Tax Alert

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Anticipated new transfer pricing rules in Mongolia

The Ministry of Finance and the National Tax Administration (NTA) have developed a number of draft regulations strengthening the current transfer pricing ("TP") rules.

The new regulations define covered transactions more specifically, introduce tools for analysing TP, determine TP documentation requirements and establish other important rules.

The existing Methodology for using benchmark prices* (in force since 2007) and several limited provisions in tax laws have been the only TP rules in Mongolia. These TP rules are vague and not enforced.

Anticipated changes

The proposed changes include the following:

Scope of TP regulations (covered transactions)

- TP rules will apply to virtually all types of transactions between related parties and all cross-border transactions regardless relationship of parties.

Definition of "related parties"

- For corporate income tax purposes, the definition of 'related parties' will be extended by incorporating definitions from the Company Law, the Family Law, and the Law on preventing conflict of self-interest and coordinating public and personal self-interest in the public service.
- E.g, the new definition will include virtually all family members, shareholders and civil servants who have interest in a company's profit generating activity etc.
- The current definition of related parties is limited to vertical participation in shareholding, dividend distributions or management of 20% and more.

**Approved by the Ordinance of the Minister of Finance No. 86 of April 2007*

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TP concepts

- Basic TP concepts commonly used in internationally recognised practice will be introduced, including: comparability analysis, internal and external comparables, economic benefit, etc.

TP methods

- Similar to the OECD's TP Guidelines for Multinational Enterprises and Tax Administrations, there will be five methods for TP analysis:
  - Comparable uncontrolled price method
  - Cost plus method
  - Resale method
  - Profit split method
  - Transactional net margin method
- The current TP rules establish only the first three methods (so-called "traditional transaction methods") from the above list.
- Any of the five methods can be used following the most appropriate method approach i.e., that provides the best estimation of an arm's length result in each particular case.

TP documentation requirements

- TP documentation will need to be maintained for all transactions subject to TP rules and should be presented to the tax authorities on their request.

Penalty

- Non-disclosure of information about TP or provision of invalid information will result in a penalty of 10% of the transaction amount.

Clearly, the NTA is now focused on TP. Businesses with related-party transactions will need to extremely conscious of the anticipated increased TP requirements.