# TO ENHANCE COOPERATION IN TAX MATTERS

*/JAPAN AND MONGOLIA/*

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Tokyo, Japan
18th October 2023

## CONTENTS

## 1. ABSTRACT


**Research Aim**

The aim of this research is to analyze the current economic and business environment between Japan and Mongolia, and to investigate potential tax-related areas of collaboration between the two countries to boost trade and investment. This is a timely and important research topic, as Japan and Mongolia are both looking to strengthen their economic ties.

**Key Research Questions**

- What are the general socio-economic circumstances in Japan and Mongolia?

The answers to this question will provide a general overview of the economic and social conditions in both countries. This information is important for understanding the context in which tax-related collaboration can take place /Section 3/.

- What role do the governments of Japan and Mongolia play in supporting business activities?

This question will examine the specific policies and programs that the Japanese and Mongolian governments have in place to support businesses, both domestic and foreign. This information is important for understanding the potential for government-to-government collaboration on tax matters /Section 4/.

- What good policies can Mongolia learn from Japan in the field of taxation?

This question will identify specific Japanese tax policies and practices that Mongolia could learn from to improve its own tax system. This includes good policy and tax administration practices for Mongolia to adopt in the future /Section 5/.

- What are the key areas in the field of taxation where Japan and Mongolia can collaborate?

This question will identify specific areas of tax policy and administration where Japan and Mongolia can work together to improve the cross-border business environment. This could include areas such as double taxation avoidance, tax information exchange, and tax dispute resolution /Section 6/.

- What actions should the governments of Japan and Mongolia take to promote tax-related collaboration?

This question will make specific recommendations for how the Japanese and Mongolian governments can work together to promote tax-related collaboration. This could include recommendations for joint studies, technical assistance programs, and capacity building initiatives /Section 7/.


## 2. BACKGROUND

An important topic in the world economy today is international taxation. Cross-border transactions are increasing in frequency as a result of business globalization, necessitating greater international cooperation and collaboration between nations to ensure that taxes are applied correctly to international transactions and that tax evasion and avoidance are kept to a minimum.

Japan is one of Mongolia's top commercial partners, and the two countries enjoy a strong economic partnership. Nevertheless, despite this connection, there is little cooperation between Japan and Mongolia in terms of international taxation.

## 3. GENERAL SOCIO-ECONOMIC SITUATION

In this section, the research intended to analyze the current socio-economic situation from an economic growth and investment perspective.

### 3.1. General comparison

Mongolia is much larger than Japan in terms of land size, with a total area of 1,566,500 square kilometers, which is roughly four times larger than Japan's 377,975 square kilometers. However, Mongolia's population is estimated to be 3.5 million (Mongolian Population, 2023), which is roughly 37 times smaller than Japan's 125.8 million (Japan Population, 2023).

The different land sizes and population densities of Mongolia and Japan have several implications. First, Mongolia's large land size and small population make it difficult to develop infrastructure and provide services to its population. For example, the average distance between two neighboring villages in Mongolia is over 100 kilometers, making it difficult to build roads and schools. Second, Japan's high population density puts a strain on its natural resources and environment. For example, Japan imports over 60% of its food, making it vulnerable to food price shocks.

In addition to the differences in land size and population density, Mongolia and Japan also have very different economies. Japan is a highly developed country with a diversified economy, while Mongolia is a lower-middle-income country with an economy that is heavily dependent on mining.

In 2023, Japan's GDP per capita is estimated to be $42,440 (Japan GDP Per Capita, 2023), while Mongolia's GDP per capita is estimated to be $4,210 (Mongolian GDP per capita, 2023). This means that the average Japanese person is about 10 times wealthier than the average Mongolian person. Japan's economy is also much larger than Mongolia's economy, with a GDP of $4.8 trillion in 2023 compared to Mongolia's GDP of $15.7 billion.

The main industries in Japan are manufacturing, services, and construction. Japan is a major exporter of cars, electronics, and machinery. Japan has a highly skilled workforce and a well-developed infrastructure.

On the other hand, the main industries in Mongolia are mining, agriculture, and livestock. Mongolia is a major exporter of coal, copper, and gold. Mongolia has a young and growing workforce, but its infrastructure is less developed.

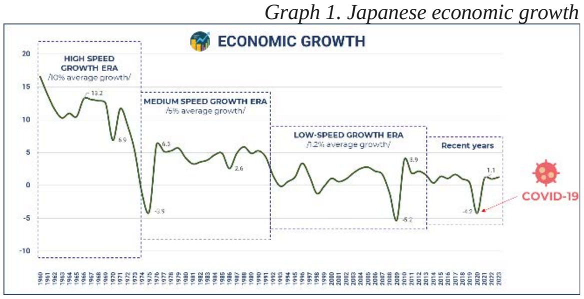
*Figure 1. General facts of Japan and Mongolia*


Overall, Japan has a much more developed and diversified economy than Mongolia. However, Mongolia is a rapidly growing economy with a lot of potential.

### 3.2. Economic growth

Japan's economic growth has been relatively slow in recent years, while Mongolia's economic growth has been relatively fast. In the past five years, Japan's average annual GDP growth rate has been around 1%, while Mongolia's average annual GDP growth rate has been around 5%.

*Graph 1. Japanese economic growth*




Source: World bank (GDP growth - Japan, 2023)

Historically speaking, Japan's economic growth since 1960 has been remarkable. The country experienced a period of rapid economic growth, known as the Japanese economic miracle, from the early 1960s to the early 1990s. During this period, Japan's GDP grew at an average annual rate of 7.2%. This rapid growth was mainly driven by factors such as high investment, strong export sector, developed workforce and proper economic development policies.

However, Japan's economic growth slowed in the early 1990s due to major events and circumstances that happened in the 1980s.

For instance, Japan saw a tremendous asset price bubble in the late 1980s, with stock and land values rising to all-time highs. But when the bubble broke in 1990, asset values fell through the floor. As a result, consumer spending and investment fell precipitously, sending the Japanese economy into a recession.

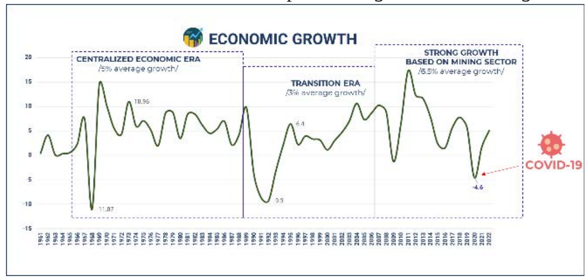
Furthermore, the Plaza Accord was an agreement reached by the G-5 countries (France, Germany, Japan, the United Kingdom, and the United States) in September 1985 to address the growing trade imbalance between the United States and Japan. At the time, the US dollar was overvalued, and the Japanese yen was undervalued. This made Japanese exports more competitive and US exports less competitive.

The Plaza Accord sought to address this mismatch by making the Japanese yen stronger and the US dollar weaker. The G-5 nations decided to buy Japanese yen and sell US dollars to intervene in the foreign exchange market. The yen's value compared to the dollar increased as a result. The yen's increase reduced the competitiveness of Japanese exports and negatively impacted the country's economy. Japanese businesses saw a drop in profits because of their inability to charge as much for their goods abroad. As a result, Japan saw a decline in investment and employment growth.

On the other hand, Mongolia has experienced uneven economic growth since 1960. Under the socialist Mongol People's Republic (MPR), the nation saw a period of exceptionally fast economic growth from the 1960s to the 1980s. The GDP of Mongolia increased at an average annual rate of more than 6% during this time. The nation's natural resources, including coal, gold, and copper, as well as Soviet assistance, were the main drivers of this growth.

However, Mongolia's economy began to decline in the late 1980s and early 1990s due to the collapse of the Soviet Union, the end of socialist planning, and extreme weather conditions such as dzud.

*Graph 2. Mongolian economic growth*




Source: World bank (GDP growth - Mongolia, 2023)

Since the mid-1990s, Mongolia's economy has recovered and grown modestly. The country's GDP has grown at an average annual rate of around 5% since 1995. This growth has been driven by the mining sector, which accounts for over 80% of Mongolia's exports.

Overall, the disparity in economic growth between the two nations are generally influenced by the following three factors:

- Different development level
- Natural resources
- Demographic profile.

Japan's advanced economy and level of development are among the factors. Consequently, Japan faces greater challenges in attaining substantial rates of economic expansion. Mongolia, on the other hand, is a developing nation with a lower middle class of income. It so has greater potential for economic expansion.

One further factor contributing to the disparity in economic growth is Mongolia's abundance of natural resources, including gold, copper, and coal. Mongolia's economy has benefited from the recent surge in demand for these minerals. Conversely, Japan lacks abundant natural resources. It is hence more reliant on imports and exports.

Japan and Mongolia are two countries with very different demographic profiles. Japan has an aging population and a shrinking workforce, while Mongolia has a young and growing population.

For instance, Japan has one of the oldest populations in the world, with a median age of 48.6 years old in 2023. The country's total fertility rate (TFR) is also very low, at just 1.36 children per woman in 2023 (Japan Population, 2023). Furthermore, Japan's aging population is putting a strain on its social welfare system. As more and more people retire, the government will have to spend more on pensions and healthcare. This will increase the government's debt burden and reduce its ability to invest in other areas, such as education and infrastructure.

On the contrary, Mongolia's median age, on the other hand, is just 29.3 years old, and its TFR is 2.75 children per woman (Mongolian Population, 2023). This demographic advantage is a boon for Mongolia's economy. It provides businesses with a large and growing pool of workers.

### 3.3. Key sectors

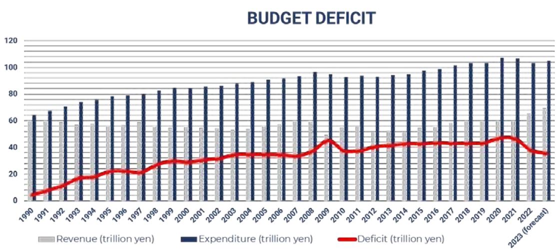
Japan's economy thrives on a diverse tapestry of industries, including a robust services sector, manufacturing excellence, and technological innovation. The services sector reigns supreme, accounting for over 60% of GDP, while manufacturing forms the backbone of the economy, accounting for over 20% of GDP (Japan GDP from Manufacturing, 2023). Japan is a pioneer in technological innovation and research and development, with its expertise shining through in various fields. Japan's financial sector is well-developed and sophisticated, with Tokyo serving as a major global financial hub. The country's success is due in part to its ability to adapt to changing economic conditions, innovate new technologies, and maintain a strong focus on quality and efficiency. Big companies play a pivotal role in the economy, contributing significantly to employment, exports, investment, and technological innovation.

In contrast, Mongolia's economy is heavily reliant on the mining sector. Mining and related activities contribute around 22% of GDP and account for over 80% of the country's exports (Mongolian Export, 2023). While the mining sector provides significant revenue for the Mongolian government, funding public services, infrastructure development, and social programs, it is highly vulnerable to fluctuations in global commodity prices, particularly for copper and coal. This overdependence can make the economy vulnerable to external shocks and limit its diversification potential.

### 3.4. Public finance

Japan has been facing significant budget deficits, with national debt rising to over 261% of GDP in 2022 (Japan General Government Gross Debt to GDP, 2023). The slow-growing economy, aging population, shrinking workforce, and high debt burden are major contributors.

*Graph 3. Japanese budget deficit*



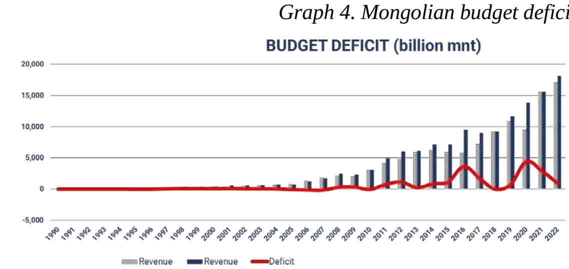

Source: Trading Economics (Japan Government Budget, 2023)

The Japanese government has taken a number of steps to try to address these challenges. For example, it has raised the retirement age and cut social security benefits. It has also tried to stimulate the economy through fiscal and monetary policies. However, these measures have not been enough to eliminate the budget deficit.

The Japanese government has set a goal of reducing its debt-to-GDP ratio to 200% by 2060 (Economic analysis, 2023). However, it is unclear whether this goal is achievable. If the government is unable to reduce its debt burden, it will eventually be forced to make more drastic cuts to spending or raise taxes.

In contrast to Japan's long-standing budget deficit, Mongolia has only recently begun experiencing this financial strain. Over the past decade, Mongolia's budget deficit has steadily increased, reaching an alarming 40% of GDP by 2022. This sharp deterioration in public finances is a cause for concern, as it threatens to undermine Mongolia's economic stability and long-term growth prospects.

*Graph 4. Mongolian budget deficit*




Source: National Statistics Office of Mongolia (Mongolian Government budget, 2023)

Several factors have contributed to Mongolia's growing budget deficit. One significant factor is the decline in revenue from the mining sector, which has traditionally been the backbone of the Mongolian economy. As global commodity prices have fluctuated, Mongolia's export earnings from mining activities have also varied, leading to significant swings in government revenue.

Furthermore, Mongolia's expanding social welfare programs have placed additional pressure on the budget. As the population ages and healthcare demands rise, the government has been compelled to increase spending on social programs, putting further strain on its fiscal resources.

Infrastructure development has also played a role in the widening budget deficit. Mongolia has made significant investments in infrastructure projects, such as roads, railways, and power grids, to support economic growth and improve connectivity. However, these investments have come at a cost, contributing to the overall growth in government expenditures.

To address the growing budget deficit, the Mongolian government has implemented a range of measures, including fiscal consolidation efforts, tax reforms, and increased borrowing. However, these measures have not been sufficient to fully eliminate the deficit, and the government continues to face significant fiscal challenges.

The growing budget deficit poses several risks for Mongolia's economy. It could lead to higher interest rates, which would increase the cost of borrowing for businesses and households, potentially dampening economic activity. Additionally, if the government is unable to manage its debt effectively, it could face a credit downgrade, making it more expensive for the government to borrow in international markets.

### 3.5. Recent economic policies

The Japanese government has implemented a number of economic policies in recent years to stimulate growth and address challenges like an aging population and debt burden (Economic Policy, 2023). Notable policies include:

**New capitalism:** Prime Minister Fumio Kishida's initiative focuses on digital transformation, green growth, and inclusive capitalism.

**Monetary policy:** The Bank of Japan has maintained ultra-loose monetary policy with near-zero interest rates and quantitative easing.

**Fiscal policy:** The government has implemented fiscal stimulus measures, including tax breaks and subsidies.

**Structural reforms:** The government has implemented deregulation and labor market reforms.

Japan's recent economic policies have had some positive impacts, such as economic growth and a low unemployment rate. However, challenges remain, including an aging population and high debt burden. The long-term effectiveness of these policies remains to be seen.

Similarly, Mongolia has also implemented economic policies to stimulate growth and address challenges like overreliance on mining, an emerging middle class, and infrastructure needs. Key policies include:

**Economic Diversification:** Mongolia is actively implementing strategies to reduce its reliance on the mining sector. These efforts include promoting agriculture, developing tourism, and encouraging FDI. This shift in focus aligns with the government's decentralization efforts, aiming to distribute economic opportunities and infrastructure across the country.

**Infrastructure Development:** Mongolia has made significant investments in infrastructure, including transportation networks, energy infrastructure, and telecommunications infrastructure.[18] This infrastructure development is crucial for supporting economic growth, social progress, and improved connectivity in both urban and remote areas.

**Social Policies:** Mongolia has implemented a range of social policies to enhance citizen well-being.[18] These policies include expanding access to education and healthcare, establishing social safety nets, and implementing recent tax reforms. These initiatives aim to promote social inclusion, reduce poverty, and enhance the overall quality of life for Mongolian citizens.

While these policies strive to foster a more diversified, resilient, and inclusive economy, challenges persist, including the lingering dependence on the mining sector and the inadequate infrastructure in remote areas. The long-term effectiveness of these policies remains to be seen.

### 3.6. Foreign direct investment

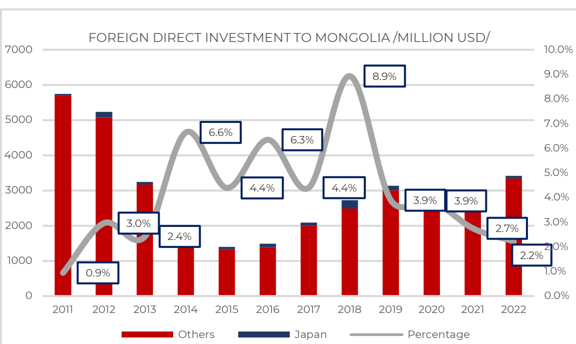
Japanese investment outside of Japan has witnessed a surge in recent years, reaching a record high of over 20 trillion yen in 2021. This expansion reflects Japanese companies' strategic approach to diversifying their business portfolios and tapping into promising global markets.

Japanese companies are actively investing across a diverse range of industries, including manufacturing, finance, and technology. The United States, Europe, and Asia stand as key destinations for Japanese investment, driven by factors such as market access, favorable labor costs, and technological advancements.

A significant portion of Japanese overseas investment is directed towards information and communications technology (ICT), accounting for 14.3% of total investment. Manufacturing follows closely with 12.7% of total investment, highlighting the continued importance of Japanese manufacturing prowess in the global landscape. Finance and insurance (12.2%), logistics and transportation (10.1%), and real estate (8.5%) also represent substantial areas of Japanese investment abroad.

In contrast, Mongolia's outbound investment remains relatively modest. While Japan ranks among Mongolia's top investors, with an average annual investment of approximately 110 million USD, there is ample room for further engagement.

*Graph 5. Foreign direct investment to Mongolia*




Source: National Statistics Office of Mongolia (FDI to Mongolia, 2023)

Mongolia presents attractive investment opportunities across various sectors, including mining, telecommunications, agriculture, and renewable energy. The country's vast natural resources, and growing consumer market offer compelling prospects for Japanese companies seeking to expand their global footprint.

By leveraging their expertise and resources, Japanese companies can play a pivotal role in Mongolia's economic development, contributing to infrastructure upgrades, resource exploration, job creation, and technology transfer. This mutually beneficial collaboration can foster sustainable growth and prosperity for both Japan and Mongolia.

## 4. GOVERNMENT AGREEMENTS

### 4.1. Key agreements to promote economic activity

Bilateral treaties play a crucial role in promoting economic activity between two countries by establishing frameworks and regulations that facilitate trade, investment, and cooperation. There are numerous bilateral treaties that countries can sign to enhance economic ties (Investment Policy, 2023). These generally include:

**Bilateral Investment Treaty (BIT):** A BIT aims to protect and promote foreign investment between the two countries. It typically includes provisions related to the protection of investments, non-discrimination, repatriation of profits, and dispute resolution mechanisms.

**Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital (DTT):** A DTT helps prevent double taxation of income and capital gains for individuals and companies operating in both countries. It provides clarity on tax liabilities and promotes cross-border investment.

**Free Trade Agreement (FTA):** An FTA eliminates or reduces tariffs and non-tariff barriers on goods and services between the signatory countries. This agreement aims to boost bilateral trade, enhance market access, and foster economic integration.

**Preferential Trade Agreement (PTA):** Similar to an FTA, a PTA reduces tariffs on certain products between the participating countries, but to a lesser extent than an FTA. PTAs are often used as stepping stones towards full FTAs.

**Customs Union:** A customs union goes beyond an FTA as it not only eliminates tariffs but also establishes a common external tariff on imports from non-member countries. This promotes deeper economic integration and a unified trade policy between the countries.

**Economic Partnership Agreement (EPA):** An EPA is a comprehensive agreement that covers various aspects of economic cooperation, including trade in goods and services, investment, and development assistance. It is often signed between developed and developing countries to promote sustainable economic growth.

**Bilateral Currency Swap Agreement:** This agreement allows central banks to exchange their currencies directly, facilitating trade and investment by reducing currency risks and volatility.

**Mutual Recognition Agreement (MRA):** An MRA establishes a framework for recognizing each other's product standards and certifications. This helps streamline trade by reducing the need for retesting and re-certification of products in each country.

**Air Services Agreement (ASA):** An ASA liberalizes air transport services between the signatory countries, allowing airlines to operate flights more freely, leading to increased tourism and business travel.

**Intellectual Property Rights (IPR) Agreement:** This agreement focuses on protecting and enforcing intellectual property rights, encouraging innovation, and creating an environment that fosters research and development collaborations.

### 4.2. Existing bilateral agreements:

In accordance with the 1972 Moscow agreement on diplomatic relations, Japan and Mongolia have established diplomatic ties (Bilateral agreements, 2022).

Since then, Japan and Mongolia has established various bilateral agreements:

- Agreement on establishing cultural relations between Japan and the Republic of Mongolia, 1974.09.23. Ulaanbaatar city
- Agreement on economic cooperation between the Republic of Mongolia and Japan, 1977.03.17. Ulaanbaatar city
- Intergovernmental Trade Agreement between the Republic of Mongolia and Japan, 20.03.1990, Tokyo
- Intergovernmental Agreement between the Republic of Mongolia and Japan on the Acceptance of Volunteers Overseas in Japan, Tokyo, March 19, 1991
- Agreement between the governments of Mongolia and Japan on air communication, November 25, 1993. Tokyo city
- Intergovernmental Protocol between Mongolia and Japan on the reception of Japanese veteran volunteers, 1999. Ulaanbaatar city
- Agreement between the governments of Mongolia and Japan on mutual protection and promotion of investments, 2001.02.15. Tokyo city
- Agreement between the governments of Mongolia and Japan on technical cooperation, December 5, 2003. Tokyo city
- “Memorandum of defense cooperation between the Ministry of Defense of Mongolia and the Ministry of Defense of Japan”, 2012
- “Medium-term program of strategic partnership between Mongolia and Japan (2013-2017)”, 2013
- “Medium-term Program of Strategic Partnership between Mongolia and Japan (2017-2021)”, 2017
- “Inter-Governmental Agreement on Cooperation in the Implementation of Training in the Field of Humanitarian Aid, Disaster Relief and UN Peacekeeping Operations” was established. 2015.

It is safe to assume that Japan and Mongolia have established many of the key bilateral agreements that have been mentioned in the previous section. However, the two countries have yet to establish an Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital (hereafter referred to as “double tax treaty”).

### 4.3. Other agreements in tax issues

Besides the double tax treaty, there are several bilateral and multilateral agreements in the field of tax. These include:

**Exchange of information agreements:** to exchange information about taxpayers for tax enforcement purposes.

**Assistance on collection of taxes:** An agreement between two countries to cooperate in the collection of taxes from their respective citizens and residents.

**Multilateral convention on mutual administrative assistance in tax matters:** to promote international co-operation for a better operation of national tax laws, while respecting the fundamental rights of taxpayers. The Convention provides for all possible forms of administrative co-operation between the parties in the assessment and collection of taxes, with a view to combating tax avoidance and evasion.

While Japan and Mongolia do not have a bilateral agreement on exchange of information or assistance on collection of taxes, they are both parties to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which facilitates international tax cooperation and helps combat tax evasion and avoidance. This convention provides a framework for countries to exchange information and cooperate in tax collection efforts, even if they do not have a bilateral agreement in place.

## 5. GENERAL TAX ENVIRONMENT

### 5.1. Taxes and tax revenue

The Japanese tax system is a multi-tiered system consisting of national taxes, prefectural taxes, municipal taxes, and special taxes.

The national government is responsible for collecting national taxes, while prefectural and municipal governments are responsible for collecting prefectural and municipal taxes, respectively. Special taxes are levied for specific purposes. These include:

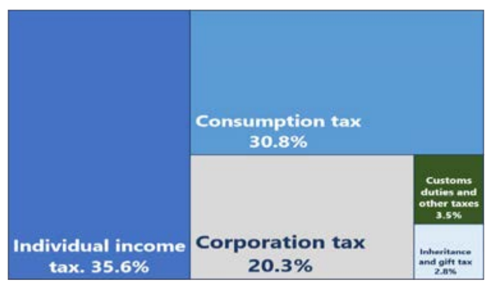
**National taxes:** Corporation tax, consumption tax, inheritance and gift tax, fixed assets tax, real estate acquisition tax, real estate registration tax.

**Prefectural taxes:** Enterprise tax, automobile tax, mineral products tax, tobacco tax.

**Municipal taxes:** Resident tax, business tax, light vehicle tax, city planning tax.

**Special taxes:** Alcohol tax, gasoline tax, liquefied petroleum gas tax, aviation fuel tax.

*Graph 6. Japanese tax revenue composition /2022/*




Source: Ministry of Finance of Japan (Tax Revenue, 2022)

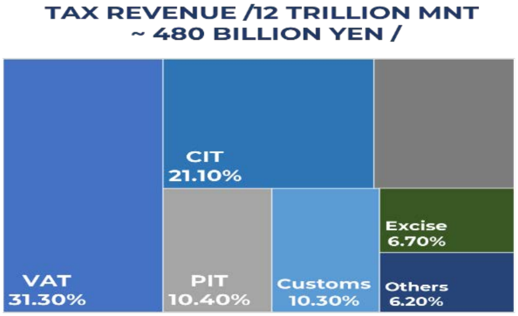
Furthermore, Japan’s tax revenue is a significant source of funding for the government’s budget. In 2022, tax revenue accounted for approximately 83% of Japan’s total government revenue. The majority of Japan’s tax revenue comes from income taxes, followed by consumption taxes and corporate taxes.

On the other hand, the Mongolian tax system is a two-tiered system consisting of national taxes and local taxes. These include:

**National taxes:** Corporate income tax, value added tax, Customs tax, Mining royalty tax, Excise tax.

**Local taxes:** Personal income tax, property tax, land fee, and other stamp taxes.

*Graph 7. Mongolian tax revenue composition /2022/*




Source: National Statistics Office of Mongolia (Tax Revenue, 2022)

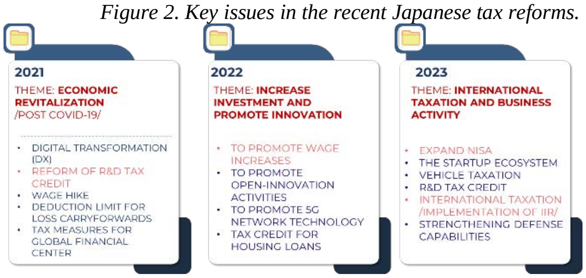
Mongolia's tax revenue is also a crucial source of funding for the government's budget. In 2022, tax revenue accounted for approximately 70% of Mongolia's total government revenue. Most of Mongolia's tax revenue comes from the mining sector.

The Mongolian government allocates its tax revenue to various purposes, including infrastructure development, education, healthcare, and social welfare programs. Infrastructure development is a major priority for the Mongolian government, as it is essential for economic growth and poverty reduction.

### 5.2. Recent reforms

Japan has implemented several tax reforms in recent years to address the challenges of the Japanese economy and society. The focus of these reforms has been towards economic revitalization, promoting investment and innovation, reducing inequality, and introducing new rules against tax avoidance.

*Figure 2. Key issues in the recent Japanese tax reforms.*




Source: Ministry of Finance of Japan (Tax Reform, 2022)

To elaborate on some noteworthy policy changes:

**Expansion of NISA scope and duration:** The NISA (Nippon Individual Savings Account) is a tax-advantaged savings account that allows Japanese residents to invest in stocks, bonds, and other financial assets without having to pay capital gains tax on their profits. The government has expanded the scope and duration of the NISA program in recent years, making it more attractive to investors.

**Revision of inheritance tax and gift tax:** The Japanese government has revised the inheritance tax and gift tax systems in recent years, making them more progressive and reducing the tax burden on middle-class and low-income families.

**Revision of qualified invoice system:** The Japanese government has revised the qualified invoice system in recent years to make it more efficient and easier to use for businesses.

**Creation of tax incentive to spur re-investment in startups:** The Japanese government has created a new tax incentive to encourage re-investment in startups. This incentive provides tax breaks to investors who reinvest their capital gains from startup investments into other startups.

**Extension of exercise period within stock option rules:** The Japanese government has extended the exercise period for stock options from five years to ten years. This change gives employees more time to exercise their stock options and benefit from any potential gains.

**Strengthened taxation on the income of high-net-worth individuals:** The Japanese government has strengthened the taxation of the income of high-net-worth individuals. This includes measures such as increasing the tax rate on capital gains and dividends for high-income earners.

**Implementation of the OECD's Income Inclusion Rule (IIR):** The IIR is a new international tax rule that is designed to ensure that multinational companies pay a minimum level of tax on their global profits. Japan has agreed to implement the IIR, and it will come into effect on April 1, 2024.

**Revisions to the R&D tax incentive:** The Japanese government has revised the R&D tax incentive to make it more attractive to businesses and to encourage investment in research and development.

**Introduction of a digital transformation and investment promotion tax incentive:** The Japanese government has introduced a new tax incentive to promote investment in digital transformation. This incentive provides tax breaks to businesses that invest in DX technologies.

**Introduction of a tax incentive to promote carbon neutrality investments:** The Japanese government has introduced a new tax incentive to promote investment in carbon neutrality. This incentive provides tax breaks to businesses that invest in carbon-neutral technologies.

While Japanese tax reforms have been adjusting some factors in the overall design, Mongolia has been carrying out major structural reforms to promote domestic businesses and simplify tax services to reduce tax compliance burden. In this regard, the tax reform of 2019 has been carried out introducing new sets of rules and regulations which has been effective since 1 January 2020.

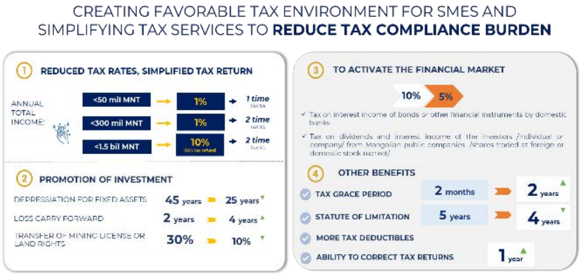
Under the tax reform, a new draft of General tax law, Corporate income tax law and personal income tax laws have been implemented. The reform had 3 main integral purposes:

1. Creating favorable tax environment for businesses
2. Digitalization of tax services
3. Implementation of international rules against tax avoidance.

**Creating favorable tax environment:** The recent tax reform in Mongolia focused significantly on improving the business tax environment, especially for small and medium enterprises (SMEs). For example, the frequency of corporate income tax return filing was reduced from quarterly to biannual for SMEs. Additionally, a simplified tax filing scheme was introduced for SMEs with gross taxable revenue of less than 50 million MNT. This scheme offers easy tax filing and a tax rate of 1% on gross income.

The Mongolian government has also made major changes to promote investment. For example, the depreciation period for fixed assets in non-mining sectors has been reduced to 20 years. Additionally, the loss carryover period has been extended from two to four years. To promote the mining sector, the tax rate on income from the transfer of mining licenses or land rights has been reduced from 30% to 10%.

*Figure 3. Major changes introduced under the tax reform in Mongolia*




Source: Ministry of Finance of Mongolia (Tax Reform, 2023)

To activate the financial market, the tax rate on interest income from bonds or other financial instruments issued by domestic banks has been reduced from 10% to 5%. Similarly, the tax on dividends and interest income of investors (individuals or companies) from Mongolian public companies has been reduced from 10-20% to 5%.

Additionally, several favorable changes have been made **available** for all taxpayers. These include:

- Raising the tax grace period from 2 months to 2 years.
- Reducing the statute of limitations from 5 years to 4 years.
- Expanding the scope of tax deductibles to include any costs that meet certain legal requirements.
- Allowing taxpayers to correct their annual tax return within 1 year after submission.

**Digitalization of tax services:** In a concerted effort to modernize and streamline its tax administration, Mongolia has embarked on a comprehensive digitalization initiative. As a pivotal step, the General Tax Authority of Mongolia launched the New Tax Administration System on January 14, 2019. This system marks a significant departure from Mongolia's legacy tax administration processes, ushering in an era of enhanced efficiency, transparency, and taxpayer convenience.

The new tax administration system has revolutionized the taxpayer registration process, enabling seamless 100% online registration of taxpayers. Additionally, the system leverages data from the e-barimt system (VAT receipts system), to assist taxpayers in preparing their annual tax returns. This streamlined approach extends to tax return submission and tax payment, which can now be completed entirely online.

Tax audits are now conducted entirely based on a risk-assessment framework utilizing the comprehensive tax database. In this context, the implementation of automatic exchange of information (AEOI) will significantly enhance the Mongolian tax administration's ability to identify and address tax evasion and avoidance risks.

### 5.3. Lessons to be learned from Japanese experience

Upon taking a closer look at Japanese tax laws and related regulations, the researcher has identified several notable concepts that Mongolia could incorporate into its tax system in the future.

**On tax policy:**

**Group tax regime:** The consolidated group tax regime in Japan, introduced in 2003 and revised several times since, offers a tax-saving opportunity for companies by allowing them to consolidate their profits and losses. This can significantly reduce the overall tax liability of the group.

Furthermore, dividends paid between group companies are generally exempt from taxation, which eliminates economic double taxation. The regime also simplifies tax compliance by allowing companies to file a single consolidated tax return, rather than having to file separate tax returns for each subsidiary. This can save companies time and money.

The consolidated group tax regime can also improve a company's financial flexibility by allowing it to use the profits of its subsidiaries to offset its own losses. This can make it easier for companies to borrow money and invest in new projects.

On the other hand, companies must meet stringent requirements, including being 100% subsidiaries owned by a single Japanese parent to qualify for group tax relief. The regime also imposes anti-avoidance rules to prevent potential tax evasion, such as transfer pricing and thin capitalization rules.

According to the Japan National Tax Agency, there were over 10,000 companies that filed consolidated group tax returns in Japan in the fiscal year 2021. This represents a significant increase from the 5,000 companies that filed in 2012.

Overall, the consolidated group tax regime can be a valuable tool for reducing tax burdens, but it requires careful consideration of its complexities and potential for tax avoidance.

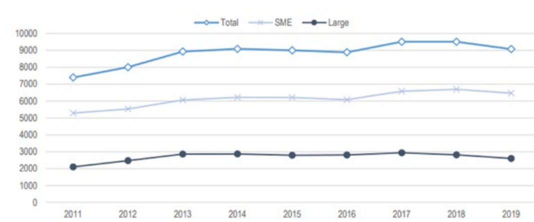
As Mongolian companies adopt increasingly complex corporate structures, including the formation of group companies, the issue of economic double taxation at the group level has emerged under the current corporate income tax law. This issue warrants careful consideration by Mongolian policymakers, as it can potentially hinder investment and business growth. By addressing economic double taxation, Mongolia can foster a more conducive environment for business activities and attract further investment.

**Research and development tax incentive:**

Japan has offered the R&D tax credit since 1967. It is a government incentive designed to promote research and development in Japan. It is available to corporations, partnerships, individuals, and non-profit organizations that conduct R&D activities in Japan.

To qualify for the Japanese R&D tax credit, the R&D must be new or innovative and conducted for the purpose of developing new products, processes, or services. The R&D must also be conducted by a qualified taxpayer.

*Graph 8. Number of Japanese R&D tax relief recipients*




Source: OECD (R&D Tax Incentives: Japan, 2021)

The Japanese R&D tax credit is calculated as follows:

- Multiply the qualified R&D expenses by the applicable tax credit rate.
- Subtract the resulting amount from the taxpayer's corporate income tax liability.

The applicable tax credit rate is 20% for most businesses. However, the rate is 30% for businesses that conduct joint or contracted R&D with universities or national research institutes.

To apply for the Japanese R&D tax credit, businesses must file a tax return with the Japanese government. The tax return must include a detailed description of the R&D activities that were conducted and the expenses that were incurred.

The Japanese R&D tax credit is a valuable tool that can help businesses to reduce the costs of R&D and make it more affordable to innovate.

Mongolia is a developing country with a relatively small domestic market. An R&D tax credit could make Mongolia more attractive to foreign investors by reducing the cost of R&D activities. This could lead to increased investment in Mongolia, which could create new jobs and boost the economy.

There are several lessons that Mongolia can learn from the Japanese experience. First, it is important to design the R&D tax credit system carefully to ensure that it is targeted at the right types of R&D activities. The Japanese R&D tax credit system is designed to incentivize businesses to invest in basic research, applied research, and experimental development.

Second, it is important to set the tax credit rate at a level that is high enough to incentivize businesses to invest in R&D, but not so high that it is a drain on the government budget.

Third, it is important to have a robust system in place for verifying and approving R&D tax credits. The Japanese government has a rigorous system in place for reviewing and approving R&D tax credit claims. This helps to ensure that the tax credit system is not abused and that it is only used to fund legitimate R&D activities.

By carefully studying the Japanese experience, Mongolia can design an R&D tax credit system that is effective and efficient and that will help to promote innovation and economic growth.

**On tax administration:**

While Mongolia has made significant progress in simplifying tax procedures and streamlining tax services, there remains a need for further adaptation to the unique needs of diverse taxpayer groups. This is particularly relevant for foreign investors, including Japanese investors, who may encounter challenges in accessing and comprehending tax information tailored to their specific circumstances.

The Japanese tax authority provides a comprehensive suite of explanatory materials and consultation services to support investors in navigating the complex landscape of Japanese tax regulations. The documents are also translated into English.

This extensive array of resources caters to the diverse needs of both domestic and foreign investors, ensuring that they have access to the information necessary to make informed tax decisions and comply with all applicable tax obligations.

Furthermore, the Japanese tax authority places a strong emphasis on building and enhancing the expertise of its workforce through a comprehensive capacity-building strategy. This commitment to professional development is exemplified by the establishment of the National Tax College, a specialized institution dedicated to training and educating tax professionals at the highest level.

Drawing inspiration from Japan's success in establishing the National Tax College, Mongolia should proactively address future challenges by forming a dedicated institution, regardless of its initial size, to nurture and enhance the expertise of its tax professionals. This strategic move would lay the foundation for a skilled and knowledgeable tax administration capable of navigating the complexities of the ever-evolving tax landscape.

## 6. INTERNATIONAL TAXATION ISSUES

### 6.1. Types of taxes relevant for international businesses

Cross-border transactions involve various taxes that can impact both individuals and businesses engaging in international trade, investment, and other activities.

The types of taxes involved in cross-border transactions can vary based on the nature of the transaction, the countries involved, and the specific tax regulations in place. The common types of taxes that may be relevant in cross-border transactions includes:

**Customs Duties:** Customs duties, also known as tariffs, are taxes imposed on goods when they are imported into a country. These duties are typically based on the value of the goods, their classification, and their country of origin.

**Value Added Tax (VAT):** Many countries impose a VAT or GST on the supply of goods and services. In cross-border transactions, these taxes can be complex, involving considerations such as the location of the supplier and the recipient, as well as potential exemptions for exports and imports.

**Corporate Income Tax:** Companies engaging in cross-border activities may be subject to corporate income tax in the countries where they operate or generate income. Tax treaties and the presence of a permanent establishment can impact the taxation of business profits.

**Individual Income Tax:** Individuals earning income from cross-border activities, such as employment, investments, or consulting services, may be subject to income tax in multiple jurisdictions.

**Transfer Pricing Regulations:** Many countries have transfer pricing regulations that require related parties engaging in cross-border transactions to ensure that prices are set at arm's length, reflecting market conditions. These regulations aim to prevent profit shifting.

**Capital Gains Tax:** Cross-border capital gains can be subject to taxation, especially for real estate transactions, sales of businesses, and certain investments.

**Taxes on assets:** When individuals have assets or beneficiaries in multiple countries, estate and inheritance tax considerations can arise.

**Local Taxes:** Depending on the country and region, there may be additional local taxes or levies that impact cross-border transactions.

**Social Security Contributions:** In some cases, individuals working abroad may need to consider social security contributions in both their home and host countries.

While domestic tax laws play a significant role in shaping many of these taxes, international considerations are also crucial in determining income tax liabilities. Income tax issues, encompassing both personal and corporate income taxes, are influenced by both domestic tax laws and double tax treaties. Given that income tax is a central issue in international taxation, this research will focus on income tax issues from an international taxation perspective.

### 6.2. Recent developments in international taxation issues

Japan has been a leader in international taxation issues and has made significant advances in this area. The country's commitment to transparency, fairness, and efficiency in its tax system and its active participation in international organizations demonstrate its commitment to promoting the effective functioning of the international tax system.

Japan has been actively involved in international tax issues and has made significant advances in this area. Some of the key developments in international taxation in Japan include:

**Implementation of the BEPS Action Plan:** Japan has fully implemented the Base Erosion and Profit Shifting (BEPS) Action

Plan including the measures such as the country-by-country reporting and the transfer pricing rules.

**Double Taxation Agreements (DTAs):** Japan has signed 72 double tax agreements applicable to 79 jurisdictions, to avoid double taxation of income earned by residents of one country in the other country (The List of Japan's Tax Conventions, 2023).

**Tax Reforms:** Japan has implemented several tax reforms aimed at improving its tax system and increasing revenue. The recent international tax reform includes the introduction of the income inclusion rule. The Income Inclusion Rule (IIR) is a key component of the global minimum tax (Pillar Two) framework developed by the Organisation for Economic Co-operation and Development (OECD). It aims to ensure that multinational corporations (MNCs) pay a minimum effective tax rate of 15% on their global profits, regardless of where they are earned.

**Automatic Exchange of Information (AEOI):** Japan has fully implemented the Common Reporting Standard (CRS), which is the international standard for AEOI. This enables Japan to exchange tax information automatically with other countries, improving its ability to combat tax evasion and avoidance.

**Participation in international organizations:** Japan is an active member of the OECD and has participated in its efforts to promote international tax cooperation and the implementation of international tax standards.

On the other hand, Mongolia began improving its foreign taxation system and conforming to international standards in late 2017. Recent changes in Mongolian international taxation include the following:

**Base Erosion and Profit Shifting (BEPS) Action Plan Implementation:** Mongolia has taken steps to execute the BEPS Action Plan, to address tax evasion and avoidance by multinational corporations. This includes actions like the implementation of transfer pricing regulations and the establishment of country-by-country reporting requirements.

**Commitment to implementing Common Reporting Norm (CRS), the global standard for automatic exchange of information (AEOI):** Mongolia has committed to implementing the EOI standards. Furthermore, Mongolia has recently become a member to the multilateral Convention on Mutual Administrative Assistance in Tax Matters. This would improve Mongolia's capacity to fight tax evasion and avoidance by enabling automatic exchange of tax information with other nations.

**Implementation of BEPS actions into its existing tax treaties:** Between 1990 and 2004, Mongolia signed 26 double tax treaties (DTTs) with a number of nations to prevent double taxation on cross-border income and to encourage investment between the nations. To safeguard its network of treaties from aggressive tax planning methods, Mongolia has pledged to join the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (hereafter referred to as "MLI"). Mongolia has become the 100th country to join the MLI in October of 2022.

### 6.3. Income tax issues

The income tax laws in both Japan and Mongolia share a strong structural similarity, aligning with the fundamental principles of income taxation prevalent worldwide.

However, there are some distinguishing features regarding income classification for corporations. While Japan maintains a consolidated approach for corporate income, Mongolia employs an income classification approach with different tax rates for each income classification. Furthermore, Mongolia has different tax rates for withholding taxes for residents and non-residents. The idea is to promote incorporation of investments.

In this context, both countries should thoroughly examine the potential benefits and implications of establishing a new tax treaty to facilitate effective taxation of cross-border businesses.

### 6.4. Tax treaties

Double tax treaties are designed to prevent double taxation of income and provide guidelines for allocating taxing rights between contracting states which are parties to such agreements. In general, double tax treaties cover issues such as taxation of business income, dividends, interest, royalties, capital gains, and more.

By reducing the risk of double taxation, DTTs make international investment more attractive, encouraging businesses to expand their operations across borders. This leads to increased investment flows, job creation, and economic growth in both the source and residence countries.

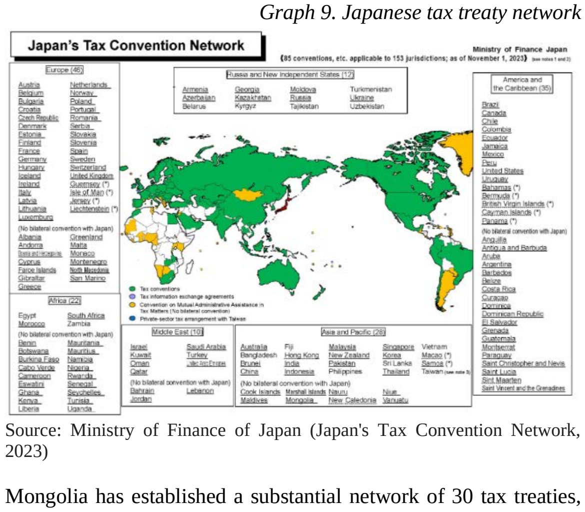
Double tax treaties also facilitate the exchange of information between tax authorities, enabling better identification and prevention of tax evasion and avoidance. This strengthens tax compliance and promotes a more equitable distribution of tax revenues.

Furthermore, double tax treaties establish mechanisms for resolving tax disputes between countries, avoiding costly and lengthy litigation. This enhances cooperation between tax authorities and promotes a more efficient and impartial resolution of tax disputes.

Japan has an extensive network of double tax treaties that encompasses 72 conventions applicable to 79 jurisdictions. As Japan is one of the OECD member states, Japanese tax treaties in general follow the OECD model convention.

Japan's recent double tax treaty with Algeria, signed on February 7, 2023, stands out as a noteworthy example of a tax treaty between a developed and a developing nation. The ratification of this treaty is currently pending approval from both parties.

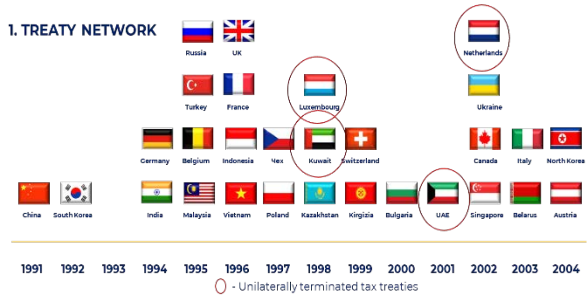
*Graph 9. Japanese tax treaty network*




Source: Ministry of Finance of Japan (Japan's Tax Convention Network, 2023)

Mongolia has established a substantial network of 30 tax treaties, encompassing most of its key trading partners. This comprehensive treaty network, relative to Mongolia's economic size, effectively eliminates double taxation and creates an attractive environment for foreign investment.

*Graph 10. Mongolia’s tax network*




Source: Mongolian Tax Administration (Mongolian Tax Convention Network, 2023)

However, the evolving international tax landscape, the booming mining sector, and the absence of source taxing rights in certain tax treaties have made Mongolia vulnerable to aggressive tax planning through tax treaty shopping. This would have resulted in substantial revenue losses that have adversely impacted Mongolia’s budget. In response, the Mongolian government has taken proactive steps to amend its tax treaties to safeguard its tax base.

Despite its efforts to renegotiate certain tax treaties, Mongolia resorted to unilateral termination of four double tax treaties in 2013. This decision was driven by the concern over zero withholding tax rates on passive income sources such as dividends, interest, royalties, and technical fees.

In the past decade, Mongolia has exercised caution in concluding new tax treaties, recognizing that its current network is extensive for a developing country. Additionally, domestic tax loopholes have been identified that could enable multinational corporations, particularly in the mining sector, to engage in tax avoidance practices.

Therefore, Mongolia has demonstrated a commitment to modernizing its tax environment by adopting a range of international tax developments, including the implementation of BEPS actions. Further demonstrating its commitment to international tax cooperation, Mongolia joined the Multilateral Convention to Implement Tax Treaty Related Measures (MLI) in 2021, with ratification expected by the end of 2024.

Mongolia’s tax treaty policy emphasizes source taxation, aligning closely with the UN Model Tax Convention.

Tax treaty with Japan will be one of the first since then. This is why this treaty is very important for us because it will determine the next 10 years of treaty negotiations. This is why we would like to align this potential treaty with our position.

Mongolia’s tax treaty position is heavily based on source taxation thereby strongly aligning with the UN model.

To foster a favorable investment climate for Japanese businesses in Mongolia, it is imperative for both countries to acknowledge each other’s viewpoints and work collaboratively towards mutually beneficial solutions. A comprehensive tax treaty could serve as the cornerstone of this cooperation, addressing taxation rights allocation, information exchange, tax collection assistance, and a robust mutual agreement procedure (MAP) for resolving tax disputes. The MAP would play a crucial role in eliminating double taxation, especially in transfer pricing cases, thereby instilling confidence among Japanese investors venturing into the Mongolian market.

### 6.5. Transfer pricing

While Mongolia has coded transfer pricing issues in its domestic laws including general tax law and corporate income tax law on 22 March 2019, which has been implemented since 1 January 2020, Japan already has vast experience in this field.

Furthermore, Japan’s Transfer Pricing Guidelines are fully aligned with the OECD Transfer Pricing Guidelines, which serve as a global framework for establishing appropriate transfer prices for various types of transactions, such as the sale of goods, provision of services, and licensing of intellectual property. The guidelines provide detailed methodologies for determining transfer prices and require companies to maintain proper documentation supporting their transfer pricing practices.

The Japanese transfer pricing guidelines recognize various methods for establishing arm’s length prices, including the Comparable Uncontrolled Price (CUP) method, Resale Price Method (RPM), Cost Plus Method (CPM), Transactional Net Margin Method (TNMM), and Profit Split Method (PSM). The appropriate method depends on the specifics of the transaction.

Furthermore, the Japanese guidelines require taxpayers to consider the functions performed, assets used, and risks assumed by each party to a controlled transaction when determining the arm’s length price.

The Japanese guidelines require taxpayers to use the most appropriate transfer pricing method, considering all of the relevant facts and circumstances. This is also true with the OECD guideline, where it encourages taxpayers to use the most appropriate transfer pricing method, after carefully considering the effectiveness of methods in that circumstance and the relative reliability of the methods under consideration.

The Japanese guidelines allow taxpayers to use the profit split method in certain circumstances, even if the controlled transaction does not involve the transfer of all or substantially all of the risks and rewards of the business activity. The OECD guidelines encourage taxpayers to use the profit split method if the controlled transaction involves the transfer of all or substantially all of the risks and rewards of the business activity. (Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2022)

The required retention period for transfer pricing documentation varies by jurisdiction, with most aligning with the statute of limitations for tax assessments. The OECD typically recommend countries to keep documentation for a minimum of five years (Toolkit to support the successful implementation of effective transfer pricing documentation requirements). In the case of Japan, the documentation requirement is seven years from the fiscal year end.

Furthermore, Japan is one of the most stringent countries when it comes to transfer pricing. This is due to a number of factors, including:

**A strong focus on protecting the domestic tax base:** The Japanese tax authorities are very concerned about ensuring that Japanese companies do not shift profits out of the country using transfer pricing manipulation.

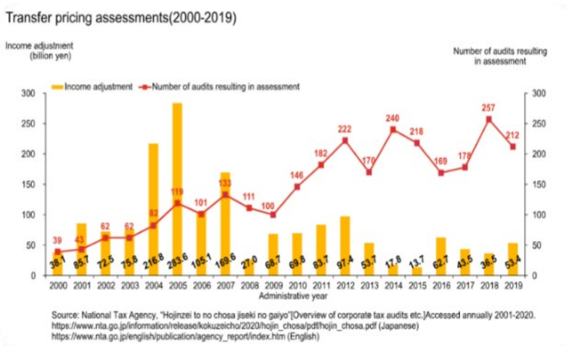
**A well-developed transfer pricing framework:** Japan has a comprehensive set of transfer pricing rules and regulations in place. These rules are based on the arm’s length principle, which means that transactions between related parties should be priced as if they were taking place between independent companies.

**A strong enforcement record:** The Japanese tax authorities have a history of aggressively enforcing their transfer pricing rules. This has led to a few high-profile cases in recent years.

As a result of these factors, Japanese companies are subject to a high level of scrutiny when it comes to transfer pricing. This can make it challenging for Japanese companies to do business internationally, but it also helps to ensure that they are paying their fair share of taxes.

Japan's remarkable success in transfer pricing is evident in the declining trend of total adjusted income and the rising number of transfer pricing audits. This indicates that Japanese taxpayers have become increasingly compliant with transfer pricing guidelines, leading to a more efficient and transparent tax system.

*Graph 9. Japanese transfer pricing assessments*




Source: PWC (Transfer pricing assessment, 2020)

Furthermore, Japan introduced Advanced Pricing Agreements (APAs) in 1987. This made Japan the first country in the world to implement such a procedure. APAs are a form of tax agreement between a taxpayer and one or more tax authorities that provide certainty about the transfer pricing methodology that will be applied to specific transactions between related parties for a fixed period of time.

The introduction of APAs in Japan was a significant development in the country's transfer pricing regime. APAs have helped to reduce tax uncertainty and compliance costs for Japanese taxpayers and have also improved tax planning and investor confidence.

The Japanese APA program has been very successful and the number of APA cases are significant. For instance, the National Tax Agency (NTA) received 188 new bilateral APA requests in 2021.

On the other hand, Mongolia has just implemented transfer pricing since 1 January 2020. Mongolia's guidelines are simple and generally in line with the OECD transfer pricing guidelines.

*Figure 4. Mongolian transfer pricing documentation statistics*

| STATISTICS | 2020 | 2021 | 2022 |
|---|---|---|---|
| Local file | 5,268 | 5,487 | 5,291 |
| Master file | 5185 | 5,443 | 5,241 |
| Annual TP report | 54,763 | 54,690 | 65,166 |
| **Total tax returns file** | 65,231 | 131,338 | 75,698 |

Source: Ministry of Finance of Mongolia (Transfer Pricing, 2022)

Since the introduction of transfer pricing regulations in 2020, the Mongolian tax authority estimates an additional 400 billion MNT in tax revenue.

While the implementation of transfer pricing regulations has helped Mongolia curb tax avoidance, particularly in the mining sector, foreign investors, including Japanese investors, have raised concerns about the clarity of Mongolia's transfer pricing rules. Many businesses contend that the Mongolian tax authority lacks expertise in certain aspects of transfer pricing and exhibits an aggressive approach in conducting transfer pricing audits. Additionally, some businesses allege that the tax authority is demanding transfer pricing documentation for domestic transactions, which is not a standard practice.

Drawing from Japan's extensive experience in transfer pricing administration, Mongolia could enhance its approach in the following ways:

**The importance of documentation:** Japan has strict documentation requirements for transfer pricing, and taxpayers who fail to comply with these requirements may be subject to penalties. Mongolia can learn from this and adopt similar documentation requirements to ensure that taxpayers are complying with the law.

**The importance of advance pricing agreements (APAs):** APAs are agreements between taxpayers and tax authorities that set out the transfer pricing methodology that will be used for a specific transaction or group of transactions. APAs can provide certainty for taxpayers and help to avoid disputes with tax authorities. Mongolia can consider introducing APAs to provide certainty for taxpayers and help to avoid disputes.

**The need for cooperation between tax authorities:** Japan has a strong network of tax authorities with which it cooperates on transfer pricing matters. This cooperation helps to ensure that taxpayers are complying with the law in all jurisdictions. Mongolia can learn from this and develop similar cooperation arrangements with other countries.

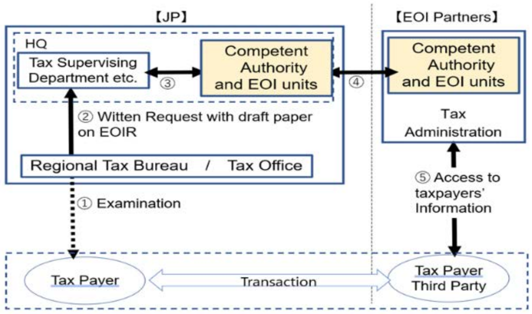
**Capacity building:** Building capacity in transfer pricing is essential for ensuring fair, efficient, and sustainable tax systems that support economic growth, promote responsible business practices, and contribute to achieving global development goals. Mongolia should undoubtedly draw upon Japan's extensive experience in nurturing and training tax officials to effectively address intricate matters such as transfer pricing.

### 6.6. Exchange of information

Japan is an early member of the Global Forum on Transparency and Exchange of Information for Tax Purposes, joining in 2009. As a testament to its commitment to international tax cooperation, Japan has implemented the key measures to facilitate the exchange of information for tax purposes and is one of the leaders on this issue in Asia. This has made Japan a valuable partner in the fight against tax evasion and avoidance.

Japan's tax authorities are committed to exchanging information with other countries to combat tax evasion and avoidance. Japan's tax authorities have a good reputation for being cooperative and efficient in exchanging information with other countries. Furthermore, Japan has established robust systems that facilitate seamless information exchange among all parties involved, including regional and national tax agencies.

*Figure 4. Japanese EOI scheme*




Source: Ministry of Finance of Japan

The exchange of information for tax purposes is a powerful tool that can be used to combat tax evasion and avoidance. The exchange of over 2.6 million information items annually empowers Japan's tax risk analysis system to effectively identify and mitigate tax avoidance risks.

*Figure 5. Japanese statistics on exchanged information*

JAPANESE EXPERIENCE

| EOIR | 2019 | 2020 | 2021 |
|---|---|---|---|
| Request | 613 | 638 | 639 |
| Requested | 233 | 251 | 128 |

| SEOI | 2019 | 2020 | 2021 |
|---|---|---|---|
| Receipt | 394 | 20,351 | 448 |
| Provision | 106 | 106 | 73 |

| AEOI | 2019 | 2020 | 2021 |
|---|---|---|---|
| Receipt | 2,216(K) | 2,019(K) | 2,600(K) |
| Provision | 1,345(K) | 1,338(K) | 1,419(K) |

Source: Ministry of Finance of Japan

Since ratifying the Convention on Mutual Administrative Assistance in Tax Matters in 2018, Mongolia has actively utilized the Exchange of Information on Request (EOIR) mechanism, demonstrating commitment to global tax cooperation. This proactive approach has resulted in over 70 requests for information from other jurisdictions and the successful recovery of over USD 2,000,000 in taxes.

Although this is insignificant in comparison to Japanese accomplishments, the actions underscore Mongolia's capability and determination to leverage international frameworks to enhance tax compliance and counter evasion.

Another significant step for Mongolia towards global tax compliance is the commitment to implementing the Automatic Exchange of Information (AEOI) standard by 2026, in line with OECD guidelines. This commitment will mark a substantial advancement in Mongolian tax administration, ensuring seamless and secure exchange of financial account information with other jurisdictions, including Japan.

In this regard substantial legislative reforms are underway to meet the objectives. These reforms include updating tax laws, enhancing data protection standards, and establishing frameworks for automatic information exchange. Our readiness to sign the Multilateral Competent Authority Agreement on the automatic exchange of financial account information by the end of 2023 further underscores Mongolia's dedication to these reforms.

In parallel to these legal amendments, Mongolia is also focusing on technological and administrative enhancements. This includes developing secure data transmission systems and providing comprehensive training to tax officials to effectively handle the new AEOI mechanism.

In conclusion, Mongolia's dedication to adhering to international tax cooperation standards through the Convention on Mutual Administrative Assistance in Tax Matters, EOIR, and the impending implementation of AEOI, reflects a deep commitment to enhancing tax administration and compliance. On this issue, Mongolia should seek Japan's help for experience and guidance.

## 7. CONCLUSION

Despite their close economic ties, with Japan being one of Mongolia's largest trading partners and investors, there remains significant untapped potential for further expanding economic cooperation between the two countries.

One promising avenue to enhance economic activity is the establishment of a double tax treaty, which would alleviate the tax burden on businesses and individuals operating in both countries. Such a treaty would provide clarity and predictability in tax matters, particularly in the intricacies of transfer pricing. This, in turn, would streamline tax planning for businesses and individuals, fostering greater investment and trade.

While the process of establishing a tax treaty between Japan and Mongolia is undoubtedly complex, the potential benefits make it an endeavor worth pursuing. A tax treaty would not only enhance certainty and predictability but also promote cooperation between the tax authorities of both countries, leading to improved tax administration and reduced tax evasion.

In addition to pursuing a tax treaty, Mongolia should continue refining its tax system to enhance transparency, efficiency, and fairness. A sound tax system is crucial for attracting foreign investment and stimulating economic growth. Furthermore, a well-designed tax system can contribute to poverty reduction and inequality mitigation.

To further facilitate economic growth, the governments of Japan and Mongolia should strengthen their collaboration on tax matters. This could involve sharing best practices and providing technical assistance. Enhanced government collaboration would undoubtedly improve the tax systems of both countries, making them more attractive to investors and businesses.

In conclusion, there is immense potential for expanding economic activity between Japan and Mongolia. A combination of a tax treaty, improvements to the tax systems of both countries, and enhanced government collaboration on tax matters could play a pivotal role in achieving this goal.

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### List of persons met

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| 1 | Akira Matsuoka | Deputy Director, Collection Division, National Tax Agency |
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