



Open talks on taxation



Why Tax Reform and Where to Start? Part 2: Value-Added Tax

Is the Mongolian tax system an effective tool for the Mongolian economy?

Last week's briefing discussed some of the issues and considerations for reduction of the tax burden on businesses, primarily corporate income tax. This briefing explains how value-added tax (VAT) impacts businesses.

A business pays VAT on its purchases of goods, works and services, then collects VAT upon the sale of its products. When the business remits the tax receipts to the government, it pays only the difference between the amount it collected and the amount it paid. Thus, there should ultimately be no real expense to the business.

	<u>Amount without VAT</u>	<u>VAT Amount at 15%</u>
Expenses for goods, works and services	300,000 MNT	45,000 MNT
Selling price	500,000 MNT	60,000 MNT
Amount remitted to Government (60,000 less 45,000):		15,000 MNT

In actuality, VAT has substantial effects on both businesses and on the economy as a whole.

Effects on businesses:

- Although the net “expense” of VAT is intended to be zero, there is a financing cost associated with paying VAT on purchases and not recovering the amount until production completion and sale. This is overly damaging to Mongolian businesses, with the high interest rates available.
- Unregistered businesses must still pay VAT on their inputs, but cannot charge VAT on the sale of products. As a result, they do not recover the cost of the VAT on their purchases of goods, works and services. This leaves these smaller businesses at a disadvantage when competing against larger businesses. It is particularly harmful to business start-ups that must pay VAT on their initial purchases.

Effects on the economy:

- As VAT is paid upon every purchase of goods, works and services, it is the most difficult tax for businesses to avoid. Participants in the informal economy must pay it when they make VAT-taxable purchases through the formal economy. It is beneficial for companies operating in the informal economy to be registered as VAT payer. This provides an incentive for these companies to register, and to participate in the formal economy.
- VAT is the best economic tool for encouraging domestic production, by collecting VAT on all imports and exempting exports and smaller or selected local producers. This is one way for domestic businesses to better compete against foreign competitors.
- As the tax is paid on most goods, works and services purchased, the VAT tax base is relatively large and stable. Income tax revenues, on the other hand, are more variable and income taxes can be more easily avoided by companies.

- With the relatively large level of imports of Mongolia, the majority (approximately 60 percent) of VAT is collected at the borders. This means that the collection and administration costs are relatively low in relationship to the total amount collected. These expenses for other types of taxes are higher but bring in less revenue.

As is evidenced by the above, Government is obviously required to give extensive consideration to a variety of alternatives in reforming the VAT law.

This briefing is the seventh 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).