Mongolia joins BEPS Inclusive Framework

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Executive summary

Following Mongolia's recent inclusion on a blacklist of countries by the European Union (EU) as one of the 17 non-cooperative jurisdictions, Mongolia is now urged to take action to scratch itself off the blacklist. The nation has taken its first step by deciding on 25 December 2017 to join the Inclusive Framework of the Base Erosion and Profit Shifting Project (BEPS Project) of the Organization for Economic Cooperation and Development (OECD). By becoming a BEPS Associate country, Mongolia is committing to implement various BEPS minimum standards, namely:

- Action 5: Countering harmful tax practices
- Action 6: Preventing treaty abuse
- Action 13: Transfer pricing documentation
- Action 14: Enhancing dispute resolution

Such implementations of BEPS actions will impose more transparent tax compliance and reporting obligations by MNC subsidiaries operating in Mongolia in certain areas, more specifically in areas of granting tax treaty benefits, as well as transfer pricing documentation and reporting requirements.

Refer to following section of this alert for more details.

DETAILED DISCUSSIONS

Overview of EU's blacklist consequences on Mongolia

The Council of the European Union adopted on 5 December 2017 a blacklist and a grey list of non-cooperative jurisdictions for tax purposes. The blacklist includes 17 countries which are considered as not cooperative on various tax reform matters, including Mongolia. In particular, the EU noted that Mongolia had not committed to any of the global cooperation platforms such as: (i) Mongolia is not a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes, (ii) Mongolia is not a party to the OECD Multilateral Convention on Mutual Administrative Assistance (MCMAA) and (iii) Mongolia had no commitment to adopting BEPS minimum standards. The potential consequence is that there are some defensive measures against the blacklist jurisdictions to be further taken by EU and its Member States, involving various sanctions in both tax and non-tax economic relations including a limitation to accessing EU's financial sources.

In an effort to address the EU's blacklist implications, Mongolia started making efforts to get de-listed from the non – cooperative jurisdictions, by becoming the 111th member of OECD's BEPS Inclusive Framework, thereby becoming a BEPS Associate on 3 January 2018.

What are Mongolia's obligations as a BEPS Associate

BEPS refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. The BEPS project comprises of 15 Actions recommended by the OECD (in support of the G20) to equip governments with domestic and international instruments to address tax avoidance, ensuring that profits are taxed where economic activities generating the profits are performed and where value is created.

On 23 February 2016, the OECD announced a new framework that allows all interested countries and jurisdictions to join efforts to update their international tax rules consistent with the BEPS framework. Under the inclusive framework, over 100 countries and jurisdictions are collaborating to implement the BEPS measures and tackle BEPS.

As BEPS Associates, the participating countries will work on an equal footing with the OECD and G20 members on implementing various BEPS recommendations. The framework's mandate plans to focus on the review of implementation of four BEPS minimum standards, in the areas of harmful tax practices, tax treaty abuse, transfer pricing documentation and improvements in cross border tax dispute resolution.

Mongolia's position

Mongolia has just pledged that the country will join the inclusive framework for the global implementation of the BEPS project and work with other jurisdictions to help progress implementation and monitoring.

Mongolia is therefore committed to implementing the four BEPS minimum standards, and being subject to peer review regarding its progress in this respect. The timing of implementation of the BEPS measures will be subject to the time required for legislative amendments. The timelines will be determined based on the characteristics of the domestic tax regime, the envisaged magnitude of legislative changes involved and the practical need to prioritize among the BEPS measures. The Government will conduct an analysis on the BEPS package in order to map out the priorities among the BEPS measures.

In this regard, Mongolia's immediate needs will include transfer pricing rule enhancement, improving the tax treaty application and administration against treaty abuse, and developing a multilateral instrument to implement BEPS treaty-related measures.

Key impact on Mongolia

Transfer pricing documentation. Mongolia already broadly adheres to the internationally agreed arm's length principle based on the OECD Guidelines. Currently there are some requirements to prepare contemporaneous transfer pricing documentation. However, the format of these documentation requirements do not align with the three tiered documentation requirements of the OECD, which include Master file, local file, and country-by-country reporting. At minimum, Mongolia will be expected to adopt country-by-country reporting requirements, which are one of the four BEPS minimum standards.

Treaty abuse. As a BEPS Associate, Mongolia will need to commit to improve administration of tax treaty applications, with a focus on preventing treaty abuse and implementing measures that meet evolving international standards.

In this respect exchange of information will be a key priority, including mechanisms for the Automatic Exchange of Information (AEOI) in relation to tax matters.

Mongolia is not currently part of a group of jurisdictions working together under the aegis of the OECD and G20 to develop a multilateral instrument for incorporating BEPS measures into existing bilateral treaties to counter treaty abuse.

The ad hoc group (which now includes around 100 jurisdictions) comprises countries working together to implement the multilateral instrument. Hence, there may be some interest that Mongolia would be part of the ad hoc group and to become signatory to the multilateral instrument.

Countering harmful tax practices. The BEPS project has placed priority and renewed focus on requiring substantial activity for any preferential regime and on improving transparency, which may require more detailed disclosures on preferential tax regimes. Mongolia is not considered a country that offers any preferential tax regimes under its laws. Nevertheless, there is an expectation that Mongolia be open to peer review regarding its tax rules and any preferential treatments or incentives offered.

Enhancing dispute resolution. As a BEPS Associate, Mongolia will have to work closely with other jurisdictions to monitor the implementation of minimum standards on dispute resolution developed under the BEPS Project. This will complement the other BEPS minimum standards and facilitate that taxpayers have access to effective and expedient dispute resolution mechanisms under bilateral tax treaties.

Implications

By joining the inclusive framework, Mongolia has committed to adopting the minimum standards under the aforesaid four BEPS measures. Other BEPS measures concerning transfer pricing under BEPS Action Plans 8, 9, 10 as well as Action 13 were approved on 23 May 2016 by the OECD Council for incorporation into the revised OECD Transfer Pricing Guidelines, formally elevating the status of these BEPS measures. Notwithstanding the above, further refinements to Mongolia's tax system may still be needed for it to fully adhere to the BEPS recommendations. It remains to be seen whether and how Mongolia will adopt the remaining BEPS measures.

As a BEPS Associate, Mongolia can work with other participating jurisdictions to facilitate the consistent implementation of measures under the BEPS project, and a level playing field across participating jurisdictions. Joining this inclusive framework demonstrates Mongolia's intention to meet the key principles underlying the BEPS project, which is important in restoring the status of Mongolia as a robust tax location.

With these BEPS changes (particularly around transparency), there will inevitably be additional burdens placed on taxpayers around reporting and indeed reviewing their operating models to facilitate compliance with the new international standards. However, improving Mongolia's reputation as an internationally compliant player, particularly in a world now characterized by greater transparency, will likely result in higher benefits or lesser challenges from other tax authorities. Taxpayers should be reminded that BEPS goes beyond tax. The new global tax environment, being driven by the focus on BEPS, touches every aspect of the business organization, including holding structures, operating models, IT infrastructure, human resource mobility, financing arrangements, etc. Any taxpayers with international operations, whether large or small, will need to navigate the BEPS journey carefully in addressing the competing business and tax pressures.

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