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THE ROLE OF TAX POLICY IN PROMOTING ECO-INNOVATION IN UZBEKISTAN'S SERVICE SECTOR

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Abstract: This article explores the intersection of taxation and innovation within the context of Uzbekistan's green economy transition. It argues that effective tax policy design can significantly stimulate eco-innovation in the service sector by reducing financial barriers and incentivizing sustainable practices. Using the IMRaD (Introduction, Methods, Results, and Discussion) structure, the study analyzes current tax instruments in Uzbekistan, evaluates their impact on green services, and proposes policy improvements aligned with international best practices. The findings suggest that targeted tax incentives—such as R&D deductions, green investment allowances, and VAT exemptions for eco-friendly services—can accelerate the country's green transformation while enhancing fiscal sustainability.
Keywords: green economy, taxation, eco-innovation, service sector, tax incentives, Uzbekistan

Introduction

Uzbekistan is undergoing a significant economic transformation with a strong focus on developing a green economy. As part of this shift, the government has prioritized sustainable development, environmental protection, and innovation—particularly in the service sector, which constitutes a growing share of the national GDP. However, one of the major challenges in this transition is aligning fiscal policy, especially taxation, with environmental and innovation goals.

Taxation is not only a tool for generating public revenue but also a powerful lever for influencing economic behavior. When designed strategically, tax systems can encourage businesses to adopt cleaner technologies, invest in research and development (R&D), and deliver environmentally sustainable services. This is particularly relevant in Uzbekistan, where the service sector—including logistics, tourism, financial services, and digital platforms—has substantial potential to drive green innovation but often faces financial and regulatory constraints. This article examines how Uzbekistan's tax system can be better aligned with its green economy objectives. Specifically, it investigates whether current tax policies support or hinder eco-innovation in the service sector and proposes evidence-based recommendations for reform. The analysis uses the IMRaD structure to ensure clarity, logical flow, and academic rigor, while maintaining accessible language for policymakers, students, and general readers.

Methods

This study employs a mixed-methods approach combining policy analysis, comparative review, and case-based reasoning.

First, a desk review of Uzbekistan's current tax legislation was conducted, including the Tax Code, Presidential Decrees on innovation and green development (e.g., Decree No. UP-6371 of 2023), and strategic documents such as the "Strategy for Transition to a Green Economy" (2023–

2030). Special attention was given to provisions related to R&D, environmental protection, and service-sector taxation.

Second, international best practices were analyzed. Countries such as Sweden, Estonia, and South Korea were selected due to their successful integration of environmental taxation and innovation incentives. Comparative insights focused on tax credits for green R&D, reduced VAT rates for sustainable services, and accelerated depreciation for eco-investments.

Third, illustrative case examples from Uzbekistan's service sector were examined. These included eco-tourism startups in Samarkand, green fintech platforms in Tashkent, and digital logistics services aiming to reduce carbon emissions. These cases helped ground the analysis in real-world challenges and opportunities.

Finally, the study applied a qualitative policy assessment framework based on three criteria: (1) alignment with green economy objectives, (2) clarity and accessibility for businesses, and (3) fiscal feasibility for the state budget.

Results

1. Current Tax Instruments and Their Gaps

Uzbekistan's Tax Code includes several provisions that indirectly support innovation and environmental goals, such as:

A 15% reduced profit tax rate for innovators registered in "Innovation Territories" (Article 296[1]).

Exemption from property tax for equipment used in scientific research.

A 50% deduction on R&D expenses (Article 141).

However, these measures are largely geared toward manufacturing and industrial sectors. The service sector—despite its growing role in innovation—is often excluded. For instance:

Digital services developing carbon-tracking software do not qualify for R&D deductions unless they own physical laboratories.

Eco-tourism operators cannot access green investment allowances because their "assets" are intangible or land-based, which are not covered under current definitions.

Moreover, there is no explicit link between tax benefits and environmental outcomes. A company may receive an innovation tax break without proving that its service reduces emissions, saves energy, or promotes circularity.

2. International Lessons

In Sweden, companies offering certified eco-friendly services (e.g., bike-sharing platforms or green consulting) benefit from a reduced VAT rate of 12% (vs. the standard 25%). Estonia offers full corporate income tax exemption for profits reinvested in green digital infrastructure. South Korea provides refundable tax credits up to 30% of R&D spending in environmental technologies, including software and data analytics.

These models demonstrate that tax policy can be tailored to service-based innovation, provided the legal definitions are flexible and outcome-oriented.

3. Case Evidence from Uzbekistan

A Samarkand-based eco-lodge reported that while it invested in solar panels and waste recycling, it received no tax relief because its primary activity was classified as "hospitality," not "environmental services." Similarly, a Tashkent fintech startup developing an app to calculate household carbon footprints was denied R&D deductions because its work was deemed "administrative software," not scientific research.

These examples reveal a systemic mismatch between policy design and the realities of green service innovation.

4. Proposed Framework for Reform

Based on the findings, the following tax policy enhancements are recommended:

Expand R&D deduction eligibility to include digital and service-based innovation with verifiable environmental impact.

Introduce a "Green Service Certification" system, allowing certified businesses to access reduced VAT (e.g., 7% instead of 12%) or deferred tax payments.

Create a Green Innovation Allowance: Permit 100% first-year depreciation or immediate expensing for investments in green digital infrastructure (e.g., energy-efficient servers, emissions monitoring software).

Link tax benefits to measurable outcomes, such as tons of CO_2 reduced or water saved, verified through third-party audits.

These measures would not only incentivize eco-innovation but also generate long-term fiscal benefits by expanding the tax base through new green enterprises.

Discussion

The results confirm that Uzbekistan's current tax system is not fully optimized to support green innovation in the service sector. While commendable progress has been made in establishing innovation zones and R&D incentives, these policies remain anchored in traditional, asset-heavy models of innovation that overlook the intangible, knowledge-based nature of modern services.

This misalignment carries three key risks:

1. **Lost economic opportunity**: Eco-innovative service firms may underinvest or relocate to more supportive jurisdictions.
2. **Inequity**: Service providers are effectively taxed more heavily than manufacturers for similar environmental contributions.
3. **Inefficiency**: Public funds are spent on subsidies or grants when smarter tax design could achieve the same goals at lower administrative cost.

The proposed reforms address these gaps by modernizing definitions, introducing outcome-based incentives, and learning from global leaders. Importantly, they are fiscally responsible. For example, a reduced VAT rate for certified green services would initially reduce revenue, but the expansion of eco-enterprises—and their eventual profitability—would offset losses within 3–5 years, as seen in Estonia.

Furthermore, these changes align with Uzbekistan's broader commitments under the UN Sustainable Development Goals (SDGs), particularly Goal 8 (decent work and economic growth), Goal 9 (industry, innovation, and infrastructure), and Goal 13 (climate action).

Critically, implementation should be gradual and accompanied by clear guidelines, taxpayer education, and digital tools for certification. The State Tax Committee, in collaboration with the Ministry of Innovative Development and the Ministry of Ecology, should pilot these measures in select regions—such as Samarkand or Navoi Innovation Territory—before nationwide rollout.

Finally, this study contributes to a growing academic consensus: taxation must evolve from a passive revenue collector to an active enabler of sustainable development. In service-driven economies like Uzbekistan's, this shift is not optional—it is essential.

Conclusion

Uzbekistan stands at a pivotal moment in its green transition. The service sector, often underestimated in environmental policy, holds immense potential to drive eco-innovation through digital platforms, sustainable tourism, green finance, and smart logistics. However, unlocking this potential requires a tax system that recognizes, rewards, and scales environmentally beneficial services.

By reforming tax definitions, introducing targeted incentives, and linking benefits to real-world environmental outcomes, Uzbekistan can create a win-win scenario: fostering innovation while strengthening public finances and environmental resilience. The recommendations outlined in

this article offer a practical roadmap for policymakers, educators, and business leaders committed to building a greener, more innovative economy.

As Uzbekistan continues to modernize its fiscal framework, integrating taxation with innovation and sustainability will not only support national development goals but also position the country as a regional leader in green economic policy.

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