



Open talks on taxation



Why Tax Reform and Where to Start?

Many people think Mongolia's current tax laws are hindering the economy.

Government's position is that changing the tax structure will encourage investment, both domestic and foreign. Additional investment will create additional jobs and would reduce poverty. These additional jobs would be part of the formal economy, thus increasing the tax base. Increasing the tax base permits lower percentage tax rates:

$$\text{Tax Base} \times \text{Tax Rates} = \text{Government Income From Taxes}$$

As Government requires a fixed amount of money in order to provide those public services demanded by the population, a lower tax base causes higher tax rates for those that do pay taxes.

So what changes are being considered?

Of primary concern is the taxation of businesses. Among others, this includes income tax and value-added tax. These two taxes combined represent almost one-half of total government tax revenues and are the most influential in affecting business behavior. And, while it is true that all taxes are ultimately paid by individuals, it is through business that individuals receive income. To encourage business growth, government is considering some of the following options in revising the corporate income tax law:

- Raising the income threshold, at which the 15% tax rate increases to 30%; the current threshold of 100 million togrog encourages businesses to form subsidiary companies rather than concentrate capital and grow larger, become more efficient, and more competitive. Permitting companies to pay the 15% rate to a higher income level would encourage them to grow.
- Offering specific incentives to encourage businesses to increase investments: this could be done either through accelerated depreciation, which permits a company to recover its investment more quickly, or through investment tax credits, which offer an immediate rebate of a small percentage of the amount of capital invested.
- Permitting additional deductible expenses; the current law restricts many types of legitimate business expenses that may truly be reasonably necessary for the business to operate.
- Eliminating tax exemptions and holidays: There are a variety of provisions in the law that permit certain investors and industries to avoid paying any income taxes. While considered necessary in the past to encourage foreign investment, these exemptions and holidays also serve to discourage domestic investors.
- Permitting businesses to "carry-forward" business losses: Mongolian businesses currently must pay taxes in a profitable year, but receive no benefit from suffering a loss in one year.

Also, new companies often lose money in their early years when they are also making substantial investments. A carry-forward provision would permit companies to pay taxes based on longer term financial performance.

These are some of the more major changes being considered, and it may not be possible to accept all of them. Among other possibilities, government must carefully evaluate the potential revenue losses and overall economic gains that would result before it adopts specific measures. But to become more competitive, Mongolia's tax structure must conform with international best practices.

Changes are also being considered in the value-added tax law. These will be discussed next week.

This briefing is one 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 can be found of these briefings can be found at The Open Government website (www.open-government.mn), the Ministry of Finance website (www.mof.pmis.gov.mn) and the NDGT website (www.mta.mn).