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Article

The Effect of Local Taxes on The Activities of Business Entities

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Abstract: The aim of this paper is to analyse the influence of local taxes (primarily property tax) on the functioning of business entities. Local taxes represent substantial components of local budget revenues and have implications for firms' investment, production and employment decisions/choices. Despite common use of property taxes as a fiscal tool, their actual impact on business activity is still debated, leaving scope for empirical assessment with cross-country data.

This paper fills this gap by examining the response of fixed capital investment to changes in property tax rates. The analysis relies on official statistics of the Ministry of Economy and Finance, the State Statistics Committee, and the Tax Committee of Uzbekistan. Using descriptive analysis and regression methods, the study assesses the link between the tax rate on properties and the growth in investment.

Core to the empirical findings is that a decrease in property tax rates builds up the growth rate of one capital fixed. In particular, even a one percent reduction in the tax rate on property paid by firms may raise the rate of growth of fixed capital investments by as much as 4.35 percent. Nonetheless, this effect is statistically weak due to the high share of non taxable assets such as machinery and equipment in total fixed capital investments and the issue of property taxation on small business entities.

This indicates that tax incentives of property alone have a fairly small direct impact on investment activity. The local tax policy in the context of sustainable development should aim at the balance of appropriate intensity of tax burden and reliability of the local tax system with respect to generating stimulatory effects of tax policy on business development and investment activity in the region.

Keywords: local tax, property tax, tax rate, tax base, tax credit, business entities, capital, investment.

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1. Introduction

Local taxes are an integral part of the country's tax system and play an important role in the formation of local budget revenues. Local taxes are introduced as sources of budget revenues necessary for the implementation of established tasks by regional authorities, and these taxes are levied within their jurisdiction. Local taxes are the main financial source for meeting local needs and are of great importance in expanding the powers of local authorities in the fiscal sphere.

The impact of local taxes on business activities is assessed from a positive and negative point of view. The negative impact of local taxes leads to a decrease in the level of income and investment opportunities of business entities, a decrease in the motivation of employees and managers. The positive impact of local taxes leads to an increase in the efficiency of production factors and the creation of new jobs. It should be noted that local taxes have long been one of the main internal sources of financing at the local government

level. From the point of view of the scientific literature on the economic impact of property taxes in the context of local taxes, it is emphasized that this tax has a distorting effect on the use of capital at the local level [1].

In general, despite the fact that extensive empirical research has been conducted on the economic impact of local taxation, there are many uncertainties in assessing the impact of local taxes and this remains one of the most discussed issues in public finance. Thus, reducing the burden of local taxes is one of the main conditions for the development of business activities in the new economic conditions. At the same time, it is necessary to form sufficient budget revenues to meet the socio-economic needs of local governments within the framework of the implementation of the tasks assigned to them. The purpose of many scientific studies is to assess the impact of property taxes, which are part of local taxes, on business activities.

Literature review

Economists emphasize that ensuring the financial stability of local budgets, in turn, has a positive impact on optimizing taxation, expanding the tax-free revenue base, effective asset management, and a clear division of powers between budgets at different levels [2]. Property taxes levied on the immovable property of business entities, which form the basis of local taxes, are considered to have the least negative impact on the economy and economic growth. The introduction of property taxes leads to the transfer of property to business entities that are more profitable owners. Property taxes reduce part of the income (profit) of business entities not directly, but indirectly by increasing the costs of maintaining property. Property taxes, which are a component of local taxes, usually have a smaller impact on revenue than income taxes. However, the negative impact of property taxes depends on the level of profitability of business activities and can lead to a liquidity crisis, especially in low-income sectors and during periods of loss [3].

The scientific literature has examined the impact of property taxes on business activities from the perspective of local taxation and employment. In particular, an analysis of data on the production activity of business entities in Italy for 2001-2010 found that local property taxes have a negative and statistically significant impact on employment, capital, total factor productivity and sales. An average increase in local taxes by one unit can lead to a decrease in employment by 0.5 units and a decrease in capital by 8,150 euros. The imperfect exchange of capital has led to a reduction in employment, but due to market imperfections, the changes negatively affect the effective reorganization of production, production efficiency, and lead to a decrease in sales volume [4].

However, Gobey and Matikonis (2021) argue that reducing corporate property taxes does not stimulate the development of small businesses and employment growth [5]. An analysis based on data from business entities operating in 43 sectors in the United States found that state-level property tax incentives have a positive effect in the form of increased employment only in the early years of enterprise activity [6].

Property tax forms part of the capital expenditures of business entities and, like income tax, affects the investment activity of enterprises. A high tax burden on property taxes for business entities can reduce demand for capital goods and, at the same time, reduce investment. According to economists, the broader negative consequences of an increase in property taxes paid by business entities are manifested in the substitution effect, which leads to a loss of well-being. In particular, business entities may refuse to implement investment projects in response to an increase in property taxes. If business entities have the opportunity to invest their capital within the country, losses in the total volume of investments at the national level will be minimal. The negative impact can manifest itself in an excess flow of investments into more profitable (privileged) areas of activity, while an investment deficit will arise in other areas, which will lead to structural disruptions in the economy. On the contrary, if the refusal to implement investment projects is associated with the outflow of capital from the country, the impact of the substitution effect will be maximal.

Thus, the property tax paid by business entities performs both fiscal and regulatory functions, since the property tax not only provides a stable source of tax revenues for local

budgets, but also serves as an established incentive factor for the investment process in terms of the modernization of production assets [7].

However, it should be noted that the relatively low mobility of real estate, which is considered the tax base, limits the negative impact. This reduces the likelihood of transferring capital to other jurisdictions in the medium term. Thus, an increase in the local tax burden negatively affects the development of investment activity of business entities and, in the long term, leads to the cessation of production activities due to the depreciation of fixed capital. Given the key role of the active part of fixed assets in the production process, subjecting it to property tax enhances the substitution effect. The analysis of data on fixed capital investments in the sector for 2006-2011 revealed a direct relationship between investment and property tax with high statistical significance [8]. This shows that an increase in the volume of fixed capital investments leads to an expansion of the property tax base and an increase in local tax revenues. Thus, in order to stimulate investments in fixed capital, the provision of local tax benefits (property tax) leads to the creation of new jobs by stimulating the expansion and development of business entities.

2. Materials and Methods

The research study examined the impact of local tax incentives on the activities of business entities, in particular, the impact of property tax paid by legal entities on employment, capital, total factor productivity, sales volume and investment growth of business entities, and a review of scientific literature was conducted [9]. At the same time, based on data from the Ministry of Economy and Finance, the State Statistics Committee and the Tax Committee, the dynamics of local tax revenues, the share of property tax and land tax paid by enterprises in budget revenues, the growth rate of fixed capital investments, and the composition of fixed capital investments by fixed assets were analyzed.

The article provides a regression assessment of the impact of a decrease in the property tax rate paid by enterprises on the growth rate of fixed capital investments. Based on the conducted analyses, relevant conclusions were drawn [10]. The research used methods such as scientific abstraction, analysis and synthesis, induction and deduction, descriptive statistics, comparative analysis, regression analysis, and analysis.

3. Results and Discussion

Today, when relevant reforms are implemented in the directions of expanding the base of local budget revenues, introducing the obligation to pay property tax for all business entities, and improving the taxation procedure, the share of local budget revenues in the state budget tax and compulsory payments of property tax and land tax, which are a component of local taxes calculated from their own sources, as well as property and resource taxes, has relatively increased (Table 1).

Table 1. Analysis of the dynamics of local tax revenues

Tax revenues	2021	2022	2023	2024
total tax revenues, trillion. soum	138,3	159,8	184,5	215,5
share of property and land tax, in percent	4,7	5,8	6,5	7,0
resource fees and property tax revenues, trillion. soum	23,0	23,9	28,1	36,4
share of property and land tax, in percent	28,4	39,0	42,7	41,3
property tax revenue, trln. soum	6,5	9,3	12,0	15,0
share of property tax, in percent	37,6	43,1	42,5	45,3
share of land tax, in percent	62,4	56,9	57,5	54,7

Source: Information from the Ministry of Economy and Finance, 2025

Бироқ, корхоналар тўлайдиган мол-мулк солиғининг базаси камайишига (кўчмас Despite the decrease in the average residual value of properties) and the tax rate, the main reasons for the increase in local tax revenues can be attributed to the increase in the number of business entities paying property taxes and the increase in land tax rates

[11]. According to the amendments to the tax legislation, from January 1, 2019, microfirms and small enterprises, regardless of the number of employees and the volume of product sales, will pay property and land taxes for legal entities. Previously, these taxes were not paid by microfirms and small enterprises. In particular, as of January 1, 2021, the number of legal entities paying property tax was 58,856, and the number of legal entities paying land tax was 155,023, while as of January 1, 2024, the number of legal entities paying property tax was 78,272, and the number of land tax payers was 186,131, or the number of business entities paying property taxes increased by 2.5 times during the analyzed period [12]. The restriction on increasing the amount of property tax on non-residential real estate intended for entrepreneurial activities compared to the previous year has been abolished (in 2022, this restriction was no more than 30 percent compared to 2021). In addition, in accordance with the current tax legislation, the tax base for property of legal entities is set at the following rates per 1 sq. cannot be lower than the minimum value set in absolute terms per meter:

In Tashkent - 3,300 thousand soums;

In Nukus and regional centers - 2,200 thousand soums;

In other cities and rural areas - 1,300 thousand soums.

However, the reduction in the property tax rate paid by enterprises from 5 percent to 1.5 percent, the establishment of the residual value of real estate as the tax base, and the widespread use of property tax benefits have led to a decrease in the share of tax revenues (Table 2) [13]. In particular, the reduction in the property tax rate paid by enterprises from 5 percent to 2 percent in 2019 led to a 1.7-fold decrease in the share of property tax revenues in budget revenues.

Table 2. Analysis of the dynamics of property tax paid by enterprises in budget revenues

Years	share of property tax, %	share of land tax,%
2016	2,3	1,2
2017	2,2	1,2
2018	2,4	1,0
2019	1,4	1,2
2020	1,5	1,0
2021	1,0	1,6
2022	1,5	1,7
2023	1,6	1,9
2024	1,8	1,9

Source: Information from the Ministry of Economy and Finance, 2025

Of course, the low rate of taxation of only the average annual residual value of real estate as the property base of enterprises influenced the increase in the share of investments in the main funds of production (buildings and structures) of business entities in the structure of investments in fixed capital (Table 3) [14].

Table 3. The structure of investments in fixed assets by types of fixed assets, %

Basic capital structure	2019	2020	2021	2022	2023	2024
Residential buildings	7,0	7,4	8,7	8,2	7,4	5,7
Non-residential buildings, other facilities	19,1	20,8	23,6	27,5	24,1	25,0
Land improvement	0,04	0,1	0,1	0,1	0,2	0,2
Machinery and equipment	65,8	64,1	60,4	58,1	59,4	60,8

Source: Data from the Statistical Agency of the Republic of Uzbekistan, 2025

A regression analysis conducted based on the Statistics Agency's data on the growth rate of fixed capital investments and the Tax Committee's data on property tax rates paid by legal entities for 2016-2024 assessed the impact of fixed capital investments (Y-dependent variable) and property tax rates paid by enterprises (X-independent variable) (Table 4).

Table 4. Correlation matrix of the effect of the property tax rate paid by enterprises on the growth rate of investment in fixed capital

	Y	***X***
Y- growth rate of investment in fixed capital, in %	1	
X - property tax rate paid by enterprises, in %	0.31337	1

It can be concluded that there is a correlation between the dependent variable and the independent variables taken as influencing factors [15]. Thus, a relationship was found between the growth rate of fixed capital investment (Y) and the property tax rate paid by enterprises (r= 0.31337) (Table 5).

Table 5. Results of the regression analysis model

Multiple correlation coefficient R	0. 31337
Coefficient of determination R^2	0.09819
corrected coefficient of determination R^2	-0.0306
Standard error	23.1131
Observations	9

The multiple correlation coefficient R=0.31337 characterizes the direct statistical relationship between the dependent variable (growth rate of fixed capital investment) and the independent variable taken as one of the influencing determinants, the decrease in the property tax rate paid by enterprises [16]. The multiple correlation coefficient indicates the presence of a direct linear relationship between the indicators. The determination coefficient R2=0.09819 indicates that a 1.0% change in the growth rate of fixed capital investment, the dependent variable, is explained by a change in the selected independent variable (Table 5). In general, it should be noted that the effect of the reduction in the property tax rate paid by enterprises on the growth rate of fixed capital investments is weak, due to the high share of property (machinery and equipment) not included in the tax base in fixed capital investments, and the introduction of property tax for small businesses [17].

Table 6. Results of variance analysis

	df	*SS*	*MS*	*F*	*Importance F*
Regression	1	407.206	407.21	0,7622	0,4115
remainder	7	3739.522	534,22		
general	8	4146.728			

According to the results of the analysis of variance, the model is significant and statistically adequate to the data, since the Fisher adequacy criterion (Fcalculated = 0.7622) is greater than the tabulated value of the Fisher criterion (0.4115) (Table 6). The actual value of the F-test at a significance level of $\alpha = 0.05$ is greater than its critical value [18]. Therefore, a probability of 0.95 indicates that there is a relationship between the dependent variable and the obtained independent variable. Thus, in 95 out of 100 cases, the growth rate of fixed capital investments depends on the selected indicator, therefore the econometric model is considered reliable.

Table 7. Point estimation of model parameters

	Odds	t-statistic	P- significance level
Y-intersection	120,30	7,4778	0,0001
X- property tax rate paid by enterprises, in%	4,35	0,8730	0,4115

According to Table 7, we build an econometric model:

$$y=120{,}30+4{,}35x \quad (1)$$

A 1 percent decrease in the property tax rate paid by enterprises could lead to a 4.35 percent increase in the growth rate of fixed capital investments [19], [20]. However, it should be noted that the direct positive effect of a decrease in the property tax rate paid by enterprises on the growth rate of fixed capital investments was found to be statistically insignificant.

4. Conclusion

Property taxes levied on the immovable property of business entities, which form the basis of local taxes, are considered to have the least negative impact on the economy and economic growth. Property taxes, which are a component of local taxes, usually have a smaller impact on revenue than income taxes.

Property taxes have been found to have a negative and statistically significant impact on employment, capital, total factor productivity, and sales. Property taxes form part of the capital expenditures of business entities and, like income taxes, affect the investment activities of enterprises. A high tax burden on property taxes on business entities can reduce investment by reducing demand for capital goods.

The more widespread negative consequences of increasing property taxes paid by business entities are manifested in the substitution effect, which leads to a loss of welfare. In particular, business entities may refuse to implement investment projects in response to an increase in property tax.

It was found that a 1% decrease in the property tax rate paid by enterprises could lead to an increase in the growth rate of fixed capital investments by 4.35%, but the direct positive effect is not statistically significant. It should be noted that this is due to the high share of non-taxable property (machinery and equipment) in fixed capital investments and the introduction of property tax for small business entities.

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