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Global Tax Alert

Mongolia reforms its key tax legislation

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Executive summary

The Mongolian Government has been engaging in an extensive tax reform discussion over the past months. Following this discussion, key tax laws including the General Law on Taxation, the Corporate Income Tax Law, the Value Added Tax (VAT) Law and Personal Income Tax Law have been substantially revised by the Mongolian Parliament (the legislative body), under the Government's tax reform packages.

The new tax laws require the Cabinet, Ministry of Finance and Mongolian Tax Authority (MTA) to release a number of implementing guidelines. As these regulations will play an important role to set the tone of the taxing rules, taxpayers should monitor these developments in a timely manner.

The new tax rules are effective on 1 January 2020.

Several important changes that may have material impact on taxpayers, require taking appropriate action to comply with the new requirements.

This Alert summarizes some of the key changes. Separate Alerts will be issued to provide greater detail on a number of the changes.

Building a better working world

Detailed discussion

New General Taxation Law – GTL

Description	Current GTL	New GTL
Statute of limitations	The statute of limitations for the MTA to assess taxes on a taxpayer expires five years from the due date of the return.	The new law reduces the statute of limitations to four years.
Pre-court dispute resolution mechanism	Currently, there are two levels of Tax Dispute Settlement Councils (the Councils) in Mongolia being: (i) the Capital City [Ulaanbaatar] Council (or Municipal Council); and (ii) the Council under General Department of Taxation (GDT) which is the highest level of the Councils whose decision is the final decision at all taxing authority levels. Following is the appeal procedures: ▸ A taxpayer must first submit complaints to its corresponding Municipal or Capital City Council if the corresponding tax authority (of the taxpayer who submits complaints) is a district tax office or municipal tax office. ▸ If the taxpayer disagrees with the decision made by the Capital City Council (or Municipal Council), the taxpayer has the right to appeal to the Council under the GDT whose decision shall be final at pre-court level.	The two-level appeal procedures have been eased and there will be only one Council level at the MTA level for tax dispute cases as pre-court dispute resolution requirements. Under the new rules, the Council may decide to suspend the case and instruct the MTA to re-audit the case if certain conditions are met. Such re-audit shall be conducted by a higher level of the tax authority and shall not last more than three months. If a new assessment act is released, the original assessment act shall be cancelled. A 10% cash deposit is required by taxpayer to proceed with a dispute case and such deposit shall be capped at MNT100 million.
Tax payment extension	Taxpayers may request an extension for the payment of taxes up to 60 days under current rules.	Taxpayers may request an extension for the payment of taxes and the MTA may allow an extension for up to a two-year period. In the case of extensions, a security or guarantee arrangement may be required.

Description	Current GTL	New GTL
Tax collection and enforcement	See the new changes on the right.	Secondary tax obligation. In cases where a taxpayer (who has an outstanding tax debt) has transferred its assets to others free of charge or below market value or cancelled a receivable due from others, the asset receiver or the person whose debt is forgiven shall be obliged to pay the transferor's tax obligations. A tax debt shall be collected immediately from a taxpayer if it is considered that such tax debt is at risk. The MTA shall be entitled to start operations to collect this tax debt from the taxpayer via special procedures. The MTA shall be permitted to collect tax debts by expropriating the properties of the respective taxpayers and disposing them via auctions for cash. The MTA can freeze bank accounts and instruct banks to transfer funds for the tax debt collection. The MTA may instruct third parties to make a tax payment on behalf of the taxpayer in the event that the taxpayer has an outstanding tax due and receivable from the third party. Various legal procedures are available for the MTA to enforce tax collection. The MTA may put a restriction on a taxpayer's auto vehicle as an initial reminder of to pay the tax debt. The MTA also may request the immigration office to put a ban on the taxpayer (non-Mongolian) if the amount of tax debt is more than MNT20 million and he or she has no assets to cover his or her tax debts.
Sanction on tax non-compliance	As a general rule, the law imposes a 30% automatic base penalty for non-reported taxes. In addition to that, daily interest is charged.	A 30%-50% penalty shall be imposed on tax non-compliances for failure of tax obligations or tax withholding obligations in addition to the taxes due.
General Anti-Avoidance Rule (GAAR)	No formal GAAR in the tax laws.	The new GTL has introduced a GAAR which is a set of broad principle-based rules within a country's tax code designed to counteract the perceived avoidance of tax. The GAAR is a concept within the law that provides the taxing authority a mechanism to deny the tax benefits of transactions or arrangements believed not to have any commercial substance or purpose other than to generate the tax benefit(s) obtained.

Description	Current GTL	New GTL
Transfer Pricing	Various sections in the current tax law refers to the need for transactions between related parties to be conducted on an arm's-length basis. Failing this, the tax authorities may seek to adjust the transaction to a fair market value. There is no single, all-encompassing transfer pricing legislation in Mongolia. Instead, transfer pricing rules are contained in various individual tax laws.	Mongolia endorses the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines in the General Taxation Law. It is important to note that new amendments have imposed severe administrative penalties for the failure to comply with transfer pricing documentation requirements and these administrative penalties are equal to 2% – 4% of transaction value, apart from penalties and fines resulting from transfer pricing adjustments. The new transfer pricing rules include stringent transfer pricing documentation be prepared including: ▸ Transactional transfer pricing documents ▸ Local File ▸ Master File ▸ Country-by-Country report A separate detailed Global Tax Alert will be issued on transfer pricing changes.
Base Erosion and Profit Shifting (BEPS) related changes	Mongolia has not yet addressed BEPS-related changes.	New tax laws have introduced various changes related to the OECD's BEPS project reflecting recent global tax developments. A separate detailed Global Tax Alert will be issued on these changes.

New Corporate Income Tax Law – CIT

<table>
<tr><th>Description</th><th>Current CIT Law</th><th>New CIT Law</th></tr>
<tr><td>CIT rate</td><td>Taxable income up to MNT3 billion is subject to a 10% rate. Taxable income in excess of MNT3 billion is subject to a 25% rate.</td><td>Taxable income up to MNT6 billion is subject to a 10% rated. Taxable income in excess of MNT6 billion is subject to a 25% rate.

CIT rate is 1% for business entities with annual turnover under MNT300 million; certain qualifying conditions may apply.</td></tr>
<tr><td rowspan="2">Other special tax rates</td><td>Direct and indirect transfer of land rights, mineral exploration and mining rights and other covered rights are subject to withholding tax at a rate of 30% on gross basis.</td><td>The withholding tax rate is 10% with certain deductions allowed.</td></tr>
<tr><td>The interest tax rate on debt instruments issued by a Mongolian listed company:
▸ Resident taxpayer: 10%
▸ Nonresident taxpayer: 20% withholding</td><td>5% for both resident and nonresident taxpayers. Mongolian listed company excludes business entities holding exploration and mining license in mineral, oil and uranium industry.</td></tr>
<tr><td rowspan="2">Tax credits & exemptions</td><td>Investment fund income is exempt from tax i.e., the fund vehicles are tax transparent. A 90% tax credit is available to business entities with annual turnover under MNT1.5 billion, and operating in one of the following industries:
▸ Agriculture and livestock production and related auxiliary activities
▸ Food production
▸ Manufacture of garment and textiles
▸ Manufacture of building materials</td><td>The new law abolished the investment fund tax exemption. A 90% tax credit is available to all entities with annual turnover under MNT1.5 billion excluding the entities operating in the following sectors:
▸ Transportation, exploration, mining and sale of mineral and radioactive minerals
▸ Importing alcoholic beverages and tobacco, planning and manufacturing tobacco
▸ Manufacture of petroleum products, import, wholesale, and retail of all types of fuel, exploration, mining and sales of oil

A 50% - 90% tax credit is available to companies with principal management and operations in the remote areas that are more than 500 km away from Ulaanbaatar: subject to certain qualifying conditions; certain industries are excluded.

(This is largely in the current law and the credit expires on 1 January 2019 with current law.)</td></tr>
<tr><td>A limited foreign tax credit is applicable for countries with an available tax treaty with Mongolia.</td><td>Domestic CIT law provides a unilateral foreign tax credit irrespective of the tax treaties in place.</td></tr>
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Description	Current CIT Law	New CIT Law
Loss carryforward	From two – eight years. Maximum carryforward duration for tax losses is two years with only 50% of taxable profits in any tax year that can be offset by such tax losses. Mining and infrastructure companies can carryforward tax losses four to eight years depending on the investment amount, without any restriction on the use of such losses.	Four years. Carryforward duration is four years without sector differentiation with a universal restriction of 50% of taxable profits in any tax year. Tax losses can't be transferred during company reorganizations.
Useful life of buildings for tax depreciation purpose	See table 1 below	See table 1 below

Table 1

Non-current assets	Current CIT Law / Non-current assets useful life (years)	New CIT Law / Non-current assets useful life (years)
Building and construction	40	For non-extractive industries: 25 For extractive industries including exploration and mining supply chains: 40
Machinery and equipment	10	10 (no change)
Computers, computer parts, software	3	2
Intangible asset with indefinite useful life	10	10 (no change)
Intangible asset with definite useful life (includes licenses for mineral and exploration) and extraction	Validity period	Validity period (no change)
Other non-current assets	10	10 (no change)

New Corporate Income Tax Law – CIT (continued)

Description	Current CIT Law	New CIT Law
Deductible expense	*Listing approach* Current CIT law does not provide general deduction rules for expenses incurred wholly and exclusively for the purposes of the trade, rather the legislation provides a list of deductible expenses.	*Criteria based approach* New law recognizes any expense as a deductible expense for tax purposes if the following pre-determined criteria have been met: ▸ Incurred for the reporting period ▸ Incurred for income generating purpose ▸ Recognized according to accounting laws with supporting documents ▸ Recorded in VAT system or customs clearance with some exceptions, if applicable ▸ The expense is paid or expected to be paid by the taxpayer
Interest deductibility rules	Thin capitalization restriction of 3:1 debt to equity ratio.	Combination of 30% EBITDA (earnings before interest, tax, depreciation and amortization) restriction and current 3:1 thin capitalization restriction. Under current law, thin capitalization arises when investor's debt-to-equity exceeds 3:1 ratio and any interest attributable to the debt exceeding the ratio debt is non-deductible for tax purposes. In addition, the New CIT law introduced another restriction that such related party loan interest shall not exceed 30% of EBITDA for any given year.
Capital gains earned by nonresidents	10%/25% (the current law lacks clear taxing provisions).	Under the new rules, nonresidents are likely to be taxed at the rate is 20% on gross capital gains.
Ring-fencing rules for separate mines	No ring-fencing rules.	Under the new rules, income and expenses that are incurred for different mines must be accounted separately for tax purpose. In other words, a company will need to prepare separate profit and loss statements for each mine or exploration areas. This is expected to lead to an addition of efforts to process such data from an accounting and tax perspective.
Tax filing	CIT filing requires quarterly and annual lodgment of the tax returns for all segments of taxpayers.	Small and medium enterprises (SMEs) with annual taxable income under MNT6 billion can file twice while large taxpayers remain subject to filing quarterly tax returns. Small entities with less than 50 million annual taxable income can elect for a flat 1% gross tax and file just one tax return a year.

Description	Current CIT Law	New CIT Law
Tax Residency	Tax residents of Mongolia are taxed on their worldwide income. A company is regarded as a resident of Mongolia under either of the following circumstances: ▸ It is incorporated in Mongolia ▸ It is a foreign entity that has its head office located in Mongolia i.e., effective management is exercised in Mongolia	The law introduces a new rule for treating a foreign company as a Mongolian resident if they meet certain criteria. If any three of the following conditions are met, the foreign company shall be treated as a Mongolian resident: ▸ More than 50% of shareholders (or their nominees) reside in Mongolia ▸ More than 50% of shareholder meetings have been held during the preceding four years ▸ Accounting or financial documents are maintained in Mongolia ▸ More than 25% of board members or their nominees reside in Mongolia ▸ More than 60% of total income is sourced from Mongolia

New amendments to Value Added Tax Law – VAT

Description	Current VAT Law	New amendments
Recovery of input VAT on capital goods	Under current VAT rules, an input credit or tax refund of VAT incurred on a business's capital expenditure is disallowed. This stipulates that input VAT paid on purchasing, procuring or developing "fixed assets" is unrecoverable irrespective of whether the company is registered for VAT agent.	An amendment was made to the VAT Laws in this area. With the new laws, the input VAT incurred on capital expenditure can be recovered as follows: ▸ Buildings and construction: Input VAT shall be recovered over 10 years with equal amount ▸ Equipment/Exploration activity: Input VAT shall be recovered over five years in equal amounts ▸ Other capital assets: Input VAT shall be recovered in the same year the company purchased the asset
VAT on loan interest	In the current VAT law, there has been some uncertainty as to whether loan interest of non-banking transactions is exempt from VAT. Article 13 of the VAT Law provides a list of tax exempt supplies and article 13.5.5 says that "service of granting of a loan" is exempt from VAT while article 13.5.7 says that an interest of bank, NBFIs and savings and loan entities is exempt VAT.	Under the new rules, the article 13.5.7 has been amended to capture corporate loan interest for exemptions.

New Personal Income Tax Law – PIT

Description	Current PIT Law	New PIT Law
Tax Residency	Under the current law, individuals are liable to pay PIT on their income. Mongolia divides individual taxpayers into two separate groups, resident and nonresident taxpayers. A resident taxpayer of Mongolia is taxable on his/her worldwide income. The legislation defines a permanent resident taxpayer as: ▸ An individual who possesses a residential home in Mongolia; or ▸ An individual who resides in Mongolia for 183 or more days in a given calendar year. A nonresident taxpayer of Mongolia is subject to tax on the income earned in the territory of Mongolia in a tax year and is defined as: ▸ An individual who has no residential home in Mongolia and has resided in Mongolia for less than 183 days in a tax year.	The new law has re-defined tax residency as follows: ▸ An individual shall be a Mongolian resident taxpayer if either of the following two criteria are met: – An individual who resides in Mongolia for 183 or more days in a given consecutive 12-month period. – If income earned in Mongolia and/or Mongolian sourced income is more than 50% of an individual's worldwide income. The first criteria will need to be checked first. A resident taxpayer of Mongolia is taxable on his/her worldwide income while nonresidents shall be taxed on Mongolian-sourced income only.
Tax rates	All resident entrepreneurs are generally taxed at 10% on their profits from operating income.	A resident individual entrepreneur may elect a 1% gross tax instead of 10% tax on the taxable income from business operations if annual turnover is under MNT50 million. Mongolia keeps its current 10% tax rate for most of the income including employment income, operating income, capital gains, passive income of dividends, interest and royalties and other indirect income for resident tax payers. The current 20% withholding tax shall remain for nonresidents.
Foreign tax credit	Foreign tax credits are limited to countries with which Mongolia has tax treaties.	Foreign tax credits are now available under domestic PIT laws irrespective of tax treaties in place.
Mongolia – Source rule	Current PIT law largely employs language that provides nonresidents are taxed for income earned in or within the territory of Mongolia.	The new law introduced a "Mongolian-source" rule that intends to cover broader income source for nonresidents, similar to CIT laws. It almost serves as a catch-all provision in the laws. The definition for "Mongolian-sourced income" covers all income types set out in the PIT law and refers to the Mongolian source rule in the CIT Law.

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