



MALDIVES

TECHNICAL ASSISTANCE REPORT—MODERNIZING THE GOODS AND SERVICES TAX

June 2022

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Maldives

Modernizing the Goods and Services Tax

Maria Coelho, Lee Burns, and Peter Mullins



Technical Report

March 2022

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ABBREVIATIONS AND ACRONYMS

B2B	Business-to-business
B2C	Business-to-consumer
BPT	Business Profit Tax
BPTA	Business Profit Tax Act
CD	Capacity Development
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization
GAAR	General Anti-Avoidance Rule
GDP	Gross Domestic Product
GGST	General Goods and Services Tax
GST	Goods and Services Tax
GSTA	Goods and Services Tax Act
HIES	Household Income and Expenditure Survey
IMF	International Monetary Fund
LVIG	Low-Value Imported Goods
MIRA	Maldives Inland Revenue Authority
MOF	Ministry of Finance
OECD	Organization for Economic Cooperation and Development
OTA	Offshore Travel Agent
P2P	Peer-to-Peer
SAARC	South Asian Association for Regional Cooperation
SME	Small and Medium Enterprise
TAA	Tax Administration Act
TGST	Tourism Goods and Services Tax
TPU	Tax Policy Unit
VAT	Value-Added Tax

PREFACE

In response to a request from the Maldivian Ministry of Finance on October 17, 2021, a remote technical assistance mission was conducted during January 6-24, 2022, comprehensively reviewing the existing Goods and Services Tax (GST) legislation and proposing concrete priority reforms to be included in a GST Act amendment. This mission of the International Monetary Fund's (IMF) Fiscal Affairs Department (FAD) comprised Ms. Maria Coelho (head), Mr. Lee Burns and Mr. Peter Mullins (both FAD external experts).

The mission had several rounds of productive discussions with the following officials and members of their staff: Minister of Finance Ibrahim Ameer and Mr. Ahmed Saruvash Adam (Ministry of Finance, MOF), Ms. Mariyam Juwairiya, Mr. Arshad Jameel, Ms. Aishath Hasna Ahmed, Mr. Mohamed Raaidh, and Ms. Nadheema Latheef (Tax Policy Unit -TPU - members and consultants). The mission also met with staff from the Maldives Inland Revenue Authority (MIRA), including Commissioner General Fathuhulla Jameel, Ms. Asma Shafeeu, Mr. Mohamed Ali Waheed, Ms. Aminath Zumra, Ms. Mariyam Jaidha, Mr. Ibrahim Rasheed, Mr. Ali Muaaz, Mr. Hussain Amir, and Ms. Fathimath Amaanee Khalid. The mission met with multiple representatives from the Ministry of Economic Development, Ministry of Tourism, and USAID consultants to MOF. Finally, the mission also met private sector representatives including PwC Maldives, CTL Strategies, S&A Lawyers, the Maldives Association of the Tourism Industry, the Maldives Association of Travel Agents and Tour Operators, and the Maldives National Chamber of Commerce and Industry.

A half day workshop was provided to the authorities on international best practice for Value-Added Tax (VAT) coverage of the digital economy, with participants from MOF, MIRA and the Tax Appeal Tribunal.

The mission is grateful for the collaboration of the authorities and the efficient support provided in organizing and facilitating the discussions.

This report contains the mission's findings, incorporating consultations with the authorities.

EXECUTIVE SUMMARY

This report reviews the Goods and Services Tax (GST) regime in the Maldives and identifies policy and legal reform options to support its modernization, as well as enhancing efficiency, equity, and revenue mobilization. Despite five existing amendments to the Goods and Services Tax Act (GSTA) and 28 amendments to the associated regulations, the core parameters of the GST have barely changed in nearly 12 years. In addition, rapid changes to global business models and the increasing digitalization of the Maldivian economy have made key features of the legislation – such as place of supply rules – increasingly inadequate. The mission identified several key GST policy reforms and proposed legal redrafting recommendations that should be prioritized by the authorities in the upcoming reform window. Table 1 summarizes the potential revenue implications and implementation timeline of the main policy measures proposed.

The GST is a workhorse for Maldivian tax revenue collection, but its efficiency is undermined by a series of design and implementation flaws. Despite relatively low rates by international comparison, GST revenues represent nearly half of all government tax revenue in the Maldives, with one of the highest measured collection efficiencies in the world. Notwithstanding, behind that strong revenue collection are several design and implementation weaknesses that severely hamper the GST's impact on economic efficiency. In particular, the lack of contemporaneous refunds of excess input tax credits and the amortized crediting of GST on capital equipment are particularly detrimental to exporters and capital-intensive sectors. In addition, the current design of the GST effectively exempts imported goods and services, leading to a bias in intermediate input supply away from domestic providers, as well as opportunities for revenue leakage. Moreover, a relatively low GST registration threshold and lack of an alternative presumptive regime for SMEs contributes to elevated compliance costs for small businesses, as well as administrative burden for MIRA.

Reflecting the composition of the Maldivian economy, GST revenues are heavily reliant on the tourism sector, which is liable for GST at double the general GST rate. The dual rate design has been a distinctive characteristic of the Maldivian GST since its introduction, as it originally replaced and broadened the base for a previously existing tourist accommodation tax, while reducing reliance on customs tariffs. With few exceptions, the dual rate structure has thus far functioned without substantial distortions, given inelastic demand and robust economic rents for high-end tourism in the country, and the high degree of segmentation between the tourism and domestic markets. From 2024 onwards (once global inflationary pressures abate), the authorities should consider gradual increases to both the general and tourism GST rates, which has substantial revenue potential. A gradual closer alignment of the two rates in the long-term should also be considered, depending on the growth of the homestay and guesthouse accommodation in otherwise inhabited islands, and an assessment of administrative and enforcement concerns.

Most exemptions and zero-rating of goods and services in the Maldives are regressive but rationalizing many of them requires a comprehensive review of direct subsidies and social assistance programs. In general, the types of goods and services exempted or zero-rated in the GSTA are within the international norm, if somewhat generous. However, a recent household incidence study has shown that except for zero-rating of basic food items, most other tax expenditures (including residential rent, electricity, fuels, domestic flights for residents, education, and water services) disproportionately benefit the richest quintiles. While rationalizing them along with direct cash transfers of equivalent or smaller magnitude is expected to have a poverty reducing effect, doing so would require a revision of the existing direct retail price subsidies to various imported foods, as well as fuels and electricity. In addition, the current social assistance system may not yet be sufficiently developed to ensure adequate compensation of the most vulnerable households to some potential price increases. Notwithstanding, some narrower exemptions could be eliminated more swiftly (e.g., commercial leases, certain financial services, de facto exempt domestic transport). More broadly in the short run, at a minimum the mission recommends not expanding the current list of exempt and zero-rated goods and services.

Expanding the coverage of the GST to digital goods and services will require the development of mechanisms to give effect to the destination principle for such transactions. Widespread internet usage is underpinning growth in e-commerce, including online platforms and marketplaces domestically, as well as online transactions between offshore sellers and foreign tourists for services ultimately consumed in the Maldives that fall, in practice, out of the scope of the current GST. For both cross-border digital services provided directly to final consumers (B2C) and low-value goods imported from online marketplaces, the vendor collection model should be adopted. That includes the growing segment of sales of tourist packages and accommodation by offshore travel agents (OTAs) and online platforms re-selling those services to tourists visiting the Maldives. In turn, all cross-border digital services (as well as imported goods and services more generally) provided to GST registered businesses should be subject to a reverse charge rule, currently absent from the legislation.

Given the extensive character of reforms proposed, the authorities should consider a full redraft of the GSTA, incorporating in it provisions currently scattered over regulations, tax rulings, and the Tax Administration Act (TAA). A sixth amendment of the GSTA could still be used to pass some key reforms, but the law would be less ambiguous, most harmonized with secondary legislation, and thereby most taxpayer friendly (leading to less litigation) if a full redraft were considered.

Table 1. Revenue Impact and Timeline of Main Policy Recommendations

Recommendation	Timing 1/	Revenue Impact 2/ (% of GDP)
GST Rates		
Increase GGST Rate to 8-10 percent	MT	0.9-1.8
Increase TGST Rate to 14-15 percent	MT	0.9-1.3
Align GGST and TGST Rates	LT	++
GST Exemptions and Zero-Rating		
Review and rationalize exemptions and zero-ratings:		<2.0
• Remove exemptions for public utilities	MT	+
• Remove exemption for postal services	ST	+
• Narrow scope of financial services exemption	ST	+
• Tax all domestic transport services	ST	+
• Zero-rate rather than exempt international transportation	ST	-
• Consider taxing donor funded projects	MT	+
• Remove exemption for commercial leases	ST	+
• Assess whether zero-rating of essential goods could be replaced by targeted subsidies	MT	+
• Ensure other ministries and government agencies cannot grant GST concessions	ST	None
Resist pressure to expand exemptions and zero-ratings	ST	None
Impose GST on imported goods and services	ST	0.87
GST and the Digital Economy		
Extend GST coverage to digital services through reverse charge for B2B and vendor collection model for B2C	ST	0.1
Extend GST coverage to low value imported goods through vendor collection model	ST	0.1
GST on Offshore Booking Platforms		
Treat a supply of inbound tourism products and booking services related to these products as a supply in the Maldives	ST	0.2
Other Reforms		
Introduce a presumptive tax at 2 or 3 percent of turnover on small businesses along with a higher registration threshold of MVR 1.5-2m	MT	+
Allow for full refunds of excess input tax credit claims	ST	<-0.2
Legal Framework		
Reform the GST legislation preferably through a rewrite	ST	None
Eliminate both payments and hybrid accounting	ST	None
Include a general anti-avoidance rule in the GST Act	ST	+
Provide a GST simplification rule for joint ventures	ST	None
Provide that a supply of digital currency for goods and services is as supply of money or an exempt supply of financial services	ST	+
1/ ST-Short term (12-18 months); MT-Medium Term (2-5 years); LT-Long Term (>5 years)		
2/ + small revenue gain; ++ significant revenue gain; - small revenue loss; -- significant revenue loss		

I. INTRODUCTION

1. **High deficits and elevated debt positions over the medium-term jeopardize fiscal sustainability in the Maldives.** The fiscal deficit is projected to remain in the double digits as a share of GDP until 2022, and the country currently stands at a high risk of external and overall debt distress. Moreover, the Maldives needs stronger revenue mobilization to support an increase in infrastructure spending that can promote inclusive and climate change resilient growth. However, the high dependence on tax revenue from the tourism sector (which suffered a sharp blow in the early months of the COVID-19 pandemic but has since partially rebounded) makes the broadening of the tax base in the Maldives challenging. Therefore, IMF staff and the authorities concur the medium-term policy focus should shift to diversifying the tax base towards domestic (non-tourism sector) sources.

2. **Tax revenue was hit hard during the pandemic by the losses in tourism.** Total revenue declined by 32 percent in 2020 relative to 2019, despite the multiple positive tax policy reforms in the past couple of years. Since 2019, the Maldives has undertaken notable tax policy reforms (in part supported by IMF capacity development (CD)), including setting up a Tax Policy Unit, introducing a Personal Income Tax, abolishing tax incentives under the Foreign Investment Act, and implementing international minimum standards for corporate income taxation. There is positive political momentum, but more progress remains to be done on the indirect tax front. Despite downside risks to tourism inflows associated with COVID's Omicron wave, macroeconomic indicators (including tax revenues) are expected to rebound to pre-pandemic levels by 2023.

3. **Against this background, the authorities are pursuing an amendment to the Goods and Services Tax Act (GSTA), aiming to enhance its efficiency and revenue capacity in a world of increasing digitalization.** The recommendations of this report, along with those of other IMF tax policy and revenue administration CD reports in 2020 and 2021, can serve as building blocks for the development of an integrated Medium-Term Revenue Strategy for the Maldives. Beyond another amendment, undertaking a full redrafting of the GSTA and regulations at this juncture would be pivotal to establish a taxpayer friendly regime fostering economic diversification, and ensuring broad-based revenue sources post-pandemic – in line with the objectives of the authorities' 2019-2023 Strategic Action Plan. Notwithstanding, implementation of new revenue mobilization measures should be delayed until 2023 at the earliest, in order to mitigate any temporary contractionary effects.

4. **A comprehensive GST reform as proposed in this report is expected to have a positive net impact on the Maldivian economy.** A fully functioning excess input tax credit refund mechanism (particularly beneficial to exporters), along with GST coverage of imports should lead to an improvement in the current account. Higher medium-term tax rates on consumption can encourage greater domestic private saving and immediate refunds of GST on

capital inputs can support investment. And despite a small one-off upward price adjustment, the policies recommended are unlikely to lead to permanently higher inflation rates.

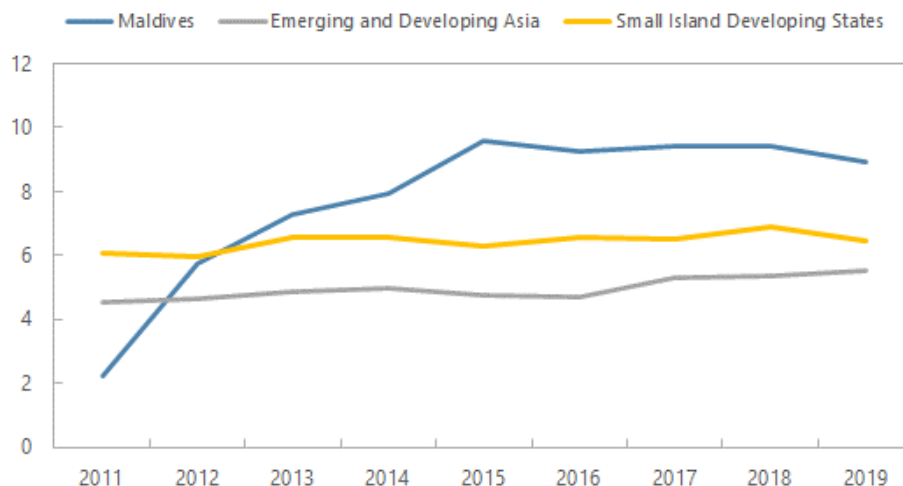
5. **This report reviews the overall design of the Goods and Services Tax and explores reform options for the Maldives.** The revenue productivity and taxpayer characteristics of the current system are summarized in Section II.A. Section II.B outlines tax policy reform proposals regarding the harmonization of taxation in the tourism and domestic sectors, while Section II. C. reviews rationalization options for exemptions and zero-rated goods and services. Section II. D. focuses on the treatment of digital transactions of goods and services (both domestic, cross-border, and offshore in the case of tourism services), and Section II. E. deals with other important design and implementation challenges, including regarding tax refunds and the registration threshold. Section III considers the current legal framework of the GST and proposes concrete reforms to GST Act (GSTA) provisions and regulations in the upcoming draft amendment.

II. TAX POLICY FRAMEWORK OF THE GOODS AND SERVICES TAX

A. Revenue Productivity and Taxpayer Characteristics

6. **Despite relatively low GST rates, the Maldives has raised substantial revenue from the GST since its introduction in 2011 (Figure 1).** The Maldives GST consists of two categories: the General GST (GGST) applying a rate of 6 percent for the domestic sector, and a Tourism GST (TGST) applying a rate of 12 percent to the tourism sector. These rates were both increased from the original 3.5 percent rate in 2011.¹ By international standards these rates are at the lower end (discussed further in Section B), but despite this, GST revenues account for around 9 percent of GDP (about half of all total government tax revenues in 2021), with nearly two-thirds coming from the tourism sector. The Maldives GST/VAT revenue as a share of GDP is higher than the averages for small island developing countries and for emerging and developing Asia (see Figure 1). Differences in VAT revenue as a share of GDP can be attributed to three factors: the VAT standard rate; the share of consumption in GDP; and the C-efficiency ratio. The latter is the ratio of the actual VAT revenue to the theoretical revenue derived from the product of aggregate final consumption (pre-tax) and the VAT standard rate (Keen, 2013).

Figure 1. Maldives and Comparators: VAT Revenue, 2007-2019 (in percent of GDP)

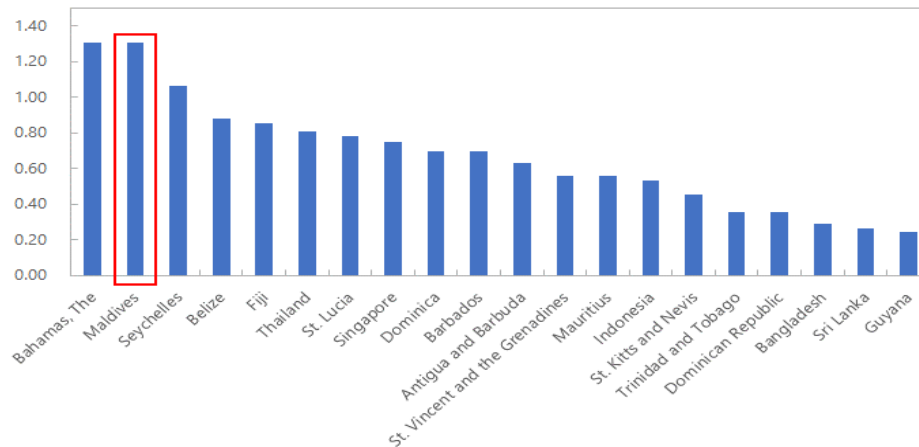


Source: IMF Internal World Revenue Longitudinal Database (WoRLD). VAT includes both VAT and Goods and Service Tax that effectively works like a VAT.

¹ The GST was imposed at a rate of 3.5 percent from its commencement in October 2011, and then increased to 6 percent from 1 January 2012. From January 2013 the GST rate on tourism was increased to 8 percent and then to 12 percent from 1 November 2014.

7. **The Maldives has one of the highest VAT C-efficiency ratios in the world (Figure 2).** The Maldives' C-efficiency in 2019 of 1.3 indicates that actual revenue collection is 130 percent of hypothetical revenue collection.² While a value less than one reflects policy gaps (mainly due to zero rating and exemptions) and compliance gaps (e.g., due to weak enforcement), a value greater than one (which is rare) can happen in some tourism-dependent economies, where C-efficiencies are usually skewed upward. This can be due to expenditures by tourists not being counted as part of consumption in national accounts, but rather as exports. The extreme dependence on tourism partly explains the high C-efficiency observed in the Maldives. In addition, previous technical assistance (Hebous and others, 2019) identified a few additional determinants of the high GST revenue collection efficiency in the Maldives, including the large number of GST payers, the lack of cash GST refunds (with excess GST input credits carried forward against future GST liability, rather than being paid out as a refund) and the amortization of credits for GST on capital inputs.

Figure 2. Maldives and Comparators: VAT C-Efficiency, Latest Available Year (units)



Sources: VAT revenue data from FADTP WORLD Database (internal), VAT rates data from FADTP Rates Database (internal), consumption data from WEO. Formula: VAT C-Efficiency = VAT Revenue / (Total Final Consumption net of VAT Revenue * VAT Rate). The value for the Maldives is based on the weighted average effective VAT rate, per MIRA data for 2019.

8. **Most GST taxpayers are in the non-tourism sector, but most of the revenue comes from the TGST.** The two categories of GST in the Maldives differ on the GST rate and the GST registration thresholds. The TGST covers all goods and services provided by the tourism sector including supplies made by tourist resorts, hotels, guesthouses; tourist related services (e.g., water sports facilities); travel agency services; foreign tourist vessels; and domestic air transport to non-Maldivian citizens. The threshold for the GGST (the non-tourism GST) is MVR 1 million, while for the TGST there is no registration threshold (effectively zero). Table 2 shows that the number of GGST registered taxpayers is significantly greater than the TGST taxpayers, despite the latter having no threshold (Table 2 uses 2019 data as that reflects normal economic activity,

² Using a weighted average GST rate of 8.8 percent for the whole economy. Focusing more narrowly only on GGST collection at a 6 percent rate, the measured C-efficiency for the Maldives would be 0.7, still higher than most peers.

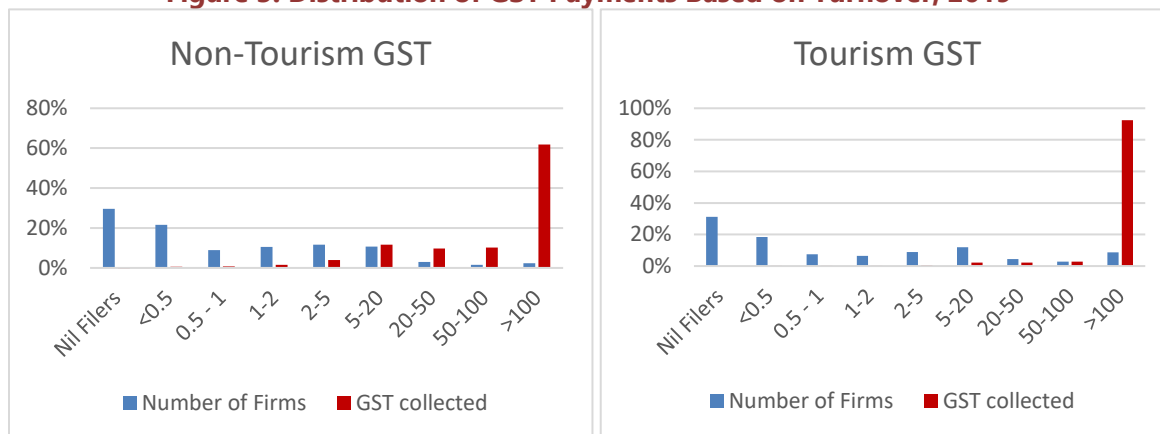
rather than the past two years that have been significantly impacted by COVID). Despite TGST payers being significantly fewer than GGST payers, the TGST raises much greater revenue, likely due to the higher TGST rate, as taxable sales are less than for the GGST (see items 2 and 4 in Table 2). Figure 3 shows that the largest TGST payers (around 9 percent of the total) pay a substantial portion of the TGST revenue (around 93 percent of total TGST revenue). The GGST is similar with around 7 percent of GGST payers paying 82 percent of GGST revenue. This is consistent with the international experience with the VAT, that the largest 20 percent of taxpayers pay around 80 percent of the VAT revenue.

Table 2. Key Parameters of the Existing GST, 2019

Item	Non-Tourism GST	% of Total	Tourism GST	% of Total	Total
(1) Tax rate, in percent	6.0		12.0		
(2) Revenue, MVR million	2845	36.7	4903	63.3	7748
(3) Tax/GDP, in percent (2)/(8)	3.3		5.7		9.0
(4) Taxable Sales, MVR million (2)/(1)	47415	53.7	40862	46.3	88277
(5) Average Rate, (2)/(4)	6.0		12.0		8.8
(6) Revenue per percentage point of rate, MVR million (2)/(1)	474	53.7	409	46.3	883
(7) Revenue per percentage point of rate, share of GDP (6)/(8)	0.5		0.5		1.0
(8) GDP					86259
(9) Number of Taxpayers	11106	86.6	1712	13.4	12818

Source: IMF staff calculations based on MIRA data.

Figure 3. Distribution of GST Payments Based on Turnover, 2019



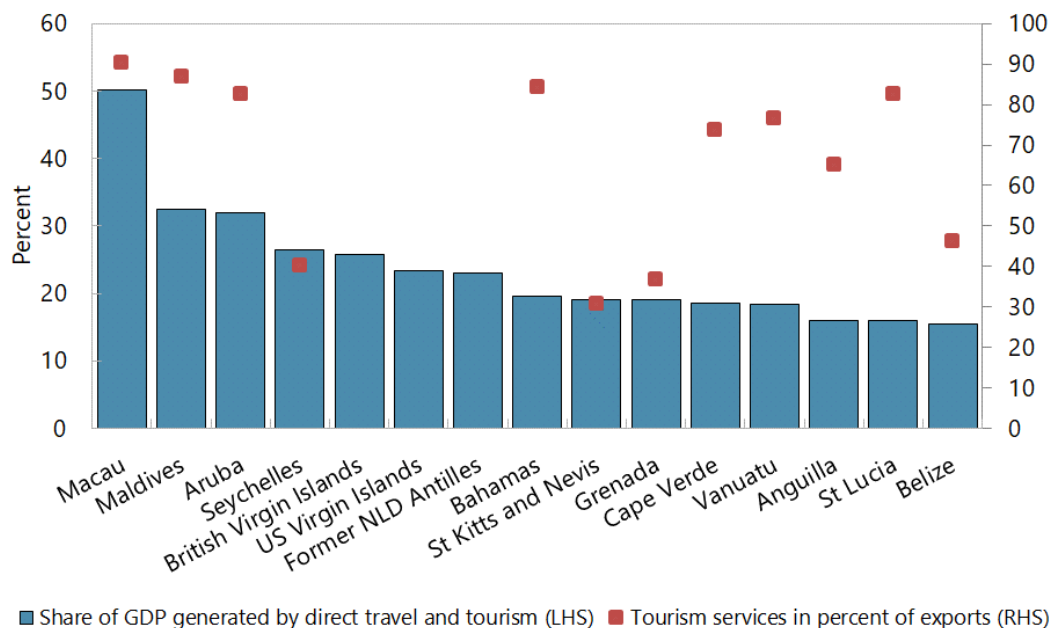
Source: IMF staff calculations based on data from MIRA. Numbers on the horizontal axes are in million MVR.

B. Dual Rate Structure and Ring-Fencing of Tourism

9. **The significant revenues from the TGST also reflects the prominent role of the tourism sector in the Maldives economy.** Before the onset of the COVID-19 pandemic, the

Maldives had the second largest ratio of tourism services to both exports and GDP in the world (Figure 4). The importance of the tourism industry for the country is hard to overstate. The “one island, one resort” model³ has been key to the country’s development success as a high-end tourism destination. Direct travel and tourism services accounted for nearly a third of GDP pre-pandemic, and over 80 percent of total exports. The onset of the COVID-19 pandemic in 2020 resulted in a sudden stop of tourist inflows through July 2020 which contributed to an unprecedented contraction in both GDP and GST revenue collection from the sector by 32 percent. More recently, the successful vaccination program in the Maldives, which also prioritized workers in the tourism sector, helped to provide confidence among tourists to return. However, the COVID-19 surge in South Asia, including in the Maldives, is slowing the recovery. Since reopening to tourists on July 15, 2020, tourist arrivals have been steadily increasing, recording 76 percent of their pre-COVID levels in 2021 up to end-November, but the surge of new COVID variants may jeopardize the speed of the recovery. Medium-term tourism prospects remain positive, with infrastructure investment set to accommodate higher tourist arrivals, which are projected to reach pre-COVID projections for 2020, around 2 million visitors per year, in 2023, according to the latest IMF staff projections.

Figure 4. Share of GDP Generated by Direct Travel and Tourism and Tourism Services as a Share of Exports, top Countries 2019



Sources: WTTC and UNWTO.

³ Maldives consists of 1,192 islands spread across 26 atolls. Approximately 200 islands are inhabited; a further 100 are designated ‘resort islands’, each consisting of only one resort per island.

10. **The dichotomy of the Maldivian GST between tourism goods and services and all other sectors is its most prominent deviation from a uniform broad-based VAT.** The separation is enshrined in Section 14 of the GSTA, which specifies the two categories. This separation includes requiring separate registration for GGST and TGST and filing separate returns (there are separate GGST and TGST return forms); even for a business carrying on taxable activities in both the tourism and non-tourism sectors (see GST Regulations, Chapter 1, section 3(c)). However, in practice, sales between tourist and non-tourist companies are treated under normal VAT rules concerning charging and crediting VAT, though at different rates.

11. **This ring-fencing is unusual internationally, although several other tourist dependent island economies have similar practices but in the opposite direction** (see Figure 5). From a VAT/GST/sales tax⁴ perspective, multiple small tourist dependent countries often grant a lower rate than the standard VAT rate to tourism services with the intent of incentivizing the sector (tourism services may be broadly defined or only apply to certain services, such as hotels or restaurants).⁵ It is very unusual to have a dual rate VAT system with a higher rate applying to tourism, as is the case in the Maldives.⁶ Given the relatively inelastic demand for high-end tourism located in the country, the higher rate can function as a second-best rent tax, as it also falls on labor and normal profits.⁷ However, a comprehensive comparison of the tax treatment of tourism in comparator countries brings in a more nuanced picture: though lower VAT rates benefiting the sector are common, tourism dependent countries often also apply other charges focused on the tourism sector, such as special accommodation levies or sector-specific environmental taxes—all taxing the same final tourist consumption base as the VAT, and therefore tempering the VAT incentive. The Maldives itself has in place a small Green Tax fee charged on overnight tourist stays and since January 2021 has mandated a 10 percent minimum service charge be collected by tourism employers and distributed to employees.

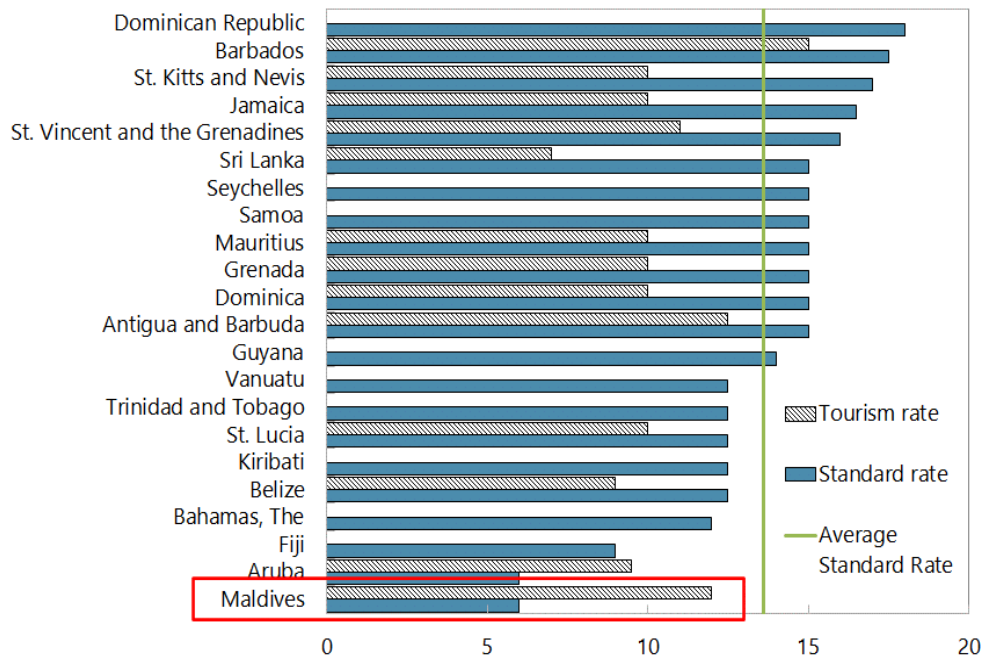
⁴ For cross-country comparative purposes, these terms are used interchangeably in the report.

⁵ At the extreme, Israel regards tourism as service exports for tax purposes, rather than as final consumption by foreigners in Israel; since export supplies are zero-rated, it therefore zero-rates most tourism services entirely. See also Corthay and Loeprick (2010) for a discussion of tourism taxation challenges in developing countries.

⁶ The mission is only aware of one such case at present, in Aruba. Fiji used to have a tax system that was effectively a higher tax on the tourist sector. The GST rate was the same as for the non-tourism sector, but an additional Services Turnover Tax was applied to goods and services mostly consumed by tourists. This effectively increased the rate of tax applying to the tourism sector. The Services Turnover Tax was abolished in 2020, partly in response to the impact of COVID on Fiji's tourism sector.

⁷ This has some parallel with international experience applying higher sectoral VAT rates as a second-best rent tax in the telecom sector in Argentina, Brazil, Jamaica, and Mauritania.

Figure 5. GST/VAT in Small Island Developing States (in percent)



Source: IMF-FAD Rates Database. Note "tourism rate" corresponds to either a broad tourism sector rate or that applicable to hotel accommodations.

12. **Both the general and tourism GST rates in the Maldives are low compared to the international practice.** The general GST rate is the lowest among a selection of small island developing states, and significantly below the average general/standard rate for those countries (see Figure 5). It is also below the average standard VAT rate of 14.2 percent imposed in other South Asian Association for Regional Cooperation (SAARC) countries.⁸ The tourism rate is higher compared to most countries that have a separate tourism rate, though the difference is not significant. The tourism rate in the Maldives is lower than most standard VAT rates among the selected countries. The comparatively higher tourism rate in the Maldives is justified due to its unique characteristics as a tourism destination, and its attraction to high-end tourists.

13. **Given the level of rates, the authorities should consider increasing both the GGST and TGST rates to 8-10 percent for the GGST and 14-15 percent for the TGST, but any increases should be in the medium term.** As mentioned previously, the country is facing significant fiscal challenges and therefore needs to mobilize revenues. An increase in rates would assist in revenue mobilization and closer align the rates to those in other small island tourist dependent countries and the other SAARC countries. These rates would provide an increase in revenue while still being consistent with international GST rates, which have trended upwards in the past decade. As mentioned previously, the general GST rate of 6 percent is very low by international standards, and even an increase to 8-10 percent will mean the rate is still lower than the GST/VAT rate in almost every small island country (see Figure 5) and most SAARC countries.

⁸ The SAARC countries include Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. Afghanistan does not have a VAT, while Bhutan is intending to introduce a VAT later in 2022.

14. **An increase in the TGST rate can be justified given the relative inelasticity of demand for the tourism sector in the Maldives and its high profitability.** This inelasticity of demand in the Maldives is due to the unique nature of its tourism sector and the tourism experience provided.⁹ The unique tourist experience in the Maldives likely generates economic rents that suppliers of tourism services will try to capture through higher prices. In theory, taxes can be imposed on these economic rents without impacting the supply of the services, providing an opportunity for governments to increase tourism's benefits to residents. A recent survey of the Maldives hotel sector suggests for 2018, the EBITDA (Earnings Before Income Tax, Depreciation and Amortization) margin per room was 18 percent. Even representatives of the tourism sector anticipate an increase in the TGST, yet do not expect it to impact on the demand for tourism in the Maldives. The Green Tax and the recently mandated services charges do increase the effective government charges imposed on the tourism sector. However, the Green Tax is only small (USD 6 per night for tourist resorts, hotels and vessels, and USD 3 for guesthouses) in comparison to the cost of hotel accommodation in the Maldives, while the service charge essentially mandates surcharges that are already common for high end tourism and are transferred back to employees (hence not formally a tax, though mandated by the government and perceived by the industry as presenting a similar burden on profits). The only other example of such a levy in the Maldivian context is a recurrent tourism land rent tax¹⁰ levied on resorts, hotels and guesthouses built on public land (though not classified as a tax in fiscal accounts), raising substantial revenue (in the order of 2 percent of GDP pre-pandemic). There can also be benefits from a political economy perspective in higher taxes for tourists, as the taxes in the tourism sector do not have a direct impact on resident constituents.

15. **Given the current global inflationary pressures and continued COVID-19 pandemic, it would be advisable to wait until at least 2024 to begin increasing the GGST and TGST rates.** Headline inflation in the Maldives is still very low by international standards—projected at 1.4 percent in 2021 and increasing to 2.3 in 2022 on the back of higher commodity and food prices, and to decline to 2 percent over the medium-term. In addition, international evidence provides little ground for fears of significant and/or persistent price hikes following changes in VAT rates, especially when the change happens to previously reduced rates, where there is at best evidence of noticeably lower passthrough (Benedek and others, 2020). Notwithstanding, at the peril of de-anchoring inflationary expectations on the back of a GGST and TGST rate revision (often misperceived by the public as having a lasting inflationary impact), the mission would recommend waiting out the pandemic and supply driven high inflation elsewhere before increasing or announcing an increase in the GST rates.

16. **The misalignment of the GGST and TGST rates is inconsistent with the preferred policy for a VAT.** The first best policy is to have a single GST rate. Multiple VAT rates create several problems including excess credits arising due to differences in input and output VAT rates; complications with composite supplies (i.e., supplies of goods and services with two or more components that may be subject to different VAT rates), which can lead to tax planning; and complexities for taxpayers in determining which rate to apply. A VAT's revenue-raising and

⁹ For a discussion of the elasticity of tourism, including 'high-end' tourism, see Laframboise et al (2014), which discusses these issues in relation to tourism in the Caribbean.

¹⁰ Tourism Land Rent Regulation 2010/R-20.

non-distortionary properties are also maximized when a single rate is applied to the broadest possible consumption base. A well-designed single rate VAT is neutral with respect to its effect on relative prices and international trade, as well as savings and investment, and is thus ideal to raise significant revenues with the minimum deadweight loss possible.

17. However, some of the usual concerns with multiple rates may be less of an issue in the Maldives given the structure of the economy and the design of the GGST and TGST.

There are two distinct markets operating in the Maldives—one focused almost entirely on foreigners and one focused on the domestic economy, with very little overlap. The GST is designed to reflect these two markets—with separate rate, registration and filing for the GGST and TGST. For example, the market separation means that a domestic consumer is unlikely to make a consumption choice between a good or service taxed at 6 percent compared to a good or service taxed at 12 percent as they are generally not consuming goods and services in the tourism market (there may be some minor exceptions such as a restaurant in a resort). A tourist may consume a good or service in the domestic market due to the lower tax, but this is likely to be limited, especially if many of the resorts are on isolated islands. The difference in rates is also unlikely to deter investment by local residents in the tourism sector, due to the potential for significant profits in that sector. It was suggested by the private sector and MIRA that there are some administrative/enforcement issues in having two rates, but as the markets are so distinct it seems that these issues are not significant as there is little cross-over (other than resorts buying goods from the domestic market at 6 percent, but this does not give rise to any complexity as the goods are simply on-sold at 12 percent).

18. While alignment of the GGST and TGST rates should be pursued, this should be a longer-term objective given the uniqueness of the economy and design of the GST in the Maldives. Such an alignment (towards a higher future TGST rate, per the recommendation above to increase both rates) will be consistent with first best policy for a VAT. However, it is not an urgent reform, given the two distinct markets currently operating in the Maldives. An alignment of rates may become more necessary as the share of market for homestay and guesthouse increases, due to the potential for greater overlap between the different markets targeted by the GGST and TGST. This will depend in part on any administrative/enforcement concerns that arise. Any such alignment should have a long transitional period so as to attenuate the impact on the most vulnerable households of what would likely be a significant increase in the GGST rate.

19. The revenue impact of each percentage point increase in the GGST or TGST rate is estimated to be around 0.5 percent of GDP. Table 2 shows that prior to the COVID crisis each percentage point of the GGST and TGST raised around 0.5 percent of GDP. However, it is likely that as rates increase, there may be more incentive for avoidance, so that the rise in revenue due to an increase in the rates may be slightly below that figure. This would suggest that an increase of the GGST rate to 10 percent may increase revenue by around 1.8 percent of GDP, and an increase in the TGST rate to 15 percent may raise additional revenue of around 1.35 percent of GDP.

Recommendations

- In the medium term, increase the GGST rate to 8-10 percent and the TGST rate to 14-15 percent.

- In the long term, seek to align the GGST and TGST by adopting a single GST rate.

C. Incidence and Rationalization of Exemptions and Zero-Rated Goods/Services

Destination vs. Origin Principle

20. **Under the destination principle, a GST/VAT is a broad-based tax on final consumption that occurs within the taxing jurisdiction (OECD, 2017).** In practice, this is implemented through the following structure: (i) Imports of goods and services are taxed. (ii) Domestic supplies of goods and services are taxed. Tax is levied at all stages in the production and distribution of goods and services with tax levied at earlier stages fully credited so that, ultimately in net terms, only final consumption is taxed. (iii) Exports are zero-rated with any input tax incurred up to the point of export refunded to the exporter. This has the effect of fully relieving a country's exports from GST.

21. **The authorities often referred to the Maldivian GST as being based on the origin (rather than destination) principle.** In broad terms, under the origin principle, exports are taxed, and imports are exempt. The intention under the origin principle is that tax is collected at source where value is added by producers. On this basis, exports leave the jurisdiction taxed but with a notional credit allowed in the country of import for the export country's tax. Given that exports are zero-rated,¹¹ the view that the Maldivian GST is based on the origin principle is due to the unusual absence of immediate taxation of imports of goods or services. There is no taxation of imported goods at the border and no reverse charge rule for imported services acquired by registered persons. The place of supply rules for imported services focuses on the place of performance of the services rather than the place of consumption. A supply of services by a person outside the Maldives without a physical presence in the Maldives is not a supply of services in the Maldives and, therefore, is not subject to GST.¹² This is the case even if the services are utilized in the Maldives.

22. **While there is no immediate taxation of imported goods or services in the Maldives, the value added by imports may be taxed if ultimately used to produce taxable supplies in the country.** This applies where the imported goods or services are used by a registered person as an input to make taxable supplies as the cost of imports will be factored into the pricing of those subsequent taxable supplies on which GST is charged. However, there is no taxation of imports of goods or services used to make exempt supplies, imported for personal use, or on-sold in the informal sector. This can give foreign suppliers of goods a competitive advantage over local suppliers, since the latter have to impose GST on goods sold.

¹¹ Section 22(b) of the GSTA

¹² Regulations 104 and 104-1

23. **For consistency with international norms, the Maldives should fully implement the destination principle by extending the GST base to include imports.** Most small island countries rely on VAT on imports as the most significant source of VAT revenue. This is because most goods are imported, and it is relatively easy to impose VAT as the goods cross the border, usually collected by Customs, reducing the potential for avoidance of the VAT. In addition, the non-taxation of imported goods and services gives rise to the possibility of double non-taxation as the country of export will likely have zero-rated the export of goods or services to the Maldives on the assumption that the Maldives will tax under the destination principle. The taxation of imported services (discussed more at length in Section II. D., in the context of cross-border digital transactions) requires the implementation of the reverse charge rule and reform of the place of supply rules. Doing so will protect the GST base against revenue leakage and reduce the distortionary bias against local producers. In order to mitigate any concerns with cashflow problems for importers, deferred payment schemes can be introduced for taxpayers with good compliance records. The mission estimates capturing GST on imported goods and services used to produce exempt supplies in the Maldives is estimated to potentially yield 0.87 percent of GDP in added revenues due to unrecoverable input tax (based on 2014 SUTs).

Recommendation

- Fully implement the destination principle by imposing GST on imported goods and services.

Explicit Exemptions and Zero-Rating in the GSTA

24. **There are a number of reasons why countries provide GST exemptions and zero-rating for goods and services.** These reasons include: (1) improving and enhancing the progressivity of the tax system through low or no taxation of necessities on which lower income consumers spend proportionally more of their income; (2) advancing social purposes to ensure the supply of ‘merit’ goods—that is, goods that are welfare enhancing (whose consumption has strong positive externalities) and may be consumed in sub-optimal quantities if taxed (e.g., education); (3) simplifying administration as there are some goods and services where it can be simpler to exempt them due to the difficulties and/or high administrative costs in imposing GST (e.g., margin based financial services); (4) misperceiving that doing so is encouraging investment in a certain sector, product or project; and (5) meeting requirements under international agreements, such as for diplomats and consular officials.

25. **However, there are also adverse consequences of exemptions and zero-rating.** These include: (1) impacting revenue (usually adversely)—the 2021 FAD report on tax expenditures in the Maldives (Hebous and others, 2021) estimated that the cost of tax expenditures for zero-rated goods and services was 6.0 percent of total tax collected, and 4.5 percent for exemptions (these estimates may not include all zero-ratings or exemptions);¹³

¹³ The value of tax expenditures does not include the cost of non-compliance, which can be estimated using a separate VAT Gap Analysis.

(2) creating distortions that lead to inefficiencies in production and consumption (e.g., producers may divert resources to exempt sectors, or exemptions may encourage consumption of exempt rather than taxed goods and services); (3) cascading (i.e., tax on already taxed goods) arising from exemptions of intermediate business-to-business supplies; (4) encouraging ‘exemption creep’—that is, providing an exemption to one sector, taxpayer or category of supply, can create pressure from similar ‘worthy’ taxpayers for the same exemption; (5) increasing opportunities for tax evasion; (6) complicating tax administration and compliance; and (7) concealing the true cost of government support for favored sectors or projects.

26. **The Maldives has a range of GST exemptions and zero-rating, some of which are consistent with international practice.** The exemptions and zero-rated goods and services are set out in Chapters 4 and 5 and Schedule 1 of the GSTA. The list of items includes exemptions that are consistent with international practice such as: (1) exemptions of goods and services that advance essential social needs, such as the provision of education and health services and medicines; and (2) exemptions for difficult to tax services, such as financial services. Supplies by small businesses below the GGST registration threshold (MVR 1 million) are also effectively exempt. Exports are zero-rated, which is consistent with the destination principle for the GST. However, there are other exemptions and zero-rated goods and services that should be reviewed.

27. **As mentioned previously, a key argument for exemptions and zero-rating is improving the progressivity of the tax system, to especially assist low-income households.** A recent USAID study for the Ministry of Finance has analyzed how effective the GST exemptions and zero-rating of goods and services in the Maldives has been in enhancing the tax system. The study found that the GGST is highly regressive when measured against income and slightly regressive when measured as a percentage of expenditure. However, they also found that while the exemptions and zero-ratings reduce the burden of tax on the poorest households, the rich benefit most from the concessions and those benefits represent an unnecessary revenue leakage. The study also finds that the GGST does not have a significant impact on household’s poverty levels. The study recommends that a better policy is to focus on raising greater revenues, and then provide social welfare through targeted subsidies to poorer households, rather than through the GST concessions.

28. **The Maldives should review GST exemptions and zero-rated goods and services to determine if they are still necessary and if they can be rationalized.** This analysis should include determining if the exemptions or zero-rating are achieving their purpose and if they are cost effective (e.g., whether the value of the benefit of the exemption outweighs its revenue cost). There should be no need to review those exemptions or zero-rated goods and services that are consistent with international practice—that is, exemptions for education services, health

services, medicines and medical devices,¹⁴ sale of donated goods by non-profit bodies, day-care services, and zero-rating of exports and sales of business as a going concern.

29. **There are several exempt or zero-rated supplies that the mission has identified that should be reviewed to improve the efficiency of the GST and raise revenue.** These are listed below:

- *Public utilities (electricity, water, and sewerage services)*—It is usual practice to tax supplies by these public utilities. Firstly, to encourage their efficient usage and to adequately reflect the cost to the consumer of providing these services—this is especially important for the supply of electricity which should be correctly priced to encourage energy efficiency given concerns around greenhouse gas emissions. Secondly, if these services are being used by a business, then there is a potential for GST cascading, as the business will not obtain an input tax credit, despite the price charged by the utility provider including GST paid on its business inputs. The preferred approach is to fully tax these utilities. If there are concerns for low-income households, then alternative mechanisms should be found, such as lower tariffs for those households, direct subsidies, or if relief is to be provided via the GST, then providing a limited exemption (e.g., exempting the first 50 or 100 units of electricity). In addition, any exemption should be limited to households (i.e., not apply to businesses). The utility providers should be able to distinguish between services provided to households and businesses.
- *Postal services*—Many countries treat postal services like any other service, and so apply VAT to those services. This is especially the case now that government postal companies are often competing with the private sector on services such as the delivery of parcels (with the supply of parcels increasing due to the expansion of online purchases of goods, especially during COVID). The usual policy is to impose VAT on these services, so as to ensure that government postal services do not obtain a competitive advantage over private sector suppliers.
- *Financial services*—The Maldives provides a comprehensive list of exempt financial services in the GST regulations (regulation 35). Most countries exempt financial services because of the administrative difficulty in measuring the financial services to be taxed. This is especially the case for margin-based transactions where it is difficult to quantify the amount of fee for services included in the transaction (e.g., the interest margin—that is, the spread between the interest charged to borrowers and the interest paid to depositors—which can cover the time value of money plus a risk premium, as well as a fee for providing a financial service). However, explicit fees for financial services can be readily identified (e.g., fees paid for providing international transfer services) and therefore are able to be taxed. Similarly, supply of products such as general insurance services should also be taxed as they are not margin-based transactions.

¹⁴ There is room to make education and healthcare exemptions more narrowly defined in the Maldives, by excluding private service provision, as well as certain elective healthcare procedures (e.g., aesthetic interventions). However, at present the mission considers there is greater value in prioritizing rationalization of exemptions and zero-rating in other areas, both from a social and revenue perspective.

- *Domestic transport*—MIRA explained that some domestic transport services, such as taxi services, are not taxed in practice, despite not being exempt in the law. Other transport services, such as bus services, are taxed. Most countries impose VAT on taxi services, assuming that small taxi businesses will be exempt due to being below the VAT registration threshold. However, there are alternative approaches, such as in Australia where, as a compliance and administration measure, all taxi businesses have to register irrespective of their turnover. The preferred policy approach is to impose VAT on all domestic transport services, including taxi services. Tax should also apply to ride-sharing services provided by apps. While domestic air transport can represent an important service for a multi-island nation, recent evidence on the regressive household incidence of the current exemption for residents suggests GST coverage should be expanded regardless of domestic passenger residence.
- *International transportation services*—The Maldives exempts international transportation services. This is inconsistent with the usual international practice which is to zero-rate such services, given the complexity of taxing these services and the potential for tax competition between different states. The Maldives should consider zero-rating, rather than exempting, such supplies.
- *Donor funded projects*—Many countries like the Maldives exempt donor funded projects from VAT. This is because donor countries are often reluctant to pay VAT as it is viewed as a payment to the government rather than for the relevant project. There can also be concerns that the recipient country is not using its taxes effectively. Therefore, many countries exempt donor funded projects, often due to political pressure from the donors. From a tax policy perspective, VAT should be imposed on goods and services purchased as part of donor projects, as failure to impose VAT poses the same avoidance problems as other exemptions. Despite the past practice, there is now a trend (by both governments and donors, such as the French government, the World Bank and Inter-American Development Bank) towards being willing to pay tax on such projects. The United Nations Committee of Experts on International Cooperation in Tax Matters have developed guidelines on the taxation of overseas development assistance, including removing exemptions for goods imported by aid projects, other than in special circumstances (e.g., humanitarian aid).¹⁵ Therefore, the Maldives should reconsider these exemptions in the medium term, as more donors are willing for their projects to be taxed.
- *Real estate/immovable property*—The best practice for taxing real property is as follows: commercial real property should be fully taxable, whether supplied by sale or lease, and whether it is new or existing property; construction services and other inputs into construction should be fully taxed; residential property is only taxed when first sold (i.e., new);

¹⁵ See United Nations Guidelines on the Tax Treatment of Government-to-Government Aid Projects, April 2021 available at: <https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2021-04/g-to-g-web.pdf>.

and sales and leases of other residential premises should be exempt. The Maldives currently exempts leases of all immovable property, irrespective of whether it is a commercial or residential lease. The current blanket exemption in the Maldivian GST also notably exempts peer-to-peer (e.g., Airbnb, VRBO) type accommodation rentals, which are otherwise not designated as hotels or guesthouses, but can technically function as commercial operations. Therefore, the authorities should remove the exemption for commercial leases, consistent with the international best practice. In addition, the timeshare market is developing in the Maldives.¹⁶ Though the ultimate treatment will depend on the terms of the contractual arrangement, typically the right to occupy accommodation is likely to be an interest in immovable property similar to a tourist's right of occupation of a hotel room and, therefore, the TGST treatment of tourist accommodation should apply. Annex I elaborates with greater detail on real estate GST considerations for small tourism-dependent countries.

- *Essential goods*—A list of essential goods are zero-rated in the Maldives (Schedule 1 of the GSTA). These goods include basic foodstuffs (see regulation 40 for a list of the food covered), cooking gas, diesel and petrol, baby and adult diapers and sanitary napkins. Some countries provide VAT exemptions for basic items on the basis that the exemptions will reduce the distributional impact of the tax—that is, it will avoid affecting prices for consumers. However, VAT exemptions are not usually considered a good instrument for promoting equity. This is because even if the poor spend a larger *proportion* of their income on some particular item (such as food) the better-off will typically spend a larger *absolute* amount.¹⁷ Therefore, a GST exemption on that item actually transfers more money to the better-off than it does to the poor. This is the case in the Maldives as shown in the USAID incidence study mentioned previously. The better policy is to tax at the standard rate and use the enhanced revenue this yields to finance pro-poor spending that may be better targeted. Given the impact of the COVID-19 pandemic, the mission recognizes the challenges of removing preferential treatment on some of the goods and services without having adequate compensation mechanisms for low-income households.¹⁸ In addition, standard GST should also apply to purchases of diesel and petrol, but such a reform should be done only in tandem with a comprehensive review of government subsidies to the fuel importer (State Trading Organization) – since any GST can be offset by a reciprocal price subsidy.
- *Exemptions approved by government ministries or agencies, other than the Ministry of Finance*—There is often pressure for ministries and government agencies, other than the Ministry of Finance, to give the ministry or agency power to grant GST exemptions in certain circumstances. This should not be permitted as these ministries or agencies are likely to grant

¹⁶ A timeshare is a contractual agreement under which a person is granted a right to occupy accommodation for a specified number of days per year (e.g., 14 days) with the right granted for a specified period of years.

¹⁷ For a further discussion of the distributional aspects of a VAT, see 'The VAT Experience in LIDCs' in *Macroeconomic Developments and Prospects in Low Income Developing Countries—2019*, December 2019, IMF Policy Paper.

¹⁸ Further improvement in the depth and breadth of coverage of social protection programs in the Maldives in parallel with GST exemption rationalization would be critical to mitigate any regressive impact from the reforms.

exemptions to promote their own policy objectives, with little regard for the financial costs to the budget. Therefore, the Ministry of Finance, with the assistance of MIRA, should be the prime authorities for advising on and approving exemptions, due to their understanding of the broader budget issues. This prevents a proliferation of GST exemptions provided by other ministries and agencies that can be difficult to monitor and enforce. Any review by the Ministry of Finance should also include the granting of exemptions under the Special Economic Zones (SEZ) Act. That law, introduced in 2014, provides GST exemptions for up to 10 years with a further extension as decided by the President at the advice of a Board. At this stage no projects have been permitted under the SEZ Law, so there may be an opportunity to review and limit the GST exemptions available under that Act.

30. **In addition to reviewing and rationalizing the existing exemptions and zero-ratings, the authorities should avoid expanding the list of exemptions and zero-rated goods and services.** As mentioned previously, governments often come under pressure to provide new or expanded goods and services covered by GST exemptions and zero-rating. The mission was advised that there have been proposals for lower rates or exemptions to encourage development in certain remote islands, or to encourage guesthouse accommodation, or to provide renewable electricity. While these may be worthy causes, using GST exemptions and zero-ratings to promote these causes amplifies the GST problems outlined above, especially the loss of revenue, and likely leads to pressure for further GST concessions. Therefore, any request for expansion of exemptions and zero-ratings should be resisted.

31. **A rationalization of the exemptions and zero-rating will have a positive revenue impact, in addition to the efficiency gains.** The size of the revenue impact will depend on which exemptions and zero-ratings are rationalized. However, based on the estimates of tax expenditures in the 2021 FAD report mentioned previously, the revenue gains could be as high as 1.1 percent for zero-rated goods and services and 0.9 percent of GDP for exemptions.

Recommendations

- Review and rationalize GST exempt and zero-rated goods and services to ensure they are still necessary and are achieving their objectives—potential reforms being:
 - ✓ Removing the exemptions for public utilities or at least limiting the exemptions to services provided to households.
 - ✓ Removing the exemption for postal services.
 - ✓ Narrowing the scope of the exemption for financial services by taxing fee-based services and general insurance.
 - ✓ Ensuring all domestic transport services, including taxis and ride-share apps, are taxable.
 - ✓ Replacing the current exemption for international transportation services with zero-rating.

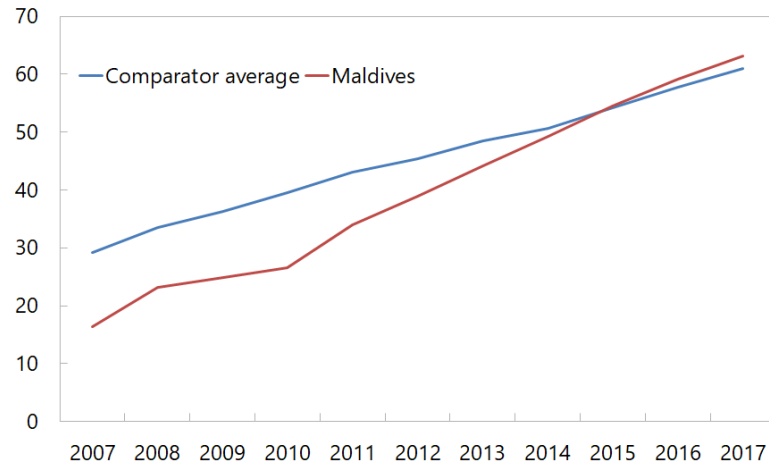
- ✓ In the medium term, reconsidering the GST exemption for donor funded projects as more countries allow for the taxation of such projects.
 - ✓ Removing the exemption for commercial leases.
 - ✓ Assessing whether the zero-rating of essential goods (including fuels) would be better achieved through targeted subsidies rather than via the GST.
 - ✓ Ensuring that ministries and government agencies, other than the Ministry of Finance, do not have authority to grant GST exemptions or zero-rating.
- Resist pressure to expand the range of exempt and zero-rated goods and services.

D. Treatment of the Digital Economy

32. **Widespread internet usage is underpinning growth in e-commerce, online platforms and marketplaces domestically, as well as online transactions between offshore sellers and foreign tourists for services ultimately consumed in the Maldives that fall in practice out of the scope of the current GST.** Internet penetration levels are high and have steadily grown in the Maldives over 2007-2017 – the last year with available survey data (Figure 6), with potential for further growth. Similarly, survey-based estimates of average growth in e-commerce sales for Maldives comparator countries suggest a marked upward trend in recent years, particularly during the pandemic (Figure 7).¹⁹ In addition, over the last decade digitally delivered services more than doubled as a share of total trade in services for the Maldives (a growth rate twice as large as the average for other small island developing states), and now account for almost half of all service trade in the country, though that level continues to be modest relative to comparators (Figure 8). Although many of these activities relate to business-to-business (B2B) transactions and would not result in additional GST revenue if covered, a non-negligible share is linked to supplies made to final consumers. Moreover, social distancing measures related to the COVID-19 pandemic have led to a spike in demand for digital media services (Figure 9).

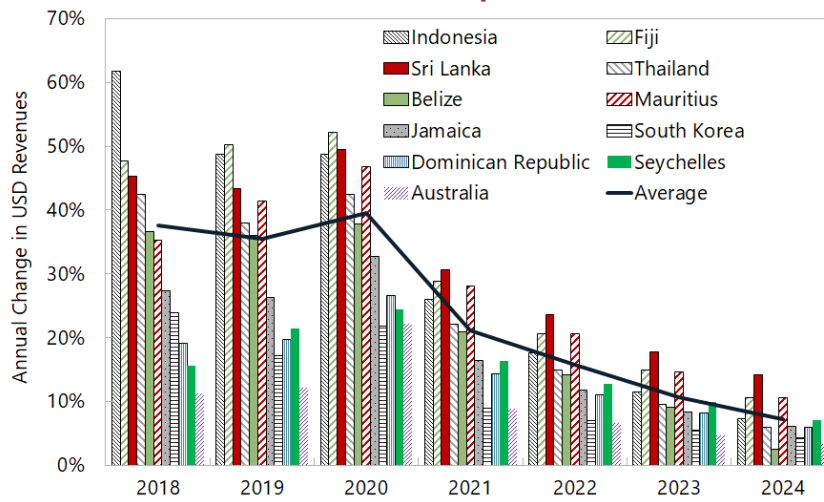
¹⁹ In Indonesia and Singapore, for example, e-commerce sales grew by 30-50 percent in 2020 alone, some of the fastest rates in the world.

Figure 6. Maldives and Comparators: Internet Users in Total Population (Percent)



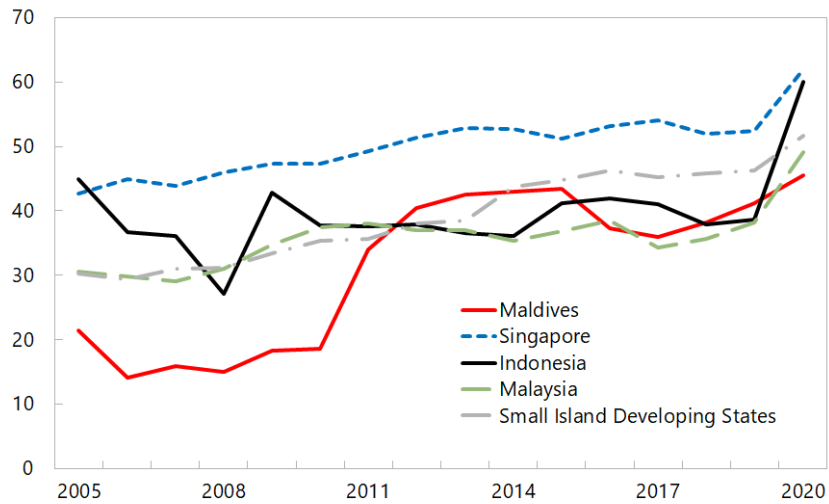
Source: International Telecommunications Union, up to latest year available for the Maldives.
 Note: Comparator list is identical to that used in Figure 2 for all countries with available data.

Figure 7. Average Annual Change in E-Commerce Sales (Available Maldives' Comparators, Percent)



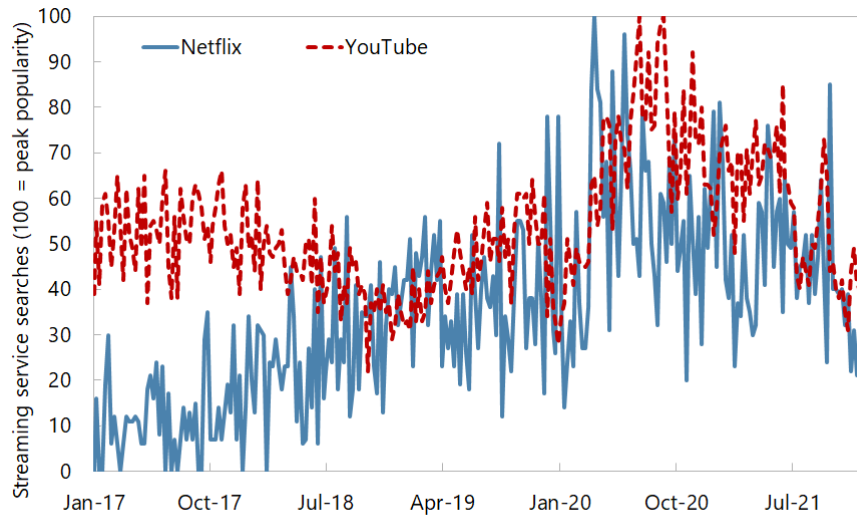
Source: Statista and IMF staff calculations. Note: market projections 2021 onwards.

Figure 8. Maldives and Comparators: Digitally Deliverable Services (in percent of total trade in services)



Source: UNCTAD and IMF staff calculations.

Figure 9. Maldives: Relative Demand for Digital Media



Source: Google Trends

33. **The authorities have identified the taxation of digital transactions as a priority issue, in the context of a rapidly digitalizing global economy.** Broadly, digital transactions are transactions conducted wholly or partly electronically. Digital transactions may be conducted over the internet, via email, or through a social media or other electronic platform. The purchase of a digital product (such as an e-book) is an example of a transaction conducted wholly electronically with ordering, payment, and delivery all done electronically. The online purchase of physical goods (such as clothes) is an example of a transaction partly conducted electronically with ordering and payment done electronically, and physical delivery.

34. **There are four broad categories of digital transactions.** Business-to-Business (B2B) transactions are supplies of goods or services between businesses. Business-to-Consumer (B2C) transactions are supplies of goods or services by a business to a consumer. Consumer-to-Consumer (C2C) transactions are supplies of goods or services between consumers, such as online auctions of private goods or homestays. Consumer-to-Business (C2B) transactions are supplies of goods or services by a consumer to a business, such as where a business pays to advertise on an individual's blog or social media page.

35. **The primary issue is the GST treatment of B2B and B2C cross-border digital transactions.** This covers digital products, electronic services, and electronically ordered goods. There are also developments internationally concerning the GST treatment of C2C transactions, particularly where the transaction is conducted through an electronic marketplace or platform. This relates to both cross-border and domestic C2C supplies. These issues are discussed below on the assumption that the Maldives fully implements the destination principle. The special case of offshore online booking platforms is discussed separately in the next subsection.

36. **The mission estimated the direct short-term revenue potential of charging GST on remotely delivered digital services and some electronically ordered goods to customers in the Maldives is around 0.11 percent of GDP.** Averaging Statista consumer and market survey data for a list of comparator countries (since no observations are available for the Maldives directly), adjusting for the higher share of tourism services in GDP than in peers, and applying the current GST rates, the mission estimated modest revenue impact from this policy reform,²⁰ in line with ranges estimated for several other countries, between 0.02 and 0.17 percent of GDP. Australia projected its introduction of GST on digital services in 2017 would generate 0.02 percent of GDP over two years. Thailand expects to raise about 0.017 percent of GDP from the implementation of a 7 percent VAT on non-resident service providers in 2021, and estimates based on survey data for multiple other countries suggest intermediate values (IMF, 2021b).

37. **In addition to raising revenue, applying GST to cross-border digital products and services utilized in the Maldives can level the GST playing field for domestic suppliers and present opportunities to improve broader tax compliance and further increase in revenues.** By ensuring that foreign competitors of domestic providers are liable for the same GST, such a reform can eliminate distortions and contribute to supporting local digital entrepreneurship. In addition, MIRA can request information collected by online marketplaces and platforms on the incomes of suppliers operating through the marketplace or platform. This information can then

²⁰ Applying the 12 percent TGST rate to mobility and travel services and the 6 percent GGST rate to everything else. We assume 100 percent of transactions of digital media content, 10 percent of all e-commerce transactions, 5 percent of digital advertising, and 15 percent of e-services, mobility and travel services captured by Statista are provided by unregistered remote suppliers to final consumers and/or unregistered resident entities. E-commerce includes B2C sale of physical goods via a digital channel; e-services capture sales of services and digital goods (event ticket reservation, dating, food delivery, etc) with an online checkout process; digital media captures spending on audiovisual media contents and applications distributed online; digital advertising captures advertisement spending for online channels.

inform compliance management, for example in the tourism sector and of mobility services, and significantly contribute to income tax revenues. Introducing reporting obligations to obtain information on consumption and income generated via digital platforms is an important additional consideration beyond the initial gain in GST. Recent guidance provided by OECD (2020) on model reporting rules for platform operators provide a useful reference framework.

GST Classification of Digital Products

38. **There is a GST classification issue with digital products.** These are products that are delivered and utilized online, but which may have a physical equivalent (e.g., a book). As there is a physical equivalent, it may be argued that a digital product is goods. However, classification as goods would mean that the rules on imported goods apply. This is problematic because digital products do not pass-through border control. For this reason, digital products are conceptually better treated as services for GST purposes.

39. **For the avoidance of doubt, the definition of “goods” should expressly exclude digital products.** These can be defined as products that are transmitted by means of a wire, cable, radio, optical, or other electromagnetic system, or by means of a similar technical system. As “services” is defined to mean anything that is not “goods”,²¹ the express exclusion of digital products from the definition of “goods” means that they are services for GST purposes. This makes clear that the rules on imported services apply.

Models for GST Taxation of Imported Services

40. **There are two main models²² for taxation of imported services: (i) reverse charge; and (ii) vendor collection (Brondolo and Konza, 2021).** Under the reverse charge model, the normal operation of the GST is “reversed” with the recipient of imported services self-charging and reporting GST on the services. Under the vendor collection model (also known as “vendor registration model”), the foreign supplier of the services is required to register and account for GST on services supplied in the Maldives. The reverse charge model is applied in taxing B2B imported services and the vendor collection model is applied in taxing B2C imported services. The vendor collection model can apply also to tax low value electronically ordered imported goods (as discussed below).

²¹ Section 4.

²² Another option used in Latin America, and also in the Maldives’ region, such as Bangladesh and Vietnam, involves requiring financial intermediaries (e.g., banks and payment service providers) to withhold GST on consumers’ payments to foreign businesses, but such an alternative is considered more limited in scope and difficult to operate particularly as it assumes that the only amounts paid into the account are for taxable supplies. Further, this may be difficult to apply in the Maldives context because of the dual rate structure.

Taxation of B2B Imported Services

41. **The international norm is that the reverse charge model applies to B2B supplies of imported services.** This means that a registered person who receives imported services self-charges GST on the value of the services. If the registered person uses the imported services wholly to make taxable supplies, the person can claim an input tax credit for the reverse charged GST. As the reverse charged GST and input tax credit are reported in the same GST return, the net GST liability on the imported services is zero. However, if the registered person uses the imported services wholly or partly to make exempt supplies, the reverse charge rule will generate a net GST liability for the registered person. It is important that a reverse charge rule applies in this case otherwise there is an incentive for registered persons who also make exempt supplies to acquire services for the purpose of making of those supplies from foreign service providers. As output tax is not charged on exempt supplies, the value added by the imported services is not included in the GST base.

42. **The reverse charge rule can be avoided by a registered person acquiring the services from another part of the same entity located abroad (such as the entity's headquarters or a foreign branch).** For example, there is an incentive for a local branch of a foreign financial institution to acquire services related to the making of exempt supplies from its foreign headquarters (or another part of the institution located outside the Maldives) rather than from a local supplier, thereby avoiding a liability for any GST on the services. Again, this puts local suppliers of the same services at a competitive disadvantage because they must charge GST on their supplies. This is prevented by extending the reverse charge rule to the internal acquisition of services from another part of the registered person located outside the jurisdiction.

43. **The reverse charge rule can also be extended to large, unregistered businesses making exempt supplies and to unregistered government bodies.** For example, as financial institutions mainly make exempt supplies of financial services they may not be registered. In fact, financial institutions may have taxable activities, such as leasing, in a separate entity to ensure that the entity undertaking the core business of supplying financial services is not registered. If the reverse charge rule is limited to registered persons, there is an incentive for unregistered suppliers of exempt services and government bodies to acquire services from foreign suppliers. For example, financial institutions may source training services, such as virtual learning offerings, from abroad to limit unrecoverable GST input tax. Extending the reverse charge rule to these persons removes that incentive. The extension of the reverse charge rule to those making exempt supplies (effectively requiring them to register with MIRA on a pay only basis) should be limited to persons with an annual turnover (counting all supplies) exceeding the registration threshold amount.

Taxation of B2C Imported Services

44. **The rise of digital transactions greatly expands the category of B2C imported services, so it is important to implement rules for the effective taxation of such services.** It is not feasible to apply the reverse charge model to B2C imported services as consumers are unlikely to comply and the costs of forcing them to do so would be very high. Instead, the vendor collection model should apply. A foreign service provider should be required to register for GST if the level of their taxable supplies in the Maldives exceeds the registration threshold. The registration requirement should apply even where a foreign service provider does not have a place of business in the Maldives.

45. **Administrative measures can be put into place to facilitate compliance.** Foreign service providers should be able to deal wholly electronically with MIRA. Under this model, foreign service suppliers are required to register for GST, charge and collect GST on supplies to Maldivian consumers, and remit the revenue to MIRA. Those countries using the vendor collection model rely on achieving voluntary compliance through a simplified registration process for foreign service suppliers.²³ This typically requires issuing guidance on making payments for the GST due, through a simplified online registration and compliance process.

46. **The design of the rules for GST taxation of B2C imported services are now largely settled.** Following the work of the OECD and G20 under BEPS Action 1, the concept of “remote services” has been developed, which is now the norm for taxing B2C imported services.²⁴ In broad terms, remote services are services supplied where the supplier and recipient are not in the same jurisdiction at the time of supply. The supplier is located outside the Maldives without a fixed place of business in Maldives, while the recipient is in the Maldives. While the concept of remote services was developed for digital products and electronically delivered services, it should apply to any services (digital or not) provided to a customer in the Maldives by a foreign service provider that does not have a fixed place of business in the Maldives. For example, this is the approach taken in Australia and New Zealand.

47. **An alternative approach is to include a list of taxable digital services in the law.**²⁵ This approach is not preferred as it can be subject to tax planning through the structuring of digital arrangements to fall outside the list. It also means that the list must be regularly reviewed

²³ For examples of simplified registration processes see: Australia, <https://www.ato.gov.au/Business/International-tax-for-business/Non-resident-businesses-and-GST/Simplified-GST-registration/>; Norway, <https://www.skatteetaten.no/en/business-and-organisation/vat-and-duties/vat/foreign/e-commerce-voec/electronic-services/>.

²⁴ These rules are discussed in the OECD’s International VAT/GST Guidelines: <https://www.oecd.org/ctp/international-vat-gst-guidelines-9789264271401-en.htm> .

²⁵ Some countries (e.g., Indonesia) initially also listed particular companies in scope rather than activities, which brings its own challenges. While the idea of targeting just a few large players initially may help address concerns on administrative burdens created by the new rules, it comes with the challenge of identifying relevant companies and creates distortions between included and excluded suppliers.

and amended as new digital services are developed. While this is the current approach in Singapore, it is proposed that the rules will be extended to non-digital services from 2023.²⁶

48. **The remote services rule uses residence of the recipient of the services as the basis for locating a B2C supply of imported services in the Maldives.** This resolves a conflict that had emerged where some countries were locating B2C imported services at the physical location of the recipient of the services at the time of the supply, while other countries were locating such services at the place of residence of the recipient of the services. The absence of a uniform rule for B2C imported services resulted in double taxation and double non-taxation.

49. **Basing the place of supply on the residence of the recipient is a more certain test for the supplier to comply with than the actual physical location of the recipient at the time of supply.** Where the place of supply is based on the physical location of the recipient, it may be difficult for the supplier to know the precise location of the customer at the time of a particular supply. For example, a resident of Country X may be physically located in Country Y at the actual time of downloading an e-book, but the supplier may not know this.

50. **It should be made easy for the supplier to determine the residence of the recipient of the supply.** It is not appropriate, therefore, to use the income tax fiscal residence rules as the factors on which income tax residence is based may not be readily observable by the supplier. For example, one of the residence tests for individuals under the ITA is based on physical presence in the Maldives for 183 days or more in any 12-month period.²⁷ This is information that will not be easily observed by a foreign supplier of B2C imported services. Rather, the determination of the residence of the customer for GST purposes should be based on commercially observable indicators. It is important that the indicators used give an accurate indication of the recipient's residence, but also are easily collected by the supplier in the normal course of business to minimize compliance burdens. This and other design issues with the taxation of remote services are discussed in Annex II.

51. **Taxing foreign suppliers of B2C imported services directly is unlikely to change their behavior.** Concerns that it may be difficult to exert taxing rights over foreign suppliers, and that foreign suppliers will be deterred from supplying to the Maldives if GST compliance costs were introduced, especially given the small size of the Maldivian market, are not borne out by cross-country experience. In fact, perceived reputational costs associated with non-compliance are usually large enough to ensure registration and constructive engagement by major companies. This can be done through the intermediary of the large tax advisory firms that act for these companies worldwide. Moreover, the application of GST to foreign supplies of digital services is widely accepted and enshrined in OECD guidance. Over 60 countries have adopted the vendor collection model, including a growing number in Asia and small island developing states,

²⁶ See [https://www.iras.gov.sg/taxes/goods-services-tax-\(gst\)/consumers/purchasing-digital-services-from-overseas-service-providers](https://www.iras.gov.sg/taxes/goods-services-tax-(gst)/consumers/purchasing-digital-services-from-overseas-service-providers)

²⁷ Section 79(kk)(1)(ii) of the ITA

for both e-services and low-value imported goods. Modelling the GST legislation on approaches introduced by other countries is advisable to minimize compliance costs for large digital providers.

Supplies Made Through an Electronic Marketplace or Platform

52. **Supplies of digital products and electronic services may be provided through an electronic marketplace or platform.**²⁸ The operator of the marketplace or platform, rather than the underlying supplier, can be treated as the supplier and required to register if the value of taxable supplies made through the marketplace or platform exceeds the registration threshold. The threshold should take account of the value of third-party supplies made through the marketplace or platform, as well as any service fee charged. A registered operator of the marketplace or platform is liable to account for GST payable on supplies of digital products and electronic services ordered through the marketplace or platform. This will increase compliance as there are a much smaller number of such operators than underlying suppliers. However, it is usually limited to cases where the operator of the marketplace or platform has some control over the terms of the supply or is an intermediary for payment for the supply.

53. **The operator is liable regardless of whether the underlying supplier is registered or even required to apply for registration.** For example, a host under a Homestay or similar platform that makes a room available in their home to a guest may not be carrying on a taxable activity and, therefore, not required to be registered. Requiring the operator to account for GST avoids arguments about whether the host is carrying on a taxable activity, removes the compliance burden from the host, and ensures fairness as between hosts that are registered and those that are not.

54. **An exception can apply where the underlying supplier is GST registered in the Maldives.** In this case, the underlying supplier is responsible for the GST on the supply. As a simplicity measure, the underlying supplier may be permitted to agree with the operator of the marketplace or platform that the operator meets the GST obligations on the supply made through the marketplace or platform. However, the underlying supplier should remain liable if the operator of the electronic marketplace or platform fails to pay the GST.

55. **For goods or services supplied through an electronic marketplace or platform, the consideration for payment for the underlying supply, and the service fee charged for the use of the digital platform need to be distinguished.** The treatment of the underlying supply is discussed above. Some marketplaces or platforms charge service fees only to suppliers, but sometimes fees may be charged to both suppliers and users (e.g., Airbnb charge fees to both hosts and guests). In the case of Airbnb or VRBO, the fee charged to hosts will be subject to GST either under the reverse charge rule if the host is registered or as a supply of remote services in a

²⁸ Though some make a distinction between the terms (depending on the platform's direct involvement in the final stage of the transaction), this report uses the terms electronic marketplace and platform interchangeably.

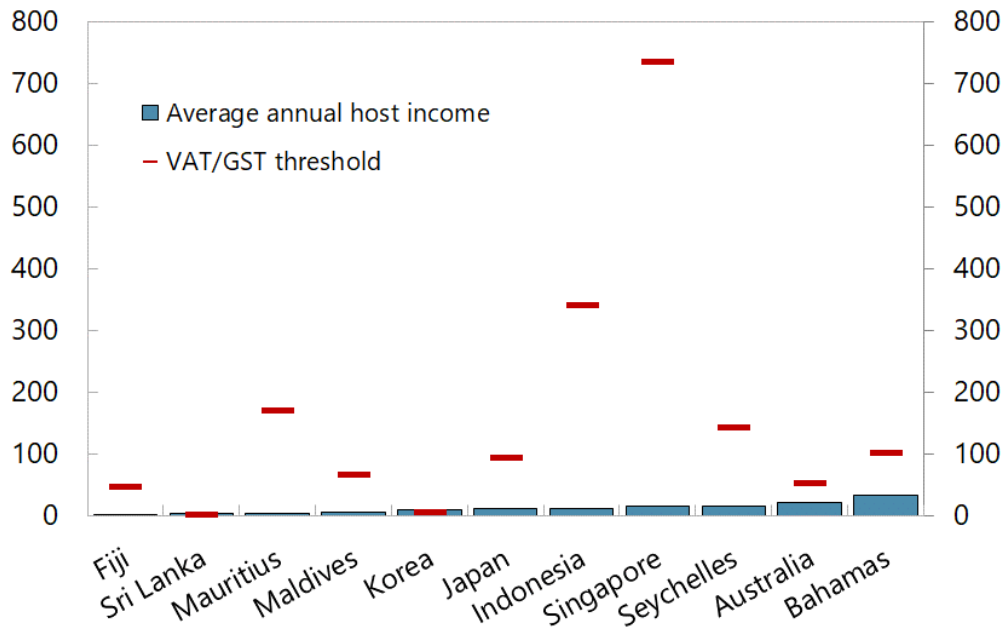
B2C supply. However, the fee charged to guests will not be a remote service where the guest is not a resident of the Maldives. In this case, a special rule is needed providing that the place of supply of the service provided to the user is the place of consumption of the underlying supply. In the Airbnb example above, this is the place where the accommodation is located.

56. **There remains significant controversy around the GST liability of ride-sharing companies (e.g., AVAS Ride), with Uber being at the center of several national court challenges.** If these companies are classified as transportation companies with employed drivers its entire turnover from the provision of services would be subject to GST (IMF, 2021b). However, if they are considered simply intermediation service providers to self-employed individuals, the current practice has been to exempt these services as most drivers do not have enough turnover through the app to meet GST registration thresholds. The Maldivian legislation should closely track international developments as practices normalize.

57. **Major online intermediaries (e.g., Airbnb, VRBO) are increasingly making provisions to collect taxes on behalf of governments and the Maldives should take advantage of this option.** As shown in Figure 11, most Airbnb hosts in the Maldives and comparator countries do not earn enough per year through the platform to meet the GST registration thresholds. To widen the domestic VAT net to such taxpayers, Canada and India have recently announced revisions to VAT rules for accommodation/hospitality services facilitated by online marketplaces/platforms, which include a requirement to collect tax on supplies made through their platforms by all nonregistered domestic suppliers – including those considered to be small suppliers below the current VAT registration threshold. The Bahamas have also recently changed their VAT law to clarify that online marketplaces such as Airbnb and VRBO are required to remit VAT on the value of rental services, as well as their commissions. This practice may be attractive for the Maldives as an effective means to mitigate potential negative impacts on GST revenue²⁹ and administrative burden from the growth of small suppliers in the sharing economy (Aslam and Shah, 2017). For example, as of January 2020, Airbnb had over 400 agreements with local and national governments and organizations around the world on the automated collection of tourism taxes. In collecting taxes, the online retailer usually: (i) favors simplicity (i.e., levying one tax/levy rather than a combination of several taxes/levies); and (ii) advocates equal treatment (i.e., all online platforms should be asked to collect and remit taxes).

²⁹ Based on an average daily rate of USD 132 per night and barely over 500 current listings, the mission estimates the potential added GST revenue from starting to tax existing Airbnb hosts in the Maldives is minute at present (only about 0.01 percent of GDP). However, estimates from other small tourism dependent countries with a larger presence of online marketplaces for vacation homes go up to 0.3 percent of GDP, suggesting this potential could grow over time as these types of platforms expand their presence in the country.

Figure 10. Average Income from Airbnb Inc. by Country vs Indirect Tax Thresholds (USD thousands)



Sources: airdna.com and alltherooms.com based on highest average monthly revenues for hosts in large cities in each country in 2021.

Imported Goods Ordered Online

58. **Currently, only import duty is imposed on imported goods.** The imposition of import duty is subject to a low value imported goods (LVIG) exemption set at MVR 6,000 (USD 388).³⁰ In other countries, it has been common for a LVIG exemption to apply to both import duty and GST. This has been justified on the basis that it facilitates trade and achieves a balance between the cost of collection and the revenue received. While the LVIG exemption is a simplification measure it does create a distortion in favor of foreign suppliers as equivalent local purchases are subject to GST.

59. **E-commerce has made it easier for foreign companies without a domestic presence to supply goods to consumers in different countries and, as a result, the volumes of these transactions have increased globally as a result of digitalization.** This has exacerbated the fairness issue for local suppliers and increases revenue forgone for the government. Bringing LVIG into the tax net can be difficult, though, where goods are imported as personal items.

60. **In response to growing volumes of LVIG, several countries³¹ have eliminated or reduced GST relief for LVIG, without interfering with the exemption threshold for customs duties.** Where this step has been taken, simplified methods for foreign businesses to register,

³⁰ Law No: 31/79 (Maldivian Import Export Act).

³¹ Including Australia in 2018, New Zealand 2019, Norway 2020, and EU members in 2021.

account, and remit GST to the consumers' jurisdiction have been introduced and/or liability for intermediary marketplaces and platforms as discussed above has been extended to LVIGs. This avoids the administrative difficulties in collecting GST on LVIG at the border (including by the postal service).

61. **The taxation of LVIG can apply to foreign sellers, electronic marketplaces and platforms, and re-deliverers.** A re-deliverer is a foreign entity that provides Maldivian consumers with access to goods that foreign businesses do not normally ship to the Maldives. Re-deliverers may provide an address outside the Maldives to which goods can be delivered and then the re-deliverer redelivers the goods to the Maldivian customer. Alternatively, they may provide online shopping services to Maldivian consumers acting as agent in the purchase of goods outside the Maldives.

62. **The normal GST registration threshold should apply to foreign sellers, electronic marketplaces and platforms, and re-deliverers.** For operators of electronic marketplaces and platforms, as well as re-deliverers, the threshold should take account of the value of third-party sales made through the marketplace, platform, or the re-deliverer, as well as any service fee charged. The simplified methods outlined above for foreign businesses to register, account, and remit GST to the Maldives should apply also to registered persons under the LVIG regime.

63. **The taxation of LVIG is achieved by providing a special place of supply rule for such goods.** The basic requirement of the rule is that the foreign supplier, operator, or re-deliverer arranges for the delivery of the LVIG to the Maldives. This results in the supply of LVIG being a supply in the Maldives and, therefore, a taxable supply. If registered, the foreign supplier, operator, or re-deliverer is required to charge GST on the supply of the goods. Where the LVIG rule applies, the import rules are excluded so that GST is not charged at the border. This type of arrangement is usually limited to low value goods, where the value may be based on the exemption threshold that previously applied. The GST on imports of other goods should be collected at the border. The mission estimates expanding collection of GST to LVIG could yield at least 0.1 percent of GDP in additional revenues, extrapolating from data shared by the Customs authority for December 2021.

Recommendations

- Treat digital products as services so that the rules for imported services apply.
- Apply the reverse charge model to B2B imported services requiring registered persons to account for GST on imported services received including on internal transfers of services.
- Consider applying the reverse charge rule to imported services received by unregistered persons primarily making exempt supplies and Government entities.
- Apply the vendor collection model to B2C supplies of remote services and LVIG.

- Require operators of electronic marketplaces and platforms through which remotes services and LVIG are supplied to be registered and collect GST.

GST Treatment of Digital Currencies

64. **There is experience in the Maldives of supplies of goods or services being paid in digital currencies (i.e., cryptocurrencies).** Money is the measure of value under the GST. A supply of goods or services is made in return for the price of the goods or services. The price is usually paid or expressed in money. There is no definition of “money” in the GSTA so it will have its ordinary meaning, namely –coins and notes that are legal tender. It is clear from section 62(a) of the GSTA that money is intended to include foreign currency (i.e., foreign legal tender). In broad terms, legal tender is currency that is designated as legal tender under legislation and is usually issued by a central bank. Digital currencies are not money within the ordinary meaning because they are not issued by a central bank and are not legal tender.

65. **Initially, some countries, such as Australia, classified digital currency as intangible property for GST purposes.** Based on EU case law, the UK and EU have classified a supply of digital currency as a supply of financial services (i.e., an exempt supply). Australia now treats digital currency used as the price for goods or services to have the same GST treatment as money. Each of these possible classifications is discussed below.

Digital Currency as Intangible Property

66. **The treatment of digital currency as intangible property means that it is classified as “services” for GST purposes.** As such, a supply of digital currency is a taxable supply of services subject to GST. On this basis, a transaction whereby digital currency is used to “pay” for goods or services is treated as a barter transaction.

67. **The classification of digital currency as intangible property can result in higher GST taxation for final consumers than if goods or services are paid for with money.** For example, assume that X (consumer) purchases MVR 100 worth of digital currency from a domestic digital currency exchange. The supply of digital currency by the operator of the exchange is a taxable supply of services and, assuming a 6 percent GST rate, MVR 6 in GST is charged on the supply. X then uses the digital currency to purchase goods costing MVR 100 with MVR 6 in GST payable on the supply. Consequently, X has borne MVR 12 in GST in purchasing goods worth MVR 100. If X had used legal tender to acquire the goods, rather than first acquiring digital currency, the GST cost would be MVR 6. This is because no GST is charged on the acquisition of money.

Exempt Supply Treatment

68. **A supply of digital currency may be treated as an exempt supply of financial services.** This means that no GST is charged on the acquisition of digital currency. However, it does mean that the operator of the digital exchange in the example above will not be entitled to

any input tax credits in making an exempt supply of digital currency. It also means that traders may incidentally deal in digital currencies. For example, a trader may accept digital currency as payment for a supply of goods or services and then use the digital currency to purchase business inputs or convert it to money (i.e., legal tender). This means that a trader that accepts digital currency as payment may make exempt supplies that could result in some loss of input tax credits. In this regard, the *de minimis* rule in Regulation 49 may apply to limit this possibility, although this may depend on the volume of purchases made with digital currencies.

Digital Currency Treated the Same as Money

69. **An alternative approach is for digital currency to have the same GST treatment as money when it is used to pay for supplies of goods or services.** This is now the approach in Australia. Under this approach, the only treatment of digital currency as a supply is when local or foreign currency is converted to digital currency, or vice versa. This is the same treatment when local currency is converted to foreign currency, and vice versa. The supply of digital currency in these circumstances is an exempt supply of financial services. Arguably, treating digital currency as the equivalent of money is the technically correct approach.

Definition of Digital Currency

70. **Treating digital currency, the same as money or as an exempt supply requires a definition of digital currency.** In broad terms, a digital currency is a digital asset secured by cryptography operating through a public automated and consensus-based distributed ledger that records and validates transactions, often in the form a blockchain. As the design of digital currencies is subject to ongoing technical change and development, it is difficult to define in legislation. Further, there are digital assets that bear some similarities to digital currencies, but which are not sufficiently similar to fiat currencies to be treated the same as money for GST purposes (e.g., non-fungible tokens).

71. **There are two possible approaches to defining digital currency in GST legislation.** First, the central criteria of a digital currency that aligns it with fiat currencies (such as CNY) can be specified and the digital asset is then tested against these criteria for classification as a digital currency. Alternatively, digital assets that qualify as digital currencies can be expressly listed in Regulations. The advantage of the first approach is that it provides greater flexibility in dealing with the evolving nature of digital currencies. The definition can apply automatically to new digital currencies and cease to apply to existing digital currencies if their attributes change to no longer satisfy the criteria. Under the listing approach, there will be a time lag between development and listing as a digital currency, and in removal from the list. Given the large number of possible digital currencies today, keeping the list up to date will be a significant administrative burden.

72. **It is best practice, therefore, to define “digital currency” by reference to the key features of such currency that align them with fiat currencies.** “Digital currency” can be defined to mean digital units of value that satisfy all the following conditions:

- The digital unit is fungible. This means that the digital unit must be fully interchangeable for the purposes of use as the price for a supply. A digital asset that is valuable because of a specific feature (such as a photograph) is not a digital currency. The fungibility requirement does not require that individual digital units cannot be identified, rather just that they can be used interchangeably as consideration. For example, bank notes have a serial number for identification, but the serial number does not affect the value of the note.
- The digital unit can be provided as the price for a supply of goods or services. In other words, the digital unit must be suitable for use as a medium of exchange. A digital asset that is not suitable for use as the price for a supply is not a digital currency. For example, loyalty points provided by retailers that can be used only for the redemption of products sold by the retailer are not a digital currency.
- The digital unit must be generally available to members of the public without any substantial restrictions on their use to pay for supplies of goods or services. A digital asset that is “currency” used in online gaming is not a digital currency as the “currency” can be used only in the game. Minor restrictions on use should not prevent a digital unit from being a digital currency if the other requirements are satisfied.
- The digital unit is not denominated in the currency of any country. For example, a digital unit that has its value pegged to a fiat currency (such as USD) is not a digital currency.
- The value of the digital unit does not depend on, nor is derived from, the value of anything else. For example, a derivative is not a digital currency as its value is not derived from its ability to be used as the price for goods or services.
- The digital unit does not give an entitlement to receive, or to direct the supply of, a particular thing or things, such as memberships or vouchers. There is an exception where the entitlement is incidental to the holding of the digital units of value or using the digital units of value as consideration. This exception applies, for example, to the updating of a digital ledger to recognize transactions.

73. **To avoid overlap, the definition of digital currency should expressly exclude money (i.e., legal tender).** Currently, it is unlikely that there is any overlap between the definition of “money” and the definition of “digital currency”, however, that may change, for example, if a government were to issue digital currency, or adopt an existing digital currency, as legal tender (e.g., the recent case of El Salvador).

Conversion

74. **The value of a taxable supply is expressed in local currency or USD in the case of tourism supplies.** This means that, where the price for a taxable supply is paid for by digital currency, the digital currency amount must be converted to currency. This may not be an easy task as there is no central authority or foreign exchange reference rate for digital currencies comparable to the ones published in respect of fiat currencies. Further, digital currencies may be traded on multiple exchange platforms and, therefore, its value in fiat currencies may vary at any given moment, depending on the exchange platform. This may make it difficult to determine the most appropriate exchange for conversion purposes. For this reason, a definitive conversion rule may not apply, but rather a requirement to convert based on the most appropriate exchange rate in the circumstances.

Recommendation

- Provide that a supply of digital currency in return for goods or services is either a supply of money (preferably) or an exempt supply of financial services.

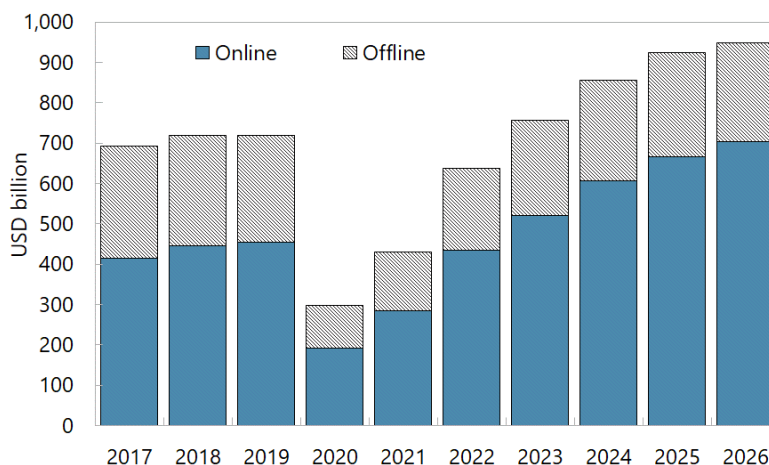
GST Taxation of Offshore Booking Platforms for Tourist Accommodation

75. **Offshore booking platforms for tourist accommodation are a special case of digital service provision where both the platform and consumer may be outside of the Maldives, but the underlying service is ultimately supplied in the Maldives.** Overall, globally online sales channels have been capturing an expanding market share of tour packages and travel bookings (Figure 11). For the Maldives specifically, nearly 70 percent of all accommodation bookings in 2021 were made through either foreign tour operators or offshore travel agents.³² There are two business models for the operation of offshore booking platforms: (i) a Maldives resort makes a bulk “sale” of rooms at a discount to the offshore booking platform that then “on-sells” the rooms to tourists; or (ii) the offshore booking platform acts as agent to facilitate room bookings by tourists. Under the current law, the GST treatment differs depending on the model used (see discussion below). The mission estimated adequately capturing this type of offshore tourism value-added could yield about 0.2 percent of GDP in additional GST revenue.³³

³² Based on guest information collected through the green tax form.

³³ Based on the relative size of the online segments of the travel, tourism and mobility services surveyed by Statista worldwide, adjusted for the absolute size of the Maldivian tourism sector, and assuming an offshore seller markup of 5 percent.

Figure 11. Global Travel and Tourism Revenue by Sales Channel



Source: Statista and IMF staff calculations. Note: market projections 2021 onwards.

76. **The discussion below focuses on tourist accommodation but is equally relevant to other tourism products, such as meals and tours, that may be packaged with accommodation and provided through a booking platform.** It is understood that tourism packages are more commonly provided by booking operators that are related to the owner of the accommodation in the Maldives. Independent booking operators tend to provide only accommodation bookings.

Bulk Sale of Rooms

77. **The bulk sale of rooms involves two transactions: (i) the “sale” of the room by the Maldives resort to the offshore booking platform; and (ii) the “on-sale” of the room by the platform to a customer.**³⁴ Under this business model, the operator of the offshore booking platform acts as principal in the sale of accommodation to tourists. Currently, TGST applies only to the discounted price charged by the resort to the operator of the booking platform. The on-sale of the room is outside the scope of the TGST being a supply that takes place from a place of business outside the Maldives to a customer outside the Maldives. It is understood that a substantial percentage of sales of rooms by Maldives resorts is to booking platforms operated by related parties and the price discounts can result in a significant shift of value added outside the Maldives and, therefore, outside the current TGST base.

78. **While commercially this model refers to the “sale” of rooms, what is actually “sold” is a right to occupy accommodation in the Maldives.** This right is an intangible and, therefore, counts as “services” for GST purposes. Consequently, the rules relating to services apply. There may be an argument that the supply of services by the resort to the offshore booking platform is a zero-rated export of services given the resort supplies the services to a person who has no

³⁴ The Australian rules for GST on sales of Australian accommodation by offshore sellers are illustrated by examples at: <https://www.ato.gov.au/Business/GST/In-detail/Your-industry/Travel-and-tourism/GST-on-sales-of-Australian-accommodation-by-offshore-sellers/>

place of business in the Maldives and who uses the rooms in their business activity of selling rooms to tourists, which activity is undertaken outside the Maldives. However, the sale of rooms (service) by the resort relates to immovable property in the Maldives so may be excluded from being an export. The norm is that services relating to immovable property are treated as supplied at the place where the property is located.

79. **This norm will not apply to other tourism products that may be packaged with accommodation, such as meals (board) and tours.** To avoid any argument, it should be expressly provided in the GSTA that the supply of any inbound tourism product is not an export. For this purpose, “inbound tourism product” means accommodation, meals, transport (transfers), tours, and other tourist activities in the Maldives.

80. **As the sale of rooms to the offshore booking platform is a taxable supply subject to TGST, one option to deal with the shifting of value added to a related person operating the offshore booking platform is to adjust the consideration for the supply to the open market value of the supply.**³⁵ If the Maldives resort also sells rooms to an unrelated booking agent, then the consideration for the supply can be used as the open market value of the supply to the related person operating the platform offshore. This will increase the TGST base applicable to the supply by the Maldives resort to the booking operator (thereby mitigating transfer pricing risks to the Business Profit Tax (BPT) base as well) but will not capture the full value of the accommodation.

81. **The trend of package holiday providers to switch from mere travel organization to in-house fleet and hotel provisions is likely to exacerbate transfer pricing risks related to the taxation of offshore tourism service sales.** This trend will be all the more important for the Maldives as China and other Asia Pacific countries return as major tourist sources post-pandemic. While arrivals from these countries have dwindled due to travel restrictions on their side post-COVID, and the composition of tourist arrivals changing towards India and Russia, East Asian tourist arrivals are expected to resume post-pandemic. Notably, those tourists tend to rely more heavily on package holidays, with travel and accommodation sold for one price. As online travel agencies, such as Expedia and Opodo, increase their market share in the package holiday segment, large package holiday providers, such as Tui, have been changing the focus of their business from travel organization and flights to buying their own cruise ships and building their own hotel chains, increasing transfer pricing opportunities to be used in lowering value added recorded in the Maldives, absent explicit digital service taxation targeted at offshore tourism service sellers.

82. **To ensure that the full value of inbound tourism products is subject to TGST in the Maldives, a special place of supply rule should be included in the GSTA to the effect that a supply of inbound tourism products is a supply of services in the Maldives.** This aligns with the export rule mentioned above. This will mean that the supply of accommodation and other

³⁵ Regulation 25

inbound tourism products by the offshore booking platform is a taxable supply. As there is no registration threshold for the TGST, the operator of the offshore booking platform will be required to register for GST and charge TGST on the value of supplies of inbound tourism products to customers with an input tax credit allowed for the TGST paid to the Maldives resort. This will ensure that the full value of rooms and other inbound tourism products are fully taxed in the Maldives. Further, it will ensure neutrality in the TGST treatment of tourist accommodation regardless of whether the tourist acquires the accommodation directly from the resort or through an offshore supplier.

Offshore Booking Platform as Agent

83. **Under the alternative business model, the offshore booking platform may act as an agent for the Maldives resort.** In this case, the operator of the offshore booking platform charges a commission or fee for the service of booking accommodation on behalf of the Maldives resort. It may be the case that the operator of the offshore booking platform also charges the tourist a fee for the booking service.

84. **As the relationship between the Maldives resort and the operator of the booking platform is an agency relationship, the contract for the supply of accommodation is between the resort and the tourist.** There are two possible payment methodologies under the agency model: (i) the tourist pays the Maldives resort the full amount of the room cost, and the Maldives resort separately pays commission to the agent; or (ii) the tourist pays the agent the full room cost and the agent passes on this payment to the Maldives resort net of commission.

85. **Under both payment methodologies, the Maldives resort should be accounting for GST on the full amount of the accommodation cost payable by the tourist (before commission).** This is relatively straightforward where the tourist pays the accommodation cost directly to the resort. In this case, as the amount paid is inclusive of the agent's commission, the value added by the agent will be captured in the price of the room and, therefore, there is no need for separate GST taxation of the commission.

86. **It is understood that, under the second payment methodology, resorts have been paying TGST only on the net amount remitted for the room.** Resorts have indicated that they do not know the full price paid by the tourist as this is paid to the booking agent. As stated above, under the agency model, the contract for the supply of accommodation is between the resort and the tourist, so the resort should have access to information concerning the full amount paid by the tourist under the agency agreement. At a minimum, the resort will have agreed a rate of commission under the agency agreement that could be used to convert the net amount to a gross amount being the full cost of the accommodation. GST should then be levied on that amount.

87. **A booking agent may also charge a tourist a separate booking fee.** This will not be captured in the room cost. This should be treated as a supply that occurs in the Maldives based

on the rule proposed above in relation to electronic marketplaces and platforms. Though international practice is still mixed, given the potential for double non-taxation if the Maldives were to exempt booking fees from TGST (e.g., if the country of tourist residence treats the booking fee as a service export for tax purposes), the risk of incentivizing business model shifting by OTAs towards charging fees rather than a value-added price markup, and the importance of tourism services for the Maldivian economy, the mission recommends equal TGST treatment of all fees (agency and booking) as well as value-added pertaining to the on-sale of any inbound tourism services ultimately consumed in the Maldives.³⁶ Since the underlying supply is a supply of tourism services, the offshore booking agent is therefore required to register and account for GST on booking fees charged to tourists.

Recommendations

- Treat a supply of inbound tourism products and booking services related to these products as a supply in the Maldives.
- In the short term, strictly enforce adjusting the consideration for the supply to its open market value (using the arm's length principle) for discounted accommodation sales to related parties to mitigate transfer pricing risks.
- Over the medium term, introduce a simplified supplier registration process and collection mechanism to facilitate compliance by non-residents.
- Introduce reporting requirements to leverage marketplace information for compliance management.

E. Other Design and Implementation Issues

Registration Threshold

88. **The registration requirements under the GSTA follow international norms providing for both compulsory and voluntary registration.** Aiming to balance the administrative burden to MIRA and compliance costs for very small businesses, a registration threshold applies to the GGST but not to the TGST. The registration threshold for the GGST has been set at an annual value of supplies of goods and services in excess of MVR 1,000,000 (approx. USD 65,000). Importers of goods for business purposes are required to register for GST regardless of turnover. This is no doubt a consequence of GST not currently applying to imports

³⁶ As an evolving issue, there is still significant international disparity in the treatment of booking fees related to accommodation services in each jurisdiction charged by a foreign platform to an overseas consumer. As of 2021, many countries (including Australia, Singapore, Japan, the EU, etc) do not apply domestic VAT to such fees unless the customer resides in their jurisdiction, as they are considered to be services consumed overseas. In contrast, Mexico, South Korea, and Malaysia do apply domestic VAT to booking fees paid by overseas consumers upon booking accommodation located in their respective jurisdictions.

of goods. If imports are included in the GST base, this compulsory registration requirement can be deleted. Current legislation also allows for businesses with turnover below the threshold to voluntarily register for GST, which is attractive for businesses primarily making taxable supplies to registered persons.

89. **The GGST registration threshold has not changed since the GGST was introduced in 2011.** In 2021 Q3, according to MIRA administrative data, over 97 percent of GGST revenue was collected from businesses with an annual turnover in excess of MVR 2,000,000. Given the low level of revenue contribution from small GST registered businesses, consideration should be given to increasing the registration threshold. The mission endorses the recommendation in Hebous and others (2020) that the threshold could be increased to MVR 1,500,000 or MVR 2,000,000. Increasing the threshold would significantly decrease the number of registered taxpayers,³⁷ thereby also lowering both administrative costs for MIRA and compliance costs for taxpayers while having only marginal impact on revenues. An increase in the GST registration is further supported by the recommended introduction of a presumptive tax for unregistered small businesses.

90. **Concerns about GST compliance by small businesses may justify including a limitation on voluntary registration.** One option is to put a floor on voluntary registration so that only small businesses with a turnover above a specified amount can voluntarily apply for registration. This could be set at MVR 500,000 - the amount applicable for applications for deregistration.³⁸ Another option is to limit voluntary registration based on the level of supplies made to registered persons. For example, it could be provided that a small business can voluntarily apply for registration only if they principally make taxable supplies to registered persons. Given the zero-rating of basic foodstuffs, the first option may be preferred so that smaller (but not micro) retailers can apply for registration even though they are the end of the distribution chain.

91. **The absence of a registration threshold for the TGST will be challenged by policy changes aimed at diversifying the tourism sector to encourage the mid-range and the lower end tourism markets.** This includes encouraging the establishment of small guesthouses and homestay arrangements, although operators of the homestay platforms could be liable to account for the TGST on stays at Maldives' properties. Like any small business, smaller tourism operators will struggle to comply with GST's record-keeping and reporting obligations. The application of the presumptive tax to the tourism sector would facilitate the same registration threshold applying to both the TGST and GGST.

³⁷ The number of total active GST taxpayer identification numbers have increased from 2,474 in 2011 to 15,623 in 2021.

³⁸ Section 55(a)(1) and (2) of the GSTA.

Recommendations

- Increase the registration threshold to MVR 1,500,000 or 2,000,000.
- Apply the presumptive tax to the tourism sector to facilitate a uniform registration threshold for both the TGST and GGST.
- Consider including a limit on voluntary registration.

Small Business Presumptive Tax

92. **The Maldives does not have a simplified tax regime for small businesses, as is common around the world.** Small businesses subject to GST registration requirements face the same income tax and GST system as other businesses, which exposes them to significant compliance costs to meet reporting and accounting requirements. On the other hand, if a business' taxable activities place it under the GGST registration threshold, it currently falls outside the GST revenue net but may still be liable for BPT or PIT. Most simplified SME regimes globally function on a presumptive basis, applying a low uniform tax rate on turnover of businesses below the GST/VAT registration threshold. Doing so while allowing for voluntary registration (e.g., for businesses making extensive supplies to other registered businesses) typically reduces compliance costs for businesses, as well as the administrative burden for the revenue administration to handle returns of a large number of taxpayers for little revenue gain.

93. **Introducing a presumptive tax on small businesses in lieu of BPT/PIT and GST in the Maldives can complement an increase in the GST registration threshold.** The mission endorses the recommendation in Hebous and others (2019 and 2020) for the introduction of a turnover-based presumptive tax set at a moderate rate of 2 or 3 percent for businesses that are not registered for GST.³⁹ Given normally higher financial sophistication and profit margins, liberal professionals,⁴⁰ and publicly listed companies with turnover below the registration threshold should be excluded from this regime and required to register. This will allow MIRA to focus on larger businesses from whom most the revenue is collected. It is worth noting that the introduction of a presumptive tax will require a review of the PIT brackets following its recent introduction, to ensure compatibility between the presumptive tax and PIT, given a currently very high tax-free threshold of (MVR 720,000) and low first marginal rate of 5.5 percent potentially

³⁹ Note the rate recommended here is slightly lower than that in Hebous and others, as the latter was based on hypothetical higher personal income tax rates and lower personal income tax brackets than those that were ultimately introduced in 2020. Given current BPT and GGST (TGST) rates, a domestic (tourism) company with a 10 percent taxable profit margin and 15 percent value-added in sales would break-even at a 2.4 (3.3) percent rate. Applying the same rate to all sectors, and to dissuade currently registered small taxpayers from switching to the presumptive regime after an increase in the registration threshold unless truly encumbered by compliance costs, the mission recommends a 2-3 percent range.

⁴⁰ Understood to be individuals exercising activities regulated by professional bodies, on the basis of special skills.

incentivizing many sole traders to register under the PIT to mitigate overall tax liability. Doing so should require GST registration as well.

Recommendations

- Introduce a presumptive tax set at 2 or 3 percent of turnover for small businesses with turnover under the registration threshold.
- Review compatibility of the presumptive tax and the PIT tax-free threshold.

Small GST Registered Businesses

94. **There are generally two options for simplification of the GST as it applies to small businesses: (i) simplified GST calculation; or (ii) simplified administrative procedures.** Beyond the presumptive tax discussion above for non-registered businesses, it is important to consider the application of GST to small businesses that are registered, including those businesses that have done so voluntarily. They may experience cash flow problems where invoice GST accounting applies (the general rule in the Maldives), or still find it difficult to comply with GST record-keeping and reporting requirements. Simplifying the GST to these businesses can be done through simplified administrative procedures (which focus more on the cash flow problem), or through a simplified GST calculation (which focuses more on reducing the record-keeping burden). The latter, usually applying a specified percentage of turnover to determine net GST/VAT payable liability for small businesses, are not considered best practice, since they can significantly increase the complexity of the administration of GST for the revenue administration authority.

95. **The GST compliance burden for small, registered businesses can be best addressed through administrative simplifications, such as: (i) allowing payments-based GST accounting; or (ii) providing for a longer reporting period.** Under payments accounting, a registered person reports output tax in the taxable period in which it is received and claims input tax credits in the taxable period in which the input tax is paid. This focuses primarily on cash flow by aligning the GST burden of small registered businesses with their cash flow. However, this approach raises a challenge when co-existing with invoice accounting, by facilitating the potential risk of missing trader fraud (where a buyer using the invoice method may claim an input tax credit that is due to be paid by a payments-based supplier only upon receipt of the payment, which may never happen). Alternatively, a longer filing period, usually quarterly, could apply. This both eases the cash flow burden and reduces the compliance burden through reduced reporting requirements.

96. **The GSTA already provides for both payments accounting and quarterly reporting but keeping only the latter option should suffice.** Note the threshold for each differs with a much higher threshold applying to quarterly reporting (MVR 1 million taxable supplies per month, compared to MVR 2 million per year for payments-based accounting). Payments-based accounting requires complex rules applying to changes in accounting method as businesses

move from payments to invoice accounting, and vice versa, to avoid non-taxation and double taxation. Currently, there are no rules in the GST legislation dealing with the movement between GST accounting methods. In addition, the GSTA already provides for a reduction in GST liability corresponding to irrecoverable debts under the invoice accounting method. Given the narrow focus of payments accounting on cash flow, it is considered that quarterly reporting provides greater compliance relief for small, registered businesses. Further, there is less complexity with the movement between quarterly and monthly reporting as compared to the movement between payments and invoice accounting.

97. **If payments accounting is retained, clear rules dealing with movement between payments and invoice accounting should be provided.** While the GSTA and Regulations include reporting obligations on a change in accounting method, the Act should expressly provide for the treatment of GST under such a change to avoid double taxation or double crediting, and non-taxation or non-crediting, as a result of the change. For example, on a move from payments to invoice accounting, output tax invoiced before the change but received after the change should be reported in the taxable period after the change and input tax invoiced before the change but paid after the change should be credited in the taxable period after the change.

98. **In addition to payments accounting, the GSTA provides for a third methodology with no active use: the hybrid method.** This method involves accounting for output tax on an invoice basis and input tax on a cash basis. Likely copied from the New Zealand GST legislation, the method has little relevance to the Maldives situation. It is understood from both the private sector and MIRA that it is not used, and so it should be deleted in the rewritten GSTA.

Recommendations

- Do not introduce simplified GST calculations.
- Provide cash flow and compliance relief for small, registered GST businesses through the option of quarterly reporting.
- Eliminate both payments-based and hybrid GST accounting.

Refund of Excess Input tax

99. **There will be taxable periods where a person's input tax exceeds output tax.** For registered persons primarily making zero-rated supplies, this will be a regular feature of their business. For other registered persons, excess input tax may arise from time to time due to events such as a large purchase of inventory, the purchase of capital equipment, or a downturn in sales.

100. **There is no refund mechanism for excess input tax under the GST legislation.** While section 32 of the GST Act provides for refunds, it applies only where a registered person has

overpaid tax to MIRA. This will not cover an excess input tax credit situation. Regulation 69 of the Tax Administration Regulations also applies to an overpayment of tax providing for the offset of the overpayment against other tax liabilities, including future tax liabilities. It is expressly provided in Regulation 69(e) that excess input tax can only be carried forward and offset against future output tax. There is indefinite carry forward.

101. **The no refund rule applies regardless of how the excess input tax arises.** For those registered persons primarily making zero-rated supplies (e.g., exporters and suppliers of basic foodstuffs), this means that the amount of carried forward excess input tax continues to grow as there will be little or no output tax against which to offset input tax. In other cases, the excess input tax is likely to be offset over time against output tax. In some cases, such as a large purchase of inventory, this may be a relatively short period of time as the inventory is sold. In other cases, such as business start-ups, recovery of excess input tax may take longer. It is noted that, as recommended below, an immediate credit for input tax on large capital purchases will increase excess input tax.

102. **For GST to be a fully neutral tax for businesses, a properly functioning input tax recovery mechanism must be put in place.**⁴¹ For a country like the Maldives, the best practice is to provide for immediate refunds of excess input tax to those registered persons primarily making zero-rated supplies and a short carry forward period in other cases. Registered persons primarily making zero-rated supplies will always have excess input tax, so a process needs to be put in place to facilitate regular refunds of the excess. For other registered persons, an excess input tax should only be a temporary situation and, therefore, a short carry forward period (3 – 6 months) could apply to allow for a “smoothing” out of excess input tax without the immediate administrative burden of paying a refund. At the end of the carry forward period, the excess could be set off against other tax liabilities of the registered person and, if none exist, refunded.

103. **A change in the law to allow for refunds of excess input tax will require a strategy to deal with the existing “stock” of carried forward excess input credits.** Any carried forward excess that relates to businesses that have shut down can be written off. For other registered persons, a transitional rule will be needed to deal with the pre-existing carried forward excess. For those registered persons primarily making zero-rated supplies, the excess should be refunded either in a lump sum or in instalments over several taxable periods. For other registered persons, the pre-existing carried forward excess can be bundled up into a single amount of input tax allowed as a credit in the first period after the refund rule comes into operation. It can be carried forward along with any new excess over the carry forward period and then any uncredited amount at the end of the carry forward period applied against other taxes or refunded. According to administrative data made available to the Mission, the current stock of outstanding

⁴¹ See IMF (2021a) for an overview of best practices in management of VAT refunds.

GST refunds should not amount to more than 0.04 percent of GDP, suggesting dealing with this transition should be fiscally feasible.

Recommendations

- Provide immediate refunds of excess credits for registered persons primarily making zero-rated supplies.
- Provide for a short carry forward period (3-6 months) for excess credits in other cases.
- Develop a transition strategy for refunding existing excess credits.

Input Tax Credits on Capital Investment

104. **The three-year write off period and the deferred start of that period for input tax in relation to capital expenditure are important departures from the international norm.**

Likely measures intended to limit the arising of excess input tax credits and resulting refunds, the current regulations include two important limitations on the crediting of input tax paid in relation to capital expenditure. First, Regulation 46(a)(2) provides that input tax incurred in relation to capital expenditure in excess of MVR 500,000 is credited equally over a period of 36 months from the taxable period in which the expenditure was incurred rather than being fully creditable in the taxable period in which the input tax was incurred. Any uncredited amount at the end of the 36-month period is carried forward indefinitely. Second, Regulation 46(a)(4) provides that the 36-month period does not commence until output tax is first generated by the taxable activity. There is an issue as to whether the GSTA properly enables the making of these Regulations, particularly as section 37(b) of the Act seems to expressly provide for the crediting of the “full” amount of input tax that satisfies the terms of the section.

105. **The input tax credit mechanism is an essential component of the GST as it ensures that, ultimately, GST is payable only on private consumption.** Any deficiencies in the input tax credit mechanism can have the effect of imposing GST on investment and production, and result in the cascading of tax. The norm is that credit for input tax should be allowed in the taxable period in which it is incurred (invoice basis) or paid (payments basis). Limitations on claiming input tax credits are likely to have negative impacts on investment and administration and should be eliminated. Current provisions distort GST neutrality across business sectors, disadvantaging businesses requiring significant investment in capital assets. In addition, compliance and administrative costs are increased due to monitoring needs of input tax credit claims over a 36-month period.

Recommendation

- Eliminate limitations on claiming input tax credits for capital expenditure.

General Anti-avoidance Rule

106. **A specific anti-avoidance rule is targeted at a particular transaction or arrangement.** Once a specific anti-avoidance rule is enacted, the targeted tax avoidance activity is closed. Importantly, a specific anti-avoidance rule has no real scope of application beyond the targeted tax avoidance activity. Some countries rely solely on specific anti-avoidance rules to counter tax avoidance. This means, though, that the response to tax avoidance is always reactive in the sense that the government is constantly responding to the existence of a particular tax avoidance activity.

107. **In recent years, many countries have introduced a general anti-avoidance rule (GAAR) to provide a more flexible approach to countering tax avoidance arrangements.** A GAAR differs from a specific anti-avoidance rule as it is not targeted at a particular tax avoidance activity. Instead, a GAAR is intended to have an ongoing application to different types of transactions or arrangements that may exist currently or in the future. Consequently, a GAAR is a proactive measure for dealing with tax avoidance.

108. **While there are some specific anti-avoidance rules in the GSTA and Regulations (such as open market value rules for related party transactions), there is no GAAR.** In contrast, section 66 of the ITA provides for a GAAR applicable for the purposes of the income tax. The ITA GAAR applies where the Commissioner General has reasonable grounds to believe that one of the purposes of an arrangement or transaction entered into was the avoidance of tax or obtaining of a reduction in tax liability. Where this requirement is satisfied, the Commissioner General has a broad power to void the arrangement or transaction.

109. **The ITA GAAR is framed in very broad terms and literally could apply to many commercial transactions as tax will often be a consideration (purpose) in the structuring of such transactions.** Further, a particular transaction may be entered into because the tax legislation provides incentives for the transaction, but the incentives may result in a reduction in tax and, therefore, fall under the GAAR.

110. **The risk where a GAAR is framed in very broad terms is that the Courts will inevitably read it down.** Some years ago, a Judge in Australia observed that the history of judicial decisions on the GAAR reveals fluctuating views of Judges as to the extent to which the section should be read down. The scope of broad-based GAARs of the type in section 66 of the ITA is likely to be read down by the Courts as Judges place the section in a proper perspective in relation to the other provisions of the legislation, but at the same time giving the section work to do in an appropriate case.

111. **For the reasons given above, the rewritten GSTA should include a GAAR.** However, the GAAR should be better focused than section 66 of the ITA to ensure that it applies in appropriate cases. This can be achieved by comprehensively defining the scope of the GAAR around the countering of tax benefits. In the context of GST, the main tax benefits are: (i) a

reduction in the liability of a person to pay GST; (ii) an increase in the entitlement of a person to an input tax credit; (iii) creating an entitlement to a refund of GST; or (iv) the deferral of a liability for the payment of GST.

112. **A GAAR should apply only where an arrangement has been entered into with the principal purpose of a person obtaining a tax benefit.** In contrast, section 66 of the ITA can apply where obtaining a reduction in tax liability is one of several purposes of a particular transaction. A principal purpose test should avoid a GAAR impeding normal commercial operations. Further, a GAAR should not apply where a taxpayer has genuinely entered into a transaction incentivized by the tax legislation or makes an election provided for in the tax legislation.

Recommendation

- Include a GAAR in the rewritten ITA that applies to arrangements that have the principal purpose of obtaining a tax benefit.

Joint Ventures

113. **Several entities may form an unincorporated joint venture to undertake a particular project.** This is particularly commonplace in the Maldives due to ownership restrictions for small foreign direct investment. An unincorporated joint venture is a contract-based arrangement that does not involve formation of a separate entity, such as a company or partnership.⁴² Unincorporated joint ventures are commonly used for extractive industries, fishing, and real property development. The participants in an unincorporated joint venture are usually unrelated entities. The participants in an unincorporated joint venture will commonly appoint an entity as the “operator” of the joint venture. The operator has responsibility to make acquisitions and supplies related to the venture’s operations on behalf of all participants. Under the normal operation of the GST, each participant in the joint venture must account for the GST in respect of their percentage interest in acquisitions and supplies made by the operator, which can be complex.

114. **A special rule can apply to joint ventures to simplify GST compliance by the participants in the joint venture.** The rule applies only where all participants in the joint venture are registered persons. In broad terms, the operator is liable for output tax and claims input tax credits in relation to supplies and acquisitions made to, or received from, third parties on behalf of the joint venture participants for the sole purpose of the joint venture’s operations. The joint venture aggregation rule is limited to supplies and acquisitions made by the operator on behalf of all participants. Internal supplies by the operator to a participant, or vice versa, for

⁴² A partnership is a contractual relationship that exists between two or more persons carrying on business for joint profit. An unincorporated joint venture is usually structured so that the participants share output rather than profit. If they do share profit, then the relationship is a partnership, which are usually registered for GST as a separate entity.

the sole purpose of the joint venture's operations are ignored for GST purposes. The GST applies in the normal way to all other supplies and acquisitions made by the joint venture participants, including supplies to, or from, the operator solely or partly for a purpose other than the joint venture's operations.

115. **The operator is responsible for GST administration requirements relating to the joint venture's operations.** This includes filing returns, paying VAT, making adjustments, providing VAT documentation, and receipt of refunds. It is necessary to include rules for changes in participants in the joint venture. For example, an adjustment will need to be made where the operator has transferred goods to a participant in the joint venture who subsequently leaves the joint venture retaining ownership of the goods. The participants remain jointly and severally liable for any administrative responsibility that the operator fails to perform.

Recommendation

- Consider providing a GST simplification rule for unincorporated joint ventures.

III. LEGAL FRAMEWORK OF THE GOODS AND SERVICES TAX

Overview of GST Legislation

116. **The GST legislation comprises the GSTA and Regulations.** In addition, MIRA has power to make rulings, which are binding on MIRA but not taxpayers.⁴³ The GSTA was enacted in 2011 and replaced the Tourism GSTA that was enacted in 2010. While section 14 of the GSTA provides for two categories of GST, namely TGST and GGST, many of the rules in the Act and Regulations apply uniformly to both categories of GST.

117. **The GSTA provides for many of the core provisions commonly found in GST legislation.** This includes general rules relating to supplies; taxable activity; zero-rated supplies; exempt supplies; input tax credits; GST accounting; GST documentation; and reporting and payment of GST on a periodic basis. Issues have arisen in practice concerning the relationship between the GSTA and the Regulations. In particular, there have been disputes concerning whether certain Regulations are consistent with the Act and, in some cases, whether they are even enabled by the Act. This is discussed further below.

118. **It is important that all the core rules relating to GST are in the Act rather than Regulations.** For example, under GST legislation, there are three core issues concerning supplies: time of supply; value of supply; and place of supply. While the GSTA includes basic rules for the time and value of supplies, there are no rules in the Act on the place of supply. These rules are necessary because GST is imposed on supplies of goods or services “in the Maldives”.⁴⁴ In broad terms, place of supply rules locate supplies of goods and services as occurring in the Maldives. Place of supply rules are found in section 104 and 104-1 of the Regulations in the Chapter 16 dealing with Miscellaneous Provisions. These are core rules that should be in the Act.

119. **Section II. C. describes that the design of the GST needs to be reformed to fully implement the destination principle.** The refocus of the GST on the destination principle will require fundamental reforms to the structure of the legislation, particularly providing for taxation of imported goods and services. As discussed in Section II. D., the taxation of imported services (including digital services) will involve the inclusion of the reverse charge rule and a fundamental redesign of the place of supply rules for B2C supplies.

120. **The authorities have begun a review process of the GSTA, with the objective of clarifying ambiguous provisions in the legislation and modernizing it to adequately cover the growing digital economy and other developments.** A particular issue discussed during

⁴³ Section 84 of the TAA

⁴⁴ Section 12 of the GSTA

the mission is whether the reform of the GST legislation involves amending the existing legislation or engaging in a rewrite of the legislation. Given that GST reform will involve fundamental changes to the structure of the legislation, and a review of the relationship between the Act and Regulations, and also the GST legislation and the tax administration legislation, it would seem appropriate to undertake a rewrite of the GSTA rather than simply amending the Act. The rewrite should take account of the matters raised below. The rewrite of the legislation should also include a review of whether the content of some rulings issued by MIRA should be in the Regulations.

Recommendation

- Undertake fundamental reform of the GST legislation preferably through a rewrite of the legislation.

Enabling Provisions for Regulations

121. **The GSTA is supported by detailed Regulations.** As noted above, disputes have arisen with taxpayers as to whether the GSTA properly enables the making of all regulations in the GST Regulations. In particular, arguments have arisen as to whether some regulations are in conflict with the GSTA. For example, section 37(a) of the Act permits a registered person to credit input tax against output tax for a taxable period. Further, section 37(b) of the Act provides that input tax paid for goods or services acquired in carrying on a taxable activity is to be credited “in full” against output tax. There are some limitations in the GSTA on the claiming of input tax where the proper documentation supporting the credit is not held by the registered person or relating to particular types of expenditures (such as providing private benefits). Apart from these cases, it is arguable that section 37(a) and (b) permits a credit for the full amount of input tax in the taxable period incurred. However, for large capital expenditure, Regulation 46 requires the input tax credit to be claimed equally over 36 months. There is an argument that this Regulation may not be supported by the Act.

122. **There are cases where the GSTA clearly enables the making of Regulations.** For example, section 17(c) and 19(d) enable the making of Regulations concerning the time and value of supply, respectively. Even in these cases, the enabling provision may not support all Regulations made. For example, section 19(d) provides that the Regulations may provide for the value of the following supplies of goods or services: (i) supplies between related parties; (ii) supplies made through a machine, meter, or other device operated by coins or tokens; (iii) supplies paid for by a voucher; and (iv) supplies paid for by loyalty points. However, section 19(d) is framed as an exhaustive list so that the section may not support the making of Regulations on valuation in other cases, such as lotteries.

123. **The mission endorses the recommendation in Hebous and others (2019) concerning the responsibility for the making of Regulations.** It should be provided that MOF (through the TPU) is responsible for the making of Regulations concerning tax policy or interpretive matters,

albeit with technical input from MIRA, and that MIRA has responsibility for the making of Regulations concerning administrative and procedural matters.

124. **It is usual to have a general regulation-making power in tax legislation that can support the making of regulations for the better administration of the Act.** While section 67 of the Act deals with Regulations, it is merely procedural specifying who has responsibility for the making of Regulations and providing for their publication. It does not contain a general regulation-making power.

125. **It is acceptable to provide for special cases in the Regulations (as is currently the case) so that the Act provides for the core principles.** It will not necessarily be possible to anticipate every special case, so a more general regulation-making power is preferred. It is essential that the core principles are in the GSTA and that any special cases to be dealt with in the Regulations are properly enabled by the Act. Regulations concerning special cases should be made by MOF with MIRA input.

Recommendations

- Use the rewrite as an opportunity to ensure that GST Regulations are properly enabled by the Act.
- Provide that MOF is responsible for the making of Regulations concerning tax policy matters or interpretive matters, albeit with technical input from MIRA, and that MIRA has responsibility for the making of Regulations concerning administrative and procedural matters.
- Include a general power to make Regulations for the efficient administration of the GSTA

Relationship between the GSTA and the TAA

126. **Consistent with international norms, Maldives has a separate TAA providing for administrative and procedural rules applicable to all taxes.** The normal legislative structure where a TAA applies is for administrative and procedural rules specific to a particular tax to be in the Act imposing that tax and general rules applicable to all taxes to be in the TAA. This ensures that there is consistency in administration across all taxes.

127. **The obligation to file a tax return provides an example of the intended relationship between the primary taxing Act and the TAA.** The due date for filing a tax return is specific to a particular tax. For example, an income tax return is filed annually whereas a GST return is either filed monthly or quarterly. This means that the due date for filing a return should be specified in the primary Act.⁴⁵ However, the general rules concerning tax returns, such as the granting of an extension of time to file a return and the presumption as to authority should be consistent across

⁴⁵ Section 28(a)(1) of the GSTA requires tax returns to be filed by the 28th day following the end of the taxable period (calendar month or quarter).

all taxes and, therefore, included in the TAA. In the case of GST, these general provisions are provided for in the GSTA.⁴⁶

128. **There are also examples of tax-specific provisions being in the TAA rather the relevant primary taxing law.** The provisions in Chapter 5 of the TAA dealing with double tax relief are relevant only to the income tax and, therefore, should be included in the ITA. The provisions in Chapter 5 dealing with mutual administrative assistance are appropriately located in the TAA as these may relate to taxes other than the income tax. Another example is Regulation 69 of the Tax Administration Regulations, which provides for the treatment of overpaid tax. It is provided in Regulation 69(e) that excess input tax of a registered person for a taxable period is not an overpayment of tax, and the excess can be offset only against the person's output tax in the subsequent taxable period. This is an important GST-specific rule that should be in the GSTA.

129. **A full review of the TAA and its relationship with the primary tax laws (including the GSTA) is outside the scope of this Report.** The rewrite of the GSTA is an opportunity to better coordinate the GSTA (as the primary taxing law) and the TAA (as providing generic procedural and administrative provisions). Examples of administrative and procedural provisions in the GSTA that are generic in nature and better included in the TAA are sections 26, 28(a)(2) and (b), 30, 31 (this is part of self-assessment), 32, 33, 40, 48(a), 61, and 63. There are also generic administrative and procedural rules in the Regulations, particularly in Chapters 11 (tax returns) and 14 (record-keeping) that are better located in the TAA legislation. Discussion of additional technical issues is provided in a separate note to the authorities providing for a section-by-section review of the GSTA.

Recommendation

- As part of the GST rewrite, provide only for GST-specific administrative and procedural rules in the GST legislation with generic rules in the TAA legislation.

⁴⁶ Section 28(a)(2) (the granting of an extension of time to file a tax return) and section 30 (the presumption of authority).

Annex I. GST Treatment of Real Estate in Small Tourist-Dependent Countries

Construction and Supplies of Real Property

Consistent with international best practice, all supplies of services and goods regarding real property should be subject to GST with only three exceptions:

- The first sale or transfer of relatively newly constructed property if the property has been occupied by the owner or an immediate relative as their principal place of residence for at least two years and no credit for input GST has been granted.
- The sale or transfer of real property by entities not engaged in a commercial business, such as religious organizations, charities, hospitals and schools.
- The long-term rent of a dwelling or condominium unit used as a residential property.

All other supplies of goods and services regarding real property (including improved or undeveloped land) should, consequently, be subject to GST if carried out by a supplier that is registered or should be registered for GST. This includes the sale or lease of real property by entities engaged in a GST-exempt commercial business (e.g., an insurance company); and on the construction, repair, maintenance, renovation and alteration of a real property (i.e., all supplies of goods and services regarding a real property), whether the real property is a dwelling used for residential purposes (used for housing), a commercial property (used for production purposes) or a property used for tourism purposes.

Table 1. Best Practices for VAT Treatment of Real Estate Transactions

Type of Transaction	International Best Practice
1. Sales	
Commercial Properties	taxable supply with input tax credits
Residential Properties First Sale	taxable supply with input tax credits for builder
Residential Properties Resale and Owner Constructed Personal Residence	exempt supply (e.g., embedded GST on initial construction plus on the costs of repairs, renovations and additions)
2. Construction Goods and Services	taxable supply, whether supplied in relation to an exempt residential property or a taxable property that could claim an input tax credit
3. Leasing	
Commercial Properties	taxable supply with input tax credits
Residential Properties	exempt supply

Residential Property

The best practice is for repairs, renovations, additions or the purchase of a newly constructed home or condominium unit to be fully taxable; in other instances, the sale, lease, transfer, or license of residential property should be exempt from VAT. Conceptually, a GST levied on residential property is similar to that paid on the purchase of a durable good, which is equivalent to the pre-collection of tax on the future imputed rental value associated with the consumption of the good over its useful life. However, due to substantial challenges regarding the resale of residential property and the administration of GST input tax credits, in practice a simple application of the standard GST rules to supplies of housing is impractical to effectively administer in a fair and efficient manner. Therefore, the resale of used residential property should be an exempt supply with no right to an input tax credit, while a builder of a new residential unit would collect GST from the purchaser, claim input tax credits for the GST paid on construction supplies and sub-contracted services, and remit the net amount to MIRA. An owner that built, renovated or expanded their residence would pay GST on their purchases of construction supplies and services (e.g., electrician).

- New residential property should include any residential property that has not been used as the vendor's primary place of residence for at least two years. Thus, if an owner built a new house and sold it without continuously living in the house for at least two years, then the full value of the sale would be subject to GST.
- The residential rent category of exempt supplies often includes longer stays at a university residence, an old age home or a rehabilitation facility that may be of less than a year in duration. As with other exemptions, the difficulty is defining the threshold at which the taxable short-term rental of accommodation related to tourism becomes the exempt supply of residential property.

The sale, lease, transfer, or license of commercial property should be part of the standard GST base. The existing exemption covering commercial leases should therefore be eliminated, while resale of residential property should be considered an exempt supply.

Relief for Low-Income Households

To relieve some of the financial burden that a GST on new residential construction imposes on households, a rebate could be targeted at low-income households that buy or build a new home. Any new housing rebate should be for homes with a value below a suitable threshold and should only be available to individuals in respect of their principal place of residence (possibly applying a de minimis holding period of two years to prevent abuse). The low-income GST housing rebate should not be available to corporations (including condominium corporations), trusts, or an individual that co-owns the housing with a corporation, trust, or other entity that is not an individual.

GST Treatment of Vacation Properties with a Potential Dual Use

Where the real property could be used as either a personal residence or as part of a tourism business with a reasonable expectation of profit, the GST treatment becomes more complicated. Vacation properties purchased for personal use are often placed in a rental pool when their owners do not use them for personal use; the main purpose of a rental pool is to provide short-term, hotel-type accommodation. Under the terms of a typical rental pool agreement, a management company is hired to rent a vacation property on behalf of the property owner and to provide various services common to hotel establishments such as reservations, housekeeping, and front desk services. Owners are generally required to notify the rental pool manager of the times when they intend to use the property themselves.

If the vacation property is primarily (i.e., 183 nights or more per year) rented or leased then its GST treatment should be consistent with commercial property (e.g., hotels), though special attention should be taken to restrict input tax credits in order to limit tax planning opportunities. When the value of the supplies exceeds the GST registration threshold, then the owner should be:

- required to register for the GST.
- required to collect GST on any sale, lease, transfer, or license of the property.
- allowed to claim input tax credits for all related operating costs (e.g., marketing expenses, management fees, housekeeping charges); and
- allowed to claim input tax credits for a portion of the GST paid on the purchase or construction of the property.

Rules to determine the portion of capital GST that should be allowed as an input tax credit could be based on: the degree of personal use; the confidence of the tax administrator that the rental-income business has a reasonable expectation of profit; and the risk that GST would not be collected on a subsequent sale (e.g., deny input tax credits if the property is owned by a nonresident corporation that derives its value from the real property interest).

If the owner of a property claimed any input tax credits for the GST paid or payable on the last acquisition of the property, or in respect of improvements made to the property since its last acquisition, then GST should be required to be collected on any subsequent sale, deemed disposition, lease, transfer, or license of the property.¹

- One tractable approach to capital input tax credits for vacation properties that are primarily rented or leased is to require all GST paid to purchase, construct or improve the property to

¹ Where a vacation property has been previously occupied for more than two years, focusing on whether input tax credits have been claimed is preferable to a purpose test in determining whether a sale of residential property should be a taxable supply. It would be difficult for the tax administrator to verify whether the use of the property was primarily commercial with all rentals at arms-length (i.e., the property has been operated like a hotel) and relatively easier to examine the history of input tax credit claims.

be pooled. Those properties that have been rented or leased (at market rates) for 183 nights or more in a given year could then be allowed a (refundable) capital input tax credit for that year; the credit could have a value equal to five or ten percent of the pool. An allowed credit would reduce the size of the pool available as the base for future potential claims.

- If a vacation property that was primarily rented was also occupied by the owner at any time during the year, the capital input tax credit allowed for that year should be removed from the pool and only a reduced portion should be claimable. For example, if the property was owner occupied for 50 nights, rented for 200 nights and vacant otherwise, then the claimable portion of the credit could be $200/(200+50)=80$ percent.

If the vacation property is occasionally rented or leased (i.e., less than 183 nights per year) or done so without a reasonable expectation of profit, then the purchase of a new vacation property should be fully taxable and input tax credits related to capital costs should not be allowed. If the value of the supplies exceeds the GST registration threshold, then the owner should still be required to register for the GST and collect GST on the full value of any lease or license of the property or other taxable supply. But where the property is occasionally rented or leased, input tax credits should be denied for GST paid on capital costs and GST registrants should only be allowed input tax credits for the GST paid on those incremental operating expenses directly related to any commercial taxable supply and be allowed to carry-forward excess input tax credits in lieu of a refund. A real property business that voluntarily registers for the GST, should similarly be denied input tax credits related to capital costs and be ineligible for a refund of excess input tax credits related to operating expenses.

Construction Costs of Tourism Projects

Developers of hotels often lobby governments for a GST exemption with respect to the construction or renovation of a tourism project, as developers do not want to wait for input tax credit refunds to be processed and paid out. However, instead of providing administratively problematic exemptions or waivers, the introduction of a GST deferral system for imports of building materials specified in regulations and used for the eligible large construction project could be considered if the registered business is in good standing with respect to all of its tax obligations. Such a deferral regime should not be applied to the local purchase of building materials nor to the supply of construction services. As a second-best measure, this would mitigate concerns over the cashflow impact of charging GST on imported capital goods if full refunds for excess input tax credits cannot otherwise be made fully operational in the short run.

The deferral regime could be structured in the following manner:

- Under the deferral regime, building materials imported by an eligible GST taxpayer could be

released from Customs without payment of GST.²

- The GST deferred must be reported as tax due on the GST return covering the period during which the import took place, and a corresponding input tax credit would be allowed. The result is no net tax payment.
- The GST legislation should provide the authority for GST to be deferred only for an eligible large construction project when the business is in good standing. The GST legislation could define a registered GST taxpayer to be in good standing if:
 - (i) throughout the 24-month period before importation, the business has remitted all amounts required to be remitted under the GSTA and the BPTA; and
 - (ii) throughout the 24-month period before importation, the business has filed all returns required to be filed under the GSTA and the BPTA on or before the day which those returns were required to be filed under those laws.

New GST registrants could be required to deposit a certain amount (e.g., three months of import GST) to be held in trust until they have a 24-month track record. In the event of non-compliance, the government should end a business's access to the deferral regime and use these trust funds to cover deferred GST and any other outstanding arrears.

- Good management and communication between MIRA and Customs administrators is essential:
 - Customs needs to know upon clearance which importers and goods can benefit from deferral; and
 - MIRA needs access to real time import data coded by tax identification number, to reconcile Customs data with information collected on the GST return.

² The GST deferral regime should not affect the payment of customs duties, charges and excise taxes. If desired, these taxes and charges could be independently relieved under separate rules in the relevant laws.

Annex II. Design Issues for B2C Taxation of Imported Services

This Appendix discusses a number of technical issues concerning the legislative design for the taxation of remote services. Sample legislation is provided at the end of this Appendix for the GST taxation of remote services and electronically ordered goods. The sample legislation is provided for guidance only and any actual legislation developed will need to be consistent with the overall design and structure of the GSTA.

Relationship Between B2B and B2C Imported Services

A GST-registered foreign service provider may make supplies of both B2B and B2C imported services. In this case, the issue is whether the reverse charge rule should apply to B2B supplies or whether all supplies are accounted for by the registered foreign service provider. There are good arguments for continuing to apply the reverse charge rule to any B2B supplies made by a registered foreign service provider. Reverse charging is simple to apply, particularly as most B2B supplies are tax neutral (reverse charged GST offset by input tax credit). The alternative to reverse charging, where the foreign service provider is liable to account for GST on B2B supplies, entails the foreign service provider providing a tax invoice to the B2B customer, which adds to its administrative burden. There is also the revenue risk that the foreign service provider fails to remit the GST to MIRA.

On the other hand, limiting the GST liability of a foreign service provider to B2C supplies means that the foreign service provider must determine whether a customer is registered. As a foreign service provider has no place of business in the Maldives, it may be difficult for the foreign service provider to verify the GST registration status of the customer. Inevitably, the foreign service provider must rely on representations made by customers as to whether they are registered. There is a risk that a consumer may misrepresent to the foreign service provider that they are registered so that no GST is charged on the supply.

Applying the reverse charge rule to B2B supplies is preferred as it is simpler and poses less revenue risk. There should be an obligation on registered persons to notify a registered foreign service provider that they are registered - providing a certified copy of their GST registration certificate or similar evidence of registration. This provides authority for a registered foreign service provider to not charge GST on the imported services. A registered foreign service provider must charge GST on any imported services where such notification is not provided.

Registration Threshold for Foreign Service Providers

It may be argued that a lower registration threshold should apply to a foreign service provider. This is based on neutrality grounds as a foreign service provider is likely to fragment supplies across a number of jurisdictions. Further, a foreign service provider can use multiple

entities to fragment supplies made to customers in a particular jurisdiction, which may be difficult to detect.

A lower threshold is likely to be unnecessary for two reasons. First, the normal registration threshold in the Maldives is relatively low (and zero for the online supply of tourism services) so that setting an even lower threshold for foreign service providers is likely to create enforcement difficulties. If however the normal registration threshold is increased as recommended in this report (harmonized across TGST/GGST, along with a presumptive regime below the threshold), there may be merit to keeping the current threshold as the relevant one for foreign service providers. Second, many digital products and electronic services may be supplied through electronic marketplaces or platforms and the focus can be on collecting the GST from the operator of the marketplace or platform (which is much more likely to exceed the threshold).

The value of B2B and B2C imported services should be considered in determining whether a foreign service provider exceeds the registration threshold. Once registered, it is suggested above that a registered foreign service provider accounts for GST only on B2C imported services with the reverse charge rule applying to B2B imported services.

Determining the Residence of the Recipient of Imported Services

As stated in Section II. D., the determination of the residence of the recipient of remote services should be based on commercially observable indicators. The following indicators of residence are commonly adopted:

- The recipient's billing address.
- The recipient's home address.
- Internet protocol (IP) address of the device used by the recipient.
- The location of the recipient's bank account.
- The origin of the payment.
- The recipient's transaction history.

The EU and New Zealand approach is to require a foreign service provider to treat the recipient as resident if it has at least two non-conflicting pieces of evidence of the customer's residence. It would be expected that, for most recipients of remote services, the indicators listed above would be consistent in identifying their residence and, therefore, such a quantitative approach would be effective in determining the recipient's residence. However, it is possible that there may be evidence that indicates residence in one country and other evidence that indicates residence in another country. New Zealand deals with this by supporting the quantitative test with a qualitative test. If the evidence is conflicting, the supplier is required to determine the residence of the recipient by reference to the most reliable indicators of residence.

This is likely to be the recipient's address, transaction history, and credit card information, as a sim card and IP address may have been acquired for short-term travel in a particular country, so are less reliable evidence.

Foreign Service Providers and Input Tax Credits

The registration of a foreign service provider who does not have a place of business in the Maldives can be on a "pay only" basis. This means that the foreign service provider is not permitted to claim input tax credits in respect of taxable supplies made. Given that the foreign service provider does not have a place of business in the jurisdiction, the service provider is unlikely to have input tax (or any significant level of input tax). Further, it will be difficult for MIRA to police any input tax credit claims. If a foreign service provider wants to claim input tax credits for supplies made in the Maldives, the service provider can always establish a place of business in the jurisdiction.

An exception should apply to the online supply of accommodation and other inbound tourism products that are acquired and on-sold by the operator of a foreign booking platform. In this case, the service supplied is an intangible right that is acquired from a supplier (hotel or tour operator) in the Maldives with GST payable on the acquisition of the right.

Currency Conversion

TGST is reported and paid in USD or other foreign currency as determined by MIRA,¹ while GGST is reported and paid in MVR.² The TGST is reported in foreign currency as it is charged by registered persons in foreign currency. The same is likely to be the case with supplies of remote services so the TGST rule could be extended to remote services, where registered foreign suppliers without a place of business in the Maldives could elect a functional currency on which to determine its GST liability (with the government thereby assuming associated currency exchange risk).

Alternatively, foreign currency amounts can be converted to local currency at the time of supply. If instead the GST on supplies of remote services is required to be reported in MVR and given a large volume of foreign currency transactions, simplified foreign currency conversion rules should apply. Examples of such rules include: (i) converting foreign currency amounts based on the average exchange rate for the taxable period; or (ii) converting foreign currency amounts based on the rate applicable on the last day of the taxable period. Simplified currency conversion rules should apply only if the foreign supplier of remote services elects for the rules to apply and there will need to be rules to limit tax planning through movement between currency conversion methods.

¹ Section 62(a), although the Minister of Finance may determine that TGST is payable in MVR (section 62(b)).

² Section 62(c).

Simplified Procedures

Simplified procedures should apply to foreign service providers to better ensure compliance. Importantly, as a foreign service provider does not have a place of business in the Maldives, they must be able to deal wholly electronically with MIRA. This involves online GST registration, and online return filing and payments. It is recommended that all GST documentation and guidelines are available in the main languages to facilitate compliance. A foreign service provider should have the right to keep GST records offshore and in a foreign language, but subject to the obligation to produce the records to MIRA as required. In addition to a penalty, failure to do so may result in the privilege to keep records offshore being withdrawn.

There are two options for dealing with a foreign service provider that is a compliance risk. First, the foreign service provider could be required to provide security for the tax payment. Second, the foreign service provider may be required to appoint a local person as their “agent” for meeting GST obligations. Requiring a registered foreign service provider to provide security for the tax payment is likely to be the simplest option but should apply only where there is a real risk of non-compliance by the foreign service provider. The requirement for the appointment of a local GST representative is likely to be problematic as the business model of foreign service providers is that they have no physical or agency presence in the Maldives, so it will be difficult to identify a person who would have the capacity to meet the GST obligations of a foreign service provider.

Sample Legislation

1. Supply of goods in the Maldives

- (a) Subject to subsections (b) and (c), a supply of goods occurs in the Maldives if:
 - (1) for a supply of goods that involves transportation, the transportation of the goods commences in the Maldives; or
 - (2) for any other supply of goods, the goods are made available in the Maldives by the supplier.
- (b) A supply of electronically ordered goods occurs in the Maldives if the following conditions are satisfied:
 - (1) the supply involves the goods being brought into the Maldives.
 - (2) the supply is made through an electronic distribution platform.
 - (3) the operator of the platform either:
 - (a) delivers the goods in the Maldives; or
 - (b) procures, arranges, or facilitates the delivery of the goods in the Maldives;
 - and
 - (4) the value of the supply of the goods does not exceed [].
- (c) A supply of goods occurs in the Maldives if the following conditions are satisfied:
 - (1) the goods are delivered to a re-deliverer at a place outside the Maldives;

- (2) the re-deliver either:
 - (a) delivers the goods in the Maldives; or
 - (b) procures, arranges, or facilitates the delivery of the goods in the Maldives; and
- (3) the value of the supply of the goods does not exceed [].
- (d) Where subsection (c) applies, the re-deliverer is treated as having made the supply of the goods for the purposes of this Act.
- (e) In this section and section 3:

“Electronic distribution platform” means a website, internet portal, gateway, store, marketplace, or other similar platform that is operated electronically through which a supplier makes a supply of remote services or electronically ordered goods through another person (the operator of the distribution platform) to a third person (the recipient), but only where the operator does any of the following:

 - (1) authorises the charge for the supply to the recipient.
 - (2) makes or authorises the delivery of the supply to the recipient.
 - (3) directly or indirectly sets a term or condition under which the supply is made.

“Electronically ordered goods” means goods that are ordered from a supplier outside the Maldives by way an electronic communication.

“re-deliverer” means a person who, in carrying on a taxable activity and as a result of an arrangement with the recipient of a supply of goods or a person acting on behalf of the recipient:

 - (1) does either or both of the following:
 - (a) provides, or procures, arranges or facilitates, the use of an address outside the Maldives to which the goods are delivered; or
 - (b) purchases the goods, or procures, arranges or facilitates the purchase of the goods; and
 - (2) redelivers the goods in the Maldives, or procures, arranges, or facilitates the delivery of the goods in the Maldives.

2. Supply of services in the Maldives

- (a) Subject to subsection (b), a supply of services occurs in the Maldives if the services are supplied from a place of business of the supplier in the Maldives.
- (b) Despite subsection (a) and subject to section 3, a supply of services by a person who does not have a place of business in the Maldives occurs in the Maldives if the recipient of the supply is not a registered person, Government entity, or exempt body and:
 - (1) the services are physically performed in the Maldives by a person who is in the Maldives at the time of the supply.
 - (2) the services relate to immovable property in the Maldives.
 - (3) the services are remote services supplied to a person who is resident in the Maldives as determined under subsection (c); or

- (4) the services are a supply of an inbound tourism product, or agency or booking services relating to a supply of an inbound tourism product.
- (c) For the purposes of subsection (b)(3) and section 3, and subject to subsection (d), a recipient of a supply of remote services is treated as resident in the Maldives if at least two of the following factors support the conclusion that the person is resident in the Maldives:
- (1) the recipient's billing address.
 - (2) the internet protocol address of the device used by the recipient or based on information from another geo-location method.
 - (3) the recipient's bank details, including the account the recipient uses for payment or the billing address held by the bank.
 - (4) the mobile country code of the international mobile subscriber identity stored on the subscriber identity module card used by the recipient.
 - (5) the location of the recipient's fixed land line through which the service is supplied to the recipient; or
 - (6) any other commercially relevant information.
- (d) Where there are two factors on the list in subsection (c) supporting that the recipient is resident in the Maldives and two factors supporting residence in another country, the recipient's residence is based on the factors that, in the circumstances, are the most reliable indicators of the recipient's residence.
- (e) Where a supplier has established that the recipient of a supply is resident in the Maldives under subsection (c), the supplier must treat the recipient as not being a registered person unless the recipient has notified the supplier that they are a registered person in accordance with subsection (f).
- (f) A registered person receiving a supply of remote services from a registered person who does not have a fixed place of business in the Maldives must notify the supplier, in writing, that they are a registered person, and the notification must include a certified copy of their GST registration certificate or other evidence of registration as required by the MIRA.
- (g) A notification under subsection (f) must be provided to the supplier of the remote services at or before the time of supply.
- (h) In this section:
- "exempt body" means a person, other than a registered person, making supplies of goods or services a total annual value in excess of the amount specified in section 51(a)(1) and (2) of the Act.
- "inbound tourism product" means accommodation, meals, transport, tours, or any other tourist activities in the Maldives; and
- "remote services" means services that, at the time of the supply of the services, there is no necessary connection between:
- (1) the place where the services are physically performed by the supplier; and
 - (2) the location of the recipient of the services.

3. Supply of remote services or goods through an electronic distribution platform

- (a) This section applies where:
- (1) a supplier, referred to in this section as the “underlying supplier”, makes a supply of remote services or electronically ordered goods through an electronic distribution platform.
 - (2) the electronic distribution platform is operated by a person, referred to in this section as the “operator”, who does not have a fixed place of business in the Maldives; and
 - (3) the recipient of the supply is resident in the Maldives as determined under section 2(3).
- (b) Where the conditions in subsection (1) are satisfied and subject to subsection (3), this Act applies on the basis that the operator of the electronic distribution platform is treated as having made the supply of remote services or electronically ordered goods in the course or furtherance of a taxable activity carried on by the operator.
- (c) This section does not apply where the underlying supplier is registered for GST and the underlying supplier and the operator of the marketplace have agreed in writing with MIRA that the underlying supplier is liable for the payment of GST on the supply.

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