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Methodology for Assessing The Effectiveness of Local Tax Incentives

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Abstract: The paper proposes methodologies for evaluating the effectiveness of tax incentives at the local level. Based on a retrospective analysis, the comparative aspects of existing methodologies were evaluated, and the author's approach to determining the effectiveness of local tax incentives was introduced. The proposed methodology enables a comprehensive and qualitative assessment of tax incentives at the level of municipalities. Furthermore, the article develops specific proposals and practical recommendations aimed at enhancing the effectiveness of tax incentives, eliminating ineffective privileges, and improving tax stimulation mechanisms.

Keywords: effectiveness, budgetary efficiency, economic efficiency, social efficiency, amount of revenue loss

1. Introduction

In contemporary fiscal policy, tax incentives serve as a pivotal instrument for regulating economic processes, supporting the business environment, and stimulating priority areas of regional development. Specifically, tax incentives applied at the local level play a crucial role in realizing strategic objectives such as enhancing the investment attractiveness of regions, expanding production capacities, fostering small business and private entrepreneurship, ensuring employment, and developing social infrastructure. However, given that the implementation of tax incentives is inextricably linked to issues of fiscal stability, budget revenue forecasting, and the efficient utilization of resources, there is a growing necessity for a regular and objective assessment of this instrument's effectiveness.

Empirical evidence indicates that while tax incentives may exert a positive impact on economic growth or social welfare in certain instances, they can also precipitate negative consequences, including a reduction in local budget revenues, a contraction of the tax base, and uncompensated fiscal losses. Furthermore, the absence of a fully established unified approach to evaluating effectiveness, the lack of systematized assessment mechanisms, and the insufficient harmonization of indicators with specific criteria limit the ability to determine the true economic and social outcomes of incentives in a scientifically grounded manner [1]. This necessitates enhancing the efficiency of tax stimulation instruments within the local financial management system, integrating an analytical approach into the decision-making process regarding incentives, and strengthening the principles of result-oriented fiscal management.

2. Materials and Method

A.S. Balandina, investigating the theoretical foundations of tax incentives, places special emphasis on distinguishing between the concepts of tax incentives and tax preferences. In her view, tax incentives serve as a fundamental tool for realizing the

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regulatory and stimulatory functions of taxation. This perspective is supported by D.G. Chernik, who, in addressing pathways for tax system reform, asserts that the system of tax stimulation constitutes the state's primary instrument for economic regulation [2].

The practical mechanisms of tax incentives, specifically issues regarding the accounting and recovery of instruments such as depreciation bonuses, have been extensively studied by I.I. Krjukova. Such instruments are designed to enhance the investment activity of economic entities and exert a direct influence on the formation of the tax base at the local level [3].

The research of T.A. Malinina is of significant importance regarding international experience and the methodology for evaluating incentives. Drawing upon the experience of foreign countries, the author conducted a comparative analysis of various approaches to determining budgetary efficiency when evaluating tax exemptions. Furthermore, O.N. Savina, in analyzing the challenges associated with assessing the effectiveness of tax stimulation instruments, critically examines the lack of systematization in assessment mechanisms and the absence of a unified approach in current practice [4].

Issues related to stimulating innovation activity through taxation and measuring its performance have been investigated by O.V. Fisher and other scholars. They propose multifactorial models to determine the correlation between the tax burden and the efficiency coefficients of stimulating innovation activity via tax incentives [5].

Among domestic scholars, research conducted by B. Abdurakhmonov focuses on the criteria for classifying incentives within the tax system of Uzbekistan and the specific features of their application. In his works, he substantiates the necessity of developing a comprehensive methodology for evaluating the effectiveness of stimulatory tax incentives in the regions.

The analysis indicates that despite the abundance of research on tax incentives, the mechanism for evaluating social, economic, and budgetary efficiency in an integrated manner at the local budget level remains fragmentary in nature. This further underscores the relevance of the unified comprehensive methodology proposed in this article.

Research Methodology. The study employed a comprehensive and multi-criteria approach to evaluate the effectiveness of stimulating tax incentives at the regional level. The theoretical analysis utilized methods of scientific abstraction, analysis, and synthesis. During the empirical phase, an economic-statistical analysis was conducted based on comparison, grouping, time series analysis, and relative indicators. The effectiveness of tax incentives was assessed based on budgetary, economic, and social criteria, with the GDP deflator applied to mitigate the impact of inflation. Ultimately, an integral indicator was determined, forming the basis for conclusions regarding the continuation, modification, or termination of the incentives.

3. Results and Discussion

Although the domestic "Strategy for Improving Tax Administration" indicates the necessity of defining precise criteria and mechanisms for granting tax incentives based on an evaluation of their efficiency, systematic and substantive work in this direction has not yet been implemented in practice. Consequently, decisions regarding the introduction, retention, or abolition of tax incentives are frequently based on isolated fiscal or administrative approaches rather than on comprehensive analysis.

At the current stage, various methodological approaches to evaluating the effectiveness of tax incentives are being actively discussed in academic circles and practice; however, a unified conceptual approach to this issue has not yet been formed. According to leading economists in the field of taxation, tax incentives serve as a vital tool for realizing the regulatory and stimulatory functions of taxes. Accumulated international and national experience demonstrates that a tax stimulation system based on altering the volume of tax receipts and applying a flexible approach to tax rates is considered one of the primary instruments of state tax regulation.

However, in the majority of regions, methodologies for evaluating the effectiveness of tax incentives duplicate certain indicators, which does not allow for the determination of the actual correlation between tax incentives and budget revenues. As a result, it

becomes difficult to clearly distinguish which factor – the impact of incentives, legislative changes, or improvements in market conjuncture – is responsible for changes in tax revenues. This situation poses a serious obstacle to assessing the true effectiveness of tax incentives.

The budgetary, economic, and social efficiency of tax incentives granted on local taxes must be defined as the objects of evaluation. The assessment must be carried out on a mandatory basis by competent authorities for each separate local tax, for each granted incentive, and across each category of beneficiaries, as well as for specific types of activities.

Tax return data serves as the primary information source for evaluating the effectiveness of tax incentives. In cases where necessary information is not available in tax reports or access is restricted, it is expedient to utilize statistical data provided by statistical authorities, expert assessments, and data submitted by incentive beneficiaries or applicants upon the request of competent authorities.

Based on the foregoing, there arises a necessity to develop a unified comprehensive methodology for evaluating the effectiveness of tax incentives in the context of Uzbekistan. This methodology, while designating budgetary efficiency as the primary criterion, should also allow for the integrated assessment of economic and social efficiency indicators. Such an approach ensures scientific substantiation in decision-making regarding the introduction and abolition of tax incentives, and serves to strengthen the stability of local budgets and ensure the effective use of tax stimulation instruments.

In the process of evaluating the effectiveness of tax incentives, the competent authority utilizes the following indicators:

- tax rate;
- taxable base at the beginning and end of the reporting period;
- preferential tax rate;
- information regarding taxpayers' refusal to use the granted incentive;
- the amount of reduction in the tax base for the past period of the reporting year;
- strictly targeted use of funds released as a result of granting incentives or funds remaining with taxpayers due to incentives;
- value of fixed assets at the beginning and end of the reporting period;
- payroll fund at the beginning and end of the reporting period;
- amount of tax arrears to the regional budget;
- amount of taxes accrued to the regional budget;
- amount of taxes paid to the regional budget.

Analysis of tax incentives reveals that they possess a predominantly social character and are directed towards:

- supporting organizations that provide social protection to citizens;
- reducing the tax burden on budgetary organizations;
- social support of the population.

As an effective economic regulatory tool, the system of tax incentives must meet specific requirements. If these requirements are not met, the operation of the system ceases to be expedient.

Foreign experience, particularly conducted research and analysis, suggests that tax incentives should be viewed not merely as "aid", but as tax expenditures that must yield specific results. Considering the absence of a single regulatory legal framework for evaluating the effectiveness of tax incentives in the Republic of Uzbekistan, it is proposed within the scope of this research to evaluate the effectiveness of all types of tax incentives and other tax stimulation instruments based on a unified comprehensive approach. Within this approach, it is considered expedient to introduce the following system of indicators:

1. Budgetary Efficiency of Tax Incentives. This indicator characterizes the impact of granting tax incentives on the volume of local budget revenues.

The coefficient of budgetary efficiency of tax incentives $K_{byudjet}$ is calculated based on the following formula:

$$K_{byudjet} = \frac{B_{samara}}{B_{yo'qotish}}, \quad (1)$$

Where:

B_{samara} – the amount of budgetary efficiency (gain) from tax incentives;

$B_{yo'qotish}$ – the amount of revenue loss resulting from the granting of tax incentives.

If the efficiency coefficient of tax incentives is equal to or greater than one ($K \geq 1$), the tax incentives are considered to have high budgetary efficiency. If this coefficient is less than one ($K < 1$), the tax incentives are assessed as having low budgetary efficiency.

The amount of forgone budget revenue resulting from the granting of tax incentives $B_{yo'qotish}$, if the incentive is granted in the form of exempting a part of the tax base from taxation, is calculated based on the following formula:

$$B_{yo'qotish} = S_{qisqartirish} \times S_{stavka}, \quad (2)$$

Where:

$S_{qisqartirish}$ – the amount of reduction in the tax base due to the granting of incentives;

S_{stavka} – the tax rate during the period the incentives were in effect.

If the incentive is granted in the form of taxation of a part of the tax base at a reduced tax rate:

$$B_{yo'qotish} = S_{bazasi} \times (S_{bazaviy} - S_{imtiyozli}), \quad (3)$$

Where:

S_{bazasi} – the amount of the tax base to which the preferential rate is applied;

$S_{bazaviy}$ – the current (or envisaged) base tax rate during the period the incentives were in effect;

$S_{imtiyozli}$ – the preferential tax rate.

Budgetary efficiency of tax incentives is evaluated for a period of at least three years. Results obtained from granting incentives that are lower than the real losses of the budget indicate the low efficiency of the tax incentives. Upon detection of such cases, tax incentives should not be granted, and previously granted incentives should be abolished. Exceptions may be applied to certain types of activities designated as priorities for the settlement in the socio-economic development forecast.

2. Economic Efficiency of Tax Incentives. This represents the achievement of positive dynamics in the planned key indicators intended to be stimulated by the incentive over a period of five years from the introduction (or ongoing application) of the tax incentive. This includes progressive growth of investments in fixed capital by taxpayers, expansion and modernization of production, implementation of research and development (R&D), creation of new jobs, and other indicators.

As coefficients of economic efficiency, the following indicators characterizing the innovative activity of enterprises can be used: the tax savings coefficient on R&D expenses, the efficiency coefficient of stimulating innovation activity through tax incentives, the tax capacity of profit derived from innovation activity, the tax burden coefficient on innovation activity, and others. Furthermore, all these indicators can be divided into two groups: first-order coefficients having a direct impact on innovation activity, and second-order coefficients having an indirect impact [6].

3. Social Efficiency of Tax Incentives. This is determined through indicators confirming an increase in the level of social protection of the population and the creation of favorable conditions for the development of social infrastructure. This indicator is calculated when tax incentives are granted to specific categories of the population or non-profit organizations.

Outcomes such as wage increases, creation of new jobs, improvement of working conditions and labor protection, employment of socially vulnerable individuals, creation of favorable living conditions for them, and improvement in the quality of services provided by the taxpayer are considered as social efficiency.

Tax incentives are introduced not only to regulate the economy but also to alleviate the tax burden for certain taxpayers. However, the assessment of social efficiency is of a presumptive nature [7]. Data obtained from such assessments cannot be evaluated precisely from a mathematical standpoint; that is, the results of social and budgetary efficiency assessments differ from one another [8].

Budgetary efficiency is the most reliable indicator in determining the effectiveness of a tax incentive. Budgetary efficiency possesses a degree of reliability and is expressed in numerical indicators. It is relatively easy to systematize and calculate based on a uniform scheme throughout the country. At the same time, this scheme may have specific deviations in the form of regional and local characteristics.

Economic efficiency, like budgetary efficiency, is expressed in numerical indicators. However, the level of economic efficiency may vary across different economic entities within the same period. In such cases, it is expedient to group economic entities by turnover volume, field of activity, and other criteria. Nevertheless, the economic indicators of organizations operating on the same scale and in the same field may also differ. This situation is explained by numerous factors, including poor management quality. Therefore, calculations should primarily take into account large enterprises that create a significant number of jobs.

The foregoing does not imply that calculations should only take budgetary efficiency into account [9], [10]. It is necessary to utilize all types of evaluation; however, it is primarily required to unify the process of evaluating budgetary efficiency and systematize its results. Social and economic efficiency should be evaluated by local regions. These methodologies should be developed jointly by regions and local government bodies and may serve a supplementary role in evaluating budgetary efficiency. Since social efficiency has specific characteristics, it is expedient to evaluate it through sociological surveys.

The final indicators obtained from evaluating social and economic efficiency can subsequently be converted into numerical values that allow for comparison with data obtained from the budgetary efficiency evaluation.

Having studied existing methodologies, this research proposes the use of the Aggregate Economic Efficiency E_{yigma} indicator for evaluating tax incentives. This indicator is calculated based on the following formula:

$$E_{yigma} = \frac{k_t + (k_{ijt} + k_{iqt})}{X_{baholash}}, \quad (4)$$

Where:

k_t – the coefficient of the impact of social and economic efficiency;

k_{ijt} – the social efficiency coefficient;

k_{iqt} – the economic efficiency coefficient;

$X_{baholash}$ – the costs of conducting the evaluation.

Let us now examine in detail the procedure for calculating the coefficients k_t , k_{ijt} , and k_{iqt} within formula (4).

The Coefficient of the Impact of Social and Economic Efficiency k_t is determined based on the following ratio:

$$k_t = \frac{k_s \times n}{100}, \quad (5)$$

Where:

k_s – the quality coefficient, determined based on table units developed by regions and local authorities, and expressed in points (from 1 to 5);

n – the number of indicators applied by a specific region [11].

k_s consists of the sum of three magnitudes: the target nature (addressability) of granting incentives, the transparency of granting, and the breadth of coverage (indicative list). Each indicator is evaluated with a certain number of points:

Target nature (Addressability) of granting incentives (1 to 5 points): If beneficiaries cannot be classified by any criterion, addressability equals 1; if beneficiaries can be divided into more than 4 groups, this indicator equals 5.

Transparency of granting incentives: Determined based on sociological surveys and evaluated from 1 to 5.

Breadth of coverage: An increasing indicator.

k_{iqt} is determined as the sum of three indicators: capitalization level, investment level, and profit received for a conditional period (indicative list). The capitalization level is equal to the ratio of long-term liabilities to the sum of the organization's long-term liabilities and equity [12]. The investment level is determined as the difference between

the sum of investments made by small and large investors during a conditional period and the sum of investments made by the largest investor.

k_{ijt} and k_{iqt} should consist of at least three indicators. The greater the number of indicators, the higher the accuracy of the formula. The general list of indicators should be approved at the federal level. Each indicator is calculated via a certain number of points. The quality indicator depends on the significance of other indicators affecting the formula (e.g., social efficiency indicators may have a lower value relative to economic efficiency indicators, while the addressability of incentives may have a higher value relative to transparency) and on the characteristics of the economic activity of the entity for which the economic efficiency coefficient is calculated.

The evaluation of the effectiveness of granted tax incentives should be carried out by the local finance department in cooperation with the tax administration. This body aggregates information on tax revenues for each region. It is expedient to conduct the evaluation of tax incentive effectiveness across each tax type and category of taxpayers. Incentives in the form of tax base reduction and tax rate reduction are taken as the object of analysis [13].

Based on the results of the tax incentive effectiveness evaluation, the competent authority of the region prepares a conclusion, on the basis of which one of the following decisions is made:

- to retain the granted (or planned) tax incentives;
- to abolish the granted (or planned) tax incentives;
- to correct (modify) the granted (or planned) tax incentives.

A critical aspect regarding the effectiveness of using tax incentives is that no obligation is imposed on taxpayers to use the funds retained at their disposal as a result of incentives for implementing investment policy or for other purposes envisaged when granting the incentives. The taxpayer receiving the incentive is not bound by an obligation to use it for a targeted purpose.

In the Tax Code of the Republic of Uzbekistan, clearly defined procedures for tax control and tax monitoring of the effectiveness of tax incentives still do not exist. This makes it practically impossible to collect and prepare the information necessary for analyzing and making decisions regarding the subsequent application of incentives. Therefore, although a unified comprehensive methodology for evaluating tax incentive effectiveness has not been implemented in practice, it is necessary to continue work in this direction.

Tax incentives granted to economic entities, rather than individuals, should be of a mandatory character. Presumably, such an obligation should be established at the legislative level and accepted by the beneficiary [14], [15].

It is known that tax incentives often have a prolonged effect over time, leading to the gradual growth of the taxpayer's assets and, consequently, an increase in tax revenues to the budget system in the future. In this regard, it is necessary to introduce the concept of the aggregate (cumulative) effect of tax incentives into the efficiency evaluation mechanism. Here, evaluation criteria that assess forgone budget revenues in correlation with the results of the financial-economic activity of economic entities should be taken as a basis. Undoubtedly, work on improving the mechanism for evaluating the effectiveness of tax stimulation instruments must continue in the direction of eliminating identified shortcomings, increasing the objectivity of evaluation, and simplifying it. This will assume significant importance for planning tax revenues to local budgets in the future.

4. Conclusion

The results of the conducted research demonstrate that tax incentives constitute a crucial instrument in modern fiscal policy for stimulating regional socio-economic development. However, the absence of a unified, systematic, and scientifically grounded evaluation mechanism to determine their real budgetary, economic, and social efficiency during the implementation and application process at the local level diminishes the effectiveness of using this instrument.

The comprehensive approach proposed in the article allows for an integrated assessment by designating budgetary efficiency as the priority criterion while incorporating economic and social efficiency indicators. This approach serves to evaluate tax incentives not merely as “forgone revenue”, but as tax expenditures that must yield specific results.

The study revealed that in current evaluation practice, the impact of tax incentives is not sufficiently isolated from other factors (market conjuncture, legislative changes, economic activity). This situation exacerbates subjectivity in decision-making and may exert a negative impact on fiscal stability.

Furthermore, the system of aggregate (integral) indicators developed in the article serves as a significant scientific and practical basis for determining the short- and long-term impact of tax incentives, as well as for making grounded decisions regarding their retention, modification, or abolition.

Based on the analysis conducted and the conclusions drawn in the article, it is considered expedient to put forward the following scientific and practical proposals:

1. It is necessary to develop a unified, mandatory, and standardized methodology for evaluating the effectiveness of tax incentives in the Republic of Uzbekistan and to implement it as a regulatory legal act.
2. The introduction or continuation of tax incentives should be carried out only in cases where the budgetary efficiency coefficient is equal to or greater than one, with social incentives being evaluated separately as an exception.
3. Tax incentives granted to economic entities must be linked to targeted expenditures, investment obligations, or employment indicators, and these obligations must be consolidated at the legislative level.
4. Taking into account the delayed effect of tax incentives, a mechanism should be introduced to evaluate the correlation between budget losses and economic results over a period of at least 3–5 years.
5. It is expedient for social and economic efficiency to be evaluated by local government bodies and finance departments, taking into account regional characteristics, while budgetary efficiency should be calculated centrally based on a unified methodology.
6. Aggregating tax reports, statistical data, and tax monitoring results through an integrated digital platform will enhance the transparency and accuracy of the tax incentive effectiveness evaluation.

As a result of implementing these proposals into practice, the budgetary, economic, and social efficiency of tax incentives will increase, ineffective incentives will be reduced, and local budget revenues will stabilize. The target nature (addressability) and transparency of tax stimulation mechanisms will be strengthened, exerting a real impact on attracting investments and increasing employment. Consequently, tax incentives will transform into an effective fiscal instrument ensuring regional development.

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