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Changes in tax rates / Abolishment of simplified VAT regime / New bank account suspension procedure

Transfer pricing / Controlled foreign corporations / Thin capitalisation / Consolidated group of taxpayers / 'E-services' by non-residents / Tax residency definition / Permanent Establishment

Changes into legislation



On 2 September 2019, the Draft Tax Code of the Republic of Uzbekistan (**New Tax Code**) was released for public discussions. New Tax Code was developed by the Ministry of Finance and State Tax Committee of the Republic of Uzbekistan in collaboration with International Monetary Fund, World Bank, as well as international and national experts.

Generally, it is aimed at harmonization of tax system by reducing the number of taxes and obligatory payments, introduction of internationally common tax concepts (such as controlled foreign corporations, thin capitalisation, transfer pricing) and provision of more detailed guidance on taxation, as described further.

New Tax Code is expected to become effective as of 1 January 2020.

Besides, a Presidential Decree #YII-5837 “On measures on further improvement of the tax policy of the Republic of Uzbekistan” was issued on 26 September 2019 (**Decree 5837**). Certain provisions of the Decree 5837 have become effective from 1 October 2019 while others to be included in New Tax Code and enforced accordingly.

In this issue, we have summarised the most notable changes, including the following:

- ❖ Changes to rates for value-added tax (VAT), excise tax, corporate income tax (CIT) and unified social payment (USP);
- ❖ ‘Risk-based’ bank account suspension procedure;
- ❖ Detailed transfer pricing regulations;

- ❖ Controlled foreign corporation rules;
- ❖ Thin capitalization rules;
- ❖ Introduction of beneficial ownership concept;
- ❖ Consolidated group of taxpayers;
- ❖ Taxation of ‘e-services’ provided by non-residents;
- ❖ Amendment into tax residency definition;
- ❖ Other changes related to specific taxes.

Decree 5837

Effective 1 October 2019, VAT rate is decreased from 20% to 15 %.

The excise tax rates for goods produced and services rendered in Uzbekistan are generally increased. Few examples are displayed in the table below:

Type of goods / services	Old rate	New rate
Cigarettes	UZS 117,900 per 1,000 pcs and 4% of the customs value	UZS 141,500 per 1,000 pcs and 9% of the customs value
Mobiles services	15%	20%
Petrochemicals, e.g. gasoline AI-91/ AI-92/ AI-93	UZS 35,343 per ton	UZS 250,000 per ton
Natural gas (incl. for export)	15%	20%
Polyethylene granules	25%	30%

Effective 1 January 2020, CIT rate is increased from 12 to 15%. USP (i.e. employer’s social contribution) is reduced from 25 to 12% for entities with state participation thereby aligning the rate with the one applicable to other taxpayers.

Simplified VAT regime for certain taxpayers introduced in 2019 for 2 years is to be abolished as of 1 October 2020 due to its inefficiency and lack of interest from taxpayers.

Existing procedure on suspension of banking operations is to be abolished. The revised procedure should be based on “risk-analysis” method with suspension period not exceeding 30 days. Previously, suspension could be carried out for indefinite period.

Draft Tax Code

Below we provide brief comments on the expected changes as per the New Tax Code. We note that the draft may undergo revisions before it gets enforced in 2020. Our comments are based on the version of the draft released for public discussion in September 2019.

Transfer pricing

New Tax Code introduces elaborate transfer pricing (TP) provisions, including definition of related parties, controlled transactions, pricing methods, documentation and reporting requirements, pricing agreements etc.

Controlled transactions

TP rules apply to both transactions between Uzbekistan residents as well as cross-border ones.

Generally, transactions between Uzbek resident related parties are viewed as controlled if the amount of annual turnover between such parties exceeds UZS 5 bln. (approx. USD 530k) per calendar year.

Local related party transactions may also be viewed as controlled if the turnover exceeds a lower threshold of UZS 500 mln. (approx. USD 50k) and the following criteria is met:

- one of the parties is participant of special economic zone/ uses special tax regime, or
- at least one of the parties is exempt from taxation, or
- subject of the concerned transaction is a mineral resource, envisaging ad valorem tax rate.

As for cross-border transactions, controlled transactions include operations between related parties, as well as operations (including those between non-related parties) involving:

- goods traded on global commodity exchanges that fall within commodity groups such as non-ferrous metals, precious metals and stones, natural gas, mineral fertilizers, cotton fibre and yarn, or
- transactions where one of the parties is registered in tax haven jurisdiction.

Related parties

Under New Tax Code legal entities / individuals are considered to be related in the following cases:

- indirect/direct share participation of one legal entity / individual in another legal entity exceeds 20%;
- legal entities where one party has more than a 20% direct or indirect participation in each of these entities;
- legal entity and individual authorized to appoint sole executive body / 50% of the collective executive body or Board of Directors of this legal entity.
- legal entities in which not less than 50% of the collective executive body is appointed by the same individual
- legal entities in which not less than 50% of the collective executive body are the same individuals;
- legal entity and individual acting as its sole executive body;
- legal entities in which the same individual is a sole executive body;
- legal entities and individuals if the chain of direct participation of the entities in each other exceed 50%;
- individuals if one of them is subordinate employee;
- individual, his/her spouse, parents (including foster), parents of spouse, children (including adopted), brothers and sisters (with complete and incomplete kinship), brothers and sisters of spouse, guardian and ward.

For determination of participation share in the legal entity, shares of individual, his/her spouse, parents etc. (mentioned above) may be jointly considered.

TP methods

New Tax Code outlines the following five methods, similar to those used in the international TP practice (i.e. based on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations) to analyse the arm's length nature of the controlled transactions:

1. comparable uncontrolled price (CUP),
2. resale price,
3. cost plus,
4. transactional net margin,
5. profit split.

If necessary, a combination of two or more methods may be used. Nevertheless, the CUP should be a priority when analysing the arm's length nature of the controlled transactions.

TP compliance

The taxpayer should report on controlled transactions not later than the date of filing of annual financial reports for the year when controlled transactions took place.

Tax authorities may request taxpayer to provide documentation on a particular transaction or group of similar transactions. Such documentation may include a document or set of documents prepared in a free format that contains certain information, e.g. list of parties involved in the transaction, description of the transaction, applied pricing method, payment terms, functions of parties etc. Tax authorities cannot request such documentation until 1 June of the year following the calendar year when the controlled transaction took place.

Penalty

Liability for underpayment of taxes as a result of applying non-market prices in controllable transactions may result in a penalty of 40% of underpaid tax. Moreover, non-provision of the report on controlled transactions or provision of such report with incorrect information results in a fine of UZS 500k (currently, around USD 50).

Advance Pricing Agreement

Taxpayers qualified as 'large taxpayers' are eligible to apply to tax authorities for 'advance pricing agreement' (APA). APAs may be valid for the period of up to 3 years and may be extended for additional two years upon taxpayer's request.

Controlled foreign corporations (CFC)

Generally, CFC rules are applicable to individuals and legal entities, Uzbekistan tax residents, owning or controlling foreign legal entities and/or structures. The main purpose of the new CFC rules is to tax undistributed profits of foreign companies and structures like trusts, foundations etc.

Eligible entities and structures

A foreign legal entity (or other structure) is deemed to be a CFC if it meets the following criteria:

- it is not considered to be an Uzbek resident for tax purposes, and
- it is controlled by a legal entity or an individual considered an Uzbek tax resident.

Definition of ‘controlling person’

A controlling person of a foreign company is defined as:

- legal entity or individual whose **direct and/or indirect** participating interest in a foreign company is **more than 25%**, or
- legal entity or individual who **directly or indirectly** owns **more than 10%** of a foreign company where Uzbek tax residents hold a direct or indirect interest(s) **in excess of 50%**.

For individuals, participating interest is calculated jointly with their family members.

Definition of ‘control’

The definition of ‘control’ is rather broad and may be interpreted to mean that control exists even when the percentage of a shareholding (interest) is less than the thresholds noted above, but if there is explicit or implicit ability to influence the decisions of the CFC’s management in respect of distribution of profits.

CFC profit calculation

The retained income of a CFC shall be viewed as income of the Uzbek controlling person(s) and included into taxable base of such persons for corporate income tax or personal income tax purposes in proportion to their interest(s) in the CFC.

Please note that income of CFC included into taxable base of controlling person only if the amount of such income exceeds UZS 300 mln. (approx. USD 32,000).

Exemptions

New Tax Code provides that profits earned by the following types of companies (or other structures) are exempt from CFC taxation in Uzbekistan:

- Non-commercial organisations that do not distribute profits in the country of incorporation.
- Companies that qualify as ‘active companies’ or ‘active foreign holding companies’ as defined by the New Tax Code (provided such company is not located in an offshore jurisdiction).
- Companies residents in jurisdictions that have a tax treaty with Uzbekistan and that pay tax at an effective rate equal to or higher than the applicable Uzbek corporate income tax rate.
- Banks and insurance companies operating in tax treaty jurisdictions.

Reporting requirements

There are notifications that should be submitted to the Uzbekistan tax authorities, if a taxpayer has a foreign company or structure subject to CFC rules.

Penalty

New Tax Code envisages the following liability for breaching CFC-related regulations:

- tax underpayment due to failure to include CFC’s income into the taxable base may result in a fine of 20% of unpaid tax amount, but not less than UZS 10 mln. (approx. USD 1k);
- failure to provide notification within the established deadlines or provision of incorrect information on CFCs results in a fine of UZS 10 mln. (approx. USD 1k) per each CFC;

- failure to provide notification or provision of incorrect information on participation in foreign legal entities – results in a fine of UZS 5 mln. (approx. USD 530) per each legal entity.

Thin capitalization

New Tax Code introduces regulations on deductibility of taxpayer's interest expense on controllable debt from a foreign participant. Controllable liability is defined as liability owed to:

- foreign legal entity or individual that is not considered as Uzbek tax resident with a direct/indirect ownership of 25% of shares in the charter capital of the taxpayer;
- other related entity of this foreign participant;
- other persons for which the above-mentioned persons act as guarantors or otherwise undertake responsibility to ensure the repayment of this taxpayer's debt.

The deductibility limitations apply if the amount of debt exceeds the amount of equity by 3 times (13 times for banks and leasing companies). There is a specific mechanism for determining the deductibility limits.

Beneficial ownership

New Tax Code introduces a beneficial owner concept.

Thus, a beneficial owner of income paid by a legal entity shall be a person having the right to independently use and (or) control (dispose of) such income, or a person in whose interests another person is entitled to control (dispose of) such income. It is not important, whether this right arose due to direct and (or) indirect participation in this legal entity, or control over it, or due to other circumstances.

A foreign person/entity is not recognized as beneficial owner of income from sources in Uzbekistan if such person/ entity has limited powers with respect to control (disposing of) such income, performs intermediary functions in respect of said income in the interests of another person/entity, without performing any other functions and taking no risks, directly or indirectly paying such income (fully or partially) to this other person.

Consolidated group of taxpayers

New Tax Code provides an opportunity to form a consolidated group of taxpayers, which may comprise of two or more Uzbek legal entities. The taxpayers should meet the 'ownership' criteria, i.e. participation share of one legal entity in the charter capital of other legal entity(ies) should comprise at least 90%. Furthermore, legal entities should not be undergoing liquidation or bankruptcy processes, and their net assets should be higher than the charter capital.

Moreover, all legal entities forming consolidated group of taxpayers shall satisfy other criteria related to turnover, taxes paid and assets value. The advantages of applying this regime may include, without limitation, ability of filing one set of reports for the group; offsetting profits of one group company against losses of another group company.

'E-services' provided by non-residents

Foreign legal entities that supply e-services to individuals whereby the place of supply is considered Uzbekistan, are subject to VAT in Uzbekistan. In such a case, the foreign service provider is liable for registering for VAT purposes in Uzbekistan.

Taxable base shall comprise actual sales price of such services inclusive of VAT.

There is an extensive list of e-services covered by these provisions, including, without limitation:

- rights to use software (including online games), databases, updates and add-ons;
- rights to use e-books and other publications, educational materials, pictures, musical compositions with /without text, audio-visual products through Internet;
- advertising services on the Internet;
- intermediary services (e.g. technical, organizational, informational etc.) between buyers and sellers on the Internet such as marketplaces or auctions;
- administration and maintenance of e-resources in the Internet, provision of access or opportunity to modify such resources to other Internet users;
- automatic remote maintenance of software as well as administration of information systems and sites in the Internet;
- storage and processing of information, if the information provider can access this information through Internet;
- provision of domain names and hosting;
- automatic search and data processing services such as stock exchange reports or automatic translation;
- services related to search of information on potential buyers, provision of access to search engines.

New Tax Code also provides the list of services which are not treated as e-services:

- sale of goods or services ordered via Internet whereby delivery of service/goods is performed offline (i.e. not through the Internet);
- sale of software (including games) and databases on physical medium;
- consulting services provided by email;
- Internet access services.

Amendment into tax residency definition

The list of legal entities considered tax residents of Uzbekistan is amended to include:

- foreign legal entities which are considered as Uzbek tax residents based on the tax treaty provisions (residents only for the purposes of application of tax treaties);
- foreign legal entities the place of effective management of which is Uzbekistan, unless otherwise provided by relevant tax treaty.

Uzbekistan shall be viewed as place of effective management of foreign legal entity if one of the following conditions is satisfied:

- executive body of such entity regularly exercises its functions from Uzbekistan;
- top executives of the entity mainly manage the activities of foreign legal entity from Uzbekistan.

The above being said, certain functions, including strategic planning, budgeting, preparation and compilation of consolidated financial and management reports, analysis of activities, internal audit and internal controls, approval of standards and policies etc. should not result in recognition of Uzbekistan as effective place of management.

Permanent Establishment changes

Certain changes are introduced with respect to permanent establishments (PE).

Currently, activities performed under personnel provision agreements do not lead to PE provided that seconded personnel act exclusively on behalf and in the interest of host entity. New Tax Code additionally specifies that (i) the provider of personnel should not bear any

responsibility for the results of the work of seconded personnel, and (ii) profit margin of personnel provider should not exceed 10% of total cost related to provision of personnel.

Furthermore, if activities of a foreign legal entity constitute two or more PEs subject to registration in the same tax inspectorate, such activity may be performed through a single PE. This rule does not apply to construction sites, installation objects etc.

The list of documents required for registration of PE of foreign legal entity is supplemented by document confirming state registration of the foreign legal entity in the country of incorporation, notarized copies of permits or licenses. Also, original or notarized copies of the registration documents should be filed, along with their translation into Russian or Uzbek.

If a foreign legal entity concludes a contract for a term exceeding 183 calendar days, it should file PE registration application within 30 calendar days after start of activities. Also, if a foreign legal entity concluded several contracts with aggregate duration of activities exceeding 183 days, it should register with tax authorities within 30 calendar days after start of activities or conclusion of the contract that triggers excess in PE threshold. However, such aggregation may conflict the concept of separate projects.

Changes to specific taxes

Value added tax

- foreign legal entities carrying out activities in Uzbekistan via permanent establishment become VAT payers. Moreover, certain categories of taxpayers, including agricultural producers, law firms may also be subject to VAT;
- VAT refund is extended to any excess of input VAT over output VAT (currently, refund is only envisaged in relation to zero-rated turnover);
- input VAT related to purchase of fixed and intangible assets is fully recoverable at acquisition (currently, offset is provided in equal instalments within 12 months for fixed and intangible assets, and 36 months – for immovable property);
- simplified VAT regime introduced in 2019 is abolished;
- reporting and payment deadlines have been changed.

Corporate income tax

- definition of justified expenses is introduced and definition of ‘documented expenses’ is clarified;
- mechanism to tax interest income at the level of recipient – tax residents in Uzbekistan - is introduced, except for non-commercial and budget organisations (currently, withheld at the source of payment);
- advance payments are abolished, except for large taxpayers with a taxable income threshold of UZS 5 billion per annum;
- investment deduction on depreciable assets in the amount of 5% and 10% (depending of type of asset) is introduced in lieu of tax preferences provided previously for new technological equipment, i.e. reduction in taxable base by the expenses on its purchase (but not exceeding 30% of taxable profits);
- list of non-deductible expenses is expanded to include, without limitation, expenses related to income exempt from taxation, taxes and obligatory payments to state budget (except for corporate income tax) accrued in and paid in excess of amounts established by law, cost of goods and services transferred free of charge, and others;
- ‘7% rule’ implying that taxable base for the purposes of calculation of corporate income tax of PE cannot be less than 7% of the total cost, was abolished;

- period for carry-forward of tax losses was extended from 5 to 10 years. The gross amount of losses to be accounted for in each following year cannot exceed 60% of taxable income (profits) of the current year (previously, 50%).

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Timur Zhursunov,
Partner, Tax and Legal
timur.zhursunov@pwc.com

Otabek Muhammadiyev,
Partner, Assurance
otabek.muhammadiyev@pwc.com

Jamshid Juraev,
Director, Tax and Legal
jamshid.juraev@pwc.com

Oybek Yuldashev,
Senior Manager, Advisory
oybek.yuldashev@pwc.com

Audit Organization
“PricewaterhouseCoopers” LLC
88A, Mustaqillik prospekt,
Mirzo-Ulugbek district,
Tashkent 100000, Republic of Uzbekistan
T: +998 (78) 120 6101
www.pwc.com/uz

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