

Uzbekistan a business and investment guide July 2005

This guide provides a brief introduction to foreign investment in Uzbekistan. Because of the rapid pace of change in the country, potential investors are advised to contact PricewaterhouseCoopers Uzbekistan for specific advice before acting upon the information provided (see page **Contacts** for contact details).

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Contents

Key statistics	1
Political and economic context	3
Historical background	3
Political context	4
Ethnic and social issues.....	4
Economic context.....	5
Investing in Uzbekistan	9
Investment context.....	9
Investment protection.....	9
Profit repatriation.....	10
Land ownership.....	11
Investment incentives	11
Environmental protection	15
Forms of business organisation	16
Registration requirements.....	17
Production Sharing Agreements.....	18
Taxation issues	20
Introduction	20
Corporate taxation	20
Income (profits) tax	20
Alternative taxation regimes	24
Value Added Tax	25
Other taxes and charges	27
Tax penalties	30
Personal taxation	34
Operational issues	36
Financial information.....	36
Banking system.....	36
Employment issues	38
Uzbek staff	38
Expatriate staff	38
International trade issues	39
Import taxes	39
Export duties	41
Contacts	42

Uzbekistan – A Business and Investment Guide

Key statistics

Official Name:	Republic of Uzbekistan
Total Area:	447,400 sq. km.
Population:	26 million (2005) ^[1]
Principal cities:	Tashkent (2.4 million) Samarkand (392,000) Namangan (378,000)
Languages:	Uzbek (official language) Russian (lingua franca)
Neighbouring states:	Kazakhstan, Turkmenistan, Afghanistan, Tajikistan, Kyrgyzstan
Currency:	Uzbek Soum (UZS)
Exchange rate:	UZS 1,115=USD 1 (30 June 2005)

Gross Domestic Product (GDP)^[1]

	2000 ^a	2001 ^a	2002 ^a	2003 ^b	2004 ^b
GDP (UZS bn)	3,256	4,925	7,469	8,571	9,339
Real change (%)	3.3	4.1	3.1	1.5 ^a	7.1
GDP per capita (UZS thousand)	128.3	185.8	236.6	336.8	363.4
Real change (%)	2.3	2.8	1.9	0.8	6.6

Stabilisation indicators^[1]

	2000	2001	2002	2003	2004
Inflation (% change in consumer prices)	24.9	27.2	24.2	13.1 ^a	1.7 ^a
Budget balance (% GDP)	(1.0)	N/a	(0.8)	(0.4)	(0.7)
Exchange rate (UZS/USD, end period)	325	688	970	980	1,058
Average monthly wage (UZS)	9,780	N/a	31,200	N/a	N/a
Unemployment rate (official %)	0.3	0.3	0.5	0.5	0.6

Foreign trade, foreign debt and official reserves^{[1], [2]}

	2000 ^a	2001 ^a	2002 ^a	2003 ^b	2004 ^b
Exports (USD mn, on customs basis)	2,935	2,740	2,510	3,240	4,290
Imports (USD mn, on customs basis)	2,441	2,554	2,186	2,404	3,210
Trade balance (USD mn, on customs basis)	494	186	324	836	1,080
Foreign debt (USD bn, end-period)	4.4	4.7	4.6	4.5	5.1
Gross (net of gold) foreign reserves (USD mn, end-period)	600 ^b	781 ^b	709 ^b	1,250	1,300

Uzbekistan – A Business and Investment Guide

Notes and sources:

[1] The Economist Intelligence Unit (EIU), *Country Profile 2005: Uzbekistan, Country Report March 2005: Uzbekistan*.

The Economist Intelligence Unit
15 Regent Street
London SW1Y 4LR
Tel: +44 207 830 1000
Fax: +44 207 499 9767

[2] European Bank for Reconstruction and Development, *Report on Uzbekistan, 3-5 May 2003*

^a Actual

^b Economist Intelligence Unit estimates

Political and economic context

Historical background

The Republic of Uzbekistan has an immensely rich heritage in terms of culture, art and natural resources. The monuments that remain throughout the country bear witness to a long and eventful history in which Alexander the Great, Genghis Khan and Tamerlane the Great all left their mark. The Uzbeks are descendants of nomadic Mongol tribes who mixed with the sedentary inhabitants of Central Asia during the 13th century. The Khanates of Khiva and Kokand and the Emirate of Bukhara ruled the region during the 18th and 19th centuries. Russia became increasingly interested in the region in the 18th century. This interest intensified in the 19th century as Russia and Britain competed for influence in a diplomatic and occasional military struggle known as "The Great Game"¹. In 1865 Tashkent, the richest city in Central Asia, fell to the Russians, and by 1873 the last of the region's powerful traditional rulers, the Khans in Khiva, had fled and Russia stood in control of the whole of Central Asia.

The Central Asian territories initially supported the 1917 Bolshevik revolution in the hope that they could achieve independence from Russia. However, support soon turned to fierce opposition from the nationalist *basmachi* movement and the Soviet forces were forced to withdraw. Soviet power was re-established in September 1919, although armed opposition continued into the early 1920s. On 27 October 1924 the Uzbek Soviet Socialist Republic (UzSSR) was created, and in May 1925 became part of the Union of Soviet Socialist Republics (USSR). There had been little industrial development in Central Asia under Tsarist rule, although some raw materials were extracted. During World War II, Uzbekistan's industrial base was enlarged by the re-location of factories from the war-zone. Post-war Soviet development policies focused on the exploitation of the country's raw materials, with particularly heavy investment in the production of cotton. By the late 1980s the republic was producing 90% of the Soviet Union's cotton, a third of its gold and half of its uranium.

The rise to power of President Mikhail Gorbachev and the greater political and cultural freedom permitted under *glasnost* (openness) allowed for the wider discussion of economic and ecological issues as well as previously unexamined aspects of Uzbek history. The poor state of the environment as a result of over-irrigation of the cotton crop and the high incidence of birth defects attributed to the indiscriminate use of pesticides were major sources of popular dissatisfaction. On 29 August 1991, 10 days after the collapse of the anti-Gorbachev coup in Moscow, an extraordinary session of the Supreme Soviet voted to declare the Republic independent, and changed its name to the Republic of Uzbekistan.

Direct presidential elections were held on 29 December 1991 and won by Mr Karimov with a reported 86% of the vote. A referendum was held simultaneously in which 98% of participants endorsed Uzbekistan's independence. Mr Karimov won a referendum in 1995, allowing him to stay in office until 2000. He was further re-elected in the January 2000 presidential election. A referendum in January 2002 extended the presidential term in office from five to seven years. The next presidential elections are to take place in 2007.

¹ Vivid accounts of "The Great Game" can be found in: John Keay, *The Gilgit Game: the explorers of the Western Himalayas 1865-95*, Oxford University Press, 1979 and Peter Hopkirk, *The Great Game: on secret service in High Asia*, Oxford University Press, 1990.

Uzbekistan – A Business and Investment Guide

Political context

According to the Constitution of 8 December 1992, Uzbekistan is a sovereign, democratic republic. The country is headed by a President who is elected for no more than two consecutive five-year terms (after the January 2002 referendum, the presidential term in office has been extended to seven years). The government (Cabinet of Ministers) is subordinate to the President, who appoints the Prime Minister, deputy Prime Ministers and ministers subject to the approval of the legislature.

The highest legislative body is the two-chamber *Oliy Majlis* (Supreme Assembly), which is elected for a five-year term. The Legislative chamber (lower) consists of 120 members elected by Uzbek citizens based on secret voting. Members of the higher chamber – the Senate – are elected from each region of Uzbekistan, the Republic of Karakalpakstan and Tashkent city, by six members from each territory. Sixteen members of the Senate are appointed by the President of the Republic of Uzbekistan out of the most competent citizens with outstanding achievements in and contributions to science, literature and art. The President, with the approval of the Constitutional Court, may dissolve the *Oliy Majlis*.

There are five officially recognised parties which are the People's Democratic Party, the National Democratic Party "Fidokorlar", the Social Democratic Party "Adolat", Democratic Party "Milliy Tiklanish" and the Liberal Democratic Party "Movement of Entrepreneurs and Businessmen".

Since 1999 a series of terrorist attacks occurred, presumably arranged by extremist organisations linked with Al-Qaeda leading to certain unrest in the Republic. Disturbances also occurred in Andijan (one of the major Uzbekistan cities located in the Ferghana Valley) in May 2005 that resulted in significant civilian casualties. In these incidents Islamic terrorists were blamed; however at the time of writing this guide the investigations have not been completed. Otherwise, Uzbekistan remains, in general, a politically stable country with immense cultural and historical background, and rich and variable natural resources.

Ethnic and social issues

Uzbekistan is a heterogeneous society dominated by ethnic Uzbeks. Some 76% of the population are Uzbeks, 6% are ethnic Russians, 5% are Tajiks, 4% are Kazakhs and 9% are from other ethnic groups. Many members of the minor ethnic groups have left the country since independence. For instance, many Jews emigrated to Israel or America, and a considerable number of ethnic Germans and Russians returned to their homelands. This has resulted in the loss to Uzbekistan of many valuable technical, industrial, and professional skills. However, the situation has recently improved and currently Uzbekistan possesses a number of young professionals who received various educational degrees at American and European universities through the state-funded educational programme "Istedod Foundation".

During the communist years, religious observance was strictly forbidden. Thousands of mosques were closed, observance of Ramadan banned, and wearing veils and the sale of the Koran was forbidden. As a result, only a few Uzbeks have an in-depth knowledge of Islam, although the majority of them would describe themselves as Muslims and Islamic traditions run deep. Many mosques have re-opened, and veils are becoming more prevalent outside Tashkent. Official government policy is opposed to the emergence of Islamic extremism in Uzbekistan, and has put pressure on the country's Muslim clergy to guard against a rise in extremism. Roughly 99% of Muslims in Uzbekistan are followers of the "Hanifism" wing of Islam, which is the most liberal school of Islam in terms of religious tolerance.

Uzbekistan – A Business and Investment Guide

Economic context²

The government adopted a "gradualist" approach to economic reform during the early years of independence. State intervention in the economy remained high and privatisation, particularly of large enterprises, was slow. Although the economy was not impacted as severely as those of most of the other CIS countries, the government's reluctance to cut budgetary expenditure contributed to a growing budget deficit and high inflation.

However, the adoption of a World Bank-inspired comprehensive economic reform programme in early 1994 marked a significant change in direction. The programme included measures to stimulate private enterprise, reduce state control, accelerate privatisation and encourage foreign investment by providing improved legal protection for investors and tax incentives. Unfortunately, this programme achieved very limited success.

Although reliable recent data is not available, Uzbekistan's economy remains skewed towards an inefficient agricultural sector that subsidises a growing industrial sector. Agriculture is probably still the largest sector in the economy. In 2001 it generated 24% of GDP (the most recent full-year data available), and employed 34% of the economically active population. Most agricultural output and much of light industrial output is related to cotton, which is grown throughout the country. Lack of reform had stifled the sector, and, combined with several years of drought, this has contributed to a substantial fall in the cotton harvest over the past decade, keeping the cotton crop well below government targets. In order to achieve self-sufficiency in food production, the government has transferred to grain some of the acreage formerly given over to cotton. Nevertheless, cotton remains Uzbekistan's main source of export earnings.

Gold is the country's second largest export earner, accounting for an estimated annual average of about 15% of total export revenue over the past five years. Most gold is mined at the giant open-cast Muruntau mine in Navoi region. The government does not release production figures for gold, but industry sources estimate output in 2001 at 86 tonnes, making Uzbekistan the world's ninth-largest producer.

In July-August 2001 Uzbekistan, jointly with the International Monetary Fund (IMF), launched a staff monitored Program of macroeconomic stabilisation and structural reform aimed at strengthening efforts to implement market reforms. This included the gradual removal of all restrictions on access to foreign exchange for current account transactions and the unification of exchange rates by the end of June 2002. The Program was monitored by the IMF who performed a review of the implementation of the Program measuring from January 1 – June 20, 2002.

On 3-5 May 2003 Uzbekistan hosted participants of the European Bank for Reconstruction and Development (EBRD) Annual Governors' Meeting. The event brought together over 2,000 participants, including senior government officials, bankers, business people and investors, SMEs, media, over 200 non-governmental organisations and EBRD staff. Many hoped that after the Meeting, the Uzbek government would liberate some of its political and economic regulations. We have yet to observe that these hopes are fulfilled.

Uzbekistan has membership in a number of international organisations, including IBRD, EBRD, ADB, IMF, United Nations, Islamic Bank, Interpol, etc. Uzbekistan has recently entered the

² Drawn from the Economic Intelligence Unit Country report on Uzbekistan

Uzbekistan – A Business and Investment Guide

Shanghai Cooperation Organisation which previously counted five members – China, Russia, Kazakhstan, Kyrgystan and Tajikistan.

GDP

Economic dislocation resulted from the separation of Uzbekistan's economy from the rest of the Soviet Union and caused an immediate fall in GDP, industrial and agricultural output. GDP fell in real terms by more than 11% in 1992. However, the decline in GDP was more modest during 1993, 1994 and 1995 when it fell by 2.3%, 4.2% and 0.9% respectively. Although the initial decline in GDP was considerably less severe than in any other former Soviet republic, the economy has stagnated and the signs of recovery are weak. GDP is believed to have grown by some 1.6% in 1996, 2.5% in 1997, and 4.4% in 1998. In 1999 and 2000 GDP growth was 3.4 and 3.3 accordingly. As reported by the government, the GDP growth in 2001 approached 4.1%. However, in the following 2002 and 2003 slid down to 3.2% and 3.0% respectively.

In 1997-1998 significant foreign investments in the textile, electronics and auto sectors contributed to strong growth of industrial output. Uzbekistan is one of the largest producers of gas among the former Soviet republics. However, production has not increased to meet the anticipated higher export demand from countries such as Ukraine. A shortfall in the cotton crop, which suffered severe weather damage in early summer 1997, subsequent poor crops in 1998 and 2000 - the lowest since independence - had a detrimental effect on the country's balance of trade. Cotton accounted for 41.5% of total export receipts in 1998. In 1999, the lower export price and the poor crop of 1998 pushed cotton's share of exports down to 27.3%, which further declined to 26.6% in 2002. Although the share of cotton in Uzbekistan's export has been continuously declining the figures for 2004 indicate continued reliance on cotton as a source of export revenue. Cotton provided about 18% of the total export revenue in 2004. Nonetheless, Uzbekistan remains as one of the world's leading producers and exporters of cotton.

Following the withdrawal of the IMF's representative in April 2001, only limited data relating to GDP is now available. Official data put GDP growth at an annual average of 4.4% in 2001-02, whereas the IMF has estimated it at 3.7%. Data for 2003 diverge even more substantially. According to the government, GDP expanded by 4.4% in real terms in 2003, whereas IMF estimates put growth at 1.5%. In 2004, however, the IMF appears to have accepted official claims – albeit with caveats over the quality of the data – that real GDP grew by well over 7%.

Inflation

Consumer price inflation was exceptionally high between 1992 and 1994. The situation improved markedly during 1995 and 1996. Year-on-year inflation fell from over 836.2% in 1994 to just under 29% in 1997. Over the following years the inflation rate has been steadily falling and was running at 14.6% at the end of 2003 (EIU estimates), down significantly compared with the 2001 and 2002 figures of 27.2% and 24.2% respectively.

The authorities have claimed a rapid deceleration in consumer price inflation over the past two years, as a result of their tighter credit policy. According to official figures, year-end inflation was just 3.7% in 2004 almost unchanged compared with the previous year. However, in the past, international financial institutions have judged that official inflation figures tend to underestimate the true rate by about one-half, in part owing to the flawed methodology used to collect the consumer price data. For example, official data fail to capture accurately price trends in the markets, where most consumer goods and food are sold. EIU believe that rises in utility tariffs and increases in public-sector salaries are likely to exert inflationary pressure in 2005-06, but a combination of price controls and government efforts to limit the amount of UZS in circulation will keep officially recorded annual inflation well below 10%.

Uzbekistan – A Business and Investment Guide

Foreign trade

Independence put an end to subsidised communist-bloc trade, and turned a trade surplus equivalent to 2% of GDP in 1991 into a deficit equivalent to 12% of GDP in 1992. The trade balance returned to surplus in 1994 because of the weakness of local currency, which restrained imports, and a surge in the world prices of Uzbekistan's main exports, cotton and gold. In late 1995 and early 1996 Uzbekistan encountered a new trade crisis when the price of cotton dropped. To bring the external deficit under control, the government formally introduced four authorised exchange rates from January 1997 and introduced severe trade restrictions. As a result, the trade deficit fell sharply, and by 1998 trade was in surplus by USD 171m. According to EBRD, the trade surplus remained roughly stable in 1999 and rose up to 4% of GDP in 2000. In both 2001 and 2002 the trade balance seems to have been in surplus, although official customs data tend to understate the true cost of imports. Non-cotton exports have risen, mainly owing to an increase in metals and automotives export to Russia. In 2003 and 2004 the trade balance figure estimated by EIU rose to USD 836m and USD 1,370m, respectively.

Russia remains Uzbekistan's largest trading partner, with its share of trade reviving thanks to increased cotton exports. Exports to the rest of Central Asia are mainly accounted for by gas, for which payment is usually received late. Outside of the CIS, important export markets are the UK, Switzerland and South Korea, the first two being the initial destinations for gold and cotton sales, respectively. Much of the trade with South Korea is connected with Daewoo's activities in Uzbekistan.

Foreign direct investment

Despite the country's abundant natural resources (e.g. oil and gas, gold and other metals, cotton and other agricultural products) and political stability, Uzbekistan has so far failed to attract a significant amount of FDI, which averaged just over 0.5% of GDP between 1992 and the first quarter of 1996. In contrast Kazakhstan attracted some 87% of all FDI committed to Central Asia and has an FDI rate per capita 40 times greater than that of Uzbekistan. To attract more FDI the Uzbek government will need to be seen to be more welcoming to foreign investors, show greater commitment to economic reform, and be prepared to unify the exchange rate and make the current account convertible.

The UK, South Korea, Turkey, Russia and the US are the largest investors in Uzbekistan, with the FDI directed mainly to the mining, tobacco, automotive and oil and gas sectors. The most sizeable foreign investments to date have been made by: BAT (tobacco), Newmont Mining (gold), Daewoo Corp. (automobile manufacture), Case New Holland (agricultural machinery), LUKOIL and Gazprom (oil and gas).

Uzbekistan received USD 69m (0.6% of GDP) in FDI in 2000, a year on year decrease of 50%. By contrast, foreign debt inflows amounted to USD 1.3bn. The shortage of hard currency, as well as lower exports, in particular to hard-currency markets, has made debt servicing difficult. According to EIU estimates, Uzbekistan's debt burden was USD 3.8bn by the end of 2000. The EIU estimates that Uzbekistan had USD 799m of debt-servicing obligations in 2000. Assuming that these repayments are evenly spaced throughout the year, then the debt-service ratio in the first half of 2000 was 23%. A more accurate comparison is the ratio of debt repayments, which are almost all hard currency denominated, to exports of goods and services to hard-currency markets. About 70% of goods and services exports earn hard currency, making the debt/exports of goods and services ratio about 33%.

Uzbekistan has been among the least successful of the CIS members in attracting FDI. The EIU estimates that cumulative net FDI inflows at the end of 2004 amounted to about USD 1.18bn, or 13% of GDP. Extensive restrictions on currency transactions and the unpredictable treatment of foreign investors by the tax authorities have discouraged most Western investors from entering

Uzbekistan – A Business and Investment Guide

the Uzbek market. The stock of FDI per head, at an estimated USD 46 at the end of 2004, is one of the lowest in the CIS.

Natural resources and the environment

Uzbekistan has considerable natural resources, including oil, gas and gold. Proven oil reserves were 600 m barrels at end-2000, according to BP – just 0.1% of world oil reserves. Oil reserves are sufficient for domestic demand. Massive investment in exploration, production and pipeline construction would be required for large-scale exports to become possible, and even then Uzbekistan would be only a marginal producer.

Gas reserves are more significant, at 1.87 trn cu metres at the end-2000. According to BP, Uzbekistan holds the world's 14th largest reserves, representing 1.3% of the world total. There are substantial gold deposits, and workable deposits of silver, copper, lead, zinc, coal and uranium.

Investing in Uzbekistan

Investment context

The Laws On Foreign Investments and On Guarantees and Measures for the Protection of Rights of Foreign Investors adopted on 30 April 1998, the "Foreign Investment Laws", provide the legal framework for foreign investment in Uzbekistan. The laws define the types of entities in which foreigners can invest, the conditions governing repatriation of profits and earnings, and the general rights to and guarantees of foreign investors. The legislation offers a number of attractive tax concessions for entities with foreign investment (see below). Foreigners can invest in a business venture in Uzbekistan in a number of ways, including by:

- Acquiring share in an existing company by participating in auctions or tenders organised under the privatisation programme;
- Acquiring share in an existing company by direct negotiation with the owners of the shares or by purchasing shares on the stock market;
- Forming a joint venture with an Uzbek enterprise or individual;
- Establishing a new, wholly owned company;
- Any other form that does not contradict Uzbek legislation.

The definition of an enterprise with foreign investment applies to those entities which satisfy the following criteria:

- Their charter fund capital exceeds USD 150,000;
- At least one of the participants is a foreign legal entity;
- Foreign investors own at least 30% of the total charter capital.

Effective 1 July 2002, the amended criteria for the status of an enterprise with foreign investments is used for enterprises with the participation of foreign capital newly established in the Republic of Karakalpakstan and Khorezm region. The minimum charter capital to meet the criteria of an enterprise with foreign investment for such enterprises shall be USD 75,000, as opposed to the above standard minimum limit. This measure is intended to stimulate investment to these distant regions of Uzbekistan.

Investment protection

Under the Foreign Investment Laws, investments cannot be nationalised or confiscated without the payment of compensation. The significant guarantee for an entity with foreign investment is contained in the Foreign Investment Laws that provide for protection against adverse changes in the law for a 10-year period following registration. The guarantee does not cover changes in the legislation related to matters of national safety. However, the application of this guarantee has been in practice challenged by tax authorities in most respects.

Besides, in accordance with the recently issued Presidential Decree, the application of the above 10-year guarantee has been restricted to certain conditions, and further regulations on the application of the 10-year guarantee are expected to be issued in the near future.

Uzbekistan – A Business and Investment Guide

Profit repatriation

Under the Foreign Investment Laws, foreign investors are entitled to repatriate profits in convertible currency after the payment of any taxes and other fees, which are due. However, at the time of writing this remains a difficult task to achieve because of the restrictions on currency convertibility (please see below).

Currency exchange rates

The government introduced currency convertibility on 15 October 2003, lifting many of the restrictions on the purchase of hard currency and unifying the exchange rate of UZS, which at the year-end of 2004 was equal to UZS 1,058 : USD 1. Since unifying the exchange rate the government has allowed the currency to depreciate against the US dollar by a monthly average of 0.5% in nominal terms – a policy that is expected to be maintained throughout 2005-2006.

Currently, exchange desks offer somewhat UZS 1,115 for USD 1; however, most of them are not able to supply enough UZS due to lack of UZS cash in the republic. This has been followed by rebirth of the parallel market exchange rate, which is this time lower than the official rate.

Currency convertibility

There is a number of measures taken by the government to monitor foreign currency movement in Uzbekistan. Thus, all Uzbek enterprises including enterprises with foreign investment (except for small size enterprises meeting certain criterion), are required to convert 50% of their hard currency revenue receipts into UZS through the domestic foreign exchange market. The conversion must be arranged through a bank authorised to undertake such activity.

All companies participating in foreign trade are obliged to present to the authorities monthly statistic reports on export and import of goods (works, services) and on movement of hard currency associated with export-import operations. On the basis of these statistic reports the Ministry of Economy, Ministry of Foreign Economic Relations, Investments and Trade and Ministry of Finance together with the Central Bank establish and monitor fulfilment of forecasted export-import operations and mandatory sale of hard currency proceeds.

To stabilise and further regulate the use of UZS, settlements between businesses may only be performed through bank transfers, regardless of the type of business. Settlements for goods (works, services) in Uzbekistan are allowed in UZS only. An enterprise's right to hold petty cash is also severely restricted, and it may only withdraw cash from its bank accounts for two specific purposes: for the payment of wages and to cover certain allowances for business trips. Uzbek enterprises are prohibited from holding bank accounts outside the country without obtaining prior approval from the Central Bank. Uzbek nationals are not allowed to hold bank accounts outside of Uzbekistan.

Uzbek nationals are allowed to export foreign currency in equivalent of up to USD 2,000 in cash without any approval. A bank certificate is required for export of foreign currency in the equivalent of between USD 2,000 to USD 5,000. Any amounts of foreign currency exported in excess of the equivalent of USD 5,000 are subject to special permission of the Central Bank. Foreign individuals are allowed to export hard currency from Uzbekistan but only up to the amount initially declared at customs upon arrival in the country or withdrawn from their USD bank account in Uzbekistan. These limits were significantly lower in the past.

There used to be considerable drawbacks for the enterprises to convert their UZS making the conversion next to impossible. However, beginning with 1 October 2002 (after certain import regulations were introduced in summer 2002), the restrictions were loosened. Apparently, all legal entities and individuals are now allowed to convert UZS to USD for the purpose of importing

Uzbekistan – A Business and Investment Guide

goods provided that certain requirements are met. Such requirements include timeliness and completeness of payment of applicable import taxes and duties, presence of certificates of conformity for the imported goods and strict observance of trade rules, such as mandatory registration with respective authorities, use of cash-register machines, mandatory labelling of certain listed goods in Uzbek language, etc.

Conversion for other purposes has also become more practicable; however there are also certain conditions to meet.

Land ownership

According to the Uzbek Land Code, land is state property and cannot be bought or sold in Uzbekistan. Limited exceptions are made for selected individuals; small and medium size businesses, diplomatic representations and foreign enterprises (under special decree by the government). Effectively, enterprises lease plots of land when they acquire the objects of trade or service located on these plots. When buildings are sold or otherwise transferred, the right to lease the land plots are also transferred to a new owner with a moderate re-registration fee. Legal title to land plots is granted by the State authorities. Legal entities may develop and sell the real estate they own. Legal entities may also purchase residential premises with automatic re-allocation of the land on which the premises are located.

Investment incentives

There are certain tax incentives to encourage investments. Most are directed towards foreign investors, manufactures, importers and exporters of strategically important products.

Tax concessions for new enterprises

All newly formed enterprises, except stock or commodity exchanges and trading enterprises, are subject to profits tax at reduced rates in the first two years after registration. The profits tax rates in each year of activity are as follows: first year: 25% of the basic rate (i.e.3.75% at the time of writing); second year: 50% of the basic rate (i.e.7.5% at the time of writing).

Newly established in rural areas enterprises, including enterprises with foreign investments (except those in wholesale/retail, intermediary, logistics and storage businesses), are exempt from income (profits) tax in the first year starting from registration of the enterprise; they are allowed a 75% reduction of the normal tax rate in the second year; and pay 50% of the normal tax rate in the third year. In subsequent years such enterprises are taxed at the normal rate.

At the same time, if an entity ceases its activities before it has completed one full year of operation after the expiry of the exemption period, the relief is withdrawn and the profits tax liability is reassessed at the basic rate. The relief is not allowed for an enterprise established and based on an existing enterprise or for an enterprise using equipment rented from an existing enterprise.

In addition to the profits tax concession, newly formed enterprises are given an exemption for two years from property tax, subject to the same restrictions as for profits tax above.

Concessions for Oil & Gas exploration and extraction companies

Foreign companies carrying out oil & gas exploration works are granted with certain incentives that include exclusive exploration rights for a territory with the possibility to engage in extraction

Uzbekistan – A Business and Investment Guide

either through a joint venture company or on terms of a concession. Such companies and their foreign contractors and subcontractors are exempt from payment of all forms of taxes and payments effective in Uzbekistan during exploration period. Additionally, exemptions should apply to customs payments on the import of equipment, material and technical resources and services necessary for the exploration and related works.

Enterprises and organisations – residents of Uzbekistan – supplying materials and rendering services to such foreign companies are exempt from value-added tax.

Additional privileges are given to oil & gas extracting joint venture companies established with participation of foreign companies that are involved in the exploration. Among such privileges are:

- 7-year profits “tax holiday” with a 50% reduction in the effective profits tax rate upon expiry of the holiday period;
- Exemption from tax on property and income of foreign investors derived from participation in joint venture companies;
- Exemption from mandatory conversion of foreign currency proceeds received from oil & gas production and refining until the capital invested in the exploration is recovered.

Concessions for carrying out export activities

Enterprises exporting goods (works, services) of their own production for freely convertible currency may apply reduced rates of **income (profits) tax** as follows:

- If export share in total sales ranges from 15% to 30%, the effective income (profits) rate shall be reduced by 30%;
- If export share in total sales is 30% or more, the effective income (profits) tax rate shall be reduced by 50%.

In addition, with effect from 1 January 2004 exporters are granted with an incentive to apply a reduced **property tax** rate depending on the export share in total sales:

- If export share ranges from 15% to 30%, the rate is reduced by 30%;
- If export share ranges from 30% and higher, the rate is reduced by 50%;

Both incentives are subject to a restriction that they do not cover trading or intermediary companies, nor revenues from the export of specific items such as cotton fibre, oil, gas, precious metals, etc.

Producers can also defer the payment of their import VAT in respect of material and technical resources used for production of goods to be exported. The deferral is granted for up to 90 days without application of any interest.

Concessions for producers of consumer goods

Enterprises specialised in production of children consumables, toys and women hygiene goods pay profits tax at a reduced rate of 10%. This rate is applied when such specialisation comprises 60% and more of total production.

In addition, newly established or being modernised enterprises specialising in the production of public consumer goods are exempt from value-added tax in respect of the imported technological equipment.

Uzbekistan – A Business and Investment Guide

Furthermore, effective from 1 January 2003 to 31 December 2007 producers of certain consumer goods specifically listed in the legislation are granted with the following incentives:

- producers of consumer goods are allowed to pay income (profits) tax in respect of income received from the production of consumer goods applying the rate reduced by 20% against the effective one;
- producers of goods for children are allowed to pay income (profits) tax in respect of income received from such production applying the rate of 7% (for qualifying for this benefit a reference is provided to Clarification of the Cabinet of Ministers #327-ϕ of 14 July 1999 and other relevant legislation documents);
- micro-firms and small enterprises are allowed to pay unified tax in respect of revenue received from the production of consumer goods at the rate reduced by 25% against the effective one;
- income (profits) of production companies resulting from the growth in volumes of consumer goods production are exempt from income (profits) tax and unified tax;
- enterprises producing non-food consumer goods (excluding tobacco and jewellery production) are exempt from payment of excise tax provided that the resulted savings are used for the development of production, expansion of assortment and increase of competitiveness of the goods produced;
- enterprises producing consumer goods are allowed to choose, at their own discretion, depreciation methods to apply in respect of fixed assets based on the useful life of these fixed assets.. However for taxation purposes the direct (straight line) method should still be applied within the rates set by the Tax Code;
- enterprises' expenses for advertising consumer goods of their own production would be fully deductible for income (profits) tax purpose.

Effective from the above date, producers of consumer goods are also provided with a number of benefits related to customs payments, land tax and property tax.

Enterprises specialised in production of consumer goods (provided that their consumer goods production comprises 60% and over in total production) are allowed in 2003-2005 to carry on obligatory sale of foreign currency proceeds from the export of consumer goods with a reduction for value of the raw materials and assembling units imported for their own production needs.

The above incentives and benefits are provided to producers of consumer goods on condition that the resulting savings would be used for the development of the production, expansion of assortment and increase of competitiveness of the consumer goods (purposeful use). In case of non-purposeful use of the savings, producers lose the incentives and should fully pay to budget the exempt taxes plus applicable penalties and fines.

Enterprises involved in the processing of milk, wool, fruits, vegetables, etc. are allowed to make cash payments for these products to individuals and farms provided that the latter are direct producers of these products. However, in reality cash transactions are strictly monitored and often restricted, thus, the application of the above stated could potentially be problematic.

Concessions for insurance companies

Effective 1 February 2002, all insurance companies are exempt from income (profits) tax for a period of 3 years, provided that the resulting savings are used for the development of their material and technical base, creation of widely spread agent network, and personnel (including overseas) training. If the savings of insurance companies that are (partially) owned by the state

Uzbekistan – A Business and Investment Guide

were directed towards the increase of their charter funds, such savings would replenish the state's share.

Concessions for lease activity

Effective 1 September 2002, lease charges are exempt from value-added tax and technological equipment imported to the territory of Uzbekistan for lease purposes is exempt from customs payments and value-added tax, subject to respective confirmation by the authorised bank on the technological nature of the equipment.

With effect from 1 September 2002, companies-lessees are exempt from the property tax in respect of leased property for the period of the lease contract. Interest and other charges, paid by lessors on the loans received for purchase of property for leasing purposes, are deductible for income (profits) tax purposes.

Investment relief

The taxable profits may be reduced by the amounts of expenditure that qualify as "investments" less the total annual depreciation charge. The term "investments" for the purposes of the relief is defined broadly and includes any investments to develop an entity's own production base, such as the purchase or construction of business premises, plant and machinery. The aggregate tax relief for "investment" expenditure is generally limited to 30% of taxable profits.

Tax concessions for entities with foreign investment

Additional tax concessions are available for production entities with a substantial foreign investment component. To qualify for the concession, an enterprise should meet the criteria of an enterprise with foreign investment as described in the section

Investment context above.

- Entities with foreign investment are exempt from value added tax on technological equipment imported as a charter fund contribution.

Furthermore, the entities with foreign investments are also granted with the following concessions:

- A production entity included in the Strategic Investment Programme of the Republic of Uzbekistan is exempt from profits tax for seven years from the date of establishment (registration);
- Foreign investors may import free of import duties goods for their own production and their personal needs and for personal needs of foreign citizens located in Uzbekistan in accordance with labour agreements established with foreign investors.

With effect from 1 July 2002, newly established enterprises in the Republic of Karakalpakstan and Khorezm region that qualify as enterprises with foreign investment based on the adjusted criteria as described above are also eligible for the above incentives and exemptions.

Effective 1 July 2005 the following tax incentives have been offered to direct foreign investors.

Enterprises attracting private foreign investments are exempt from income (profits) tax, property tax, infrastructure development tax, ecology tax, unified tax for micro-firms and small enterprises, as well as contributions to the Republican Road Fund. Exemption is applicable to main business activity only.

Uzbekistan – A Business and Investment Guide

The above tax incentives are available for different periods depending on the size of direct foreign investment:

USD 300,000 – USD 3,000,000	3 years
USD 3,000,000 – USD 10,000,000	5 years
In excess of USD 10,000,000	7 years

The above tax incentives are granted if the following conditions are met:

- The enterprises are located in the labour surplus regions (Karakalpakstan, Djizak, Kashkadarya, Syrdarya, Surhandarya, Khorezm), as well as in rural areas of Navoi, Andijan, Namangan and Ferghana regions;
- Republic of Uzbekistan does not provide sovereign guarantees for such foreign investment;
- Share of foreign capital of enterprises should not be less than 50%;
- Investment should be made after the state registration of the above enterprises (not very clear requirement);
- Investment should be made in hard currency or new /modern technological equipment;
- Respective tax savings should be reinvested for further development of enterprises.

The respective Decree also provides for additional benefit clauses, as below.

- Interest on long-term loans attracted by enterprises with foreign investments with no sovereign guarantee of the Republic of Uzbekistan is deductible for income (profits) tax purposes.
- Losses on main activity in newly established enterprises with foreign investments, may be carried forward for five years. However, the wording in the Decree is unclear on the exact procedure for implementation of this option.
- In the event of any subsequent adverse legislative changes to the investment conditions, the above tax incentives are applicable to the entire period originally granted.

Environmental protection

The government has adopted laws to prevent and reduce industrial pollution. The most important of these include: the Protection of Nature Law; the Water Law; the Mining Law; the Forest Law; and the Atmosphere and Air Law. The State Committee for the Protection of Nature (*Goscompriroda*) is the principal agency responsible for environmental matters, and its responsibilities include the preparation and implementation of government policy in respect of the environment. Under the 1992 Protection of Nature Law, all new construction projects, and imported and exported products must pass a mandatory ecological review. Enterprises are required to keep records about the discharge of harmful substances into the environment, and their compliance with targets for pollution and the use of natural resources. If demanded, such information must be provided to *Goscompriroda*. In general, enterprises have a duty to:

- Obtain permission from Goscompriroda prior to starting industrial activity;
- Comply with established environmental regulations and discharge limits, including rules governing the disposal and handling of waste and harmful substances;

Uzbekistan – A Business and Investment Guide

- Pay compensation for the use of natural resources and for the disposal of polluting substances or other damage caused to the natural environment.

Forms of business organisation

Foreign investors may choose from a number of different forms of organisation to conduct business and business-related activities in Uzbekistan, including limited liability societies, joint stock societies, partnerships, subsidiaries, representative offices and branches of foreign enterprises.

According to the Civil Code of the Republic of Uzbekistan, founders/participants of a legal entity or owners of its property are generally not responsible for liabilities of the legal entity. Such responsibility arises when these persons' or a parent entity's actions have led to the insolvency (bankruptcy) of this legal entity.

Open joint stock societies, entities with state participation and enterprises engaged in insurance, banking, stock and commodity exchanges, investment funds and other financial institutions are subject to an independent audit.

Limited liability societies

Limited liability societies are governed by the Law on Societies, #310-II of 6 December 2001, enforced from 1 March 2002. Limited liability societies are considered separate legal entities and may be established by one or several founders. The founders' financial liability is generally limited to their contribution to the owners' equity (capital) of the company. The equity capital cannot be less than 50 times the minimum monthly wage (MMW), UZS7,835 effective since 1 May 2005. The equity capital should be contributed within a term defined by foundation documents not to exceed one year from the date of state registration. A limited liability society does not issue shares, but divides its foundation capital amongst its participants.

Joint stock societies

Joint stock societies are governed by the Law on Joint Stock Societies and the Protection of Shareholder Rights of 26 April 1996. Joint Stock Societies are considered separate legal entities and may be established by one or several founders. There are two types of joint stock society - "open" and "closed". The minimum charter capital for closed joint stock societies is 200 times the monthly minimum wage. Effective from 1 February 2003, the minimum charter capital for open joint stock societies is established to equal USD 50,000.

The equity capital should be contributed within a term defined by foundation documents not to exceed one year from the moment of state registration. The number of shareholders in a closed joint stock society must not exceed 50, whereas the number of stockholders in an open stock company is not limited. There is no concept of a "shelf" company in Uzbekistan. The financial liability of shareholders is generally limited to their contribution to the owners' equity (capital) of the company.

Joint stock societies must create a reserve fund. The declared reserve fund cannot be less than 15% of the entity's charter fund capital and the annual allocation to it should not be less than 5% of the entity's net profits until the reserve fund equals the amount declared in the charter. Joint stock societies can use the reserve fund only for limited purposes (e.g. recovery of losses, redemption of debentures, payment of dividends on preferred shares).

Uzbekistan – A Business and Investment Guide

Partnerships

Partnerships are governed by the Law on Partnerships, #308-II of 6 December 2001. Partnerships are considered to be legal entities. The minimum equity capital is 50 times the minimum monthly wage. The foundation capital should be contributed within a term defined by foundation documents not to exceed one year from the moment of state registration. There are two types of partnership - limited partnerships and general partnerships - both must have at least two founders. A limited partnership must have at least one general partner, who has unlimited liability for partnership debts. The liability of other partners is limited to the amount of their investment. In a general partnership, all partners have unlimited liability. Both types of partnership are taxed in the same manner as companies.

Subsidiaries

According to the Civil Code of the Republic of Uzbekistan, subsidiaries are viewed as separate legal entities. A subsidiary is established by a parent economic society, provided that the latter, by force of its participation in the charter fund or appropriate agreement may influence decision-making process of the subsidiary. A subsidiary does not hold responsibility for any liability of its parent.

Representative offices

Representative offices of foreign companies are not viewed as separate legal entities in accordance with the Civil Code of the Republic of Uzbekistan. These are used to gather information, to establish business contacts, etc.

Branches

According to the Civil Code, branches of legal entities can carry out all the functions of a legal entity, without constituting a separate one. However, in practice, this business form is not widely used by foreign investors as the authorities generally treat them as a separate Uzbek legal entity.

Foreign legal entities

A foreign legal entity may perform certain business activities in Uzbekistan without the establishment of an Uzbek legal entity.

Joint activities

Contracts governing joint activities are not considered to have a separate legal identity but may be used to facilitate certain business purposes.

Registration requirements

Effective 1 October 2001, a new procedure for state registration applies in respect to enterprises operating in the Republic of Uzbekistan.

The new procedure provides for a one-window registration of enterprises. Enterprises have to apply to a relevant state authority responsible for its statutory registration. Following the statutory registration with the relevant authority, such authority becomes responsible for the subsequent registration of the enterprise with tax and statistics authorities, Road Fund, Labour, Employment and Social Security Departments and receiving permission from the Ministry of Internal Affairs for the enterprise to produce a seal and a stamp.

Uzbekistan – A Business and Investment Guide

Registration responsibilities are split among the Ministry of Justice and Khokimiyats (local authorities) of districts and cities. The Ministry of Justice is responsible for the registration of audit and insurance organisations, exchanges, enterprises with foreign investments and market places (bazaars) created in Tashkent. Khokimiyats of districts and cities are responsible for the registration of all subjects of entrepreneurship, including enterprises with participation of foreign capital, except for those to be registered by the Ministry of Justice.

Under the new procedure, the registration requirements differ for enterprises with foreign investments, subject to registration with the Ministry of Justice, and enterprises with participation of foreign capital³, subject to registration with Khokimiyats.

The total period of registration of the enterprise with all the subsequent registration with tax and other authorities may vary from 7 days to 1 month depending on the complexity of each case. State registration of joint ventures is subject to a registration fee of 5 times the minimum monthly wage plus USD 500. The fee for the registration of an enterprise wholly owned by foreign legal entity is USD 2,000. Joint stock societies established with state participation are exempt from the state registration fee.

Representative offices

Representative offices must be accredited with the Ministry of Foreign Economic Relations, Investments and Trade. Similar to the incorporation of enterprises with foreign investment, the accreditation of representative offices is not in theory a long process to pass. However, in practice the registration takes approximately one month. Accreditation lasts for up to three years, normally with prolongation carried out on an annual basis.

Production Sharing Agreements

With effect from 7 December 2001 the new Law on Production Sharing Agreements (PSA) was introduced. It specifies definitions and terms under which foreign investors may enter into PSAs.

In particular, the Law stipulates that subsurface plots to be explored under a PSA shall generally be limited to those plots that have not been proven to have natural resources stores. The proven natural resources stores may be included in the PSA only in cases when there is a lack of financial and technical means for the exploration of such stores provided that this is useful for the republic's economy.

The Law also specifies procedure for entering into PSA. As a general rule, subsurface plots should be provided under PSA on a competitive bid basis. However, the Cabinet of Ministers of the Republic of Uzbekistan may adjust the procedure in certain cases, e.g. when the bid for the field is participated in by one foreign investor only. Activities under PSA are subject to licensing with the Cabinet of Ministers. The licence is issued for the period of PSA validity.

Among key terms of performing activities under a PSA, there is a requirement that audits of financial and economic activity and implementation of the proposed budget be performed as of the end of financial year at the expense of the foreign investor.

Reasonable expenses of foreign investors would be reimbursed in the form of products. The reimbursement should begin in the year when the commercial extraction is launched. Expenses

³ Companies with participation of foreign capital, which do not meet criteria set for enterprises with foreign investments (please refer to criteria described in Investment CONTEXT section above).

Uzbekistan – A Business and Investment Guide

that are not reimbursed in the current calendar year are subject to reimbursement in the following years within the period of duration of the agreement. The term 'reasonable' shall not include taxes, insurance of business or other risks, investor's selling expenses, fines and penalties. The Law also specifies taxes that would be payable by foreign investors under PSA: income (profits) tax, land tax, subsurface use tax, water use tax, environmental pollution fee, and payroll taxes. The investor is exempt from all other taxes levied in the Republic of Uzbekistan. Goods, works and services provided to the investor by resident legal entities are subject to VAT at a zero rate. Customs payments shall not apply to import of goods, works and services required for the purpose of PSA, nor to the export of the investor's share of production.

Taxation issues

Introduction

The fundamental provisions of the current Uzbekistan tax system were laid down as part of a major set of tax reforms introduced during 1991. The Uzbekistan State Tax Committee was created around the same period to monitor compliance, verify tax calculations and to issue instructions on the application of tax laws. The tax system has been amended on numerous occasions and remains one of the more complex aspects of the Uzbekistan business environment. The main taxes affecting foreign investors are as follows:

- Corporate income (profits) tax, including income tax withholding at source of payment of income (withholding tax);
- Value-added tax and turnover charges;
- Personal income tax and other payroll charges;
- Customs duties;
- Other taxes and charges (e.g. subsurface use tax, excise tax, property tax, land tax, water use tax, ecology tax and other local taxes and charges).

At the time of writing this Guide, the Uzbekistan Ministry of Finance and State Tax Committee jointly with other relevant institutions have been working on a new tax code, which should be effective as of 1 January 2006.

Corporate taxation

Income (profits) tax

The following entities are generally subject to income (profits) tax in Uzbekistan:

- Uzbek legal entities, including entities with foreign investments;
- Foreign legal entities operating in Uzbekistan.

Taxable profits include trading profit, capital gains, profits from financial activities and other profit items.

Uzbek legal entities, including those entities with foreign investment and their branches outside the Republic are taxable on worldwide profits. Foreign legal entities carrying out their activity in Uzbekistan are only taxable on their profits from activities performed in the Republic of Uzbekistan.

Tax base

The taxable profit of an Uzbek enterprise is based on statutory accounting profits, adjusted for specific items. All Uzbek enterprises and branches are required to maintain their accounts in accordance with stringent accounting regulations that primarily facilitate tax accounting. The list of expenses that may be deductible for tax purposes is also set by legislation. According to the Law on Accounting, as from 1 January 1998 enterprises must account for both revenue and expenditure on an accrual basis. This norm also extends to the tax accounting. The accounting period for both tax and statutory accounting purposes is calendar year.

Uzbekistan – A Business and Investment Guide

Tax treatment of entities with foreign investment is broadly similar to other Uzbek legal entities. However, compared to other Uzbek enterprises, entities with foreign investment involved in production activities are provided with additional tax concessions that may reduce the tax liability during the early years of operation (please see

Tax concessions for entities with foreign investment).

A foreign legal entity that is considered to have a taxable permanent establishment in Uzbekistan is subject to taxation in respect of the portion of profits relating to the business activity in Uzbekistan. If the accounting records of a foreign legal entity do not allow for the accurate calculation of taxable profits attributable to its business activity in Uzbekistan, taxable profit can be calculated on the basis of the worldwide mark-up of the particular foreign legal entity in a proportion attributable to Uzbekistan.

If a foreign enterprise derives income from sources in Uzbekistan, but does not carry on activities that lead to creation of an Uzbek taxable permanent establishment, it becomes subject to income tax withholding at source as opposed to profits tax (please see

Withholding tax below).

Tax rates

According to the tax code, the highest rate of income (profits) tax is 35%. This rate is usually reviewed by the Cabinet of Ministers on an annual basis and may be reduced. Thus, the effective rate for 2005 is 15% except for entities established with foreign investors, export-oriented enterprises, entities producing children's and certain cultural goods (for which the effective rate may be further reduced), and entities engaged in mass concert performances and auction activities (for which the maximum rate of 35% applies). Profits of foreign legal entities from activities carried out through a permanent establishment are taxed at the rate applicable to Uzbek entities (15%).

Profits (income) repatriated by a permanent establishment abroad are subject to an additional tax at 10%. This additional tax does not apply if payment is made by an Uzbek legal entity directly to the head office of a permanent establishment.

Dividend and interest income received by Uzbek enterprises is taxed at source at the rate of 15%.

Calculation of the tax base

Most types of expenses are deductible for tax purposes. Permanent establishments are eligible to deduct expenses incurred outside of Uzbekistan if they directly relate to their business in Uzbekistan. The following restrictions exist:

- Entertainment, voluntary insurance and telephone (long distance and international) expenses are restricted to (low) limits that are based on an enterprise's turnover;
- Expenses related to the maintenance of an enterprise's cars and reimbursement to individuals for personal cars used for business purposes are not deductible;
- Interest on bank loans is deductible only within the rates established by the Central Bank. Interest on overdue and long-term debt is not deductible.

Capital gains - Capital gains arising from the disposal of tangible and intangible assets are calculated as the difference between the selling price and the net book value (depreciated value) of an asset. The capital gain is included in taxable profits, and the capital losses are deductible (only if the disposed asset had been used for business purposes for three or more years).

Uzbekistan – A Business and Investment Guide

Currency exchange losses - According to the current regulations, taxpayers have option either to recognise exchange losses as expense when incurred or defer such recognition on the balance sheet until the loss is in fact realised along with settlement of related hard currency balance sheet items. Realised exchange losses are deductible for profits tax purpose.

Salary - Salary paid to contracted employees is generally deductible. The main exception relates to banks and insurance companies, which cannot deduct salary for profits tax purposes.

Taxes - All taxes, levies and obligatory charges to state (republican and local) budget and non-budgetary funds are deductible for profits tax purpose, except for infrastructure development tax which is assessed on profits after the payment of profits tax.

Depreciation - For tax purposes, depreciation and amortisation are calculated on a straight-line basis in accordance with the tax code. If different depreciation method is used then the difference between the straight-line method and calculations based on alternative approach is deferred to future periods as a temporary difference.

Depreciation is calculated from the date on which the asset was brought into use until it is fully depreciated, disposed or written off. If the asset is acquired or disposed of during the year, the amount of depreciation should be adjusted accordingly. The maximum annual depreciation rates applicable to different types of fixed assets and intangibles are outlined in the table below.

Depreciable item	Rate
Buildings and other structures:	5%
Cars, tractors, special equipment, computers and related hardware:	20%
Lorries, buses, special cars and trucks, industrial machinery and equipment, agricultural machinery and equipment, office furniture:	15%
Railway, river and air transport vehicles, thermo-technical equipment, turbines, electric and diesel drives, power supply and communication lines, pipelines:	8%
Depreciable assets not mentioned above:	10%
Intangible assets:	Please see below

Intangible assets, including leases and other property rights, are amortised over the asset's useful life or the period of activity of the enterprise, whichever is the shorter. Where an asset's useful life cannot be ascertained, it should be amortised over five years.

According to the tax code, expenses related to geological exploration and developmental works necessary for the extraction of natural resources will be deductible for profits tax purposes through depreciation at a rate of 15% per annum.

For statutory accounting purposes fixed assets can be depreciated using one of the following methods:

- (1) Straight-line;
- (2) Production method;
- (3) Double declining balance method;
- (4) Sum-of -the -years digits method.

Lease - The tax treatment is different for operating and capital lease. For tax purposes, the criteria for lease to consider as operating or capital are defined by the tax code.

Uzbekistan – A Business and Investment Guide

A capital lease is treated by a lessee as a purchase of a fixed asset and is subject to the normal depreciation regime, whereas operating lease payments are deductible from profits for tax purposes.

Losses: deductibility and carry forward - Losses are non-deductible and generally cannot be carried forward or backward. However, there is an exception for losses resulted from the sale below cost to be deductible for income (profits) tax purposes in respect of the export of goods (works, services) of their own production for hard currency. Also losses from fixed assets disposal can be deducted, if the fixed asset has been used for more than three years.

Anti-avoidance provisions - Transfer pricing rules have been established for related parties transactions (i.e. foreign enterprises and their Uzbek subsidiaries, Uzbek enterprises and their subsidiaries outside Uzbekistan, or Uzbek and foreign enterprises owned by the same legal or physical persons). In particular, for profits tax purposes, income received from operations between related parties may be adjusted according to the prices that would be used between unrelated entities. The transfer pricing rules are intended to affect international rather than domestic transactions. Since neither the State Tax Committee nor the Ministry of Finance has issued further guidelines, there is considerable uncertainty regarding the application of the transfer pricing rules at the time of writing.

Tax filing requirements

Effective from 1 January 2003, Uzbek enterprises including entities with foreign investment are required to make three advance instalments of profits tax in each quarter based on estimated profits in the quarter. The instalments are payable by the 15th day of each month. Final quarterly payments based on the actual profit figures are payable no later than five days after the filing deadline for the quarterly tax returns (which is the 25th day of the month following the period of assessment). The annual payment must be made within 5 days after the filing deadline for annual financial statements that is 15 February of the year following the year of assessment and 25 March for entities with foreign investment. Enterprises engaged in commercial activity with quarterly proceeds less than 200 times the minimum monthly wage pay profits tax on a quarterly basis without making advance instalments.

Foreign legal entities carrying out activities through a permanent establishment should file annual tax returns no later than 25 March following the reporting year. Tax is payable within a month after the assessment note of the tax authorities is received.

Withholding tax

If a foreign legal entity does not have a permanent establishment in Uzbekistan, withholding tax should be assessed at source with no deduction at the following rates:

Income type	Rate
Dividend and interest:	15%
Insurance and reinsurance premiums:	10%
International transport and telecommunications:	6%
Royalties, rents, lease income, management fees and other income:	20%

The rates of withholding tax may be reduced under the terms of a relevant double tax treaty (please see Withholding tax rates under effective **Double Taxation Treaties** section) upon

Uzbekistan – A Business and Investment Guide

application to the Uzbek authorities. Treaty protection should be claimed either in advance or within a year of remittance.

Alternative taxation regimes

There are alternative taxation regimes to apply to certain categories of taxpayers. Application of these alternative regimes is mandatory for wholesale/retail sale and public catering companies; and optional for other companies qualifying specific criteria.

Gross margin tax of wholesale/retail sale and catering companies

With effect from 1 July 2003, wholesale and retail sale companies (including small companies and micro-firms) as well as public catering companies are subject to the Gross Margin Tax. This tax is generally calculated on 'Gross income' which is the total revenue less direct purchase costs as per Uzbek accounting rules. The tax rates vary from 16% to 20% depending on the location of the company. Besides, the above companies are subject to property tax and mandatory payments to designated state funds applied on turnover (described further).

The gross margin tax regime also implies separate accounting to be maintained. For instance, a company whose main activity is wholesale/retail – the gross margin tax payer – carrying on production activities along with wholesale/retail should maintain separate accounting for the production and pay standard taxes (or apply any of the other two optional regimes as described below). At the same time, a production company involved in wholesale/retail of goods, unless these are of its own production, should follow the same requirement for separate accounting and pay gross margin tax on its wholesale/retail revenue. It is also worth mentioning that wholesale/retail activity is subject to licensing, and the production company under such circumstance should obtain the license prior to commencement of the sale.

Unified tax payment

Effective from 1 July 2005 small enterprises and micro-firms, other than small companies and micro-firms involved in public catering, trade (wholesale/retail), procurement, brokerage, enterprises providing services per commission contracts may opt for the application of the Unified Tax Payment in lieu of paying all other republican and local taxes, mandatory payments, and duties (except for excise tax, value-added tax and customs duties in respect of imports). An enterprise is eligible for payment of the unified tax payment if it meets criterion based on the number of employees.

Unified tax payment is generally assessed on sales and charged at the standard rate of 13%. Individual notary offices pay unified tax payment at the rate of 50%. Companies engaged in arranging concerts and similar events are subject to the unified tax payment at the 30% rate on their turnover. Agricultural enterprises except agricultural producers paying unified land tax (discussed later in this section) are subject to 6% rate. Lease companies are taxed at 13% on their lease income (margin).

Unified tax

Prior to the introduction of the above unified tax payment small enterprises and micro-firms had the right to be taxed under the Unified tax regime. Under this regime the taxpayers were required to pay Unified tax and other mandatory payments to state funds (Pension Fund, Road Fund, School Education Development Fund). Notwithstanding the introduction of Unified tax payment, small enterprises and micro-firms involved in procurement, brokerage, providing services per commission contracts have the right to retain the old Unified tax regime, paying Unified Tax at the rate of 30% as well as mandatory payments to designated state funds applied on turnover at following rates:

Uzbekistan – A Business and Investment Guide

- Mandatory payment to the off-budget Pension Fund (1.5%)
- Mandatory payment to the Republican Road Fund (0.7%)
- Contribution to School Education Development Fund (1%).

Unified land tax

All agricultural enterprises are subject to unified land tax in lieu of all republican and local taxes (except for excise tax). Taxable base is the land area owned, used or rented by the taxpayer. The amount of tax is determined by basic rates adjusted in accordance with coefficients, which depend on the quality, location and water supply conditions of the land. The Cabinet of Ministers establishes these rates and coefficients.

Fixed tax

Legal entities and individuals involved in certain entrepreneurial activities are subject to fixed tax payable on the basis of fixed rates with adjusting ratio applied. List of activities subject to the fixed tax includes provision of hairstyling services, billiards, rent/sale of video and audio-tapes, catering (by individuals only), computer games.

This fixed tax is a replacement of all republican and local taxes and levies except for import taxes (VAT, excise, import customs duty), state duties, non-budgetary contributions, licences and registration fees.

Value Added Tax

The sale of goods, works and services by a taxpayer is subject to Value Added Tax (VAT). VAT taxpayers include legal entities engaged in entrepreneurial activity in Uzbekistan, except for subjects of alternative taxation regimes. Most trading enterprises, except for a selected few with foreign investment, are not subject to VAT.

Import of goods, works and services by legal entities and individuals into Uzbekistan is subject to import VAT.

Tax rates

Standard VAT rate is 20%. The export of goods, works and services for hard currency is zero-rated. Goods are considered exported for VAT purposes once they cross the customs border and revenue in hard currency is collected. As far as works/services are concerned, these are viewed as having been exported depending on the place of supply rule and may be different for particular types of works/services.

Export to the countries that are parties to the bilateral agreements "On Principles of Indirect Taxation for Exported and Imported Goods" (currently Russia, Kyrgyzstan and Azerbaijan, Moldova), is zero-rated, regardless of the currency of payment and type of goods exported. In addition, VAT on goods and services sold for official use by diplomatic and similar representations and for the personal use of their foreign staff is charged at the zero-rate, on condition that the counter country applies the same principle with respect to Uzbek diplomatic representations (reciprocity).

Tax concessions

There are certain items exempt from VAT, including:

- Insurance and certain financial services;

Uzbekistan – A Business and Investment Guide

- Lease payments, including interest under financial lease terms;
- Import of technological equipment for lease;
- Operations related to bank accounts, currency circulation and securities circulation;
- License fees for intellectual property rights;
- Certain medical services;
- Publications;
- Other activities as per effective VAT regulations.

A VAT input credit is not allowed for expenses related to the provision of works, services and production of goods that are VAT exempt.

Tax base

The tax base is generally the turnover of goods, works or services not specifically exempt from VAT. VAT is charged to customers at the appropriate rate and paid to the authorities, net of input VAT related to production expenses or circulation costs (please see Input tax below).

Input tax

An input tax credit is given with respect to the amount of VAT payable to suppliers in respect of goods (works, services) received during the reported period, which will be used for production of taxable supplies. The credit for the input tax is allowable once the purchaser accepts the goods, works or services and the purchaser receives a "schet factura" (VAT invoice - please see below). VAT paid on imported goods, works or services is treated as input VAT. This VAT is generally creditable against output VAT. In May 2003 new rules for offset of VAT on imported goods were introduced. Previously, the basis for such offset was the customs declaration (GTD) stating the amount of import VAT payable by the importer. According to new rules, import VAT paid at customs is eligible for offset only to the extent that it does not exceed the amount of import VAT payable on the declared customs value of goods (including excise tax and customs duty). This provision is applicable when import VAT payable is calculated by customs officers on the estimated value of imported goods, which may well exceed the declared value. If such is the case, the amount of VAT eligible for offset is considered to be the amount of import VAT **due** on the declared customs value of goods, while the **balance** (the difference between import VAT calculated on estimated customs value and declared value) should be recorded as **cost** of imported goods.

Exporters are eligible for input VAT offset only after the goods have been physically exported from Uzbekistan and respective export proceeds have been received. This new rule is rather restrictive compared to general VAT offset rules applying to domestic sale. Input VAT on goods (works, services and material resources) imported as charter fund contributions can be offset when these goods (works, services and material resources) are further sold or used in taxable production.

VAT incurred on the acquisition of tangible and intangible fixed assets is not recoverable. Instead, this cost should be capitalised with the cost of the asset and depreciated over its useful life.

It is vital that a supplier of goods, works or services issue a VAT invoice according to a prescribed tabular format ("Schet Factura"), since only then is VAT recoverable by the customer. Excess input VAT over output VAT can be offset against a future VAT liability or against other tax liabilities if this excess occurs at the year-end. However, if taxpayer's input VAT exceeds output VAT due to application of zero-rate, such excess can be claimed for refund provided that the taxpayer does not have outstanding tax liabilities.

Uzbekistan – A Business and Investment Guide

Tax filing requirements

Taxpayers are required to file VAT returns by the 15th day of the month following the reporting month and to pay their VAT liability by no later than the reporting date.

Other taxes and charges

Payroll taxes

Like most other CIS countries, compulsory social security charges are calculated and paid by employees and employers on wages. In addition to personal income tax, employees are required to pay the following amounts, charged as a percentage of their salaries:

- 2.5% to the Pension Fund;
- 1% to the Professional Union Fund (if an individual is a member of any professional/trade union).

Please note that expatriates that live in Uzbekistan are exempt from social charges unless the benefits resulting from such social contributions are to be claimed. Such benefits include: pension, sick leave pay, unemployment allowance, disability allowance etc.

Employers must make contributions to social security funds. As of 1 January 2004 a single payment procedure have been introduced instead of an array of mandatory social security contributions with cumulative rate of 37.2% effective in 2003 (35% to Pension Fund, 1.5% to Employment Fund and 0.7% to Trade Union Federation Council). Now employers are to pay a unified social security contribution applied to the total remuneration provided to staff. The rate for 2005 is 31%.

The new contribution should be distributed by tax authorities as follows:

- | | |
|----------------------------------|------|
| • Pension Fund | 30% |
| • Employment Fund | 0.5% |
| • Trade Union Federation Council | 0.5% |

Besides paying their own payroll tax liability, employers are required to deduct their employees' tax liability at source and remit it to the relevant budget/funds. Employers must generally file a quarterly tax return with each of the funds. In addition, tax authorities that are now in charge of collections for the Pension Fund also require monthly reporting prior to the 10th day of each month. Payments of all charges must be made on a monthly basis and on the same date as that cash for salary is withdrawn from the bank.

Effective 1 January 2005, the existing pension system is supplemented with a new cumulative pension mechanism. This mechanism implies obligatory withholding of 1% (in 2005) of employees' monthly employment income by employers. However, this amount withheld will decrease personal income tax liability calculated from the same monthly employment income. Individuals or employers may also make voluntary contributions to the cumulative pension fund. The contributions (both obligatory and voluntary) would be accumulated and maintained by the Narodny (People's) Bank of Uzbekistan.

Beneficiaries of the accumulated pension can withdraw their pension funds when they reach pension age determined by the legislation. The withdrawal would be allowed based on a pension certificate to be issued by a social security department at the place of permanent residency. The

Uzbekistan – A Business and Investment Guide

accumulated pension can be withdrawn prior to the pension age in case (i) of beneficiary's death when his/her accumulated pension funds are inherited as per relevant legislation; or (ii) if an individual immigrates from the Republic of Uzbekistan.

Subsurface use tax (Royalty)

All enterprises and individuals engaged in the extraction or other use of natural resources are subject to a subsurface use tax. The taxable base and tax rates as set by the Cabinet of Ministers are indicated below.

	Business activity	Taxable base	Tax rate
1	Extraction of natural resources and by-products	Volume of extraction	0.3% - 24% Examples: natural gas 58%, precious stones 24%, oil 35%, gold 5%.
2	Utilisation of by-products received during the extraction of natural resources.	Volume of extraction	30% of tax rate for extraction of natural resources

Excise tax

Excise tax has to be paid by all individuals and enterprises that produce, import or export certain products. The Cabinet of Ministers establishes the list of products subject to excise taxes and the applicable rates. The following goods produced in Uzbekistan are subject to excise tax in 2005: vodka – UZS 2,660 per 1 litre, cigarettes with filters - 5,206 UZS per 1,000 cigarettes (4,175 for cigarettes in soft box), cigarettes without filters - 1,476 UZS per 1,000 cigarettes, gasoline –45%, diesels – 40%, natural gas - 19%, etc. As of 1 January 2005, excise taxes for rice, oil and gas condensate and carpets were abolished.

Products sold for export are exempt from excise tax, except for goods specifically listed as subject to excise by the Cabinet of Ministers. Examples of such goods with respective excise tax rates, as set by Resolution of the Cabinet of Ministers #554 of 31 December 1999, are: cigarettes 50%, alcohol 50%, paper 50%, home electronic appliances 50%, UzDaewoo cars EUR3 per 1 cubic centimetre etc. The above goods if exported by the manufacturers and their official distributors for hard currency are not subject to export excise tax.

Excise tax rates on certain goods imported in the Republic of Uzbekistan were also changed. In particular, excise tax for imported fruit/ vegetable juices and furniture has increased from 35% to 70% and from 30% to 50%, respectively. Imported cigarettes are subject to excise tax at the rate of 50% but not less than USD 7 per 1,000 cigarettes. Several new taxable items have been included, e.g. excise tax on imported air conditioners is introduced at 20%. The rate of excise tax on imported pet food was increased from 30% to 70%.

Excise tax rate on imported insulated wires, twin-axial cables and other conductors is increased from 10% to 50%. Imported recyclable paper or cardboard is excluded from the list of excisable imported goods.

The full list of effective excise tax rates is available with PricewaterhouseCoopers office in Tashkent.

Property tax

Under current legislation, property tax is imposed on both individuals and enterprises. In 2005 property tax of legal entities is set at 3.5%. The tax is assessed on residual value of the fixed

Uzbekistan – A Business and Investment Guide

assets adjusted for the effect of revaluation, which should be performed on an annual basis as at 1 January, residual value of intangibles, value of overdue construction-in-progress and equipment not installed in due time. The effective rate is doubled for equipment not installed in due time.

Individuals pay the tax at the rate of 0.5% of the property's value, if property was re-valued as at 1 January 1998 and at a rate of 7%, if the property was not re-valued.

Newly opened enterprises are exempt from property tax for a period of two years from their date of registration. There is also the rate reduction benefit available to companies engaged in production and export of goods (work, services), as already mentioned above. Property tax exemption is also available in respect of equipment financed by a foreign loan for a period of settlement of the loan not to exceed 5 years, and leased property – for a period of lease.

Land tax

Individuals and enterprises owning land plots or rights to their use are subject to land tax. It is applied to taxpayers on the basis of fixed fees established and based on the quality, location and level of water supply to each piece of land. Production enterprises with foreign investments are exempt from land tax for two years from their date of registration. Exemption is also provided to companies involved in projects included in the Strategic Investment Programme of the Republic of Uzbekistan in respect of land plots used for construction for the period of the construction.

Effective from 1 January 2005, new amended rates of land tax were introduced. Most of the new rates represent an increase of about 30% compared to the 2004 rates. In particular, land tax rates imposed on companies in Tashkent range from UZS 1,686,013 per hectare of land to UZS 18,410,535 per hectare of land depending on the zone where the company is located.

Water-use tax

Enterprises using water in their own production are subject to a water-use tax. The tax rate is set by the Cabinet of Ministers and depends on the source of the water (i.e. surface or underground). Effective 1 January 2005, new amended rates of water tax were established. Compared to the previous year, the amendment represents a 30% increase for enterprises of all industries, which will now pay 650 tiyin (UZS 6.5) per 1 cubic metre of surface water and 820 tiyin (UZS8.2) per 1 cubic metre of water used from underground source.

Road tax

Legal entities are required to pay:

- Obligatory payment from turnover: road tax at 1.5% of annual turnover, except for trading enterprises, which are taxed at 1% of annual turnover, and transport enterprises taxed at 2.5% of annual turnover;
- Additional payments which apply to legal entities involved in certain activities: purchase tax at 6% for cars and 20% for lorries and buses; and a levy of USD 400 (without visa and customs payments) for every foreign vehicle entering Uzbekistan.

Effective 1 January 2004 new reporting and payment deadlines for mandatory contributions to the Road Fund are introduced. The new reporting and payment deadlines are 15th and 20th days of the month following the reporting month, respectively. In 2003, the Road Fund contributions were paid in advance on 15th day each month and reported quarterly within the deadlines for quarterly and annual financial reporting.

Uzbekistan – A Business and Investment Guide

The same Resolution also provides for what appears to be a new mandatory payment on the temporary import of motor-vehicles, charged at 6% for cars and 20% for lorries. The current text of the Resolution is not very clear in this regard and further clarification should be sought in order to verify this new payment.

Contributions to School Education Development and Pension Funds

Legal entities are required to make contributions to certain off-budget funds. Such contributions are assessed on the company's turnover at the following rates:

- School Education Development Fund – 1%
- Pension Fund – 0.7%

The contributions are due on monthly basis.

Ecology taxes

All legal entities are liable to a 1% ecology tax assessed on the production cost of goods, works, and services, or circulation costs for trading entities. Effective 1 January 2003, ecology tax base has been expanded, and now it includes all expenses, except for mandatory payments to the state budget, taxes, levies and contributions to the state special purpose funds.

There is also a pollution fee which is assessed on the volume of pollution in excess of the norm of 5 times the MMW (currently UZS 39,175).

Local taxes

There is a number of taxes which local authorities in Uzbekistan are permitted to levy and they enjoy considerable discretion in determining the tax rates.

With effect from 1 January 2002, a new infrastructure development tax was introduced. This local tax replaces two other taxes, which had applied before 1 January 2002 (social infrastructure development tax and maintenance levy). The maximum tax rate is 8% assessed on profits after payment of profits tax.

In addition to property tax, land tax and infrastructure development tax, which were discussed above, local taxes include some other locally set collections and levies.

Tax penalties

Penalties, fines, and interest may be applied if a taxpayer is found to have breached the tax regulations. For example:

- The entire amount of concealed or understated income for profits tax purposes, together with a 100% penalty charged on this amount (in the case of other taxes a 100% penalty is applied on the amount of the understated tax liability). The voluntary disclosure of unintentional mistakes will not result in the imposition of penalties;
- Issuance of a VAT invoice (schet-factura) with violation of the established procedure of sale of goods (works, services) leading to non-payment of VAT is subject to a fine in the amount of 10% of the sale under this invoice;
- Reflection in an invoice of VAT amount by a supplier which is not the VAT payer leads to imposition of a fine equal to the doubled VAT amount shown;

Uzbekistan – A Business and Investment Guide

- Non-issuance of VAT invoices or issuance of invoices of inadequate format (i.e. non-indication or inaccurate indication of taxpayer's identification number and/or other taxpayer's details to be shown on invoices) leads to imposition of a fine in the amount of 10 times minimum monthly wage for each inadequate invoice;
- 10% penalty is levied if a taxpayer fails to account properly for a taxable item;
- 1% per day interest charge (but not more than 10% of the tax due) if a taxpayer fails to file a tax return within the prescribed time limit;
- Use of land plots in excess of plot square defined in appropriate documents is fined at 2% for legal entities and 1.5% for individuals of the land tax amount;
- Interest is charged for late payment at the rate of 0.07% (prior to 1 January 2002 the interest rate was 0.15%) of the outstanding liability per day. As part of recent changes in tax legislation the President of Uzbekistan issued a decree, whereby along with other things it was proposed to reduce the rate to 0.05%, which is yet to take effect;
- For the failure to use cash register machines required by regulations when selling goods or providing services, as well as failure to issue checks, receipts, etc. required by regulations, the fine is levied in the amount of:
 - 100MMW for legal entities. If violation repeated within a year from financial sanction the fine is levied in the amount of 200 MMW;
 - 100MMW for individual entrepreneurs.
- For the use of cash register machines that do not comply with technical requirements, cash register machines with altered fiscal memory software, the fine of 200 MMW is levied on legal entities and individual entrepreneurs. If the same violation is repeated the fine is charged in the amount of 500 MMW.
- For the sales of non-food consumer goods at the food markets, i.e. not in specialised trade places, 100 MMW fine is levied on individual entrepreneurs.
- For the failure to register revenue from goods or services in respective revenue registers the fine of 10 MMW is levied on individual entrepreneur. If the violation is repeated the fine of 50 MMW is charged.
- For the concealment of cash revenue received from customers through specialised trade places or provision of services the fine in the amount of concealed revenue is charged on individual entrepreneurs as well as legal entities.
- For the violation of the established procedures for wholesale trading of consumer goods, the entire revenue received from such activity is seized from legal entities (producers, wholesalers) and the fine in the same amount is imposed.

There has been a change in the relevant legislation effective 1 July 2005, suggesting that the following legal actions can **only** be imposed on entrepreneurs based on appropriate **court decisions** (previously these could have been exercised by tax and other controlling authorities at their own discretion):

- Termination of activities;
- Temporary suspension of activities, excluding temporary suspensions for not more than 10 days related to the prevention of disasters, epidemics and other real threats to human lives and health;
- Temporary freeze of bank accounts, excluding the identified cases of money laundering and funding of terrorism;
- Imposition of financial sanctions other than tax late payment interest or cases when an entrepreneur admits the committed breach and voluntarily pays the respective fines;

Uzbekistan – A Business and Investment Guide

- Confiscation of items related to violation of law (probably, e.g. excise-liable goods lacking excise marks, goods imported with no duty paid, etc);
- Termination or temporary suspension of more than 10 days of licences (permits) for certain types of entrepreneurial activities, excluding licences issued by the commissions of the Cabinet of Ministers or by the Central Bank of Uzbekistan.

Uzbekistan – A Business and Investment Guide

Withholding tax rates under effective Double Taxation Treaties

	Dividends	Interest	Royalties
Austria	5 ⁶ / 15	10	5
Azerbaijan	10	10	10
Belarus	15	10	15
Belgium	5 ⁸ / 15	10	5
Canada	5 ⁶ / 15	10	5 ^{3,4} / 10
Czech Republic	10	5	10
China	10	10	10
Finland	5 ⁶ / 15	5	5 ³ / 10 ⁴
France	5 ⁶ /10	5	0
Georgia	5 / 15	10	10
Germany	5 ¹ / 15	5 ²	3 ^{3,7} / 5 ⁴
Greece	8	10	8
India	15	15	15
Indonesia	10	10	10
Israel	10	10	5 ⁴ / 10
Italy	10	5	5
Japan	15	10	10 / 20
Kazakhstan	10	10	10
Kyrgyzstan	5	5	15
Latvia	10	10	10
Luxembourg	5 ¹ / 15	10	5
Malaysia	10	10	10
Moldova	5 / 15	10	15
(The) Netherlands	5 ¹ / 15	10	15
Pakistan	10	10	15
Poland	5 / 15	10	10
Romania	10	10	10
Russia	10	10	0
South Korea	5 ¹ / 15	5	2 ⁷ / 5
Switzerland	5 ⁵ /15	5	5
Thailand	10	10 ⁹ / 15	15
Turkey	10	10	10
Turkmenistan	10	10	10
UK	5 ⁵ / 10	5	5
Ukraine	10	10	10
Vietnam	15	10	15

* Under Uzbek domestic law the dividend withholding tax rate is 15%.

¹ Where the beneficial shareholder owns not less than 25% of the capital of the paying entity.

² Where one state has identified specific types of interest income which may be subject to a 0% withholding tax, the same treatment is taken by the other state.

³ Where royalties are paid for patents, trademark, know-how, etc.

⁴ Where royalties are paid for copyrights on literature, cinema, musical works, etc.

⁵ Where the beneficial shareholder owns not less than 20% of the voting shares.

⁶ Where the beneficial shareholder owns not less than 10% of the voting shares.

⁷ Where royalties are paid in respect of use or the right to use industrial, commercial or scientific equipment

⁸ Where the beneficial owner holds at least 10% of the capital of the paying entity.

⁹ Where the interest is received by any financial institution (including insurance companies).

Uzbekistan – A Business and Investment Guide

Personal taxation

Tax residence

An individual is considered resident in Uzbekistan for income tax purposes if he/she is present in Uzbekistan for 183 days or more during any 12-month period beginning or ending in a financial (i.e. calendar) year. Although the legislation is silent on the issue, it would be prudent to treat all part-days in the country, such as days of arrival and departure as full days for purposes of determining residency.

Resident individuals are taxed on their worldwide income. According to the tax code, a tax credit in respect of taxes paid abroad will be allowed only if there is a double tax treaty between Uzbekistan and the country concerned.

A non-resident is only taxed on income derived from sources in Uzbekistan. However, the sourcing rules are broadened under the tax code, and non-residents are taxed on income arising from their activities in Uzbekistan. Income payable to a non-resident individual is subject to withholding tax in accordance with the rates applicable to non-resident foreign enterprises (please see **Corporate taxation**).

At the time of writing this Guide, the Uzbekistan Ministry of Finance and State Tax Committee jointly with other relevant institutions have been working on a new tax code, which should be effective as of 1 January 2006.

Corporate taxation However, employment income payable to a non-resident individual is subject to withholding tax at standard rates discussed below. Resident individuals are also subject to the standard tax rates.

Calculation of personal tax

An Uzbek resident is taxed at progressive rates on all earned income, passive income and capital gains (subject to the allowances and exemptions described below).

In 2005 the personal income tax brackets and corresponding rates are established as follows:

New: Gross income, UZS	New Rate
Up to 5 minimum annual wage*	13%
From 5 to 10 minimum annual wage	21%
In excess of 10 minimum annual wage	30%

* Currently, the minimum annual wage is UZS 88,800 (4*UZS 6,530 + 8*UZS 7,835)

The following is the representative list of items exempt from personal taxation:

- Most social security benefits;
- State pensions;
- Compensation for work-related injuries;
- Business trip allowance within the established norms;
- Proceeds from the sale of private property unless the sale relates to entrepreneurial activity;
- Insurance benefits;

Uzbekistan – A Business and Investment Guide

- Money and property received in the course of inheritance;
- Bank interest from Uzbek banks;
- Dividends used for the purchase of shares of a company from which the dividends were received. Recent changes in legislation introduced 5-year exemption for dividend income received from shares of companies created on the basis of privatised enterprises;
- Income from intellectual property;
- Mandatory contributions to cumulative pension funds and interest on those.

Taxation of individual entrepreneurs

Individuals carrying out entrepreneurial activities, without establishment of a legal entity, are subject to fixed income tax. The rates vary depending on the type of activity and area where it is performed. The range of rates with corresponding adjusting ratios is between 1.5 and 17.5 MMW per month. Below are the rate ranges for certain activity types (specific rates are set by area authorities).

Type of Activity	Fixed Rates Per Month
Retail sale without a fixed place (bazaars)	3.0 – 13.5 MMW
Production of goods and their subsequent sale	2 – 4.5 MMW
Utilities	1.5 – 7.5 MMW
Transport services and rent of transport vehicles	2.5 – 17.5 MMW
Other services	1.5 – 5 MMW

* MMW - minimum monthly wage (currently, UZS 7,835)

Individual entrepreneurs may not engage in wholesale and provision of public catering services as these activities can be performed by legal entities only.

Taxation of foreign nationals

Under the tax code, no special rules are applied to expatriates. In calculating the Uzbek tax liability, expatriates who are normally remunerated in hard currency should convert for reporting purposes their hard currency receipts into UZS at the official exchange rate applicable at each payment date.

Expatriate individuals should file a preliminary return within 30 days of arrival in Uzbekistan, and file a final return by 1 April of the year following the reporting year. Any tax liability remaining at the submission of the final return is payable after receipt of the tax assessment issued by the tax authorities, but not later than 1 June of the year following the reporting year.

Operational issues

Financial information

The lack of reliable information is one of the first problems that an investor must overcome when considering an investment in an Uzbek enterprise. Since 1991, when Uzbekistan gained its independence, the country removed the control and constraints of the old Soviet system which prevented the development of the republic; great efforts were made to facilitate a new economic structure that could be more in line with the structures of the world's leading countries. As one of the objectives, new accounting and investing policies suitable for foreign investors coming to Uzbek market were established.

Uzbekistan was the first former Soviet Union republic to apply a Regulation on Cost Composition that differed greatly from the principles applied before. Uzbekistan has recently developed and introduced National Accounting Standards that are in most respects based on the International Accounting Standards. In addition, international accounting practice and requirements served as a basis for a new chart of accounts already applied by companies with foreign investment and other companies as of 1 January 2003.

The transition to international accounting standards is a long and difficult process and the procedures and approaches involved are sometimes difficult for local accountants who are used to and more comfortable with Soviet nomenclature. Accounts are still essentially produced to enable the authorities to assess the tax liability of an enterprise, and accounting is primarily a matter for the legal classification of transactions and provision of supporting documentary evidence. There is a lack of "prudence" concept in the preparation of financial statements, nor are accountants expected to exercise the degree of professional judgement that is a feature of western accounting practice. Most potential investors restate the accounts of the enterprises in which they are considering investing in accordance with International Financial Reporting Standards (IFRS) or another national or group standard so as to portray an understandable and meaningful financial position of the enterprise.

Foreign investors may experience difficulties in their dealings with Uzbek managers, entrepreneurs and state officials because of cultural differences. Uzbek businessmen usually have very different backgrounds from their counterparts in the West, and it should not be assumed that they share the same understanding of business concepts and practices (e.g. they may not consider written contracts as having the same formal status as is the case in Europe or North America). Many of the managers who control newly privatised enterprises were previously managers of enterprises in the Soviet era and may have retained the values and attitudes that characterised that period, such as secrecy and an unwillingness to share information. The chief accountant would have reported to the general director of the enterprise who would report up through the party hierarchy, and the idea of sharing information with third parties is often alien. Frequently, managers expect to be able to obtain investment or know-how from a foreign investor without providing information or ceding management control.

Banking system

The Central Bank of Uzbekistan regulates the banking system in Uzbekistan. The banking sector can be divided into distinct groups: government controlled banks – National Bank of Uzbekistan for Foreign Economic Activity (NBU), UzPromstroybank, Pakhta bank, Asaka bank, Ipoteka bank, etc; banks with foreign investment – ABN AMRO Bank NB Uzbekistan A.O., UzDaewoo Bank,

Uzbekistan – A Business and Investment Guide

UzPrivat Bank, Uzbekistan-Turkish Bank, Soderot Bank and medium and smaller size private banks Hamkor Bank, Capital Bank etc.

The largest bank is the state-owned NBU, which controls most of the commercial bank loan portfolio and around 66% of Uzbekistan's foreign-exchange business⁴. The NBU is a foreign trade and foreign exchange bank, but it also acquires most of the government loans and borrowings including from the funded agencies.

⁴ EIU Country Profile 2003

Employment issues

Uzbek staff

Employment conditions for Uzbek national staff is governed by the Uzbekistan Labour Code and the Law on Employment in Uzbekistan. These are still largely influenced by practices in the Soviet era and consequently tend to favour the employee rather than the employer. The most important features are as follows:

- Written employment contracts are compulsory and are usually valid for an unlimited period. Fixed-term contracts, either for five years or less, or for the duration of a project, are possible under certain conditions. A contract may include a three-month probationary period during which time an employee may be dismissed without reason.
- Notice of dismissal under a fixed-term contract must be provided no later than one week after the last day of the contract, otherwise the contract will be regarded as having been confirmed and the appointment made permanent. Employees are protected against instant dismissal, except in cases of drunkenness, theft and “immoral activity”. Dismissal for other reasons, such as incompetence, must be preceded by a history of under-performance and a minimum of three reprimands. It is recommended that job descriptions be given to all staff, and that they be informed of the disciplinary procedures in force at the enterprise.
- The Labour Code specifies the minimum benefit requirements, although most foreign enterprises usually offer more advantageous packages. Women are guaranteed up to 140 days' paid maternity leave and an option to work on reduced pay for up to a year after the birth of a child. Leave for holidays, paternity leave and family bereavement is also mandatory.
- Employees have the right to strike and may join labour unions.
- The regular work week is 40 hours. For each hour of overtime work, an employee must be compensated at double of his/her normal hourly rate.
- The minimum paid annual vacation is 15 working days. Certain categories of employees (underage workers, working disabled employees) may receive extended paid annual vacation of up to 30 working days.
- Uzbekistan enterprises must pay their Uzbekistan employees in UZS. The minimum wage should not be less than the industry minimum set by the Uzbek government (currently, UZS 7,835).

Expatriate staff

Foreigners wishing to work for an Uzbek enterprise, including those with foreign participation, or for a representative office of a foreign enterprise must possess a valid visa and work permit. These can be obtained from the Ministry of Foreign Affairs and the Ministry of Labour, respectively.

For expatriate individuals accredited with the Ministry of Foreign Economic Relations, Investments and Trade (MFERIT), an accreditation card is a sufficient ground for working in Uzbekistan, and no work permit is required.

International trade issues

Foreign enterprises can trade directly with an Uzbek individual or enterprise, or they can use the services of a foreign trade agent. Although the government maintains strict non-tariff controls over exports and imports, it has said that it intends to shift the emphasis to customs tariffs. In this regard mandatory registration of import contracts with the MFERIT has been abolished as a measure to further liberate foreign trade. However, in order to engage in import/export activities Uzbek enterprises and individuals are required to pass through registration with the MFERIT as participants of international trade.

Import taxes

Import of goods (works, services) is subject to a number of import taxes that include excise tax (as applicable), customs duty (depending on the type of imported items) and VAT on import. There is also a minor Customs clearance fee assessed on customs value of the import/export.

Excise tax is charged as percentage of declared customs value of the imported item or at fixed amounts (e.g. cigarettes). The rates depend on the type of imported items and may deviate significantly (please see **Excise Tax**).

VAT is charged on all imports at the standard rate of 20%. The tax base includes declared customs value, customs duties and excise, if so applied.

Customs duty rates levied on the value of imported commodities vary from 0% to 30% depending on the type of goods (fixed rates are also set for certain goods as minimum, e.g. malt beer rate is 30% but not less than USD 0.7 per litre). There are certain exemptions from import customs duties, for instance:

- Goods imported by foreign legal entities whose total direct investment to Uzbekistan have comprised USD 50 million and more, provided that the imported goods are of their own production and are not in the list of consumer goods;
- Technological equipment imported by foreign investors as their charter fund contributions;
- Goods imported by enterprises with foreign investment for their own needs;
- Goods imported by foreign investors for their own production and personal needs and for personal needs of foreign citizens located in Uzbekistan in accordance with labour contracts established with foreign investors;
- Goods imported for processing and then exported;
- Goods imported for statutory needs, provided that these are not in the list of consumer goods.

Application of customs duties also depends on the country of origin of imported items, in particular:

- No import customs duties are applied to import of goods originated from members of the CIS Free Trade Zone convention (i.e. Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tadjikistan, Turkmenistan and Ukraine);
- Import customs duties are applied at the standard rates to import of goods originated from countries which have been granted most favoured nation status listed in the table below:

Uzbekistan – A Business and Investment Guide

Europe	Austria, Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Israel, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Portugal, Romania, Slovakia, Spain, Sweden, Switzerland, United Kingdom, Cyprus, Malta, Slovenia
Asia	Bangladesh, China, India, Japan, Jordan, Korea, Malaysia, Pakistan, Turkey, Saudi Arabia, Vietnam
America	USA
Africa	Egypt

- Import customs duties are payable at double the standard rates on imports from all other countries.

Goods are classified according to the harmonised system of customs codes. Some examples of the import duty rates are as follows:

Category	Rates
Alcohol:	30% but not less than USD 1 per litre
Cigarettes:	30% but not less than USD 3 per 1,000 cigarettes
Clothing:	10% - 30%
Foodstuffs:	10% - 30%
Household appliances:	30%
Furniture:	10% - 30%
Metals:	10% - 30%
Motor vehicles:	30%

Effective 1 June 2002, there is a special procedure to apply to goods and products imported by individuals for commercial needs. Customs authorities define whether goods and products are imported for commercial needs, which is critical since no import duty would apply to imports for personal needs provided that such do not exceed equivalent of USD 1,000 per person.

Individuals importing goods and products for commercial needs are subject to state registration as individual entrepreneurs operating without establishing a legal entity with the right to perform import and export operations and would be subject to a simplified regime of customs payments – a unified customs duty instead of combination of import customs duty, VAT and levies. However, excise liable goods and products would still be subject to excise tax at the established rates as described above.

The unified customs duty is charged on the declared customs value of goods and products without application of duty-free norms on all categories of goods and products at the following rates:

- 40% for food products (except for flour);
- 70% for non-food products;
- 20% for flour imported for commercial needs.

Uzbekistan – A Business and Investment Guide

Transport and freight-forwarding companies are not allowed to carry out customs clearance procedures on behalf of private individuals whose goods they transport. Customs clearance of such goods and subsequent payment of the unified customs duty should be implemented only by such individuals.

Export duties

In contrast to the import taxes above, export of goods (works, services) is not subject to customs duties that were abolished in 1997.

In accordance with the Tax Code of the Republic of Uzbekistan, excise tax is not assessed on exports, except for export of certain goods, the list of which is determined by the Cabinet of Ministers, unless otherwise provided by inter-governmental agreements of the Republic of Uzbekistan (please see **Excise Tax**).

VAT on exports for freely convertible currency, unless otherwise provided by intergovernmental agreements, is charged at Zero rate.

Export restrictions are imposed on certain goods including basic foodstuffs. Some products, mainly raw materials, are subject to export quotas that are set by the Cabinet of Ministers. Export quotas can be traded on the country's commodity exchanges.

Contacts

Tashkent office:

Contact Names	Address	Communications
Assurance and Advisory services (AA) - Altaf Tapia*	PricewaterhouseCoopers 5, Ivlev Street Yakkasaray District Tashkent 700090 Republic of Uzbekistan	Tel: +998 (71) 120 6101 Fax: +998 (71) 120 6645
Tax Services (TS) - Courtney Fowler** - Abdulkhamid Muminov***		

* Partner, AA, resident in Tashkent

** Partner, TS, regional TS leader, based in Almaty (see below)

*** Director, TS, based in Tashkent and Almaty

Almaty office:

Contact Names	Address	Communications
Managing Partner - Richard Land	PricewaterhouseCoopers Hyatt Regency Office Tower 29/6 Satpaev Avenue Almaty 480070 Republic of Kazakhstan	Main office numbers Tel: +8 (3272) 980 448 Fax: +8 (3272) 980 252
Partner, Regional TS Leader - Courtney Fowler		

Baku office:

Contact Names	Address	Communications
Assurance and Advisory - Richard Land - Nick Blower	PricewaterhouseCoopers Landmark Building, 5 th floor 96 Nizami Street Baku 370004 Republic of Azerbaijan	Tel: +994 (12) 972 515 Fax: +994 (12) 989 932
Tax Services (TS) - Courtney Fowler - Robert Jurik		