Uzbekistan

Annual Changes to Taxation Regime Enacted

As usual, Uzbek politicians enacted a host of new legislation immediately before the beginning of the new fiscal year, with both the Cabinet of Ministers and the Parliament enacting legislation affecting the taxation regime both for legal entities and individuals. The changes include, among others, establishing new tax rates, introducing a new royalty, allowing for VAT refunds, and eliminating certain tax benefits for companies with foreign shareholdings. These key changes are summarized below.

New Tax Rates Established

Decree No. 610 of the Cabinet of Ministers, dated December 28, 2004 (“Decree No. 610"), focuses on the introduction of new rates for those taxes that are subject to the jurisdiction of the Uzbek Government. Specifically, Decree No. 610 reduces the corporate income tax rate from 18% to 15% of income, which is defined as total revenue less permitted deductions (both as defined in the Tax Code, enacted on January 1, 1998). Decree No. 610 also increases the rates of some taxes, such as the land tax (by approximately 30% over 2004 rates), the water use tax (from US$0.46 to US$0.60 for 1,000 cubic meters of surface water, and from US$0.59 to US$0.77 for 1,000 cubic meters of underground water), and the subsurface use tax (for natural gas, from 18.5% to 58% of the total volume of production; for unstable gas condensate, from 6.7% to 32%; for crude oil, from 12.3% to 35%; rates for refined cooper (8.1%), gold (5%), and silver (8%) are maintained at 2004 rates). The average rates for excise taxes on excisable goods produced in Uzbekistan remain unchanged, with two exceptions: the excise tax rate on natural gas is reduced from 40% to 19% of its sales price, and sales of crude oil and gas condensate are not subject to the excise tax in 2005. The new tax rates suggest that the Government is prepared to share the income of upstream oil companies and to encourage investors to participate in the natural gas production sector.

VAT Refunds Possible

By issuing Decree No. 610, the Government also seems to be trying to resolve a long-standing issue related to the zero value-added tax (“VAT”) rate. Previously, legal entities which sold goods and services at the zero VAT rate could only carry forward negative balances to the next period to make a set-off. However, as they never charged VAT, in reality they could never set off those amounts. Pursuant to Section 19 of Decree No. 610, these legal entities may now be able to receive a refund for negative balances of VAT amounts under two conditions: (i) if the legal entity does not have any outstanding debts for taxes or other mandatory state payments; and (ii) if the refund is made from specially allocated funds in the State Budget. Decree No. 610 calls for the Ministry of Finance to issue a regulation outlining the procedure for receiving refunds. Currently, it is unclear whether negative balance amounts would carry over and be eligible for refunds in subsequent years if funds allocated to the State Budget in a given year are not sufficient to cover all VAT refund amounts.

New Education Royalty

Section 7 of Decree No. 610 also establishes a new tax, requiring all legal entities to pay a royalty equal to one percent of their net sales (minus VAT and excise tax amounts, if any) to the Non-budgetary Fund for School Education, for the development of the school system in Uzbekistan. However, although the royalty reflects the Government’s good intentions to fund children’s education, its constitutionality is doubtful. It appears that in introducing this new tax, the Government has exceeded its power under the Constitution, which states in Article 78 that only the Parliament is authorized to establish taxes and other mandatory payments. Uzbek law, including the Law on the Cabinet of Ministers, dated May 6,1993, does not grant the Cabinet of Ministers any rights to establish mandatory payments, including royalties (regardless of their nomenclature), except the right to establish the rates for certain taxes. Nonetheless, the Government has tried to legalize the royalty by stating that its status “shall be equivalent to State taxes and levies”.

Companies with Foreign Shareholdings Lose Benefits

In its last session on December 2, 2004, the Parliament revoked the right of companies with foreign investment to a 2-year exemption from the land tax, thus continuing its efforts to equalize the tax regime for companies with foreign shareholdings and those without such shareholdings. Over the last three years, the Parliament has abolished many tax benefits and incentives which had been granted in 1998-2000 to companies with foreign investment. It appears that as of today only two specific major benefits remain under the Tax Code for companies with foreign investment: the 7-year co prorate tax holiday (if the company is included in the Investment Program of the Republic of Uzbekistan), and the exemption from import VAT on certain imports of technological equipment, as well as on imports of raw materials and production components for their own manufacturing needs. It seems that the Government has begun to understand that, given the lack of interest of foreign investors in the Uzbekistan economy, it should pay attention to local investors who were previously disadvantaged. However, this attention will require the Government to create a solid policy establishing transparent rules by which businesses can access resources controlled by the Government (fuel, cotton, gold, grain) and "equalizing" the powers of government agencies and commercial companies in the economy by making it impossible for government agencies to adopt arbitrary decisions against businesses and to interfere in business activities.

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