Upcoming modifications to Mongolian Double Tax Treaties

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Please contact us, if you have any questions regarding MLI or require professional assistance in evaluating impact of MLI on your business.

In brief

Multilateral Convention to Implement Tax Treaty Measures to Prevent Base Erosion and Profit Shifting, also known as the Multilateral Instrument (MLI), is a flexible instrument which modifies tax treaties according to a jurisdiction's policy preferences with respect to the implementation of the tax treaty-related BEPS measures.

On 6 October 2022, Mongolia become the 100th jurisdiction to join the BEPS Convention (by signing the MLI), which now covers around 1850 bilateral tax treaties worldwide.

As a result, the double tax treaties (DTTs) of Mongolia are expected to be modified from 1 January 2024 in the expectation that the MLI would be ratified by the Parliament in the 2023 spring session.

In detail

In terms of the process, firstly the Mongolian Parliament should ratify the MLI and subsequently the instrument of ratification could be deposited to the OECD: then the MLI will be fully effective on all 'covered' DTTs provided that relevant ratifications are made by the corresponding authorities.

Mongolia has chosen to cover all **26 of its DTTs.** However, other Contracting States of those DTTs must also choose to cover the DTT with Mongolia for the MLI to be effective on the specific DTT. Currently, as reported by OECD, **17 other** Contracting States in the Mongolian DTT network have chosen to include DTT with Mongolia in their coverage of the MLI. Countries can still update the covered DTTs even after depositing of the instrument of ratification.

The MLI will modify the preamble of all covered Mongolian DTTs by including the text of "*intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance"*. The updated preamble ensures that the DTTs are interpreted to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. This includes treaty-shopping arrangements aimed at obtaining relief provided in those agreements for the indirect benefit of residents in the third jurisdictions.

Upcoming modifications to Mongolian Double Tax Treaties (cont'd)

Additionally, due to the Mongolian reservations and notifications made, there are some changes on taxing rules on the Capital Gains (Article 13) and determination criteria for Permanent Establishments (Article 5) of some DTTs. Other changes are expected that could impact significantly on many cross-border transactions.

A crucial aspect of the MLI is the new tax anti-avoidance measures which are in the form of the Principal Purpose Test ("**PPT**") and Simplified Limitation on Benefits ("**S-LOB**"). The PPT will generally restrict access to treaty benefits in case of transactions, where obtaining that benefit would be **one of the principal purposes** of any arrangement or transaction (unless granting a treaty benefit is in accordance with the object and purpose of the relevant provisions of the DTT). S-LOB provisions are complex and require various tests to be met (e.g., qualified person, active conduct of a business test etc.).

Takeaway and what we can offer:

Adoption of the MLI will impact significantly DTT rules. Specifically, the DTT benefits are not applicable if, having regard to all relevant facts and circumstances, obtaining that the DTT benefit **was one of the principal purposes** of any arrangement or transaction. Hence, considering the anticipated changes, taxpayers may need to review their international operational, financial and holding structures, arrangements and transactions in advance to get prepared for the introduction of new rules.

We are happy to assist you in assessing the impact of the MLI on your businesses.

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