



## Application of foreign experience in expanding the taxable base by reducing shadow economy

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**Abstract.** The article is devoted to the consideration of the core factors impacting formation and development of the “shadow economy”, including some organizational and legal aspects of reducing and eliminating the “shadow economy”, the amount of cash payments in financial transactions, direct criminal liability for certain economic deeds in our national legislation, as well as and ways to effectively combat the “shadow economy”. Moreover, the article provides conclusions on improving the efficiency of penalties and other legal measures to combat illegal economic activity and effective use of public oversight mechanisms, thereby optimizing the taxable base.

**Key words:** “shadow economy”, cash payments, penalties and other legal sanctions, liability, differentiation in holding liable, preventive measures, public oversight, anonymous appeals.

**Introduction.** First of all, it should be noted that there is no unified internationally admitted interpretation of the “shadow economy” concept and no clear way to determine its scope. The “shadow economy” term is also used in the literary sources to refer to “informal economy”, “unofficial economy” and various other terms. Shadow economic activity is mainly latent, that is, it has a hidden nature, and the technique of its implementation are characterized by constant variability, complexity, and the fact that it is carried out through various schemes. This means that they are difficult to identify and make public.

In addition, the high level of “shadow economy” in the country results in a high level of corruption. In low-income countries, as the scope of the “shadow economy” increases, so does the level of corruption.

There is also a positive correlation between the “shadow economy” and inflation, and a negative correlation with the tax burden. The analysis of informal employment with the “shadow economy” demonstrates that in developing countries, the number of informally employed citizens is greater than the number of citizens engaged in formal employment.

With the expansion of informal economic activity, the involvement of the economic entities, which are honestly doing their business, is also considered a threat to economic security.

**Literature review.** Matthew (2000) acknowledges that some aspects of illegal economic activity (facilitating the transition to a market economy, spending at least two-thirds of revenues in the shadow economy on the formal economy, etc.) indirectly make a positive impact on other sectors. Similarly, the “shadow economy” is a natural phenomenon for the countries in the transitive period, which promotes the organization of

the formal sector, but the long-term existence of the shadow economy makes a negative impact on the country's development.

In general, the "shadow economy" negatively impacts the development of the state and society, and serves to raise unfair competition between those who are engaged in doing legitimate business activities and those engaged in illegal activities. If it is not effectively combated, it will undermine the socio-economic situation in the country, as well as undermine the rule of law, increase corruption, unemployment and other socio-economic problems, and jeopardize the security of the state and society.

In general, there are several ways to reduce the "shadow economy", its transfer to the formal sector and efficiently combat it.

While the national economic development will result in the reduction in the "shadow economy", the share of the "shadow economy" in countries where electronic payments will prevail, will be small, as the digital economy can solve the problem of the "shadow economy".

Furthermore, other researches considered the fight against corruption as the most efficient way to combat the "shadow economy" (Faye, 2017).

The Organization for Economic Cooperation and Development (OECD) has proposed three basic areas to reduce the share of the shadow economy - training taxpayers and simplifying law enforcement, reducing opportunities for illegal activities and raising the transparency, as well as strengthening social standards (OECD, 2017).

According to the World Bank, in 2017 the average level of shadow economic activity throughout the world constituted 22.5% of GDP, in Azerbaijan - 66.12%, in the Ukraine - 46.12%, in Russia - 39.29%, in Turkey - 24.95%, in India - 16.55%, in China - 10.17%, in the United States - 7.69 %. At the same time, globally, these figures are projected to decline to 21% by 2025 (Faye, 2017).

According to the researches done in this field, there are 10 main factors influencing the "shadow economy" are the tax burden, perfect governance and corruption, regulations, public services, taxpayer behavior, preventive measures, the level of development of the formal economy, self-employment, factors such as unemployment and the share of the agricultural sector in the economy (Schneider and Buehn, 2018).

**Analysis and results.** In general, there are several ways to reduce the "shadow economy", its transfer it to the formal sector and effectively combat it.

While the national economic development will result in the reduction in the "shadow economy", the share of the "shadow economy" in countries where electronic payments will prevail, will be small, as the digital economy can solve the problem of the "shadow economy".

The Organization for Economic Cooperation and Development (OECD) has suggested three main focus areas to reduce the share of the shadow economy - training taxpayers and simplifying law enforcement, reducing opportunities for illegal activities and enhancing transparency, strengthening social (OECD, 2017).

In this regard, this article focuses on some organizational and legal aspects of reducing and eliminating the "shadow" economy.

The first focus area is related to cash payments, which is one of the biggest risks. According to the data of the Central Bank, as of January 1, 2020, money supply in the national currency amounted to 62785.8 billion UZS, of which 24246.0 billion UZS or

38.62% of circulating cash (excluding cash in the national currency at the cash offices of the Central Bank and commercial banks). The large amount of cash circulation in our country makes a significant impact on the further development of illegal economic activity. Particularly large denomination banknotes, including foreign currency banknotes, can be used as a convenient tool for money laundering or smuggling of assets out of the country. The advent of cutting-edge technology, new cryptocurrencies, and the exchange of new and decentralized goods and services through blockchain technologies increase this risk (Bulletin, 2020).

In order to reduce such risks, the Russian Federation has introduced compulsory online registration of cash payments since 2017, and the person who made the payment in cash has the opportunity to verify the legality of the transaction through a issued QR-code payment check. In Denmark, all payments over 10 000 Danish kroner (1 445 USD) have been made electronically since 2013, and companies are required not to accept cash in excess of 50 000 Danish kroner (7 228 USD) or not to pay such or greater amounts (OECD, 2017).

In 2015 in France restriction were imposed on payments in excess of 1 000 Euro in cash between citizens and entrepreneurs, as well as between entrepreneurs themselves. In Austria cash expenditures (including salaries) in the construction sector in excess of 500 Euro are not deductible for tax purposes. In addition, it is prohibited to pay monthly salaries in cash in the construction industry (except for admissible excuses). It should be noted that as a result of practical measures undertaken in Sweden in 2015, only 2% of the total value of all payment transactions are made in cash.

The second focus area is that our national legislation does not imply direct, i.e. direct criminal liability for some economic activities and deeds and there are risks associated with thereto.

In compliance with the new version of the Tax Code, which has been introduced this year, relevant mechanisms have been introduced for the accounting and refund of overpaid and overcharged taxes, as well as the payment of interest on overpaid taxes.

This can result in the tax fraud by individuals who abuse this mechanism.

In the majority of foreign countries (Slovenia, France, Germany) criminal liability has been established for fraudulent tax refunds (FATF 2012-2018). In addition, in the United States, Germany, Canada, Singapore, Japan, the Philippines, Thailand and many other countries, individuals shall be held administratively or criminally liable for non-payment of taxes in due time or evasion of taxes, as well as illegal income received from all illegal activities (bribery, fraud, financial pyramids, etc.).

There are no legal restrictions on the introduction of this practice in Uzbekistan. Liability is determined for making illegal financial transactions (remittances, loans, credits, leasing, etc.) without accomplishing proper registration in foreign countries.

In Turkey, for example, there is criminal liability for illegally lending for getting profit. Therefore, it is proposed to establish liability for illegal provision of financial services (debt, credit, leasing, remittances) for getting profit. Finland implements the practice of criminal liability for concealment, transfer and sale of certain goods in connection with certain activities related to foreign economic activity, which are at high risk of illegal economic activity on a global scale, in particular, when it is known to an individual that they have been illegally imported.

However, in our country there is no direct responsibility for such an offense. It should be noted that the introduction of criminal liability for some of the acts specified above, is not only a requirement of the times, but also one of the obligations of the state under international agreements to which Uzbekistan is a party. In particular, in compliance with the UN Security Council Resolution 1617 (2005), the FATF recommendations are the international standards that are binding on UN member states. According to the standards of the FATF (Recommendation 3), the concept of money laundering should cover all serious crimes, including a wide range of predicate crimes.

The third focus area deals with the effectiveness of sanctions and other legal measures to combat illegal economic activities.

It is determined that a person commits an offense in reliance upon the likelihood of the offense being detected, and that the amount of the sanction is insignificant, so it is important to ensure that the person is inevitably prosecuted for the offense, but not due to strengthening the sanction.

This is obvious from the example of the efficient application of a wide range of sanctions for economic offenses in foreign countries.

In particular, criminal liability of legal entities, differentiation (stratification) in prosecution, confiscation of property as a punishment, defamation of individuals through the media will enhance efficiency of the fight against illegal economic activities. In Ireland, the system of holding liable for economic offenses is aimed at the voluntary elimination of the offense (Kimberly, 1998).

Sanctions applied for the same offense are differentiated according to the degree of cooperation with regulatory or law enforcement agencies, voluntary elimination of the consequences of the offense and the recurrence of the offense.

Therefore, it is necessary to differentiate and further liberalize the measures of responsibility depending on the level of individual participation (cooperation) in the detection and elimination of economic offenses. This creates a legal foundation for establishing mutual respect, trust and effective communication between the two parties.

The fourth focus area requires efficient use of public oversight mechanisms in the fight against and prevention of illegal economic activities.

The research has shown that strengthening the oversight and increasing the number of inspections in the fight against and prevention of illegal economic activities require the mobilization of financial costs and resources (human, time, technological, etc.). In addition, in this regard there should be admitted such factors as inability to mobilize all resources to detect economic offenses, as well as low efficiency of the oversight strengthening.

In the process of this problem, solution priority should be given to other low-cost measures, such as raising the culture of obedience to the law, effective use of the institution of compliance, voluntary reporting of violations, and combating violations through public oversight mechanisms.

In particular, in Ireland, it is noteworthy that regulators rely on public oversight mechanisms and the help of honest taxpayers to combat the shadow economy ([www.revenue.ie](http://www.revenue.ie)).

In this case, citizens, entrepreneurs, public associations, trade unions are provided with the opportunity to report cases of tax evasion and unhealthy competition by various

means, electronically, orally or in writing, including anonymously, and the identity of applicants is not disclosed.

In Singapore, a reward of 15 per cent of the amount detected and levied, but not exceeding the amount of 100 000 Singapore dollars, is paid on the basis of information provided by the informant under anonymity conditions (<https://www.iras.gov.sg>).

However, the existence of a rule in our national legislation that anonymous appeals are not considered, and the fact that some individuals do not report violations to the relevant authorities for fear of disclosure, makes a negative impact on the efficient fight against economic offenses.

The data demonstrate that the shadow economy exists in all countries of the world, regardless of the political system, living standards of citizens and other socio-economic factors.

Common cases of the shadow economy for all countries are the following: the amount of taxes and social contributions, the quality of public institutions, corruption in the state apparatus, intensity of government regulation, intensity of prevention of illegal economic activities (sanctions, fines and penalties), socio-economic development, self-employment rate, tax ethics.

According to a 2019 study by the Institute for Forecasting and Macroeconomic Research of the *United Nations Development Program (UNDP)*, the size of the shadow economy in the country constitutes 40-50% of GDP (<https://www.spot.uz/ru/2020/09/09/shadow>). The highest rates of illegal economic transactions have been recorded in economic activities such as “repair of vehicles and motorcycles”, “tourism, entertainment and recreation”, “real estate transactions”. In these areas, the level of concealment of real income and paying “salary in envelopes” constitute 32-37%.

In addition, there are construction, catering, agriculture, trade and communications sectors, where the concealment of income and “salary in envelopes” is at the level of 20-27% of the total amount of relevant income and salaries. In terms of significance, the following reasons have been identified: lack of funds, problems with settlements, payments, disbursement of funds, quality of service, high interest rates.

Currently the country is undertaking comprehensive measures to reduce the level of the shadow economy by creating additional business facilities. In particular, the foreign exchange market has been liberalized, a new tax system has been introduced, and the number of about 100 permitting and licensing rules has been reduced. As a result, the share of the informal sector in industry has fallen from 20% to 6% in the last 5 years. In this regard, the Decree of the President of the Republic of Uzbekistan PD-6044 “On measures to radically improve the licensing and permitting procedures” was adopted on August 24, 2020. In reliance upon this Decree, a total number of 70 types of licenses and 35 types of permits have been abolished since January 1, 2021. In addition, the validity of all licenses and permits that expire in 2020 has been extended until January 1, 2021 (Decree, 2020).

On August 4, 2020, an online seminar on the topic “The shadow economy and the fight against it” was held with the participation of experts from the World Bank and relevant ministries and departments. A special working group was established following the outcomes of this seminar. Currently, members of the working group are studying the world’s experience in combating the shadow economy in collaboration with World Bank

experts. Moreover, the MIMIC model is being developed in collaboration with World Bank experts to measure the scope of the shadow economy in Uzbekistan.

For reference: The MIMIC model is a world-renowned calculation method for determining the share of the shadow economy in a country's Gross Domestic Product. With the help of this model, it will be possible to monitor the development of the shadow economy in Uzbekistan over the years.

Furthermore, the World Bank experts have agreed to conduct a regional and sectoral analysis of the shadow economy, and the level of the shadow economy in Kashkadarya region of the Republic is currently being studied. As a result of this type of analysis, the information on the shadow economy in the Republic is studied on more comprehensive basis and specific measures are determined by sectors and regions.

Consumers' awareness and demand for their obligations and rights results in a decline of the shadow economy as well. Therefore, the use and popularization of new online cash registers is considered one of the most convenient tools not only to enhance consumer safety, but also to monitor the timely payment of taxes by the tax authorities.

Currently, there are 103 994 online cash registers in operation in the country, and by January 2022, the level of the shadow economy in certain sectors is expected to decrease significantly due to the transition of certain businesses to compulsory online cash registers.

Another way to reduce the shadow economy and the level of corruption is the practice of declaring the income of public officials. In many developed countries, the level of corruption has been reduced with the help of this technique. At present, it is agreed to hold a seminar with experts of the International Monetary Fund on the topic "Declaration of income of public officials" and in cooperation with the relevant ministries, committees and agencies, a working group has been established. In this way it is expected to comprehensively study this problem and elaborate the ways of further introduction of this practice in Uzbekistan.

Changes in the tax system have made a positive impact on the fight against the shadow economy as well. In particular, according to the tax authorities, as a result of the simplification of the system of self-employment, so far about 600 thousand citizens have been able to shift their activities to the formal sector. However, the level of informal employment remains high in construction, trade and catering, transportation and other services sectors. As a result of changes in the VAT system, the number of VAT payers increased by 20% per year and now accounts for more than 100 000 people. Currently relevant activities are being implemented to optimize the tax system again, and the changes are expected to cause a sharp decline in the share of the shadow economy.

In January-June 2020, the smuggling of goods worth 140 billion UZS (1.4 times more than in the corresponding period of 2019) was prevented within the framework of 4 670 cases. These figures indicate a large share of the shadow economy in the customs system. Currently experts from the Ministry of Finance of the Republic of Uzbekistan and the World Bank are studying efficient technique to develop the customs system and reduce the share of the shadow economy. In particular, relevant activities are being implemented to establish a post-customs audit system.

In accordance with the Resolution of the Cabinet of Ministers of the Republic of Uzbekistan No. 807 dated October 6, 2018 "On measures to expand the use of most advanced information and communication technologies in tax administration", the pilot project on introduction of compulsory registration of electronic invoices by all business

entities in Navoi and Syrdarya regions and Chirchik town of Tashkent region has been launched.

During the pilot project (lasted from October 15 to February 1), the number of users of the electronic invoicing system reached 17 000. According to the results of the pilot project, the Government of the Republic of Uzbekistan adopted Resolution No. 522 dated June 25, 2019 “On measures to improve the use of electronic invoices in the system of mutual settlements”. In compliance with this Resolution, since January 1, 2020, all business entities have switched to the compulsory execution of electronic documents.

As of January 1, 2021, 23 enterprises have received the status of operators in the electronic invoice management system. In addition, 11 companies have expressed their interest in becoming an operator of electronic invoicing and document management systems, and nowadays the process of inter-system integration with the roaming operator is going on.

This implies that by 2021, over 30 electronic invoice document management system operators will be able to provide quality services to businesses. In addition, this fact will enable to ensure healthy competition between operators, lower service fees, high technical capabilities and provide many other benefits.

As of January 1, 2021, the electronic invoicing information system is used by over 375.2 thousand business entities. By this time they have developed over 23 million electronic invoices, and the total turnover (excluding value added tax) constitutes 813.4 trillion UZS, and the value added tax amount equals to is 84.7 trillion UZS.

The order of gradual introduction of “online” cash registers has been approved and is currently being implemented within the framework of ensuring efficient interaction and integration of information systems of government agencies and organizations, as well as information processing and storage.

The purpose of introducing this system is to create a convenient and reliable service that will help businesses to optimize costs and accounting, enhance revenue and create timely and best services for customers.

In addition to online cash registers, a data exchange platform - a virtual cash register system with the function of sending information about settlements with the population online to the tax authorities through cash or bank plastic cards through retail outlets (service points) is being implemented.

The State Unitary Enterprise “Scientific and Information Center of New Technologies” under the State Tax Committee of the Republic of Uzbekistan is admitted as a fiscal data operator performing the functions of independent and continuous reception, processing, cryptographic protection and storage of tax information received online.

As of January 1, 2021, the number of online cash registers or virtual cash registers constitutes 103 994. In particular, 25 885 entities in Tashkent, 10 424 entities in Tashkent region, 9 552 entities in Samarkand region and 8 348 entities in Fergana region use online cash registers or virtual cash registers.

In compliance with the Resolution of the Government of the Republic of Uzbekistan No. 944 dated November 23, 2019 “On measures for the gradual introduction of the procedure for marking and further tracking of products using identification means”, starting from December 2019 in the country there has been launched the pilot project on the gradual introduction of a system of compulsory labeling of imported and manufactured goods using nano-molecular technologies.

A memorandum of cooperation has been signed between the State Tax Committee of the Republic of Uzbekistan and the Russian Center for Advanced Technology Development, which provides for joint efforts and assistance in implementing projects on the introduction of digital marking and tracking systems for certain types of goods in Uzbekistan.

The “CRPT TURON”, which has experience in successfully implementing a similar system in Russia and Kazakhstan, has been appointed as an operator in the pilot phase of the project.

The Decree of the President of the Republic of Uzbekistan No. 6098 “On organizational measures to reduce the shadow economy and enhance efficiency of tax authorities” has been adopted on October 30, 2020. This Decree, along with a number of important changes, pays particular attention to raising the number of non-cash payments within the Republic. The reason for this is that in almost all cases, the decline in the use of cash and the increase in non-cash turnover has resulted in a decline in the shadow economy level.

### **Conclusion and proposals.**

According to the opinion of all authoritative international organizations and scholars, one of the most important factors in the fight against the shadow economy is to change the attitude of the population to the shadow economy and corruption and enhance intolerance of the population to corruption and the shadow economy, as well as the attitude towards tax ethics. With this aim, one of the significant things to be done is to show and explain to the population how important the tax system and the state budget are and all the negative consequences that corruption and the shadow economy can have in the long perspective. In addition, increasing the tax literacy of the population will result in a decline in the shadow economy level. In this regard, it is advisable to perform explanatory activities through the media, with the assistance of the State Tax Committee of the Republic of Uzbekistan and the State Customs Committee of the Republic of Uzbekistan.

Furthermore, based on the results of the analysis, we conclude that the following essential issues should be solved in the fight against the shadow economy:

- in the market economy, the shadow economy and economic crime are closely interrelated. The development of the shadow economy in the country leads to the criminalization of the socio-economic sphere;

- comprehensive activities are being carried out in our country to combat the shadow economy. However, the share of the shadow economy in services, trade and transport still remains high. Therefore, it is recommended to improve taxation mechanisms in these areas in reliance upon foreign;

- reducing the level of the shadow economy can be achieved by creating equal opportunities and convenient facilities for doing business, including reducing regulatory and administrative burdens, automating procedures, as well as simplifying tax compliance procedures;

- it is required to undertake measures in cooperation with the relevant ministries and departments to reduce cash payments, as well as expand and encourage the implementation of electronic or remote payments;

- systematic introduction of the practice of publishing (making public) the list of individual offenders or dishonest business entities on official websites;

– it is necessary to encourage efficient use of public oversight mechanisms by expanding participation of non-governmental organizations, citizens and businesses via submitting application either in written form or orally, including anonymously or by various means, thus ensuring the confidentiality of the applicant;

– as a result of reducing the share of the shadow economy in GDP, the state budget revenues will increase, which, in turn, will result in the increase in financing allocated to the socio-economic sphere of the country, creation of new jobs, as well as raising incomes of the population.

These measures will serve to reduce and prevent the shadow economy by further improving holding liable and enforcement measures for economic offenses, supporting honest entrepreneurs, encouraging cooperation and public oversight.

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