



## Open talks on taxation

### Legal Entity Income Tax Investment Incentives



One of the goals of tax reform in Mongolia is to create jobs for citizens. One requirement to accomplish this is for businesses to increase investment in their operations. While there is a trade-off between capital and labor, in that in modernizing production facilities can result in machines doing some of the work rather than people, the general effect is that additional investment expands the number of jobs available. The combination of people and machinery is necessary to increase Mongolia's competitiveness in not only the international markets, but also here at home.

There are two commonly used methods for encouraging businesses to invest, each with the same ultimate result. The first of these is accelerated depreciation, wherein a business is permitted either to use a shorter than actual useful life for an asset, or to deduct a larger percentage of the depreciation in the early years of the life of an asset. The second method is investment tax credits, whereby a business simply receives a tax credit equal to a percentage of investment in the tax year.

By accelerating the depreciation of an asset, a company recovers the value of its investment more quickly. The result of this is that, with the funds available more quickly, the business will reinvest the funds in additional assets. An additional benefit of this process is that a business is better able to match its revenues and associated expenses. As a general rule, an asset does depreciate more quickly, both in monetary value and physical condition, in the earlier years of its life. This means that the maintenance expenses are often higher in the later years. Permitting accelerated depreciation means that the depreciation expense is higher when the maintenance expense is lower and that the depreciation is lower when the maintenance is lower, thus leveling the total production cost of the asset.

Implementation of an investment tax credit accomplishes much the same result as accelerated depreciation, but in a different manner. Under this method, a business totals all of its investment in new physical assets during the tax year, and receives a credit against its tax liability for a percentage of the amount. Government has arrived at 5% as the proper percentage. Further, this credit can be carried forward to the three subsequent years in the event the investment tax credit exceeds the tax liability of the business.

In considering the options, Government has determined that providing for an investment tax credit is more desirable than accelerated depreciation. The result is the same, the cost to government in tax revenues is equal, but the effect on an individual business is more beneficial. Under accelerated depreciation, a business is required to keep two separate sets of accounting records to account for its assets. This is not necessary in the case of investment tax credit. All that is required is a simple calculation when preparing the tax report. Also, the use of investment tax credits is more transparent readily understandable to all parties. There is much less chance of miscalculation on the part of either the taxpayer or the tax authority.

This briefing is the fourteenth of a series published by the Public Affairs Offices of the Ministry of Finance and the National Department of General Taxation as part of a program of consultations and communications with all Mongolians regarding the tax proposals being considered. Electronic versions of these briefings and draft laws can be found at The Open Government website ([www.open-government.mn](http://www.open-government.mn)), the Ministry of Finance website ([www.mof.pmis.gov.mn](http://www.mof.pmis.gov.mn)) and the NDGT website ([www.mta.mn](http://www.mta.mn)). Also, these weekly tax briefings are posted on a variety of websites in addition to those shown above. Several of these sites provide the opportunity to give feedback and review discussions. Citizens are encouraged to visit the sites and review the comments and offer their own opinions.