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TAXATION OF SMALL BUSINESSES AND INDIVIDUAL ENTREPRENEURS IN UZBEKISTAN

Muxammadjon Erxanov
Independent Researcher,
Tashkent State University of Economics, Tashkent, Uzbekistan

Abstract

This thesis evaluates the simplified tax regime for small business entities in Uzbekistan, with a focus on individual entrepreneurs (IEs), over 1998–2026. Combining an institutional analysis with administrative data for 2021–2025, early post-reform data for the first quarter of 2026 and a threshold-notch model, it reaches three conclusions. First, the pre-2026 system was locked in: more than four-fifths of IEs paid a fixed tax unrelated to income, and the regime structure did not change as the IE population grew. Second, the nominal threshold lost half of its real value, while the four-fold gap in turnover-tax rates between IEs and legal entities magnifies the threshold distortion for IEs. Third, after the fixed tax was abolished, the number of active IEs rose by 8.5% in a single quarter. The 2026 reform corrects the main design flaws, but a permanent smoothing mechanism and closer alignment of rates across legal forms are still required.

Keywords: presumptive taxation; turnover tax; individual entrepreneurs; tax thresholds; notches; informality; Uzbekistan.

JEL classification: H21, H25, H26, H32, L26, O17.



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Introduction

Taxing small firms efficiently and equitably is a persistent challenge for public finance in emerging economies. Small enterprises are numerous, heterogeneous and only partly visible to the tax administration, so governments trade the accuracy of the tax base for ease of administration. Presumptive and turnover-based regimes are the standard response, yet they create distortions of their own: liabilities detached from actual income, discontinuities at eligibility thresholds and incentives to favour one legal form over another (Keen & Mintz, 2004; Kanbur & Keen, 2014; Wen, 2023).

Uzbekistan is an instructive case. Small business accounted for 54.3% of GDP in 2024 and 51.5% in January–September 2025. On 1 April 2026 there were 1,208,341 active small business entities, including 324,090 IEs. Although the unobserved economy declined from 34.8% of GDP in 2024 to 22.9% in January–June 2026, it remains substantial.

Two consecutive reforms took effect in 2026. From 1 January, the fixed personal income tax for IEs was abolished and replaced by a 1% turnover tax (Resolution PQ-247; Law ZRU-1104). From 1 June, Decree PF-100 raised the threshold for mandatory transition to the general regime from UZS 1 billion to 12,000 base calculation units (BCU) and introduced an optional simplified 6% VAT for trade, catering and services. Since 1 September 2026 the threshold has stood at UZS 5.28 billion, or about USD 444,000.

The study asks three questions: how the pre-2026 mechanism distributed IEs across regimes, activities and regions; how large the distortions created by the unindexed threshold and the rate differential between legal forms are; and whether abolishing the fixed tax changed registration behaviour. Three hypotheses are tested. **H1 (regime lock-in):** a fixed tax detached from income is associated with a static distribution of IEs across regimes. **H2 (notch**

magnification): an unindexed threshold combined with a lower turnover-tax rate for IEs produces larger threshold distortions for IEs. **H3 (formalisation response):** replacing the fixed tax with a low proportional turnover tax is followed by above-trend growth in registered IEs.

Data and methodology

The analysis draws on annual counts of active IEs for 2021–2025 from the SIAT database of the National Statistics Committee (14 regions, four activity groups and three tax regimes), regional counts on 1 April 2026, macroeconomic indicators including December-on-December inflation, and the relevant legal acts.

Growth is summarised by compound annual growth rates (CAGR) and a log-linear trend estimated by ordinary least squares. For H1, linear trends are fitted to each regime's share, and a Pearson χ^2 test of independence between regime and year is complemented by Cramér's V. Regional heterogeneity is examined with Pearson and Spearman correlations, β- and σ-convergence and the Herfindahl–Hirschman index (HHI). For H3, regional growth in Q1 2026 is compared with average quarterly growth in 2021–2025 using a paired t-test and the Wilcoxon signed-rank test (n = 14). The real value of the threshold is obtained by deflating with the cumulative consumer price index.

H2 is evaluated with an adaptation of the notch model of Kleven and Waseem (2013). For a firm with turnover Y, profit margin m and value-added ratio v, after-tax profit below and above the threshold Y^* is:

$$\pi^B(Y) = (m - t)\cdot Y \quad \text{for } Y \le Y^*; \qquad \pi^A(Y) = [m(1 - \tau) - 0.12\cdot v]\cdot Y \quad \text{for } Y > Y^* \tag{1}$$

where t is the turnover-tax rate (1% for IEs, 4% for legal entities) and τ is the income-tax rate (15%). The upper bound of the dominated region, Y^D, satisfies:

$$Y^D / Y^* = (m - t) / [m(1 - \tau) - 0.12\cdot v] \tag{2}$$

A ratio above one implies a dominated region just above the threshold in which no optimising firm should locate. All calculations were performed in Python (SciPy).

Results

Regime lock-in. Between 2021 and 2025 the number of active IEs grew from 217,207 to 298,831, an increase of 37.6% (CAGR 8.3%). The regime structure, however, barely moved: in every year 81.0–83.1% of IEs paid the fixed tax, 16.2–17.9% paid the turnover tax and only 0.7–1.1% were in the general regime (Table 1). The χ^2 test rejects independence ($\chi^2(8) = 860.1$, $p < 0.001$), but a Cramér's V of 0.018 shows that the association is negligible in economic terms. Participation in the general regime rose only from 6.9 to 11.0 per 1,000 IEs. H1 is supported.

Table 1. Active individual entrepreneurs by tax regime, 2021–2025

Tax regime	2021	2023	2025	CAGR, %	Share trend, p.p./yr (p)
Fixed personal income tax	179,962 (82.9%)	194,982 (81.0%)	245,041 (82.0%)	8.0	−0.19 (0.57)
Turnover tax	35,739 (16.5%)	43,137 (17.9%)	50,502 (16.9%)	9.0	+0.09 (0.75)
VAT + income tax	1,506 (0.7%)	2,625 (1.1%)	3,288 (1.1%)	21.6	+0.10 (0.10)
Total	**217,207**	**240,744**	**298,831**	**8.3**	–

Source: author's calculations based on National Statistics Committee data.

The fixed tax also produced vertical inequity: two IEs in the same activity and district earning UZS 20 million and UZS 90 million a year could pay roughly the same amount. Retail trade dominates the sectoral structure (47.5–49.1% of IEs);

the only statistically significant shift is the decline of crafts from 10.0% to 7.5% (trend −0.76 p.p. per year, p = 0.046).

Regional heterogeneity. All regions grew in 2021–2025, but at rates ranging from 18.1% in Bukhara to 78.9% in Karakalpakstan. Growth is unrelated to initial size (Pearson r = 0.006, p = 0.985), and there is no β-convergence (β = −0.0002, p = 0.993). Disparities widened slightly: the coefficient of variation rose from 0.433 to 0.462 and the HHI from 839 to 856 (869 in April 2026), driven mainly by Tashkent city, whose share increased from 12.2% to 15.2%.

Early post-reform evidence. In the first quarter without the fixed tax (31 December 2025 – 1 April 2026), active IEs increased from 298,831 to 324,090, or by 8.5%, roughly four times the average pre-reform quarterly rate of 2.0%. The difference is significant across regions (paired t(13) = 3.71, p = 0.003; Wilcoxon W = 9, p = 0.004). Thirteen of the fourteen regions grew, led by Fergana (20.3%), Jizzakh (16.2%) and Tashkent city (14.7%). These results are consistent with H3 but are not causal: the list of activities open to self-employed persons was cut from 104 to 72, registrations may be seasonal and the April data come from a different release. The increase is therefore best read as formalisation through reclassification and registration rather than as new economic activity.

Threshold erosion and notch incentives. The UZS 1 billion threshold introduced in January 2019 was meant to be reviewed at least every three years but remained unchanged for more than seven. With cumulative inflation of 102.7% between December 2018 and December 2025, its real value fell to UZS 0.49 billion in January-2019 prices, a loss of 50.7%. The new threshold of UZS 5.28 billion is 2.61 times the original real value.

A higher threshold, however, does not remove the discontinuity. For a baseline firm with a 15% margin and a 30% value-added ratio, the tax burden jumps from 1% of turnover (IE) or 4% (micro-firm) just below the threshold to 5.85% just above it, an additional liability of about UZS 256 million for an IE and UZS 98 million for a micro-firm. The dominated region therefore extends from UZS 5.28 billion to UZS 8.08 billion (+53%) for an IE, but only to UZS 6.35 billion (+20%) for a micro-firm (Table 2). H2 is supported.

Table 2. Width of the dominated region above the threshold, % of the threshold

Margin m	Value-added ratio v	IE: standard regime	IE: first-year exemption	Micro-firm: standard regime	Micro-firm: first-year exemption
0.10	0.30	83.7	40.6	22.4	0
0.15	**0.30**	**53.0**	**22.8**	**20.2**	**0**
0.15	0.50	107.4	55.6	63.0	22.2
0.20	0.30	41.8	15.9	19.4	0

Note: the baseline case is shown in bold; zero means that no dominated region exists. Source: author's calculations based on equation (2).

The one-year income-tax exemption narrows the dominated region considerably (to +23% for the baseline IE), but only temporarily. The optional 6% VAT helps firms with high value added (for m = 0.15 and v = 0.50 it shrinks the IE dominated region from 107% to 56%), yet offers no relief to low value-added retail IEs. Internationally, at about USD 444,000 the Uzbek threshold is two to four times higher than in Germany, the United Kingdom and France and above Russia's, but below those of China and Kazakhstan.

Conclusions and policy recommendations

Before 2026, the taxation of IEs functioned primarily as a low-cost entry regime rather than an instrument linked to economic capacity. The fixed tax simplified administration and encouraged registration, but it froze the regime structure: barely 1% of IEs ever reached income-based taxation. In the terms of Kanbur and Keen (2014), the threshold partitioned taxpayers into stable compliance groups, while the absence of any link between liability and income generated vertical inequity and an incentive to stay small. The 2026 reform addresses the three most visible flaws: it restores the link between liability and activity through a low proportional rate, indexes the threshold and softens the transition to the general regime. Mandatory QR-code payments further strengthen the information base of the tax administration.

Two design tensions remain. The rate differential between IEs (1%) and micro-firms (4%) invites legal-form arbitrage and the artificial splitting of businesses into several IEs, and it magnifies the IE notch. Moreover, transition relief is temporary: once the one-year exemption and the 6% VAT option expire, bunching below the threshold is likely to re-emerge. Five measures follow:

1. Replace temporary relief with a permanent smoothing mechanism, such as a phase-in band above 12,000 BCU in which VAT and income tax apply gradually over two to three years, or a turnover-tax rate that rises within the band.
2. Narrow the rate differential between legal forms as turnover grows (for example, keep the 1% rate up to UZS 1 billion and apply a higher rate up to 12,000 BCU), and use digital payment data to detect artificial fragmentation.
3. Preserve the automatic link between the threshold and the BCU and publish the indexation rule.
4. Introduce targeted support for crafts, whose share among IEs is declining, and region-specific programmes for lagging regions.

5. Publish anonymised distributions of taxpayers by turnover band and regime, and use the October–November 2026 business census to update registers.

Future research should use administrative microdata to estimate bunching around the old and new thresholds and, once full-year 2026 data are available, assess the revenue and formalisation effects of the 1% turnover tax.

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