

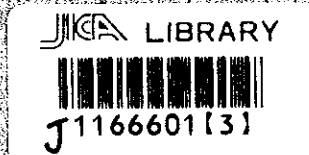
JAPAN INTERNATIONAL COOPERATION AGENCY (JICA)

General Department of National Taxation
MONGOLIA

THE STUDY ON THE SUPPORT
FOR THE ECONOMIC TRANSITION AND
DEVELOPMENT IN MONGOLIA

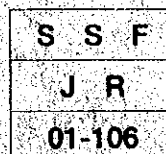
TAX COLLECTION ENHANCEMENT PHASE II

FINAL REPORT



July 2001

INSTITUTE FOR FINANCIAL AFFAIRS, INC.



JAPAN INTERNATIONAL COOPERATION AGENCY (JICA)

**General Department of National Taxation
MONGOLIA**

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Abbreviations

JICA	Japan International Cooperation Agency
GDNT	General Department of National Taxation
Tg	Togrog
VAT	Value Added Tax
CGS	Cost of Goods Sold
KWH	Kilowatt hour
CPA	Certified Public Accountant

Currency Equivalents

As of July 2001

1,096 Tg / USD 1.00

125.40 Yen / USD 1.00



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PREFACE

In response to a request from the Government of Mongolia, the Government of Japan agreed to conduct a “Study on Tax Collection Enhancement”, under the framework of the “Study on the Support for the Economic Transition and Development in Mongolia” and entrusted the study to the Japan International Cooperation Agency (JICA).

JICA selected and dispatched a study team headed by Mr. Yujiro KOYANAGI of Institute for Financial Affairs, Inc. to Mongolia, seven times from July 2000 to July 2001. In addition, JICA set up an Advisory Committee, headed by Prof. Shinji ASANUMA, Asian Tax and Public Policy Program, Hitotsubashi University, which examined the Study from specialist and technical point of view.

The Team held discussions with the officials concerned in the Government of Mongolia and the General Department of National Taxation and conducted field surveys and implemented seminars on the reform of the tax collection system. Upon returning to Japan, the Team conducted further studies and prepared this report.

I hope this report will contribute to establishing a proper and fair taxation system and to securing stable tax revenue for the government of Mongolia, I also hope it enhances the friendly relationship between our two countries.

Finally, I wish to express my sincere appreciation to the officials concerned in the Government of Mongolia and to the General Department of National Taxation for their close cooperation throughout the study.

August 2001



Kunihiko Saito

President

Japan International Cooperation Agency

August 2001

Mr. Kunihiko Saito
President
Japan International Cooperation Agency

Dear Mr. Saito,

Letter of Transmittal

We, hereby, have the pleasure of submitting our report entitled "Tax Collection Enhancement Phase II" for the "Study on the Support for the Economic Transition and Development in Mongolia". The report describes the results of the Study conducted by Institute for Financial Affairs, Inc. in accordance with the contract entered into with the Japan International Cooperation Agency (JICA).

Our Study Team carried out field surveys seven times within the period July 2000 and July 2001. Based on the results of these surveys in Mongolia and study activities in Japan, the Study Team drew up recommendations to contribute to Tax Collection Enhancement in cooperation with the Mongolian side. Regarding these recommendations, the Team conducted seminars for the tax officials and finally prepared this report.

In view of the necessity of tax collection enhancement in Mongolia and the need for socio-economic development of Mongolia as a whole, we recommend that the Mongolian government implement these recommendations as a top priority.

We wish to take this opportunity to express our sincere gratitude to your Agency, the Ministry of Foreign Affairs, the Japanese Embassy in Mongolia and the JICA Ulaanbaatar office. We also wish to express our deep gratitude to the Government of Mongolia, the General Department of National Taxation and other concerned organizations for the kind cooperation they extended to our Team, as well as for the warm hospitality provided during our stay in Mongolia.

Very truly yours,

小柳友志郎

Yujiro Koyanagi

Team Leader

The Tax Collection Enhancement Study Phase II

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Executive Summary

1 Background to the Study

The Government of Mongolia made a request to the Government of Japan for support in the establishment of development strategies, public investment plans and concrete economic reform programs during the transition from a socialist economy to a market economy and requested the implementation of a development study for the purpose of nurturing economic policy planners in Mongolia. This development study was conducted between September 1998 to March 2000.

Tax Collection Enhancement Study Phase I was conducted as one of the principal components of the studies. The objectives established for the study were to present recommendations for the enhancement of capabilities for the collection of fiscal revenues and to undertake technology transfer in order to develop tax collection officers in the fields for the General Department of National Taxation (GDNT) in Mongolia. The results of the study were compiled in a Final Report, which was submitted to Mongolia in August 1999.

The Government of Mongolia highly evaluated the JICA Tax Collection Enhancement component of the studies and requested the Japanese Government to provide ongoing assistance in this area. Based on its judgment that the benefits of the technology transfer implemented in Phase I would be further enhanced by improving the execution of tax collection in each tax category, the Japanese Government thus concluded that a Study Phase II should be implemented. Tax Collection Enhancement Study Phase II was subsequently initiated in July 2000 and was completed in July 2001.

2 Objectives of the Study

This Study for the Tax Collection Enhancement is to enhance tax administrative capabilities and executive function and to increase the flow of fiscal revenues in order to enable an adaptation to existing economic realities (transition to a market economy) in Mongolia.

Especially in Tax Collection Enhancement Study Phase II, the principal objectives were: study the GDNT's tax collection mechanism; study the tax payment mechanism of the Mongolian taxpayers; examine the preparation of various environments to supplement both of the above mechanisms; and examine the introduction of new taxes that are more effective. Based on such examinations, recommendations and technical transfers would be provided for each of the items.

The ultimate goal is to improve the effectiveness of the tax administration and enable to increase fiscal revenues.

3 Track Record of the Studies

Activities that have been implemented in Phase I and Phase II thus far by the Mongolian Government based on the recommendations of the Study Team are outlined below.

3.1 Phase I Study

The Government of Mongolia, based on the recommendations made by the Phase I Study conducted by the Study Team, has since implemented recommendations or has decided upon the implementation of the following major items.

- (a) A major functional and organizational reform of the entire Mongolian tax collection organization (February 2000)
- (b) Decision to introduce the "Registration System" for large-scale taxpayers and the Statutory Receipt System issued by the GDNT (directive of the Minister of Finance and Minister of Agriculture and Forestry issued March 2000 and Government directive issued January 2001)
- (c) Adoption of inspection methodologies and manuals that were recommended as innovative methods, guides and manuals relating to the detection of concealed income (assets), its taxation and collection (February 2000)
- (d) Improvement of incentive systems to information providers in order to facilitate the collection of information related to tax evaders
- (e) Redesign of performance reviews, promotion and salary adjustments and incentive criteria for tax officials

3.2 Phase II Study

At the time of the initiation of the Phase II Study, a request was made by the Government of Mongolia for assistance in the review of an overall tax law reform as a matter of urgency. The Study Team undertook tasks involving the reform and creation of the entire set of tax laws of the country from July through December 2000 and made recommendations relating to the reform and creation of the tax laws.

As of May 2001, proposed revisions were being deliberated in the national assembly but the principal tax systems that had been enacted based on the assistance of the Study Team as of this point in time include the followings:

- (a) Creation of the Real Estate Tax Law and Special Stamp Duty Law
- (b) Amendments to various tax laws
 - Individual Income Tax Law
 - Corporation Tax Law
 - Value Added Tax Law
 - Special Tax Law
 - Automobile Tax Law
 - Automobile Gasoline and Diesel Fuel Tax Law

The laws that still being deliberated by the national assembly are; the Law on Supervision of Tax Assessment, Payment and Tax Collection (Process Law), which defines the execution of tax administration and contains amendments of critical importance to the GDNT; and the General Tax Law, the basic law shred by the entire tax code.

3.3 Summary of Recommendations in Phase II

The Final Report promotes concrete recommendations based on the findings of the studies in Phase I and Phase II relating to the environment surrounding fiscal revenues in Mongolia as well as the results of detailed examinations from various perspectives. These recommendations offer practicable means for achieving the establishment of a tax system based on the underlying assumptions of fairness and impartiality enabling low-cost collection and trouble-free implementation with a sense of urgency, while promoting an expansion of the tax base rather than raising tax rate.

Recommendations focused on the following two aspects:

- (a) The feasibility of setting up sweeping measures capable of dealing with obligors who are earning income without regard for taxation including measures related to the taxation and collection of taxes from the underground economy, an issue that is of paramount importance to the GDNT, and measures for the taxation and collection of taxes from cash operators
- (b) Ways in which taxation, examinations and collections can be conducted assuming the objectives of the efficient execution of tax administration

Below is a summary of the Phase II recommendations.

(1) Tax System

The focuses on the recommendation for the tax systems are as follows:

- (a) Primary objective is the enhancement of fiscal revenues for Mongolia.
- (b) To minimize taxpayer resistance in the short term with a content that facilitates acceptance by the taxpayer while it looks to the future of Mongolia
- (c) To minimize the incremental costs of tax collection associated with the reforms and creation of the system
- (d) To limit only to those items that urgently require amendments or creation

In the tax laws that have already been enacted, there are some aspects that do not fully reflect the Study Team's recommendations. In consideration of their materiality, the Study Team proposed the recommendations regarding the principal tax categories deemed to be amended as well as the General Tax Law which is currently being deliberated in the national assembly. In the main report, recommendations are presented in the following areas to improve common tax law, tax enforcement law and major individual tax laws that are important in the existing tax system based on the existing laws.

- General Tax Law
- Law on Supervision of Tax Assessment, Payment and Tax Collection
- Corporation Tax Law
- Individual Income Tax Law
- Items that are common between the Corporation Tax Law and the Individual Income Tax Law
- Value Added Tax Law
- Real Estate Tax Law
- Inheritance Tax Law and Gift Tax Law

(2) Establishment of a Statutory Receipt System

By providing in the statutes a requirement for an issuance of receipts for economic transaction above a certain value, it enables the state to directly identify economic transactions above certain amounts transacted among the populations or enterprises. As a result, GDNT will acquire a means of directly ascertaining the appropriateness of the contents of tax returns submitted by tax obligors as well as facilitating the identification of those who fail to file tax returns; thus, enabling to cheaply and easily levy and collect taxes directly from the black market and cash transaction operators within a short period of time. We recommend a creation of the Statutory Receipt System as a means of achieving this objective.

(3) Presumptive Taxation

Even with a complete implementation of a Statutory Receipt System, as in any other society, there will be those who will attempt to evade taxes and many tax evaders currently exist in Mongolia; therefore, a vitally important issue exists, which is the need for the Mongolian taxation authorities establish a method to accurately collect taxes on incomes of the tax obligors defined under the various tax laws using presumptive taxation. The Study Team presented recommendations for addressing the issues in “Presumptive Taxation” section.

Under the self-assessment system, the principle is for taxpayer calculates the taxable income and the tax amount based on bookkeeping records of business revenues and expenses. It is patently clear from the principle of fairness in tax burden that the fact of the lack of bookkeeping records will not exonerate the taxpayer from his obligations for taxes.

A method to deal with such situations in which the income is determined by estimation data other than bookkeeping records is referred to as Presumptive Taxation. In the General Tax Law, Individual Income Tax Law and notices based on the laws all contain provisions for estimation of income by comparison with some other benchmarks. In actual tax inspections, determinations of income are being done by method using comparisons. However, it should not be ignored that if the resulting tax assessment is contested in the court of law, due to the lack of ways to verify the reasonableness of the method of estimation by objective evidential documents, there is a high likelihood of the tax assessment being overturned.

The guide for Presumptive Taxation has been prepared to present a source of reference for concrete methods in a logical and systematic manner as a means to deal with these situations. In addition to this, the technical transfer seminar was held against the tax officials.

(4) Corporate Income Tax Inspections

One issue that exists in the Mongolian corporate tax system is the inefficiency in the inspection system that examines the propriety of the taxpayer's tax returns. Specifically, the problems reside in areas of the selection of inspection targets, method of preparation for the inspection, the method of inspection and the tax information data system. The following items have been recommended for these issues.

- (a) Improvements in the rough screening of inspection target enterprises
- (b) Improvement of the preliminary inspections
- (c) Creation of tax records
- (d) Diversification of tax inspection methods
- (e) Establishment of excellent achievement study meetings
- (f) Establishment of a tax information system and its effective utilization
- (g) Improvement of inspector capability

(5) Introduction of the Blue Return System

It is our view that providing preferential treatment to those taxpayers who diligently file income tax returns and pay their taxes from that given to other types of taxpayers will further enhance the taxpayer awareness of such diligent taxpayers and at the same time lead to an increase in the number of diligent taxpayers as a result of many more wanting to receive such preferential measures; therefore, we recommend a creation of a system of commendation for the diligent taxpayers.

A Blue Return System is a system in which reward or incentives are provided to individuals engaged in businesses or enterprises for calculating income for the purpose of reporting income for taxation based on bookkeeping documents that records daily transactions. It is an extremely effective means to promote the acceptance of the self-assessment system.

However, the reality is that upon inspection of the state of records including taxpayer's bookkeeping records, excluding the foreign affiliated enterprises and some

medium and small-scale enterprises, practice of maintaining bookkeeping records is non-existent among most of the taxpayers.

It is important to prepare the taxpayer environment so that the taxpayer would regard the special blue return deductions and other benefits that are provided to blue return filers as being of value and desirable and be able to receive such benefits. For those who do not maintain bookkeeping records, taxation needs to be strengthened through the application of Presumptive Taxation or other methods. Besides, the tax inspections need to be conducted to instill the recognition that the payment of taxes is unavoidable regardless of the existence of bookkeeping records and that the lack of such records is unfavorable tax inspections instill the recognition that payment of taxes is unavoidable. Combined with this, the tax administration needs to make public relations efforts to elevate the taxpaying mentality, the spread bookkeeping expertise and enhance bookkeeping training and the Blue Return System should be introduced at a stage where certain degree of completion can be confirmed.

(6) Taxation for Businesses and Services with Indefinite Income

As there is gross unfairness that exists under the Individual Income Tax Law, this is a recommendation on rectification of such unfairness.

The taxation method that is being applied to taxpayers who are engaged in businesses and services with indefinite income is not a desirable method of taxation from the point of view of fairness.

The Study Team recommended that this system be abolished as soon as practicable and replace the system with in principle taxation under the Individual Income Tax Law. However, the immediate elimination of this system involves many issues including issues relating to the lack of taxpayer awareness on the part of the taxpayers, issues relating to the lack of acceptance of the practice of bookkeeping and issues relating to the inadequacies that exist in the executive organization of the tax administration. Therefore, the elimination of the system is seen difficult from the standpoint of securing in an efficient manner at least minimal amount of tax revenues

even at the expense of minor level of unfairness in taxation.

The Study Team made several recommendations as a resolution method with the ultimate objective of the total elimination of the system.

- (a) Reduce the number of industries to which the existing law would apply and revise the schedule of patent payments to reflect the existing conditions
- (b) Make the patent payment be an advance payment of the annual tax with such advance being settled at a year-end tax adjustment process
- (c) Interpret the existing law that the taxpayers who are enjoying high levels of income while making patent payment will no longer fall under the taxpayers who engaged in businesses and services with indefinite income

(7) The Tax Accounting System

In order to secure tax revenues appropriately and efficiently, in addition to the reforms in the tax administration, the tax accounting system should be widely accepted and well understood among the population and enterprises. Therefore, the Study Team proposed an establishment of an accounting system (bookkeeping system) and a creation of tax accountant system.

One of the causes for the lack of effective functioning of the tax administration is the lack of understanding of accounting on the part of the taxpayers. Mongolian Government is currently instructing taxpayers to follow the double-entry bookkeeping system. However, further measures to firmly establish double-entry bookkeeping is required and instruction to maintain bookkeeping records including general ledger and preparation of financial statements should be implemented. In order that the taxpayer gains a broad knowledge of bookkeeping, the Study Team has created an introductory level of bookkeeping textbook as a sample. If the taxpayer consciousness were enhanced and this system were accepted, laws such as "Income Tax Law for Self-employed Persons Engaged in Businesses and Services with Indefinite Income" would be amended soon and the perception of unfairness under taxation would be corrected.

The creation of the Tax Accountant System would lead to the securing of social and economic security for the tax officials after retirement, as an integral component of enhancement of revenues. Its introduction would also provide a means to break the status quo of the lack of acceptance of the bookkeeping system among the taxpayers, which makes tax administration and its execution extremely difficult for the GDNT. If a tax accountant who is a professional with regard to taxation, bookkeeping and accounting were able to become involved in the preparation of tax returns for taxpayers and other processes related to tax payment, it would lead directly to enhance revenues.

(8) The Investigation System

The Final Report identifies issues and bears mind the existing conditions in Mongolia, and provides a set of recommendations regarding Investigation System, which is a system to punish specific taxpayers with criminal punishment as a means to give a lesson.

Investigation is the most potent among the tax inspection tools; thus, it is vital that it be conducted in a thorough and accurate manner so as to force the subject tax obligor at its conclusion, to accept the investigation findings. It should also be conducted by the most capable inspectors in an organized manner under the supervision of officials who have the authority to make responsible decisions in order that the results will gain the credence of the judicial authorities.

(9) Tax Disputes

In Mongolia, when tax disputes are brought against the tax administration relating to taxation, inspection and collection, quite a few are the cases that the tax administration have lost. Even items that ought be rejected outright such as cases where taxpayers who are in violation of tax deadlines or legal provisions stipulated by the law are being accepted and in fact the tax administration loses such cases.

Followings have been presented as recommendations to remedy this situation.

(a) Legal powers of the tax administration and tax officials responsible for taxation should be expanded and ambiguous legal provisions should be eliminated.

(b) Enhance the capabilities relating to the presentment of evidence.

Inspectors' daily tasks should be performed based on facts that are shown to be true regarding the taxpayer and indication of fraudulent reporting or under-reporting must be based on verifiable facts evidenced as being true. If application of standard taxation method cannot be avoided, taxation should be conducted in a way that will enable favorable judgment in case court action is brought and as a priority item, the GDNT should examine such methodologies.

(c) The Tax Dispute Resolution Council's functions should be enhanced.

Dispute resolution by the Tax Dispute Resolution Council should be based on detailed considerations with an assumption of a follow-on legal action being brought. If legal actions are assumed, then membership in the council should include officials from the Ministry of Justice or a judge as a full time member. The GDNT should, for this end, should establish jointly with the judicial authorities (specifically the Ministry of Justice and the Supreme Court) a working deliberation council.

(10) The Tax Officials Corruption Prevention System

It is thought that the primary form of corruption is the receipt of cash in return for reduction in the taxes imposed. The single most important factor behind the staff committing corrupt actions is, it goes without saying, even before considering the staff lacking in morals, is the low level of wages. In order to eliminate corruption from the ranks of the tax staff, in addition to measures to enhance the moral standards, measures to improve the income level of the staff need to be examined.

Following three items have been presented as recommendations for improvement:

(a) Improvements in the pecuniary compensation level of tax officials

(b) Establish post for conducting clandestine monitoring

(c) Introduction of a periodic staff rotation system and enhancement of

commendation system and a creation of Tax Accountant System

(11) Creation of a Favorable Environment for Tax Payment

The followings are recommendations regarding taxpayer education and public relations toward taxpayers.

1. Taxpayer Education

- (a) The recognition of the obligation to pay taxes should not be limited to just to taxpayers but should be shared by all Mongolians. In considering the future of Mongolia, tax education should be incorporated into the ongoing curricula of elementary, junior high schools and high schools. Taxpayer's rights and obligations should be educated to the youths at a national level as a text level subject matter. Tax education should not be confined to the teaching of bookkeeping techniques for calculation of taxes but should also incorporate educating the students of the role of taxes in the maintenance and development of a democratic civic society. Thus, tax education should be taught as an integral component in teaching the workings of the national society.
- (b) We recommended that in all areas of research relating to taxation, measures should be taken to achieve an enhancement to the level of research. This may not be a measure that will bring about immediate improvements to the taxation system, but this is an element that is essential in the achievement of above measures, or in another words, infrastructure investments into tax education is required.
- (c) A recommendation regarding an establishment of a cross-sectional organization (preferably a body with some authority such as a governmental commission. If a specific item is being researched a flexible form of organization such as a project team may be desirable) within the government with the GDNT serving as the secretariat, to promote research relating to taxation was made.

2. Public Relations toward Taxpayers

- (a) In order to heighten the level of interest of the general public, a

recommendation by the GDNT by providing appropriate information to the mass media, to harness and direct the influence of the mass media toward the enhancement of taxpayer awareness. Specifically, this would include the disclosure of names of taxpayers who have paid taxes above a threshold amount and names of tax evaders

- (b) Each new taxpayer registrants should be required to attend 1-year courses covering each tax classification (e.g. once a quarter) regarding supervision of tax payment and laws regarding tax collection with the GDNT directly conducting such courses as well as conducting the necessary public relations tasks.
- (c) Fostering and organization of taxpayers with proper knowledge of taxation should be undertaken and steps to solicit cooperation in measures to raise the level of taxpayer awareness be undertaken were recommended.

With regard to details of the recommendations above, if the Mongolian Government were to swiftly implement such reforms not only can a dramatic enhancements in the tax collection at a low collection costs, it would ensure fairness in taxation and dramatically expand the tax base; therefore, the Mongolian Government should effect various measures to ensure early implementation of these recommendations.

4 Remaining Issues

The most conspicuous characteristics of Mongolia may be summarized as follows:

- (a) Population is small, approximately 3 million.
- (b) Special numbers are assigned by the state to the people and to enterprises.
- (c) The level of taxpayer awareness is limited. However, the level of sophistication of the public is at a relatively high level and, depending on the methods adopted, introduction of new and different ways can be accomplished relatively easily. This is evident in the case of the creation of the Real Estate Tax Law.
- (d) An underground economy exists but the presence of an organized underground economy appears to be limited.

Assuming the above characteristics, efforts should be made to promote the creation and prompt implementation of the Statutory Receipt System, which would target the entire taxpayer population and would enable the enhancement of the country's fiscal revenues based on the assurance of fairness in taxation and the execution of taxation and collection directly, accurately, at low cost and easily in a short period of time.

Next, even if the Statutory Receipt System were implemented, there would be those who attempt to evade taxes, as in any society; therefore, the prompt establishment of a tax assessment system in standard taxation that would enable favorable judgments in legal actions should be ensured.

Finally, the rate of taxation applied to income from the sale of real estate under the Individual Income Tax Law and the Corporation Tax Law should not be at the special tax rate but, rather, the tax laws should be amended as soon as practicable to have base tax rates applied to such income. There is a marked rate of appreciation in real estate values in Mongolia, particularly in Ulaanbaatar and, based on the fact that such price appreciation has just begun, this income, having the nature of unearned income, should be taxed, at least by applying a base tax rate, and additional taxation should be considered for capital gains from assets that are held for only a short period of time after acquisition.

PART I

INTRODUCTION

1 Objectives and Track Record of the Study

1.1 Objectives of the Study

The Study of Tax Collection Enhancement Phase I was conducted from September 1998 to March 2000 as an important component of studies in support of the transition to a market economy in Mongolia. The results of the Phase I Study have been well received and the Phase II Study was initiated from July 2000 to July 2001. The objectives of these studies are to provide the Mongolian General Department of National Taxation (GDNT) with various technical expertise relating to tax administration based on the current state of the Mongolian economy in order to effect the appropriate and efficient enhancement of the government's ability to collect various taxes. The ultimate objective is not only to contribute to the reduction of fiscal deficits in Mongolia but also to help establish a firm foundation for the country's fiscal system.

1.2 Track Record of the Study

Activities that have been implemented in Phase I and Phase II thus far by the Mongolian Government based on recommendations of the Study Team are outlined below.

(1) Phase I

The followings are the major activities that the Mongolian Government has resolved to implement or has already implemented based on recommendations in Phase I:

- (a) Major functional and organizational reforms encompassing the entire tax collection organization (February 2000)
- (b) Decision to introduce a register system for application to large-scale taxpayers and a system of statutory receipts issued by the GDNT (directive of the Minister of Finance and Minister of Agriculture and Forestry dated March 2000, and

Government directive dated January 2001)

- (c) Adoption of new guidance for the exposure of concealed income (assets) and innovative techniques for their taxation and collection as well as the adoption of inspection methods recommended for use as a manual and the adoption of an inspection manual (February 2000)
- (d) Improvements in the system of incentives provided to informants with the aim of collecting information about tax evaders
- (e) Redesign of criteria used in job evaluations, promotions and incentives for the tax staff

(2) Phase II

A request was made by the Government of Mongolia to the Study Team prior to the initiation of Phase II for cooperation in conducting a reform of the tax laws as an issue requiring some urgency. With the approval of the JICA headquarters, the Study Team undertook the tasks to amending and developing all of the country's tax laws from July through December 2000, and submitted recommendations for the amendment and creation of new systems.

The recommendations (a) have the primary aim of enhancing Mongolia's fiscal revenues and (b) its contents are formulated so as to reduce the existing level of taxpayer resistance and facilitate taxpayer acceptance while keeping the focus on the future. (c) They furthermore minimize increases in the cost of tax collection associated with the amendment or creation of new systems and (d) were limited to those areas that required immediate amendment or the development of such systems.

Although the bills containing the proposed amendments were still being deliberated by the national assembly as of end of March 2001, major tax systems realized to date for which the Study Team provided assistance and input are outlined below:

- (a) Creation of a Real Estate Tax Law and Special Stamp Duty Law

- (b) Amendments to various tax laws (Individual Income Tax Law, Corporation Tax Law, Value Added Tax Law, Special Tax Law, Automobile Tax Law, Automobile Gasoline and Diesel Fuel Tax Law)

The laws that are still being deliberated by the national assembly are the Process Law, which defines the execution of tax administration and contains amendments of critical importance to the GDNT, and the General Tax Law, the basic law shared by the entire tax code. It is not clear at this juncture whether or not the amendments will be passed.

2 Final Report

The Final Report promotes concrete recommendations based on the findings of the studies in Phase I and Phase II relating to the environment surrounding fiscal revenues in Mongolia as well as the results of detailed examinations from various perspectives. These recommendations offer practicable means for achieving the establishment of a tax system based on the underlying assumptions of fairness and impartiality enabling low-cost collection and trouble-free implementation with a sense of urgency, while promoting an expansion of the tax base rather than raising it.

The Study Team provides the recommendations mainly focused on:

- (a) Achieving means for rounding up those business operators with tax liabilities who have been acquiring income without any regard for taxes. They deal with such issues as the imposition and collection of taxes from the underground economy, the issue that is currently of the greatest importance to the GDNT, and provide a response to the imposition and collection of taxes from cash-based businesses.
- (b) Assuming the securing efficient execution of tax administration, what can be done that will result in an appropriate and effective implementation of taxation, inspection and collection against the taxpayers

Below is a summary of the issues and proposals for reform.

(1) The Tax System

In the view of the Study Team in the tax laws that have already been enacted, the recommendations including those relating to amendments put forth by the Study Team has not been sufficiently reflected. Therefore, considering the importance of the articles that require amendments in principal tax categories, below are recommendations that addresses also the General Tax Law, which is currently being deliberated in the state assembly.

(2) Establishment of a Statutory Receipt System

By providing in the statutes a requirement for an issuance of receipts for economic transaction above a certain value, it enables the state to directly identify economic transactions above certain amounts transacted among the populations or enterprises. As a result, GDNT will obtain a means of directly ascertaining the appropriateness of the contents of tax returns submitted by tax obligors as well as facilitating the identification of those who fail to file tax returns; thus, enabling to cheaply and easily levy and collect taxes directly from the black market and cash transaction operators within a short period of time. A creation of the Statutory Receipt System is a recommendation as a means of achieving this objective.

(3) Presumptive Taxation

There are many people who are evading taxation in the present Mongolia. Even with a complete and impeccable implementation of a Statutory Receipt System, naturally there will be tax obligors who will attempt to evade taxation. Considering these situations, an urgent and immediate issue for the GDNT is to estimate taxable incomes defined under the various tax laws and collect taxes based on this estimation. Presumptive Taxation is presented as means to achieve it.

(4) Corporate Income Tax Inspections

One issue that exists in the Mongolian corporate tax system is the inefficiency in the inspection system that examines the propriety of the taxpayer's tax returns. Specifically, the problems reside in the areas of the selection of inspection targets, method of preparation for the inspection, the method of inspection and the tax information data system.

(5) Introduction of the Blue Return System

It is our view that providing preferential treatment to those taxpayers who diligently file income tax returns and pay their taxes from that given to other types of taxpayers will further enhance the taxpayer awareness of such diligent taxpayers and at the same time lead to an increase in the number of diligent taxpayer as a result of many more wanting to receive such preferential measures; therefore, we recommend a creation of a system of commendation for the diligent taxpayers.

(6) Taxation for Businesses and Services with Indefinite Incomes

As there is gross unfairness that exists under the Individual Income Tax Law, this is a recommendation on rectification of such unfairness.

(7) The Tax Accounting System

In order to appropriately and efficiently secure tax revenues, in addition to the reforms in the tax administration, there is a need to have the tax accounting system widely accepted and well understood among the population and enterprises and this section addresses measures to this end.

(8) The Investigation System

This identifies issues and bearing mind the existing conditions in Mongolia provides a set of recommendations regarding Investigation System as a system to punish specific taxpayers with criminal punishment as a means to make an example for all taxpayers.

(9) Tax Disputes

With respect to tax administrative legal actions, based upon analyses of causes for the unsuccessful efforts of the GDNT and provide recommendations for improvements.

(10) The Tax Officials Corruption Prevention System

Based on analyses of ways to prevent tax officials corruption, which are now prevalent and present recommendations for improvement.

(11) Creation of a Favorable Environment for Tax Payment

This presents additional recommendations for improvements relating to taxpayer education and public relations regarding tax affairs.

With regard to details of the recommendations above, if the Mongolian Government were to swiftly implement such reforms not only can a dramatic enhancements in the tax collection at a low collection costs, it will ensure fairness in taxation and dramatically expand the tax base; therefore, the Mongolian Government should effect various measures to ensure early implementation of these recommendations.

3 Study Organization

The Study was conducted by the Japanese consultant team retained by JICA and Mongolian counterpart staff from July 2000 to July 2001. The members involved in the Study are listed below:

(1) The Members of the Advisory Committee

Name	Field in Charge	Present Post
Shinji ASANUMA	Chairman	Professor Asian Tax and Public Policy Program Hitotsubashi University
Hiroshi UENO	Member	Professor of Economics International Cooperation Studies Graduate School of Kobe University
Satoko KIMOTO	Member	Professor and Supervisor of International Training National Tax College

(2) The Members of the Study Team

Name	Field in Charge	Present Post
Yujiro KOYANAGI	Team Leader Tax Policy and Tax Education	Senior Consultant Institute for Financial Affairs, Inc.
Yoshiaki HIRANO	Organization of Tax Collection/ Corporate Income Tax	Assistant Professor Nihon University
Kazuya HORIUCHI	Organization of Tax Collection/ Value Added Tax	Professor Kanto Gakuen University
Yoshinobu WATABE	Organization of Tax Collection/ Individual Income Tax	Consultant Institute for Financial Affairs, Inc.
Seimei WADA	Tax Accounting	Consultant Institute for Financial Affairs, Inc.
Takafumi KANEMURA	Tax Law and Tax System	Professor Meikai University

(3) The Principal Members of the Counterpart Team

Name	Present Post
Luvsandash ZORIG	Director General General Department of National Taxation
Yadmaa MISHIGLUNDEN	Deputy Director General General Department of National Taxation
Baljinnyam ERDENEBAATAR	Head Research and Methodology Department General Department of National Taxation
Yadamjav PURVEE	Director Training and Information Center General Department of National Taxation
Sharav GANCHIMEG	Tax Inspector General Department of National Taxation
Sandagdorj TOGOLDOR	Tax Inspector General Department of National Taxation
Chuluunbat ZOLBAYAR	Tax Inspector General Department of National Taxation

4 Reports

The study reports prepared are as follows:

- 1 Executive Summary
- 2 Main Report
- 3 Sample of Accounting Guide
- 4 Manual for Tax Officer

The Main Report presents the summarized results of all the studies.

Accounting Guide is prepared for an education tool as a sample, which includes the basic knowledge necessary for tax accounting.

Manual for Tax Officer consists of two materials: Presumptive Taxation and Tax Investigation Method, both of which are prepared to transfer technical knowledge to tax officials in Mongolia.

PART II

THE TAX SYSTEM

Chapter 1

1 Current State of the Tax System

1.1 Review

After Mongolia's transition to a market economy, tax reform was implemented for the first time in 1993. Around that time, General Tax Law, Individual Income Tax Law, Corporation Tax Law (Economic Entity and Organizational Income Tax Law), Sales Tax Law, and Individual Consumption Law (Excise Tax Law) were instituted, and a tax system centered on income tax imposition was introduced, under the guidance of foreign assistance organizations. Subsequently, in 1997, tax revision related to the General Tax Law was executed, and in 1998, the value added tax (VAT) was instituted to replace the sales tax, with the EU-type, invoice-formula, VAT introduced. Based on this arrangement, priority of the existing tax system in Mongolia was shifted from income tax imposition to consumption tax imposition.

Ten years have passed since the Mongolian economy transformed from a centrally planned economic system to a market economy system. During this period, the tax system of the Mongolian Government was mainly aimed at securing tax revenue based on advice from foreign assistance agencies and etc., to seek the elimination of permanent fiscal deficits. In fact, however, sufficient tax revenue has not been realized even in recent years, due to the stagnant Mongolian economy and low awareness on the part of the Mongolian people. As such, the fiscal deficit in fiscal 1999 remained substantial, i.e., as much as about 85 billion Tg, which was equivalent to -8.5% of the GDP.

Because of this situation, the People's Revolutionary Party-led Cabinet, inaugurated on July 2000, put forward policies of cutting personal and corporate income taxes in its election slogans. In the tax system reform of fiscal 2001, however, the Cabinet avoided tax reduction and instead put a priority on a policy of increasing tax revenue to rectify fiscal deficits. Namely, it retained the rates of corporate and personal income taxes, while deciding to hike VAT from 13% to 15%. Furthermore, to improve tax collection functions, the Mongolian Government is reinforcing its tax collection capability, while adopting proposals from this Study Mission.

1.2 Current Structure of the Tax System

The current tax system of Mongolia consists of 19 items of national tax law, 5 items of local tax law and Law on Supervision of Tax Assessment, Payment and Tax Collection as an enforcement law. These national taxes are General Tax Law as a common tax law, individual income tax, corporation income tax (Economic Entity and Organization Income Tax Law), customs, VAT, special tax, automobile tax, inheritance/gift tax, real estate tax, gun tax, urban tax, pet dog tax, official document issuance commissions, gasoline/diesel fuel tax, hunting fees/hunting license commissions, underground resources utilization fees, ground rent, forest resources utilization fees and water utilization fees. Among them, Inheritance and Gift Tax Law which is an important component of the national tax law does not exist as a concrete positive law but exists only as a tax system. The local taxes are license commissions for utilization of natural resources other than underground resources, natural tree/grass utilization fees, "Zaha" (market) utilization fees, underground resources utilization fees, and mineral spring utilization fees. With regard to decisions on tax rates for individual tax items, determination rights for national taxes are given to the National Great Conference, while those for local taxes are given to people's communes in individual provinces. Currently, the individual income tax rates are set at two levels: 15% and 40%, while the rates of corporate income tax and VAT are 40% and 15%, respectively.

At present, principal tax laws that are positive tax laws and that which have been promulgated include Individual Income Tax Law, Corporation Tax Law, Customs, Value Added Tax Law, Special Tax Law, Special Stamp Duty Law, Real Estate Tax Law, Automobile Tax Law, Gasoline/diesel Tax Law, General Tax Law and Law on Supervision of Tax Assessment, Payment and Tax Collection. The classification of national and local taxes exists only in the General Tax Law, and in reality, some of the national taxes are distributed to local governments for their fiscal resources.

1.3 Composition of Tax Revenue

The revenue of the central government of Mongolia in fiscal 1999 is shown in Table 1-1. The total revenue was around 259,400 million Tg. Since the total disbursement of the government during the fiscal year was 344,300 million Tg, the fiscal balance was a deficit of 84,000 million Tg. Regarding the breakdown of annual revenue, current revenue, such as tax revenue and passage fees (non-tax revenue), accounted for the largest proportion, amounting to 92.8%, followed by capital revenue due to sales of national assets reaching 4.6%, and foreign grants incorporated in the budget, totaling 2.6%.

Table 1-1 Annual Revenue of the Central Government for Fiscal 1999 (Million Tg)

Total Revenue and Grants	259,437.0	(100.0%)		
Current Revenue		240,795.8	(92.8%)	
I Tax revenue			182,510.7	(70.3%)
1. Income tax				41,932.7
2. Social security contribution				29,707.2
3. Value added tax				58,863.6
4. Excise tax				26,667.7
5. Property tax				820.9
6. Tax on foreign trade				9,011.0
7. Other taxes				16,007.6
II Non-tax revenue			58,285.1	(22.5%)
Capital Revenue		11,948.6	(4.6%)	
Foreign Grants		6,692.7	(2.6%)	

Tax revenue accounted for 70.3% of the total annual revenue. The largest tax component was VAT, which represented 32% of the total tax revenue. This was followed by personal and corporate income taxes, which jointly amounted to 23%, and social security tax (fees), with 16%.

In the current tax system, VAT contributed the greatest tax revenue, thereby serving as an important tax component. VAT and individual consumption tax (Excise Tax) combined accounted for about 60% of the total tax revenue. The ratio of direct tax to indirect tax was 4:6, with the latter being substantially greater, so the Mongolian tax system may be described as a system centered on indirect tax.

Chapter 2

2 Issues in the Current Tax System and Proposals for Reform

2.1 Issues in the Current Tax System

If a tax system is to be accepted by the people of a nation, it must, first of all, be fair as a system. The reason is that, if the tax system is unfair, the people will not support it, so tax collection will become extremely difficult. Fairness as a system means that it is a tax system under which the tax burden is fairly distributed among the national people. Second, in the tax system, neutrality or efficiency must be secured for the national economy. Neutrality or efficiency of the tax system requires that it is a system through which economic activities will not become warped as a result of tax imposition. The fairness in the first requirement and neutrality in the second requirement are in fact in a trade-off relationship, so it is difficult to satisfy both at the same time. However, it is important to consider a tax system acceptable to the people in accordance with the status of the economic society on each occasion, based on these points of view.

If the current tax system is reviewed from the standpoints of aforementioned fairness and efficiency, it is possible to mention the following four points as problems.

- (1) First, the existing tax system was instituted without giving thought to the prevailing state of the Mongolian economic society, so that it is enormously unfair and inefficient. This can be pointed out for both the total tax system and individual tax systems. The current tax system is centered on tax imposition on income of both individuals and enterprises, as well as the imposition of consumption tax in the form of VAT. Under the current situation in Mongolia, however, there are many difficulties in capturing income as flow, so that, as a consequence, tax is imposed on easily grasped income, such as income of large corporations and salary income, eventually causing unfairness. With regard to VAT, it is imposed only on some portions of enterprises, so the VAT system is characterized by a lack of fairness.

- (2) Since determination of income and consumption is limited to large enterprises, this prevents institution of incentives for corporate activities and brings about inefficiency. In other words, because expansion of corporate scale invites tax imposition, only small-scale enterprises flourish, and economic activities remain inefficient.
- (3) The tax system does not provide national and local governments with sufficient fiscal funds. Due to a shortage of tax revenues, fiscal deficits arise recurrently as government revenue always falls short of expenditures. The General Tax Law divides taxes into national and local taxes, but on the occasion of actual tax collection, income tax and corporate tax revenue collected locally is sometimes not remitted to the state coffer but is applied to fiscal funds of local governments. Local finances are also recurrently short of funds. This being the case, finances of both the central and local governments must be made sounder than at present.
- (4) As important issues in the tax system, inadequacies that exist in the tax enforcement laws (Law on Supervision of Tax Assessment, Payment and Tax Collection) and common tax law (General Tax Law) must be raised. In order for the fiscal revenues to be properly secured, it is clear that each component of the tax laws must be applied fairly to the tax obligors. However, under the existing Mongolian tax enforcement and common laws, they contain many provisions that prevent proper tax enforcement. Regardless of how good tax laws that have been created, if the enforcement of the laws are not up to par, then enhancement of fiscal revenues cannot be expected. Thus, it is important that immediate steps be taken to rectify items in the laws that hinder the proper enforcement of the tax laws.

2.2 Dealing with Issues

Up to this point, with the primary objective of raising the necessary tax revenues, the Mongolian tax system has undergone many changes. These amendments that had been made, although not all, have been at the recommendations made by foreign donor institutions and at times, there had been cases in which fairness and neutrality of taxation had been sacrificed. Having to accept these recommendations may be, to and extent, a necessary evil until such time that fiscal system is able to stand on its own, and in the short term it is necessary to accept this as a given.

Because the current tax system of Mongolia was originally modeled after the tax system of advanced capitalized countries introduced almost without change, the tax system has not functioned well in this country, which is still in the development stage, and the aforementioned problems exist in the realms of system and tax collection.

As discussed above, four items have been identified an areas of issues in the tax system and these issues must be addressed and rectified as soon as it is possible.

Concerning fairness of the tax system, it is necessary to study it as a problem related to the entire tax system, thereby ensuring theoretical consistency. It is significant to build a tax system, based on the adoption of theoretical requirements, over a long period of time, although fairness may be sacrificed in the short-term perspective, in order to attain tax revenue increases. Because problems with the tax system have a great bearing on the private sector of the economy, it is necessary, from a viewpoint of promoting neutrality, to prevent the tax system from distorting specific economic activities. As for tax fund distribution into the central and local government coffers, systematized arrangement is necessary, and it is important to set up a fiscal adjustment system at an early date.

Next, in order to fairly and efficiently secure tax revenues, an environment in which the tax enforcement can be properly and efficiently realized is an absolute requirement. Issues in the enforcement law and common tax law with respect to the tax enforcement needs to be examined in the light of efficiency and reasonableness.

2.3 Proposals for Reform of the Current Tax System

Overall, the Mongolian tax system is being improved along with the progress of market development, albeit gradually. In considering the future outlook for improvement of the tax system, it is quite important to set targets while sufficiently conceiving consistency with related systems, because the tax system occupies a significant position in fiscal systems. With regard to the budget system, it is considered necessary to show, in advance based on rational reasoning, how much revenue can be expected under the existing tax rate in the current system. As to the relationship with the economic policy, it is also necessary to utilize a policy-based tax system for priority policy implementation. If a long-lasting, stabilized tax system is to be established, the important thing in assessing this outlook is for Mongolia to execute reform based on a self-independent consciousness, and to courageously move forward while upholding fairness of the tax system as the first slogan in such efforts.

Below, recommendations for improvements are presented based on common tax laws, tax enforcement law and existing principal individual tax laws.

Chapter 3

3 Items Requiring Amendments in the General Tax Law

Items requiring amendments in the General Tax Law are presented as follows:

3.1 Creation of a provision “Rule of Taxation”

Create a provision of “Rules of Taxation” and include the followings in it:

(1) “Substance Over Form in Taxation and Tax Collection Principle”

Taxation and tax collection by tax administration against tax obligors can be effected in substance, without consideration for the nominal state or the situation.

[Commentary]

Under this provision, when the tax administration undertakes taxation or tax collection, it shall not be bound by the name of the tax obligor but the provision enables a look to the substance.

With the introduction of this provision, it enables the tax administration to levy and collect taxes from tax obligors who have been evading taxation or confiscation of property by the use of names other than one’s own. Because of this capability, it would be considered that the efficiency in the execution of tax administration would be improved.

Example 1:

Sales under A’s name is reported to B tax office. As a result of a tax inspection, Sales under D’s name reported to C tax office is found to be in substance belonging to A (profit from the sales under D’s name has been transferred to A). In this case, D’s sales value should be added to A’s sales value for taxation purposes.

Example 2:

Tax obligor E had unpaid taxes. Upon an inspection of the company’s vault, numerous deposit certificates were found to be under the names of E’s wife and employees. Inspection of the fund movements confirmed that they coincided with the dates of the

unaccounted for expenditures and the deposits in substance belong to E. Accordingly, the deposits were seized and the full amount of the taxes was collected.

(2) The Blue Return System

If the tax obligor keeps accurate and proper accounting records and obtains approval from the tax administration, special deduction and others based on the blue return system is allowed to calculate taxable income under the Tax Law or under the direction of the Minister of Finance and Economy.

[Commentary]

The blue return system is based on the notion that a tax obligor who keeps accurate and proper accounting records and files return properly and makes tax payment based on the records should be treated more favorably for taxation purposes than those taxpayers who do not keep records at all.

The General Tax Law defines comprehensively that the tax obligor, who is approved by the tax administration to file a “blue return”, is entitled to benefit of special tax deduction defined under the Tax Law and the direction of Minister of Finance of Economy, in order that the self-assessment system of taxation may continue to properly develop in.

3.2 Amendment to the General Tax Law Article 16 and 18

Remain “Individual Income Tax” and “Inheritance and Gift Tax” in the General Tax Law Article 16 “National Tax” and eliminate the provisions in the General Tax Law Article 18 “Determination of Tax Rates and Tax Amounts” which allows local government to deduct tax rates and amounts for these two tax items in accordance with their financial status.

[Commentary]

The transfer of these two tax items from local tax to national tax is to contribute to the realization of a fair tax system. Suppose that the district has high taxpayers and collects large tax amounts, this administrative local district obtains larger revenue, which results in further exacerbating the regional disparities. In order to avoid such

situations, these two tax items should be controlled under the national budget and budget allotment should be made to districts.

As the two tax items properly should be national taxes, naturally, a tax rate reduction by legislative actions of the regions would not be permitted.

3.3 Creation of a provision “Tax Dispute Resolution Council”

Create a provision of “Tax Dispute Resolution Council” in the General Tax Law and “a representative of the Ministry of Justice or a Judge” should be added to the members of Tax Dispute Resolution Council.

[Commentary]

In order to protect the rights of taxpayers and properly ensure the fiscal tax revenues, disputes between taxpayers and tax administration must be resolved promptly and fairly. For this end as a means for resolution, the creation of “Tax Dispute Resolution Council” must be assured.

Obviously, a member of the Dispute Resolution Council must possess the practical capacity to resolve tax disputes. However, despite the decision of the Council, there are many cases in which the same decisions are challenged in court and the country loses the cases.

In order to respond to these circumstances, the membership of the council should include an official from the Justice Ministry or a judge from the inception in order that the deliberation of the dispute within the council are conducted at the same level as it would be in a legal proceeding. According to this, proper tasks will be performed for the resolution leading to reduction in the tax administration costs. Even if , in the end, the case is taken to court, the probability of the tax administration losing the case is dramatically reduced. For this reason, the Council should include a Justice Ministry official and/or a judge.

3.4 Amendment to the General Tax Law Article 24

The General Tax Law Article 24 “Authority of the Tax Administration and Tax Inspectors” should be amended.

- (1) Clause 1.10.f should be deleted.
- (2) Clause 2.1 “The tax inspector will confirm and seek explanation for bookkeeping records, balance sheets and other financial statements relating to taxation and tax payment” should be amended as follows:

“The tax inspector has the authority to confirm, seek explanation and inspect bookkeeping records, financial statements, balance sheets, all other related statements and all assets relating to taxation and tax payment, against all the taxpayers in his/her jurisdiction. The tax inspector also has the authority to require taxpayers to submit copies of documentary evidences necessary for tax inspection for free.”
- (3) Clause 2.2 “The tax inspector has the authority to require business counter-party and financial institutions to submit copies of documentary evidences necessary for the tax inspection for free” should be amended as follows:

“The tax inspector has the authority to require all citizens, corporations, institutions, state, local government and financial institutions which are counter-parties to the taxpayer to submit copies of documentary evidences necessary for the tax inspection for free. The authority under Article 24.2.1 of this Law can also be exercised with regard to applicable counterparts in such transactions.”
- (4) “Enterprises” as defined under Clause 2.5 should be amended to “Taxpayer”.

[Commentary]

- (1) The Clause 1.10.f prescribes that the tax administration is entitled to take legal action to seek tax payment against a tax obligor, in case he/she has tax liability even though agreed by 2 parties (The Process Law Article 27). This is defined to be the last resort for the tax liability settlement process. Tax Law must have within it basic prerequisites (provisions) that enable the state to secure revenues in accordance with the said law simply and speedily without interference by any other laws or orders. The requirement to take action through the courts to seek

payment of taxes as required under the current law can be said to impede the Tax Law's basic prerequisites (provisions) remarkably and the essential authority of the tax administration and therefore should be deleted. If this regulation were deleted, the duties of tax collection would be much improved.

- (2) The Clause 2.1 is a provision regarding the right of inspection by a tax inspector. Under the current provision, the tax inspector's authorities for tax administration are too narrow and as it is an impediment against enhancing the efficiency of tax administration, should be amended as proposed.

The proposed amendment stipulates the tax inspector's authority to question and inspect. It enables the tax inspector to inspect not only the financial documents of the taxpayer, but also all assets associated with the tax obligor. Such authorities shall be exercised over all taxpayers within the jurisdiction area where the tax administration belongs.

- (3) The Clause 2.2 provides for the tax inspector to require transaction counter-parties and financial institutions to submit copies of documentary evidences necessary for tax inspection. The existing Clause only stipulates to submit documentary evidences, accordingly it should be amended as proposed to define the scope and target.

Under this amendment, the tax inspector is enabled to require the submission of copies of documentary evidences necessary for tax examination from all transaction counter-parties (whether or not the counter-party is within jurisdiction area). In addition, the tax inspector is able to exercise the authorities given under the Clause 2.1 against said counter-party taxpayers.

This amendment would provide in the law for the regulation that the tax inspection performed by the tax inspector is proper in accordance with the General Tax Law, which would lead to the improvement of the efficiency in the execution of the inspections.

- (4) The Clause 2.5 should not be limited to incorporated enterprises, but should apply to all taxpayers.

3.5 Creation of a provision relating to “Tax Accountant” or “Agent Tax Accountant”

In the existing General Tax Law, a new provision should be created relating to “Tax Accountant” or “Agent Tax Accountant”, which defines that those who have [1st Grade for Bookkeeping and Accounting Test Certified by General Department of National Taxation] shall be eligible to take an examination of “Tax Accountant”. In addition, it regulates to vest its qualification unconditionally in “those who are in the position of bureau head or higher at GDNT, and head at National Tax Bureau and Tax Office (excluding those who are political appointees; who have taken bribes; who are subjected to legal punishments related to taxation; or who are legally punished after obtaining qualification).

The provision of “Agent Tax Accountant” should make allowance for preferential measures. It permits those who have [1st Grade for Bookkeeping and Accounting Test Certified by the General Department of National Taxation] to be exempted from some examination subjects and to be eligible to take examination.

[Commentary]

The creation of provisions related to “Tax Accountant” or “Agent Tax Accountant” provides economic and social security to the tax staff for post retirement, thereby improving the morale of the existing staff. The provision also provides for a party independent from both the taxpayer and the tax administration to conduct tax audits, which will lead to the improvement of tax return standards and quality.

With regard to the examination eligibility, it is understandable that those who have successfully completed university are eligible to take the examination. But, in order to expand opportunities to freely choose professions and to produce many great tax accountants or agent tax accountants, the amendment provides eligibility for the examination or preferential measures like exempting some examination subjects to those who have [1st Grade for Bookkeeping and Accounting Test certified General Department of National Taxation]. (Note that [1st Grade for Bookkeeping and Accounting Test certified General Department of National Taxation] should be instituted to raise the quality level of accounting business in Mongolian society.)

Moreover, those who are in the position of bureau head or higher at GDNT, and head

PART II -3 Items Requiring Amendments in the General Tax Law

at National Tax Bureau and Tax Office should be granted "Tax Accountant" qualification, even if the tenure is short, with giving due consideration for the importance and the responsibility associated with such posts.

Chapter 4

4 Items Requiring Amendments in Law on Supervision of Tax Assessment, Payment and Tax Collection (The Process Law)

Items included below require amendments but among them 4.1, 4.5, 4.8, 4.9 and 4.16 are especially important and prompt amendments of these items should be effected.

4.1 Amendment to the Process Law Article 5

The following amendments should be made to the Process Law Article 5 "Taxpayer Registration".

(1) The existing Law Article 5 Clause 3 and Clause 4 should be amended as follows:

"The tax administration shall register citizens, enterprises, institutions and withholding taxpayers in a registry kept for each tax category. For every single tax obligor, a single register number shall be issued and taxpayer registration file will be opened. The file will maintain for each tax obligor documents that contain the following information:

- 1) Taxpayer's register number/ Name of the representative, home address, telephone number
- 2) Taxpayer's address, telephone number/ Number of employees / Resume of the representative, photograph, passport number
- 3) Date of establishment / Description of the business and purpose
- 4) Assessed value of owned real estate, / Form of ownership of real estate/ Copies of fixed assets and current assets from certified balance sheet
- 5) Investor's name / Name and number of branches and offices, locations and addresses, telephone numbers / tax categories of duplicative withholdings
- 6) Status of preparation of accounting, bookkeeping and financial reporting forms / tax accountant responsible for the preparation of the previously mentioned documents, tax accountant's address and telephone number
- 7) Name, address and telephone number of the tax account hired under contract.
- 8) Amount of capital, increase or decrease of the capital / Name and address of

major business customers and suppliers

- 9) Tax categories applicable to the taxpayer, taxpayer's bank account number "

[Commentary]

The existing Law Article 5 Clause 3 and Clause 4 provides for the detailed information that should be contained in the registration of individuals, enterprises and institutions. However, it is also necessary to regulate the required information for withholding tax obligors. In addition, since the existing requirements appeared insufficiently detailed for the tax administration and registration, the above amendments should be proposed in the registration. If a taxpayer needs to be registered under multiple tax categories (i.e., if a taxpayer becomes a tax obligor for Corporate Tax, Value Added Tax and Real Estate Tax), the same registration number shall be applied throughout all tax categories.

- (2) The existing Law Article 5 Clause 5 "In the event of a change in a registry item, unless otherwise provided for by law or regulation, the taxpayer must notify a tax administration of such a change within one month, and record it in a registry" should be amended as follows:

"Each time there is any change in a item contained in the registry and the taxpayer registration file, unless otherwise provided for by law or regulation, the taxpayer must notify the tax administration of such a change and record it in the registry and the taxpayer registration file. This shall be done within 1 month from such a change."

[Commentary]

This proposed amendment obligates the taxpayer to report all changes in the taxpayer registration file as well as in the registry, to enable an efficient actions relating to the tax inspection and collection by being able to keep track of the circumstances surrounding the taxpayers.

- (3) The following should be inserted after the existing Law Article 5 Clause 5.

"If there is any change in the status of the real estate including disposal,

acquisition, transfer, donation or other form, the taxpayer must notify the jurisdictional tax administration of such a change within 20 days of such an occurrence.”

[Commentary]

This inserted provision accelerates a taxpayer’s obligation to notify the tax administration of any change in ownership of real estate within 20 days of such an occurrence. Since the real estate is of high value and importance to a tax obligor, the amendment is needed for the tax administration to be aware of its change at an early point.

- (4) Combine the existing Law Article 5 Clause 6 and Clause 7 to form the following provision:

“All taxpayers and withholding taxpayers must, without exception, record the special registration number by tax category on all returns, customs returns, receipts and other necessary documents as required by the laws and regulations relating to taxation. All taxpayers are obligated to notify his/her registration number to his/her transaction counterpart. Further, provisions to regulate the assignment of registration number to the withholding taxpayer shall be established by GDNT.”

[Commentary]

The amalgamation and amendment, based on the registry system to be introduced by GDNT, obligate the taxpayer and the withholding taxpayer to record their registration numbers on all documents related to tax and to be passed on to the taxpayer’s transaction counterparts. Due to this amendment, GDNT will control the taxpayers uniformly and effectively using registration number, as every single taxpayer is assigned a single registration number.

- (5) Eliminate the existing Law Article 5 Clause 8 and insert the following provision instead:

“ Transfer of jurisdictional tax administration relating to all tax obligors shall take place after the said budgetary year, if there is no calculation of tax obligations. If a

tax obligor has a tax liability, jurisdiction will not be transferred. Tax obligors to be transferred shall be recorded on the taxpayer registration file and the assessment list of the tax obligor, then a formal settlement shall be performed.”

[Commentary]

The obligation to register the taxpayer registration number is provided for in this Law, and as it is natural for the supreme tax administration to determine the details of such rules, the existing Law Article 5 Clause 8 will be eliminated. The insertion of the new provision is to clarify the transfer of jurisdiction of the tax obligor, which has been unclear under the existing Law.

4.2 Amendment to the Process Law Article 7

The Process Law Article 7 “Documents to be Passed to the Taxpayer by the Tax Administration and Tax Inspector” should be amended as follows:

- (1) Amend the term “Base Amount” in the existing Law Article 7 Clause 5 to read “Standard Amount”.
- (2) Amend the term “Withholding enterprises and institutions ” in the existing Law Article 7 Clause 6 to read “Withholding tax obligor”.

[Commentary]

- (1) This is the provision for a tax inspector to prepare a notice to a tax obligor, in case the tax obligor fails to pay tax within the legal term or “Base Amount” tax is imposed. The term “Base Amount” can be taken to have a connotation of a fixed amount, therefore it would be more appropriate to use “Standard Amount” which is imposed based on each taxpayer’s situation, rather than “Base Amount”.
- (2) This provision is amended so that all withholding tax obligors, including individuals, are covered, not merely enterprises and institutions.

4.3 Amendment to the Process Law Article 14

The following amendments should be made to Article 14 Clause 1 and 1.1 of the Process Law “Rules for On-site Inspection”:

The existing Law:

“The tax inspector shall perform on-site inspections in accordance with General Tax Law Article 24 Clause 2.4 using the following rules: Clarify only the tax amounts owed by taxpayer, perform on-site inspections to determine production volume, work volume and expenses.”

Amendment:

“On-site inspections shall be performed within the authorities defined under the General Tax Law Article 31 and this Law using the following rules: Perform the on-site inspections to determine the production volume, work volume, expenses and etc... in order to calculate the tax amounts owed by the taxpayer.”

[Commentary]

Under the existing Law, on-site inspections can only be performed for the purpose of clarifying the tax amounts owed by the taxpayer, and the scope of on-site inspections is excessively confined. Accordingly, the amendment makes it possible to perform on-site inspections for production volume, work volume, expenses and etc... , which are necessary to better assess the tax amount owed.

4.4 Amendment to the Process Law Article 16

Insert the following phrase just after the term “laws and regulations’ in “Records relating to Taxation” in the Process Law Article 16:

“...and notices, instructions, methods that have been issued in accordance with the law by the supreme tax administration”

[Commentary]

This law defines the details and the jurisdictional provisions with regard to the records to be kept on the tax obligor by the tax administration. The amendment stipulates that

in such a case the jurisdictional provisions would not be limited only to laws and regulations, but also include notices, instructions and guidance on methods issued by the supreme tax administration in accordance with the law.”

4.5 Amendment to the Process Law Article 17

The following amendments should be made in the Process Law Article 17 “Assessing the tax amount in comparison with other”:

The existing Law :

- “1. The tax administration may assess tax amounts by comparison with other taxpayers in the following cases:
 - if the party is engaged in production or service, or
 - if it is of certainty that the party has been engaged in such activities, but does not have records, or
 - if the party does not maintain documents or accounting records are incomplete, or
 - if the required documents for tax return or tax return form are not submitted
2. Assessment of tax amounts will be performed in comparison with a taxpayer who is engaged in comparable scale of business, production or service of similar conditions in the same area, if such exists. Without such a taxpayer, the tax amount shall be determined based on the scale of business, and incomes or other figures of several taxpayers nearby. Further, if the taxpayer has been engaged in the business in two consecutive years prior to the said taxation year, the tax amount may be assessed based on the documents and accounting records pertaining to such periods.
3. In case the tax amount is assessed by comparison, the appointment of a tax inspector and the issues relating to such assessments shall be decided by the order of the head of that tax administration.”

Amendment:

- “1. The head of the tax administration may determine the tax assessment by comparison with other taxpayers and using standard tax amounts in the following

cases:

- if the party is engaged in all production, business or service entered into profit, or
 - if it is of certainty that the party has been engaged in such activities, but does not have records, or
 - if the party does not maintain documents or accounting records are incomplete, or
 - if the required documents for tax return or tax return form are not submitted.
2. If the taxable amount is assessed based on the scale of production, business and service, and income/expenditure, and other actual figures who are engaged in production, business or service of similar size in the same area, a tax obligor is eligible to report "Standard Taxation". In such a case, the said tax obligor is obligated to submit all documents, accounting records and hand written memos.
 3. The following tax obligors cannot refuse the tax amount determined by the tax administration using "Standard Taxation":
 - the party failing to file a tax return
 - the tax obligor failing to maintain accounting records, while being engaged in production, business or service
 - the tax obligor not preparing or keeping various evidential documents
 4. To assess "Standard Taxation", the tax inspector and investigator, who are responsible for the said tax obligor, will jointly prepare a report and determine the amount of additional taxes. The report regarding the standard taxation will be confirmed, approved and signed by the head of said tax administration, considering the existence of factors stipulated in Article 30 of this Law."

[Commentary]

This amendment defines the various provisions related to the determination of tax amounts using "Standard Taxation", which is performed by the head of the tax administration based on reasons of inadequate books and records, or no tax return.

The amendment to Clause 1 is to make the term "Standard Taxation" explicit in the text of the law, and to stipulate that the head of the tax administration shall determine

the tax amount using standard taxation. In addition, it expands the scope of standard taxation to include all production, business or service entered into profit.

The amendment to Clause 2 stipulates that the tax obligor is required to present all documents held in possession, in order to ensure the appropriateness of the tax amount determined using standard taxation.

The amendment to Clause 3 stipulates that the tax obligor has no right to refuse the tax amount determined using standard taxation, due to the severity of the tax obligor's infringement of the tax law,

- by failing to submit tax returns
- by failing to prepare or maintain various evidential documents
- by failing to maintain such pertinent information.

The amendment to Clause 4 clarifies that the head of the tax administration will determine the tax amount and additional tax amount using standard taxation, and the inspection reports should be prepared in such a case.

4.6 Amendment to the Process Law Article 22

The following Clause should be inserted in the Process Law Article 22 "Collection of Delinquent Taxes":

"... taxes shall be collected by realization of property and other incomes seized from the tax obligor."

[Commentary]

The insertion of the above clause makes it explicit that delinquent taxes will be collected by realization of property and other incomes seized from the tax obligor.

4.7 Amendment to the Process Law Article 23 Clause 1

Delete the phrase "...other than by the orders of the court..." in the Process Law Article 23 Clause 1 "Tax Collection without Dispute".

[Commentary]

In the existing Law, a creditor has priority of attachment, when the creditor files a suit against the tax obligor to seek payment out of taxpayer's bank account and judgement

is delivered. Therefore, even though the tax administration has already initiated steps to seize the account prior to the aforementioned judgement, it is impossible to secure the payment of tax obligation. To avoid this situation, this phrase should be deleted.

4.8 Amendment to the Process Law Article 24

The following amendment should be made to the Process Law Article 24:

- (1) Convert the term “asset” in the title to the term “property”.
Convert the phrase “ ... collect from...” to the phrase “... collect by attachment and realization of ...”

[Commentary]

The amendment stipulates that the tax will be collected by seizure and cash conversion of taxpayer’s property and other incomes.

- (2) Delete Clause 1 and insert the following clause:

“If the tax obligor has not made tax payments on time defined in the Process Law Article 18 Clause 1.6 and Clause 2, and Article 20 Clause1 and 2, or if compulsory procedure as defined in the Process Law Article 23 is not possible, then the tax administration shall collect the taxes from the property, wages and other incomes of the tax obligor.”

[Commentary]

In the existing Law, the tax administration is required to obtain consent from the taxpayer, to collect taxes from the taxpayer’s property, wages and other incomes. However, the primary authority of the tax administration is to secure payment of tax obligation. Accordingly, the amendment will delete the clause seeking consent from the taxpayer.

The amendment is expected to bring about a substantial improvement in the collection rate for taxes and make a contribution to the increase in fiscal revenues.

- (3) Delete Clause 2 and insert the following clause:

“The valuation of the property and other assets seized for tax payment shall be performed in accordance with the legal procedures, then the tax payments shall be settled.”

[Commentary]

In the event of realization of the taxpayer’s properties seized as tax payment, it is necessary to assess their values equivalent to cash. The amendment stipulates that such an assessment shall be performed in accordance with the legal procedures.

Just as in the case of the deletion of Clause 1 above, this amendment is expected to result in a substantial improvement in the tax collection rate and make a contribution of the increase in fiscal revenues.

4.9 Amendment to the Process Law Article 26

The following amendment should be made to the existing Process Law Article 26 “Collect Taxes from Taxpayer’s Properties”.

- (1) Delete Clause 2 and insert the following:

“When an attached property is to be sold at auction, public notice through media such as newspapers shall be made after considering its quality, demand, damage, taxpayer’s opinion and the fair values in the said district. In case such a sale cannot be completed within 30 days following the date of auction, the property will be sold by a tax administration at a price available for sale, then its proceeds shall be paid into the budget.”

[Commentary]

The existing Law requires all attached properties to be converted into cash at an auction. However, the proposed amendment in Article 26 will enable the tax administration to sell them at public auctions voluntarily or in a limited term. In addition, in the case that the properties cannot be sold within 30 days following the date of auction, the amendment will permit selling them at the price available for sale.

- (2) Amend Clause 2.2 to read as follows:

“If a tax obligor desires, he/she or his/her legal representative may observe the public auction where the attached property is sold for tax payment.”

[Commentary]

This is a modification made to conform with the amendment relating to auction.

- (3) Delete Clause 2.3.

[Commentary]

The existing Law requires the return to the taxpayer of assets that could not be auctioned off. However, Clause 2.2 is amended as aforementioned so that the property can be sold at a price available for sale (i.e., ultimately the property can be sold at 1Tg). Accordingly, there will be no need to return the property to the taxpayer, and Clause 2.3 should be deleted.

- (4) Amend Clause 2.4 as follows:

“When the selling price of a property exceeds the tax payment and the expenses incurred in the auction, the disposition shall be decided and recorded in accordance with this Law Article 21.”

[Commentary]

This is a modification made to conform with the amendment relating to auction.

- (5) Amend Clause 2.5 as follows:

“When the proceeds from the sale of the attached properties are insufficient to meet the tax payments, the tax obligor will not be released from his tax obligation.”

[Commentary]

This is a modification made to conform with the amendment relating to auction.

- (6) Insert the following phrase after Clause 2.6:

“Maintain a detailed record of the attached property sold in a public auction. Proceeds from the sale at a tax shop shall be paid into the budget in the name of the said tax obligor within 3 days following the day of the sale.”

“In the event that its selling price is brought down, the tax obligor can take back the said property and make payment of the tax obligation in cash.”

[Commentary]

This is a modification made to conform with the amendment relating to the auction and to stipulate the deadline for the payment of selling proceeds into the budget.

4.10 Amendment to the Process Law Article 27

Following amendments should be made to the existing Process Law Article 27 “Litigation for Tax Payment”.

- (1) Insert the following phrase in Clause 1:

“When the court receives the suit and renders a verdict based on the laws and regulations, it cannot unfoundedly reduce or void the underlying taxes, additional taxes, interest and penalties that the tax administration has calculated as tax payments into the budget.”

[Commentary]

Some cases can be currently seen where the courts unfoundedly reduce or void the underlying taxes, additional taxes and others, when they render a verdict on a claim from the tax administration. To avoid this situation, the amendment should be made to stipulate that such judgement is no longer to be permitted.

- (2) Delete “In spite of an agreement in accordance with this Law Article 24 ...” from Clause 2.

[Commentary]

This is a modification made to be consistent with the amendment where “Consent with

the taxpayer” and “Written consent with the taxpayer” are deleted from the Law Article 24.

4.11 Amendment to the Process Law Article 31

Amend the existing Process Law Article 31 as follows:

- (1) Amend the title of this Law to read as follows:

“Obligations of Banks and Financial Institutions Related to Taxes”

[Commentary]

This amendment is to reflect the fact that the provision covers not only banks, but also all financial institutions including securities companies.

- (2) Delete the phrase “...excluding payments that have prime precedence (payment of wages to employees)...” from this Law Article 31 Clause 2.

[Commentary]

Taxes may be paid out of the tax obligor’s bank account. In such cases, the payment to secure tax obligations should take precedence over wage payments to the employees of the tax obligor. Accordingly, this phrase should be deleted from this Law.

4.12 Amendment to the Process Law Article 35 Clause 2

The following amendment should be made to each Item of the Process Law Article 35 Clause 2:

- (1) “A complaint against the decision of the tax inspector should be submitted to the tax administration where the said tax inspector belongs.”
- (2) “A complaint against the decisions of the tax administration or its head should be submitted to the said administration or its head.”
- (3) “Only when a complaint is rejected under this Article 35 Clause 2.1 or Clause 2.2, can

the taxpayer submit the said complaint to an upper administration.”

[Commentary]

This amendment defines the procedure to lay the taxpayer’s complaint against a tax inspector, the tax administration or its head. In addition, it deletes the provision, from the perspective of tax administration and its efficiency, that the tax obligor is allowed to lay complaints against any tax administration at his/her choice under the existing Law.

4.13 Amendment to the Process Law Article 36

The following amendments should be made in the Process Law Article 36:

“The complaint may be rejected through the procedures defined in this Law Article 35 Clause 2.3. Only in this case does the tax obligor have the right to bring suit to a court. However, in the case that the tax obligor has not complied with the legal requirements such as the reporting or payment deadline on his own excuse, the tax obligor may have no right to bring suit to a court.”

[Commentary]

The former part of the amendment defines the procedures for the tax obligor to file a suit to the court. Under the existing Law, the tax obligor is allowed to file at any time. But, the proposed amendment stipulates that the tax obligor can only file suit after exhausting the procedures defined in this Law Article 35.

Furthermore, the existing Law allows the tax obligor to file suit, even though he/she does not comply with the legal requirements defined in tax laws. Such a regulation will lead to a legal instability in the Tax Law and bring an abuse of tax obligor’s rights. Accordingly, the latter part of the amendment adds the provision to regulate the tax obligor’s rights to file a suit.

4.14 Amendment to the Process Law Article 37

The following amendment should be made in the Process Law Article 37:

- (I) Amend the text of the Clause 1 to read as “The tax administration and the tax inspector can seal, take as collateral or seize the tax obligor’s properties, money,

certificates, registration certificates, residence, warehouse (hereinafter referred to as “Assets”) belonging to the tax obligor who has tax liabilities.”

[Commentary]

This amendment enables the sealing, taking as collateral or seizing assets of the tax obligor, but stipulates that the rights can only be exercised in the case of a tax obligor having tax obligations.

- (2) The Clause 1.1 should be amended to read as “ If the tax obligor fails to pay taxes, interests, additional taxes, penalties and others within statutory due date of tax payment or within due date defined by a tax administration and becomes a delinquent....”

[Commentary]

This amendment specifies the case listed above, as one of the examples to apply for the Clause 1 text.

- (3) Amend the Clause1.2 to read as “... the period in which tax and volume inspection or on-site inspection is performed and the results are tallied, or the verdict is rendered”

[Commentary]

The amendment specifies the period listed above, as one of the examples to apply for the Clause 1 text.

- (4) Amend the Clause1.3 to read as “... when the tax obligor does not voluntarily make tax payments within due dates defined by the tax laws or the tax administration, or when there is such a fear,...”

[Commentary]

This specifies the case of a tax obligor failing to pay taxes voluntarily within due dates defined by the tax laws or the tax administration, or the case of such a fear, to show one of the examples of application for the Clause 1 text.

(5) The following clauses should be inserted after the Clause 2:

“When real estate is being sealed, taken as collateral or seized, the tax administration will notify the real estate registry office of such an event.”

“Properties that have been sealed or taken as collateral will be under the control of the owners at all times.”

“With regard to properties that have been sealed, taken as collateral or seized, the tax administration shall take the following procedure within 60 days :

- (a) In case the tax obligor is not able to pay the tax obligations in cash, such properties are seized by a jurisdictional tax administration and sold at a public auction advertised through the mass media.
- (b) Upon the expiration of the period defined in the Clause 1.2, such properties shall be returned to the said tax obligor.
- (c) At the expiration of the period defined in the Clause 1.3, or from the time that the taxes are not deemed to be paid voluntarily after the demand is made, the tax administration will have the right to sell such properties.”

[Commentary]

The registry office controls the registration of real estate, therefore the amendment provides the above regulation out of consideration for the safety of the real estate.

In addition to this regulation, properties that have been sealed or taken as collateral will be under the control of the owners at all times, partly because those properties may be returned.

The final amendment defines the timing for the tax administration to dispose of the properties sealed, taken as collateral or seized.

4.15 Amendment to the Process Law Article 39 Clause 2

Amend “Supreme tax administration or courts...” in the Process Law 39 Clause 2 to “said tax administration”. At the same time, insert the phrase “When such a complaint is rejected, the tax obligor may appeal to an upper tax administration. In case that it is not recognized at that level, such a complaint may be filed at the supreme tax administration. Only in the case that the complaint is rejected by the supreme tax

administration can it be lodged in the courts.”

[Commentary]

The proposed amendment stipulates the procedures that the tax obligor must follow to take steps, in case of complaint against the tax administration and the courts. According to this amendment, to lodge complaint with the court shall be the last resort for a tax obligor, though the existing Law allows it from the beginning.

4.16 Amendment to the Process Law Article 40

The maximum penalties defined in each clause of the Process Law Article 40 “Penalties” should be increased by about ten-fold from the levels defined in the existing Law.

[Commentary]

A penalty is a kind of a deterrent against further actions. If its limit is set too low, a likelihood of intentional commission of those actions will be high. Therefore, a dramatic increase in the penalties is deemed to be required.

