

HISTORY OF THE VALUE ADDED TAX IN UZBEKISTAN: MISTAKES, EXPERIENCE LEARNED, AND CURRENT PROBLEMS

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Abstract. This article is devoted to the analysis of the formation of the Value Added Tax in the Republic of Uzbekistan, changes occurred in the tax mechanism, mistakes made, experience learned and current problems existing in terms of the value added tax. In addition, the article justifies high fiscal and economic significance of this tax and presents proposals on the improvement of the existing tax mechanism.

Key words: tax, value added tax, production, receipts, sale, turnover, tax regime, taxation mechanism.

Introduction. This scientific article is devoted to the critical analysis of development trend of the Value Added Tax (the VAT) in the Republic of Uzbekistan since its inception up to present times. In addition, the article reveals the fact why 28-year long history of the VAT has not been completely formulated in the tax system yet. Moreover, the article shows the positive and negative aspects of the VAT reforms ongoing over the recent years.

The analytical part of the article justifies the point that in compliance with its essence the VAT must be imposed not from the turnover, but from the newly created (added) value at economic entities. In this regard, it is crucially important to create so-called "chain" mechanism of this tax.

The methodological part of the article deals with the impact of the VAT rate on the Gross Domestic Product (GDP) and the analytical method of panel-based information has been applied.

The conclusion part presents the research outcomes and relevant developed proposals on the VAT improvement.

Information analysis:

Mistakes made while the VAT formation and the experience learned

In 1992 Uzbekistan introduced the VAT which was typical for the market economy

and was widely used in the international practice. Its payers were represented by enterprises of all forms of ownership (except banks and insurance companies). However, at that time this tax rate was much higher and constituted 30 percent. When it became clear that such high rates of VAT would weaken the economy in some extent, its rate was significantly reduced. In particular, its rate was 20 percent in 1995 and 17 percent in 1996-1997.

As a result of tax reform in 1998, there have been significant changes in the VAT rate and composition of its payers. In particular, since this year tax rates have been differentiated, i.e. 0 percent tax rate was used for export of goods, 10 percent tax rate was used for some social goods, and 20 percent rate was applied for all other turnovers and imports. Although many countries have successfully used VAT differentiation rates, this practice has been abolished in Uzbekistan. Establishment of a 10 percent discount rate for the first five types of consumer goods and then 15 percent, respectively, has caused confusion in calculations made in the economic system. In fact, this confusion was the result of a misunderstanding of the mechanism for the budget to compensate for the amount of VAT differentials of enterprises that purchased VAT at a general rate and sold their products at a discounted rate. As a result, the VAT preferential rate was abolished and there remained only the basic rate at 20 percent.

In 1998, a simplified regime was introduced for small businesses. This system provides for a unified “single tax” instead of all taxes paid under the generally-accepted regime. Introduction of a simplified taxation regime dramatically changed the appearance and essence of the tax system in Uzbekistan. It is this unique mechanism that causes the VAT chain to fail in Uzbekistan.

In addition, since the 2000s, there have been many benefits for certain categories of businesses and some types of activities, which, in turn has resulted in worsening of the tax burden on other taxpayers. Special tax regimes and preferences have led to an uneven distribution of the tax burden between different economic entities.

Throughout the years, special tax regimes have caused continuous amendments to reduce the damage to the VAT chain.

Finally, annual turnover (gross revenue) is defined as the criterion for deciding whether an economic entity remains in a simplified tax regime or forcibly switches to a general tax regime in order to eliminate the imbalance of tax burden in generally-accepted and simplified tax regimes since 2019. According to this, enterprises with annual income of over 1 billion UZS have been transferred to general taxation regime and become VAT

payers. This measure was aimed at expanding the VAT use. However, this action was initiated without reducing the 20 percent VAT rate. Just on the eve of 2019 it was impossible to impose the VAT with such a high rate from all entrepreneurship entities as they might have experienced some challenges, as a sharp price growth for goods and some other problems. As a result, a simplified VAT regime has been invented and introduced in practice. According to this regime, business entities with revenues not exceeding 3 billion UZS are allowed to pay VAT at reduced rates. Meanwhile, the tax rate was differentiated for some types of activities. Entrepreneurs who have passed to the simplified VAT regime should have separate accounting for the VAT when doing more than one type of their business activities. Obviously, this procedure has made the taxation system even more complicated.

**Analysis of the current condition of the VAT:
national and international aspects**

The majority of entrepreneurship entities have undertaken measures to avoid the situation when their revenues exceeded billion UZS. This can be achieved in three different ways: (1) concealing their revenues; (2) closing the company which turnover has reached 1 billion UZS and opening a new one; (3) establishing a relative company, to monitor its turnover. All these ways open opportunities for the shadow economy. It should be noted, that such way of reforming the VAT is not provided for and encouraged by the Concept for the tax policy improvement (Decree of the President № 5468 as of June 29, 2018). In other words, one of the mistakes of the tax reform was its application to all entities without reducing the VAT rate. Furthermore, with the aim of restoring the chain mechanism of the VAT, many tax incentives were abolished in reliance upon the Decree of the President of the Republic of Uzbekistan (Decree of the President № 5755 as of June 27, 2019). These incentives were applied to the primary food products (flour, bread, meat and etc) and agricultural products. The VAT rate was reduced from 20 percent to 15 percent.

It should be noted, that some countries with the developed economies, such as Japan (8-10%), Switzerland (7,7%), Liechtenstein (8%), Singapore (7%), Malaysia (6%), Canada (5%) use the VAT with the rate of 5-10 percent. In addition, South African Republic (14%), Brazil (12%) and India (5%) which are BRICS member countries, as well as the Philippines (12%), Australia (10%), South Korea (10%) and Indonesia (10%) which are incorporated into the G20 use the VAT with the rate lower than 15 percent. Even in neighboring Kazakhstan, the VAT rate accounts for 12 percent. However, even despite a relatively low VAT rate in these countries, the VAT generates a significant portion of budget revenues.

In order to increase the VAT coverage in Uzbekistan it is necessary to lower its rate to 12 percent. However, it is not possible to raise the VAT collection and optimize tax burden only by reducing the rate. For this purpose it is necessary to adjust the mechanism of the VAT collection based on the economic essence of the VAT, i.e. introduce it to all businesses with VAT at all stages of its implementation. This, in turn, necessitates abolishing a special regime that envisages the current turnover tax.

At the same time, it is advisable to introduce differentiated (basic, concessional and zero) rates with the aim of ensuring taxation justice and social protection.

Having studied the international practice of VAT rates, almost all European countries with high VAT rates apply reduced (preferential) tax rates for goods and services of a social nature.

Based on foreign experience to simplify tax administration for small businesses it is necessary to introduce the concept of “minor turnover” which is not subject to the VAT payment. It is recommended to determine the volume of “minor turnover” in the amount of 30000 USD.

This means that all businesses, except for businesses that have made minor turnovers, will be subject to the VAT.

As we have stated above, VAT differential rates apply in almost half of all VAT-eligible countries. In a number of foreign countries, differentiated rates of VAT demonstrate great social importance and ensure the application of the principle of justice in the taxation of consumption. This is due to the fact that in these countries the government uses efficient practice to indemnify negative difference between VAT rates. This is because the government expects social benefits from applying such rates.

If we take into consideration that the issue of social protection in Uzbekistan has always been at core point of reforms, it is also necessary to facilitate carrying out with reforms with the help of the VAT. Different rates of VAT should also be used to encourage production of goods of a social nature. For this reason, we propose to introduce a 50% reduced (preferential) rate on basic food and agricultural products, medicines and pharmacy products, items of moral and cultural need, handicrafts, and the goods for children.

Methodology.

Our research is aimed at determining the impact of reducing the VAT rate on GDP and budget revenues (BR). Due to the fact that VAT is often invariably long-lasting, that is, there is little change over the years, and it is rather complicated to analyze in the form of time series. Therefore, we decided to perform our analysis through the data set in the panel

data view. Panel data have the potential to take into account changes in time series and objects (in our case, by countries).

The main objectives of our econometric analysis are as follows and can be illustrated as:

| | | |
|-----|---|-----|
| VAT | ↔ | GDP |
| VAT | ↔ | BR |
| BR | ↔ | GDP |

In panel data analysis, there are three different models that can be put forward. They are the following:

1. Pooled OLS (The generalized least squares method)
2. Fixed effects model
3. Random effects model

The operations performed through the EViews software has given the following results:

Table 1

Mutual impact of the budget revenues and the VAT: panel data analysis

| Variable | Pooled OLS | | Fixed effects | | Random effects | |
|--|-------------|-------------------|---------------|-------------------|----------------|-------------------|
| | C | S.e. (p-value) | C | S.e. (p-value) | C | S.e. (p-value) |
| Budget revenues | | | | | | |
| VAT | -0.08 | 0.01 (0.00)*** | -0.005 | 0.00 (0.36) | -0.007 | 0.00 (0.24) |
| Constant indicator | 6.45 | 0.26 (0.00)*** | 26.9 | 0.11 (0.00)*** | 4.97 | 0.26 (0.00)*** |
| R-square | 0.10 | | 0.99 | | 0.02 | |
| F-statistics | 40.4 (0.00) | | 1485.1 (0.00) | | 7.04 (0.00) | |
| Number of observations | 340 | | 340 | | 340 | |
| Period | 10 | | 10 | | 10 | |
| Number of countries | 34 | | 34 | | 34 | |
| According to the results of Hausman test [3.44 (0.06)] Random effects model has been selected | | | | | | |

Table 2

Mutual impact of the GDP and budget revenues: panel data analysis

| Variable GDP | Pooled OLS | | Fixed effects | | Random Effect | |
|--|----------------|-------------------|---------------|-------------------|---------------|--------------------|
| | C | S.e. (p-value) | C | S.e. (p-value) | C | S.e. (p-value) |
| Budget revenues | 0.98 | 0.00 (0.00)*** | 0.91 | 0.02 (0.00) *** | 0.94 | 0.01 (0.00) *** |
| Constant indicator | 21.9 | 0.04 (0.00)*** | 22.2 | 0.10 (0.00)*** | 22.1 | 0.09 (0.00)*** |
| R - square | 0.97 | | 0.99 | | 0.89 | |
| F-statistics | 11327.5 (0.00) | | 11050 (0.00) | | 2996.3 (0.00) | |
| Number of observations | 340 | | 340 | | 340 | |
| Period | 10 | | 10 | | 10 | |
| Number of countries | 34 | | 34 | | 34 | |
| According to the results of Hausman test [3.15 (0.07)] Random effects has been selected | | | | | | |

Conclusion. 1. One of the main problems in the tax system as a result of the unified taxation practice introduced in Uzbekistan since 1998 is the failure of the VAT mechanism. Since the majority of taxpayers have paid taxes under special tax regimes for over 20 years, the generally-accepted tax regime has completely lost its essence. The tax collection mechanism is broken due to the fact that only a small number of taxpayers are subject to VAT and the VAT is not involved in all stages of its implementation.

2. Observations and studies show that the following factors have contributed to the decline in the number of VAT-paying legal entities: (1) large companies have been divided (diminished) and re-established their performance in the form of several small business entities; (2) they couldn't continue their performance and have become bankrupt. Both factors occurred due to the generally-accepted high taxes, especially a high burden of the VAT. Moreover, because of the high VAT rate, it has become a burden on businesses, its collection rate has fallen, and its debt has increased year by year.

3. The VAT that has not been paid in one production cycle will certainly shift to the next cycle. In this case, the company acquiring production resources without the VAT will

pay this tax both for itself and for the VAT-exempted supplier. This has also led to the fact that large companies – the VAT-payers often fail to cooperate with taxpayers in the simplified regime.

4. The VAT mechanism needs to be expanded to better regulate and reduce its burden. Along with the reduction of the VAT rate, its implementation at all stages of sale will result in the restoration of this tax mechanism. Herewith, establishing the VAT-exempted turnovers facilitates tax administration for small businesses.

5. Taking into consideration that the issue of social protection in Uzbekistan has always been the the core point of reforms, it is also necessary to facilitate carrying out with reforms with the help of the VAT. Furthermore, different rates of VAT should be used to encourage the production of goods of a social nature. It should be noted, that introduction of a preferential VAT rate on primary social goods stimulates the production of such goods.

6. As the analysis shows, a 1percent increase in the VAT would lead to a 0,01 percent reduction of the GDP. In other words, a 1 percent reduction of the VAT would lead to a 0,01percent increase of the GDP. Thus, we can make a conclusion that the reduction in the VAT does not have a negative impact on the economic growth, however, on the contrary, it can promote the economic growth.

Reference:

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