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## Executive summary

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

The new tax laws require the Cabinet, Ministry of Finance and Mongolian Tax Authority to release a number of implementing guidelines. As these regulations largely play an important role to set the tone of the taxing rules, we encourage you to monitor these developments in a timely manner.

The new tax rules shall take effect on 1 January 2020.

A number of important changes that may have material impact on taxpayers, requires taking appropriate actions to comply with the new requirements.

We have highlighted some of the key changes in this alert. EY intends to issue separate alerts on a number of changes summarized in this tax alert.

# Mongolia reforms its key tax legislation

June 4, 2019

## New General Taxation Law - GTL

| Description                            | Current GTL  | New GTL   |
|--|--|---|
| Statute of limitation                  | The statute of limitations for the MTA to assess taxes on a taxpayer expires five (5) years from the due date of the return.   | The new law has reduced the statute of limitation to four (4) years.  |
| Pre-court dispute resolution mechanism | <p>Currently, there are two layers of Tax Dispute Settlement Council (Councils) in Mongolia being a) Capital City [Ulaanbaatar] Council (or Municipal Council) and the Council under General Department of Taxation (GDT) which is the highest level of Council whose decision is final decision at all taxing authority level. Following is the appeal procedures:</p> <ul style="list-style-type: none"> <li>• Taxpayers firstly submit complaints to its corresponding Municipal or Capital City Council if the corresponding tax authority (of the taxpayer who submits complaints) is district tax office or municipal tax office.</li> <li>• If the taxpayer disagrees the decision made by Capital City Council (or Municipal Council), taxpayer has the rights to appeal to Council under GDT whose decision shall be final at pre-court level.</li> </ul> | <p>The two-level appeal procedures have been eased and there will be only one level of Council at MTA level for tax dispute cases as pre-court dispute resolution requirements.</p> <p>Under the new rules, the Council may decide to suspend the case and instruct MTA to re-audit the case if certain conditions are met. Such re-audit shall be conducted by higher level of tax authority and shall not last more than 3 months. In case new assessment act is released, the original assessment act shall be cancelled.</p> <p>A 10% cash deposit is required by taxpayer to proceed with a dispute case and such deposit shall be capped at MNT100 million.</p>   |
| Tax payment extension                  | Taxpayers may request extension for the payment of taxes up to 60 days under current rules.  | Taxpayers may request extension for the payment of taxes and MTA may allow extension up to two years period. In case of extensions, a security or guarantee arrangement may be required.  |
| Tax collection and enforcement         | Please refer to new changes on the right.  | <p>New law has introduced a rule whereby tax debt shall be firstly collected over any other debts of taxpayers.</p> <p>Secondary tax obligation. In cases where a taxpayer (who has 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.</p> <p>A tax debt shall be collected immediately from a taxpayer if it is considered that such tax debt is at risk. MTA shall be entitled to start operations to collect these tax from the taxpayer via special procedures.</p> <ul style="list-style-type: none"> <li>• MTA shall be permitted to collect tax debts by expropriating the properties of the taxpayers and disposing them via auctions for cash. MTA can freeze bank accounts and instruct banks to transfer funds for the tax debt collection. MTA may instruct third party a tax payment on behalf of the taxpayer in the event the taxpayer has outstanding tax due and receivable from the third party. Various legal procedures are available for MTA to enforce tax collection.</li> </ul> |

## New General Taxation Law - GTL

| Description   | Current GTL   | New GTL   |
|---|---|---|
| Tax collection and enforcement                          | Please refer to new changes on the right.   | MTA may put restriction on taxpayer's auto vehicle as an initial reminder of paying tax debt. MTA also may request 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                          | The law imposes a 30% automatic base penalty for non-reported taxes as a general rule. In addition to that, a 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 due taxes.   |
| General Anti-Avoidance Rule (GAAR)                      | No formal GAAR in the tax laws  | New GTL has introduced a general anti-avoidance rule (GAAR) which is a set of broad principles-based rules within a country's tax code designed to counteract the perceived avoidance of tax. GAAR is a concept within 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.   |
| Transfer Pricing  | <p>Various sections in the current tax laws refer 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.</p> <p>There is no single, all-encompassing transfer pricing legislation in Mongolia. Instead, transfer pricing rules are contained in various individual tax laws.</p> | <p>Mongolia endorses OECD (Organization for Economic Cooperation and Development) Transfer Pricing Guidelines in the General Taxation Law.</p> <p>Please note that new amendments have imposed severe administrative penalties for the failure of 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.</p> <p>The new transfer pricing rules include stringent transfer pricing documentation be prepared including:</p> <ul style="list-style-type: none"> <li>• Transactional transfer pricing documents</li> <li>• Local File</li> <li>• Master File</li> <li>• Country-by-country report</li> </ul> <p>EY will issue separate detailed alerts on transfer pricing changes.</p> |
| 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 OECD's BEPS project reflecting recent global tax developments. EY will issue separate alerts on these changes.  |

## New Corporate Income Tax Law - CIT

| Description   | Current CIT Law   | New CIT Law   |
|---|---|---|
| CIT rate  | Up to MNT3 billion taxable income - 10%<br>Excess of MNT3 billion - 25%   | Up to MNT6 billion taxable income - 10%<br>Excess of MNT6 billion - 25%<br><br>CIT rate is 1% for business entities with annual turnover under MNT300 million and certain qualifying conditions may apply.  |
| Other special tax rates                               | Direct and indirect transfer of land rights, mineral exploration and mining rights and other covered rights: withholding tax rate at 30% on gross basis.  | Withholding tax rate at 10% with allowing certain deductions.   |
|   | Interest tax rate on debt instrument issued by Mongolian listed company:<br>Resident taxpayer: 10%<br>Non-resident taxpayer: 20% withholding  | 5% for both resident and non-resident taxpayer. Mongolian listed company excludes business entities holding exploration and mining license in mineral, oil and uranium industry.  |
| Tax credits & exemptions                              | 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: <ul style="list-style-type: none"> <li>• Agriculture and livestock production and related auxiliary activities</li> <li>• Food production</li> <li>• Manufacture of garment and textiles</li> <li>• Manufacture of building materials</li> </ul> | The new law abolished the investment fund tax exemption.<br>A 90% tax credit is available to all entities with annual turnover under MNT1.5 billion excluding the entities operating in the following sectors: <ul style="list-style-type: none"> <li>• Transportation, exploration, mining and sale of mineral and radioactive minerals</li> <li>• Importing alcoholic beverages and tobacco, planning and manufacturing tobacco</li> <li>• Manufacture of petroleum products, import, wholesale, and retail of all types of fuel, exploration, mining and sales of oil.</li> </ul> A 50% - 90% tax credit is available to companies with principal management and operations in the remote areas with more than 500 km away from Ulaanbaatar: subject to certain qualifying condition and certain industries are excluded. (this is largely in the current law and the credit expires on 1 Jan 2019 with current law) |
|   | A limited foreign tax credit to countries with available tax treaty with Mongolia   | Domestic CIT law provides unilateral foreign tax credit irrespective of tax treaties in place.  |
| Loss carryforward                                     | From 2 - 8 years  | 4 years   |
|   | Maximum carryforward duration for tax losses is two years with only 50% of taxable profits in any tax year can be offset by such tax losses.<br><br>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.  | Carryforward duration is 4 years without sector differentiation with universal restriction of 50% of taxable profits in any tax year<br><br>Tax losses can't be transferred during company reorganizations.   |
| Useful life of buildings for tax depreciation purpose | See table1 below  | See table 1 below   |

## New Corporate Income Tax Law - CIT

| 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<br>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)  |

| Description                          | Current CIT Law   | New CIT Law  |
|--------------------------------------|---|--|
| Deductible expense                   | <p><u>Listing approach:</u><br/>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.</p> | <p><u>Criteria based approach:</u><br/>New law recognizes any expense as deductible expense for tax purposes if the following pre-determined criteria have been met.</p> <ul style="list-style-type: none"> <li>• Incurred for the reporting period</li> <li>• Incurred for income generating purpose</li> <li>• Recognized according to accounting laws with supporting documents.</li> <li>• Recorded in VAT system or customs clearance with some exceptions, if applicable</li> <li>• The expense is paid or expected to be paid by the taxpayer.</li> </ul> |
| Interest deductibility rules         | Thin capitalization restriction of 3:1 debt to equity ratio.  | <p>Combination of 30% EBITDA (earnings before interest, tax, depreciation and amortization) restriction and current 3:1 thin capitalization restriction.</p> <p>Under current laws, thin capitalization arises when investor's debt-to-equity exceeds 3:1 ratio any interest attributable to the debt exceeding the ratio debt is non-deductible for tax purposes. In addition to that, the New CIT law introduced another restriction that such related party loan interest shall not exceed 30% of EBITDA for any given year.</p>                              |
| Capital gains earned by Non-resident | 10%/25% (the current law lacks clear taxing provisions)   | Under the new rules, non-residents are likely to be taxed at the rate is 20% on gross capital gains.   |

## New Corporate Income Tax Law - CIT

| Description                           | Current CIT Law   | New CIT Law  |
|---------------------------------------|---|--|
| Ring-fencing rules for separate mines | No ring-fencing rules.  | Under the new rules, income and expenses that are incurred for different mines have to 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. We expect it would lead to an addition of efforts to process such data from accounting and tax perspective.   |
| Tax filing                            | CIT filing requires quarterly and annual lodgment of the tax returns for all segments of taxpayers.   | SMEs under MNT6 billion annual taxable income can file twice only while bigger taxpayers remains to file quarterly tax returns. Small entities with less than 50 million annual taxable income can elect for flat 1% gross tax and can file just one tax return a year.  |
| Tax Residency                         | <p>Tax residents of Mongolia are taxed on their worldwide income. A company is regarded as a resident of Mongolia in either of the following circumstances:</p> <ul style="list-style-type: none"> <li>▸ It is incorporated in Mongolia.</li> <li>▸ It is a foreign entity that has its head office located in Mongolia i.e., effective management is exercised in Mongolia.</li> </ul> | <p>The law introduces new rule for treating a foreign company as a Mongolian resident if they meet certain criteria. If any three of following conditions are met, the foreign company shall be treated as a Mongolian resident:</p> <ul style="list-style-type: none"> <li>• More than 50% of shareholders (or their nominees) resides in Mongolia</li> <li>• More than 50% shareholder meetings have been held during preceding 4 years</li> <li>• Accounting or financial documents are maintained in Mongolia</li> <li>• More than 25% of board members or their nominees resides in Mongolia</li> <li>• More than 60% of total income is sourced from Mongolia</li> </ul> |

## New amendments to Value Added Tax Law - VAT

| Description                            | Current VAT Law  | New amendments   |
|--|--|--|
| Recovery of input VAT on capital goods | <p>Under current VAT rules, an input credit or tax refund of VAT incurred on a business's capital expenditure is disallowed.</p> <p>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.</p>  | <p>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:</p> <ul style="list-style-type: none"> <li>• Buildings and constructions: Input VAT shall be recovered over 10 years with equal amount</li> <li>• Equipment/Exploration activity: Input VAT shall be recovered over 5 years with equal amount</li> <li>• Other capital assets: Input VAT shall be recovered in the same year the company purchase the asset.</li> </ul> |
| VAT on loan interest                   | <p>In the current VAT law, there has been some uncertainty that as to whether loan interest of non-banking transactions are exempt from VAT or not.</p> <p>Article 13 of 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.</p> | <p>Under the new rules, the article 13.5.7 has been amended to capture corporate loan interest for exemptions.</p>   |

## New Personal Income Tax Law - PIT

| Description            | Current PIT Law  | New PIT Law   |
|------------------------|--|---|
| Tax Residency          | <p>Under the current law individuals are liable to pay PIT on their income. Mongolia divides individual taxpayers into two separate groups, a resident and non-resident taxpayer.</p> <p>A resident taxpayer of Mongolia is taxable on his/her worldwide income. The legislation defines a permanent resident taxpayer as:</p> <ul style="list-style-type: none"> <li>• an individual who possesses a residential home in Mongolia; or</li> <li>• an individual who resides in Mongolia for 183 or more days in a given calendar year.</li> </ul> <p>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:</p> <ul style="list-style-type: none"> <li>• an individual who has no residential home in Mongolia and has resided in Mongolia for less than 183 days in a tax year.</li> </ul> | <p>The new law has re-defined the tax residency as follows:</p> <p>An individual shall be Mongolian resident taxpayer if any of the following two criteria are met:</p> <ul style="list-style-type: none"> <li>• an individual who resides in Mongolia for 183 or more days in a given consecutive 12-month period.</li> <li>• If income earned in Mongolia and/or Mongolian sourced income is more than 50% of an individual's worldwide income</li> </ul> <p>The first criteria will need to be checked first.</p> <p>A resident taxpayer of Mongolia is taxable on his/her worldwide income while non-residents shall be taxed on Mongolian sourced income only.</p> |
| Tax rates              | <p>All resident entrepreneurs are generally taxed at 10% on their profits from operating income.</p>   | <p>A resident individual entrepreneur may elect 1% gross tax instead of 10% tax on the taxable income from business operations if annual turnover is under MNT50 million.</p> <p>Mongolia keeps its current 10% tax rate for most of the income including employment income, operating income, capital gains, passive income of dividend, interest and royalties and other indirect income for resident tax payers.</p> <p>Current 20% withholding tax shall remain for non-residents.</p>  |
| Foreign tax credit     | <p>Foreign tax credits are limited to countries with which Mongolia has tax treaties.</p>  | <p>Foreign tax credits are now available under domestic PIT laws irrespective of tax treaties in place.</p>   |
| Mongolia - Source rule | <p>Current PIT law largely employs a language that says non-resident are taxed for income earned in or within the territory of Mongolia.</p>   | <p>The new law introduced a 'Mongolian-source' rule that intends to cover broader income source by non-resident, similar to CIT laws. It almost serves as a catch-all provision in the laws.</p> <p>The definition for 'Mongolian-sourced income' covers all income types set out in the PIT law and refer to Mongolian source rule in the CIT Law.</p>   |

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