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# Mongolia's New Investment Law

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# Mongolia reshapes its investment framework

On 3 October 2013, a new law on investment (the “**Investment Law**”) was passed by the Mongolian Parliament marking a significant development in Mongolia’s investment regulations. The law is intended to turn the page after the recent troubled history of foreign investment in the country. By repealing the controversial Strategic Entities Foreign Investment Law of 2012 (the “**SEFIL**”), which regulated investment in strategic sectors, the Mongolian Government now seeks to strike a better balance between promoting investment and protecting Mongolian interests. The outcome is an investment-friendly compromise overall, even though a few uncertainties remain.

## EXECUTIVE SUMMARY

### The Investment Law...

- Applies to both foreign and domestic investment
- Removes approval requirements for private foreign investors investing in sectors that were regarded as strategic sectors under the SEFIL
- Increases the minimum capital requirements for setting up a foreign-invested company in Mongolia
- Defines and specifies the legal framework for investments by foreign state-owned legal entities
- Lists new and existing incentives that may be granted to investors
- Contains various provisions on stabilization measures



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## I. OVERVIEW

On 3 October 2013, the State Great Khural enacted a new Law on Investment (the '**Investment Law**') effective from 1<sup>st</sup> November 2013. The new law replaces the Foreign Investment Law (the '**FIL**') and the Law on Regulation of Foreign Investment in Business Entities Operating in Sectors of Strategic Importance (the '**SEFIL**')<sup>1</sup>, both previously regulating foreign investments in Mongolia.

### Main features of the Investment Law

- The Investment Law unifies the regimes applicable to foreign investors and domestic investors<sup>2</sup> and places the supervision of such investment under a single Investment Agency under the Ministry of Economy and Development (see additional comments under section V below).
- The Investment Law offers a wide range of investment forms: incorporation of legal entities (including 100% foreign invested entities and incorporated joint ventures), acquisition of shares, bonds and other securities in Mongolian entities, mergers, concession, marketing, management or production sharing agreements, investing through finance leasing or franchise, and more generally any form of investment which is not prohibited by the law.
- Investors may invest in any sector of the economy, unless otherwise prohibited or restricted by other laws of Mongolia (i.e. illegal activities or activities subject to license such as banking and finance, security, justice, environment, health, etc.<sup>3</sup>).
- The Investment Law removed the mandatory approval process introduced by the SEFIL for

acquisitions by foreign private entities of Mongolian business entities operating in sectors of strategic importance, but ministerial approval is still required for large investments by Foreign State Owned Entities ('**FSOEs**') in the same sectors<sup>4</sup> (see point VI, §3 for additional details). Remaining requirements are limited to registration<sup>5</sup>, licensing or those set out in sector-specific legislations.

- The Investment Law simplifies the registration process for legal entities, since incorporating a company now only requires a registration with the State Registration Office ('**SRO**'), regardless of whether the entity is a Business Entity with Foreign Investment ('**BEFI**') or a domestic company<sup>6</sup>.
- The Investment Laws seeks to revitalize the Government policy of providing stabilization schemes to investors. Access to newly introduced stabilization certificates should be more systematic for investors, though the scope of stabilization is narrower. Extended stabilization remains available for the largest investments through stabilization agreements.
- There is a clear attempt to provide for a comprehensive overview of all incentives available for investors. However the possibility to obtain incentives listed in the law remains subject to conditions as provided for in specific laws.

<sup>1</sup>Article 2.1 of the Investment Law

<sup>2</sup>However the Investment Law does not apply to Mongolian State authorities; investments with State funding; donations or grants by international organizations, non-governmental organizations and private legal entities or individuals; or investment agreements in the nuclear energy sector which are subject to specific set of rules.

<sup>3</sup>Law of Mongolia on Licensing, February 1<sup>st</sup>, 2001, article 15

<sup>4</sup> Sectors of strategic importance are the same as under SEFIL: mineral resources; banking and finance; media and telecommunication.

<sup>5</sup>Pursuant to the Law on Registration of Legal Entities

<sup>6</sup> Under the FIL, BEFIs were subject to a two-stage process since it needed to be registered with both the Foreign Investment Regulation and Registration Department of the Ministry of Economy and Development ('**FIRRD**') and the SRO.

## II. LEGAL GUARANTEES AND OBLIGATIONS

### 1. Legal investments Guarantees

**The Investment Law reaffirms a number of Investment Guarantees**

- Guarantee relating to ownership rights: investors' assets shall not be unlawfully expropriated and, any expropriation shall be for public purposes, in accordance with due process of law on a non-discriminatory basis, and with payment of full compensation. This guarantee is also stated in article 6 of the Constitution of Mongolia. The Investment Law specifies that the compensation for the mobilized asset shall be valued at market price, however, it does not give any details about how such price will be determined.
- Guarantee relating to remittance overseas of capital and assets: Investors that have completed their tax obligations shall have the right to freely remit abroad profits, dividends, income from services provided and from intellectual property rights, principal of and interests on foreign loans, invested capital and proceeds left over after the dissolution of a business entity, as well as any other assets legally obtained or owned by the investor.

**The Investment Law introduces new investments guarantees:**

- Freedom to choose a domestic or international arbitration in case of a dispute relating to an agreement between an investor and the Government of Mongolia ('GoM'); and
- Protection of intellectual property rights owned by the investors.

The Investment Law aims to ensure the stability of this new legal framework and restore investor confidence by providing that any proposed amendment to the Investment Law shall be passed by a two-thirds majority of Members of Parliament. At first sight this may raise a constitutional issue as it clearly seeks to

bind future Parliaments. However, according to the Constitution itself, it may be possible for a law to depart from the general rule of the majority vote<sup>7</sup>, besides the current state of legislation includes a favourable precedent.

### 2. Investor obligations

**The Investment Law adds new obligations to the usual obligations regarding compliance with Mongolian laws (including laws on Taxation and on Social Insurance), as follows:**

- provide work and services and maintain accounting records in accordance with national and international standards;
- implement investment activities that are in the interest of customers, environmentally-friendly, and supportive of human development;
- provide training and improve professional skills of employees, introduce good corporate governance principles; and
- respect the traditions and customs of the Mongolian people.

Not all of these new obligations are sanctioned equally. For example, some of them are likely to give rise to administrative sanctions<sup>8</sup>, whereas others - such as those in respect of traditions and customs of the Mongolian people - rather resemble soft law<sup>9</sup>. Even if most of the unclear obligations have been excluded from the scope of administrative sanctions, there is still a chance that these can be used to discriminate against foreign investors.

## III. PROMOTION OF INVESTMENTS

### 1. Tax incentives

**The Investment Law provides several tax incentives including:**

<sup>7</sup>Under article 27.6 of the Constitution, decisions shall be taken by a majority of all members present and voting unless the Constitution and other Laws provide otherwise.

<sup>8</sup> Articles 7.2.1 - 7.2.5 and 7.2.8 of the Investment Law

<sup>9</sup> Articles 7.2.6, 7.2.7 and 7.2.9 of the Investment Law



- tax exemptions;
- tax discounts;
- accelerated depreciation and amortization that is deductible from taxable income;
- carry-forward of losses;
- deduction of employee's training costs from taxable income; and
- custom duties exemption and zero percent VAT rate for some equipment and technology imported during the construction period of projects such as power plants, railways and other plants for processing of construction materials and petroleum.

## 2. Other incentives

**The Investment Law provides several other incentives** related to land rights and immigration matters for foreign investors. Various other incentives have also been introduced, including: simplified procedures to obtain relevant permissions, financial guarantees, and new foreign labour quotas for the implementation of projects in the following sectors: infrastructure, manufacturing, science, education, innovation, or in the following zones: free trade zone, industrial and technological parks<sup>10</sup>.

**However, both tax and non-tax incentives are not automatically available to investors<sup>11</sup>, the obtaining of such being governed by other laws<sup>12</sup>. Hence, the access to these incentives is uncertain and is mostly subject to applicable laws and the discretion of the local authorities.**

More generally, the Investment Law neither states the time frame for amendment of referenced laws, nor precisely defines the extent to which it supersedes them.

As a consequence, the list of incentives provided in the Investment Law looks more like a guidebook for the benefit of public bodies than a valuable '*New Deal*' for investors, since it is very hard now to foresee how deep the change is going to be in practice.

## IV. STABILIZATION

**In order to offer certainty to investors regarding the tax environment, the new law intends to promote stabilization undertakings.** Even though this was already provided for in the legal framework, the Investment Law intends to renew the mechanisms by introducing two features instead of one: stabilization certificates and investment agreements.

### 1. Stabilization Certificates

For any investor investing in large-scale projects (from 2 to 500 billion MNT / USD 1.2 to 300 million), the Investment Law introduces a stabilization certificate ('SC') which aims to guarantee a stable tax treatment to its holder for an extended period of time (from 5 to 18 years).

#### • *Stabilized taxes*

The general rule provided in article 13.4 of the Investment Law is that if new tax rates are introduced during the period of validity of the SC, the holder shall benefit from any decreases in tax rates but not suffer increases.

However, the scope of tax rates included in the stabilization is limited to the following four taxes:

- corporate income tax;
- custom duty tax;
- value-added tax ; and
- mineral resource royalty<sup>13</sup>.

Under the previous regime, virtually every taxes incurred by investors in Mongolia were potentially subject to stabilization<sup>14</sup>.

<sup>10</sup> Article 12 of the Investment Law

<sup>11</sup> Under articles 11.1 and 12.1 of the Investment Law, the incentives "may be provided to the investors"

<sup>12</sup> See list of applicable laws in article 12.2

<sup>13</sup> Article 14.1 of the Investment Law

<sup>14</sup> Resolution n°24 of 02 February 2005 refers to taxes listed in the General Law on taxation

- *Conditions for stabilization*

To qualify for an SC, the investment must meet the following conditions:

- total amount of investment specified in the business plan and feasibility studies shall exceed minimum amount for investment specified in **Appendix 1**;
- if required by law, environmental impact assessment must have been carried out;
- investment shall create stable job places; and
- investment shall introduce advanced technologies.

The wording of these conditions is quite vague and therefore investors cannot assess in advance if they will be eligible for an SC. The decision will largely depend on whether the Investment Agency applies a broad or narrow interpretation of the conditions.

- *Amount of investment and period of stabilization*

The Investment Law provides for different stabilization periods depending on the contemplated sector and geographic location of the investment (stabilization is more favourable in less developed parts of Mongolia such as the Eastern and Western regions):

- for mining projects, heavy industry and infrastructure investments (see **Appendix 1, Table 1** for the complete chart), taxes may be stabilized from investments of MNT30 billion (USD17,5 million) and above, giving rise to a 5 to 18 years stabilization depending on the amount of investment. In the meantime, the investment must be completed (i.e. the committed investment amount has been fully and timely disbursed) in a definite period of time, ranging from 2 to 5 years;
- in other sectors (see **Appendix 1, Table 2** for the complete chart), taxes may be stabilized for investments of MNT2 billion (USD1.2 million) and above, giving rise to a 5 to 15 years stabilization depending on the amount of investment. Investments must be completed within 2 to 5 years.

- *Extension of the period of stabilization*

If investors cannot complete the investment within the specified time frame, they may be granted an extension of up to two years, provided the request is considered reasonable<sup>15</sup>.

The Investment Law allows for periods of stabilization to be extended by 1.5 times for certain priority projects<sup>16</sup> as follows:

- investment over MNT500 billion (USD300 million) to produce goods that are of special significance to the long term social and economic development of the country, which require a construction period of over 3 years;
- carrying out manufacturing operations that add value and exporting related products.

However, the criteria for extension of SCs are again quite vague, giving rise to uncertainty regarding the implementation of the law.

- *Procedure*

Applications should be made to the Investment Agency and shall include, amongst others:

- evidence that the above conditions are met;
- presentation of new technology to be introduced, if applicable;
- environmental impact assessment study if required;
- business plan for investments under MNT10 billion (USD6 million); and
- feasibility study for investments above MNT10 billion.

After receipt of the application, the investment will be assessed by an *ad hoc* council appointed by the member of the Cabinet of Ministers in charge of investment affairs. The Investment Agency shall make a decision within a 30 days period, which can be extended to 45 days. In case of refusal, the agency shall

<sup>15</sup> Article 16.5.A of the Investment Law

<sup>16</sup> Article 16.3 of the Investment Law

give a written notice to the investor, citing the grounds for refusal.

By introducing a binding time frame and an obligation to justify refusal, the Investment Law aims to make the issuance of SCs more clear and objective. This should result in more certainty in the issuance process and eventually more beneficiaries of stabilization undertakings.

- *Revocation of SCs*

SCs may notably be revoked on the following grounds:

- Full transfer of the investment outside of Mongolia;
- the beneficiary has obtained the SC by presenting false or illegal documents;
- following a merger or an acquisition, the new beneficiary does not satisfy the requirements set out above; Investment is not completed in due time.

## 2. Investment agreements

- *Conditions to enter in an investment agreement*

For investments above MNT500 billion (approx. USD300 million) an investor can apply for an investment agreement to be granted by the government<sup>17</sup>. Apart from general obligations applicable to investors, the Investment Law does not provide for specific requirements to apply for investment agreements. If the applicable conditions are not provided for in further regulations, it is likely that eligibility to enter into a stabilization agreement will be determined on a case by case basis.

- *Scope of stabilization*

The scope of stabilization is here broader than the one applicable to SCs. An investor may apply for every incentive provided in this law<sup>18</sup>, and also for incentives to stabilize its operation environment in general<sup>19</sup>. The interpretation of these provisions is likely to be quite

broad, as the GoM is supposed to provide for regulatory and financial support to the beneficiary of such an agreement.

- *Period of stabilization*

Under investment agreements, stabilization should be granted from 15 to 18 years, depending on the location and the sector of investment concerned (see **Appendix 1**, for complete charts). Extension of investment agreements is possible under the same conditions than those applicable to SCs.

- *Procedure*

The agreement is to be entered into with the member of the Cabinet of Ministers in charge of investment affairs. For the detailed procedure, a regulation on investment agreement is to be issued by the government.

Whereas SCs are quite precisely defined, and relevant procedures should probably be efficient in practice, investment agreements are still very little regulated. This leaves flexibility in the issuance procedures, hence room for decisions based on discretion.

## V. REGULATION OF INVESTMENT

The Ministry of Economic Development remains the main authority in charge of investment, with the following powers:

- ensure and monitor implementation of the Mongolian laws and regulations governing investments;
- formulate and submit to the Government of Mongolia draft investment policies; and
- issue approvals required for FSOEs to invest in business entities operating in sectors of strategic importance.

The creation of the state administrative agency in charge of investment affairs provided for in the Investment Law (the '**Investment Agency**') has been approved by the Cabinet of Ministers on 9 November 2013. Unlike the former FIRRD, the Investment Agency

<sup>17</sup> Article 20 of the Investment Law

<sup>18</sup> Art. 20.4 of the Investment Law

<sup>19</sup> Art 20.1 of the Investment Law

will be in charge of investments by both foreign and domestic investors.

This Investment Agency shall have the following obligations and powers:

- promote and advertise investment in Mongolia;
- promote the legal environment and favourable conditions for investment;
- provide services to investors, such as assistance to establish investment plans or provide assistance regarding other government services in relation to an investment; and
- issue stabilization certificates and follow up by monitoring and inspecting the activities of SC holders.

## VI. REMAINING UNCERTAINTIES REGARDING INVESTMENT CLIMATE

The outcome of fierce parliamentary debates and of several changes in the drafting commission's objectives is a quite obvious lack of coherence and clarity in the final drafting of the Investment Law. It is often difficult to comprehend the parliament intentions as some elements have been amended at the last minute. Even if the spirit of the law seems to be quite liberal, the leeway let to public bodies as well as textual inconsistencies might result in a quite protectionist implementation.

- *Inconsistent definition of investment:*

Pursuant to Article 3.1.2 of the Investment Law, an investment is defined as *"tangible and intangible assets invested in share capital of a legal entity carrying out profit-making activities in Mongolia as reflected in the financial statements"*.

This definition related to share capital of a legal entity' is very restrictive and inconsistent with the wide range of investments vehicles provided under article 5 of the Investment Law.

- *Consequences of the new definition of BEFIs*

While a specific chapter was dedicated to BEFIs in the FIL, the regulation of BEFIs in the Investment Law is

only provided for through its definition: *"A business entity which is established in accordance with the laws of Mongolia; in which foreign investor(s) hold(s) a 25% or more interest; and the capital contribution made by each foreign investor (shareholder) exceeds USD100,000 (or equivalent in MNT)"*.

This provision has been used by the SRO to increase the minimum capital requirement for companies which have more than one foreign shareholder, by requiring that each foreign shareholder contributes USD100,000.

Moreover, this definition is also detrimental to incorporated joint businesses between foreign and Mongolian investors, since every foreign investor holding a substantial stake in a Mongolian entity is now required to raise its contribution to USD100,000. A substantial number of small investors do not have the financial capacity to do so, which is also often the case of their Mongolian partners who wish to avoid dilution of their interest in the business. Offshore management of equity remains an option for foreign investors who want to limit their investment to USD100,000, without consideration of the number of foreign investors involved in the project.

As regards existing foreign invested companies, the law on the implementation of the Investment Law provides that once the certificates of such companies expire, they shall renew it according to the new capital requirements set out in the Investment Law.

- *Limitations to investment in strategic sectors*

The Investment Law provides that FSOEs<sup>20</sup> are still required to obtain the Ministry of Economy and Development's approval for any acquisition of at least 33% of the shareholding of a Mongolian-incorporated legal entity which operates in any sectors that were defined as sectors of strategic importance under the

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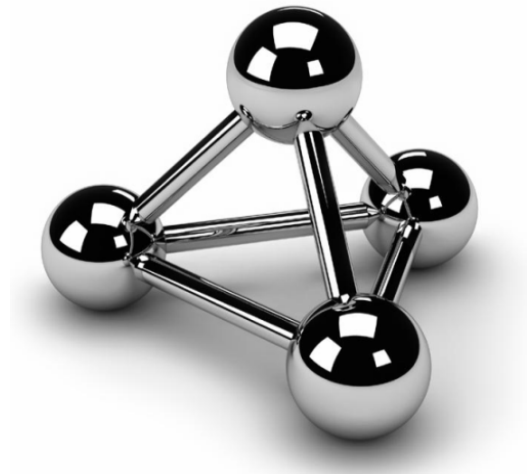
<sup>20</sup> Under article 3.1.11 of the Investment Law, a FSOE is a legal entity of which at least 50% of issued shares are directly or indirectly held by a foreign state.



SEFIL, including but not limited to minerals; banking and finance; media and telecommunications.

The controversial Parliamentary approval for the acquisition of more than 49% of the shareholding is removed. All approvals are given by the Ministry of Economy and Development and there is only one remaining threshold of 33%.

However, regarding criteria considered by the Ministry of Economy and Development in order to make its decision, the Investment Law maintains the same criteria than those provided in the SEFIL: Mongolian national security interests; ability of the applicant to comply with Mongolian legislation and established business practices; restrictions of competition; adverse impacts on budget policy and state revenues. Most of these criteria are quite general which leaves room for arbitrary decision-making.



## CONCLUSION

By repealing the SEFIL, the Investment Law apparently solves the main issue which led to the recent downturn in foreign direct investment in Mongolia. Having now one single law dealing with all aspects of investments is a significant improvement in terms of clarity, and the law tackles the issue of procedures and authorizations delays that have adversely impacted on business projects in the past years.

Most of the criticisms that can be raised eventually lead to one point, which is lack of precision. The Investment Law currently includes too many general provisions that cannot be applied as such by public bodies. In the meantime, authorities still benefit from a considerable leeway to promote or restrict investment on a discretionary basis. Time is then necessary to assess which approach the public authorities will take, hoping that they will follow the investment-friendly path drawn up by the State Great Khural.

## APPENDIX 1

**Table 1**

**Stabilization Certificates issuance period  
in mining operation, heavy industry and infrastructure sectors**

Volume of investment (in billions of MNT)	Issuance term of the Stabilization Certificate(in years)					Time for completion of the investment
	Ulaanbaatar region	Central region	Khangai region	Eastern region	Western region	
30 – 100	5	6	6	7	8	2
100 – 300	8	9	9	10	11	3
300 – 500	10	11	11	12	13	4
> 500	15	16	16	17	18	5

**Table 2**

**Stabilization Certificates issuance period in other sectors**

Volume of investment (in billions of MNT)					Issuance term of the Stabilization Certificate (in years)	Time for completion of the investment
Ulaanbaatar region	Central region	Khangai region	Eastern region	Western region		
10 – 30	5 – 15	4 – 12	3 – 10	2 – 8	5	2
30 – 100	15 – 50	12 – 40	10 – 30	8 – 25	8	3
100 - 200	50 – 100	40 – 80	30 – 60	25 – 50	10	4
> 200	> 100	> 80	> 60	> 50	15	5

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