

# Enhancing Vat Administration: International Practices and Policy Recommendations for Uzbekistan

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**Abstract:** This study examines the role of VAT compensation and subsidy mechanisms in promoting the formalization of businesses, enhancing transparency, and reducing shadow economic activity. Drawing on international experiences from countries including South Korea, the Netherlands, Poland, Italy, Mexico, Germany, and France, the analysis demonstrates that linking VAT incentives to compliance requirements, electronic accounting, and proper registration effectively encourages businesses to operate legally. The evidence shows that such mechanisms not only improve fiscal efficiency but also strengthen tax discipline and governance in sectors of high social and economic significance. The findings suggest that targeted VAT reforms, combined with digital reporting, licensing, and continuous oversight, provide a practical tool for both increasing government revenue and reducing the informal economy.

**Keywords:** VAT, tax incentives, compensation mechanisms, subsidies, informal economy, business formalization, electronic accounting, tax compliance, fiscal efficiency, economic governance.

## INTRODUCTION:

Efficient tax administration plays a critical role in ensuring fiscal stability, funding public services, and fostering transparency and fairness in any modern economy. Among various forms of taxation, Value Added Tax (VAT) is a key instrument for generating government revenue and promoting equitable tax compliance. Over the past decades, many countries have undertaken significant reforms in VAT administration, introducing innovative practices such as digital tax reporting, electronic invoicing, risk-based audits, taxpayer education programs, and automated compliance monitoring systems. These initiatives have proven effective in enhancing efficiency, increasing compliance rates, and reducing administrative costs.

In Uzbekistan, VAT administration has undergone gradual modernization, including improvements in reporting systems and taxpayer services. However, challenges remain in achieving full compliance, minimizing administrative burdens, and aligning local practices with international standards. Inefficiencies in tax collection and gaps in taxpayer knowledge continue to limit the effectiveness of VAT as a fiscal instrument. Therefore, it is important to analyze the

experiences of foreign countries and identify best practices that can be adapted to the Uzbek context.

The purpose of this study is to examine the key directions in the development of VAT administration in foreign countries and provide evidence-based recommendations for Uzbekistan. By analyzing successful international experiences and identifying practices suitable for local implementation, this research aims to contribute to the development of a more effective, transparent, and fair VAT system. Ultimately, improving VAT administration will not only enhance revenue collection but also strengthen public trust in the tax system and support sustainable economic growth.

## LITERATURE REVIEW

Efficient tax administration is widely recognized as a cornerstone of sustainable fiscal policy and economic development. According to Bird and Zolt (2014), modern tax administration systems are critical for enhancing compliance, reducing evasion, and ensuring fair revenue collection. The development of Value Added Tax (VAT) administration, in particular, has been a focus for many countries due to its efficiency and wide revenue base (Alm & Torgler,

2011).

In developed economies, digitalization has emerged as a key trend in VAT administration. For instance, European countries such as Italy and Spain have successfully implemented electronic invoicing systems that significantly reduce tax evasion and administrative costs (European Commission, 2020). Risk-based audit systems and automated compliance monitoring are widely applied in countries like Germany and France, enabling tax authorities to focus on high-risk taxpayers while simplifying reporting for compliant businesses (Keen, 2013). Furthermore, taxpayer education and support programs have been emphasized in Australia and New Zealand, which have strengthened voluntary compliance and improved public trust in the tax system (OECD, 2019).

Despite these advancements, challenges persist globally. Developing countries often face difficulties such as limited technological infrastructure, insufficient staff training, and low taxpayer awareness (Slemrod & Bakija, 2017). In transitional economies, inefficiencies in VAT administration can lead to revenue losses and distortions in economic activity (Bird, 2015). These challenges highlight the need for context-specific reforms that consider both international best practices and local constraints.

In Uzbekistan, VAT administration has gradually modernized through digital reporting systems, online filing, and improved taxpayer services (IMF, 2021). Nevertheless, gaps remain in compliance, enforcement, and taxpayer education. Studies indicate that adopting practices such as risk-based audits, electronic invoicing, and targeted taxpayer support could significantly enhance the efficiency of VAT administration in Uzbekistan (World Bank, 2020). Comparative analyses suggest that learning from the experiences of countries with successful VAT systems provides actionable insights for Uzbekistan's ongoing reforms (OECD, 2021).

The literature consistently emphasizes that effective VAT administration requires a combination of technological innovation, risk-based enforcement, and taxpayer education. While developed countries offer successful models, developing economies must adapt these practices to local conditions. For Uzbekistan, the application of international best practices, alongside continued modernization of systems and capacity building, is essential to strengthen VAT compliance, improve revenue collection, and support sustainable economic growth.

## METHODOLOGY

This study primarily employs a qualitative research

approach, focusing on understanding and interpreting VAT administration practices in different countries. Qualitative methods allow for an in-depth examination of policies, strategies, and outcomes, emphasizing the context and mechanisms of successful reforms. A comparative analysis was used to systematically examine VAT administration experiences in selected foreign countries. This approach highlights effective practices, common trends, and challenges, which are then evaluated for their relevance and applicability to Uzbekistan.

Data for the study were collected from secondary sources, including academic literature, international organization reports, government publications, and case studies. These sources provide information on administrative structures, reform strategies, and outcomes of VAT implementation. The analysis involved identifying key practices in foreign countries, evaluating their effectiveness, and assessing their potential adaptation to Uzbekistan. The combination of qualitative and comparative methods provides a comprehensive understanding of VAT administration and informs practical recommendations tailored to the local context.

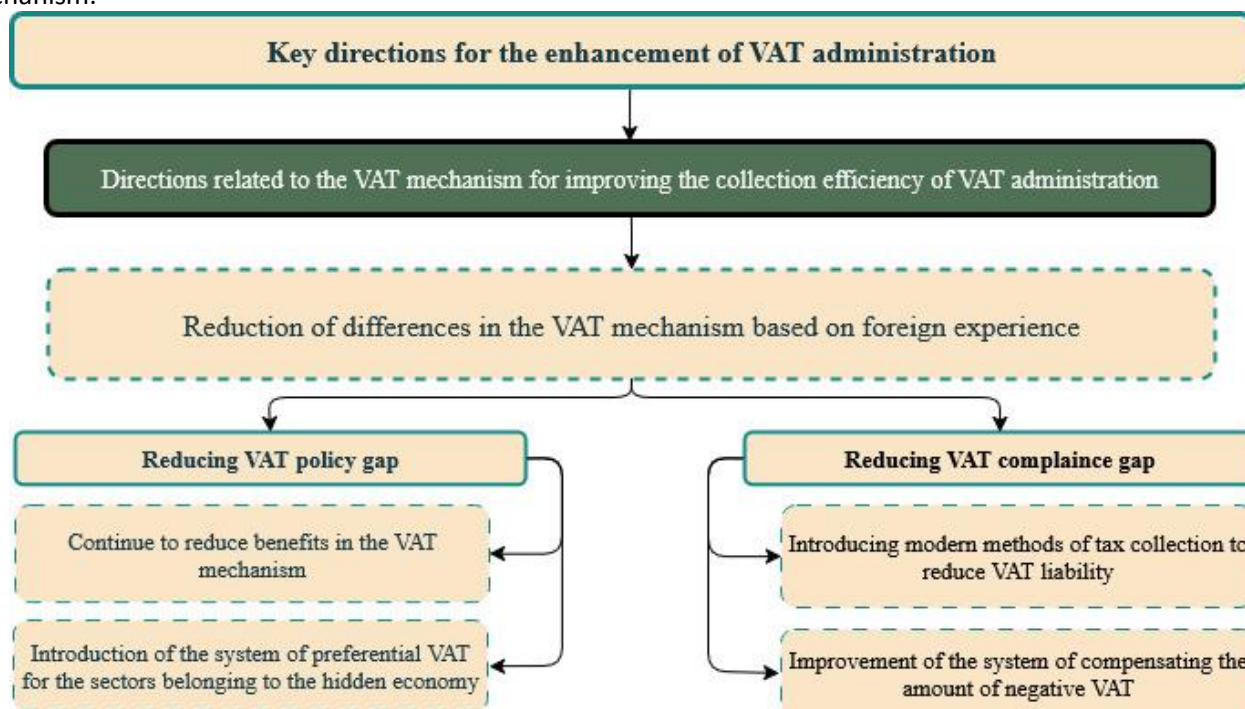
## ANALYSIS AND DISCUSSION OF RESULTS

Based on the analysis of the literature and the study of VAT administration practices in foreign countries, the directions for improving the efficiency of VAT administration in Uzbekistan are summarized in Figure 1. These directions focus on enhancing the VAT mechanism to ensure more effective revenue collection and increased compliance. They include the implementation of digital reporting and e-invoicing systems, the adoption of risk-based audits and compliance monitoring, the strengthening of taxpayer education and support programs, and the development of administrative capacity. By following these directions, Uzbekistan can optimize VAT revenue collection, reduce administrative costs, minimize opportunities for tax evasion, and promote a more transparent and equitable tax system. The strategic application of these measures, as illustrated in Figure 1, is expected to significantly improve the overall efficiency and effectiveness of the VAT administration.

First of all, from a theoretical perspective, the modern model of VAT, considered ideal, presupposes that all final consumption expenditures (excluding intermediate consumption) should be taxed at a single lower rate without any exemptions. This is because VAT exemptions disrupt the VAT chain, resulting in the tax burden remaining with intermediate consumers. Consequently, such

exemptions deprive taxpayers of the right to claim input VAT, encourage informal arrangements, generate additional costs, and lead to the shifting of the tax burden onto others. For this reason, any VAT exemption negatively affects the functionality of the mechanism.

In recent years, Uzbekistan has also shown a tendency to move toward a modern VAT model (similar to New Zealand). This can be explained by the implementation of a single lower standard tax rate and the gradual reduction of exemptions.



**Figure 1. Ways to increasing the efficiency of VAT administration by improving its mechanism**

Taking the above into account, to bring the VAT mechanism closer to its ideal model, it is proposed in the next phase of exemption reduction to recognize legal entities engaged in the trade of pharmaceutical products and the provision of medical services as VAT payers, regardless of their turnover. In addition, it is recommended to abolish VAT exemptions granted for passenger transportation services under unified tariffs.

The pharmaceutical and healthcare sectors are considered fully or partially covered by VAT exemptions. The reason for this is that medicines and services, being socially significant products, are expected to remain affordable for the general population. However, in practice, these exemptions break the VAT chain, depriving pharmacies and medical institutions of the ability to claim input VAT. This leads to increased product costs, forces businesses to work exclusively with entities benefiting from exemptions, creates closed-market

situations, and weakens cooperation with other sectors of the healthcare system, particularly with entities involved in the official sale of medical equipment and devices.

The experience of foreign countries demonstrates a clear approach to this issue. Specifically, Table 1 presents the practices of 10 developed countries, showing that separate reduced VAT rates have been implemented for pharmaceutical products and public transport. For instance, in France and Germany, preferential rates of 2.1% and 7% are applied to medicines. On one hand, this ensures price stability while considering the social needs of the population; on the other hand, it creates conditions to preserve the integrity of the VAT chain. In countries such as South Korea and Australia, pharmaceutical entities are registered as general VAT payers, but the social burden is alleviated through state subsidies and digital accounting systems.

**Table 1**  
**International practices in applying VAT in the pharmaceutical and public transport sectors**

Country	Year Implemented	Pharmaceutical Sector (Rate)	Public Transport (Rate)	Additional Features
Germany	1968	7%	7%	Reduced rate linked to E-Prescription system
France	1979	2.1%	5.5%	Reduced rate for medical products;
Netherlands	1969	9%	9%	Preferential rate for medicine
Australia	2000	10%	10%	Pharmaceutical entities are VAT payers
South Korea	2010	10%	10%	Mandatory online invoicing; automated VAT refund
Poland	2004	8%	8%	VAT refunds only for real exports; 8% tax on transport
Czech Republic	2004	10%	10%	Reduced rate in public transport; monitored by e-Ticket
Canada	2007	5%	0%	Reduced rate for pharmaceuticals; no VAT on transport
Italy	1973	10%	5%	Reduced rate for pharmacy; medical services VAT-exempt
Estonia	2011	9%	9%	Digital monitoring for public transport and medicines

In the public transport sector, countries such as the Czech Republic, Poland, and Estonia apply reduced VAT rates (8–10%), allowing the integration of the sector into the tax system while preserving the VAT chain without artificially increasing service costs for the population. In Canada, public transport is completely VAT-exempt, but this is economically justified as all payments are fully subsidized by the state.

The additional features shown in the table—such as e-invoices, digital monitoring, online control systems, and e-Ticketing—indicate that improving VAT administration in these sectors depends not only on setting rates but also on technological and institutional mechanisms for implementation.

Thus, the analysis shows that for full and effective VAT application in the pharmaceutical and transport sectors, it is important to use preferential rates that do not break the VAT chain, employ electronic monitoring and accounting mechanisms, and coordinate subsidy policies. These experiences can serve as practical guidance for Uzbekistan to modernize VAT and fully utilize its fiscal potential.

In Uzbekistan, implementing this proposal would allow more than 11,000 legal entities engaged in pharmaceuticals and medical services to become VAT payers based on their turnover. According to analyses, if these entities in the pharmaceutical and healthcare sectors are registered as VAT payers, an additional 33.9 billion UZS in VAT revenue could be collected. This amount is not just revenue but a

restoration of the potential fiscal capacity lost due to exemptions. Furthermore, these measures could reduce discrepancies in VAT policy by 3–5%, ensuring fiscal stability and rigor in the country. Therefore, implementing this proposal is a crucial step in bringing Uzbekistan's VAT mechanism closer to a modern model and ensuring the full functioning of the VAT chain.

Although in the ideal VAT mechanism tax exemptions are considered a factor that reduces the efficiency of VAT administration, in practice, various forms of VAT exemptions have been applied worldwide. These are primarily aimed at supporting the consumption of socially significant goods and services, as well as encouraging sectors operating in the shadow economy to formalize their activities. To minimize disruptions in the VAT chain, most countries make wide use of reduced tax rates or fully impose the tax and later return it under certain conditions (in the form of compensation or subsidies).

Foreign experience in attracting sectors operating in the shadow economy to taxation through VAT exemptions in the form of compensation or subsidies. Such reforms not only encouraged business entities to transition to legal activities but also contributed to reducing the shadow economy. In these countries, the sectors where the reforms were applied and the conditions for refunds were key factors in reducing informal activities.

Specifically, in Australia, from 2004, VAT compensation was introduced for small farms and local educational services. Registered activities were



required to issue electronic invoices, creating financial incentives against unregistered activities. As a result, the level of the shadow economy in the country decreased, falling from 10.5% of GDP in 2007 to 7.8% in 2021 (ATO, 2023).

In South Korea, in 2011, a compensation mechanism was introduced for private medical services and the pharmaceutical sector. Under this reform, only fully reporting entities were entitled to tax refunds. Consequently, this system increased transparency in the sector and helped reduce the share of the shadow economy to 22.5% by 2020 (Kwon, 2011).

Similarly, in the Netherlands, in 2009, a refund mechanism in the form of subsidies was introduced for agricultural products and small-scale production activities. By providing benefits exclusively to registered entities, the state successfully formalized agriculture. As a result, in 2021, the shadow economy accounted for 11.8% of GDP (OECD, 2015).

In the same vein, Poland implemented a VAT refund mechanism based on compensation in 2015, targeting education, healthcare, and local services. This system required a single electronic tax ID and QR invoices, thereby attracting taxpayers to the formal system. Consequently, by 2019, the level of the shadow economy had decreased to 12% (WB, 2018).

Moving to Italy, in 2018, subsidies were introduced for environmentally friendly vehicles and renewable energy sectors. The state provided limited support for activities compliant with environmental standards, which encouraged formalization. As a result, the share of the shadow economy decreased to 26.1% (OECD, 2023).

In Mexico, a compensation mechanism was introduced in 2020 for the service sector, particularly in tourism and household services. Through electronic accounting and licensing, state-regulated entities were incentivized. Accordingly, the level of the shadow economy fell to 21.9% in the same year (OECD, 2022).

Overall, the analysis shows that in these countries, compensation or subsidy mechanisms related to VAT refunds contributed significantly to the formalization of the economy. These reforms were implemented through electronic accounting, licensing, ID coding, and monitoring systems. Consequently, the level of the shadow economy decreased by 2% to 5%. This demonstrates that VAT reforms are not only effective for fiscal purposes but also serve as a practical tool for improving tax discipline and reducing the shadow economy.

In general, a review of these foreign experiences

shows that preferential treatment through the VAT mechanism has been applied primarily in the service sectors, providing a model for enhancing transparency and formalizing economic activity.

## **CONCLUSION AND POLICY RECOMMENDATIONS**

International experience shows that VAT compensation and subsidy mechanisms can effectively encourage businesses to formalize, increase transparency, and reduce shadow economic activity. Linking incentives to compliance requirements, electronic accounting, and proper registration ensures that only accountable entities benefit. These measures not only improve fiscal efficiency but also strengthen tax discipline and economic governance, particularly in sectors of social and economic importance. Overall, VAT reforms can serve as a practical tool for both revenue collection and reducing informal economic activity.

It is recommended to implement targeted VAT incentives by introducing VAT refund or compensation mechanisms to promote formalization in key sectors, ensuring that only registered and compliant entities qualify. Adopting electronic reporting and monitoring through digital invoicing and monitoring systems can increase transparency and reduce tax evasion. Linking incentives to registration and licensing will encourage informal businesses to enter the formal economy by making VAT benefits contingent on proper registration and licensing. Policymakers should focus on strategic sectors with high social or economic significance, such as essential services, green technologies, and small-scale production. Finally, maintaining oversight and evaluation through regular audits, monitoring results, and adjusting policies will help maximize compliance, transparency, and the reduction of informal economic activity.

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