



## LAW OF MONGOLIA

June 29, 2006

Ulaanbaatar

### ECONOMIC ENTITY INCOME TAX (Newly Drafted)

#### SECTION ONE

#### General Provision

##### **Article 1. Purpose of the law**

1.1. The purpose of this law is to regulate relations concerning imposition of tax on economic entity income, transference thereof to the budget, and its reporting.

##### **Article 2. Legislation**

2.1. The legislation on economic entity income tax (hereinafter referred to as 'tax') shall comprise the General Taxation Law,<sup>1</sup> this law, and other laws and legal acts enacted in conformity with them.

##### **Article 3. Framework of the law**

3.1. This law shall regulate relations concerning imposition of tax on income of the following economic entities:

3.1.1. An economic entity formed under the laws of Mongolia and their subsidiaries and representative offices;

3.1.2. A foreign economic entity that has a headquarter located in Mongolia;

3.1.3. A foreign economic entity earning income in Mongolia and its representative office.

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<sup>1</sup> General Taxation Law - 'State Information' Gazette No. 1, 1993

#### **Article 4. Definition of legal terminology**

4.1. The following terms used in this law shall have the following meanings:

4.1.1. “Income earned in a foreign country” refers to a taxpayer’s income earned in a foreign country and income from activities, property, and sale of property as specified in paragraph 7.3 of this law;

4.1.2. “Goods” refers to movable and immovable property other than monetary assets;

4.1.3. “Immovable property” is as defined in paragraphs 84.3 and 86.2 of the Civil Code<sup>2</sup>;

4.1.4. “Intangible asset” refers to a non-material asset that has no physical substance, has a relatively long useful life, and gives its owner a right, preferential right, or exclusive right;

4.1.5. “Economic entity” refers to a company, partnership, cooperative, or an enterprise with state and local property registered with the state register and that conducts business activities, and other similar legal entity obliged to pay income tax;

4.1.6. “Withholder” refers to an entity obliged to withhold tax imposed on taxpayer’s income in conformity with this law and transfer the withholding to the state and local budget;

4.1.7. “Foreign currency exchange rate gain (loss)” refers to exchange rate gain (loss) derived from transactions such as a purchase of foreign currency and payment of receivables and payables in a foreign currency.

#### **Article 5. Taxpayer**

5.1. An economic entity that earns gross taxable income for the tax year or that is liable to pay tax under this law, even though the same income may not have been earned, shall be a taxpayer.

5.2. A taxpayer specified in paragraph 5.1 of this law shall be classified as a permanent resident-taxpayer or non-resident taxpayer of Mongolia.

5.3. A taxpayer that resides in Mongolia on a permanent basis shall include the following economic entity:

5.3.1. An economic entity formed within the laws of Mongolia;

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<sup>2</sup> ‘Civil Code,’ ‘State Information,’ No. 7, 2002

5.3.2. A foreign economic entity that has its headquarter office located in Mongolia;

5.4. A taxpayer that does not reside in Mongolia shall include the following economic entities:

5.4.1. A foreign economic entity that conducts its business activities in Mongolia under its representative office;

5.4.2. A foreign economic entity that earns income in Mongolia in forms other than that specified in subparagraph 5.4.1 of this law.

5.5. A representative office shall include the following units that partially or wholly conduct business activities of a foreign economic entity specified in subparagraph 5.4.1 of this law:

5.5.1. Branch (unit and section);

5.5.2. Plant;

5.5.3. Trade and service provider;

5.5.4. Oil and natural gas well or a mine that extracts natural resource.

#### **Article 6. Related party**

6.1. If the following relation is present with a taxpayer, it shall be “a related party”:

6.1.1. Holds 20 percent or more of the common stock;

6.1.2. Has the right to receive 20 percent or more of the dividends or distributions;

6.1.3. Has the right to appoint 20 percent or more of the management of the economic entity or is otherwise able to determine its policies.

## **SECTION TWO**

### **Gross Taxable Income**

#### **Article 7. Gross Taxable Income**

7.1. Income earned for the tax year in a territory of Mongolia and a foreign country by a taxpayer specified in paragraph 5.3 of this law shall be subject to tax.

7.2. Income earned for the tax year from activities in the territory of Mongolia by a taxpayer specified in paragraph 5.4 of this law shall be subject to tax.

7.3. The following income of a taxpayer shall be subject to tax:

- 7.3.1. Income from activities;
- 7.3.2. Income from property;
- 7.3.3. Income from sale of property.

7.4. Gross taxable income shall be determined by deducting exempt income.

7.5. In case of the exchange of goods, works, and services, gross taxable income shall be determined in reference to value of similar goods, works, and services sold among non-related parties.

7.6. An exchange rate established by the Bank of Mongolia for the day shall be used in converting income earned and expenses incurred in a foreign currency to togrogs.

#### **Article 8. Income from activities**

8.1. The following income from activities of a taxpayer shall be subject to tax:

8.1.1. Income from primary and auxiliary production and sale of work and services;

8.1.2. Income from sale of rights;

8.1.3. Income from sale of shares and securities;

8.1.4. Income from quizzes, gambling, and lotteries;

8.1.5. Income from sale and rental of erotic publications, books, and video recording, and service of erotic performance;

8.1.6. Income from goods, work, and service received from others free of charge;

8.1.7. Income from sale of intangible assets;

8.1.8. Income from technical, management, consulting, and other services;

8.1.9. Income from interest and/or penalty for nonperformance of contract duties, and compensation for a damage;

8.1.10. Realized gain from foreign currency exchange rate;

8.1.11. Other income similar to those specified in subparagraphs 8.1.1-8.1.10 of this law.

8.2. Income from sale of rights shall include income from transference of rights issued by an authority for purposes of conducting specific types of activities or ownership and use.

8.3. Income from sale of an intangible asset shall include income from transference of intangible assets specified in subparagraph 4.1.4 of this law to others in forms specified in laws.

### **Article 9. Income from property**

9.1. The following property income of a taxpayer shall be subject to tax:

- 9.1.1. Income from movable and immovable property leases;
- 9.1.2. Royalty income;
- 9.1.3. Dividend income;
- 9.1.4. Interest income.

9.2. Royalty income shall include the following payments:

9.2.1. Payment for usage of copyrighted works specified in the Law on Copyright and Corresponding Rights;<sup>3</sup>

9.2.2. Payment for usage of invention, product prototype, and useful design specified in the Patent Law;<sup>4</sup>

9.2.3. Payment of usage of trademark specified in the Law on Trademark and Geographic Specification;<sup>5</sup>

9.2.4. Payment for transference of technology specified in the Law on Transfer of Technology;<sup>6</sup>

9.2.5. Payment for usage of information related to production, trade, and scientific experiment;

9.2.6. Payment for usage of other rights similar to those specified in subparagraphs 9.2.1-9.2.5 of this law.

9.3. Dividend income specified in subparagraph 9.1.3 of this law shall include income in monetary and non-monetary forms and interest received from a joint stock economic entity through profit sharing and dividend distribution.

9.4. Interest income specified in subparagraph 9.1.4 of this law shall include payment, discount, and premium paid to a taxpayer for transactions made with the purpose for using money such as loan interest, interest on balance of correspondent account, interest on savings account, payment for issuing guarantee, and interest on notes payable (bond).

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<sup>3</sup> Law on Copyright and Corresponding Right – ‘State Information’ Gazette No. 7, 2006

<sup>4</sup> Law on Patent – ‘State Information’ Gazette No. 7, 2006

<sup>5</sup> Law on Trademark and Geographic Specification – ‘State Information’ Gazette No. 19, 2003

<sup>6</sup> Law on Transfer of Technology – ‘State Information’ Gazette No. 131, 1998

**Article 10. Income from sale of property**

10.1. The following income of a taxpayer from sale of property shall be subject to tax:

- 10.1.1. Income from sale of immovable property;
- 10.1.2. Income from sale of movable property.

**Article 11. Determining taxable income from goods sold and work and services provided among related parties**

11.1. If parties specified in article 6 of this law have sold or transferred goods, performed work, or rendered services among themselves below or above fair market value, the tax authority shall determine gross taxable income of such goods, work, and services based on value involving transactions of similar goods, work and services among non-related parties.

11.2. The member of Government in charge of finance shall approve a methodology for using benchmark prices specified in paragraphs 7.5 and 11.1 of this law.

**SECTION THREE**

**Deductible Expense from Gross Taxable Income**

**Article 12. Deductible expense from gross taxable income**

12.1. Taxable income shall be determined upon deducting the following expenses from gross taxable income:

12.1.1. Expenses of all types of inventories such as raw materials, primary and auxiliary materials, semi-processed products, steam, water, energy, fuel, petroleum, spare parts, and packaging and wrapping material;

12.1.2. Salaries and base and additional wages on which social and health insurance premiums and personal income tax are imposed;

12.1.3. Social and health insurance premiums;

12.1.4. Employee bonuses, incentives, and allowances for housing, transport, meal, and fuel expenses;

12.1.5. Depreciation and amortization expenses of non-current asset;

12.1.6. Regular maintenance expenses;

12.1.7. Loan interest;

- 12.1.8. Realized loss from foreign currency exchange rate;
- 12.1.9. Payment for work and services performed by others;
- 12.1.10. Lease payments;
- 12.1.11. Interest of finance lease payments;
- 12.1.12. Subscription of professional newspapers and magazines;
- 12.1.13. Mandatory and voluntary insurance premiums;

12.1.14. Excise taxes, immovable property tax, windfall profits tax, custom duties on imported goods, material, and raw material other than non-current asset, tax on transport vehicle, and payment and fee for using land and natural resource as imposed and payable to the budget;

12.1.15. Resource accumulated in loan risk funds of savings and loan cooperatives and a loss provision of other cooperatives;

12.1.16. Resource accumulated in loan risk funds of a bank and non-banking financial institution;

12.1.17. Advertising expenses;

12.1.18. Employee training and retraining actual expenses;

12.1.19. Per-diem expenses;

12.1.20. Expenses for seed, fertilizer, livestock and animal fodder, medication and injection, and plant protection activities;

12.1.21. Transport expenses;

12.1.22. Purchase cost of short-lived and low-valued assets;

12.1.23. Labor safety expenses;

12.1.24. Expenses for communication, stationary, cleaning, and security;

12.1.25. Expenses for eliminating damages derived from disasters specified in subparagraph 4.1.10 of the Disaster Management Law;<sup>7</sup>

12.1.26. Normal wear and tear of inventory;

12.1.27. Monetary resource accumulated for purpose of rehabilitating environment in accordance with subparagraphs 38.1.8 and 39.1.9 of the Minerals Law.

12.2. Expense deductible from gross taxable income as specified in subparagraph 12.1.6 of this law shall not exceed of 2 percent of the book value of immovable property and 5 percent of the book value of other property, and the excess regular maintenance expense shall be accounted as capital maintenance.

12.3. Voluntary insurance premium deductible from gross taxable income as specified in subparagraph 12.1.13 of this law shall not exceed 15 percent of taxable income of the economic entity.

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<sup>7</sup> Disaster Management Law - 'State Information,' Gazette No. 25, 2003

12.4. Expense deductible from gross taxable income as specified in subparagraph 12.1.16 of this law shall not include resource accumulated in a fund for performing loans of a bank and non-banking financial institution.

12.5. Expense deductible from taxable income as specified in subparagraph 12.1.19 of this law shall be an actual amount, and it shall not exceed twice the civil servant norm for per-diem expense.

12.6. The extent of damage specified in subparagraph 12.1.25 of this law shall be determined based on findings of the corresponding authority.

12.7. Government shall approve the extent of loss specified in subparagraph 12.1.26 of this law.

12.8. The following expense shall not be deductible from gross taxable income:

12.8.1. Finance lease payment;

12.8.2. Fine and penalty paid due to taxpayer's fault, and compensation paid for damage to others.

**Article 13. Calculating depreciation and amortization expense**

13.1. Depreciation and amortization expense specified in subparagraph 12.1.5 of this law shall be calculated for taxpayer's asset with a useful life of more than one year.

13.2. A non-current asset shall have the following useful life and its depreciation and amortization expense shall be calculated based on the straight-line method:

	<b>Non-current asset class</b>	<b>Useful Life (in years)</b>
1	Building and construction	40
2	Machinery and equipment	10
3	Computer, computer parts, and software	3
4	Intangible asset with undefined useful life	10
5	Intangible asset with defined useful life (includes license for mineral exploration and extraction)	Period in force
6	Other non-current asset	10

13.3. Expenditure for capital maintenance specified in paragraph 12.2 of this law shall be added to book value of an asset and depreciated over its remaining useful life.

13.4. If an asset is used partially to earn gross taxable income, depreciation expense shall be prorated and deducted from gross taxable income.

13.5. A license holder for mineral extraction shall depreciate its non-current asset used for production and social infrastructure at constant rate over useful life of the asset and account the expense as deductible expense specified in article 12 of this law every year.

13.6. Depreciable value of mineral exploration and extraction license specified in paragraph 13.2 of this law shall be the sum of its purchase price and fee paid for ownership and transference of such license.

13.7. In the case of a taxpayer ceasing use of its own depreciable asset for the purpose of earning gross taxable income, the asset shall be assumed sold and be subject to tax for the book value or market value, whichever is higher.

13.8. A lessor and lessee shall reach mutual agreement and record finance-leased asset under a contract in financial statements of one of the parties.

13.9. Land and inventory reserve shall not be depreciable.

#### **Article 14. Interest expense deductible from gross taxable income**

14.1. Interest payment for a loan borrowed to carry out primary and auxiliary production, work, and services as specified in paragraph 8.1.1 of this law and to purchase property shall be deducted from gross taxable income.

14.2. A deduction shall not be made in the case of interest paid for a loan borrowed from an individual who resides permanently in Mongolia and controls the taxpayer entity. The expense shall be considered a dividend to the individual and it shall be subject to tax.

14.3. A deduction shall not be made in the case of interest paid to the extent that the interest is paid in respect of the part the total debt owed to the recipient that exceeds three times the value of the capital invested by the recipient in the taxpayer.

14.4. In the case of construction of building and installation of equipment are financed by a loan, the interest paid during the construction period shall be added to cost of the construction. The interest paid since the construction is finalized shall be deducted from gross taxable income.

#### **Article 15. Restriction on deductible expense**

15.1. Expense shall not be deducted from gross taxable income in the following cases:

15.1.1. Expense incurred for earning exempt income specified in this law;

15.1.2. Expense not documented by a taxpayer;

15.1.3. Payment from which tax is not withheld but required to be withheld

by this law.

## SECTION FOUR

### Determining Taxable Income

#### Article 16. Determining taxable income

16.1. Economic entity income tax shall be imposed on a taxpayer's taxable income in the tax year.

16.2. Taxable income shall be determined by deducting expenses specified in article 12 of this law from gross taxable income specified in subparagraphs 8.1.1, 8.1.6-8.1.11, and 9.1.1 of this law and subparagraph 9.1.4 for a bank, non-banking financial institution, and savings and credit cooperative.

16.3. Taxable income of the following income shall be determined by the total income:

16.3.1. Dividend income;

16.3.2. Royalty income;

16.3.3. Income from the sale of immovable property;

16.3.4. Interest income;

16.3.5. Income from sale of rights;

16.3.6. Income from sale or rental of erotic publication, book, and video recording, and service of erotic performance.

16.4. In the case of liquidation of a joint stock economic entity in which a taxpayer is a shareholder, taxable dividend income shall be determined by deducting initial purchase price from income prorated to the taxpayer's shares and contributed capital.

16.5. In the case of a loan deducted from loan risk funds of banks and non-banking financial institutions and risk funds for savings and credit cooperative is repaid, the repaid amount in total shall be subject to tax as specified in this law.

16.6. Taxable income from quizzes, gambling, and lotteries shall be determined by deducting documented expenses incurred in relation with earning the income and distributed prizes in monetary and goods form.

16.7. Taxable income of an economic entity that conducts insurance activities shall be determined by deducting a reserve fund established in the year and operating expenses from total income from operations.

16.8. Taxable income from sale of share or securities shall be determined by deducting the purchase price from the selling price.

16.9. Taxable income from sale of movable property shall be determined by deducting the book value of the property from the sales income.

16.10. The following expenses shall not be deductible for a taxpayer that does not reside in Mongolia, but carries out its operation through its representative office:

16.10.1. Expenses incurred outside the territory of Mongolia;

16.10.2. Management and administrative expenses not related to earning the income.

## **SECTION FIVE**

### **Tax Rate**

#### **Article 17. Tax Rate**

17.1. If annual taxable income determined in accordance with paragraphs 16.2, 16.8, and 16.9 of this law is 0-3.0 billion togrogs, it shall be taxed at the rate of 10 percent. If annual taxable income exceeds 3.0 billion togrogs, it shall be 300.0 million togrogs plus 25 percent of income exceeding 3.0 billion togrogs.

17.2. The following taxpayer's income shall be taxed at the following rates:

17.2.1. Dividend income at 10 percent;

17.2.2. Royalty income at 10 percent;

17.2.3. Income from quizzes, gambling, and lotteries determined in paragraph 16.6 of this law at 40 percent;

17.2.4. Income from sale or rental of erotic publication, book, and video recording and service of erotic performance at 40 percent;

17.2.5. Income from sale of immovable property at 2 percent;

17.2.6. Interest income at 10 percent;

17.2.7. Income from sale of right at 30 percent;

17.2.8. In the case of the representative office of a foreign economic entity transfers its own profit overseas, the transferred income at the rate of 20 percent;

17.2.9. The following income of a taxpayer who does not reside in Mongolia earned in Mongolia shall be taxed at the rate of 20 percent:

- a) Dividend income received from an economic entity that is registered and operates in Mongolia;
- b) Loan interest and payment for issuing a guarantee;
- c) Royalty income and interest on finance lease, payment for administrative expense, rent, management expense, and lease, and income from tangible and intangible asset lease;
- d) Income from goods sold, work performed, and service provided in the territory of Mongolia.

## **SECTION SIX**

### **Tax Exemption and Credit**

#### **Article 18. Tax exemption**

18.1. The following income of a taxpayer shall be tax exempt:

18.1.1. Interest on government notes payable (bond);

18.1.2. Income specified in paragraph 17.1 and subparagraph 17.2.1 of this law derived from sale of its portion of product and earned by a taxpayer who does not reside in Mongolia but operates in the territory of Mongolia under a product-sharing contract in oil industry;

18.1.3. Income of a cooperative earned from an excess of cost of intermediary services derived from sale of its member's products.

18.2. In the case of a taxpayer specified in subparagraph 18.1.2 of this law transfers tax-exempt income earned from the sale of its portion of products overseas, the income shall be exempt from tax specified in subparagraph 17.2.8 of this law.

#### **Article 19. Tax credit**

19.1. Tax imposed on income earned by an economic entity that produces or plants the following products only shall be subject to 50 percent tax credit:

19.1.1. Cereals, potatoes, and vegetables;

19.1.2. Milk;

19.1.3. Fruits and berries;

19.1.4. Fodder plants.

19.2. Investment tax credit equal to 10 percent shall be granted for investment in priority sectors of Mongolia after January 1, 2007.

19.3. Tax credit specified in paragraph 19.2 of this law shall be granted for investment in depreciable non-current asset for purpose of starting new production and

services or expanding or renovating existing production and services in the priority sectors of Mongolia.

19.4. The credit specified in paragraph 19.3 of this law shall not be granted for an asset purchased for the purpose of earning income other than that from primary business operations.

19.5. If the credit specified in paragraph 19.2 of this law exceeds total tax imposed under paragraph 17.1 of this law in the tax year, the excess shall be credited in three subsequent profitable years.

19.6. The credit specified in paragraphs 19.1 and 19.2 of this law shall to be granted from the commencement of an economic entity's primary operations.

19.7. Government shall approve a list of priority sectors specified in paragraph 19.2 of this law.

19.8. Tax credit shall be granted to an economic entity that employs handicapped citizens who lost over 50 percent of the working capacity based on the percentage of the handicapped citizens in the total number of the employees.

19.9. Tax credit shall be granted to an economic entity that paid tax in a foreign country based on agreements not to impose double taxation on income and property and prevent tax avoidance.

#### **Article 20. Loss carryforward**

20.1. Tax statement loss is an excess of total expense specified in article 12 other than those specified in article 15 of this law deducted from gross taxable income.

20.2. The loss specified in paragraph 20.1 of this law shall be deducted from taxable income of two subsequent years since the loss incurred.

20.3. The annual amount of loss deductible from taxable income as provided in paragraph 20.2 of this law shall not exceed 50 percent of taxable income in the tax year.

20.4. The loss specified in paragraph 20.1 of this law shall not apply to tax statement losses incurred prior to January 1, 2007.

### **SECTION SEVEN**

#### **Tax Imposition, Payment to the Budget, and Reporting**

#### **Article 21. Tax payment and reporting**

21.1. A taxpayer shall accurately determine its income and tax due based on quarter-to-date and year-to-date tax statements prepared under accrual accounting and make payment to the budget.

21.2. "Tax year" is a calendar year in which income is earned and expenses are incurred.

21.3. Corresponding tax authority shall deliver monthly and quarterly tax payment schedules for the tax year to taxpayers based on schedules approved by the state central administrative organization in charge of finance.

21.4. A taxpayer shall pay the taxes due in advance by the 25<sup>th</sup> of each month in accordance with the payment schedule specified in paragraph 21.3 of this law and submit its quarterly tax statement by the 20<sup>th</sup> of the first month of the following quarter and annual tax statement by February 10<sup>th</sup> of the following year to the corresponding tax authority and make year end settlement.

21.5. A withholder specified in subparagraph 4.1.6 of this law shall withhold taxes imposed on income specified in subparagraphs 17.2.1-17.2.3 and 17.2.7-17.2.9 of this law and transfer the withholding to the budget within 7 working days.

21.6. A withholder shall withhold tax imposed on income from sale of immovable property and transfer the withholding to the budget within 10 working days following the sale of the property.

21.7. A withholder shall prepare and submit the withholding tax statement as specified in subparagraphs 21.5 and 21.6 of this law by the 20<sup>th</sup> of the first month of the following quarter on a quarter-to-date basis and annual statement by February 10 of the following year to the corresponding tax authority and make the payment to the budget.

21.8. The state shall be entitled to mobilize dividend and its share of profit from its property entirely or partially. Government shall determine the amount at each time.

## **SECTION EIGHT**

### **Other**

#### **Article 22. Entry into Force**

22.1. This law shall come into force as of January 1, 2007.

SPEAKER OF THE PARLIAMENT OF MONGOLIA  
NYAMDORJ. TS