Mongolian Tax Policy for Development SMEs

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Abstract

A strategic development of small and medium enterprises (SMEs) by providing an intensive support is becoming a main priority of the world's economy. Development of SMEs plays an important role not only in eradicating poverty and unemployment but also in increasing economic growth. In addition, SMEs development contributes significantly to lower inequality, support social stability and provide development of the private sector. Today, SMEs businesses are ran by middle class people, and is becoming the basis of sustainable economic development of many countries. 70-90 percent of total production in the developed countries accounts for small and medium enterprises (SMEs). In this paper the following will be discussed; What is the role of SMEs in the country's economy? How to support SMEs through tax policies? as well as analyzing the current state of taxation policy and its activities based on a number of policy studies of Germany and Italy under the Industry 4.0, which have been widely discussed in recent years, as well as quantitative studies on Mongolian SMEs and importance of SMEs support to achieve SMEs growth and sustainable development goals.

Keywords: *Economy, small and medium enterprises, tax system*

Introduction

SMEs play an important role in promoting market competition and accelerating economic growth. Developing into a bigger and more prosperous business while being able to compete in the world market are the proven advantages for essential economic development of small and medium-sized enterprises.

Small and medium enterprises are the key sectors that need to be developed, not only in Mongolia, but also in other countries. The development of small and medium sized enterprises has many advantages, such as raising the country's GDP, increasing employment, creating market competition and eliminating monopolies and stabilizing inflation. Particularly in countries with a large share of imported consumer goods, such as Mongolia, with a relatively low financial capital, low population (3.2 mln), unemployment (rate 9.7 / 2017) and poverty stricken (poverty level 29.6 / 2016) the development of small and medium enterprises are crucial to economic security. In recent years, Mongolia's economic and financial situation has been improving significantly compared to previous years in regards to a new policy of promoting small and medium-sized enterprises by the government in a multilateral way. Furthermore, it is planned by the government to adopt a multilateral policy such as to develop small and medium enterprises, creating local technology-friendly centers, to build national databases, to empower small and medium enterprises, to fully meet the needs of domestic markets, to export to foreign markets, and provide investment support and credit guarantee for businesses and individuals who are unable to access the loan due to lack of capital.

Taking a look at other countries, the main example is to choose one product to specialize and producing competitive commodity in the world market which in turn will help diversify the development of various small and medium sized businesses (Viral.M, 2012).

The issue of spatial diversification and concentration of small and medium enterprises has been raised today. The purpose of this study is to examine the current state of tax policy, its current state of policy support for SMEs, and to identify ways in which the sector will be able to maximize the effectiveness of the sector.

The research was done on the basis of philosophy, economics, general theory of management, market, financial and tax theory, observations, abstractions, induction, deduction and comparison methods were used.

The history and development of small and medium enterprises and their role in social economy

A small business is generally a revenue-producing or income-generating business within the law to improve living standards. Small businesses may be based on any form of ownership depending on the specifics of the country; the number of employees, and the capital amount. The government develops a policy that legalized criteria of income generation and categorizes them accordingly enabling a small business to operate.

It's also a compact in terms of the size of industry and workforce but also capable to recover its cost in a short amount of time. It's a form of low-cost, highly productive industry with flexible technology and ability to compete in the market.

According to the OECD, a medium-sized industry is limited in employees, with an independent and maximum frequency of 250 employees. Small enterprises generally have less than 50 employees, while micro-enterprises have at most 10 employees (OECD, 2005).

Although OECD has described the small business as above mentioned, each country has defined different levels based on their economic development, market size, state participation in business, employment status, and budgeting (Table 1). For example:

Table 1. Number of developed countries and

SMEs and employees in Mongolia

Name of country	Micro	Small	Medium
Europian union	1-9	10-49	50-249
United Kingdom	1-24	25-99	200
France	1-9	10-50	51-200
Germany	1-9	10-49	50-499
Italy	1-19	20-99	100-499
Japan	1-10	11-50	51-500
USA	1-24	25-99	100-499
Mongolia	1-9	10-50	51-199

Source: http://fxclubmongolia.blog.gogo.mn

The new definitions of the European Union have been applied since January 1, 2005, with a medium-sized enterprise (with 50-249 employees) not exceeding 50.0 million euros, small enterprises (10-49 employees) not exceeding 10.0 million euros and micro-enterprises (with less than 10 employees) not exceeding 2 million Euros (OECD, 2005).

Since the transition to a free-market economy in the 1990s, Mongolia started to change from a centrally-planned economic system to a social-economic relationship, with private sector enterprises emerging as a result of privatization of the industrial structure. Since then, small and medium enterprises in light industry manufacturing have emerged, such as retail and public services, food production, sewing and knitting shops.

The "Law on Small and Medium Enterprises" of Mongolia specified a medium enterprise and individuals as an entity with no more than 199 employees having USD 1.5 million[1] income from production and trading business; a small business entities and individuals are defined as those with no more than 49 employees with business income of USD 1.0 million[1]; a micro enterprise and individuals are defined as entities with no more than 9 employees and generating USD 0.250 million[1] income from production, trade and service. [2]

But the manufacture of tobacco and alcohol; paid quizzes, gambling games, lottery draws; banking, non-bank financial activities and insurance services; a business entity or an individual engaged in exploration and mining activities are excluded from the small and medium sized enterprises.[3]

The Government of Mongolia established SMEs policies and guidelines, developing "Law on Small and Medium Enterprises" in 2007 and establishing a Government Implementing Agency on "Small and Medium Enterprises" in 2008 and Small and Medium Enterprise Development Fund" in 2009. In addition, amendments to tax laws were made to exempt equipment's bought for small and medium-sized industries from customs and VAT, in 2015 "Law on Promotion of Industry", "Sustainable Development Concept-2030" and small and medium enterprise's projests were added. As a researcher, I determine the following phases of legal environment for small and medium enterprises have been established: 2007 was the first phase; the legal environment has been improving since 2012 and is still in the second phase of the sector development. Furthermore, in the future small and medium enterprises should be substantially developed.

As of 2017, 90270 small and medium-sized enterprises in Mongolia account for 69.0 per cent of total businesses, of which 92.8 per cent are micro entrepreprises.[4]

In regards of location, 66.5 percent are in Ulaanbaatar (capital city of Mongolia), and 33.5 percent are in rural areas.

In this sector, 800.0 thousand people are employed of which 88.6 percent are working in places with 1-9 employees, 9.6 percent with 10-50 employees, and 1.8 percent with 51-200 employees; making up 67.0 percent of the job market in total. All of these are accounted for 17.0 percent of total GDP and 40.0 percent of exports (Davaabayar.Ch 2018).

[1] converted to USD in 2007 at the rate of the Mongol Bank.

[2] Law on Small and Medium Enterprises of Mongolia, 2007, Article 5

[3] Law on Small and Medium Enterprises of Mongolia, 2007, Article 8

[4] Statistic data on the General Tax Authority of Mongolia, 2018

Mongolian researchers have concluded that small and medium enterprises should be trained to produce pure ecological products that meet international standards, increasing the type and quantity of export products, and making a space for Mongolia in the world market will be the key to develop the country.

Mongolian tax policy for SMEs

Recently, the general tax policy of the country is aimed at balancing the societal and economic structure and balancing many factors related to taxes. The views and opinions of F.Ramsey, J.E.Stiglitz, M.Friedman, T.Atkinson, and T.Utkina in the development of modern tax sciences are central. (Altanzaya.G, 2003)

Since the establishment of a tax system of Mongolia the taxation of the state's financial resources, Mongolian scientists and researchers have been studying theories since the centrally planned economy and market social transition period began.

When we examine how our tax legislation is supporting SMEs; crop and livestock production and related support activities; food production; manufacture of textile and apparel; the production of construction materials, and 90% discount on the operating income tax for only 4 sectors are reflecting that not all SMEs are covered entirely. In addition, in the three years that from the starting point of the Innovation law provides for the release of revenues from newly created innovation products, jobs and services, manufacturing and selling of small and medium-sized industrial equipment and spare parts; the reality is since the date of registration of production, and registration of sales in the state registry, economic benefits are not met and there are currently no other tax policy that supports SMEs.

Surveys shows that small and medium entreprises increased by almost 2.5% between 2007 and 2017, but on the other hand, taxes in 2017 were 9.1% of PIT, 10.9% of VAT and 3.8% of CIT payments by small and medium entreprises, showcases the level of development of this sector.[5]

Taxes such as Personal Income Tax, Value-Added Tax, and Corporate Income Tax are relatively small compared to other countries, but the same tax rate for all taxpayers does not support the development of SMEs.

In 2009, 2014 and 2017, Laws on VAT and VAT exemption for equipment and spare parts imported for the purpose of increasing the workplace and supporting small and medium enterprises and producing export-oriented products were approved. In 2009-2016, a total of 2899 small and medium-sized enterprises imported over 7000 equipment and spare

parts of 3201 different kinds of which all were included in the exemptions of value-added tax exemptions of 18.8 million USD and 40.0 million USD respectively however it is still considered to be on an insufficient level.[6]

In view of this, Mongolia's small and medium-sized industry sector policies and its poor implementation of mechanisms, social and political uncertainty, the environment of macroeconomics, inadequate tax policies, stagnation of investment and bad production levels are adversely affecting sector development .

[5] Statistic data of the General Tax Authority of Mongolia, 2018

[6] Statistic data of the Mongolian Customs General Administration, 2017

Today's world's policy tendency to support a manufacture is to have a private sector be a predominant, liberalizing all sectors of the economy, improving market regulation, and rapidl expansion of small and medium enterprises.

A key factor in the development of small and medium enterprises in developed countries is the active support of the state and the government becomes a unique tool for the creation of enterprises in the market, establishing and controlling the legal environment, promoting market activity, activating, protecting and managing market activities.

To do this, it is aimed at developing and implementing government programs, providing financial incentives, consulting, innovation-technological incubators, and providing more support for the younger people and women to be more involved in this business.

For the Government of Mongolia, the Law on Small and Medium Enterprises will require annual sales revenues of US $ 2.5 million[7], Corporate Income Tax rates should be reduced to 1 percent regardless of sector, simplified tax returns per year, to allocate funds equal to at least 10 percent of total investment to the sector, and micro entreprises can get a direct loan from the SME Development Fund. While this is a good news, but by learning about the experiences of some foreign countries that have developed small and medium enterprises, need to incorporate comprehensive tax exemptions into the tax code.

As countries around the world consider the "Industry IV" as a policy priority, our country has been paying special attention to this issue and has adopted this year "Three pillars of development policy" to create a foundation for the "Industrial IV" by the year 2020.

Factors and effects of Germany and Italiy's "Industry IV"

Despite talking about the "Industry IV" revolution in the world, let's look at the history of previous revolutions. These include:

In the XVIII century, the industrial progression began in England, as F.Encels called the "revolution of the industry" as its industrial revolution. The *1st Industral revolution*, which began in the late XVIII century into the early twentieth century, was introduced by the steam engine and into the production, and at that time the parodia (steam carts), paradox (steam-powered boats) were created, and strongly influenced the development of railways. As a result, rapid population change (urbanization), and many new occupations have led to dramatic changes in human society.

The *Second Industrial revolution*, which began in the early 20th century, is linked to the introduction of electrification and production into conveyors. As a result of this revolution, labor productivity has dramatically increased and the process of management has changed remarkably.

The *3rd Industrial revolution* is associated with electronic, industrial automation and information technology, and is basically started in the 70s-80s of the 20th century.

Today, however, the 3rd Industrial revolution is not yet complete, experts note that the signs of the *4th Industrial revolution* are manifesting increasingly.

[7] converted to USD in 2007 at the rate of the Mongol Bank.

Germany has initiated the new industrial revolution since January 2011, Professor K.Shab[8] says that these changes are not the continuation of 3rd Industrial revolution, but the beginning of the "Industry IV". The professor notes that the beginning of the 4th Industrial revolution is defined by the following three: First, *the speed of change*; Secondly, *their amplitude*; Third, *the consequences of these changes*. The "Industry IV" can be called digital or the era of the electronic revolution.

Speed of change: These changes are not linear, but increase growth. Everything in the world with globalization and interdependence is rapidly developing.

Their amplitude: The revolutions cover all sectors of the biosphere, genetics, energy and transport sectors, not limiting to a single sector.

Consequences or systemic effects of these changes: This will cover all systems to fully transform countries, companies, industries and societies, along with the unprecedented changes affecting the economy, politics and society.

One of the characteristics of the "Industry IV" is the recognition of development change for the first time before the end of the revolution.

In addition, in Germany, the project is managed by the government at "top" which is said to be a slow process. currently three major participants represent the revolution. These include:

The Federal Government, the Ministry of Education and Research (BMBF) and the Ministry of Economics and Technology (BMWi) of Germany leading in this team.

The research team is led by the Fraunhofer-Gesellschaft Society.

Business and industry team, representatives of Germany VDMA and ZVEI trade unions.

Just like any process, it took over two years to work on developing a number of agreements, working groups, and developing plans and recommendations.

The foundation of the project is to identifying those who are interested, combining, communicating, and creating public opinion.

This revolution is technologically advanced, and the number of network devices is expected to surpass the world population by 2020, one source say 26 billion and another other source estimates that it will reach 50 billion.

The first economic outcome is that the technologycal industry has been growing by 20 percent annually and reached 4 billion euros in 2015 and is expected to reach 7.1 billion euros in 2018.

According to these technological advances the value added will be expected to reach 153.0 billion euros in 2015-2020 and € 425.0 billion in 2025.

The German Academy of Sciences is expecting industrialisation to increase by 30% in Germany and 20% in other countries. (Ranger Gleath and Bernhard Digner, 2018)

The economic impact of the "Industry IV" is dependent on the following factors:

[8] Swiss scientist, Founder of the World Economic Forum, the initiator of "Industry IV"

Production Optimization: One product ("Losgröße 1" or 1 product flow) is combined with the advantages of mass production based on customer needs.

The new business model: The processes, components of the resource chain, even the products themselves create information, sharing information, i.e. the products and machines will become "smart" and use "Big data" analysis, artificial intelligence will play an important role.

Business modules based on digital platforms: Increase the number of users (for example, Amazon) to offer a large number of platforms to the market, which will be in the near future.

Italy has developed "Impresa 4.0" National plan for the new industrial revolution and the following amendments to the 2017 Budget Law have been implemented by January 1, 2017. These include:

Hyper and super depreciation: Supporting and offering incentives to companies that invest in new capital goods, tangible assets and intangible assets (software and IT systems) for the technological and digital transformation of their production processes

Nuova Sabatini: Supporting businesses requesting bank loans to invest in new capital goods, machinery, plant, factory equipment for use in production and digital technologies (hardware and software)

Tax credit for R&D: Encouraging private investment in Research and Development for product and process innovation to ensure the competitiveness of enterprises in the future

Patent box: Making Italian market more attractive to long-term domestic and international investors by offering a special rate of taxation for imcomes deriving from the use intellectual property

Innovative startups and SMEs: Supporting innovative enterprices at all stages of thier life cycle, sustaining the development of Italy's startup ecosystem

Guarantee fund for SMEs: Supporting businesses and professionals who have difficulty accessing bank loans because they do not have sufficient guarantees

ACE – Allowance for corporate equity: Offerring an incentive for strengthening the equity structure of Italian enterprices through financing with own capital, in ordeg to achieve a better balance between source and uses of expenditures and risk capital and debt, that will make them more competitive

IRES Corporate income tax, enterprise income tax (IRI) and cash accounting: Reducting fiscal pressure for companies that invest in the future by keeping profits in the company –

Productivity wages: Foster industrial policy targets, with particular regard to the National Plan Impresa 4.0 and increase the competitiveness and productivity of the national economy

Although these are defined in a general sense, these measures are regulated by tax policy. (Ministry of Eonomic Development, 2016)

The results of the new industrial revolution in 2017 show:

Macroeconomic trends: GDP +4.3%, Industrial production +8.0%, emplyoment +953,000;

Finance for growth: 302.700 limited companies used tax credit in 2015, totaling 18.9bn euro (claimble ACE); 728 registreted innovative SMEs; 435 agreements, of whcih 431 in 2017, tax incentive applied on 320.0 bn euro, for 620 firms; in 2017, the refinincing of the Guarantee Fund for 1 bn euro allowed to issue guarantees towards SMEs for 17.5 bn euro;[9]

The experiences and developments in these developed countries have attracted the current attention of many countries.

Discustion and conclution

It is a good idea to provide a large number of discounts and exemptions to support small and medium enterprises with tax policies, however it is also important for policy makers and researchers to discuss a way to find the source of revenue that is adequate.

In addition to supporting tax policy in small and medium-sized enterprises, the development of a comprehensive legal framework for small and medium enterprises and a comprehensive government policy aimed at creating favorable financial, loan and investment conditions will be a step towards greater results.

At the World Economic Forum in Davos 2016, Marc Benioff director of "Salesforce" said that "...there should be a minister in charge of the future matters" (Adiyasuren.B, 2016) taking into account the structural changes of the state will also contribute to the development of the sector.

The Mongolian National Development Agency aims to create a diversified, centralized production development through the creation of a logistical principle based on the Big Data data creating spatial planning based on logistics principles of Mongolia's small and medium enterprises, with the financial support of German GIZ. The Government has developed a "Three pillars of development policy" for the purpose of promoting the development of small and medium enterprises in the agricultural sector. According to statistics of 2017, 65 million heads of livestock are counted and over 20 heads of livestock per person. In particular, tax policy support for employees in agriculture is particularly challenging.

At the end of the survey, the adoption of a comprehensive tax policy supporting small and medium enterprises is expected to bring the sector's development to a new level. These include:

• Long-term socio-economic stability will form.

• Increasing employment and reducing unemployment.

• Establish the foundations for a major national manufacturer.

• External trade balance improves as imports decrease and exports increase.

• Increased production in GDP and economic growth.

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