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ANALYSIS OF THE CURRENT STATE OF TAXATION OF COMMERCIAL BANKS' PROFITS IN UZBEKISTAN

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Abstract:
The article analyzes the current state of taxation of commercial banks' profits in Uzbekistan, reviews the practice of taxation in legislation, as well as provides a comparative analysis of standard profit tax rates for commercial banks. In reliance upon the research results the author has developed relevant conclusions and proposals.

Keywords: *banking, tax, commercial banks, taxation, compulsory payments*

INTRODUCTION

In the tax system of most countries of the world, the activities of commercial banks are taxed in the same way as other business entities, but there is a relatively preferential tax regime. In particular, tax legislation provides that reserves generated for potential asset losses in the corporate income tax system are deductible when determining the tax base, and banking products and services are exempted from VAT. Business entities perform two tasks in the tax system, i.e., as taxpayers, they pay taxes and compulsory fees in accordance with the generally established procedure; secondly, there is a tax agent, who is charged with correct and timely calculation, deduction and transfer of taxes and other mandatory payments to the budget system. However, there are also third functions of commercial banks in the tax system, and thirdly, only commercial banks ensure the timely transfer of taxes and mandatory payments to the state budget and targeted funds (Abdullaev, 2020). In particular, in compliance with Article 90 of the Tax Code, commercial banks are obliged to execute a payment order for the transfer of tax to the budget system at the expense of the taxpayer's funds (hereinafter referred to in this article as the taxpayer's order), as well as a collection order from the tax authority for the transfer of tax to the budget system (hereinafter referred to in this article as the tax authority's collection order). In this case, the taxpayer's order or the tax authority's collection order is executed by the bank within one business day following the date of receipt of such an order, and the bank is not entitled to delay the execution of the taxpayer's order or the tax authority's collection order if there are funds in the taxpayer's account and the details are correctly indicated in the payment document (Code, 2024).

In addition, Article 109 of the Tax Code states that in the event of a change in the deadlines for fulfilling a tax obligation and in other cases, the obligation to pay taxes may be secured by a bank guarantee. In this case, if the taxpayer does not pay the tax amounts due and the corresponding fines within the specified period, the bank (guarantor) assumes the obligation to fully fulfill the taxpayer's obligation to pay the tax before the tax authorities due to the bank guarantee. If the taxpayer's fulfillment of the tax payment obligation is secured by a bank guarantee and the tax is not paid within the established period or is not paid in full, the guaranteeing bank will make the payment. Moreover, in accordance with the procedure and conditions established by the Ministry of Finance of the Republic of Uzbekistan, the obligation to pay taxes by a legal entity of the Republic of Uzbekistan or a foreign legal entity may be secured by a bank guarantee from a foreign bank with a high rating from international rating agencies (Code, 2024).

ANALYSIS AND DISCUSSION OF RESULTS

According to current tax legislation, commercial banks are considered payers of the following taxes: profit tax, VAT (on certain types of banking services and turnover not related to banking activities), tax on the use of water resources, property tax, land tax, and social tax. Although the share of tax payments paid by commercial banks in the total tax revenues of the state budget is not significant, the share of profit tax paid by commercial banks in the profit tax paid to the budget is relatively high, and significant growth trends can be observed for this type of tax (Table 1). Although the share of tax payments paid by commercial banks in the total tax revenues of the state budget is not significant, the share of profit tax paid by commercial banks in the profit tax paid to the budget is relatively high, and significant growth trends can be observed for this type of tax (Table 1).

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Table 1
Data about taxes and compulsory payments paid to the state budget[1], (trln. UZS)

	Indicators	2019	2020	2021	2022	2023
I	Total, revenues	112.2	132.9	165.0	201.9	231.7
	including:					
	profit tax	16.4	28.7	38.4	37.6	40.8
	VAT	33.8	31.2	38.4	52.2	57.9
	property tax	2.4	2.0	2.5	4.0	5.1
	land tax	2.3	2.4	4.1	5.3	6.9
II	Share of tax revenues paid by banks (in %)	2,4	2,4			
	including:					
	profit tax	4.2	4.5	3,9	6,9	6,9
	VAT	0.2	0.3			
	property tax	3,0	1,7			
	land tax	0.4	0.4			

[1] Compiled by the researcher based on the data of the Ministry of Economy and Finance of the Republic of Uzbekistan.

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In particular, the share of income tax paid by commercial banks in total income tax revenues has increased by 1.8 times over the past 4 years. In addition, if the share of this tax has grown due to the increase in the volume of operational lease of terminals to business entities by commercial banks, the imposition of VAT on deposit cells and some banking services, the dynamics of the decrease in the share of property tax in the total income of property taxes to the budget can be observed.

From the analysis of the indicator of income and expenses of commercial banks in the republic, it is obvious that interest-bearing income and interest-bearing expenses take the main share (Table 2). At the same time, there are also growing trends in the share of non-interest income of commercial banks, which includes income from the sale of foreign exchange (which amounted to about 42 percent), commission income (about 27 percent), and other income (which amounted to about 31 percent).

Table 2

Analysis of the indicator of income and expenses of commercial banks[2], trln.UZS

Composition of income	2018	2019	2020	2021	2022	2023
Total income, *including*	**21.1**	**35.1**	**48.9**	**64.7**	**94.9**	**128.8**
Interest-bearing income	14.5	25.5	37.1	47.4	61.7	86.7
Non-interest income	6.6	9.6	11.8	17.3	33.2	42.1
Share of interest-bearing income in total income, %	*68.7*	*72.6*	*75.9*	*73.3*	*65.0*	*67.3*
Total expenses, *including*	**17.2**	**29.4**	**41.9**	**59.3**	**82.3**	**113.6**
Interest-bearing expenses	8.4	15.6	23.1	30.8	37.6	57.7
Non-interest expenses	1.3	2.8	3.5	4.9	11.7	13.3
Operating expenses (taxes paid, wages, etc.)	5.6	6.8	8.1	11.1	14.9	19.6
Other expenses (provisions for possible losses on assets)	1.9	4.2	7.2	12.5	18.1	23.0
Profit before tax	3.9	5.7	7,0	5.4	12.6	15.2
Amount of profit tax	0,7	1,3	1,7	1,5	2,6	2,8

[2] Compiled by the author based on the data of the Central Bank of Uzbekistan.

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Although non-interest income of commercial banks has increased by 6.4 times in the analyzed years, the high share of interest-bearing income (interest received on loans) and interest-bearing expenses (interest paid on deposits) in turn means that the income tax paid by commercial banks affects the interest rates on loans and deposits. In particular, researches have shown that, in conditions of high profit tax rates, commercial banks shift the bulk of the tax burden (up to approximately 90 percent) to bank customers by increasing interest rates on loans or reducing interest rates on deposits. It implies that any changes in the taxation of commercial banks and the resulting imbalances will make a negative impact on the financial activities of bank customers.

In order to further promote expansion of investment activities of commercial banks in the republic, increase the volume of financing long-term investment projects aimed at modernization, technical and technological re-equipment of economic sectors, strengthen their resource base, and support the financing of small businesses, the following profit tax benefits have been granted in recent years in a separate procedure:

1) In accordance with the Resolution of the President of the Republic of Uzbekistan №PR-2344 dated May 6, 2015 "On measures to further increase the financial sustainability of commercial banks and develop their resource base", the period of tax benefits with a reduced profit tax rate depending on the share of investment loans in the loan portfolio of commercial banks has been extended until January 1, 2020 in the following order: when the share of investment loans is up to 35 percent-40percent, the current profit tax rate is 20 percent: when the share of investment loans is up to 40 percent -50 percent, the current profit tax rate is 25 percent: when the share of investment loans is higher than 50 percent, the current profit tax rate by 30 percent.

2) In accordance with the Resolution of the President of the Republic of Uzbekistan №PR-3270 dated September 12, 2017 "On measures to further develop and raise the sustainability of the banking system of the Republic", when transferring the authorized capital of the National Bank of Foreign Economic Activities and "Asaka" JSCB previously generated in foreign exchange to national currency through the sale of foreign currency according to the established procedure, the income (profit) received by commercial banks from the sale of foreign exchange funds is not included in the tax base and is used to increase the share of their shareholders.

3) Part 42 of Article 483 of the Tax Code states that income in the form of interest received on bank loans allocated for projects by commercial banks participating in the "Comprehensive Program for Continuous Support of Small Business" is included in the composition of deductible expenses for the purpose of calculating income tax for the period from January 1, 2024 to January 1, 2026.

In general, the profit tax rates of commercial banks are set higher than the fixed basic tax rates, which were reduced to 22 percent in 2018, and from 2019 the tax rate is set at 20 percent (Figure 1).

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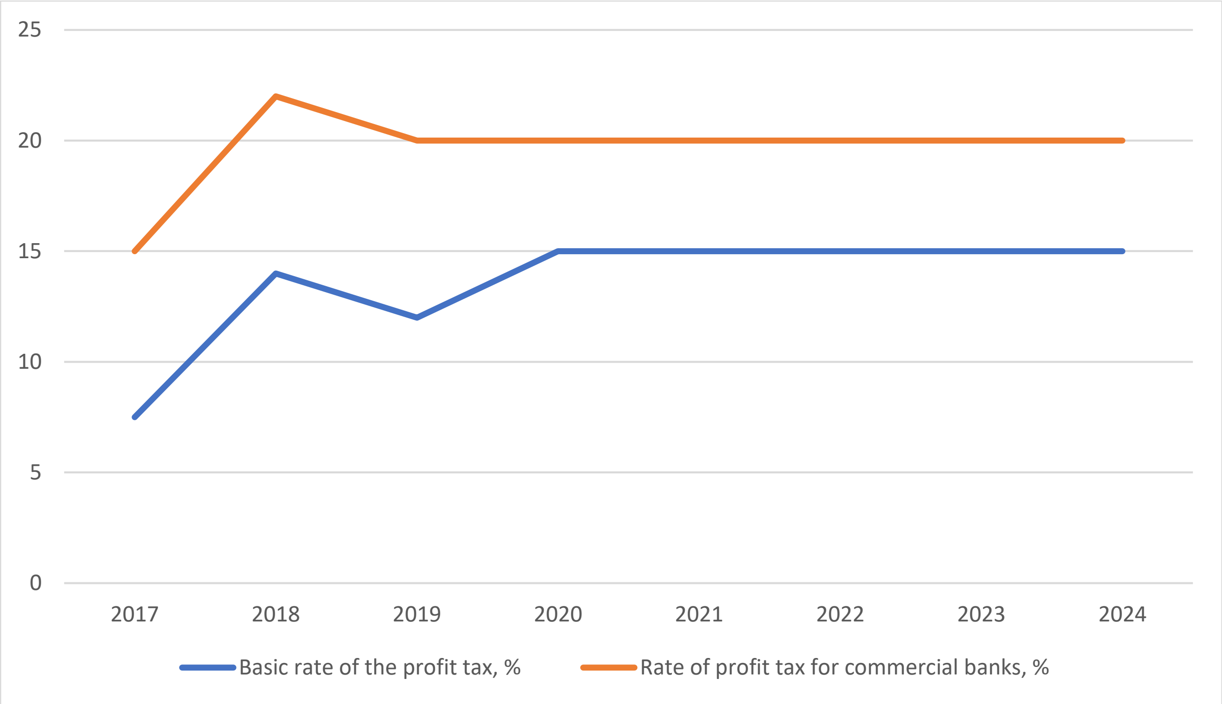

Figure 1. Changes in the rate of basic profit tax and commercial bank profit tax[3],%

[3] Developed by the researcher based on the studies.

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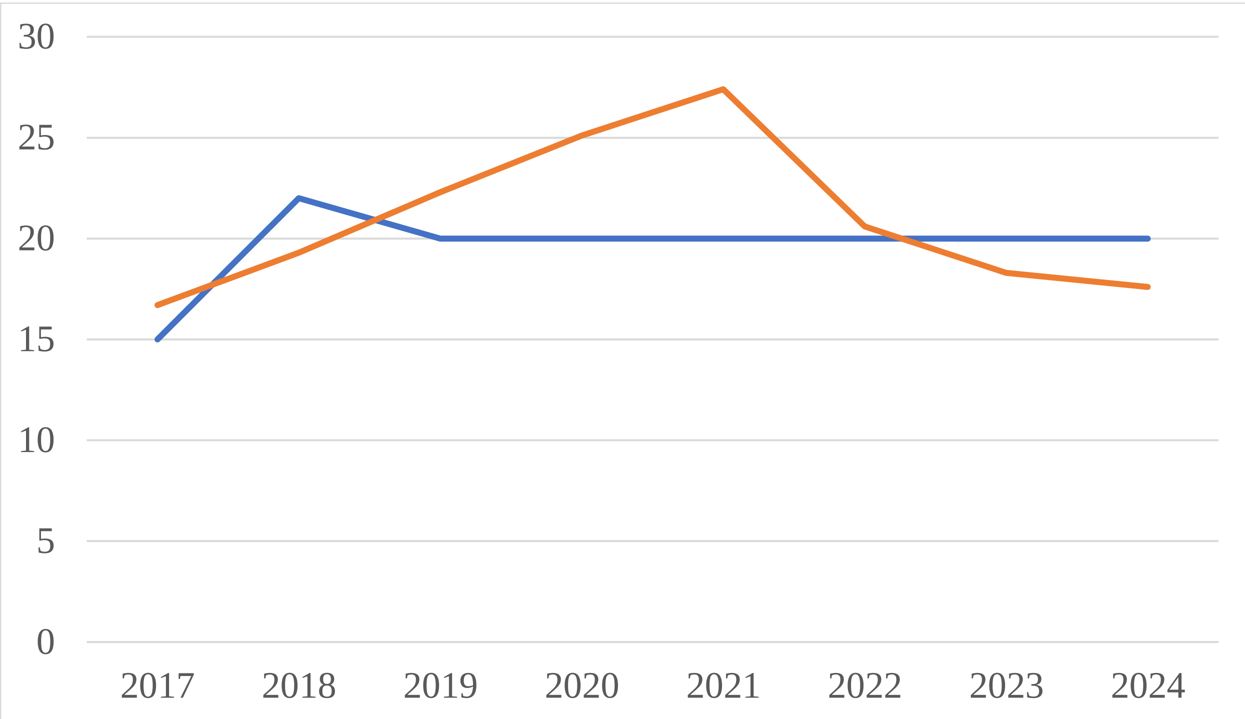
A higher tax rate on commercial banks' profits will result in an increase in interest rates on bank loans. Empirical analyses have revealed that up to 90 percent of the tax burden of the profit tax paid by commercial banks is transferred to bank counterparties, and there is a positive relationship between the profit tax rate and bank profitability. This means that the profit tax paid by commercial banks is transferred to legal entities and individuals who consume bank products (as part of the cost of interest on loans and other services). The negative consequences of this will have a more lasting effect on the activities of small business entities because small business entities mainly rely on bank loans to finance their activities.

Meanwhile, due to expenses that are added back to the tax base, the amount of income tax calculated relative to the amount of income tax, that is, the effective average tax rate, will exceed the established income tax rate (Figure 2). It should be noted that widespread application of reduced tax rates or tax deductions on taxable income relative to fixed tax rates reduces the level of effective average tax rates. Thus, the efficient average tax rate is one of the essential indicators in accurately assessing the level of the actual tax burden on profits.



Fixed profit tax rate, %
Efficient average tax rate, %

Figure 2. Comparative analysis of standard profit tax rate and effective average tax rate of commercial banks[4],%

[4]Developed by the researcher based on the studies.

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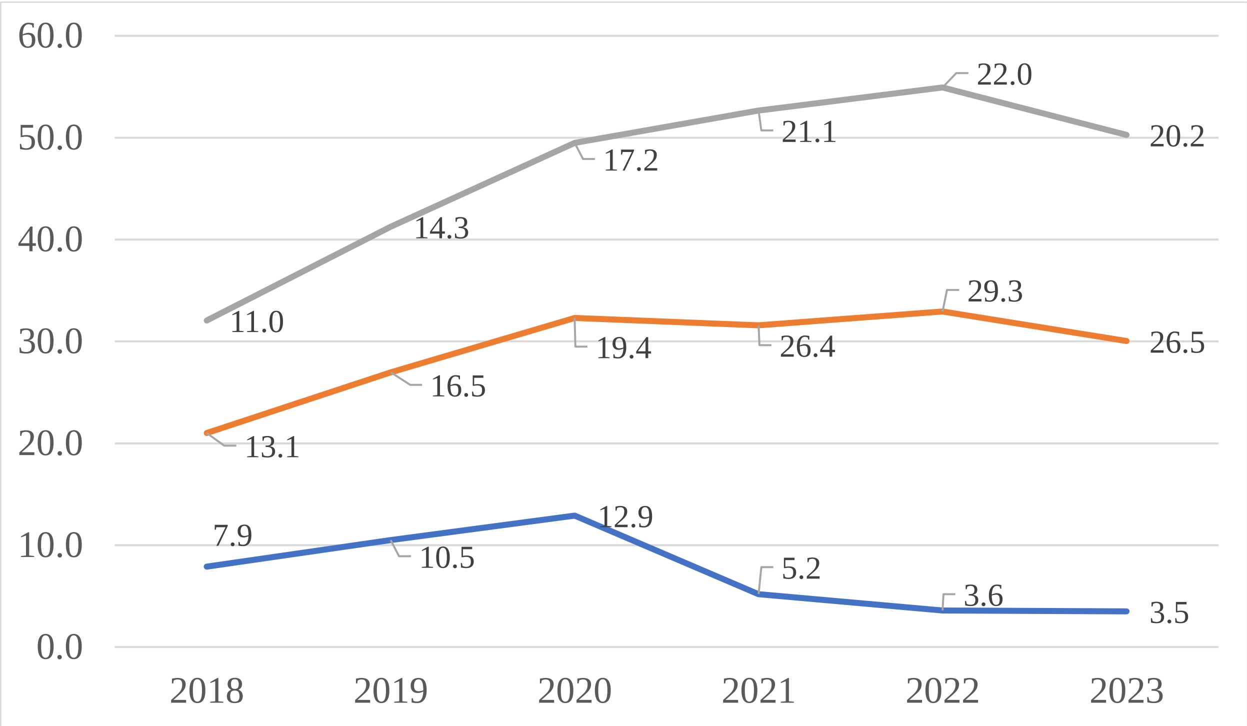
In order to reduce lending risk, commercial banks accumulate a certain amount of funds as a cushion to cover possible losses on bank loans, and these funds are called reserves for potential losses on loans or reserves for non-performing loans. Provisions for potential losses on loans are of a great concern by banking regulators, supervisory authorities, and accounting standards developers, because large amounts of loans on banks' balance sheets make them vulnerable to loan defaults that may arise from worsening economic conditions, this affects borrowers' ability to repay loans, requiring banks to form sufficient reserves for potential loan losses (Abdullaev, 2020).

According to Article 315 of the Tax Code, the reserves generated for possible losses on loans are not more than 80 percent of the norm established by the law in determining the tax base of banks and those performing certain types of banking operations on the basis of the license for the implementation of banking operations, in particular, in determining the profit tax base of commercial banks, are to be deducted. It should be noted that, as a result of the introduction of changes in the tax legislation, a reduction in the share of reserves in the bank's total expenses is obvious in 2023 as a result of the introduction of a limit on tax deductions for reserves formed for possible losses on loans.



Share of non-performing loans in relation to total loans (%)
Share of provisions for losses of the loans in interest-bearing income (%)
Share of provisions for losses of the loans in the bank expenses (%)
Figure 3. Analysis of the impact of the provision for possible losses on loans[5],%

[5]Developed by the researcher based on the studies.

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The amount of reserves formed by commercial banks for possible losses on loans can be observed in the share of the bank's total expenses and the share of interest-bearing income (Figure 3). Over the past period, the share of non-performing loans in the volume of total loans has significantly decreased, but the share of provisions for possible losses on loans is high.

In particular, additional reserves in the amount of 2.4 trillion UZS were generated in 2023. To reduce the amount of problem loans, it has been determined that assets with payment terms of 91 to 180 days (*previously 91 to 120 days*) will be classified as unsatisfactory, assets with payment terms of 181 to 365 days (*previously 121 to 180 days*) will be classified as doubtful, and assets with payment terms of 366 days or more (*over 180 days*) will be classified as bad.

As part of measures to mitigate the negative impact of the pandemic on the economy, in 2021, 14647 economic entities whose activities have not been fully restored will receive 21.4 trillion UZS (*15 percent of the banking system's loan portfolio*) repayment terms for potentially problematic loans have been repeatedly extended by 3-6 months. The balance of loans extended by banks as of January 1, 2022 amounted to 88.4 trillion UZS, of which 73.9 trillion soums (84 percent) belong to legal entities and **14.5** trillion UZS (16 percent) to individuals. Of these loans, **12.8** percent or 11 trillion UZS constituted **non-performing loans**, while 13.1 percent or 12 trillion UZS accounted for **potentially non-performing (substandard) loans** that were overdue by more than 30 days. At the end of 2021, the total balance of loans with extended repayment terms amounted to **27** percent of the banking system's loan portfolio (88 trillion UZS), and in some banks this indicator was significantly higher than average. In particular, it amounted to **42** percent in the People's bank, **41** percent in Turonbank and Uzbekistan Industrial and Construction Bank, **38** percent in Kyshloq Kurilish Bank and Asakabank. In 2021, within the framework of measures to reduce the weight of non-performing loans in the bank's balance sheet, amounts of non-performing loans worth **3.3** trillion UZS that have not been repaid for more than a year, of which **251** billion UZS were allocated for family business development programs were withdrawn from banks' balance sheets. Although banks levied 12.6 trillion UZS in non-performing loans during 2022, an additional amount worth 9.6 trillion UZS in non-performing loans was generated[6].

According to the principle of formation of reserves for possible losses on loans, according to the quality of assets of commercial banks, loans are also classified into "standard", "substandard", "unsatisfactory", "doubtful" and "hopeless" categories. Based on this, a bank must generate a provision of reserve assets in relation to the total value of commercial bank assets:

a. one percent when classified as "standard";
b. ten percent when classified as "substandard";
c. twenty-five percent when classified as "unsatisfactory";
d. fifty percent when classified as "doubtful";
e. one hundred percent when classified as "bad".

In this case, a commercial bank must form reserves for possible losses from the date of the emergence of the bases for classifying loans provided for in this Regulation (2015) and make accounting transfers on them in a programmed manner.

CONCLUSION

Reserves for possible losses should be generated separately for each asset in the currency of the loan, in which currency the loan has been made. Reserves in the amount of 1 percent of the balance of loans (assets) classified as standard are made at the expense of the banks' net profit remaining after paying taxes and other compulsory payments. Therefore, tax deductions are not applied to the formation of reserves generated from net profit. The amount of reserves formed for potential losses on problem loans belonging to the remaining categories is taken to expenses and affects profit before tax.

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