The Effectiveness of Tax Incentives in the Tourism Sector of Uzbekistan

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Abstract---The research aimed to assess the effectiveness of tax incentives in the tourism sector of Uzbekistan. To this end, the literature and empirical researches on the assessment of the effectiveness of tax incentives were studied, and on its basis, 11 types of tax incentives provided to the tourism sector of the country in 2018-2019 were analyzed. The results obtained from the research shows that the lack of a system for granting and monitoring the effectiveness of tax incentives in the tourism sector has led to low efficiency of tax incentives in the study period, as well as out of the existing tax incentives, only "tax holidays" have yielded high results in terms of lowering the tax burden and creating job.

Keywords---AETR / METR, cost-benefit analysis, effectiveness, tax incentives, tourism.

Introduction

To achieve the goal of developing the relevant sector, it is not enough to provide tax incentives, but it is important to regularly assess their effectiveness. Indeed, if the tax costs incurred from tax incentives exceed the benefits that accrue from it, it can hurt both the government and the recipients of tax incentives (James, 2014; Steshenko & Tikhonova, 2018). Hence, according to Hungerford et al. (2006), for tax incentives to be effective, they should reduce the number of budget revenues lost under the tax exemption; simplify the administration and enforcement of the tax exemption; reduce the impact of market failures; reduce external shocks. Moreover, Toder et al. (2002) argue that tax incentives should have a clear purpose, set criteria for evaluating its success, and give priority to their direct budget expenditures in achieving the intended goals through the introduction of tax incentives.

Since the President of the Republic of Uzbekistan designated tourism as a strategic sector of the national economy on December 2, 2016, to accelerate the sector development until the beginning of 2020 have been provided 11 types of tax incentives. However, at present, there are no clear criteria, mechanisms, and a single methodology for assessing the effectiveness of these tax incentives. These circumstances, as noted in the Decree of the President of the Republic of Uzbekistan #4389 on July 10, 2019, hinder the increase of business and investment activity, the formation of a healthy competitive environment, as well as the effective implementation of tax reforms. Taking into account the abovementioned, the author researched to assess the effectiveness of tax incentives in the tourism sector in the Republic of Uzbekistan (Klemm & Van Parys, 2012; Surugiu & Surugiu, 2017).

Method

While reviewing the literature, one can see that most researchers have used and recommended the Cost-benefit analysis for assessing the effectiveness of tax incentives. At the same time, by the researchers, the cost-benefit analysis was carried out mainly based on average and marginal effective tax rate trends (AETR / METR), Input-output, and Differences in Difference methods (Table 1).

Table 1
Literature on assessing the effectiveness of tax incentives

Authors	Date	Country	Period	Model and analysis method (technique)
A. Klemm and S. Van Parys	2010	47 countries	1985–2004	Analysis of average and marginal effective tax rates (AETR / METR)
S. Van Parys and S. James	2010	7 Caribbean countries	1997–2007	Cost-benefit analysis, "Differences in Difference" technique
S. James	2013	136 countries	2011-2012	Cost-benefit analysis
Oxfam and UN	2016	Vietnam	2019-2013	Cost-benefit analysis
C. Surugiu, M.-R. Surugiu	2017	Romania	2014	Cost-benefit analysis. Input-output method
Garsous, Grégoire et al	2017	SUDENE territory of Brazil	2002-2009	Cost-benefit analysis. "Differences in Difference" technique
UN and CIAT	2018	Dominican	2011-2015	Cost-benefit analysis

Based on the above, to assess the effectiveness of tax incentives in the tourism sector in the Republic of Uzbekistan the components of the cost-benefit analysis were calculated by the following methods:

- Direct costs: the revenue-foregone method, which is used in many countries by estimating the loss, incurred by the governments due to the tax incentives (IMF, OECD, UN, & World Bank, 2015);
- Direct benefit:
  - benefits of locational incentives: a method of analyzing the impact of tax incentives on the average effective tax rate (AETR) (Clark & Skrok, 2019);
  - benefits of behavioral incentives: a comparing method that assesses the level of incentives to direct businesses to achieve the intended purpose as a result of tax incentives;
- Indirect benefit: Input-output method, which assesses the jobs created by suppliers in direct contact by using the estimated employment-to-sales elasticity (Kronfol & Steenbergen, 2020).

One of the important conceptual steps in the implementation of this analysis is to classify the tax incentives to be evaluated based on their intended purpose. In the literature, they are divided into "locational incentives" – to attract new investors to a country or region by reducing business tax costs and raising profit expectations, and "Behavioral incentives" – to direct and motivate businesses to a particular activity by reducing operating costs (Kronfol & Steenbergen, 2020). The current classification of tax incentives in the tourism sector based on their purpose is given in Table 2.

Table 2
Classification based on the purpose of granting tax incentives in the tourism sector within the analysis

Locational incentives	Behavioral incentives
Tax holiday	Tax deductions
Investment tax incentives, including within the free tourist zone	

For assessing the direct benefits of locational incentives in the industry, the model of effective tax rate analysis proposed in the study of Devereux & Griffith (2003) and developed by Klemm (2008) was used. In this case, the average effective tax rate (AETR), i.e. the tax burden arising from the investment in tourism and reflected in the percentage of financial benefits expected from the investment during the entire period of the project.
The following model was used to calculate the AETR:

$$AETR = \frac{R^* - R}{p/(r + \delta)}$$

where $R*$ is the present value of the economic rent received in the absence of taxation; R is the value of that value in the absence of taxation; p is the profit before tax (less depreciation); r is the real interest rate, δ is the actual economic depreciation.

R * - pre-tax economic rent is determined as follows:

$$R^* = \frac{p-r}{r+\delta}$$

After deducting taxes, taxes R are determined as follows:

$$R = \left(\frac{(p+\delta)(1+\pi)}{(\rho-\pi+\delta(1+\pi))}\right)(1-\tau-t_s) - 1 + A - (1-\tau)T_P + E$$

where:

ρ is the discount rate applied by the investor; i is the nominal interest rate, calculated as $i = (1+\pi)(1+r)$. In the absence of personal income tax $-\rho = i$;

π is the pace of inflation rate;

τ is the rate of income tax applied to the investment project under consideration;

A is the present value of the depreciation allowance, including the possibility of an investment discount. Depreciation on new investments is assumed to begin when the fixed assets (funds) are included in the production process for use. Depreciation is distributed based on the rate of annual deductions for $T\square = 1 / T$.

T_P is the present value of the property tax to be deducted from the company's income. The carrying amount of a property is the depreciable amount of property adjusted for inflation.

E is the present value of tax incentives in the form of deductions for capital expenditures in Uzbekistan. This exemption means that the company is allowed to deduct 30% of its taxable profit for 5 years, minus annual depreciation allowances, for expenses incurred in purchasing or constructing a building, equipment, or facilities or repaying loans obtained for these purposes.

For straight-line depreciation, the value of A is:

$$A = \tau\varphi + (1-\varphi)\left(\frac{\tau\square}{1+\rho} + \frac{\tau\square}{(1+\rho)^2} + \cdots + \frac{\tau\square}{(1+\rho)^T}\right) = \tau\varphi + (1-\varphi)\frac{\tau\square}{\rho}\left[1 - \frac{1}{(1+\rho)^T}\right]$$

where φ is the investment discount for the period in which it is invested.

In straight-line depreciation, the present value of the property tax T_p is determined as follows:

$$T_P = t_p + t_p\frac{(1-\square)(1+\pi)}{1+\rho} + t_p\frac{(1-2\square)(1+\pi)^2}{(1+\rho)^2} + t_p\frac{(1-3\square)(1+\pi)^3}{(1+\rho)^3} + \cdots + t_p\frac{(1-(T-1)\square)(1+\pi)^{T-1}}{(1+\rho)^{T-1}}$$
$$= t_p\left[1 + \frac{(1-\square)}{1+r} + \frac{(1-2\square)}{(1+r)^2} + \frac{(1-3\square)}{(1+r)^3} + \cdots + \frac{(1-(T-1)\square)}{(1+r)^{T-1}}\right]$$

The size of the investment incentive in the form of allocations to capital expenditures E is determined by the following formula:

$$E = \tau\left[(0,3(p+\delta) - \square) + \frac{(0,3(p+\delta)(1-\delta)(1+\pi) - \square)}{1+\rho}\right] + \tau\left[\frac{(0,3(p+\delta)(1-\delta)^2(1+\pi)^2 - \square)}{(1+\rho)^2}\right]$$
$$+ \tau\left[\frac{(0,3(p+\delta)(1-\delta)^3(1+\pi)^3 - \square)}{(1+\rho)^3}\right] + \tau\left[\frac{(0,3(p+\delta)(1-\delta)^4(1+\pi)^4 - \square)}{(1+\rho)^4}\right]$$

Moreover, the marginal effective tax rate (METR) is also used to calculate the profitability of projects after tax, as well as to decide on the expansion of enterprise activities in a competitive sector. To calculate the METR, the value of R is set to "0" and a solution is found for the net profit before tax $\acute{p}$ (see, for example, Abbas & Klemm (2012) or Botman et al. (2008).

$$\acute{p} = \left(\frac{1 - A + (1 - \tau)T_P - E}{1 - \tau - t_s}\right)\left(\frac{\rho - \pi + \delta(1 + \pi)}{1 + \pi}\right) - \delta$$

METR is calculated as follows:

$$METR = \frac{\acute{p} - r}{\acute{p}}$$

The analysis used the economic and tax parameters listed in Table 3. In addition to taxes that affect the value of capital, there is also social insurance, which is paid by commercial entities from the payroll fund. However, in an economy where wages are determined by market laws and forces, a significant portion of labor taxes falls on workers. Therefore, given that labor taxes affect short-term business decisions, the focus has been on taxes that fall solely on the owner of the capital (Klemm, 2008; James, 2014).

Table 3
Economic and tax parameters used in the analysis

Variables	Symbol	Value
Actual economic depreciation	δ	12,25%
Inflation	π	3,19%
Real interest rate	r	5,75%
Pre-tax profit rate	p	20%
Depreciation allowances	☐	Straight-line depreciation
Corporate income tax	τ	14%
Investment discount	φ	30%
Property tax	t_p	2%
Turnover tax	t_s	4%

For the analysis, based on data of the State Committee for Tourism Development, the State Statistics Committee, the State Tax Committee of the Republic of Uzbekistan as well as World Bank, World Tourism and Travel Council a database has been formed that includes the share of tourism in GDP in 2016-2019, employment in tourism, the volume of investments in tourism, the number of tourism entities, the volume of tax benefits (UN, 2018; Sunariani et al., 2019).

Result

Within the research, 11 types of tax incentives are analyzed which were granted in the period before the coronavirus pandemic (Van Parys & James, 2010; Garsous et al., 2017). During the coronavirus pandemic, 10 types of tax incentives granted by the government to businesses in the tourism sector to support them in a difficult economic situation are not be considered. Provided 11 types of tax incentives to the tourism sector include tax holidays, tax deductions, and investment tax incentives (including within the free tourist zone). Given that the bulk of these tax incentives were provided in 2018-2019, their analysis was carried out based on indicators for these years. According to the analysis, 148 tourism entities benefited from the tax incentives provided during this period, and the number of tax incentives amounted to 35,482.5 million souls (Table 4).

Table 4
The use of tax incentives in the field of tourism in Uzbekistan

Tax incentives	Number of entities benefiting from the incentives		Amount of provided incentives *(in million soums)*	
	2018	2019	2018	2019
Tax holidays	32	46	7,089.7	11,193.5
Tax deductions	26	34	11,370.1	4,509.6

Investment tax incentives, including within the free tourist zone	4	6	480.0	839.6
Total:	62	86	18,939.8	16,542.7

Out of the tax incentives provided in the period reduction of the tax base granted in the form of tax deductions (60 entities, 15.9 billion soums) and the tax exemption for new entities granted in the form of tax holidays (50 entities, 11.5 billion) were the most used by the tourism industry (Zee et al., 2002; Rumina et al., 2015). According to the analysis of the effectiveness of the use of these tax incentives, during 2018-2019 a total number of 424 hotels were created, out of which 25.2% (107) were created using tax incentives. The share of hotel rooms in them is 28.8% of the total. The tax incentives have greatly accelerated the establishment of theme parks (93.3%). The effectiveness of tax incentives provided to tour operators was low, as well as the incentives provided to them were rarely used. This means that the needs of tour operators in providing tax incentives and the incentives` ability to solve a specific problem in the sector have not been sufficiently explored (Table 5).

Table 5
The use of tax incentives in the tourism sector in 2018-2019 in Uzbekistan

Established objects / subjects	2018-2019		
	total number	number within incentives	share
Newly established hotels	424	107	25,2%
Newly established hotel rooms	7,431	2,140	28,8%
Tour operator	1,482	13	0,9%
Newly established sanitary-hygienic centers	1,401	126	8,9%
Established theme parks	30	28	93,3%
Newly created jobs	42,900	6,000	13,9%

As mentioned above, in addition to the results from tax incentives in the tourism sector, a comprehensive analysis of the effectiveness of tax incentives is important. Direct tax expenditures incurred as a result of tax incentives in the tourism sector in 2018-2019 amounted to a total of 35.5 bln soums or 3.1% of total tax revenues in the tourism sector (Table 6).

Table 6
Comparison table with direct tax expenditures and other indicators for 2018-2019 (billion soums)

Indicators	2018	2019	Difference
Total tax revenues	54 185,9	81 353,0	27 167,1
Tax revenues in the tourism sector	406,0	732,2	326,2
Share in total tax revenues	0,75%	0,90%	0,15%
Tax expenditures in the tourism sector	18,9	16,6	-2,3
Share in total tax revenues	0,03%	0,02%	0,01%
Ratio of tax revenues in the tourism sector	4,6%	2,3%	-2,3%

First of all, the trend of change of AETR and METR in the Republic of Uzbekistan for the last five years was studied and evaluated (Figure 1). While Barzel & Mintz (2016) calculated these figures for 2016, for 2017 these figures were assessed taking into account that there were no significant changes in the tax system in this regard. For 2018, the International Monetary Fund used the indicators calculated in the 2018 study of the tax system of Uzbekistan, while the indicators for 2019 and 2020 were calculated based on the abovementioned calculation method. As shown in Figure 1, the AETR and METR indicators remained high (34% and 48%) in 2016-2018, after changes in property tax, corporate income tax, and turnover tax rates as a result of tax reforms in 2019 and 2020, these indicators (26 % and 34%) significantly decreased. However, it should be noted that these figures are higher than in other countries. In particular, in the research of Barzel & Mintz (2016), the METR rate was 26.9% in Kazakhstan, 29% in the Russian Federation, 23.2% in Georgia, and 24.1% in South Korea.
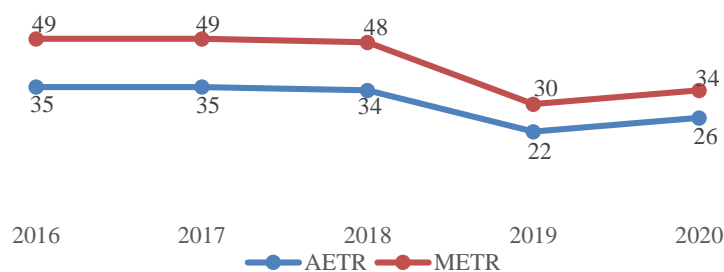
Figure 1. The trend of change in the average effective tax rate and marginal effective tax rate for tourism entities (in percentage)

The impact of tax incentives in the tourism sector on the AETR and METR was assessed (Table 8). According to that, tax incentives in the form of tax holidays and investment tax incentives for a specified period, in particular for tax holidays of 3-5 years, investment tax benefits for 3-7 years, or the period of the free tourism zone have led to a decrease in AETR from 22% to 8% and METR from 30% to 14%.

Table 7
The impact of tax incentives in the tourism sector on the average effective tax rate
and marginal effective tax rate (in 2019)

Tax incentives in the tourism sector	AETR (%)	METR (%)
Without tax incentives	22	30
Tax holiday	8	14
Investment tax incentives, including within the free tourist zone	8	14

The benefits of behavioral incentives, in particular, the level of incentives to direct enterprises to achieve their goals as a result of tax incentives were considered. According to the analysis, if the exemption from deducting the cost of printed advertising products from the tax base has not been used for 2 years, 8.9% of entities has used the tax incentives in the form of the exemption for the construction and maintenance of sanitary facilities, 0.5% – the exemption for creating websites. In addition, the government has allocated an average of 125 million soums for the construction and maintenance of one sanitary-hygienic center, while this figure amounted to 5.7 mln. soums for the creation of 1 special website selling tourism services (Koga, 2003; André et al., 2016).

Indirect benefits from the tax incentives, the next component of the cost-benefit analysis, assessed the jobs created by suppliers directly involved in the tourism supply chain as a result of tax incentives using employment multipliers in tourism (Table 8). According to the analysis results, because of the tax incentives in the tourism sector in 2018-2019, an additional 2,140 hotel rooms were created (total – 7,431), which created 4,815 jobs in the accommodation services for visitors. Accordingly, it has led to the creation of 15,533 new jobs in the chain of other major tourism sectors in the tourism supply chain (Read, 2013; Ozdemir, 2020).

Table 8
The indicators of employment and employment multiplier in the tourism sector of Uzbekistan

Tourism sectors	Indicators		As a result of tax incentives	Multiplier
	2018	2019	2018-2019	
Number of hotel rooms	20,200	26,100	2,140	-
Number of employees in legal entities				
Visitor accommodation services	47,564	54,536	4,815	-
Moreover:				
Catering services	58,126	66,646	5,884	1.22
Passenger transport services (air, rail,	67,358	77,232	6,819	1.42

road)				
Vehicle rental services	1,559	1,788	158	0.03
Travel agency services and other booking services	2,784	3,192	282	0.06
Services in the culture sphere	9,630	11,042	975	0.20
Sports and leisure services	13,979	16,028	1,415	0.29
Total number	153,436	175,928	15,533	-
Total:	201,000	230,464	20,348	-

Based on a comprehensive analysis of the cost-benefit analysis of the effectiveness of tax incentives in the tourism sector, an indicator of expenditures in the form of tax incentives to create additional jobs was assessed. According to that, the indicator of tax incentives in the form of tax holidays for job creation is 1.3 (1.3 million soums for 1 job), in the form of investment tax benefits – 0.3, tax deductions – 5.1 (Table 9).

Table 9
The results of the assessment of the tax benefits` effectiveness in the tourism sector in 2018-2019
by the method of cost-benefit analysis

Tax incentives	Direct cost (billion. soum)	Benefit		Result (2/(3+4)=5) (million soum)
		Direct benefit	Indirect benefit	
1	2	3	4	5
Locational incentives				
Tax holiday	18.3	3,806	9,795	1.3
Investment tax incentives, including within the free tourist zone	1.3	1,453	3,349	0.3
Behavioral incentives				
Tax deductions	15.9	741	2,389	5.1
Total:	35.4	6,000	15,533	1.6

Based on the above, it can be said that from the tax incentives used in the tourism sector, the investment tax exemption (including within the free tourist zone) is found to be highly effective in reducing the tax burden on tourism entities and creating jobs. Tax incentives in the form of tax deductions have had a negligible effect on reducing the tax burden and creating jobs. Moreover, the level of use of behavioral tax incentives is very low, especially if one of them is not used at all, and the rest are used only by up to 8.9% of those who have the right to use them (Bernini & Pellegrini, 2013; Palmer & Riera, 2003).

Discussion

Finding the right balance between introducing an attractive tax regime for domestic and foreign investment using tax incentives and providing the necessary revenue for public spending is a major political dilemma (IMF, OECD, UN, and World Bank, 2011). The lack of criteria, mechanisms, and a unified methodology for granting tax incentives and assessing their effectiveness, has led to the granting of low-efficiency tax incentives and an increase in tax expenditure in the tourism sector alone. The analysis of the tax incentives applied in the tourism sector showed that the tax incentives in the form of investment tax incentives (including within the free tourist zone) are highly effective in reducing the tax burden on tourism entities and job creation. Tax benefits in the form of tax deductions have had a negligible effect on reducing the tax burden and creating jobs. Moreover, the level of use of behavioral tax benefits is very low, especially if one of them is not used at all, and the rest are used only by up to 8.9% of tourism entities who have the right to use them (Vjekoslav et al., 2012; Suryanata, 2019). The tax incentives in the form of tax holidays and investment tax incentives for a specified period, in particular for tax holidays of 3-5 years, investment tax benefits for 3-7 years, or the period of the free tourism zone have led to a decrease in AETR from 22% to 8% and METR from 30% to 14%. The comprehensive analysis of the cost-benefit analysis of the effectiveness of tax benefits

in the tourism sector shows that the indicator of tax benefits in the form of tax holidays in the creation of jobs is 1.3 (1.3 million soums for 1 job), in the form of investment tax incentives – 0.3, tax deductions – 5.1.

Conclusion

The main objective of the study is to assess the effectiveness of tax incentives in the tourism sector. To this end, the literature was analyzed and a mechanism for assessing tax incentives was developed, based on which the tax expenditure incurred as a result of tax incentives in the sector were calculated and their effectiveness was assessed. Based on the results of the study, it can be concluded that the lack of criteria and mechanisms for granting tax incentives in the tourism sector and the lack of a methodology for regular evaluation of their effectiveness create inefficient tax expenditure in the sector. Moreover, the study shows the need to further improve tax holidays and investment tax incentives, which are highly effective in reducing the tax burden on tourism entities in the country and creating jobs in the sector.

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