



Ways to improve the mechanism of direct taxation of commercial banks based on advanced foreign practices.

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Abstract

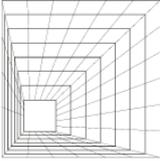
The stable operation of the banking system is fundamentally important for the entire economy. As such, bank taxation should be directed toward ensuring the stability of the banking system. While various regulatory and tax measures have been implemented, a discussion continues about unanswered questions, particularly concerning macro-prudential effects linked to systemic risks and negative micro-prudential externalities stemming from limited liability and asymmetric information. This issue has become a pressing concern for policymakers, academics, and international regulatory bodies. This paper examines the current state of commercial bank taxation in Uzbekistan and proposes a new approach based on advanced foreign practices, specifically from Japan and China, as well as the United States, Germany, and France. The study employs a comparative-analytical method, using data from commercial banks in these countries to develop a framework for implementing a direct bank taxation theory in Uzbekistan. The findings suggest that a well-structured system of direct bank taxes can support fiscal stability while promoting financial integrity and investment activity. The paper concludes with project-based solutions for implementing a direct bank taxation mechanism in Uzbekistan, including the use of an IT-based "tax-rating system" and the integration of automated information systems for real-time monitoring.

Introduction

The stable operation of the banking system is of fundamental importance to the entire economy. Therefore, the taxation of banks must be structured to ensure their stability. Although various measures, including taxes and regulations, have been implemented, a persistent discussion remains regarding unanswered questions. This is particularly true for macro-prudential effects associated with systemic risks and negative micro-prudential externalities arising from limited liability and asymmetric information. This issue has become a pressing concern for policymakers, academics, and international regulatory bodies, as these externalities affect the growth and development of many nations.

Macro-prudential supervision is an important tool for mitigating asset price inflation and ensuring banks are insured against bankruptcy through capital adequacy ratios and deposit insurance funds. However, the effectiveness of these measures is still being tested and verified. Current reforms aimed at ensuring financial stability should focus on strengthening regulations and systemic measures through taxation and balancing the relationship between regulation and taxation. Notably, revenues from such taxes can serve as deposit guarantee and protection funds for smaller banks.

In recent years, Uzbekistan's banking and financial system has been undergoing large-scale reforms. With the banking sector's increasing contribution to state budget revenues, new



approaches to commercial bank taxation are needed. The theory of direct bank taxes is widely applied and has shown positive results in international practice. This paper aims to present project-based solutions for implementing a direct bank taxation theory in Uzbekistan based on advanced foreign experience.

The core problem addressed in this paper is the current, undifferentiated approach to taxing banks in Uzbekistan, where they are taxed as general legal entities rather than as distinct subjects. This contrasts with global best practices in countries like Germany, France, Japan, and China, where special tax policies are applied to banks.

2. Methodology

This research employs a comparative-analytical approach to study the direct taxation mechanisms for commercial banks. The primary data sources include half-yearly financial reports of commercial banks in Japan (1998-2002) and data from the Asian Development Bank. The study also draws on legal and regulatory documents from China, the United States, Germany, and France. The analysis is based on a **difference-in-differences (DiD)** method to evaluate the impact of the Tokyo Bank Tax on bank liquidity. This method compares the changes in liquidity metrics of banks affected by the tax (treated group) with those of unaffected banks (control group) before and after the tax was introduced. This allows for a robust assessment of the tax's net effect, isolating it from general economic conditions.

The proposed project-based solutions for Uzbekistan are developed based on a synthesis of the analyzed foreign practices, adapting them to the specific economic and financial context of the country.

3. Results

Direct bank taxes are defined as taxes calculated on the direct financial activities of banks (profit, interest income, proceeds from financial operations, etc.). International practice shows that for an effective mechanism of direct bank taxation, the tax rate, tax base, and collection procedure must be clearly defined.

3.1. Lessons from Japanese Experience

Japan's tax policy, including its direct and indirect taxes, is notable for its use of non-tax revenues, such as fees for licenses and public services, which can account for up to 25% of the state budget. This indicates a policy of diversifying non-tax revenues.

A key example is the **Tokyo Bank Tax**, introduced in 2000. This tax was a 3% levy on the gross profits of large commercial banks in the Tokyo Prefecture with total assets exceeding ¥5 trillion (\$46 billion).

The tax mechanism was structured as follows:

- **Tax Base:** Gross profit of the banks.
- **Application:** Applied only to banks above a certain asset threshold.
- **Duration:** Set for a 5-year term, but was annulled by a court ruling in 2002.

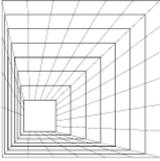
The tax was a direct profit tax specifically targeting the banking sector, with the main goal of stabilizing local budget revenues. However, practical results showed a significant impact on banks' financial activities.

Table 3.6 and **Figure 3.3** illustrate the impact of the Tokyo Bank Tax on bank liquidity creation.

Table 3.6: Changes in Liquidity Creation Ratios before and after the Tokyo Bank Tax (%)

(Source: Half-yearly financial reports of commercial banks in Japan, 1998–2002)

Indicator	Period	Tax Affecte banks	Unaffected Banks
Broad Liquidity	Before	36.88	32.19



(LC/TA)			
	After	35.15	33.35
Narrow Liquidity (LCn/TA)	Before	34.98	31.09
	After	33.70	32.43
Capital Ratio	Before	3.77	4.26
	After	4.59	5.23

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The broad liquidity of tax-affected banks decreased by 2.9% (from 36.88% to 35.15%), while liquidity indicators in unaffected banks increased. Although the capital ratio increased in both groups, the growth was lower for the affected banks.

The analysis of broad liquidity (LC/TA) shows that tax-affected banks experienced a decrease of 1.73 percentage points (from 36.88% to 35.15%), a relative decline of 4.7%. Conversely, unaffected banks showed an increase of 1.16 percentage points (from 32.19% to 33.35%), a relative growth of 3.6%. The **difference-in-differences** measurement confirms a clear negative net effect of the tax on bank liquidity.

This decline in liquidity for the affected banks is consistent with the "**Risk-taking**" hypothesis, as the tax reduced bank capital and their ability to provide long-term credit. The increase in the control group suggests that overall economic conditions or other factors expanded their liquidity creation capabilities. This shift from illiquid assets to short-term liquid assets on the balance sheets of the affected banks likely limited long-term financing for the real sector and negatively impacted private sector investment.

3.2. Recommendations Based on International Experience

The Tokyo Bank Tax experience offers several practical lessons:

Clear Tax Base: The use of gross profit as the tax base in Japan simplified the tax collection process.

Consideration of Financial Stability: The negative impact on liquidity suggests that measures must be taken to minimize financial consequences.

Fiscal Stability: While special bank taxes can increase budget revenues in the short term, there is a risk of reduced lending in the long run.

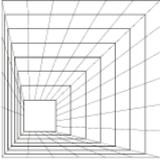
Selective Application: Applying the tax only to large banks helps maintain the competitiveness of smaller banks.

Monitoring and Evaluation: Continuous assessment of the tax's impact on bank performance is crucial.

Table 3.7: Proposed Direct Tax Enhancements for Commercial Banks Based on Foreign Experience (Source: Prepared by the author based on academic sources)

Tax Type	Key Object	Proposed Tax Rate	Purpose of Application
Interest Income Tax	Interest income	5%	Reduce speculative profits
Commission Fee Tax	Service commissions	3%	Improve service quality
Bank Asset Tax	Total assets	0.1%	Optimize tax burden for large banks
Currency Operations Tax	Currency operations	1%	Ensure stability in the currency market

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4. Discussion and Recommendations for Uzbekistan

Uzbekistan's current tax system is dominated by indirect taxes like VAT and excise duties, which make up a significant portion of budget revenues. While this ensures fiscal stability in any economic climate, it may pose risks to social equity and the investment climate. Therefore, increasing the role of direct taxes, especially on commercial banks and other active subjects, is critical.

A progressive tax scale, which balances the tax burden with bank capital, is an advanced mechanism for direct taxation. This policy could be structured to account for economies of scale in bank operations. Furthermore, tax incentives that stimulate banks' investment activities are crucial. For example, a tax discounting mechanism based on the **Weighted Average Cost of Capital (WACC)** for long-term credit investments could ensure proper valuation of bank income, an approach successfully applied in Ukraine and the Czech Republic.

4.1. Recommendations Based on Chinese Experience

China has a special "**Financial Services Tax**" levied on the gross turnover of financial services. Additionally, selected strategic banks are granted tax incentives. Uzbekistan can adopt a similar approach:

Implement a "Tax-Rating System": Provide incentives to banks with high tax discipline.

Exemptions for Strategic Projects: Grant tax exemptions or deferrals to banks participating in state-guaranteed projects.

Automated Information Systems: Use automated systems for real-time monitoring of bank activities from a tax perspective. A unified "Soliq-Bank" information platform and API integration between banks and tax authorities are essential for this purpose.

4.2. Broader International Practices

United States: Direct taxes are the main source of tax revenue at the federal, state, and local levels. They are used to reduce social inequality and stimulate economic growth. The three-tiered tax administration system allows for independent collection at each level, a model that could be adapted to balance tax revenues across Uzbekistan's regions.

Germany: The system of joint taxes (Gemeinschaftssteuern) distributes tax revenues from income and corporate taxes proportionally between federal and regional budgets, ensuring an equitable distribution of tax resources—a viable model for Uzbekistan.

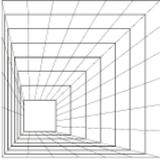
France: The VAT is the main source of budget revenue, with a two-tiered rate system to support basic needs and socially significant goods. This balance between direct and indirect taxes serves to ensure tax justice.

5. Conclusion

The current principles of international bank supervision necessitate ensuring adequate capitalization, liquidity, and stability of commercial banks. Simultaneously, it is crucial to support their investment and commercial activities. This requires limiting excessive debt financing and reducing the negative effects of tax deductions on interest, which can be achieved through rules on interest limitation or "anti-base erosion rules."

The main shortcoming of the current profit tax for legal entities in Uzbekistan is the lack of specific tax incentives for small, innovative enterprises. Similarly, deficiencies in mineral resource taxes include their purely fiscal orientation, the absence of rental income, and a lack of a targeted source for financing geological exploration. The key direction of tax policy should be to support innovative ideas, technologies, and sciences through new incentives, thereby encouraging investment in the country's innovation sector.

The provided analysis and recommendations offer a foundation for reforming Uzbekistan's direct taxation system for commercial banks. Implementing a progressive tax scale, introducing tax



incentives for long-term investments, and adopting a modern, automated tax administration system will be crucial for fostering a balanced and stable financial system. Future research should focus on a more detailed analysis of the impact of each proposed tax type on bank profitability and the broader economic system.

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