

## LEGISLATIVE UPDATE: MONGOLIAN TAX REFORM



### POSITIVE NEWS FOR MINING AND LAND RIGHTS HOLDERS - REDUCTION FROM 30% TO 10% TRANSFER TAX

The Parliament of Mongolia adopted the revised *General Taxation Law* (the “**GTL**”), the *Law on Corporate Income Tax* (the “**CIT Law**”) and the *Law on Personal Income Tax* (the “**PIT Law**”, together the “**Taxation Package Laws**”) on 22 March 2019, which became effective from 1 January 2020.

In connection with these revised laws, approximately 23 laws were amended, including the Civil Code, the Criminal Code, the Law on Licensing of Legal Entities, the Law on Minor Offences, the Law on Bankruptcy, the Law on Minerals, the Law on State Registration of Legal Entities and the Law on Banking. Revised methodologies on valuation of minerals licenses and land rights for tax purposes were approved by the Ministry of Finance and officially published as of 20 January 2020.

### 1. INTRODUCTION

The current General Taxation Law (2008), Law on Corporate Income Tax (2006) and Law on Personal Income Tax (2006) have been amended to reflect the fast-changing and developing business and international regulatory environment. In 2017, Mongolia became a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes (“Forum”) and agreed to apply Base Erosion Profit Shifting (“BEPS”) standards in order to be discharged from the EU list of non-cooperative jurisdictions for tax purposes.

Pursuant to the recommendations and requirements by BEPS and the Forum, Mongolia was required to address certain issues, apply internationally recognized rules, regulations and concepts regarding information exchange, transparency and confidentiality in its tax laws. In order to enhance tax revenues and move towards international standards in relation to tax evasion and transfer pricing, the Government of Mongolia revised and amended a number of key tax laws.

This briefing does not address all aspects of the tax reforms but focuses on key changes of interest to domestic and foreign investors, specifically in relation to tax on transfers of land and minerals license rights.

### 2. CORPORATE INCOME TAX LAW



Generally, under the revised CIT Law, the threshold for taxable income of resident taxpayers has been increased from MNT 3 billion to MNT 6 billion with the rate remaining at 10 per cent. Above MNT 6 billion of taxable income, tax is payable at the rate of 25 per cent.

Under the CIT Law, lower rates, simplified tax reporting (half-year and annual basis) and tax credits will be applied in certain circumstances, depending on the total taxable income, annual sales revenue and location of a taxpayer, and the sectors in which a taxpayer operates.

The CIT Law also seeks to define some terms that were unclear and vague under the previous law, including “Mongolian sourced income”, “foreign legal entity whose governing body resides in Mongolia” and “foreign legal entity managed from Mongolia”.

Below are some other key points of the CIT Law.

#### 2.1 Sale of Rights by a Beneficial Holder: Reduction from 30% to 10%

##### (a) Tax rate

Under the new CIT Law, transactions involving a full or partial disposal of shares held directly or

indirectly by a beneficial holder in a legal entity holding exploration or mining licenses for minerals, radioactive minerals and petroleum, and land possession and use rights, will be treated as a “sale of rights”, which is now subject to 10 per cent tax in lieu of the previous 30 per cent rate.

The CIT Law now provides for some deductible expenses from revenue generated from sales of rights, which was not available under the previous law, for the purpose of calculating taxable income.

See section 3.2 below for further details of the revised definition of “beneficial holder” under the GTL.

#### (b) **Methods of calculation**

Previous orders of the Minister of Finance, which set out methodologies for assessment of the value of licenses and rights for tax purposes, have been replaced by new methodologies in Orders No.302 and 303 of the Minister of Finance, each published on 20 January 2020 and 17 January 2020, respectively.

The new methodologies were expected to provide more thorough and practical guidance on some unclear issues in the law and prior regulations, however only limited changes have been introduced.

Although contract price remains the main factor to determine the value of minerals licenses and land rights under the new methodologies, they do not reference some commonly used types of commercial arrangements in the market, such as earn-in or farm-in agreements, beyond simple share sale and transfer agreements. This could lead to a risk of discretionary interpretation by tax authorities.

Under the previous law, tax was to be remitted within 7 business days of the transaction. Although this period is now increased from 7 to 30 days, the starting point remains unclear as to whether it is from the date of signing of contracts, the date of payment of the purchase price or the date of completion.

It remains the case that any tax payable on a sale of rights is an obligation of the direct right or license holder in Mongolia, rather than the seller or buyer of the right or license.

From the definition of “beneficial holder” given under the GTL and lack of clear guidance in the CIT Law and the Orders, it is possible that shareholders at each level of an ownership chain may be treated as beneficial holders.

#### (c) **Reorganization**

An important development under the CIT Law is that share transfers within a group of companies by way of intra-group restructuring will not be considered as a “sale of rights” by the beneficial holder provided that the size and amount of share participations and voting rights held by the beneficial holder does not change.

#### (d) **Tax exemptions for domestic beneficial holder and listed companies**

There are certain exemptions that can apply to: (i) sales of shares or sales of rights by a beneficial holder that is a Mongolian resident tax payer, or (ii) if shares of a license holder, its beneficial holder or any legal entity within the ownership chain are listed on a domestic or foreign stock exchange.

### 2.2 **Tax residency and Mongolian sourced income**

#### (a) **Resident tax payer**

The CIT Law introduced several criteria that could classify a foreign legal entity whose governing body resides in Mongolia as a “Mongolian resident taxpayer”.

In addition, the CIT Law has also introduced a rule to treat some foreign legal entities as Mongolian resident taxpayers under a new definition of “foreign legal entity managed from Mongolia”.

“A foreign legal entity managed from Mongolia” is a foreign legal entity in relation to which: (i) 50% or more of the shares and voting rights are held directly or indirectly by a Mongolian taxpayer or an individual who permanently resides in Mongolia through an ownership chain of one or more levels, and (ii) which conducts its operations in a foreign country or territory regarded as an “offshore jurisdiction” determined pursuant to the Law on Conflicts of Interest.

As an exemption to this classification, if a foreign legal entity was established for the purpose of undertaking an initial public offering at a foreign stock exchange, it will not be treated as a Mongolian resident taxpayer.

#### (b) **Non-resident tax payer**

The definition of non-resident taxpayer in the CIT Law remains the same as under the previous law. However, the CIT Law looks to provide a clearer definition of “Mongolian Sourced Income” for non-resident taxpayers.

### (c) Tax deductions

Rather than listing out all deductible expenses, the CIT Law contains various requirements, conditions and limitations on classifying deductible expenses for tax purposes. Deductible expenses on interest payments made to related parties are limited to 30 per cent of the EBIDTA of the taxpayer for any given year.

Another development under the new CIT Law is that, to avoid double-counting, tax paid in foreign countries will be deducted or set-off from the tax payable in Mongolia, which further requires the Mongolian tax authority to cooperate and exchange information with foreign tax authorities.

### 3. GENERAL TAXATION LAW



Generally, the Taxation Package Laws aim to provide more favorable terms and conditions for taxpayers, especially small and medium sized

enterprises. The GTL has introduced or revised several important points including (1) rules of tax priority, and asset seizures for tax debt, (2) extended deadlines for payment of tax debt, (3) shortened the statute of limitation for tax inspections from 5 years to 4 years, (4) the ability to revise tax reports within 3 days upon notification by the tax authority of an error, or within 1 year without penalty, (5) tax inspection based on the taxpayer risk, (6) simplified tax reporting and payment regimes, (7) increased tax credits, (8) revised definitions including “related parties” and “beneficial holder”, and (9) measures against tax avoidance.

The GTL also has introduced new terms, and regulations, including “tax evasion”, “tax avoidance”, “tax scheme” and “transfer pricing rules” more in line with international tax standards, General Anti-Avoidance Rules (“GAAR”) and BEPS, as measures against tax evasion.

Below are the some selected developments in the GTL applicable to businesses.

#### 3.1 Extended deadline for payment of tax debt

Under the GTL, the deadline for payment of tax debts for companies experiencing financial difficulties can be extended up to 24 months. The previous limit was 2 months.

### 3.2 Beneficial Holder

In November 2017, a new concept of “**beneficial holder**” was initially introduced into Mongolian laws which was later changed to “**beneficial owner**”. Beneficial owner was then redefined under the Law on Combatting Money Laundering and Terrorism Financing to mean an individual who solely, or individuals who jointly, directly or indirectly, exercise the major part of control over an entity, its business and assets.

The definition of “**beneficial holder**” has now been separately introduced in the GTL as a person (an individual, legal entity, or organization) that holds more than 30 per cent of the shares or participation rights, or exercises more than 30 per cent of the voting rights and is entitled to receive dividends from, a legal entity holding exploration or mining licenses for minerals, petroleum, radioactive minerals, or land possession and use rights, either directly itself or indirectly through one or more levels of an ownership chain.

#### 3.3 Related Parties

In connection with enhanced rules regarding transfer pricing and its reporting, the GTL has expanded the definition of “**related parties**” to extended family members and members of group companies.

#### 3.4 Rules of priority

The ranking of tax debt was unclear under the previous regime, and it was not uncommon for tax debt to be paid after other debts and liabilities of a taxpayer. The GTL now specifies that tax debt must be paid before any other debts of taxpayers, subject to (i) debt from pledged assets or a mortgage with first ranking security interest, (ii) loss or damage caused to lives and health of other people, or (iii) parental or care liability towards others.

#### 3.5 Asset seizure and auction

Subject to the tax priority rule, if a taxpayer fails to pay tax debt on time, the tax authority is entitled to seize the movable, immovable and intangible assets of that taxpayer regardless of any security interest over such assets and properties. The tax authority has the right to sell the seized properties by way of auction in accordance with the Civil Code and the Law on Enforcement of Court Decisions, or a direct contract in certain circumstances. A separate regulation on seizing and storing the assets of taxpayers is expected to be issued in the near future by the Ministry of Finance.

### 3.6 Pre-court tax dispute resolution mechanisms, deposit and tax refunds

Under the old law, pre-court tax dispute resolution mechanisms were vague and there were numerous stages of appeal procedures for taxpayers to submit complaints.

The GTL now categorizes complaints and appeals by the nature of the issue, for example, whether the complaint relates to a tax audit act or relates to other matters.

As a result, the procedures for settling complaints against a tax audit act should be simplified, in that complaints will be resolved by a Tax Committee as a pre-court dispute resolution, prior to submitting a complaint or appeal to the Administrative Court.

However, in order to file a complaint against a tax audit act, taxpayers must deposit 10 per cent of the tax debt in question with a bank account designated by the relevant tax authority in a tax audit act, up to a maximum cap of MNT 100 million.

Any overpaid tax paid as a result of a tax audit act will be refunded by the tax authority within 30 business days.

#### 4. CONCLUSIONS

It is a positive step that Mongolian lawmakers and authorities are looking to enhance the tax regime to meet international standards, especially in the areas of money laundering and tax evasion compliance. Likewise, there are some promising tax incentives for small and medium sized businesses.

The previous 30 per cent tax on license and land rights transfers was a major impediment to joint ventures and M&A transactions in the mining sector, resulting in a number of transactions being put on hold or abandoned due to the potential additional cost for investors or buyers. We hope that the reduction in this transfer tax to 10 per cent can stimulate FDI in the mining sector.

However, on the flip side of that, the Taxation Package Laws do grant more authority to tax inspectors, for example, as to seizure of assets without judicial procedures, which could significantly impact on businesses. While the amendments are comprehensive and cover a large number of areas, there are still some vague provisions in the laws and regulations which could result in challenges for businesses in terms of implementation and compliance.

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