

MONGOLIA¹

In 1992 the Government established General Department of State Taxation—a separate government agency reporting to the Cabinet under the Minister of Finance—to administer a number of taxes and range of new taxes introduced following reforms to the taxation and budgetary systems of Mongolia.

Major taxes such as general taxation, personal income tax, economic entity and organization income tax (corporate income tax), sales tax and excise tax were introduced in 1993. Laws on these and other taxes, 9 laws in all, were amended in April 1997 and came into force on 1 May 1997. Sales tax was replaced by value added tax (VAT) in July 1998. In accordance with the amendments to the general taxation law, General Department of State Taxation was renamed General Department of National Taxation (GDNT).

Tax policy became one of the most important issues of public administration in Mongolia, taking into account its impact on investment, business development, and economic growth. Measures taken within the taxation reforms were as follows:

Four-tier (15, 25, 35, 40) was changed into two-tier corporate income taxation (15 and 40).

Five-tier (2, 15, 27, 40,) was changed into three-tier personal income taxation (10, 20, 40).

Further major changes were also made in a package of tax laws enacted in 2000 and 2001. The tax reform aimed to utilise the tax policy to support economic growth and optimize demand and supply side of the economy, rather than serve as a revenue collection tool. It is focused on the expansion of tax base, reduction of various tax exemptions and holidays, and creation of a fair environment for the taxpayers. VAT rate was increased to 15% and some excise taxes were changed to increase budget income in 2001. The tax law on unification of import duties was in effect imposing taxes on majority of import goods.

The intergovernmental transfer system was modified based on new equalization model: centralization of 80% of VAT and 50% of excise tax and reallocation based on various criteria. Reports show that tax collections from corporate and individual income taxes have been increasing from year to year.

In addition, as a result of the government's policy to improve tax collection, percentage of budget income to GDP has increased to 36% in 2001-2003. This strong fiscal performance was a result of sequential policy measures aimed at strengthening tax administration and expenditure management with strong focus on reducing dependence of budget on bank credit, eliminating domestic and external arrears, and enhancing efficiency of intergovernmental fiscal relations. During 2000-2002 the government reduced domestic arrears twice.

In 2004 the top corporate tax and personal income tax brackets were reduced from 40 to 30.

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To reform the Mongolian tax system—including reduction of tax burden on taxpayers, broadening of tax revenue base, increasing tax policy efficiency and revenue productivity, eliminating tax exemptions and tax holidays, increasing tax collection efficiency, strengthening the taxpayers' legal rights and introduction of new obligations to serve taxpayers by Mongolian tax authority—the Government has drafted a comprehensive tax reform package including revisions and amendments to tax laws.

Mongolian Parliament passed tax package reform in July 2006. Amendments to Corporate tax law, Personal Income tax law, Excise tax law and the Value Added tax laws took effect from 1 January 2007. The main purpose of this reform is to increase simplicity, transparency and efficiency of the tax system, to reduce market distortions, to lower tax burden on domestic producers, to lower prices of domestic goods, to reduce shadow economy sector, to increase investments in processing sectors, to create more jobs and increase tax revenue.

This new tax reform package introduced the following changes:

The revised corporate income tax law reduced the corporate income tax from 30% to 25% for annual incomes above 3 billion tugrugs (approximately US\$ 2.6 million) a year and to 10% for annual incomes up to 3 billion tugrugs.

Personal income tax also has been reduced to a flat rate of 10% as part of the tax reform.

This reform introduced a number of progressive changes to improve overall investment environment. For instance, the value added tax has been reduced from 15% to 10%; a reinvestment tax credit of 10% has been established; a loss carry-forward provision of three years has been implemented, improved depreciation allowances and a re-investment tax credit have been included in the amended Tax law. These business deductions are expected to compensate for the elimination of tax holidays that previously applied only to foreign owned companies, not to domestic entities.

Excise tax law levied on goods such as vehicles and alcohols has been changed slightly whereas gambling tax has increased by 10 times.

The main objectives of the tax reform package are to reduce tax burden, encourage business enterprise, and reduce the unequal tax burden. These tax regime packages have had positive recovering effects such as the steady reduction of the shadow economy, expansion of tax base, increased tax collection efficiency, elimination of various tax exemptions and holidays, and creation of a fair environment for the taxpayers, improved compliance and reduced complexity by clarifying and simplifying the tax laws.

There is also greater concern on working to tighten tax administration and improve tax collection efficiency and revenue productivity from different sectors such as efficient utilization of tax revenues from the mining sector.

Even though the tax revenue will be decreased substantially and expenditures are rising, the overall policy is to maintain sustainable fiscal position.

The amended tax laws approved by the Parliament represent the economic reform measures undertaken by the Parliament and the Government aimed at supporting economic growth by tax policy, creating favorable business environment, supporting industries, encouraging investment and creating employment, which are to be further continued and implemented in stages.

In 2007 the Government will pay special attention to the implementation of the amended laws and expansion of the tax base, improvement of control and supervision over tax imposition and payment as well as to upgrade of the tax collection activities.

In 2006 it was planned to revise and amend the Customs Law and the Law on customs tariffs were discussed at the autumn session of the Parliament in relation to the decision adopted at the spring session of the Parliament in 2006 to join the Kyoto international convention on “Customs formalities procedures unification”.

According to the newly revised customs law, the following objectives will be pursued in 2008, to link the customs formalities with international standards and levels, to introduce risk management on customs supervision and control, to rationally select and check goods, vehicles and passengers with high risks on the basis of studies, to introduce information technology in customs control, to transfer customs border control to supervision and monitoring after fulfilling formalities on the basis of audits, to use the automated information systems, to support electronic purchase and to accelerate the transfer to electronic filing of customs declaration system as well as activities for collection of customs duties.

. The tax impact on the economy

The required level of tax pressure on the economy is measured by meeting a target not exceeding the GDP growth rate for the budget tax revenue increase rate. Mongolia's target is estimated as follows:

GDP to budget tax revenue increase (in percent)

	2004/2003	2005/2004	2006exp / 2005	2007prop/ 2006 exp
GDP growth(current prices) *	30.7	18.6	27.6	14.3
Increase in tax revenue*	38.5	18.7	42.2	9.1
Increase in tax revenue per 1% GDP growth*	1.3	1.0	1.5	0.6

- **GDP** at current prices, tax revenue –the amount of collections to the treasury.

Political pressure convinced the Mongolian Government to effect the following changes in the mineral law this year: The mineral law charges a single rate royalty of 5% for all metals, this doubles the previous 2.5% applied to copper and gold. However, the royalty increase will be offset by 5 percentage point reduction in the CIT, to 25%.

According to the new mineral law, all royalty payments shall be deposited in the local and state budget, 10% into the budget of sum or district, 20% into the budget of aimag or capital city, 70% into the state budget.

Up to 30% of the royalty payment paid to state budget shall be distributed to finance the geology and mining sector.

The term for an exploration license is increased from 7 to 9 years. The maximum mining license term is from 70 years, reduced from 100 years under the previous 1997 Minerals Law.

A minimum of 10% of the common shares issued by a public company, that holds mining license for a deposit classified as being of strategic importance must be made available for trading on the Mongolian Stock Exchange.

According to the revised mineral law, the license holder shall pay the following rates per hectare explored. \$0.1 for the first year, \$0.2 for the second year, 0.3 for the third year, \$1 for each of the fourth to sixth year, \$1.50 for each of the seventh to ninth year.

Mining license shall be payable for each hectare in the mining area at \$15. For coal and other common mineral resources the fee shall be \$5 for each hectare. Holders of mining licenses can enter into investment agreement with the government that set tax rates for defined period of time, establish a licensee's right to sell its products as international market price or guarantee the rights of the license holder to receive and dispose of income derived from its sales, and issues on amount and term of the license holder's investment, mining of the minerals with minimum damage to environment and public health; protection and reclamation of the environment, support to develop the region and create more employment and compensation for damages caused to the environment. The investment contract, formerly known as Stability agreement, has been made more flexible and has enhanced its recognition of investors making larger and longer term commitments. Projects involving an investment of US\$50-100 million will have 10 year terms; US\$100-300 million projects will have 15 year agreements; and projects involving more than US\$300 million will have 30 year agreements.

According to the new minerals law Mongolian government will have a right to obtain ownership up to 34 %. However, it is currently unclear how these equity participation will be acquired.

The law defines a strategic deposit as one with potential to have an impact on Mongolia's national security, economic and social development; with minerals that are in strong international demand; or deposit capable of annual mineral production that exceeds 5% of country's GDP.

Any state acquisition in mining project will be subject to negotiation with the license holder as part of the Investment Contract process.

The Mongolian Parliament decided to follow other mining countries as mineral prices rose and announced the imposition of the windfall tax. Windfall tax law was enacted on 12 May 2006 to impose tax on additional income generated from increased prices of some products and its allocation to a special fund. There were strong objections from domestic and foreign mining companies

The imposition of the "Windfall tax", while generating a significant amount of revenue in the short term, could affect the investment climate in the mining sector.

The tax reform in 2006 aimed to support the business activities and to reduce the tax burden by introducing new concepts in compliance with international practice. It offered lower rate and provided equal and fair tax environment for both foreign and domestic companies. The main Mongolian legislations related to the mineral sector were:

1. General taxation law

2. Minerals law
3. Corporate income tax law
4. Windfall tax law.

The General taxation law states the rights and obligations of all taxpayers regardless of their types of activities. But minerals law applies to mining companies which operates in the territory of Mongolia. Under the minerals law, mining companies are subject to pay 5 percent royalty based on their sales revenue. Most importantly, new minerals law refers to state equity participation in the strategic deposits based on the negotiation with investor. Government has a right to hold a stake up to 34 percent of strategic mineral deposits discovered in privately financed exploration.

New minerals law also offers investment agreement if investor makes an investment that exceeds a certain amount. Investment agreement provides the investor a stable tax regime which protects the investor from the volatility of future tax laws.

Rate of Corporate income tax law reduced from 30 percent to 25 percent, from 15 to 10 percent will decrease the tax burden. New corporate income tax law also introduced the loss-carry forward section which is suitable for mining industry. The new Corporate income tax law provides similar rights and obligation to both foreign and domestic investor which the previous law did not.