Tax risk assessment and tax scoring reform

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Mongolian Tax Authority (MTA) has implemented a new functionality in its electronic tax system which allows, starting June of 2023, taxpayers to view their tax risk assessment and their tax scoring. With this tax and legal alert, we present you the highlights of the general tax risk assessment and tax scoring system implemented by the MTA.

General risk management principle introduced by MTA:

Per the General Tax Law (GTL) of 2020, MTA has been employing the risk-based approach when it comes to tax inspections. Consequently, the reform in the electronic tax system is introduced to promote transparency between the MTA and the taxpayers. Additionally, this enables the taxpayers to manage their own tax risk by providing them with the opportunity to identify and reduce factors that affect their tax score.

Tax Risk Assessment related legislation:

Law	The GTL, dated 22 March 2019, provides general risk management (“**RM**”) rules including the RM principles, stages of implementation of RM measures, and other principles such as the body that promulgates RM-related procedures.
Procedure	“Operating procedures of the Risk Management activities of the tax office and its Risk Management committee” approved by Ordinance #305 of the Minister of Finance on 31 December 2019, provides the underlying guidelines and framework for risk identification, assessment, management, and supervision of the risk management activities.

General Risk assessment (R) calculation formula

$$\mathbf{R} = a_1 \cdot R_1 + a_2 \cdot R_2 + a_3 \cdot R_3 + a_4 \cdot R_4 + a_5 \cdot R_5$$

a(1,2,3,4,5) - Percent weight on each indicator

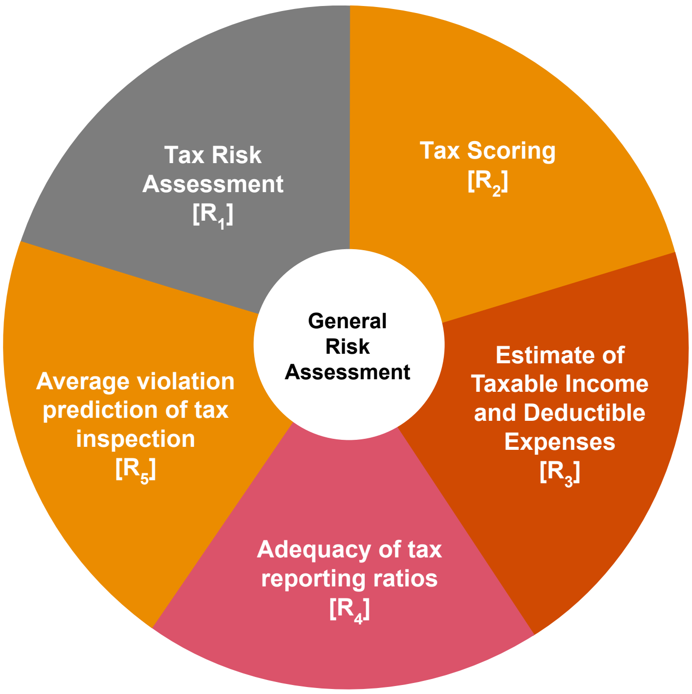
The general risk assessment is determined by multiplying the five factors by their respective weighted percentages and then summing the results. The risk score falls into the following different categories:

0 < risk score < 25: "Acceptable"
25 < risk score < 50: "Low"
50 < risk score < 75: "Medium"
75 < risk score < 100: "High"

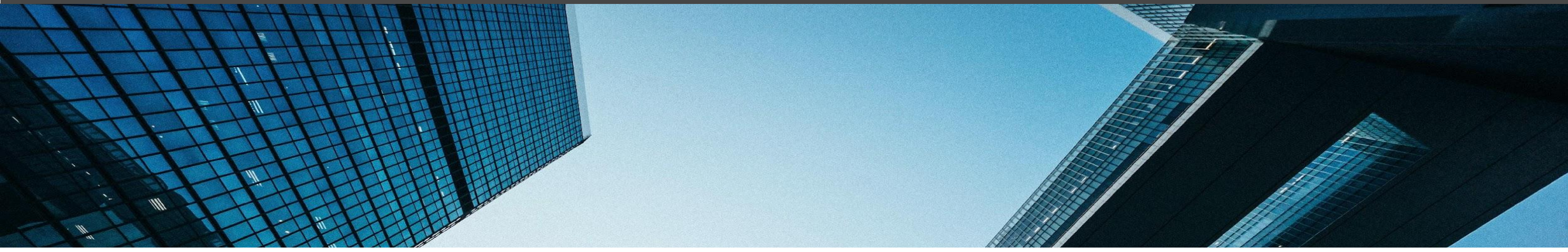
Taxpayers can access their general risk assessment through the electronic tax system.

The risk assessment encompasses factors such as industry risk averages and external data (i.e. financial reports, customs declarations), in addition to the entity's own operational record on reporting. All of the information is compiled at the MTA data warehouse, which is where machine learning and artificial intelligence (AI) are being used to calculate and assess individual taxpayer's risk.

For further details on tax risk assessment and scoring, please refer to the next page.



If you have any inquiries on the tax risk assessment and tax scoring or would like to obtain professional consultation, please do not hesitate to contact us.



(R_1) Risk Assessment detailed breakdown of scores

r_1, r_2: Sub-score based on taxable income and deductible expenses

Taxpayers are categorized into 4 segments (large, medium, small, and micro), and then they are ranked according to the amount of taxable income and deductible expenses.

/the higher the income higher the related risk assessment/

r_3: Sub-score based on differences

The higher the discrepancy between the amounts reported on the tax returns the higher the tax risk score.

Additionally, tax authority uses external information from various sources:

- Financial statements
- Payment receipts
- Customs information

r_4: Sub-score based on financial analysis

Based on the financial statements of the large-segment taxpayers, the following ratios are used to determine the rankings of the entities:

a. Financial stability
b. Solvency

r_5: Sub-scores based on regression analysis

Regression analysis will be performed on the historical data on bookkeeping, accounting, reporting, payments, and inspection results. Based on the results of the tax inspection report, the probability value will be the risk score.

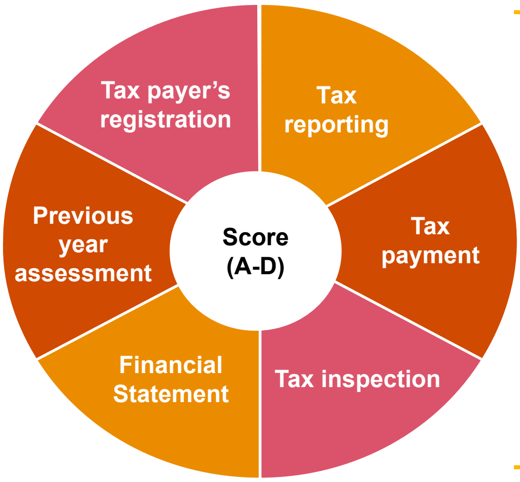
r_6: Sub-score based on industry average

The risk score is calculated based on the taxpayer's pre-tax profit level and how much the actual effective tax rate deviates from the average values reported in the taxpayer's operating sector.

The “Tax Risk Assessment" is calculated using the following formula using the above sub-scores. The cumulative score is an indicator representing the potential risk that the taxpayer may encounter in the future.

$$R_1 = a_1 \cdot r_1 + a_2 \cdot r_2 + a_3 \cdot r_3 + a_4 \cdot r_4 + a_5 \cdot r_5 + a_6 \cdot r_6$$

(R_2) Tax Scoring



Tax Scoring evaluates the taxpayer's adherence to tax laws and is determined based on six factors.

Grade Description:

- **A (90 – 100)** score is a guarantee of reputation.
- **B (80 – 90)**
- If a company did not operate during the reporting period or has no taxable income within the latest 4 years, it will automatically receive a **C (70 - 80)** score.
- Group company (If one of the companies within the group receives a **D (0 – 70)** score, all the other companies within the group will receive a **D** score as well.)
- Organizations with a **D** score are likely to be subject to tax inspections.

If you receive “D” rating, you are not eligible to receive an “A” rating in the next 3 years)

The tax scoring assessment is comprised of possible **106** deductible points. The table shows the maximum deduction points for each criteria:

Taxpayer's registration	-11
Tax reporting	-38
Taxation imposition	-10
Tax payment	-16
Tax inspection	-5
Previous year assessments	-11
Financial Statement	-15

To enhance and effectively manage tax scoring and tax risk assessment, taxpayers should ensure that they adhere to the tax laws, accurately calculate taxes, file tax returns promptly, and make timely tax payments.