

LEGAL ENTITY INCOME TAX LAW

(Newly formulated)

SECTION ONE GENERAL PROVISIONS

Article 1. Purpose of the law

The purpose of this law is to regulate the imposition of tax on legal entity income and transference thereof to the budget.

Article 2. Legal entity income tax legislation

2.1. The legislation on legal entity income tax (hereinafter referred to as “tax”) comprises the General Taxation Law, this Law and other laws and regulations enacted in conformity with them.

2.2. If the present law is other than the International Agreement of Mongolia and the Stability Agreement formed between the Government of Mongolia and foreign investors, the International Agreement and the Stability Agreement shall be followed.

Article 3. Framework of the law

3.1. Legal entity formed under the legislation of Mongolia, foreign legal entity with income earned in the territory of Mongolia, branch and representative office of foreign legal entity shall be subject to this Law.

3.2. Imposition of income tax on non-operating income earned by budgetary organization that meets requirements of the Article 13.4 of Law on Management and Financing of Budgetary Organization shall be subject to this Law.

Article 4. Legal terminologies

4.1. In this law, the following terms shall have the following meanings:

4.1.1. “Income earned in foreign country” is income earned by a taxpayer’s operation, ownership and use of movable and immovable property, and ownership, use, transfer and sale of rights in countries other than Mongolia;

4.1.2. “Goods” is movable and immovable property other than cash;

4.1.3. “Immovable property” is defined as specified in the Article 84.3 and 86.2 of the

Civil Code;

4.1.4. “Intangible asset” is an asset with no physical substance, used for relatively longer period, and grant rights, exclusive right and competitive advantage to the owner;

4.1.5. “Sale of right” is a legal transfer of rights with payment to others for running certain activities approved by an authoritative body and ownership and use of property;

4.1.6. “Income from royalties” is income specified in paragraph 11.2 of the Personal Income Tax Law;

4.1.7. “Withholder” is a legal entity which imposes and withholds tax from a taxpayer in conformity with legislation and transfers it to state or local budget;

4.1.8. “Realized gain from foreign currency exchange rate” is gain from foreign currency exchange difference from selling foreign currencies at market rate and payment of receivables and payables made in foreign currency;

4.1.9. “Book value” is book value of asset remaining after deducting depreciation expense;

4.1.10. “Investment” is asset invested in non-current assets for purpose of creating new production or services and expanding and renovating of existing production or services;

4.1.11. “Interdependent entity” is the following entity with direct or indirect participation in management, control and property rights of a taxpayer defined in this Law:

4.1.11.1. An entity that owns 20 percent or more of common stocks of the company;

4.1.11.2. An entity with a right to receive 20 percent or more of profit distribution or dividend of the legal entity;

4.1.11.3. An entity with a right to appoint 20 percent or more of management of the legal entity;

4.1.11.4. In case of defining operating policy and guidance of the legal entity in form other than those specified in the subparagraphs 4.1.11.1-4.1.11.3 of this Law.

TAXPAYER

Article 5. Taxpayer

5.1. An entity that resides or does not reside (hereinafter referred to as “taxpayer”) in the territory Mongolia shall be a taxpayer of the legal entity income tax.

5.2. Legal entity formed in accordance with the legislation of Mongolia shall be a taxpayer that resides in the territory of Mongolia.

5.3. The following entity shall be a taxpayer that does not reside in the territory of Mongolia:

5.3.1. Foreign legal entity that operates through branch or representative offices in Mongolia;

5.3.2. Foreign legal entity with income earned in the territory of Mongolia other than specified in subparagraph 5.3.1 of this Law.

5.4. The Central Bank (Mongol Bank) shall not be a taxpayer specified in paragraph 5.2 of this Law.

SECTION TWO GROSS INCOME

Article 6. Gross income

6.1. Income earned in the territory of Mongolia and foreign country during a tax year of a taxpayer specified in paragraph 5.2 of this Law shall be subject to income tax.

6.2. A taxpayer specified in paragraph 5.3 of this Law who earns income from its operation in the territory of Mongolia and a non-resident taxpayer of Mongolia shall be subject to income tax.

6.3. The following income of a taxpayer shall be a subject to tax:

- 6.1.1. Operating income;
- 6.1.2. Income from property;
- 6.1.3. Income from sale of property.

6.4. Income exempt from income tax shall not be included in gross income.

6.5. An exchange rate established by the Mongol Bank shall be used for converting the income earned and expenses incurred in a foreign currency.

Article 7. Operating income

7.1. The following income from goods sold, work performed and services rendered shall be subject to operating income of legal entity and branch and representative office of foreign legal entity:

- 7.1.1. Income from main and auxiliary production, work and services;
- 7.1.2. Income from sale of rights;
- 7.1.3. Income from sale of share and securities;
- 7.1.4. Income from lotteries quizzes and games;
- 7.1.5. Property, work, services received from others free of charge;
- 7.1.6. Income from sale of intangible asset;

- 7.1.7. Income from technical, management, consulting and other services;
- 7.1.8. Income from interest and penalty of nonperformance of contract duties;
- 7.1.9. Other income identical to those specified in subparagraphs 7.1.1-7.1.8 of this Law.

Article 8. Property income

8.1. Property income includes the following income of a taxpayer:

- 8.1.1. Income from movable and immovable property lease;
- 8.1.2. Income from royalties;
- 8.1.3. Income from dividend and similar income;
- 8.1.4. Income from interest and similar income;
- 8.1.5. Foreign currency exchange realized gain;
- 8.1.6. Income exceeding insurance proceed after deducting book value of insured asset;

8.2. Income from dividend and identical income includes the following income:

8.2.1. Company dividend and monetary or non-monetary distribution of income identical to dividend prorated based on contributed capital;

8.2.3. Distribution from taxpayer's joint cooperative;

8.3. Income from interest and identical income includes the following income:

- 8.3.1. Loan interest;
- 8.3.2. Interest on balance of bank account;
- 8.3.3. Interest on savings account;
- 8.3.4. Payment for issuing guarantee;
- 8.3.5. Interest on notes payable (bond).

Article 9. Income from sale of property

9.1. Income from sale of property includes the following income:

- 9.1.1. Income from sale of immovable property;
- 9.1.2. Income from sale of movable property.

Article 10. Transfer price

10.1. In case a taxpayer has exchanged or presented goods, sold property, work and services to others or made purchase at price higher or lower than fair market value, it shall be considered that transfer price took place.

10.2. In case of a transfer price, taxable income shall be determined by the tax authority in accordance with methodology approved by a member of the Government in charge of finance.

SECTION THREE DETERMINING OF TAXABLE INCOME

Article 11. Determining of taxable income

11.1. Legal entity income tax shall be imposed on taxpayer's taxable income of the current tax year.

11.2. The taxable income of a taxpayer in current tax year is defined by deducting deductible expenses specified in the Article 12 of this law from gross income specified in 7.1.1; 7.1.3; 7.1.5-7.1.9; 8.1.1; 8.1.4-8.1.6; and 9.2 of this law.

11.3. The following income of a taxpayer shall be taxed on total amount of each income:

- 11.3.1. Income from dividend and identical income;
- 11.3.2. Income from royalties;
- 11.3.3. Income from sale of immovable property;
- 11.3.4. Income from interest and identical income;
- 11.3.5. Income from sale or transfer of rights.

11.4. In case of closing down of joint stock company, a taxpayer shall calculate his share in conformity with his stock and joint stock by deducting initial buying price of share from the total income.

11.5. Income tax from lotteries, quizzes and games shall be defined by documented expenses related with income from lotteries, quizzes and games, and by difference of deducting proceed from lottery and price of product.

11.6. Difference of deducting reserve fund accumulated in current year and operating expenses from net income of insurance fee of entities conducting insurance activities.

11.7. Operating income of a non-resident entity of Mongolia earned through operations of branch or representative office shall be treated as taxable income.

11.8. The following income shall not considered deductible to determine taxable income specified in the Article 11.7 of this Law.

- 11.8.1. Expense incurred outside the territory of Mongolia.
- 11.8.2. Administrative expenses incurred not related to generate the income.

Article 12. Deductible expenses from taxable income

12.1. The following expenses shall be deducted from taxpayer's taxable income:

12.1.1. Expenses of all types of materials (raw material, basic or auxiliary materials, semi-processed products, steam, water, energy, fuel, petroleum, spare parts, packaging and wrapping expenses).

12.1.2. Salaries, wages, additional wages (salaries paid after social insurance and personal income tax, base and additional wages);

12.1.3. Social and health insurance premiums;

12.1.4. Bonuses, allowances, housing, transportation, meal, and fuel timber cost allowance paid to employees;

12.1.5. Amortization and depreciation expenses of non-current asset; depreciation shall not be calculated for land and inventory reserve;

12.1.6. Regular maintenance expense;

12.1.7. Loan interest; overdue loan interest shall not refer to this clause;

12.1.8. Realized loss from foreign currency exchange rate;

12.1.9. Purchase price of stock, or equity portion of sold stock;

12.1.10. Purchase price of securities;

12.1.11. Payment for work and service performed by others;

12.1.12. Lease payment;

12.1.13. Interest portion of finance lease payments;

12.1.14. Subscription of professional newspaper and magazine;

12.1.15. Mandatory and voluntary insurance premium. Voluntary insurance premium total to be deducted from the gross income shall not exceed 15 percent of entity's taxable income;

12.1.16. Excise and immovable property taxes paid to the budget, custom duties of imported inventories, materials and raw materials other than fixed assets, tax on transport vehicles, payment for use of land and natural resources;

12.1.17. The resources accumulated in the loss reserve fund of finance lease payment. The fund amount shall not exceed 5 percent of total finance lease payment.

12.1.18. The resources accumulated in [allocated to] the risk fund of a savings and loan cooperative, or similar resources accumulated in [allocated to] the reserve fund of a cooperative

other than a savings and loan cooperative, or, in case of a cooperative involved both in savings/loan and other activities, the resources accumulated in [allocated to] either fund;

12.1.19. The resources accumulated in the loss reserve fund of a bank and non-banking organizations. Performing loan fund shall not be included in deductible expenses;

12.1.20. The monetary capital accumulated in one of the funds of a taxpayer specified in the Articles 12.1.17, 12.1.18 and 12.1.19 of this Law;

12.1.21. Advertising expenses;

12.1.22. Employee training and retraining expenses proven as actual expenses. Tuition fee of foreign and local universities and institutes and special professional schools shall be determined by tuition norm of state local schools;

12.1.23. Per-diem expenses. Per-diem expenses shall be calculated accordance with civil servant norms;

12.1.25. Expenses for fertilizer, food for animal, injections, activities of protecting plant;

12.1.26. Transportation expenses;

12.1.27. Cost of assets with short life and low cost;

12.1.28. Workplace safety expenses;

12.1.29. Communication, stationary, sanitary and security expenses;

12.1.30. Book value of sold movable property;

12.1.31. Damages caused due to force major. Damage estimate shall be based on reports by related institution;

12.1.32. Normal wear and tear of inventory. The amount of normal wear and tear of inventory shall be approved by the Government;

12.1.33. Expenditures incurred for purchasing of software product shall be deducted from the taxable income.

12.1.34. Monetary source accumulated in accordance with the Article 29.7 and 30.11 of the Minerals Law for purpose of rehabilitating land soil by mineral license holder;

12.2. Materials, basic and auxiliary raw materials, spare parts, fuel and petroleum expenses used for production and services shall be calculated by weighted average cost.

12.3. Expense specified in the Article 12.1.6 of this Law shall not exceed 2 percent of book value of immovable property and 5 percent of book value of other property. Expense exceeding the amount specified in this clause shall be treated as capital maintenance.

12.4. In case of payment of loan that is deducted from taxable income of a risk fund of bank, non-banking institutions and saving and credit cooperatives as well as the fund for the probable bank loan losses, the total paid amount shall be a subject to tax.

12.5. Expenses incurred for holding and transferring the license shall be included in production expenses by straight-line amortization during validity of the mineral license and accumulation amortization shall be formed.

12.6. Accumulated depreciation of all assets used for production and social infrastructure, which are established by a license holder of mineral resources shall be formed at straight-line amount during useful lives of those buildings and structures, and expenses related with it shall be production expense of current fiscal year.

12.7. Loan interest expenses for period of construction, assembly and installation of equipments shall be capitalized as part of the asset cost. When the asset is put in service, interest expenses shall be deducted from gross income.

12.8. Interest payment on the amount exceeding 30 percent of the total capital of the creditor if loans and amounts of any interest-bearing liabilities issued to the taxpayer by an interdependent legal entity shall not be deducted from gross income.

12.9. Finance lease payment shall not be deductible from gross income.

Article 13. Calculating of depreciation

13.1. Depreciation expenses of cost of assets shall be calculated by straight-line method using following period:

Asset group	Depreciation period
1. Building, construction	40
2. Machinery, equipment	10
3. Computer, computer parts, software	5
5. Intangible assets with unknown useful life	10
6. Intangibles with known useful lives, including mining and exploration licenses	Useful life
6. Other fixed assets	10

13.2. Expenditures on capital repair of assets included in the Article 12.3 of this Law shall be added to book value and depreciated for remaining useful lives.

13.3. Tax authority shall estimate cost of building based on method approved by the tax authority in case of building and land are purchased or sold together.

13.4. Depreciation expense of an asset prorated to production ratio that is used in a certain portion of production to generate gross income shall be included in expenses deductible from gross income

13.5. If taxpayer ceases use of assets used for generating gross income, the asset shall be treated as sold for higher of book value or market value.

13.6. Lessee shall depreciate finance leased asset.

SECTION FOUR TAX RATES

Article 14. Tax rates

14.1. Taxable income determined in accordance with the Article 11.2 of this Law shall be subject to 15 percent tax.

Annual taxable income of 0 to 500,000,000 togrogs shall be imposed at rate of 15 percent and the tax on annual taxable income of over 500,000,000 togrogs shall be 75,000,000 togrogs plus 30 percent of the amount of income over 500,000,000 togrogs.

14.2. The following income of a taxpayer shall be taxed at below rates:

14.2.1. Dividend income and identical income shall be taxed at 15 percent.

14.2.2. Income tax rate from royalties shall be 10 percent.

14.2.3. Income tax rate from lotteries, quizzes and games shall be 40 percent.

14.2.4. Income tax rate from sale of immovable property and transfer of immovable property by will and gift contract shall be 2 percent.

14.2.5. Income tax rate from bank interest shall be 15 percent.

14.2.6. Income tax rate from sale of rights shall be 30 percent.

14.2.7. In case a representative office of non-resident of Mongolia transfers from his income abroad, the tax of that income shall be 20 percent.

14.2.8. The following income derived from sources in Mongolia from operations of non-resident legal entity shall be taxed at rate of 20 percent:

14.2.8.1. The dividend and identical income of a shareholder received from a registered economic entity operating in Mongolia;

14.2.8.2. The loan interest and fee for issuing guarantee;

14.2.8.3. The income from royalties, payment for administrative expense, rent payment, income rent of tangible or intangible assets;

14.2.8.4. The income from goods sold, work performed and service rendered in the territory of Mongolia.

14.3. The State as a shareholder can mobilize, fully or partially, the profits of shares and its dividends to the budget. The Government shall define its amount in each case.

14.4. A withholder shall withhold income tax from dividend and pay to the budget and a dividend receiver shall not be taxed twice.

Article 15. Tax imposition on non-profit legal entity and legal entity operating in social sector

15.1. Income other than those specified in subparagraph 16.1.3 of this Law of non-profit legal entity that serves its members and non-profit legal entity formed with social purpose shall be subject to income tax.

15.2. Income other than those specified in subparagraph 16.1.4 of this Law of legal entity conducting the following activities in social sector shall be subject to tax.

15.2.1. To provide medical services;

15.2.2. To provide training of preschool, primary school and high school education, professional training, and higher education;

15.2.3. Business activities of budgetary organization.

SECTION FIVE TAX EXEMPTION AND CREDIT

Article 16. Tax exemption

16.1. The following income of a taxpayer shall be exempted from income tax

16.1.1. Interest of Government loan (bond);

16.1.2. The income, derived from the sale of the share products by a non-resident taxpayer, carrying out business in Mongolia in accordance with a product-sharing contract concluded with the Government of Mongolia in oil sector shall be exempt from the taxation described in subparagraphs 14.1 and 14.2.1 of this Law;

16.1.3. The following income of non-profit organization that serves for society:

16.1.3.1. Income from core operation;

16.1.3.2. Monetary and non-monetary contribution;

16.1.3.3. Membership fee and recruit fee;

16.1.3.4. Humanitarian and non-returnable aid;

16.1.3.5. Property received free of charge.

16.1.4. The following income of entity specified in 15.2 of the Law:

16.1.4.1. Financing from the budget;

16.1.4.2. Humanitarian and non-returnable aid;

16.1.4.3. Monetary and non-monetary contribution;

16.1.4.4. Income after deducting the financing from the budget upon the approval of general budget administrator from business income earned by entity specified in 15.2.3 of this Law.

16.2. The income after tax, derived from the sale of the share products by a non-resident taxpayer, carrying out business in Mongolia in accordance with a product-sharing contract

concluded with the Government of Mongolia in oil sector, and the its transfer to foreign country thereof shall be exempt from the taxation described in subparagraph 14.2.8 of this Law;

Article 17. Tax credit

17.1. The income tax of economic entity engaged in manufacturing cereals, potato and vegetables shall be reduced by 50 % (income only from these activities).

17.2. Credit equal to 5% of the total investment made in priority sectors of Mongolia after .../date/ 2006 by foreign and domestic investor shall be granted to the entity. The Government shall approve a list of priority sectors.

17.3. The credit specified in paragraphs 17.1 and 17.2 of the Law shall commence from the beginning of entity's operation.

17.4. If the credit specified in paragraph 17.2 of the Law is more than income tax of that taxable year specified in the Article 14.1 of this law, the exceeding amount shall be credited in subsequent 3 profitable tax years.

17.5. The income tax of legal entity that employs individuals who lost over 50 percent working capacity due to disability shall be reduced by percentage of number of disabled people in the total number of employees of that legal entity.

SECTION SIX. TAX IMPOSITION, PAYMENT TO THE BUDGET AND REPORT

Article 18. Tax payment and report

18.1. A resident taxpayer of Mongolia shall calculate amount of income tax by him based on year-to-date quarterly and annual accounting financial statements and pays it to the budget.

18.2. Subsidiary and daughter companies shall create tax report consolidated with the parent company.

18.3. A tax year shall be the same as calendar year.

18.4. Taxation office shall determine monthly and quarterly payment schedule of income tax of a taxpayer in that reporting year.

18.5. A taxpayer makes an advance payment of income tax by the 25th of each month of a reporting year in accordance with the payment schedule approved by the taxation office and submits quarterly report to the State Taxation Authority by the 20th of the first month of the next quarter and annual report by February 10th of the next year.

18.6. A withholder shall withhold imposed tax on income specified in the subparagraphs 14.2.1-14.2.4, 14.2.6-14.2.9 of this law and pay it to the budget within 7 working days. The report shall be prepared quarterly by year-to-date amount within 20th of the first month of the next quarter and annual report by February 10th of the next year and submitted to the corresponding tax office.

18.7. Income tax from sale of immovable property shall be paid within 10 days following the sale.

SECTION SEVEN OTHER

Article 19. Entry into force

19.2. The present law shall come into effect from/date/ 2006.

SIGNATURE