

THE INFLUENCE OF TAX REFORMS ON THE PROSPERITY OF MICRO-FIRMS AND SMALL BUSINESSES IN UZBEKISTAN

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The article gives inside into tax system of Uzbekistan, a former Soviet republic. It analyses major tax reforms in the country since the early days of its independence (1991) with special attention given to the simplified method of taxation, used for micro-firms and small businesses (MSEs). The results of 30 in-depths interviews with representatives of MSEs revealed substantial reductions in tax rates (the average tax burden is 14.9 per cent) and overall improvements in the business environment. However, despite the numerous changes in Uzbek taxation, the issues related to tax administration (tax audits, reporting and competence of tax inspectors) make it difficult to operate in Uzbekistan without breaking rules. To be effective and successful, tax reform needs to be accompanied by institutional and structural reform throughout the economy.

I. INTRODUCTION

Since independence in 1991, Uzbekistan has pursued a gradual approach to the transition from a planned to a market economy. The Government aimed at building a socially oriented market economy and developing industrial and manufacturing capacity in a predominantly agricultural economy using substantial and direct central control (Gemayel and Grigorian 2005).

The tax system of Uzbekistan developed in line with the country's course of reforms, and the elements of a modern tax system, administrative and institutional capacity evolved in successive steps. This less-than-ideal tax reform was the result of a compromised to preserve government revenues in the early years of independence (Martinez-Vazques and McNab 2003).

Early tax reforms were mainly directed towards the fiscal role of taxation and underestimated its regulatory, social and stimulating roles. This short-term fiscal policy negatively affected private sector development, investment and employment and led to the rapid growth of an informal economy.

More recent reforms in taxation were directed towards reducing the tax burden, optimizing the structure and rates of taxes, simplifying and unifying the tax system, as well as increasing the stimulatory and regulatory functions of tax policy.

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From 2000 to 2007, the tax burden in the economy fell from 40 per cent to 27 per cent (Tuchkova 2008). This was achieved through consecutive reductions of federal and local tax rates, mandatory payments and the streamlining of taxes.

The small business sector plays an increasingly important role in Uzbekistan. According to the State Committee on Statistics, in 2008, small business accounted for 48.2 per cent of GDP and 76 per cent of total employment (Uzbekistan, 2008). Changes in tax legislation create favourable preconditions for the further development of small business. In 2007 alone, tax exemptions increased the financial resources of the business sector by 830 billion sums (Karimov 2008).

However, numerous amendments in Uzbek taxation do not yet testify to the creation of a perfect tax system, and this remains as one of the most complex aspects of Uzbekistan's business environment.

This study is divided into five sections. Section I analyses the development of the tax system in Uzbekistan since its independence in 1991, with special attention to the simplified method of taxation used for micro-firms and small businesses (MSEs). Section II develops research methodology and builds up primary data collection instrument for the study. Section III presents the findings of 30 in-depth interviews which were conducted with representatives of MSEs in five regions of Uzbekistan to explore the impact of recent tax reforms on business activities. Sections IV and V, the final part of the research, contain a list of conclusions and recommendations which are directed towards improving the business climate in Uzbekistan.

II. DEVELOPMENT OF THE TAX SYSTEM IN UZBEKISTAN

Over the past 18 years, the Uzbek tax system has gone through roughly four development phases:

Phase 1 – from 1991 to 1994;

Phase 2 – from 1995 to 1999;

Phase 3 – from 2000 to 2004;

Phase 4 – 2005 to the present.

Phase 1 (1991-1994)

In the early 1990s, Uzbekistan's economic situation was very fragile; consequently, the tax system was geared first of all to meet its *fiscal* targets. These targets were to be met against the backdrop of a rupture of economic relations, high inflation rates, a slump in production and a narrow taxable base. The deciding factor in the economic policy of 1991-1994 was the need to prevent a collapse of the economy, the sudden impoverishment of population and the stratification of society.

The share of GDP derived from private sector activities was very small in all transition countries early after independence. In Uzbekistan, it was less than 1 per cent (International Monetary Fund 1991)!

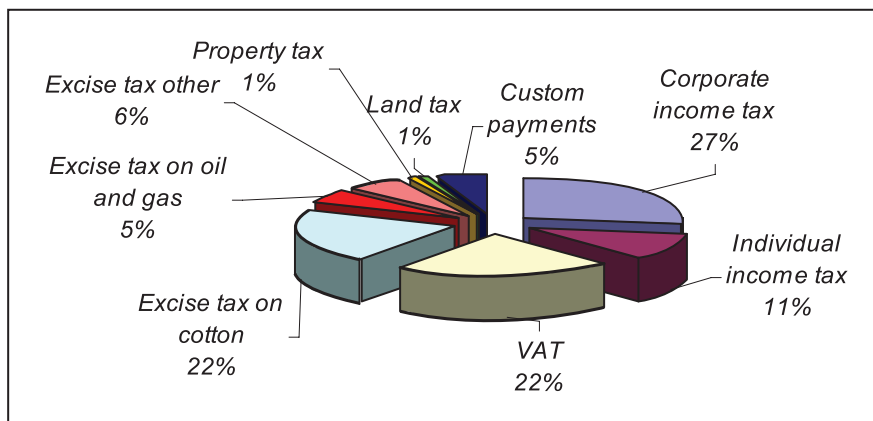
The process of transition from a centrally planned economy to a market one (Tanzi and Tsibouris 2000):

- Destroyed the plan and thus eliminated the information that the plan had provided on quantities produced and on prices at which the output was sold. The Government now had to rely on other sources, including the declarations of the taxpayers, to obtain this information. As a consequence, the prospect of tax evasion rose;
- Increased dramatically the number of producers and thus the number of potential taxpayers, as many private sector activities came into existence. Tax administrations that had been used to dealing with relatively few, friendly enterprises had to deal with hundreds of thousands or even millions of unfriendly taxpayers;¹
- Much of the growth originated from the new small and difficult-to-tax private producers, who required scrutiny on the part of the tax authorities because of their high propensity for tax evasion. At the same time, these small producers required protection from unscrupulous tax officials (Kornai 1997).

These changes required the creation of a new tax system, laws, fiscal institutions and new skills. Fiscal institutions needed clear strategies and objectives, well-defined legal powers and well-defined legal obligations towards those taxpayers. An acute need was to develop the basic economic knowledge of government employees responsible for forming the new tax policy. Interestingly, during this stage, taxation was considered part of the responsibility of accountants and, consequently, at institutions of higher education, taxation was a component of accounting subjects.

These economic conditions in the country necessitated the implementation of new taxes and payments suitable for the transition period but the tax regime at this stage was not characterized by diversity of taxes (figure 1).

¹ In Soviet times, most individuals never had direct contact with the tax authorities. The majority of taxes were hidden from the people who ultimately bore them, with the result that most individuals were not even aware that, indirectly, they were paying a large amount of taxes. Thus, a "tax consciousness" or tax culture never developed.

Figure 1. Composition of taxes in government revenues, 1994

Source: Uzbekistan, Ministry of Finance, 1994.

Note: Extrabudgetary revenues were not included in government revenues.

During the first phase of reforms (and even in the later ones), some principles and practices of a socialistic tax system were observed in the Uzbek tax system (Martinez-Vazquez and McNab 2003):

- *Customized taxes:* Large tax payers could easily negotiate tax exemptions;²
- *Lack of a tradition of voluntary compliance:* Two fundamental pillars of modern tax systems, voluntary compliance and self-filing, were absent for Uzbek taxpayers (Kornai 1997);
- *Underdeveloped tax administration;*
- *Public distrust of government institutions:* The failure of government to raise general living standards combined with increased corruption among government officials encouraged taxpayers to move to a shadow economy. A high level of tax evasion affected compliant taxpayers and their perception of the fairness of the fiscal system, creating a vicious circle of *corruption, a high tax burden, and tax evasion*.

The need to maintain the relative stability of production and the reduction of inflation rates gave a start to the second round of reforms.

² A local car manufacturer; JV General Motors Uzbekistan, exports its cars at a zero rate of value-added tax (VAT), with no excise tax or duties paid.

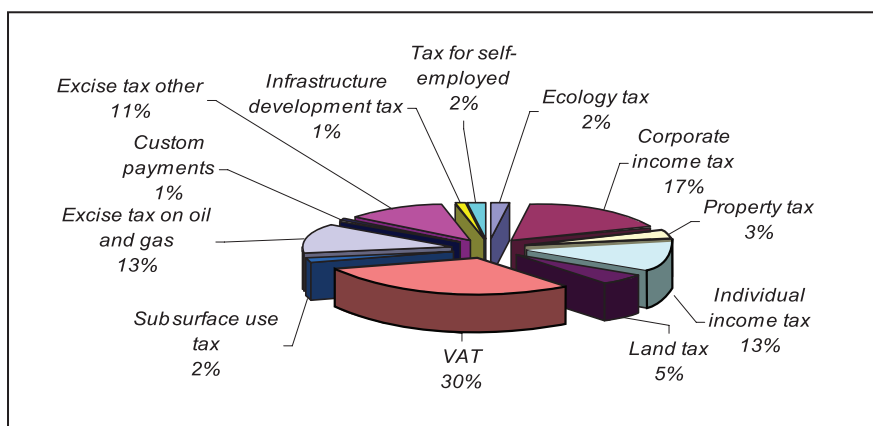
Phase 2 (1995-1999)

The main achievement of the second stage was the development and adoption of the Tax Code in 1998. The Tax Code attempted to streamline taxes, reduce the burden on taxpayers, and simplify accounting and payment procedures. The establishment of the State Tax Committee at the beginning of 1998 was aimed at ensuring compliance from all taxpayers.

The tax policy of this period sought to maintain revenue collection while easing the tax burden on enterprises. In line with the latter objective, the Government reduced the profit tax rate from 36 per cent to 35 per cent in 1998 and to 33 per cent in 1999. In 1998, authorities eliminated the cotton excise tax in response to a decline in world cotton prices. To compensate for the impact of these changes on tax revenues, excise tax rates (in particular on energy products) and VAT rate were increased in 1998 and 1999.³

At the dawn of its activities, the State Tax Committee improved tax collection, which reduced arrears on profit taxes and significantly increased income tax revenue from the self-employed.⁴

Figure 2. Composition of taxes in government revenues, 1999



Source: Uzbekistan, Ministry of Finance, 1999.

Note: Extrabudgetary revenues were not included in government revenues.

³ The standard VAT rate was increased from 18 per cent in 1997 to 20 per cent in 1998, and, in 1999, the preferential rate for food products was increased from 10 per cent to 15 per cent.

⁴ The State Tax Committee has carried out strong disciplinary actions against corrupt officials and has improved collections from the informal sector (e.g., it streamlined the collection of fees from traders in bazaars).

Since 1997, Uzbekistan has followed a strategy of import substitution that has relied heavily on administrative intervention and a restrictive foreign exchange and trade regime in order to protect domestic producers from external competition (International Monetary Fund 2000).

As a result of the abovementioned policies, the business sector expanded significantly. By the end of the 1990s, small businesses comprised more than 80 per cent of all registered enterprises in Uzbekistan.

In 1999, MSEs contributed 23.8 per cent of GDP (Uzbekistan 2008a).

Realizing the significant role of small businesses in promoting fast and healthy economic and social development, the Government of Uzbekistan in 1999 started the structural transformation of the economy through the accelerated development of the private sector, especially small enterprises, and viewed it as a priority of government reforms.⁵ The main mission of the Government during this period was to implement the small business promotion law, which involved the following tasks:⁶

- To further improve policies and measures concerning the development of MSEs;
- To remove institutional barriers that hinder the development of small businesses;
- To create a level playing field for the development of MSEs;
- To promote scientific and technological innovation and upgrading;
- To optimize the industrial structure of MSEs;
- To enhance the overall quality and competitiveness of MSEs.

One of the steps that promoted the development of MSEs was the adoption of a simplified system of taxation for micro-firms and small enterprises in 1998.⁷ The simplified order of taxation proposed payment of a single tax in lieu of all federal and local taxes and payments (except trade, licensing and registration duties). The rates of single tax vary according to the industry in which the MSE operates. The shift to a simplified system of taxation substantially reduced tax burden of small businesses and tax administration procedures became less cumbersome and costly, mainly in bookkeeping and reporting. MSEs were eligible to use either simplified or general accounting procedures based on their preference.

⁵ Welfare Improvement Strategy of Uzbekistan (2007) *Full Strategy Paper for 2008-2010* (Tashkent).

⁶ Decree UP-1987 of the President of the Republic of Uzbekistan, "On further developing private enterprises and small businesses", 9 April 1998.

⁷ Uzbekistan, Resolution #159 of the Cabinet of Ministers, "Procedures for Applying a Simplified System of Taxation for Micro-firms and Small businesses", 15 April 1998.

Despite the fundamental tax policy reforms instituted during the period 1992-1998, Uzbekistan scored 2 out of a possible 5 in an assessment of the degree of tax policy reform (Ebrill and Havrylyshyn 1999).⁸

The increasing number of small business and the complexity of the tax system created a need for qualified tax specialists. However, until the late 1990s, professional education for accountants and government employees was not available, and the system from licensing non-governmental educational institutions was costly and inflexible.

Phase 3 (2000-2004)

By the year 2000, the tax system of Uzbekistan had its established fiscal institution (the State Tax Committee) and regulatory framework (the Tax Code) as a result of the reforms implemented. The economy of Uzbekistan recovered after the separation from the Soviet Union and GDP was growing steadily. However, the overwhelming fiscal role of taxation created a high tax burden for the business sector, increased the shadow economy and suppressed investment. This was the time for new reforms directed towards enforcing the regulatory framework and stimulating the role of taxation through:

1. Reduction of the tax burden;
2. Further simplification of taxation procedures for small enterprises;
3. Simplification of tax administration.

High social security contributions and progressive income tax schedule

Mandatory social security fees, which have the same status as taxes, placed a substantial burden on MSEs. In 2004, businesses paid a consolidated social security contribution of 33 per cent of payroll. Revenue from the consolidated social security contribution is distributed among the extrabudgetary Pension Fund, the State Employment Fund and the Trade Unions Federation Council.⁹ Contributions to these funds are levied on the same base¹⁰ but administered separately. An entrepreneur has to transfer the amounts accrued to different accounts with the relevant agencies and submit separate tax calculations for each of them. This increases the administrative load on enterprises substantially.

In addition to consolidated social payment, large businesses also contribute a percentage of sales to the extrabudgetary Pension Fund.

⁸ A staff team led by L. Ebrill and O. Havrylyshyn assessed the degree of policy reforms in a number of transition countries, using the five-point Likert scale, where 1 denotes very little appropriate market-oriented reform and 5 denotes a high degree of reform.

⁹ From 1 January 2008, a consolidated social payment of 24 per cent is distributed among extrabudgetary funds as follows: Pension Fund – 23.5 per cent, state employment fund – 0.3 per cent and Trade Unions Federation Council – 0.2 per cent.

¹⁰ The taxable base for the consolidated social contribution is the payroll.

Individuals in addition to paying personal income tax based on a progressive tax rate schedule,¹¹ pay contributions to the Pension Fund and dues to the Trade Unions Federation Council.¹²

As a result of the progressive personal income tax rate and high rates of social contributions, which are levied on payroll, neither employers nor employees are interested in formalizing the labour relationship. This restricts wage and salary increases as well as growth in the number of jobs, expands the shadow economy, deprives the government of revenues, and puts employees at a disadvantage. In a number of surveys, a substantial number of MSEs “solve” this issue by paying wages and salaries unofficially. In those cases, both the companies and the employees are breaking the law. However, high payroll deductions and personal income taxes make it customary to do so.

Double taxation, “tax on tax”, and taxation of sales

A fundamental taxation principle—the one-time taxation of any taxable item—is not currently adhered to in Uzbekistan. For example, sales revenue is the basis not only for the single tax payment, in the case of the simplified taxation system, but also for mandatory payments to the pension fund, road fund, and education fund, in the case of the general tax regime.

The VAT on imports is calculated on a basis that includes the customs value, the excise tax and customs duties. This “tax on tax” is a heavy burden on the importer. The same applies to goods subject to excise tax produced in Uzbekistan.

Thus, even though the rates of taxes and other mandatory payments are low in comparison with neighbouring countries, the tax burden is actually hampering business development in Uzbekistan because the taxes (expenses, excise taxes and customs duties) are levied on the same taxable basis (International Finance Cooperation 2004).

Actions taken to reduce tax burden

Indirect taxes, which bring the highest revenues to the government budget, fulfil mainly the fiscal role of taxation, while direct taxes fulfil regulatory and stimulating roles. In order to strengthen the regulatory and stimulatory roles of taxation, the government reduced the tax rates of some direct taxes. Reduction of the tax burden is one of the instruments for stimulating local producers and developing entrepreneurial activities.

¹¹ From 1 January 2008: Lower band (up to six minimal wages) – 13 per cent, Middle band (6–10 minimal wages) – 18 per cent, Upper band (above 10 minimal wages) – 25 per cent. Minimal wage to 1 September 2008 = 25,040 UZS.

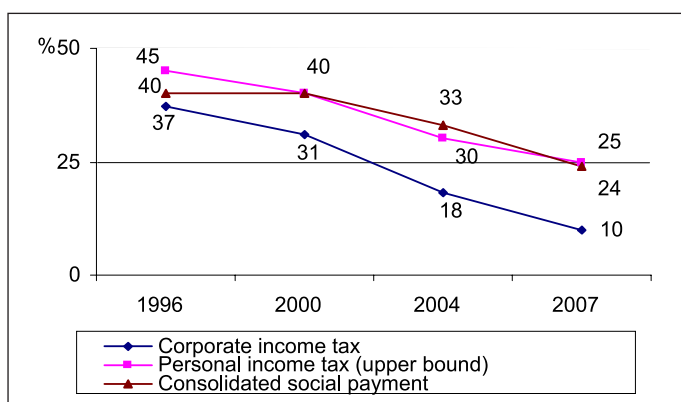
¹² Individuals contribute 1 per cent of their salary to extrabudgetary pension fund and 1 per cent to trade union fund.

**Table 1. Changes in tax rates over the years 2000-2004
(Percentage)**

	2000	2001	2002	2003	2004
Corporate Income Tax	31	26	24	20	18
Consolidated Social Payment	40	40	40	37.2	33
Individual Income Tax	Upper band-40 Middle band-36 Lower band-15	Upper band-36 Middle band-25 Lower band-12	Upper band-33 Middle band-23 Lower band-13	Upper band-32 Middle band-22 Lower band-13	Upper band-30 Middle band-21 Lower band-13

Source: Uzbekistan, Ministry of Finance, 2004.

Figure 3. Tax rate dynamics, 1996-2007



Source: Uzbekistan, Ministry of Finance, 2007.

It was expected that government losses due to the reduction of the tax burden would be partially compensated for by an increase in the tax base (i.e., through a reduction of tax exemptions) and in the voluntary compliance of taxpayers. Some models show that a reduction in the tax burden may result in reduced tax evasion and increase the voluntary compliance of taxpayers (Slemrod and Yizhaki 2000).

To further reduce the tax burden, give clear definitions of taxable bases and improve the cost accounting practices of enterprises, the Cabinet of Ministers of Uzbekistan on 15 October 2003 introduced changes and extended the list of tax-deductible items for enterprises.¹³

¹³ Uzbekistan, Resolution #444 of Cabinet of Ministers, "On Improving Cost Accounting", 15 October 2003.

Taxation of MSEs

Despite the trend towards lower tax rates, they remained high in early 2000. In Uzbekistan, MSEs pay from 5 to 10 per cent of revenue, or 25 per cent of revenue less expenses as a single tax. In the Russian Federation, for example, for MSEs paying taxes under the simplified taxation system, the unified tax rate is 6 per cent of revenue or 15 per cent of revenue less expenses.¹⁴

The “simplified” taxation scheme for small enterprises is actually not, as it envisions that, for taxation purposes, gross revenues may not be lower than the cost of the product. According to this requirement, a small company is required to maintain cost accounting records on its products, which is one of the most complicated forms of accounting and requires a highly qualified accountant. Furthermore, for many small companies involved in providing services or works, there is no point in calculating costs, so they write off all their expenditures to operational costs (periodic costs), as this is simpler and more convenient. These requirements of tax legislation significantly complicate tax administration and increase costs for small businesses (International Finance Corporation 2004).

Actions taken to simplify taxation procedures for small enterprises

Changes were introduced to the criteria for identifying small businesses in 2003. According to the legislation of Uzbekistan, as of 1 January 2004,¹⁵ there is no such term as “medium-sized business”. Most medium-sized enterprises moved to small enterprises category and enjoyed a simplified order of taxation (annex 1).

From 1 July 2003, all wholesale/retail trade and catering enterprises (including MSEs) subject to the general tax regime moved to a simplified order of taxation and proposed payment of tax on gross revenues in lieu of all federal and local taxes and payments¹⁶ (except trade, licensing and registration duties).

Furthermore, accounting and reporting procedures were simplified for all MSEs from 1 January 2004.¹⁷

One of the major achievements of phase 3 was creation of the Tax Academy – the first higher education institute specializing in preparing and retraining tax specialists – under the education centre of State Tax Committee.¹⁸

¹⁴ Article #346.20 of the Tax Code of Russian Federation, available from <http://www.russian-tax-code.com/>

¹⁵ Decree UP- 3305 of the President of Uzbekistan, “On Amending the Decree UP-1987 ‘On Measures to Promote the Further Development of Private Enterprises and Small Businesses’ from April 9, 1998”, 30 August 2003.

¹⁶ Decree UP – 3270 of the President of Uzbekistan, “Measures regulating taxation of trading and catering enterprises”, 30 June 2003.

¹⁷ National Accounting Standard of the Republic of Uzbekistan #20, “About simplification of accounting and reporting procedures”, 1 January 2004.

¹⁸ Uzbekistan, Resolution #229 of the Cabinet of Ministers, “Preparing and retraining skilled personnel”, 22 May 2003.

Phase 4 (2005 - present)

Tax reforms underwent a major overhaul in 2005 to eliminate certain features that were identified as having a negative impact on the growth of the private sector and the competitiveness of the national economy in the international arena. The most important of these are highlighted below.

Relatively high tax burden

In 2005, consolidated tax revenues made up 30.1 per cent of Uzbekistan's GDP.¹⁹ Compared to developed countries, particularly the countries of Western Europe, this tax burden does not seem excessive. For example, in 2005, the average tax revenue in EU27 countries was 39.6 per cent, with the highest tax burdens in Denmark – 46.5 per cent and Ireland – 41.4 per cent (Finfacts 2008).

However, such a comparison is inappropriate. The tax burden of a country depends directly on its level of economic development: the more developed the economy, the greater the share of taxes in government expenditure (Vasilyeva et al. 2003). Hence, it is more sensible to compare Uzbekistan's tax burden of 30.1 per cent against that of other developing countries where GDP per capita is similar to the level of income in Uzbekistan, which rarely exceeds 20 to 25 per cent of GDP (for example, China and Thailand). During the years of phenomenal economic growth in China (1979–1996), the average tax burden was reduced from 36 per cent to 13 per cent and then rose gradually (after 18 years of record economic growth) to 20 per cent (Illarionov and Pivovarova 2002).

In 2004, the tax burden on Uzbek MSEs was an average of 20 per cent of revenue, which respondents considered excessive (International Finance Corporation 2004). In the opinion of entrepreneurs, the optimum tax rate for Uzbekistan would be 10 per cent of sales. High tax burdens reduce MSEs' competitiveness with foreign and local producers that have tax exemptions.²⁰

MSEs that pay a single tax under the simplified system of taxation, in lieu of paying all other federal and local taxes, mandatory payments and duties, in reality end up paying, on average, five taxes (International Finance Corporation 2004). This is what contradicts the principles of a simplified system of taxation.

Actions taken to reduce the tax burden

On 20 June 2005, the Government of Uzbekistan introduced a single tax payment for MSEs operating in the manufacturing and service sectors of the economy.²¹ This tax

¹⁹ Tax revenue includes extrabudgetary funds.

²⁰ Having pursued an import-substituting strategy since 1997, the Government grants tax exceptions to enterprises that export goods and to enterprises targeted for production of import replacement products.

²¹ Uzbekistan, "About Calculation and Payment of Single Tax Payment", 2 August 2005.

was intended to replace the existing single tax and mandatory payments to extrabudgetary funds.²² The rates of single tax payment vary depending on the industry in which the MSE operates.

During the period from 1 July 2005 to 1 January 2007, three types of simplified systems of taxation for MSEs were in use:

1. Tax on Gross Revenues of Trade and Catering Enterprises – for wholesale/retail trade and catering enterprises (active as of 1 July 2003);²³
2. Single Tax – for procurement, storage enterprises, enterprises providing services under commission contracts, brokerage enterprises (active as of 15 April 1998);
3. Single Tax Payment – for manufacturing and service enterprises (active as of 1 July 2005).

Tax rates, reporting and taxation bases were different for all three systems.²⁴ To reduce complexity and to unify the taxes of the simplified system of taxation, the Government of Uzbekistan combined all three taxes (single tax, single tax payment and tax on gross revenue) into one—the single tax payment²⁵ (annex 3).

Along with the introduction of a new tax for MSEs, some tax rates have been reduced since 2005, and the ecology tax was abolished in 2006.

**Table 2. Changes in tax rates over the years 2005-2008
(Percentage)**

	2005	2006	2007	2008
Corporate Income Tax	15	12	10	10
Consolidated Social Payment	31	25	24	24
Single Tax Payment	-	13	1	8
Individual income tax (upper band)	29	29	25	^a

Source: Uzbekistan, Ministry of Finance, 2008.

^a The lowest band expanded from 5 minimal wages up to 6.

²² Single tax payment includes in itself mandatory payments to the extrabudgetary Pension Fund, Road Fund and School Fund.

²³ Decree UP – 3270 of the President of Uzbekistan, "About measures of regulating taxation of trading and catering enterprises", 30 June 2003.

²⁴ MSEs which paid tax on gross revenues during the period from 1 July 2003 to 1 July 2005 were required to submit monthly tax reports.

²⁵ Uzbekistan, Ministry of Finance, Resolution #26, "About Calculation and Payment of Single Tax Payment", 28 February 2007.

Some changes were introduced to the excise tax and the subsurface tax in 2004; the excise tax on energy carriers (such as gas, oil and coal) was replaced by a subsurface use tax.²⁶

The reductions in tax rates, the introduction of new taxes and the abolishment of others changed the composition of taxes in government revenues. If in 2002, three taxes (individual income tax, VAT and excise tax) accounted for 62.8 per cent of all tax revenues, by 2006 this picture had changed; there were now four taxes (individual income tax, VAT, excise tax and subsurface use tax) constituting 70 per cent of all tax revenues.

As a result of broad government support directed to the expansion of MSEs' role in the economy of Uzbekistan and reduction of tax rates, the number of registered small businesses reached 422,300 in 2007 (Uzbekistan 2008a). According to the State Committee on Statistics, MSEs in 2007 account for 45.7 per cent of GDP and 72.3 per cent of total employment.

Figure 4.
Share of MSE as a percentage of GDP

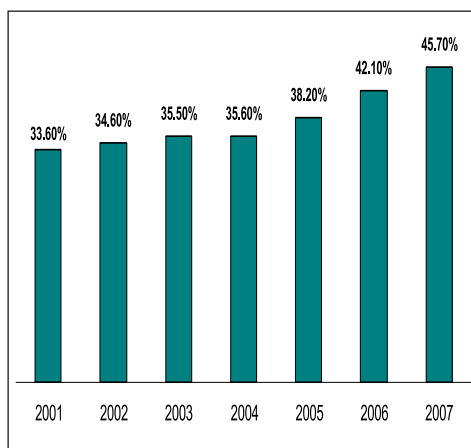
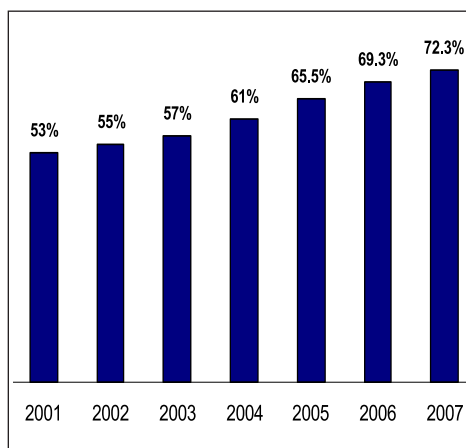


Figure 5. Share of MSE as a percentage of employment



Source: Uzbekistan, State Committee on Statistics, 2008.

The share of MSEs in all sectors of the economy rose substantially in 2006 and 2007 compared with 2005.

²⁶ Uzbekistan, Resolution #610 of the Cabinet of Ministers, "About changes in rates of subsurface use tax", 28 December 2004.

**Table 3. Share of MSE in selected sectors of economy
(Percentage)**

	Industry	Agriculture	Investments in equity	Construction	Trade	Services (paid)
2005	9.4	85.7	22.1	48.2	43.7	52.5
2006	10.0	93.9	25.2	51.0	45.7	50.8
2007	12.9	97.5	19.9	53.7	47.2	50.5

Source: State Committee on Statistics of the Republic of Uzbekistan, 2008.

Changes introduced to tax administration

On 14 June 2005, a presidential decree was introduced on improving the legal protection of businesses.²⁷ This decree restricted excessive intervention by controlling authorities in the business operations of MSEs.

On 15 June 2005, legislation on improvements to the system for submitting reports and calculating tax for MSEs was introduced.²⁸ Under this decree, reporting that had previously been done on a monthly basis was changed to quarterly.

According to the estimates of IFC experts, the implementation of this resolution may reduce the working days of accountants by about 2 million days, which is equivalent to \$6.5 million annually.²⁹

In 2005, the Center for Economic Research, with the support of the Chamber of Commerce and Industry of Uzbekistan, organized several round-table discussions with representatives of small business to explore the problems of the existing tax system. During those discussions, most entrepreneurs admitted that reporting had become less problematic and that they spent less time preparing tax forms. However, the success of this novelty depended heavily on its implementation by tax inspectors. Sometimes, entrepreneurs spent hours in a queue just to submit their financial reports. There was still some evidence that tax inspectors rejected documents on the grounds of an incorrect format or for some other mundane detail. But small "incentives" could fix the problem.

²⁷ Uzbekistan, Resolution #610 of the Cabinet of Ministers, "About changes in rates of subsurface use tax", 28 December 2004. Decree UP-3619 of the President of Uzbekistan, "On Further Improving the System of Legal Protection of Businesses", 14 June 2005.

²⁸ Resolution PP-100 of the President of Uzbekistan, "On Improving the System of Business Reporting and Raising Penalty for Illegal Demand", 15 June 2005.

²⁹ This represents the amount of accountants' fees saved as a result of the reduction in the frequency of submissions.

On 24 June 2005, legislation was introduced to reduce the financial penalties and an exemption for minor, unintentional, first-time violations.³⁰

The biggest threat for entrepreneurs is prosecution. The smallest breach of rules, even when an entrepreneur admits his guilt and is ready to pay fines, might result in the case being handed over to prosecutors.

On 5 October 2005, a presidential decree was issued to reduce the number of inspections further.³¹

A survey conducted by IFC in January and February 2006 revealed that the average number of annual inspections had fallen from 1.2 in 2005 to 0.9 in 2004.³² According to the above-mentioned decree, the financial-economic activities of enterprises can only be assessed by tax authorities.³³ Furthermore, sanctions such as stopping or closing down the operational activities of an enterprise, cancelling licences or permits, or tying up money can be done only through the courts. This decree may save MSEs \$21 million annually.

Despite government measures directed towards reducing the number of inspections, the emphasis of inspections is still on exposing violations and imposing penalties rather than on assisting entrepreneurs in avoiding violations and addressing shortcomings.

The system of selecting enterprises for inspection is not transparent. As a result, businesses with higher cash turnover are inspected more frequently than those that can cause potentially more danger to public health, the environment, or the country's economy.

Flaws in the regulatory framework

The steadiness of small businesses greatly depends on the stability of tax legislation. Flaws in the regulatory framework might be fatal for MSEs—entrepreneurs simply cannot keep up with the pace of changes, and the first serious tax mistake usually ends in the termination of the entrepreneur's business.

The Tax Code adopted on 1 January 1998 was produced quickly and had many weaknesses. More than 310 amendments had to be made over time. In addition, it was very condensed and required many normative acts (about 1,300) before it could be implemented. This hyperactive lawmaking had as a major consequence the poor integration and misinterpretation of by-laws and normative acts, which frequently contradicted each

³⁰ Decree UP-3622 of the President of Uzbekistan, "On Liberalizing Financial Liability of Businesses for Economic Violations", 24 June 2005.

³¹ Decree UP-3665 of the President of Uzbekistan, "On Further Reducing and Improving the System of Inspections of Businesses", 5 October 2005.

³² In 2001, the average number of annual inspections per enterprise was 6.2; in 2002 it was 4.2; and in 2003, it was 1.9.

³³ Over 40 government organizations have authority to inspect business enterprises in Uzbekistan.

other. As a result, tax legislation became unsystematic, non-transparent and burdensome to businesspeople.

The findings of an entrepreneurial survey (Center for Economic Research 2006) indicated the difficulty of running a successful business within the existing regulatory framework: 68.5 per cent of respondents expressed concern with the complexities and contradictions of legislation and 57.2 per cent highlighted problems of non-transparency in the tax system.

Given the unpredictability of tax liability, companies cannot adequately manage their cash flow or plan business development. Moreover, the frequent changes in taxation requirements, of which businesses are not made aware, prevent MSEs from complying with tax legislation.

Ambiguous and inconsistent legislative norms lead to tax evasion and corruption among tax officials.

Changes introduced to stabilize the regulatory framework

On 1 January 2008, the new edition of the Tax Code was adopted. It unifies and streamlines tax legislation, particularly with regard to tax administration; it also replaces normative acts, decrees and by-laws of the former tax system. It sets forth the whole system of taxes and dues, including customs duties, without reference to additional regulatory acts encompassing the whole range of tax relations both substantive and procedural.

More than 7,000 suggestions of local entrepreneurs³⁴ were taken into consideration in preparing the new edition of the Tax Code.

According to the State Committee on Statistics, changes in the new edition of the Tax Code increased government revenue from the corporate income tax to 42.6 per cent and from the single tax payment to 36.0 per cent in the first six months of 2008 compared with the same period the previous year (Uzbekistan 2008).

III. METHODOLOGY

This report is based on the results of a survey undertaken in July and August of 2008. On-site standardized interviews were conducted with 30 representatives of MSEs in five regions of Uzbekistan.

³⁴ The Chamber of Commerce and Industry created a special Internet forum to communicate with representatives of the business sector about the new edition of Tax Code.

Respondents were classified into micro-firms and small businesses according to the legislation of Uzbekistan that came into effect as of 1 January 2004.³⁵ In 2008, the simplified order of taxation envisages the payment of one of the following:³⁶

1. *Single Tax Payment.* MSEs may opt for the application of the single tax payment in lieu of paying all other federal and local taxes, mandatory payments and duties (except of excise tax, VAT, customs duties in respect of imports and consolidated social payment).
2. *Single Land Tax.* Agricultural enterprises (agricultural producers) are subject to a single land tax in lieu of all federal and local taxes (except for excise taxes and social payments). The taxable base is the land area owned, used or rented by the taxpayer.
3. *Fixed Tax.* Legal entities and individuals involved in certain entrepreneurial activities are subject to a fixed tax payable on the basis of fixed rates. The list of activities subject to the fixed tax includes provision of hairstyling services, billiards, rent/sale of video and audiotapes, catering (by individuals only) and computer games.

In this paper, only MSEs making the single tax payment are analysed.

Tax reforms that took place during the fourth phase of Uzbek tax system development were mainly targeted on providing measures for further developing small businesses; therefore, this research aims to study the influence of recent tax reforms on the prosperity of local micro-firms and small businesses.³⁷ To derive accurate results, MSEs established in 2005 and earlier will form the population of the research.

Sample Selection

The five regions of Uzbekistan chosen to conduct interviews are: Andijan, Samarkand, Tashkent, the Republic of Karakalpakstan and Tashkent City. Andijan, Samarkand and Tashkent regions are the most densely populated regions of Uzbekistan and they have the highest growth rates among the regional economies.³⁸ The Republic of Karakalpakstan, an autonomous Uzbek republic, has the largest territory among the 14 administrative

³⁵ Decree UP- 3305 of the President of Uzbekistan, "On Amending the Decree UP-1987 'On Measures to Promote the Further Development of Private Enterprises and Small Businesses' from April 9, 1998", 30 August 2003.

³⁶ Revised Edition of Tax Code 2008.

³⁷ Changes introduced in the new edition of the Tax Code, in particular the reduction in the rate of the single tax payment from 10 per cent to 8 per cent, are outside the scope of this research, mainly because they are too recent.

³⁸ According to the Socio-Economic Indicators for 2007 of the State Committee on Statistics, in the Tashkent region, the gross regional product in 2007 rose by 16.8 per cent, in Samarkand by 11.6 per cent, and in Andijan by 10.5 per cent (the average in Uzbekistan is 9.5 per cent).

subdivisions of the country but a relatively low economic growth rate. Tashkent is an independent city and the capital of Uzbekistan.

The scope of the research encompassed all registered MSEs. The sample for research was randomly selected from the annually renewed database of the Chamber of Commerce and Industry, based on the following criteria:

1. Regions in which MSEs operate;
2. Economic sectors in which MSEs are engaged.

Three sectors of the economy were observed in the current research:

- Manufacturing
- Wholesale/retail sale and catering enterprises
- Service sector

MSEs operating in these three sectors of the economy have different tax burdens for the following reasons:

- (a) The retail sale of certain types of products—for example, alcohol, tobacco products, and articles of jewellery containing precious metals or stones—is subject to local taxes/fees, and enterprises engaging in such activities are required to pay those local taxes in addition to making the single tax payment, which goes to the federal coffers;
- (b) enterprises usually pay excise tax and customs duties and even VAT when they import goods. The same is true for manufacturing enterprises when they import components or raw materials for their production process;
- (c) Service enterprises usually make only a single tax payment.

Calculating the Tax Burden of Enterprises

Within the framework of the current research, the tax burden of enterprises was calculated using the following formula:

$$\text{TaxBurden} = \frac{\text{TaxPayments}}{\text{Gross Revenue}} \times 100\%$$

where: *Tax Payments* include all tax payments made by an enterprise, withholding tax on dividends, interest and brokerage fees;

Gross Revenue includes revenue from the sale of goods (rendering services) and other revenues, including indirect taxes.

The larger the figure, the higher the tax burden of an enterprise.

IV. PRESENTATION OF FINDINGS

Main characteristics of respondents

The average age of respondents was 42 years. Most firms are started by and operated by men (68 per cent). Managing the demands of both work and family is a continuing challenge for Uzbek female entrepreneurs, and in the conflict between work and family roles, Uzbek women are inclined more towards fulfilling their family roles. Promoting gender equality is an integral element of human development, and social welfare will be enhanced as the economic independence of women is furthered through equal opportunities to employment and entrepreneurship, particularly in rural areas (Welfare Improvement Strategy of Uzbekistan 2007). Uzbek women have much undiscovered potential which, given the right opportunities and conditions, could increase the number of MSEs in Uzbekistan.

Main characteristics of business

Most of the enterprises interviewed were micro-firms (63.66 per cent) with an average of 7.3 employees in 2005. By 2007, the average number of employees had reached 8.7, which represents a growth rate of 16 per cent over three years.

Evaluation of the current tax environment

Tax system

The vast majority (93.33 per cent) of the MSEs observed pay taxes according to the simplified order of taxation. The average tax burden for 30 interviewed enterprises was 14.9 per cent, with the highest being 18.3 per cent and the lowest 5.6 per cent.

Changes in the enterprise as a result of the transition to a single tax payment

A total of 69 per cent of respondents thought that moving to a single tax payment had made tax reporting less problematic, 58 per cent thought the tax burden had been reduced, and 35 per cent thought there had been no change since the move to a single tax payment.

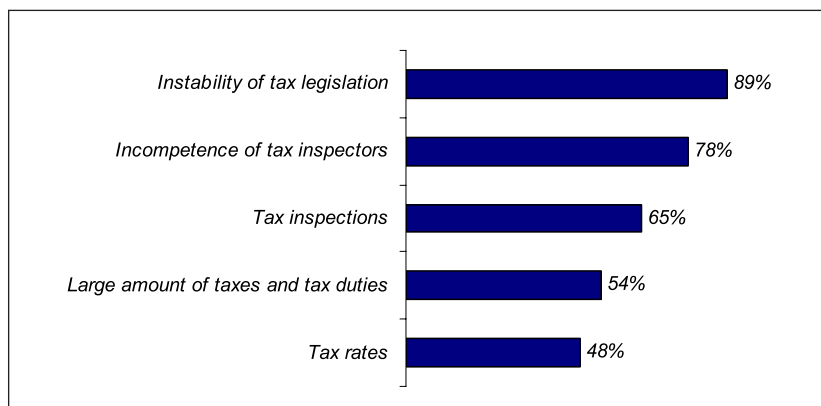
Moving to a single tax payment influenced mainly wholesale/retail sale and catering enterprises, which were subject to tax on their gross profits, with monthly reporting obligations to tax agencies.

Factors influencing the business activities of MSEs

As can be seen from figure 6, business activity is most negatively influenced by the instability of tax legislation (89 per cent), followed by the incompetence of tax inspectors (78 per cent) and tax inspections (65 per cent).

A survey of entrepreneurs held in April and May 2006 by the Center for Economic Research gave similar results: 54.4 per cent of respondents thought it was impossible to operate in Uzbekistan without breaking the law.

Figure 6. Factors hindering the business activities of MSEs



Tax administration

Reporting

According to 65 per cent of respondents, there is no difference in the level of difficulty of the tax reporting process in 2006 and in 2007; 45 per cent of MSE representatives thought that the tax reporting procedure in 2007 was just as difficult as in 2006, while the rest—55 per cent—thought that the tax reporting procedure in 2007 was the same as in 2006.

Inspections

Every MSE, on average, provided 1.5 times additional information or documents to tax authorities during the period under observation. Additional documents most often were requested from retail trade and public catering enterprises. There was an extreme case concerning a small enterprise operating in the services sector which was asked to provide additional information and documents to the State Tax Committee every single month!

It should be pointed out there are no restrictions on the State Tax Agency's legal right to demand additional information.³⁹ This increases the administrative burden on the entrepreneurs, who must then prepare and submit that information.

Most tax inspections (95 per cent), both scheduled and unscheduled, were conducted in MSEs that operate in the wholesale/retail trade and catering sectors of the economy.

Bribes

Every second respondent confessed that he/she paid money or bribed government officials to find a solution to a problem or to settle down a question related to business.

When bribery is involved, in 23.8 per cent of cases, it happens during tax inspections.

Violations of MSEs' rights

In cases where the rights of MSEs were violated, 28.6 per cent of entrepreneurs sought help from executive courts and advocates.

Tax reform

A total of 62 per cent of respondents were familiar with *all* the changes that had taken place in tax legislation related to small businesses during the period 2005-2007. And 38 per cent of respondents were familiar with *some* of the changes in the tax regulations.

The reduction of the single tax payment rate from 13 per cent to 10 per cent in 2007 created additional resources for MSEs to invest or expand their production, according to 47.3 per cent of respondents.

Self-evaluation of well-being

Respondents were asked twice to evaluate their well-being. The first time, they were asked to give a number, on a scale of 1 to 10, where 1 is the lowest level of income and 10 the highest. The weighted average score for MSEs interviewed was 4.8.

The second time, respondents were requested to describe their financial situation before they started their business and currently, using the five-point Likert scale (1 – very bad, 2 – bad, 3 – satisfactory, 4 – good and 5 – very good). According to the results of the survey, the material well-being of entrepreneurs improved from 2.88 to 3.76.

³⁹ According to Article 5 of Law 474-I of Uzbekistan, "On the State Taxation Service", 29 August 1997, tax agencies, within their competence, have the right to obtain from legal entities and individuals information, references, documents, and copies of documents relating to the taxpayer's activity.

Despite the observed improvement of welfare, entrepreneurs spent 57.5 per cent of their net profit from the business on personal and family consumption, leaving only 25.4 per cent of profit for reinvestment purposes and 8.6 per cent for savings.

Evaluation of business and the business environment

Respondents were asked to evaluate the state of their business and the business environment using the five-point Likert scale:

- As at the end of 2007;
- As at the base year, 2005, when the start was given to major tax reform to further support entrepreneurship and small business development.
- As can be seen from table 3, a slight improvement of +0.1 and +0.25 was observed in both the state of business and the business environment as at the end of 2007.

Table 4. Evaluation of the state of business and business environment, 2005 and 2007

State of business		Business environment	
2005	2007	2005	2007
3.05	3.15	2.55	2.7

V. RECOMMENDATIONS

Inspections

Establishing risk-based audits

To address the issues related to the way enterprises are selected for tax inspections, it is necessary to eliminate the subjectivity of the selection process. International experience shows that the most effective method of selecting enterprises for inspection is the one based on an analysis of the potential risks involved in the business activity. Under this method, the selection and the frequency of inspection depend on the extent of the potential danger that the operation of the business may pose to public health, the environment or the country's economy.

Under the current tax inspection system, the additional revenue collected as a result of tax audits is only 1.24 times the cost of maintaining a tax inspector. By comparison, in Kazakhstan it is 4.6 times and in the Russian Federation 5.7 times (Soliev et al. 2007).

In the United States, implementing the Discriminant Function System (DIF), a software programme that selects taxpayers for inspection on the basis of the tax declaration forms submitted, brought the number of unsuccessful inspections (i.e. those that brought no additional tax revenue to the federal budget) down from 46 per cent in 1969 to 15 per cent in 1992.⁴⁰

According to initial calculations, the development and implementation of the risk-analysis system in Uzbekistan will require 7 billion sums.⁴¹ In exchange, Uzbekistan would benefit from the following:

- (a) Improved efficiency of resource distribution at tax inspectorates. This is especially true in the case of Uzbekistan, where the conditions associated with liberalizing the national economy and creating a more favourable business environment are rapidly driving up the number of MSEs. For example, during the last three years, the number of registered small enterprises increased from 237,502 to 346,062 (Uzbekistan 2008). According to expert estimations, the workload per tax inspector will increase by more than 45 per cent within three years. An additional 300 tax inspectors would need to be recruited in order to keep up with the current workload. By 2011, salaries alone would cost the government 1.3 billion sums (Soliev et al. 2007). If, on the other hand, the current number of tax inspectors and the existing mechanisms of tax control are retained, the scope of inspections will be reduced by 30 per cent, with a corresponding reduction in effectiveness;
- (b) Reduced pressure on successful, law-abiding enterprises and the creation of an additional incentive for entrepreneurs to comply with legal requirements, because the frequency of inspections will depend on their compliance with established rules and standards;
- (c) Reduced potential for officials at various levels to abuse their positions by using inspections to punish entrepreneurs;

Introduction of distance control

On-site inspections should be replaced by off-site inspections ("cameral inspections") whereby tax officials scrutinize all documents from their offices. Introducing distance audits in Uzbekistan will allow MSEs to carry out their normal operations and reduce the number of extortion cases during the audit process.

⁴⁰ Ibid.

⁴¹ This calculation was made by a team of United Nations experts in Uzbekistan in connection with a project on improving tax administration in Uzbekistan. On the basis of the Central Bank of Uzbekistan's exchange rate on 9 September 2008 (1 United States dollar = 1,324.6 Uzbek sums), 7 billion sums is equivalent to \$5,284,614.

The new edition of the Tax Code has a special section governing cameral inspections, the purpose of which is to audit taxpayer compliance, detect tax violations, and make a demand for the unpaid amount of taxes. The results of cameral inspections can serve as criteria for the selection of enterprises for tax inspections.

Reporting

Electronic submission of reports

Information and communications technology should be used extensively in the reforms. International practices illustrate greater efficiency in administration and fewer opportunities for corruption and abuse in governance when electronic systems and technologies are used. The digitalization of administrative processes is the next logical step after unification and harmonization of procedures.

The computerization of reporting processes will reduce time for both taxpayers and tax authorities. But most importantly, it will reduce the significance of the human factor in assessing reports, i.e., it will increase objectivity and the transparency of the work of tax authorities.⁴²

Tax authorities have already started piloting the electronic submission of tax forms in Tashkent City and Tashkent region. A successful conclusion of the pilot test will pave the way for nationwide e-submission of tax reports.

The benefits of computerizing reporting processes are obvious, but are Uzbek MSEs ready for this change? A survey of entrepreneurs held in April and May 2006 by the Center for Economic Research has revealed a very low rate of computerization in domestic companies—only 36 per cent of MSEs have at least one computer. The results were even worse for micro-firms and enterprises in the Djizakh, Sirdarya and Khorezm regions of Uzbekistan. MSEs operating in the agriculture, public catering and medical services sectors were the least equipped with computers. With computerization as well as the computer literacy of local MSEs at such a low level, implementing compulsory e-submission practices might be perceived by MSEs as another obstacle to their activities. Yet, 81.1 per cent of respondents gave a positive answer to the question: “If there was an opportunity, would you submit tax reports through the Internet?” Step-by-step implementation of e-submission practices combined with continuous training of MSEs will improve existing tax reporting practices.

⁴² The New Technologies Scientific and Information Center, with financial support from UNDP in Uzbekistan, is developing a software package entitled “Receipts and Processing of Tax Returns and Taxpayer Financial Reporting for Generating Statistical Reports by State Tax Service Bodies” for the State Tax Committee of Uzbekistan. The objective of this development is to streamline the submission of financial reports and tax returns and to reduce the impact of subjective factors (such as errors by taxpayers and official abuse) on this process. The software package enables tax returns to be submitted through the Internet, thereby reducing the amount of time spent waiting in line during tax inspections.

Creating dedicated administrative structures in the national tax committee

Creating dedicated administrative structures in the national tax committee will help to address the specific needs of small businesses and enable the tax administration to combat tax evasion in the MSE community efficiently (International Finance Corporation 2005a).

Offering specific service and information programmes to the MSE community

MSEs should know and understand their rights and obligations. Research conducted by PricewaterhouseCoopers in 2006 showed that only 41 per cent of small taxpayers in OECD countries were aware of incentives and tax relief opportunities, while only 11 per cent actually used them (PricewaterhouseCoopers 2007b). In the case of Uzbekistan's small taxpayers, these figures are likely to be even lower. If tax authorities could design and offer specific information material and training courses, relations between them and MSEs could improve

Reduction of tax burden

In comparison with international practice, the tax burden in Uzbekistan is not high. The problem is that some taxes are too high. For example, an employee who receives an after-tax salary of 100,000 sums costs the enterprise 200,000. Income tax in combination with pension payments increases the tax burden of an enterprise. Under these circumstances, both employer and employee may see a benefit in declaring lower salaries in official documents.

The most efficient stimulus for the developing Uzbek economy is the reduction of the consolidated social payment rate and the rate of individual income tax (Saidova et al. 2006). Reducing these tax rates will encourage an increase in payroll and declared revenues.

At the same time, the sensitivity of government revenues to the changes in tax rates requires the additional measures of improving tax collection and limiting informal turnover of financial assets.

Setting additional criteria for MSE classification

The current classification of MSEs (based on head count) puts two enterprises with different levels of turnover in one group. Additional criteria—for example, average annual turnover combined with the classification of the type of activity—should be introduced so as to allow more accurate targeting of MSEs.

Human resources

The Government of Uzbekistan has advanced considerably in developing human resources since its independence in 1991. Creating, in 2003, the first higher education

institute dedicated to preparing and retraining tax specialists and abandoning the notion that "taxation is an accountant's job" could serve as a proof of this progress. Nevertheless, the qualifications of staff in the tax and customs authorities still leave much to be desired. Both procedural and technical reforms will work only if they are supported by adequately qualified staff. Improving the skills of civil servants will require a major effort, but it is essential if they are to be empowered to meet the objectives of the reforms.

According to the results of a UNDP survey in 2007, the majority of taxpayers complain about the low level of professional knowledge of tax authorities, unsatisfactory communication skills and lack of willingness to teach novices in the tax system. On the other hand, a survey conducted among tax officers detected a lack of economic as well as legal and business accounting knowledge among most tax inspectors.

The role of international organizations is crucial in improving the qualifications of the tax authorities. Such organizations as USAID and the Japan International Cooperation Center (JICE) have organized foreign internship programmes for the civil servants of Uzbekistan. Since 2008, UNDP, in cooperation with IFC, OSCE and OECD, has been holding short-term courses for tax authorities on innovations in tax legislation, new methods of tax control, and the specifics of taxation of particular activities.

VI. CONCLUSION

The Government of Uzbekistan attaches great importance to the development of MSEs and has integrated small business development issues into its national strategic plan for economic and social development. In order to promote the development of MSEs, the Government has gradually amended relevant legislation and launched a series of policies and initiatives.

One of the tools that can have a favourable influence on the private sector development is the tax system. In Uzbekistan, the taxation system has undergone significant reforms since independence, but most of the changes were directed towards enforcing the fiscal role of taxation and stabilizing government revenues.

Effective tax reform cannot be accomplished in isolation from the current capabilities of the tax administration systems or the taxpayers' culture. The Government of Uzbekistan focuses primarily on modernizing tax policies and relegates tax administration and taxpayer compliance issues to a remote second place.

The high tax burden on businesses led to high rates of tax evasion. To improve the country's economic situation, the Government started to reduce tax rates, hoping through this to increase taxpayer compliance. However, the factors leading to high compliance of MSEs involve not only a low tax burden but also the simplicity of the tax administration from the taxpayer's point of view. A correctly constructed tax administration will contribute greatly towards bringing the informal economy into the tax net.

The biggest challenge for tax administrations in CIS countries remains that of transforming into more market-friendly institutions stressing self-assessment, taxpayer services and enforcement—and Uzbekistan is no exception. A broadly accepted principle in tax administration is that the ultimate goal of any tax administration is to promote voluntary compliance. The Government should encourage voluntary taxpayer compliance. This is the next step in the reform of the tax system in Uzbekistan: the government helps the taxpayer to make tax assessments through the use of highly credible and effective enforcement mechanisms, via audits and legal actions, not only to collect what is due but also to deter any abuse of greater freedoms granted (Lorie 2003).

To be effective and successful, tax reform needs to be accompanied by institutional and structural reform throughout the economy. In particular, institutional reform in areas complementary to fiscal reform, such as accounting, banking and foreign exchange, are of crucial importance to Uzbekistan.

Furthermore, the role of human resources—highly skilled tax officials—cannot be overemphasized in a successful tax reform. The Government of Uzbekistan needs to focus its attention on further development of human resources by creating non-governmental educational institutes and organizing professional training for both tax authorities and MSEs in order to implement its tax reforms effectively and efficiently.

Research has shown that changes in tax rates and tax administration influence the prosperity of entrepreneurs. In three years, both the prosperity of entrepreneurs and the business environment have improved.

The Government of Uzbekistan should continue the policy of reducing the tax burden aimed at maintaining the competitiveness of local MSEs as well as improving the tax and customs administration systems.

The findings of the present paper can, to certain extent, apply to other Central Asian countries and serve as an initial overview of the fiscal and socio-economic situation of neighbouring republics, since they have many things in common: roots, cultural values, traditions and the consequences of the collapse of the Soviet Union.

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ANNEX I

DEFINITION OF MSEs ACCORDING TO UZBEK LEGISLATION

Small and Medium Enterprises (prior to 1 January 2004)	Micro and Small Enterprises (after 1 January 2004)
1. INDIVIDUAL ENTREPRENEURS 2. Micro-firms with an average annual number of employees not exceeding: 10 – in manufacturing sectors; 5 – in services and other non-manufacturing sectors; 5 – in trade.	1. INDIVIDUAL ENTREPRENEURS 2. Micro-firms with an average annual number of employees not exceeding: 20 – in manufacturing sectors; 10 – in services and other non-manufacturing sectors; 5 – in wholesale and retail trade and public catering.
3. Small enterprises with an average annual number of employees not exceeding: 40 – in industry; 20 – in agriculture and other manufacturing sectors; 20 – in construction; 10 – in science, research services; retail trade and other non-manufacturing sectors;	3. Small enterprises with an average annual number of employees not exceeding: 100 – in food, light industry, metal work and instrument-making, woodworking, furniture industry and construction materials; 50 – in mechanical engineering, metallurgy, fuel and energy, and chemicals; 50 – in agriculture and other industrial and manufacturing sectors; 50 – in construction; 25 – in science, research services, transportation, communications, services (with the exception of insurance companies); trade and public catering, and other non-manufacturing sectors.
4. Medium enterprises with an average annual number of employees not exceeding: 100 – in industry; 30 – in agriculture and other manufacturing sectors; 50 – in construction; 20 – in retail trade, services, and other non-manufacturing sectors; 30 – in wholesale trade and public catering.	

Source: Decree of the President of the Republic of Uzbekistan PP-1987 "On Amending the Decree 'On Measures to Promote the Further Development of Private Enterprises and Small Businesses'" from 9 April 1998, PP-3305', 30 August 2003.

ANNEX II**DEFINITION OF MEDIUM-SIZED, SMALL AND MICRO ENTERPRISES ACCORDING
TO THE RECOMMENDATIONS OF THE EUROPEAN COMMISSION**

ENTERPRISE CATEGORY	HEADCOUNT	TURNOVER	or	BALANCE SHEET TOTAL
MEDIUM-SIZED	<250	≤ € 50 million		≤ € 43 million
SMALL	<50	≤ € 10 million		≤ € 10 million
MICRO	<10	≤ € 2 million		≤ € 2 million

Source: Recommendation 2003/361/EC.

ANNEX III
CHANGES IN SIMPLIFIED ORDER OF TAXATION

15 April 1998	I. Single tax (until 1 January 2003 was local tax; quarterly reporting) – for all MSEs
1 July 2003	I. Tax on gross revenues (monthly reporting): a) all wholesale & retail sale enterprises (including MSEs); b) all public catering enterprises (including MSEs)
1 July 2005	I. Tax on gross revenues (quarterly reporting): a) all wholesale & retail sale enterprises (including MSEs); b) all public catering enterprises (including MSEs)
	II. Single tax (quarterly reporting) – for the rest MSEs
	II. Single tax (quarterly reporting): a) procurement and storage enterprises; b) enterprises providing services under commission contracts; c) brokerage enterprises
	III. Single tax payment (quarterly reporting) – for the rest MSEs
1 January 2007	I. Single tax payment (quarterly reporting) – for all MSEs