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Transforming Small and Medium-Sized Businesses into Large Enterprises through Tax Reforms

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ABSTRACT

The article examines the scientific and historical aspects of the formation of the tax system in the Republic of Uzbekistan. Proposals have been made to amend the tax system to develop small and medium-sized businesses.

Keywords: small and medium enterprises, tax reform, VAT.

The role of small and medium business enterprises is very pivotal for the development of any county and the position of these factors are also essential for the development of Uzbekistan along with creating job positions for population. Uzbekistan is regarded as the most crowded country in the Central Asia zone, with almost one third of residence are involved into under the age of 29 and the half of the population have been registered as living in rural areas. According to the statistics, approximately 800,000 individuals who are younger than the age of 29 are regarded as joining to the labor market every year, and this condition is revealing how much job generation is crucial and challenging priority in Uzbekistan (D, Tadjibaev, 2019). As the president of Uzbekistan has mentioned, the development of private micro and small enterprises (MSEs) and entrepreneurship are often regarded as a top priority strategy as it is considered now that small business is a major force for the purpose of economic growth, a rise in GDP and the main address to acute social issues like poverty, unemployment, particularly among youth and females and poor states of life (D. Tadjibaev, 2019). Implementation of SME definition for tax target in Uzbekistan hinders the generation and growth of job positions. Furthermore, the explanation of SMEs by a number of workers has become difficult because of part-time work, casual work or not permanent work becoming more extend employed by workers.¹

¹ Tajikulovich, U., 2019. E-Commerce and Taxation Aspects in Uzbekistan. *GIS Business*, [online] 14(3), pp.121-128. Available at: <<https://www2.deloitte.com/>> [Accessed 15 March 2021].

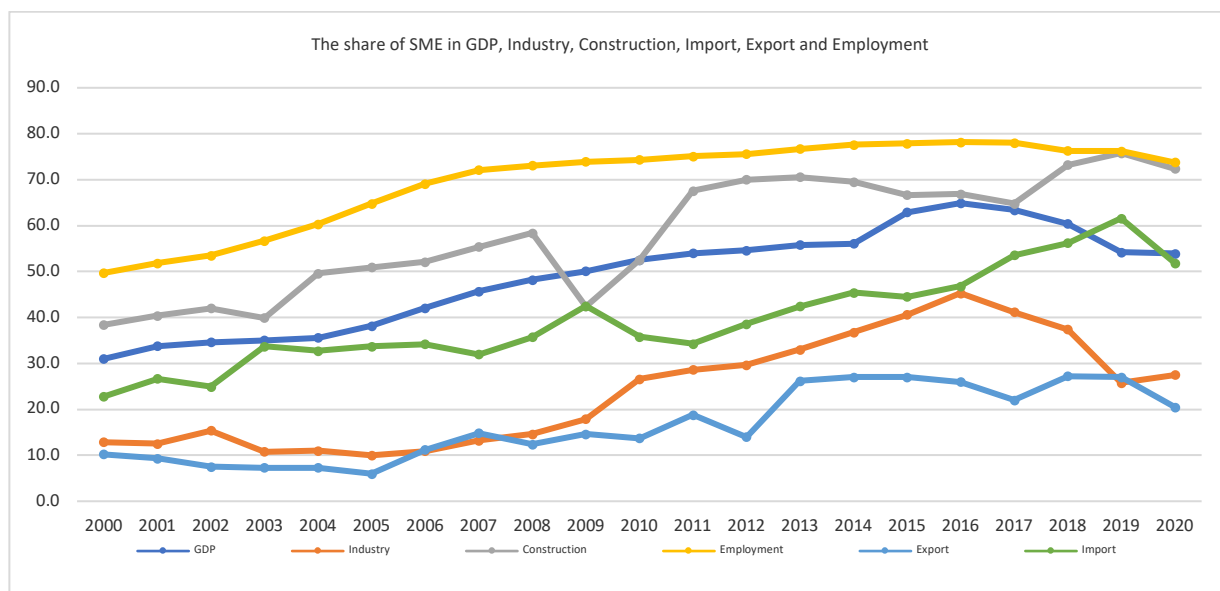


Figure 1: SME Sector in Uzbekistan

In addition to this, the contribution of SMEs to GDP has been significant during the given periods, and to be more clarify GDP witnessed to rise by 54.9% in 2017 from 38.2% in 2005, which represents that SMEs has played a considerable role in the economy of the country. According to the value contributed of SMEs in total has been equal to SUM 120, 351.6 billion by contrasted to SUM 5,437 billion in 2005 (D, Tadjibaev, 2019). Based on the graph above the value added of SMEs has been considerable during the period of 2005 and 2021. The value added of small and medium business has increased gradually from almost 75% in 2005 to roughly more than 80 % in 2021, while that of accounted for approximately 20% in the case of share of export in 2005, this number has faced outstanding growth up to nearly twice by coming 2021. In the share of export level, the contribution of SMEs has been immense and resulted in the growth of export by 40% as the case of investment in 2021. Those outstanding growth of economy because of small and medium enterprises has marked as one of the quickest countries in the Central Asia.

Uzbekistan has faced significant reforms of tax system in almost in all spheres of life since 2019. Particularly there created some mitigating atmosphere for small and medium and even to large firms to pay taxes in a convenient way. Noticeable, reduction of the tax burden on enterprises under the role of the general taxation regime which points out the decline of the VAT rate from 20 percent to 15 percent, and elimination of contributions to the State Targeted Funds from revenues declined by 3.2 percent. In addition to this, drop in the sphere of impact of turnover taxes which prior to this reform these taxes have been paid by nearly all enterprises, these days just small enterprises are going to select between turnover tax and VAT while medium and large enterprises do not cover them at all (J, Yusupov, 2020). Those initiations in the reform of taxation have helped a lot in terms of developing the business operation sphere of all small and medium sized enterprises in Uzbekistan.

Even though long-lasting reforms to boost firms' operations and create good conditions for business sector in Uzbekistan, the experience from reviewing the current situation shows that not all of the attempts succeed in reality. A deeper analysis represents that despite no formal barriers is seen here to start SME, some barriers exist to restrict the growth of SME. SMEs has no incentive to create additional jobs in formal sector due to high tax rates and expand their operations in a larger context. In some cases, transformation from individual entrepreneurship to firms appears to be inefficient due to high cost of unofficial payments and lack of financial resources. Furthermore, infrastructure and corruption practices seem to be the biggest problem in Uzbekistan as an obstacle for firms' growth. In this section, we will describe the particular obstacles to SME growth.

For almost 20 years, Uzbekistan has followed the path of creating a favorable tax environment for small businesses by applying simplified tax regimes. In particular, there is a huge discrepancy in

the level of the tax burden of taxpayers in the simplified regime with large enterprises that pay taxes in the general order. Because business entity in order to move to a single tax regime, it had to have the status of a micro-firm or small business. The only criterion for determining this status was the "number of employees. The fact that the number of employees was only criterion until 2019 that allow businesses with a large turnover, as well as large plots of land and capital to operate as several "small enterprises" to enter the "limited number of employees" in order to pay less tax.

In order to eliminate the imbalance in the tax burden of taxpayers in the general and simplified tax regimes, to prevent the abuse of the status of "SME", the annual turnover (gross income) was determined as a decisive criterion for the business entity to remain in the simplified tax regime or forced transition to the general tax regime. According to it, a turnover tax has been introduced for businesses with an annual income of up to 1 billion soums. However, the analysis of practice showed that the criterion for the transition from turnover to tax regime was not successful.

This is due to the fact that the annual income of business entities exceeds 1 billion soums, which makes them liable for VAT. There are markets where goods are not fully or partially accounted for, also there are opportunities to purchase raw materials for SMEs at lower prices without VAT in Uzbekistan, where the level of informal employment is high. This will cause such businesses to hide their sales from VAT.

For this reason, most businesses have taken measures to avoid the problem of VAT, not to exceed 1 billion soums. They can achieve this in three different ways: (1) concealing their income; (2) to close a firm with a turnover of 1 billion soums and open another; (3) establishing parallel firms and controlling their turnover. Attempts to solve this problem through a simplified VAT regime have not been justified.

Tax regimes

In determining the status of SMEs, it is necessary to include not only the amount of annual income, but also the balance (capital) of the enterprise and the number of employees. Based on the Chinese experience, it is necessary to expand the limited number of workers. Because, Uzbekistan is also one of the countries with the largest labor force. Without increasing the limited number of employees, problems in private business, such as informal recruitment and "envelope" remuneration, cannot be avoided. To this end, a proposal has been developed to update and expand the criteria for determining SME status. According to it, the following new criteria should be established:²

- number of employees (average annual);
- annual revenue (sales volume);
- balance (capital) volume.

The first criterion for determining SMEs, i.e., the new version of the limit norms on the number of employees, is as follows Table 1, it is proposed to double the limit norms on the number of employees in Uzbekistan.

Table 1. Current and proposed categories of SMEs in Uzbekistan and criteria for the number of employees

	Current categories of small businesses	Number of employees		Proposed categories of SMEs	Number of employees
I	Individual entrepreneur	< 3	I	Micro firm	< 20

² Tax Foundation. 2021. Tax Foundation. [online] Available at: <<https://taxfoundation.org/>> [Accessed 19 March 2021]. Stats.oecd.org. 2021. *OECD Statistics*. [online] Available at: <<https://stats.oecd.org/>> [Accessed 19 March 2021].

II	Microfirm:			(business entities established on the basis of individual private ownership and engaged in ordinary activities, regardless of their status as individuals or legal entities)	
2.1	Wholesale, retail and catering	< 5			
2.2	In the service sector and other non-manufacturing sectors	< 10			
2.3	In manufacturing industries	< 20			
III	Small business:				
3.1	Science, scientific services, transport, communications, services (except insurance companies), trade and catering and other non-manufacturing industries	< 25			
3.2	in mechanical engineering, metallurgy, fuel and energy and chemical industry, cultivation and processing of agricultural products, construction and other industrial and production sectors provided by the legislation	< 50	II	Small business	< 100
3.3	Metalworking and instrumentation, woodworking, furniture industry, as well as other industrial and production sectors provided by the legislation	< 100			
3.4	In the light, food and building materials industries	< 200			
	-		III	Medium business	< 500

When determining the status of a small enterprise, it is recommended to set annual revenue and balance of 3 billion soums, three times more than the current norm (1 billion soums). For medium-sized businesses, this norm should be set at 15 billion soums. The difference between the boundary norms of the criteria for determining the status of SMEs is five times hierarchically. That is, the standards for a small business are five times higher than the standards for a micro-firm, and the standards for a medium-sized business are five times higher than for a small business. This definition of border norms is in line with the principle of objectivity in taxation, as well as ensuring the competitiveness of small and medium-sized businesses and their effective operation.