



POSITION PAPER ON COMPREHENSIVE

TAX REFORM AND TAX DISPUTE RESOLUTION IN MONGOLIA

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This paper was prepared by the Financial Services Committee of the American Chamber of Commerce in Mongolia (AmCham) and the Foreign Direct Investment Working Group of EuroChamber Mongolia (EuroChamber) under the leadership of the Chairman of the AmCham's Financial Services Committee, Shaukat Tapia, and Co-chairman of the FDI working group, EuroChamber's Daniel Mahoney.

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EXECUTIVE SUMMARY

The primary objective of this paper is to outline key tax issues that discourage foreign direct investment (FDI) in Mongolia and identify potential amendments to the tax laws and practices that would render a more investor-friendly tax environment in Mongolia. This position paper highlights an urgent need to amend certain provisions of tax laws and practices to attract FDI, which includes utilizing tax exemptions/credits, adjusting the requirement of advance payments in controversial tax cases, offering a credit for reverse charge value-added tax (RC VAT) paid for imported services, basing mining royalty value on a contract price or profit basis, improving transfer pricing implications, improving the mechanism for issuing a legally binding ruling of the Mongolian Tax Authority (MTA), reducing the withholding tax rate for non-resident income earned in Mongolia to 10 percent, changing the tax base estimation to a net basis, and clarifying the tax ruling on the indirect transfer of shares.

Most of these items entail the amendment of existing laws and practices that actively discourage investment, the goal being to provide a neutral tax environment for investors to rectify the current situation, where certain tax issues often work to stop new investment in Mongolia. There are additional items that policymakers can consider in the context of actively encouraging investment, i.e., establishing a tax environment (exemptions/credits) that is competitive with the environments available in other countries and offer greater incentives to invest in Mongolia.

The second part of the position paper outlines current processes for tax dispute resolution, addresses challenges, and makes some recommendations to improve the tax dispute resolution process.

BACKGROUND

The Mongolian tax regime consists of over 20 types of taxes. In 2019, the Mongolian Parliament made significant legislative reforms to support the economy and businesses and introduced international concepts by adopting amendments to key tax laws. The amended laws became effective on January 1, 2020.¹ However, AmCham and EuroChamber believe Mongolia still needs comprehensive tax reform to attract and encourage FDI.

Major taxes in Mongolia:

- Corporate income tax (CIT)
- Value-added tax (VAT)
- Personal income tax (PIT)

Other taxes:

- Immovable property tax
- Customs duty
- Excise tax
- Stamp duty fees
- Mineral royalty fees
- Mining and exploration license fees
- Land fees
- Air pollution payment
- City tax

In addition to PIT, Mongolian citizens, foreign nationals, and stateless individuals under a labor or service contract with any business entity are subject to mandatory social insurance contributions. Depending on a company's activities and assets, it may also be subject to other taxes, such as mining royalty fees, customs duties, vehicle tax, and immovable property tax.

Mongolia joined the OECD's Inclusive Framework on Base Erosion and Profit Shifting Project (BEPS) in December 2017. The 2020 tax reforms reflected some BEPS project recommendations and international tax concepts, including a general anti-avoidance rule, comprehensive transfer pricing, and

foreign-controlled company rules.

Since 2020, tax audits have been conducted based on risk assessment criteria, and in certain cases, such as the liquidation of a company or validation of VAT refunds, subject to compulsory audits. A statutory limitation period of four years is applied for tax reassessment, fines, penalties, the utilization of tax credits, tax loss carried forward, and the validation of VAT assessment.

According to the U.S. Embassy's 2023 Mongolia Investment Climate Statement, "The government generally offers the same tax preferences to foreign and domestic investors; and occasionally waives tariffs for

¹ <https://investmongolia.gov.mn/taxation/>

imports of essential fuel and food products or for imports in such targeted sectors as agriculture or energy. Exemptions may apply to Mongolia's 5-percent import duty and 10-percent value-added tax (VAT). The government may offer traditional and green energy sector investments such incentives as feed-in tariffs, discounts on electricity rates, or tax incentives. The government may also extend tax credits on a case-by-case basis to investments in such sectors as minerals processing, agriculture, and infrastructure. Under the Investment Law, foreign-invested companies, properly registered and paying taxes in Mongolia, qualify as domestic Mongolian entities for investment incentive packages that, among other benefits, offer tax stabilization for up to 27 years. While in theory the government can issue guarantees or jointly finance foreign direct investment projects, it seldom does so in practice."²

Foreign investors state that the amount of imposed taxes is not high, but its aggregation poses an issue. For instance, foreign-invested companies are liable for 10 percent of CIT, 10 percent of VAT, and 20 percent of withholding tax, which amounts to 40 percent in taxes.

Since 2017, Mongolia has been engaging in extensive tax reform discussions. Key tax laws, including the General Law on Taxation, Corporate Income Tax Law, Personal Income Tax Law, and VAT Law, have been substantially revised by Parliament under Cabinet's tax reform packages. The new tax laws that took effect on January 1, 2020, require the cabinet, the Ministry of Finance, and the MTA to release a number of implementing guidelines.

² <https://mn.usembassy.gov/2023-investment-climate-statement-mongolia/#:~:text=EX-ECUTIVE%20SUMMARY,stakeholders%20during%20rulemaking%20warrant%20caution.>

CHALLENGES IN THE TAX AND REGULATORY FRAMEWORK AND RECOMMENDATIONS

AmCham and EuroChamber recommend the following proposals for urgent legal reforms required for tax legislation. On behalf of the hundreds of domestic and foreign-invested businesses and entrepreneurs that drive the nation's economy, create thousands of jobs, pay taxes, and consciously contribute to the nation's development, we respectfully ask Parliament and Cabinet to receive our proposals and make the relevant legal amendments to tax laws and regulations:

1

Investment Law: Opportunity to utilize tax exemptions/credits and stabilization

This law provides a number of tax incentives for businesses, but it is not implemented for investors. There is a need to amend the tax laws, as the coordination of these business laws is urgently needed to attract FDI and offer additional incentives for investors considering investment in Mongolia.

It is also necessary to clearly review the legal provisions on the main concepts and benefits of the tax stabilization framework in investment agreements. The inconsistency of these frameworks between contracted parties has resulted in a tax dispute amounting to 400 million USD.

2

Assertive enforcement of advance tax payments in controversial tax cases

Currently, the General Tax Law requires the full payment to the MTA of a disputed tax amount before a final court decision is made, which is excessively unfair and places a large financial burden on the taxpayer. Article 47.3 of the General Tax Law states that a taxpayer is required to deposit only 10 percent of the disputed tax amount, capped at a maximum of 100 million MNT, to proceed to dispute resolution with the Tax Dispute Resolution Council (TDRC). There are cases in which the MTA loses these disputes in court. Therefore, it is necessary to repeal Article 43.3 of the General Tax Law.

3**Allow RC VAT for imported services and work**

Imposing VAT on imported work or services increases the cost of business, reduces profits, and blocks intellectual capital. Imported work and services are mainly professional services based on the knowledge and experience of foreign experts. Therefore, the VAT law should be amended to include a credit for RC VAT paid on imported services.

4**Mining royalties should be based on contract price or profit**

The current royalty rate for mineral extraction is calculated based on the Ministry of Finance regulation dictating market prices, which creates an excessive tax burden for businesses and discourages investment. We suggest replacing it with a profit-based royalty or using a contracted price.

5**Improve TP implication**

Sources of information benchmarking fair market value are not clearly defined in transfer pricing (TP) regulations. Procedures performed by the MTA as part of their TP inspections should be documented to make the assessed TP adjustment process and calculations more transparent to taxpayers. The MTA should also be more open to disclosing sources of information with authorized parties (e.g., counterpart tax authorities).

6**Improve the mechanism for issuing a legally binding MTA ruling**

Remind the MTA to exercise legal authority and serve taxpayers by issuing legally binding rulings (e.g., advance rulings) regarding tax uncertainty. Only three such instances of advance rulings have been issued. Given the uncertainty and inconsistency in the interpretation of tax legislation, more rulings are needed.

7**Taxes on the sale of shares**

The 20 percent taxation of gross proceeds from the sale of shares of a Mongolian company by a non-resident should be adjusted to a tax on the capital gains earned from such sales. Last year, an amendment was made to fix this issue for the sale of shares listed on the MSE, but it is not applied generally. This current legal provision is a major disincentive. It is often a complete barrier to new investment in Mongolia when a non-resident investor is informed that they will owe income tax when exiting their investment, even when the investor sells their stake at a loss.

According to international tax rules, capital gains should be taxed on a net basis, meaning the investment contributed by foreign investors should be deducted to define the tax base. This provision can also be considered discriminatory, as resident taxpayers are taxed on a net basis while non-residents are taxed on a gross basis.

8

Withholding tax on services provided by non-residents

Current law requires that the payment for services by any Mongolian resident constitutes taxable Mongolian income for all non-resident service providers (taxed at 20 percent of the gross amount withheld by the Mongolian party). In practice, this tax is paid by the Mongolian party and not the non-resident, as the non-resident will require the Mongolian party to raise the payment to cover the Mongolian tax obligation. This is effectively a tax on Mongolian taxpayers regarding a certain portion of their expenses.

9

Sale of mining rights

Under Article 30 of the CIT Law, an indirect transfer tax rule (ITTR) was introduced in 2020. The ITTR applies to the direct and indirect sale of shares of Mongolian companies that hold land or mineral rights in Mongolia. However, the ITTR has led to double taxation, numerous uncertainties, and inconsistent interpretations by the tax authorities. For instance, it is unclear whether a 20 percent withholding tax (WHT) on a gross basis or 10 percent on a net basis will apply, how the tax base is defined, and how to avoid double taxation. Some tax authority officials interpret the ITTR as a non-resident taxpayer selling their shares in a Mongolian mining company and the Mongolian company being required to pay taxes in Mongolia. The Mongolian company pays 10 percent CIT on the mining license value, while the non-resident seller pays 20 percent WHT on proceeds from the sale of shares.

Non-compliance with the ITTR/Article 30 of the CIT Law can lead to the cancellation of respective rights, which can be catastrophic to businesses. Hence, the ITTR should be revisited to eliminate uncertainties. Without such revisions, the Mongolian investment environment may continue to face challenges; for instance, investment in mining projects may be discouraged, especially during the crucial development and capital-raising phases.

TAX DISPUTE RESOLUTION

PRE-COURT DISPUTE RESOLUTION MECHANISM

Until 2020, there were two layers of tax dispute settlement councils in Mongolia: the Ulaanbaatar council (or municipal council) and the council under the General Department of Taxation (GDT), the highest-ranking council whose decisions are final at all tax authority levels.³

Past appeal procedures:

- Taxpayers first submitted complaints to their corresponding municipal council if their corresponding tax authority was a district or municipal tax office.
- If the taxpayer disagreed with the decision made by the municipal council, the taxpayer had the right to appeal to the GDT council, whose decision was final at the pre-court level.

The two-level appeal procedures were eased under the amended General Tax Law (2020). There is now only one council at the MTA level for pre-court dispute resolution requirements. Under the new rules, the council may decide to suspend the case and instruct the MTA to re-audit if certain conditions are met. A higher tax authority must conduct the re-audit, which must not last more than three months. The original assessment will be canceled if a new action is released.

Payment of a 10 percent advance tax (from reassessed taxes) is required to proceed with a dispute, capped at 100 million MNT.

The following chart is an overview of the current tax dispute resolution process in Mongolia:

³EY's tax alert "Mongolia reforms its key tax legislation" (June 4, 2019)

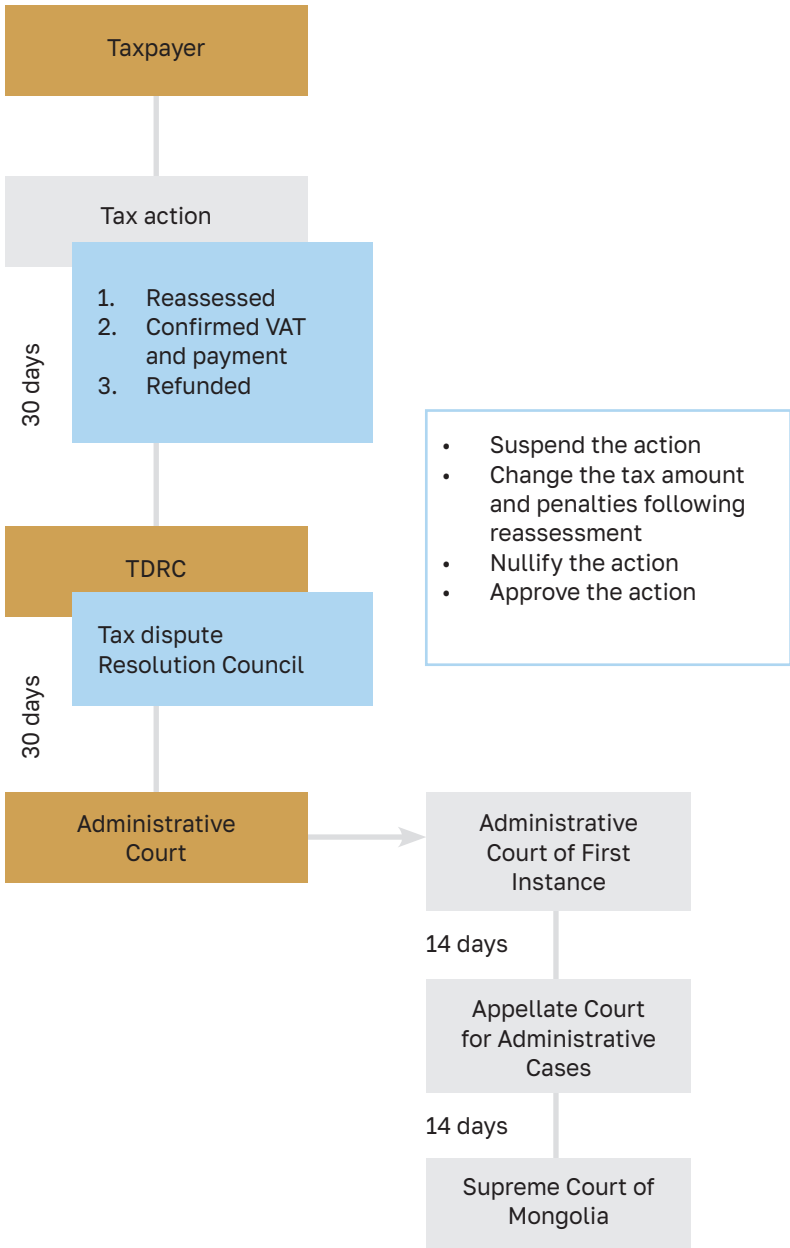
TAX DISPUTE RESOLUTION PROCESS /TAX ACTION/

The TRDC may SUSPEND and transfer a case to the supervising tax unit for review if it finds that there was a calculation error that reduced the reassessed tax amount or uncertainties in the tax action that limit the TDRC's capacity to resolve the dispute

"Calculation error" means an obvious error in calculation of the tax auction.

3-month suspension:

- The supervising tax authority must review the act and make changes.
- If no changes are made to the action, the TDRC will continue proceedings.



- Suspend the action
- Change the tax amount and penalties following reassessment
- Nullify the action
- Approve the action

1. Eliminate disparities in the application of judicial law
2. A serious violation of due process affects court decisions
3. The law was applied differently from the Supreme Court's ruling and interpretation
4. Fundamentally important to establish a new legal concept of the law's application

TAX PAYMENT EXTENSION

Taxpayers may request an extension for the payment of taxes, and the MTA may allow an extension of up to two years. A security or guarantee arrangement may be required for extensions.

TAX COLLECTION AND ENFORCEMENT

A tax debt shall be collected immediately from the taxpayer if it is considered that such debt is at risk of default. The MTA is entitled to start collections through special procedures.

- The MTA is permitted to collect tax debts by seizing the taxpayer's property and disposing of it through cash auctions. The MTA can freeze bank accounts and instruct banks to transfer funds for tax debt collection. The MTA may instruct a third party to make a tax payment on the taxpayer's behalf if outstanding taxes are 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 vehicle as an initial procedure for collecting tax debt. The MTA may also request that the Immigration Office ban a non-Mongolian taxpayer's exit if the amount due is more than 20 million MNT and the taxpayer has no assets to cover their debt.

SANCTION ON TAX NON-COMPLIANCE

A 30-50 percent penalty shall be imposed on the failure to meet compliance with tax or WHT obligations in addition to tax payments due.

NOTES