

International taxation reform and Mongolia

Overview

From 2000, global policy, documentation and software on international taxation have been developed and many countries have joined to implementation of Base Erosion and Profit Shifting (BEPS) Package. In order to effective implementation, Inclusive framework of four minimum standards of BEPS package and the Global Forum on Transparency and Exchange of Information for Tax Purposes, a multilateral framework is implemented. Over 100 countries are member of these international taxation initiatives which means many countries are proactive on international taxation matters and being a part of it.

Mongolia is blacklisted by the European Union due to its irresponsible action and non-transparent of taxation in December 2017. As result of good initiation and collaboration of the Government of Mongolia with the European Union, Mongolia has been removed from the blacklisted countries within short period. However, it does not mean that all taxation related matters are resettled; Mongolia became fully responsible for taxation reform for compliance of international taxation policy and documents.

Preamble

Due to complex structure and complicated methods used by the multinational corporation on avoiding taxation lately, there is a high demand of international taxation upgrade. It is an opportunity to the developing countries that the move to new principle from imposing income taxation in resident taxpayer to imposing taxation in a country where income is earned or sourced.

Globally, \$240 million United States Dollars evaded from the taxation annually. This figure equals to 4-10% annual income of the multinational corporations (hereinafter "MNE"). For developing countries, this figure is higher. Organization of Economic Cooperation and Development (hereinafter "OECD") concluded that developing countries especially countries rely upon the mining industries loses a notable amount of taxation¹.

Taxation avoidance and taxation evasion causes social and economic adverse impacts globally and it effects economic development of the country. Many countries have accepted it and adopting General rules on Anti-avoidance (GAAR) in domestic legislations or improving the current rules and taxation laws. The information exchange system for combating with taxation avoidance and evasion has been launched.

Exchange of information

The action on combating with taxation avoidance and evasion started in early 2000. They are:

- Members of OECD have agreed to exchange information and transparency for taxation purpose;
- For reducing taxation avoidance from 2008, international organization on creating transparent taxation has required immediately;
- The Global Forum has re-organized by initiatives of G20 countries in September 2009 as well as Peer Review Group (PRG) has formed – has 30 countries became as a member by January, 2018¹.

¹ <http://www.oecd.org/tax/transparency/about-the-global-forum/Peer-Review-Group-Members-2018.pdf>

- Global Forum has 147 member countries by 2017 and became a leading organization on ensuring transparent information exchange for taxation purpose within framework of the internationally accepted standards.
- The daily operation follows exchange of information on request standard (the EOIR standard) and automatic exchange of information standard (the AEOI standard)².

In order to create environment to exchange information for taxation purpose in each country the followings are required 1) modify confidentiality in Law on Banking 2) reconsider mutual double taxation avoidance agreement between the Governments and 3) adhere recommendation on monitoring and assessment by the Peer Review Group. 49 countries exchange information automatically by 2017 and over 100 countries will exchange information automatically by 2018³.

For the 28 EU member states, the obligation to implement Country by Country Report (hereinafter “CrCR”) has also been enshrined in a binding Directive (Council Directive 2016/881/EU). In addition, Master and Local File requirements are already being implemented by 38 jurisdictions. Applying the agreed EUR 750 million, or equivalent, threshold reduces compliance costs but also ensures that MNE groups controlling about 90% of total corporate revenues will be subject to the CbCR obligations. With the actions already taken by governments to meet their commitments, CbCR obligations covering 95% of those MNEs are already in place. With 12 months to go until the first CbCR exchanges take place, over 800 exchange relationships between pairs of jurisdictions have already been created and tax administrations are putting in place the processes to draw on the information in the CbCR in their transfer pricing risk assessment processes. Some jurisdictions have entered into bilateral Competent Authority Agreements to operationalize the exchange of CbCRs with specific jurisdictions.

Global Forum provides technical assistance on effective implementation of international standards on exchange of information on request standard and automatic exchange of information standard for transparency and information exchange⁴. They are:

- Based upon demand of the country, the capacity building and supporting activities will be harmonized with general assessment when the country joined.
- Advertise the country among the members; organize regional seminar and meeting, exchange knowledge and information and train assessment staff and monitoring etc.
- Develop tools to support enforcement of standards for the member countries for instance, practical guidelines, manual, monitoring system etc.

Base erosion and profit shifting (BEPS)

Due to weakness of the current international taxation law, OECD has developed 15 actions of BEPS package to combat with the weaknesses.

The BEPS package included many regulatory strategies and the main reasons on BEPS package are follows.

² <http://www.oecd.org>

³ Maikel Evers, Counsellor - BEPS Coordinator, OECD, Paris. An Overview: Some Early Legal and Operational Experiences with MLI under Inclusive Framework & Positions taken by Countries so far since June 7, 2017

⁴ Monica Bhatia, Head of Global Forum Secretariat, OECD, Paris (Stand in Speaker: Maikel Evers, OECD, Paris) International Financial Centres and Exchange of Information (including Beneficial Ownership) on request or on automatic exchange

- Reduces taxation on income earned from foreign activities and foreign sources through commercial structure and reduces taxation payment through transferring total profit;
- Taxable income on sourced earning is less or no taxation;
- At level of income recipient, (countries with less taxation, discounted regimes, mixed and violated regulations) no taxation or earn profit abnormally through group or organized structure;
- Pay less taxation through structure of head and subsidiary companies, or non-payment of the taxation. In further, foreign investment – inefficient cash and cash with less taxation.

BEPS⁵ is a project initiated and implemented by OECD from 2013 for setting up transparent and fair taxation system at international level. This project is considered as soft legal instrument rather than largest tax reform or binding procedure of BEPS⁶.

For officially joining to BEPS, the country shall become a member of - “Inclusive Framework” project. After joining to the Inclusive framework, the minimum standards shall be adopted and implemented in domestic laws⁷. They are:

1. **Action 5, Harmful tax practices,**
2. **Action 6, Treaty abuse,**
3. **Action 13, Transfer pricing documentation and**
4. **Action 14, Dispute resolution**

As well as BEPS package shall be accepted and obliged the members to implement the package sustainably.

Any country joining to the Inclusive Framework shall adopt it under several stages and shall pay annual payment (reduced rates applies to developing country). The taxation system and domestic laws are different to each country so monitoring mechanism on implementation shall be varied. Developed by over 100 countries and jurisdictions, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the Multilateral Instrument, or MLI) and its accompanying Explanatory Statement, is a ground breaking tool, allowing countries to rapidly amend their bilateral tax treaty network with a single instrument.

Multilateral Convention (MLI)

With the first signing ceremony in June, already more than 1100 existing tax treaties will be modified, and additional treaties will be covered as more parties join the MLI.

OECD has released multilateral convention documents on 24 January 2016 on prevention of base erosion and profit shifting. Signing and implementing the G20/OECD Multilateral Instrument represents a major commitment in the implementation of its international taxation convictions, even as challenges in already advancing international taxation perspectives had

⁵ <http://www.oecd.org/tax/beeps/>

⁶ Sam Sim and Mei-June Soo. Asian Voices: BEPS and Beyond. IBFD. 2017

⁷ Inclusive Framework on BEPS.

been already emerging in its domestic law and treaty measures. Mapping MLI (Action 15) into other Actions reveals the following connections:

- Hybrid mismatch (Action 2);
- Treaty abuse (Action 6);
- Permanent establishment (Action 7);
- Dispute Resolution (Action 14).

Parties to MLI are also required to submit an MLI Position document containing:

- Covered tax Agreements (CTAs) – tax treaties covered by the MLI;
- List of reservations and notifications made by the party⁸.

Action 15 of the 2013 OECD/G20 BEPS Action Plan mandated an analysis of the possible development of a multilateral instrument to implement tax treaty related BEPS measures “to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties”. Following the launch of the Action Plan, a “group experts” was set up to examine the feasibility of using a multilateral instrument for this purpose.

Based upon the work of Group of experts, the MLI can:

- Implement BEPS measures and modify the existing networks of bilateral tax treaties;
- Provide appropriate flexibility in the level of commitments;
- Ensure transparency and clarity for all stakeholders.⁹

MLI represents a significant efficiency gain as compared to the alternative of pairs of jurisdictions bilaterally renegotiating each of the more than 3000 tax treaties, which could have taken decades and resulted in inconsistent implementation of on BEPS measures. Instead of many different negotiations, there has been one collective negotiation. The MLI enables countries go through only one ratification procedure in their parliament in order to modify their whole treaty network rather than seeking separate rectification of amendments to each bilateral tax treaty.

The method of modification is defined by means of a compatibility clause which defines the relationship between the provisions of MLI and the bilateral treaty on objective terms. The different kinds of modification as described in MLI compatibility clauses are as follows:

- a) The MLI provision applies “in place” of an existing provision in a bilateral treaty i.e. the MLI provision replaces an existing provision if there is one.
- b) The MLI provision ‘applies’ or ‘modifies’ an existing provision in a bilateral treaty i.e. the MLI provision changes the application of an existing provision without entirely replacing it.
- c) The MLI provision applies ‘in the absence’ an existing provision in a bilateral treaty i.e. the MLI provision is, in effect, added to the bilateral treaty if there is no existing provision.

⁸ BEPS Multilateral Instrument, India’s Corresponding positions, implementation (GAAR) by Dr. Parthasarathi Shome, Chair of International tax research and analysis Foundation

- d) The MLI provision applies 'in places of or in the absence of' an existing provision in a bilateral treaty i.e. the MLI provision either replaces an existing provision or is, in effect, added to the bilateral treaty if there is no existing provision.

To accommodate different existing provisions in bilateral tax treaties and different policy preferences, the MLI allows for different forms of flexibility through system of reservations and notifications of choice between the alternative provisions and choices of apply optional provisions.

In order to ensure that there is clarity and transparency about the modifications made by the MLI to bilateral treaties, the operations of the compatible clauses described above is linked to notification provided by the Contracting Jurisdictions to the bilateral treaty. In cases of a), b) and c) described above, the operation of MLI provision requires notification by both Contracting Jurisdictions to the bilateral treaty of the existence (cases a and b) or the absence of (case c) of an existing provision. In case d), the MLI provision will apply in all cases regardless of whether there is an existing provision and regardless of the notification made by the Contracting Jurisdictions. If both Contracting Jurisdictions notify the existence of a provision, the MLI provision will replace it. If the Contracting Jurisdictions do not notify the existence of a provision, the MLI provision will be added to the bilateral treaty. In the unlikely event that, in case d), there were to be an existing provision which has not been notified by both Contracting Jurisdictions, the MLI provision would supersede the existing provision to the extent that the two are incompatible. This represents an application of the principle, reflected in Article 30(3) of Vienna Convention on the Law of Treaties, under which an earlier treaty between the same parties will apply only to the extent that its provisions are compatible with those of the later treaty.⁹

Mongolia

The Government of Mongolia is attempting to modify current laws on taxation and other related laws under tax reform in order to collaborate with European Union. The European Union has listed Mongolia as one of blacklisted country in December, 2017. Due to the following actions undertaken by the Government of Mongolia, Mongolia has delisted from the blacklist of the European Union.

- Mongolia has joined to 111st member country of Inclusive Framework on BEPS in 2018.
- Mongolia joined the international fight against tax avoidance and evasion by becoming the 148th member of the Global Forum on Transparency and Exchange of Information for Tax Purposes.

Mongolia, like all other Global Forum members will participate on an equal footing, and is committed combatting tax evasion through implementing the internationally

agreed standards of transparency and exchange of information for tax purposes-both exchange of information on request and automatic exchange of information. Members of the Global Forum include all G20 countries, all OECD members, all international financial centers and a very large number of developing countries.

⁹ Multilateral convention to implement tax treaty related measures to prevent base erosion and profit shifting: Functioning under Public International law. Note by the OECD Directorate for Legal Affairs

Mongolia will be reviewed against the standard of exchange of information upon request (EOIR) in 2020/2021.

The new draft taxation laws including Law on General taxation, Law on Corporate Income taxation, Law on Personal Income taxation and other laws are under discussion of the Standing Committee of the Budget to the Parliament of Mongolia for approval.

Draft law on General taxation had included a clause on specific requirements of Base Erosion and Profit Shifting (BEPS) and requirements of the "International Forum" for information exchange and transparency with tax purposes are applied.

Draft law on Corporate income taxation (which will be effective from 01 January 2019) has included clause 4.1.7 (a) on income earned from source of Mongolia shall be taxable income which is based upon the principal of BEPS. The income of direct and electronic service, product and work from Mongolian resident taxpayer to the taxpayer which does not reside in Mongolia shall be considered as earned income from Mongolian source.

In accordance with paragraph 4 of article 27 draft Law on Corporate income taxation, the BEPS report on each country shall contain the following information:

- Earned income, pre-taxation profit/loss/, paid taxation, debt of taxable receivables, registered capital, accumulated profit, number of employees, information about tangible assets exclusive money and other similar items in each country in where multinational group operates,
- Taxpayer number, information of tax resident, registered and if tax resident countries are different then information of each incorporated participant of the multinational group under which country laws as well as main activities of the participant of the multinational group,
- Report on country wise shall be reported on approved template in accordance with approved procedure by the Chair of the Taxation authority.

As defined under clause 27.1.6 of draft Law on Corporate income taxation, the multinational group which is not obliged to report if the multinational group's sale income is less than 1.7 trillion tugrugs under the integrated financial report. The integrated financial report contains integrated information of assets, debt, receivables, expenditures and money flow etc which prepared in accordance with accounting standards as one legal entity.¹⁰

Mongolia has executed avoidance of double taxation and the prevention of fiscal evasion with Government of 26 countries.

Sooner or later, Mongolia shall modify or amend its current 26 double taxation agreements against MLI provisions.

If you need more information or have any inquiry, please feel free to contact Bolormaa Volodya, Partner and Altanzaya Gunsen, Taxation Counsel of Absolute Advocates Law Firm via bvolodya@gratanet.com or 976 99085031.

¹⁰ Draft law on General taxation and Corporate Income taxation on www.mta.mn.