

# WHO IS TO BLAME FOR THE FLOODS?

II PAGE

*Chris Melville*

*Founding Partner at Melville Erdenedalai LLP,  
Registered foreign lawyer (England)*

# SOME TAXING QUESTIONS

IV PAGE

- **MINIMUM WAGE INCREASE**
- **BANKS INCREASE  
SHARE CAPITAL**
- **ABDUCTING THE  
DIRECTOR GENERAL  
OF TURKISH SCHOOL**
- **WORLD HEPATITIS DAY**

VI PAGE

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*This is a slightly tweaked version of a column I wrote exactly nine years ago. The flash floods of last week sent our city sinking in its sewage. This shows how the capabilities of our government have deteriorated over time, and there is no difference to how the authorities are acting. Are we going to spend another ten years breathing in and living in an environment polluted by sewage?*

**2009****2018**

## WHO IS TO BLAME FOR THE FLOODS?

The Economist, the well-known international news journal, starts each issue with the following: "First published in September 1843 to take part in 'a severe contest between intelligence, which press forward, and an unworthy, timid ignorance obstructing our progress.'" This fight, which started 166 years ago in England, is currently going full steam ahead in Mongolian society. Unfortunately, this has morphed into an unfair fight, where reasoning and intelligence are on the losing side.

There is a small group of people who pretend to care and prefer to keep the public away from the truth. They come to political power in turns and work with each other to skew people's perceptions, so that they become wealthy by stealing from public funds. These discreet and indecent actions of theirs are now causing serious implications for people's freedom and safety in Mongolia.

The most recent example is the flash floods that swept through Ulaanbaatar city in the last few days. This episode is only a reminder of the greater threat ahead.

A short but heavy rainfall turned into a flash flood in no time. It sent the city into turmoil, doing significant damage to people's properties and more tragically causing several deaths. The

flooding swept through ger districts located on Ulaanbaatar's hillsides, which resulted in sewage from pit toilets settling in the city's downtown. This was the reason why everyone's lungs felt polluted and eyes itchy when the sun emerged again. Regardless of living in gers or apartment blocks, people were trying to stop leaking water from their poorly constructed roofs and walls. Carrying buckets of water and feeling disgusted by the sewage, people succumbed to a feeling of despair and helplessness.

Helping people out and fixing the damaged roads should clearly be our immediate priority. However, the biggest challenge is what we must do in order to not repeat this and not let a few hours of rainfall bring disaster to our capital city.

If you listen to the authorities, they blame the whole thing on the forces of nature and demand more from centrally allocated funds. They will pretend to hold culprits accountable by issuing a few decrees or statements.

Unless the root cause of this problem is fixed, it will repeat itself next time we have heavy rainfall. But we know what the problem is – the governance crisis that is deep-seated in our government and society. Those who created this crisis are responsible for not only for the damage dealt by this flooding, but also similar

consequences that may arise in the future.

We have all seen how the authorities of Ulaanbaatar have been getting wealthier by trading public land instead of properly planning and developing our infrastructure. Senior officials in suburbs and districts have been abusing their power at their levels and been issuing permits everywhere. As a result, dams that were supposed to protect us from flash floods have been taken down, so that new buildings or fences could be erected. This means only a small amount of rainwater can cause significant flooding damage to our city. Furthermore, the majority of streets are now blocked by fences, preventing fire trucks from reaching their destination. This means that only a small fire could burn down an entire suburb.

*“ These disasters are the direct result of mismanagement by the Ulaanbaatar authorities who have been stealing from public funds instead of protecting and taking care of them. You reap what you sow. ”*

The city authorities have a strong interest in keeping Ulaanbaatar's infrastructure underdeveloped. If roads and sewage systems were built in the outskirts of the city, the land in the inner city would reduce in value, meaning they would no longer be able to make as much money from trading land.

*“ In a more general sense, if it didn't make profit or financial gain, there would be no one working in government. ”*

We all know how to escape this crisis in public governance – the culprits must be held accountable. The authorities understand this, however they are reluctant to do so because it

would also reveal their own abuses of power and secret connections.

If there are still clean-handed, righteous people left in those political parties, they must hold the guilty ones accountable and revive the reputation of their authority. This is how our society should progress. Otherwise, history will hold them accountable and these political parties should eventually disappear. Diseases can either be treated or die with the person.

*“ Intelligence always prevails over ignorance in the end. It is only a matter of time. ”*

One day Ulaanbaatar won't have any ger districts, and every family will enjoy proper housing connected to proper infrastructure and sewage systems.

This will be the day when corruption is gone. This will be the day when you can't become a city resident by building your ger or fence in a random location without any planning. Also, this will be the day when a few hours of rainfall doesn't cause flash floods in our city. We will be living in safe, securing housing without such worries.

But the question is, how soon will that day come?

*"Unuudur" newspaper 2009.07.28*



**Chris Melville**  
Founding Partner at Melville Erdenedalai  
LLP, Registered foreign lawyer (England)

ARTICLE

# SOME TAXING QUESTIONS



*A series of important changes to Mongolia's tax legislation, implemented as an adjunct to the approval of the State Budget in November 2017, are currently having a significant impact on FDI flows into the country.*

## Background

Effective from 1 January 2018, Mongolia introduced changes to its Minerals Law, Land Law, Law on Registration of Legal Entities and various tax specific laws, with the aim of increasing tax revenues by way of a 30% tax on the direct or indirect transfer of rights in land and minerals licences.

It was already the case that a direct transfer of a license or right itself would be subject to 30% tax, which led to the common practice of transferring shares in the Mongolian company holding such right in order to seek to reduce the tax burden to 10%, the standard basic Corporate Income Tax rate. In practice, the General Tax Authority had been treating any share transfers in Mongolian companies holding such rights as a deemed transfer of the right or licence and looking to levy tax at 30%.

While this addressed onshore transactions to an extent, the changes to the laws are significantly more far-reaching, and seek to capture the transfer of a controlling interest in land or mineral rights offshore, regardless of jurisdiction.

## What is being taxed?

The main objective of the changes is to impose tax on persons obtaining income from the indirect sale of Mongolian rights to a third

party. If this takes place offshore, for example by way of the sale and purchase of shares in a BVI company ultimately holding Mongolian mining licences, there would be no tax benefit to Mongolia arising out of the transaction.

## Implementation and Government leverage

The changes introduced a novel concept in Mongolian law of "beneficial ownership", a well-known feature of common law jurisdictions, but less so for civil law systems like Mongolia. The concept was first introduced in the Securities Market Law of 2012, in connection with the holding of shares by custodians or nominees on behalf of investors, but it is still relatively new to the Mongolian market.

In a development reminiscent of the SEFIL law of 2012, which sought to control foreign investment into strategic sectors of the Mongolian economy such as Mining and Banking, companies holding land or mineral rights were obliged to disclose their beneficial holders to the Mongolian authorities by a specific date, in this case, 1 June 2018. Failure to do so could constitute grounds for revocation of the licence.

The disclosure of "beneficial holders" to the State Registration body is designed to provide the underlying information on which the Mongolian authorities may act in the event of an indirect transfer of rights.



*“ Importantly, payment of the tax itself is the legal responsibility of the Mongolian company actually holding the land or mineral rights, enabling the Mongolian authorities to take direct action without having to take enforcement action offshore. In addition, the tax is to be paid within 7 days of the completion of the transaction resulting in a change of beneficial owner. ”*

## What are the concerns?

Both international and domestic trade organizations have expressed a number of valid concerns with the implementation and effect of these amendments. Some observations on the revised legislation include the following:

- The definition of “beneficial holder” is unclear and is based on the common law contractual concept of control, which includes the idea of directing control through management or assets. This leaves a significant amount of discretion.
- The current position is that in the case of a sale resulting in a change of control of shares, the tax will be assessed on the basis of the higher of the sale price and the valuation of the right itself. When acquiring a business, for example including land rights, these may only constitute a small part of the valuation of the business as a whole.
- The basis of valuation of the land right or mineral licence itself is unclear and open to varying interpretations.
- Offshore listed companies do not have control over trades in their shares. In certain cases, this legislation effectively acts as a “poison pill” in respect of M&A transactions for Mongolian assets, preventing the operation of a free market for offshore investors, and potentially limiting the development of the underlying assets themselves.
- A rate of tax of 30% is significant in any transaction involving Mongolian land and mineral assets, and operates as a disincentive to investment transactions.

- If the licence holder is made responsible for payment of the tax, it complicates group-wide accounting when the real benefit is offshore, and the time period for payment of tax does not allow for intra-group solutions to be put in place in a timely way.

## Conclusions

While well intentioned, these changes have been implemented with inadequate public and advisory consultation. It seems that the lessons of the 2009 Windfall Tax and the 2012 Strategic Investment Law have not been taken on board.

*“ Based on the general market reaction, instead of the desired effect of increasing Mongolia’s tax revenues, the principal outcome has been to disincentivize foreign and domestic investment, which overall will reduce the attraction of Mongolia as an investment destination and limit the vitality of the private sector, which should be the main engine for overall economic growth. ”*

Anecdotally, transactions relating to land rights and mineral licenses are now being put on hold, delayed, restructured or entirely reconsidered as a result.

A quick fix approach without proper stakeholder consultation has not stood the test of time, and this is the key takeaway from the tax law amendments. While speculative investment is always undesirable, it is hoped that these amendments will be removed or amended in a way that will facilitate the growth of the private sector, and not put the brakes on growth at a time when commodity prices are in an upward cycle and positive for the Mongolian economy.

July 2018



## DeFacto **REVIEW**

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### MINIMUM WAGE INCREASE

The Ministry of Labor and Social Protection proposed to set the minimum wage rate at 300 thousand tugriks, which is an increase of 60 thousand from its current level of 240 thousand tugriks.

In a country like Mongolia with more inflation than a normal economy of about 3 percent inflation rate per year, certain standards of wage don't meet to gain the required minerals and vitamins needed for the body. That is why Mongolia has a habit of establishing minimum wage like many other countries. The proposed amount will be minimum wage from now until next year, when there will be an increase in public officers' salaries.

The government has been discussing this potential increase with IMF, which means that this issue has extended from facilities in Mongolia. It would be more understandable if we were to increase salary for teachers and nurses in particular. Before increasing wage, we should know where we are getting the money. Money can be created from either increasing taxes, printing more money or borrowing more money from the bank, which ends up resulting in more printing. Therefore, we have to know which path to take.

Secondly, due to this increase, private companies will have to increase the number of temporary employees they hire. A minimum wage of 240 thousand tugriks means 1430 tugriks minimum wage per hour, whereas a minimum wage of 300 thousand tugriks will mean 1790 tugriks or 74 cents minimum wage per hour. In South Korea, the minimum wage per hour is 6.75 dollars, which is 8-9 times more than ours.

An increase in minimum wage means that up to 60 thousand tugriks' worth of taxes will disappear because the minimum wage is not taxed in terms of income taxes and social insurance. This means that an additional 14 billion tugriks will be needed to pay 192,000 public officers every year. Whether

this money should come from taxation or from decreasing other costs should be very clear and the government has not yet specified on that.

*“ Salary should be connected to productivity, of a company, an industry and a country. Unfortunately, productivity in Mongolia is not increasing because we are not creating new, competitive branches of economy although we keep talking about diversification. We are still very dependent on copper and coal price, which could trigger more inflation on the way. ”*

Inflation is the result of government work because government doesn't create value- they distribute values through taxation. For example, if the government is building a hospital or constructing road through taxation, then the person paying tax will consume less because he had paid. As a result, general demand for the product will not increase and may even decrease, so you can't increase price. So, if it is through taxation, it is normal in the economy, but if it goes through printing money or borrowing money, that makes an impact because some people are taking advantage as the purchasing capacity increases for the same amount of money and hence an increase in price. Therefore, inflation in a way is taxation, a work of the government and in some way, the name of stealing value from those who can't afford. In 1923, one U.S dollar was equal to 4.2 billion German marks and recently in Zimbabwe, they had to print 100 billion Zimbabwe dollars in bank notes.

*“ According to IMF, Venezuela's inflation rate is going to be 1 million percent by the end of this year. We have to learn from these examples and understand that printing and borrowing money will trigger more inflation. ”*

### BANKS INCREASE SHARE CAPITAL

Following an asset quality review conducted by the Bank of Mongolia, the banking sector needs to raise 2% of GDP, or 510 billion tugriks in equity. Banks are given until the end of 2018 to rectify this. Currently, 4 banks have raised enough money to purchase a quarter of the loop, which is 128 billion tugriks in owner's equity.

Mongol Bank has announced that there were 4 banks, but citizens want to know which banks have increased their equity and which have not, as it is the main concern of their savings. The owners of 7 banks have the right to know how their banks are doing, as well. Mongol Bank wants to keep it as confidential under the Stabilization of Banking Assistant. They should have certain responsibilities because what happens if these banks fail to save their customers' savings. According to

the law, savings insurance is only granted for savings of more than 20 million tugriks, meaning that if you have a saving of less than 20 million tugriks, you will lose everything. That is why Mongol Bank is responsible for people who have savings in those banks.

Where the raised 128 billion tugriks in question came from is unclear. Compared to the previous management, current Mongol Bank has a different approach to the public and social media. They give a press conference every month, release facts and explain people why and how. They announced that there was an increase in owner's equity, but we want to know which because there are certain owner's equity classifications. First-tier owner's equity is the owner's money and profit coming from the bank. Second-tier owner's equity is the re-evaluation

of commercial bank assets, which consists of certain collaterals and other assets they own, as well as second-payables. If the 128 billion tugriks of owner's equity are second-tier, then it is less reliable than the first-tier.

*“Savings account holders have the right to know and make a decision based on if each bank is increasing their owner's equity and which part of this owner's equity is increased.”*

Mongolia has recently introduced a new law that allows the state to inject money if commercial banks can't raise enough owners' equity by the end of the year. This not only uses tax

payers' money, but puts banks that can't pay their owner's equity at advantage to banks who can raise money from their own capital. The owner can buy the shares back after 2-3 years without paying any commercial interests. It is only fair to make sure that the share state injected to a commercial bank can't go back to the owner. Either it should go to foreign banks, or it should go to public companies. Then this money will come back to the state. Only with this understanding, people should accept the government injecting money to commercial banks that are not doing a good job and whose asset quality has decreased.

## ABDUCTING THE DIRECTOR GENERAL OF TURKISH SCHOOL

Mr. Akcay was temporarily abducted on Friday, in what appears to be the latest episode of a global campaign by the Turkish president to capture his suspected allies of the exiled cleric, accused of plotting the 2016 coup. Several hours after the abduction, the Ministry of Foreign Affairs issued a statement saying that the Mongolian government had ordered the grounding of the Turkish aircraft that was about to take Mr. Akcay away and that this abduction acts as an unacceptable violation to the sovereignty and independence, which Mongolia strongly objects against.

Mr. Gulen is blamed for the international network of Turkish schools in 150 countries by President Erdogan, but the U.S. doesn't accept this, so Mr. Gulen is still in the U.S. However, Turkey is abducting school leaders from around the world, which happened in Kazakhstan last year, the same way they tried doing it in Mongolia. Ordinary citizens of Mongolia are asking why foreign security are coming and arresting their citizen on our territory.

*“Another reason why we can't let this person go is because Mongolia is a part of an International*

*Convention against fighting and tortuize since 2000. According to this convention, if we think that there are enough bases that this person will be investigated and tortuized in his or her own country, we can't let this person go.”*

We have enough reasons to believe that Mr. Akcay will be tortured like the 70 thousand people that are in prison, according to the UN Human Rights Watch and a report on NY Times. After the 2016 coup, it was found out that torture was widespread.

When asked what happened, the Turkish ambassador said that “we have done nothing violating the laws of Mongolia”.

There are certain absolute provisions under the constitution that are not to be changed under any circumstances, including the one that says that we should not neglect a person's dignity and torture, even under war regime or in prison. Other incidents could have followed if we had let Mr. Akcay's abduction happen, so it is not only about Mr. Akcay- it is about other people who are saved from the dangers of being abducted, too.

## WORLD HEPATITIS DAY

Viral hepatitis B and C are major health challenges that affect over 325 million people globally and they are the root cause of liver cancer, which leads up to 1.3 million deaths per year. The Mongolian government has taken a couple of preventive measurements by implementing programs that focus on detecting, diagnosing and treating hepatitis.

The world is celebrating today, as we talk about the World Hepatitis Day. According to WHO statistics, 90 percent of people don't know that they have hepatitis. Mongolia has taken the first place on the list of countries with the most people

with viral hepatitis B and C in ratio to the total population. Last year, 53 thousand of 150 thousand people inspected were infected through a national program to diagnose hepatitis and because early diagnoses, Mongolia is on the right path.

*“Everyone should get checked for the virus and if they haven't, they should get vaccinated. Treatments for both viruses are available now, which tell us that the government is doing a good job.”*



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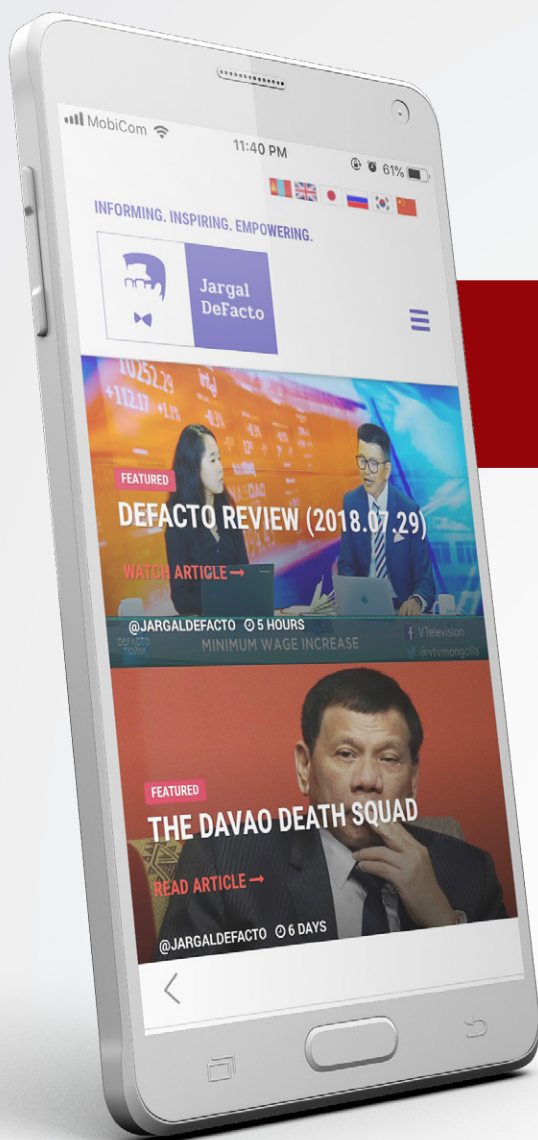
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*This review has been edited here for space and clarity. You can watch the full 30-minute review on the Defacto website [HERE](#).*





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✉ editor1@jargaldefacto.com  
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