## Income tax *(SECTION XII of the Tax Code of Uzbekistan)*

**Changes in income tax are related to the following:**

* Conceptual changes in the country's tax policy;
* The need to develop the securities market, investments;
* The increasing need for transition to international accounting and reporting standards.

**Taxpayers**

* Legal entities – residents of Uzbekistan;
* Non-residents – operating through a permanent establishment (hereinafter – PE) and receiving income from sources in Uzbekistan

**The following shall become income tax payers:**

* Legal entities – responsible members of a consolidated group of taxpayers;
* Individual entrepreneurs, whose income for tax period exceeds 1 billion UZS;
* Trustees under simple partnership agreements.

Enterprises that are payers of turnover tax shall not be defined as payers of the income tax.

**Subject of taxation**

Taxpayers’ income shall be the subject of taxation.

Definition of income for each category:

* For legal entities, individual entrepreneurs – the difference between aggregate income and costs;
* For PE - the difference between income and costs related to PE activities;
* For non-residents – income from sources in Uzbekistan;
* For consolidated group members – share of aggregate income of the group.

**Tax base**

The tax base shall be the amount of income to be determined taking into account the following:

* Its reduction in case of transfer of losses from previous periods;
* Total income of controlled foreign companies (CFCs).
* Adjustment rules in case of transfer pricing (TP).

Foreign companies that are not tax residents of Uzbekistan, but controlled by such shall be defined as controlled companies.

Legal entities and individuals that have a certain interest in foreign companies may be controlling entities.

Income of controlled foreign companies shall be included in the income tax base.

The Code envisages rules for adjustment of the tax base in case of use of transfer prices.

The amount of foregone income at transfer prices for tax purposes can be determined both by a taxpayer and tax authorities, with application of the established rules.

**Aggregate income**

The aggregate income will be all income in any form and from any activity with its detailed listing.

In addition to income from sales and what is today called as “other income”, the list includes income from the following:

* On repo transactions, i.e. purchases and sales of securities with an obligation to reverse the transaction;
* On transactions with securities and financial instruments of time transactions, the list of which shall be established by the Central Bank;
* Sale of enterprises as property complexes;
* Funds transferred by the mandatory health insurance fund. Although there is no mandatory health insurance in Uzbekistan yet, such revenues are however also included in the draft, given the emergence of such institution in the near future and its further development;
* Price adjustments in case of TP;
* CFC income;
* State enterprises due to depreciation of fixed assets attached under the right of economic management or operational management;
* In the form of targeted assets in the absence of separate accounting or in case of misuse;
* Other income.

**Costs**

The following costs shall be considered feasible or economically viable:

* Incurred for income generation purposes;
* Necessary for preservation or development of business activities, connection of which with such activities can be clearly justified;
* Proceeding from the provisions of the legislation.

Types of costs requiring detailed explanations are set apart into separate articles. These are the costs for the following:

* Depreciation costs;
* Amortization of intangible assets;
* Repairs of depreciable assets;
* Investments;
* Interest and individual costs;
* Geological survey, exploration and preparatory works for extraction of natural resources;
* Research and development;
* Bad debts;
* Value added tax;
* Formation of reserve funds;
* Formation of reserve funds for forthcoming costs on warranty repair and maintenance;
* Non-deductible.

**Investment costs**

Investment deduction during the investment period in the amount of:

* 10% of the cost of new technological equipment, modernization, re-equipment of production, as well as the cost of domestic software when creating information systems;
* 5% of the cost of new construction, reconstruction of buildings and facilities for production needs.

Hereby, the investment deduction is offered to be made irrespective of the accrued depreciation.

**Interest and individual costs**

The concept of controlled debt has been introduced. This is a debt to:

* A foreign interdependent person who is not a tax resident of Uzbekistan (with over 20% of share);
* A resident – interrelated with the foreign person mentioned above;
* Persons for whom the abovementioned persons are guarantors and warrantors for this debt.

Such debts include:

* Borrowed funds;
* Forfeit.

The "thin" capitalization rule used in international taxation applies to interest on controlled loans and forfeit.

*The term "thin capitalization" describes a company's financial condition when the amount of borrowed funds significantly exceeds its equity capital. In this case, the company's operations are financed not by the owners' investments in the Charter Capital, but by borrowed financing. This is because the interest on borrowed funds paid to the creditor reduces the tax base for income tax, and national legislation in some countries may provide for "preferential" taxation of interest received in comparison with dividends.*

*The essence of the rule is that interest and forfeit on controlled debts are deducted from the tax base in the amount not exceeding a threshold. It is determined taking into account the ratio between the controlled debt and the equity capital of an enterprise.*

The Code establishes the following capitalization ratio caps:

* For banks and leasing companies – 13;
* For other taxpayers – 3.

**Example of determining the deductible cost on a controlled loan:**

*Foreign company's share is 30%*

*The amount of the controlled loan is 500,000 thousand UZS.*

*The amount of interest for the reporting period is 90,000 thousand UZS.*

*Equity capital – 150,000 thousand UZS.*

*Let us determine the capitalization coefficient:*

*500,000 : (150,000 х 30%) : 3= 3.7*

*Deductible part of interest: 90,000 : 3.7= 24,324.32 thousand UZS/*

*Non-deductible part of interest: 90,000 – 24,324.32 = 65,675.68 thousand UZS.*

**Costs for formation of reserve funds for forthcoming costs on warranty repair and maintenance**

The Code provides for the rules of forming a reserve for forthcoming costs on warranty repair and maintenance, as well as the expenditure of reserve funds.

The enterprise shall independently make a decision on creation of such reserve and determine the threshold limit of deductions in the accounting policy for taxation purposes. The reserve shall be created in respect of those goods (services) for which warranty services are provided.

The amount of deductions to the reserve at the date of sale of these goods (services) shall be charged to expenses.

The limiting maximum amount of the reserve shall be defined as the share of actual costs on warranty repair and maintenance in the amount of revenue from the sale of the mentioned goods (services) for the actual period of their sale (but not more than 3 years), multiplied by the amount of revenue from the sale of the mentioned goods (services) for the reporting (tax) period.

**Non-deductible costs**

The Code provides for costs that are considered non-deductible, including those additionally included in the pre-existing list of non-deductible costs:

* Expenditures that are included in the value of assets;
* Dividends;
* Expenditures from reserves;
* Amount of property cost deduction;
* Costs not related to income generating activity;
* Other types of costs.

Exceptions include:

* Losses from disposal of fixed assets.

These expenditure items are classified as deductible.

**Specifics of determining the tax base**

Some Articles of the Code establish the peculiarities of determining the tax base of certain taxpayers and types of transactions.

These include, among others, the following:

* Non-profit organizations;
* Transactions with securities;
* Transactions with financial instruments of time transactions;
* Consolidated groups of taxpayers;
* Controlled foreign companies.

**Transfer of losses**

The Code allows the transfer of losses within 10 years in the amount not exceeding 60% of the tax base.

The procedure is provided for transferring losses in individual cases:

* In case of reorganization;
* Among consolidated group of taxpayers;
* In case of disposal of the shareholding;
* In case of trust management;
* From servicing farms;
* For transactions with securities and financial instruments of time transactions.

**Income tax rates**

The tax rate is 20% for:

* Banks
* Cement and PE granule manufacturers
* Cellular communication operators
* Markets and shopping malls

The 0% rate is set for:

* Agricultural producers on income from sales of own agricultural products. The volume of sales of own agricultural products shall exceed 90%;
* Social sphere;
* Budgetary organizations. By January 1, 2023, it is planned to apply the 0% rate to income from additional sources, provided their targeted use to strengthen the material, technical and social base, as well as for providing financial incentives for employees;
* Exports. Export revenues shall exceed 15%. Exports shall be documented and income received no later than 180 days after export. 0% rate shall not apply to export of raw materials as per the list, international transportation (except for motor vehicle transport), transportation by pipelines and gas pipelines;
* Enterprises employing persons with disabilities (under certain conditions);
* People’s Bank from the funds for Individual Pension Savings Account.

The rate is set at 7.5% for enterprises engaged in electronic commerce. At the same time, the volume of electronic commerce shall be at least 90%.

For all other taxpayers, the rate is 15%.

Rate of dividend tax for residents is 5%.

**Reporting submission deadlines**

The deadline for submission of quarterly reporting is being changed - no later than the 20th day of the month following the reporting period.

The deadline for submission of annual reporting is proposed to be set for all taxpayers as no later than March 1 of the year following the tax period.

**Tax payment deadline**

Enterprises with total income for the previous tax period at the amount of not less than 5 billion UZS – shall pay tax within tax reporting submission deadline.

If income for a previous tax period exceeds 5 billion UZS, the enterprise shall pay advance payments monthly no later than 23rd day.

Hereby, the tax authorities shall calculate advance payments based on an aggregate income for the current tax period, and in the first quarter – based on current payments for the fourth quarter of the previous tax period.

That is, information statements on advance payments are abolished.

**Taxation of dividends and interest**

Dividends shall be taxed at source of payment.

In this case, to avoid double taxation, the Code provides for withholding tax on the amount of dividends, reduced by the amount of dividends received by the enterprise at the time of their distribution.

The procedure for taxing interest has been changed. Now interest shall be recorded in the tax base of its recipient and taxed at the rate provided for its type of activity.

An exception is interest income paid to non-profit and budgetary organizations. For them, the tax rate is 15%.

**Taxation of non-residents**

For non-residents acting through a permanent establishment, the provision for the determination of taxable income in the amount of at least 7 percent of costs has been removed.

For non-residents not associated with the permanent establishment:

* If the contract for the supply of equipment does not separately specify the cost of services related to installation, training of personnel and others, the income from their provision shall be determined at 20% of the cost of equipment;
* If the contract provides for the provision of services both in Uzbekistan and abroad and the amount is not divided, the aggregate amount of non-resident income shall be taxable.

**Taxation of individual entrepreneurs**

A separate chapter of the Code is devoted to specifics of revenue and cost accounting and taxation of individual entrepreneurs.

An individual entrepreneur may apply a standard or simplified procedure for determining taxable income.

Under the standard procedure for determining the tax base, all expenses related to its receipt, except for non-deductible ones, shall be deducted from an aggregate income.

Under the simplified procedure, the tax base shall be determined at 25% of an aggregate income. In this case, an individual entrepreneur shall be exempted from the obligation to keep records of expenses on the basis of an application filed with the tax authorities. Exemption from keeping records of expenses shall not apply to persons engaged in trade.