIT	Salary Amount - "on hand"	Tax burden	Growth in salary
600 000	72 000	528 000	12%	+1,4%
1 300 000	156 000	1 144 000	12%	+6,1%
2 400 000	288 000	2 112 000	12%	+12,6%
4 500 000	540 000	3 960 000	12%	+18,7%

Source: Author's calculations

It turns out that the salary is growing - the tax burden is reduced. From 1,300,000 soums, a government employee will pay 156,000 soums, and from 2,400,000 soums - 288,000 soums.

CONCLUSION

Possible Scenarios after reforms

The concept of tax reform in Uzbekistan certainly has its advantages. However, in order to say for sure whether the incomes of the Uzbeks will increase, it will be necessary to answer the main question: will the money released from the introduction of the single personal income tax rate and the reduction of the CAP rate be used to increase their wages?

And here two scenarios are possible.

Positive

Considering the baseline scenario (examples of calculation for it are shown above), we can say: "Yes!", The released funds will be used to stimulate the remuneration of workers and

employees, as the employer is more than interested in increasing the efficiency of work and the welfare of employees.

If the money saved as a result of a reduction in personal income tax and single social payment rates will be used to raise wages, consumer demand will probably be stimulated. People will buy more goods and services. This will positively affect the market equilibrium, and therefore, reduce inflation in the country.

Negative

What will happen if employers do otherwise? They will keep the wage amounts at the same level, and the money released from the introduction of the single rate of personal income tax and the reduction of the single social payment rate will be used for other needs (for example, they will build a new building) or increase their profits.

Both scenarios have the right to exist in the current realities. And the way the business goes will determine the effectiveness of the implementation of the concept of tax reform relating to reducing the tax burden on the income of workers and employees. The development prospects of the national economy, which today is experiencing certain difficulties, both systemic and reputational, depend on this.

In our case, it remains to rely on the reasonableness and honesty of the business.

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