

# Tax Arrears, Tax Compliance and Tax Debt Management in Uzbekistan: Existing Issues and Possible Solutions

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## Abstract

Tax arrears and tax compliance issues have been in the acute point since the global financial downturn. Fiscal concerns over stability of businesses and income level of individuals make the governments running stricter and tighter tax administration policies. In developing and transition economies, this scenario has diverse scenes: tax administration policies and tax compliance procedures are structured around business sector development and ensuring social protection. This article studies the profile, composition and origins of tax arrears, and proposes possible solutions to avoid and prevent overdue indebtedness in the context of Uzbekistan.

**Keywords:** tax arrears, tax administration, tax compliance, Uzbekistan.

**1. Introduction.** With globalization comes the increasing need for revenue authorities around the world to cooperate to help each country administer their revenue system (OECD, 2004). The extent of compliance with the legal obligations it imposes powerfully affects the revenue yield, efficiency and fairness of any tax system (IMF, 2012). Global financial crisis hit many countries with huge fiscal gaps caused by bankruptcy of large taxpayer companies and consequent unemployment which led to the loss of revenue from taxes from individuals. Cross-border effects of fiscal downturn in some advanced economies faced tax debt and fiscal gap from four key factors: (1) income lost as a result of a downturn in economic activity, (2) tax lost to tax avoidance, (3) tax lost to tax evasion and underpayment, (4) non-payment of due tax. As a result both developed and developing world is suffering from poor tax compliance and growing tax debt despite the exploitation of solutions which are still cureless and ineffective. In developed economies large corporations, even systemic important and too-big-to-fail companies are bearing the largest proportion of tax arrears owing to decrease in revenue, limited access to global market, liquidity issues. In developing world SMEs are the key players in originating the arrears and gigantic cumulative tax debts. Even large state owned companies could not compete with them in creating a wider fiscal gap. Decrease in prices of raw materials and harshly competitive market environment became main barriers to export their goods and services. Moreover, poor financial stance of importer economies is doubling the financial burdens in SMEs. However, this scenario differs in economies depending on tax rates, tax administration procedures, economywide liquidity and profitability indicators.

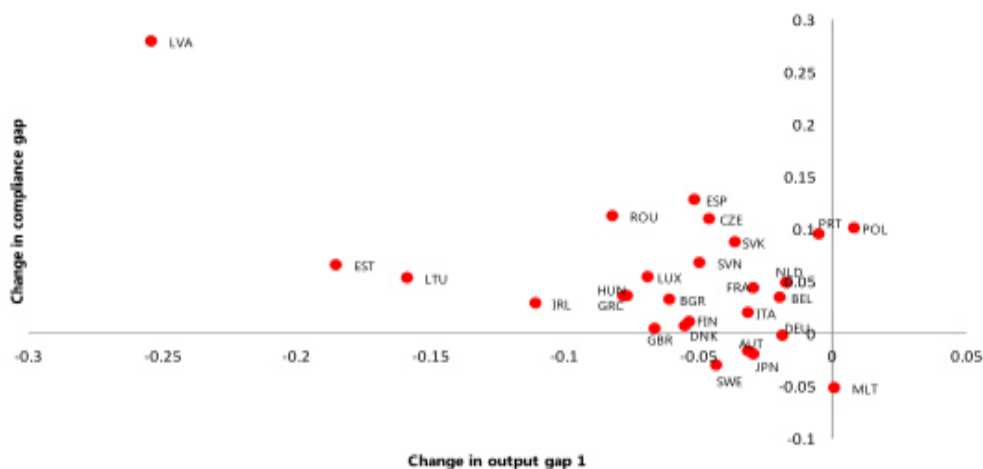
After the launch of transition strategy to market economy, Uzbek banking system experienced a cluster of in-depth structural reforms and modernization (Komolov, 2015). Large scale privatization, decentralization of public assets and liberalization led to reviewing and reforming the tax policy in consistent with market environment, new public-private and corporate relations. All post-soviet economies run similar policies toward fiscal and ownership policies. But outcomes were totally different: Russia, Ukraine and Estonia faced absolute fiscal crisis derived from tax indebtedness of private sector and failure in privatization policy; Latvia and Lithuania experienced significant fiscal shocks from tax arrears and low performance of tax compliance. Central Asian economies perceived shadow effects of new economic system from fiscal standpoint. Lack of business psychology and private sector management among people hindered appropriate functioning of tax compliance caused by inherited mindset of communism. Despite the risk of widening fiscal gap, Uzbekistan run the tax reduction policy to stimulate businesses and to increase the number of taxpayers by preferential taxation, exemption and tax holidays. As result, size of tax indebtedness and tax arrears reduced, and tax compliance measures started operating comparatively efficiently. This article provides a comparative overview of tax debt, arrears and compliance in Uzbekistan, with a particular emphasis on adaptability of best practices.

**2. Literature review.** There are many literatures on tax arrears and risk derived from them, potential effects and

solutions for avoidance. However, most of existing literatures sampled Russian and Ukrainian economies in the period of economic crisis of late 1990s and early 2000s when it comes to empirically analyze and study the real circumstance. Gerard and Turley (2000) studied the adaptability of effective and statutory taxation in post-Soviet transition economies and found that post-communist financial systems had deeply-rooted problems with tax arrears. Nestor studies the corporate reforms and tax policy in Russia with wider focus on privatization, corporate ownership and finance, and provided similar conclusions. Ivanova (1999) investigated the phenomenon of mounted tax arrears in Russian economy via systemic analysis and found that Russian companies had long-lasting losses in arrears to public budget, their own employees and service banks. Ponomareva and Zhuravskaya (2004) studied the roots of tax debt and arrears from the standpoint of liquidity and federal redistribution. Pistor, Raiser and Gelfer (2008) analyzed the fiscal structure and state of transition economies and proved that these economies lacked corporate governance, shareholder-creditor rights, and effective rule of tax law at an adequate level. However, Russia and Ukraine are not the unique pair of economies faced long term tax arrears problem. After global financial crisis, Greece became the hottest topic and controversial issue of not only unprecedented amount of external debt but also fiscal constraint and tax debt. Recent studies conducted by OECD (2013) proved that Greece's budgetary policy reforms devoted to set ceilings for all ministries and authorities led to recovery in tax debt profile. Tagkalakis (2014) linked the causes of growth in the volume of tax arrears with performance quality of tax administration and revenue collection schemes.

**3. International tax arrears, compliance gap and tax debt trends: situation and solutions.** Global financial crisis brought significant compliance challenges for revenue authorities, in often difficult environments, and exposed structural weaknesses in many. They often arose in the context of an urgent fiscal consolidation agenda, which in some countries brought management instability and policy changes needing rapid implementation (IMF, 2010). Even some countries are not in financial crisis, revenue authorities conducted narrow tax collection measures to cope with tax arrears, tax evasion and noncompliance risk (Figure 1).

Figure 1. Comparative map of tax compliance between developed and developing economies



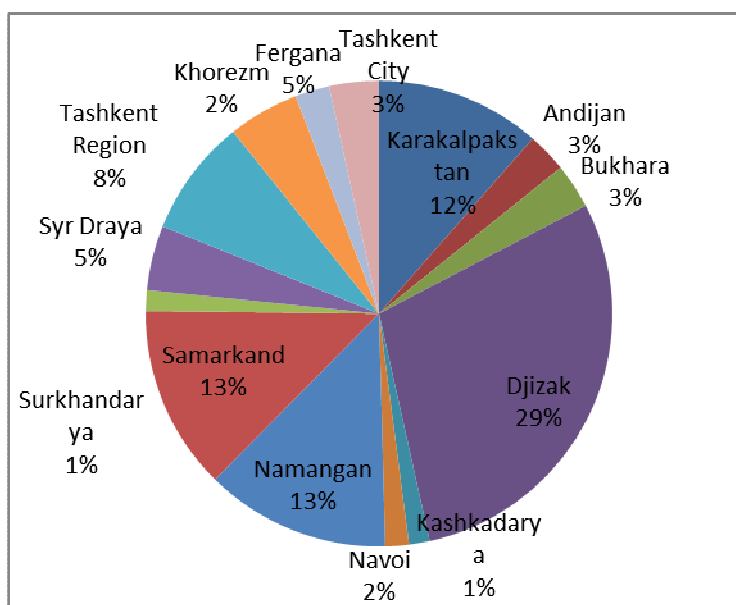
Source: IMF, 2015

Australia run a prudent policy for tax arrears and tax debt management through tailored tax collection measures depending on the profile and circumstance of the taxpayer. The Australian Tax Office (ATO) launched a debt management framework based on three elements: early collections, firmer action and strategic recovery. ATO offered tailored payment arrangements, remission of interest and penalties, and full or partial release from payment of certain debts to small businesses and individuals who were experiencing short-term financial difficulties. ATO found that a largest share of tax debt is incurred by small business, and engaged with them directly to manage debt before it arose. In 2009 the UK began to implement a revised debt management strategy which was aimed at increasing the likelihood of debt recovery, improving the speed of collection and reducing costs (OECD, 2013). The strategy was targeted to prevent taxpayers incurring debt by providing better support their tax liabilities became overdue. In implementation process the UK revenue authority used a campaigns-based approach to understand taxpayer behavior better, developed the channels of customer contact, improved information systems and quality of data on debt balances. Japan's National Tax Agency introduced a strict tax debt management strategy which took into account the taxpayer's circumstance. NTA took diverse measures depending on taxpayers' circumstances: from tax payment relief to seizure or auction of assets

considering historical compliance behavior.

**4. Tax arrears and compliance issues in Uzbekistan.** The primary goal of a revenue authority is collect the taxes and duties payable in accordance with the law and to do this in such manner that will sustain confidence in the tax system and its administration (OECD, 2004). In most of post Soviet transition economies tax compliance and tax arrears are till the major factor of fiscal imbalance. As governments have tried to establish a solid legal basis for tax compliance and regulation, business environment has not been responding to the developments consistently. In Uzbekistan, a new Tax Code entered into force from 2008 in an attempt to develop a fairer tax system, ease the tax burden on businesses, simplify tax procedures, encourage saving and investment and promote economic development in the country (Deloitte, 2015).

Figure 2. Share of top 70 firms with highest tax debt by regions, %

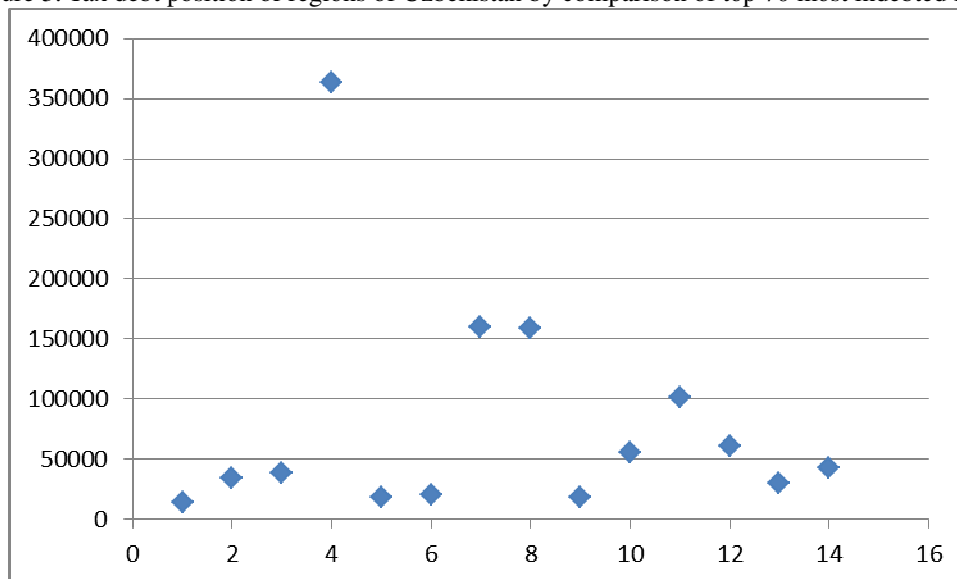


Source: Authors' compilations, 2015

Extending business climate and spread of private ownership across all sectors on economy, tax performance and compliance level have been developing at comparatively lower pace (Figure 2). In parallel with number of new business entities, number relative volume of tax arrears and evasion is increasing. Several studies and observations from researchers and practitioners found that tax compliance problems are deriving from following factors:

1. New business entities often lack the basic knowledge of business finance and taxation, especially tax calculation, reporting and deadline for tax payment. It is reasoned with implication of former Soviet legacy – prohibition of private ownership and restriction of free economic activity. Now government offers new opportunities and people consistently are acquiring asset management and public-private relations.
2. Companies face systemic challenges of transition in domestic economy related to tax law which are seen in annual changes in tax rates. Market psychology of private sector players are in development process due to cancellation of communistic mind and conversion to modern ideas of humanity.
3. Tax evasion and arrears sometimes rooted from socio-economic condition of regions depending on economic specialization and fiscal profile at local level. Analysis 70 firms with highest amounts of tax arrears by regions shows that some territories of Uzbekistan with largest share of tax arrears are subsidized by public budget to cover the fiscal gap at municipal budgets (Figure 2).
4. Resources for locally common businesses are unevenly distributed among regions, business climate has a direct impact on profitability and financial soundness of firms. Positions regions by tax arrears show that a huge gap exists between the most and the least level of tax evasion and arrears (Figure 3).

Figure 3. Tax debt position of regions of Uzbekistan by comparison of top 70 most indebted firms



Source: Authors' compilations, 2015

Tax debts of firms are accumulated by overdue of taxes and late transactions of revenues for goods and services they supplied. However, Uzbek authorities do not run a strict procedure for late payments of taxes in order to support the sustainability of businesses. They impose small penalties depending on the amount and latency period.

**5. Conclusion.** Tax system of most transition economies differ from those of developed or emerging ones who had already introduced corporate taxation and distributed benefit pension plans. But this scenario has distinguishing aspects in transition economies which are visible in taxation practices. Transition economies, as mentioned above, are introducing market principles. Businesses, especially start-ups are now highly vulnerable to any impact and cannot respond in an appropriate way. So government protects them by means of taxation tools e.g. preferential taxation depending on profitability of an enterprise, multiple low rate taxes, sector-specific taxes and simplified-unified taxation. However, for further improvement purposes, authors propose following recommendation as possible solution for reducing the volume of tax arrears and preventing tax evasions:

1. Tax debt management and compliance are vulnerable and fragile. Encouraging and enforcing the voluntary tax compliance will bridge tax gap;
2. Uzbekistan should choose relevant elements of systemic approach to tax arrears management, e.g. accurate identification of fiscal and compliance risks, effective prioritization, appropriate and adequate attention to tax administration function;
3. Uzbekistan should improve the diversity of actions and modes of intervention against noncompliance;
4. Optimizing the cooperation with banks and other authorities against tax evasion and illegal tax avoidance;
5. Accelerating the introduction of electronic tax services, e.g. e-invoicing, pre-population of tax, technology based financial control, electronic fiscal devices.

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