The GST Reforms that Can No Longer Be Delayed in the Maldives

The goods and services tax (GST) is the strongest tool for raising government revenue in the Maldives. In this article, the author puts forward three key GST reforms that are necessary to transfigure the existing outdated system. This includes modernizing the existing GST system, updating the current registration threshold to reflect the changes in the economy, and stopping the leaks in the tax base that are caused by violations of the destination principle and transfer mispricing schemes.

1. Introduction

The goods and services tax (GST) is a strong and stable economic tool that the Maldives relies on to generate a significant portion of government revenue. It accounted for 46.1% of the government revenue for the year ended 2019. A decade after its adoption, it is in desperate need of an update. In this article, the author puts forward three key suggestions of reform for the Maldives to strengthen its GST system. The first recommendation is moving towards a modern GST system. This entails unifying the rates and reducing the number of exemptions and zero-rated items. Secondly, the current GST registration threshold should be updated to reflect the changes caused by inflation. Finally, the author identifies major revenue leaks from the system which are caused by violations of the destination principle and transfer mispricing, and puts forward solutions to these. With these reforms in place, the GST system would be able to function better in the current economic climate and raise more revenue while causing minimal distortions. Before the areas for reform can be explored, the author explains the history, framework and significance of the GST to provide context for the analysis that follows.

2. History, Framework and Importance

The history of the Maldivian GST framework began in 2008 with the ratification of the new Constitution immediately after the 30-year authoritarian rule of president Maumoon Abdul Gayoom ended. The government elected afterwards, led by president Mohamed Nasheed, was taking steps to move the country towards more democratic and modern systems while adopting the best practices from developed countries. However, this period was fraught with economic challenges. While still struggling to get back on its feet after the tsunami disaster of 2004, the nation was challenged further by the global financial crisis at the end of that decade. This left a wave of economic calamities in its midst, with a negative gross domestic product (GDP) growth rate of – 3.6% in 2009. All of these factors together created the “perfect storm” for the introduction of the current tax system.

As a result, in 2010, the Maldives Inland Revenue Authority (MIRA) was established under the Tax Administration Act 2010 (Maldives). The first tax act was the Tourism Goods & Services Act 2010, which was promptly repealed in 2011. It was replaced by the Goods and Services Tax Act 2011 (GST Act). A myriad of design features of the Maldivian GST system is similar to a multistage invoice-credit based VAT that is adopted by several countries. It was introduced primarily to increase government revenues during the time of crisis while replacing the heavy reliance on import tariffs. Since then, the MIRA has grown steadily, and now it raises 75.7% of total government revenue through taxes and other fees.

In the current framework, the legislation distinguishes between two categories of goods and services: tourism goods and services and general goods and services. The tourism goods and services tax (TGST) is levied at a rate of 12% over the total revenue of supplies in the tourism sector, while the general goods and services tax (GGST) is levied at a rate of 6% over the total revenue of supplies in the general sector.

The GST Act sets out a criterion that must be satisfied for businesses to be obligated to register for GST. As per section 13 of the GST Act, a taxable activity refers to any

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5. Id.
10. Sec. 14 GSTA.
11. Sec. 15(b)(4) GSTA.
12. Sec. 16(b) GSTA.
A business that conducts a “taxable activity” must register for GST if any of the requirements below are met:  

- the total value of goods and services supplied in the past 12 months exceeds Maldivian rufiyaa (MVR) 1 million (approximately USD 64,700);  
- the estimated value of supply for the following 12 months exceeds MVR 1 million (approximately USD 64,700);  
- the business imports goods into the Maldives;  
- the business conducts a taxable activity in the tourism sector.\(^{13}\)

In addition, businesses have the option to voluntarily register if they prefer to do so.\(^ {14}\)

The Maldivian GST system also follows an input tax and output tax system similar to a standard VAT regime.\(^ {16}\) Registered businesses will have to charge output tax from customers and remit it to the MIRA. They can claim input tax from the MIRA based on its purchases from suppliers. For the input tax to be claimable, the supplier should also be registered with the MIRA. The MIRA will collect the tax from each transaction in the production chain and the collection finally ends after the good or service is sold to the final consumer. The beauty of the input and output tax system is that the tax office is able to raise revenue from each step where value is added to the good or service. This mechanism helps keep the regime less distortionary compared to other taxes.

The Maldivian GST legislation contains a list of exemptions and zero-rated items. Section 20 of the GST Act lists out exempt goods and services. Some of these goods, such as education and electricity, are exempt for public social interests.\(^ {17}\) Others, such as financial services, are exempt as it is too difficult to determine the tax base.\(^ {18}\) Taxes are not charged on these exempted goods and services, and a business supplying them cannot claim input tax credits.\(^ {19}\)

Section 22 of the GST Act lists zero-rated goods and services. GST on those goods and services is charged at the rate of 0%. These include essential goods in schedule 1 of the GST Act, goods and services exported from the Maldives and sales of a going concern. The purchaser of such a good or service is not required to pay tax in relation to those transactions.\(^ {20}\) Unlike the exempted goods, a registered person supplying a zero-rated good or service may claim GST paid to other registered persons from the

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13. Sec. 13 GSTA  
14. Id.  
15. Sec. 33 GSTA  
16. Secs. 8 and 9 GSTA  
18. Id.  
19. Sec. 21(b) GSTA  
20. Sec. 23(a) GSTA.
MIRA. This means suppliers in this category can claim input tax credits.\footnote{Sec. 23(b) GSTA.}

The revenue from the GST accounts for 9.2% of the GDP, which is at the higher end of the spectrum of GST-to-GDP ratios when compared to many other countries in the broader region.\footnote{IMF Report, supra n. 8, at p. 54.} This alone validates the importance of the GST as a tool for raising revenue for the Maldivian economy. Additionally, public debt has been spiraling continuously into the abyss for the past few years. The COVID-19 pandemic has aggravated this even further, resulting in an alarming spike in the last year (shown in Figure 1) as the government debt for 2020 reached a peak of 121.4% of the GDP, a figure that should cause concern for everyone in the country.\footnote{Maldives Monetary Authority, see https://www.mma.gov.mv/viya/series/89 (accessed 10 Nov. 2021).}

Since the majority of the government revenue is raised through taxes, and particularly GST, legislators should make haste as the time for reforming and strengthening the Maldivian GST system is now.

3. The Problem of Multiple Rates and Exemptions

The premise of the author in this article is to strengthen the Maldivian GST system through various reforms. The most crucial transformation will be moving from a traditional GST system to a modern GST system. While both are similar in most aspects, the key differences are that a modern GST system enforces a single rate across a wide tax base with minimal exemptions.\footnote{R. Krever, VAT in Africa p. 14 (Pretoria University Law Press 2008).} This section examines the notable concerns that arise due to the existence of multiple rates and exemptions. The biggest issue with such concessions and differing rates is that they thwart simplicity and create opportunities for businesses to reclassify goods and services to take advantage of exemptions or reduced rates. This results in litigation due to a lack of certainty. A significant amount of resources are spent in EU Member States to determine whether a transaction is subject to an exemption.\footnote{I. Lejeune, The EU VAT Experience: What Are the Lessons? in The VAT Reader: What a Federal Consumption Tax Would Mean for America p. 273 (Tax Analysts 2011).} 28% of VAT cases referred to the Court of Justice of the European Union (ECJ) during...
the period 2000-2009 relate to an exemption issues (see Figure 2).26

Similar to Europe, such disputes are starting to surface in the Maldives as well. In MIRA v. Maldives Bay Pvt Ltd, it was disputed whether a transaction fits into the general or tourism category.27 This is because the transaction itself was non-tourism related, despite the company operating primarily in the tourism industry. The MIRA argued that the taxable person sold fixed assets such as a sand barge and fire pump to another firm, and that this was related to their primary business operations in the tourism industry.28 The taxable person was unable to argue successfully that this transaction related to the general industry. The High Court (Maldives) held that the taxable person’s transaction therefore fell within the tourism category and so would be subject to 12% TGST instead of 6% GGST.29

While it may seem that the Maldivian tax system is simple, with stark distinctions between the classifications of two rates for two industries, this case is evidence that multiple rates and exemptions will still result in complexities and confusion. Businesses take advantage of the law when it is too simple or too complex. Legislators must strike a delicate balance between simplicity and thoroughness in drafting to mitigate such problems. Moreover, although litigation may help bring clarity to the law,30 it does result in resources being diverted from business activity. Additionally, a tax office does not have the resources to audit the books of every business with a fine-tooth comb. This is why a modern GST system is encouraged, and the unification of rates with minimal exemptions is the tenet of this section.

3.1. Changing the rates: Towards unification

As mentioned previously, the Maldives implements two different rates. While the 12% TGST is higher than the rates of other island nations, the 6% GGST rate is far lower.31 The average (weighted) tax rate is approximately 8.6%, which is lower than most international rates as shown in Figure 3.32 This section presents reasons for why the GGST rate should be increased to 12%. It also explains why the TGST should be maintained at 12%. The final desired outcome is to unify both rates.

The GGST was introduced at a rate of 3.5% and then increased to 6% in 2012.33 When the GGST rate was raised, it was clear that the rate was too low to adequately address the needs of the tourism industry. The TGST rate, on the other hand, has remained constant at 12% since its introduction in 2010. While the TGST rate is higher than the rates of other island nations, it is lower than the rates of the wider region.34

<table>
<thead>
<tr>
<th>Country</th>
<th>GST / VAT rate</th>
<th>GST rate on tourism</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maldives</td>
<td>8.6%</td>
<td>12%</td>
</tr>
<tr>
<td>Barbados</td>
<td>12%</td>
<td>12%</td>
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<tr>
<td>St. Kitts and Nevis</td>
<td>12%</td>
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<td>Guyana</td>
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<td>Bangladesh</td>
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<td>Dominica</td>
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<td>Grenada</td>
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* Source: IMF Report, supra n. 8.

26. Id.
27. MV: HC [High Court of the Republic of Maldives], 7 June 2021. MIRA v. Maldives Bay Pvt Ltd 2021 [2021/HC-A/18] and [2021/HC-A/19].
28. Id.
29. Id.
30. F. Martin, The case for specific exemptions from the goods and services tax: what should we do about food, health and housing?, 18 ejournal of Tax Research 1, p. 121 (2020).
31. IMF Report, supra n. 8, at p. 54.
32. Id.

Figures
the total revenue also increased.\textsuperscript{34} Moreover, even when
the TGST was increased from 8\% to 12\% in 2014, this led
to an increase in revenue again.\textsuperscript{35} This could be attributed
to the fact that the GST is non-distortionary in nature.

When the figures are viewed in a vacuum, it can be
inferred that the GST is inelastic due to this non-distortionary nature. However, beneath the veils, there may be
other determinants that led to the result of an increased
revenue despite an increase in the rate. For instance, the
main reason for the increased revenue in 2013, after the
rate increase of the GGST in 2012, was reported to be eco-
nomic and business growth.\textsuperscript{36} Similarly, the rise in revenue
after the TGST hike in 2014 was due to an unprecedented
amount of tourist arrivals that year.\textsuperscript{37} This shows that the
elasticity cannot be calculated by only looking at the
change in rates and revenue. Although this approach of
reverse-engineering the elasticity works well on paper, it
does not paint an accurate picture. To understand the elas-
ticity of the GST rates more comprehensively, the elasticity
of the goods and services themselves must be considered
separately. Determining the elasticity is vital in making a
well-informed decision on changing the rate.

3.1.1. TGST rate change

The TGST is applied on luxury resorts, hotels and services
related to the tourism industry. These services are most
likely price sensitive in nature. An upward change in price
will lead to more than proportionate downward change
in quantity demanded and vice versa. So, in theory, an
increase in the price caused by the increase in TGST rate
should cause the quantity demanded to fall more than
proportionately. However, as mentioned above, this was
not the case when TGST was increased in 2014, as the
year reported a rise in the total revenue. There are two
possible explanations for this. Firstly, the suppliers may
have absorbed the increase in TGST rate into their cost
to maintain price levels and the quantity demanded. Sec-
ondly, the suppliers may have increased their marketing
efforts, which caused the demand to rise. Marketing is
singled out because both resorts and the Maldivian gov-
ernment spend a significant amount of resources market-
ing the destination.

However, in the current economic climate, if the TGST
was raised, these measures would not have the same effect
as before. Due to the COVID-19 pandemic, the tourism
industry has faced tremendous losses. No amount of cost
absorption or marketing will be enough to maintain the
demand. This is not only because of the fall in purchasing
power of consumers globally as a result of job losses but
also because of border restrictions that physically prevent
travel. Therefore, it is argued that the TGST should not be

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{OECD_vat_rates_2020.png}
\caption{Standard rates of VAT in OECD countries in 2020*}
\end{figure}

\begin{itemize}
\item \textbf{OECD unweighted average: 19.3\%}
\end{itemize}

\textsuperscript{*} Source: OECD, supra n. 17, p. 47.

34. Id.
    mv/reports/MIRA\%20Annual\%20Report\%202013\%20-%20English.pdf
37. Id., at p. 24.
Many countries have temporarily reduced their GST rates to support businesses during this period. As GST payments are frequent, reducing the rates or the frequency of payments can help businesses manage cash flow and stay afloat during this arduous period. For instance, Germany temporarily reduced its GST rates from 19% to 16% as part of its economic stimulus package in response to COVID-19. The Maldives could benefit from such a policy as a nation that is predominantly dependent on tourism.

Yet, as the TGST rate (12%) is already lower than the OECD unweighted average of 19.3% in 2020 (see Figure 4), any further decrease is not advised. Ultimately, the best course of action for the country is to maintain the TGST rate at 12%. The TGST is an important revenue-raising mechanism. It is this revenue that the government can use to subsidize low-income families that are hit the worst by the pandemic.

3.1.2. General GST rate change

A similar effect can be observed in the suppliers of elastic goods and services in the general industry. If the GGST rate was increased, suppliers would bear more of this increase without passing it on to the final consumer in order to maintain the quantity demanded. On the other hand, suppliers that trade inelastic products – products where a change in price results in a less than proportionate change in the quantity demanded – would swiftly pass on the increase in GGST to the consumer. This is because inelastic goods mostly consist of necessities such as basic food items, and often have fewer substitutes. This gives suppliers who trade inelastic goods a competitive advantage, thereby distorting the market. This analysis demonstrates that increasing the rate of GGST could worsen the regressivity of the tax. The prices of elastic goods such as luxury items even in the general sector consumed by the rich are less likely to increase. However, inelastic goods such as necessities will experience a rise in price because suppliers will be able to shift the tax burden to the final consumer. Unfortunately, the poor would once again lose out.

In practice, these effects are unlikely to be seen in the Maldives. This is because necessities and staple food items are zero rated, and therefore will not be affected by an increase in the GGST rate. Nonetheless, even if zero-rated items were removed (as will be argued in section 3.2.), the Maldivian government has set up the State Trading Organization (STO) to act as a price controller for basic food items to prevent price hikes in necessities. This is done by stockpiling and varying the total supply of these items to prevent price hikes in necessities. This is done by stockpiling and varying the total supply of these items to influence the price. When other traders reduce supply to increase the price, supply is artificially created by the STO (and vice versa) similar to a buffer stock scheme. Moreover, several exempted services are provided by other state-owned enterprises through which the government can absorb any GGST increases to protect vulnerable consumers. Therefore, the distortionary and regressive effects of an increase in the GGST will be greatly mitigated.

The most compelling reason to increase the GGST is the larger tax base in the general industry. The reported number of taxable persons in the domestic sector is 11,567 in comparison to just 1,912 taxable persons in the tourism sector. This means that 85.8% of taxable persons are within the domestic sector. Based on this, the IMF Report shows that one percentage point of GST raises 30% more revenue in the domestic sector. It concluded that the domestic sector could raise MVR 447 million (USD 28.9 million) per percentage point in contrast to the tourism sector, which could raise MVR 350 million (USD 22.7 million). Thus, the low GGST rate raises a lost opportunity to raise more revenue. Unifying the GGST rate and TGST rate will therefore raise an additional revenue of MVR 2.7 billion (USD 174.8 million).

In the short run, the current TGST rate of 12% should be maintained as raising it may become the final nail in the coffin for several resorts and hotels in the tourism sector. However, as demonstrated above, raising the GGST rate from 6% is unlikely to lead to such adverse results. It is currently an under-utilized and largely neglected tool in the GST system with the potential to become one of the strongest tools available at the country’s disposal. The additional revenue that the general sector can potentially raise is crucial to improving the public deficit at this time. Moreover, it achieves the objective of simplifying the GST regime by applying a single rate widely, moving the Maldivian system closer to a modern GST system and therefore strengthening it.

3.2. Eliminating zero-rated goods and services and exemptions

The next step in becoming a modern GST is reducing the amount of GST-exempt and zero-rated items. At first glance, this seems to aggravate the regressivity of the GST, leading to a more unfair outcome. However, it will be shown that despite first impressions, these concessions could do more harm than good and result in a more regressive system instead. Finally, this section explores the practical challenges that the Maldives may face when implementing this along with potential solutions to overcome such hurdles.

The main reason why merit and essential goods are included in exemptions and zero-rated goods is to mitigate the biggest drawback of a GST regime – regressivity. While the rich can save most of their income and still afford to live exorbitant lives, the poor are often forced to spend most, if not all, of their income on basic needs. This is especially the case in developing countries such as the

38. OECD, supra n. 17, at p. 10.
39. Id.
40. IMF Report, supra n. 8, at p. 53.
41. Id.
42. Id.
43. Id.
44. See id. Calculations are the author’s own based on the report.
Maldives where public infrastructure is not strong enough to support the underprivileged adequately.

Unfortunately, despite good intentions, exemptions and zero rates may just be adding fuel to the fire. The next two paragraphs describe the ways that concessions distort the market and ultimately become free handouts for the rich.

Firstly, if concessions are offered with some goods and services, other goods and services will need to be taxed at a higher rate to raise the intended budget.45 This is most likely the reason for the dual-rate system in the Maldives despite the distortionary effects.

Secondly, and more alarmingly, the unintended outcome of concessions is that they benefit the rich instead of the poor. Although the poor may spend a higher proportion of their income on exempted and zero-rated goods such as food, the absolute amount they spend will be far less than the rich.46 This is because wealthy people have more expensive eating habits which lead to more expensive food purchases. At the end of the day, the net tax revenue lost from these exemptions on the rich and their high-value purchases outweighs the savings that benefit the poor.47 In other words, concessions become an all-you-can-eat buffet for the affluent class.

Fortunately, this is not considered to be a serious issue for the Maldives. Instead of a blanket zero rate on all food items, concessions only include specific basic commodities that the poor in particular spend on.48 It is unlikely that people will consume increasing amounts of goods such as salt, rice or rihakku (a local traditional food)49 as they get richer, just because they are zero rated. Therefore, these specifically targeted concessions are less likely to lead to such regressive consequences. Nevertheless, this current zero rating system merely mitigates the problem. Exemptions, even on targeted goods and services, still perpetuate regressivity. For instance, water is a tax-exempt basic need for the poor. However, the rich may use the same exempted water to fill their swimming pools and wash their cars.50 Does the Maldivian government intend to continue subsidizing their lavish luxuries under the pretence of creating a more progressive tax system?

Therefore, the impetus of the author in this article is to eliminate exemptions and zero-rated goods completely. Concessions, despite being widely regarded as a panacea to the ailment of regressivity, adds insult to the injury it is trying to heal. The journey to becoming a modern tax system with a strong GST is fraught with trials, none more difficult than the eradication of concessions. Using New Zealand’s approach to GST as a case study, the next part of this section investigates the practical challenges in implementing such a change and better solutions to the problem of regressivity.

3.2.1. New Zealand’s solution to regressivity and challenges

New Zealand has the simplest GST and most comprehensive GST base.51 Even “necessities” such as food, clothing, medical care and educational services are not GST exempt.52 Consequently, New Zealand has the highest VAT revenue ratio (VRR) of any GST at 0.99.53 The VRR measures the difference between the VAT revenue actually collected and the total VAT that could be collected if the standard rate was applied across the entire consumption tax base and all revenue was collected.54

Before the Maldivian government can fully eliminate concessions, the country’s VRR must be calculated to understand how much of the total consumption escapes the GST net in the first place. This data is not available in OECD reports nor in the MIRA’s annual reports. A tailored solution can only be composed once the extent of the leak is fully examined, and the parameters are marked.

After calculating the VRR, the government must then tackle the regressive effects of the modern GST. For the Maldives, the way forward to reduce this regressivity is to conduct a comprehensive cost-benefit analysis to identify ideal solutions that can be put in place. New Zealand’s solution to this conundrum is to offer income support payments in the form of direct transfers to low-income families to offset the impact of GST.55 It is contended that this measure should be put in place in the Maldives as well. This is a lucrative solution because the elimination of concessions leads to such a significant amount of additional revenue that the government will be able to both: reimburse the poor through direct transfers, and still have enough revenue left over for other redistributive purposes.56

The main challenge in executing such an initiative in the Maldives will be gaining public support and trust. People would rather be given financial alleviations on necessities, even if this causes more harm, than give additional funds to the government with the promise of reimbursement later. This is mainly due to corruption. While New Zealand was ranked as the least corrupt country in the world, the Maldives is 75th on the list of 180.57 Corruption is not a problem that can be solved by merely strengthening the tax system, so solutions to corruption are beyond the scope of this article. As long as corruption is a parasite on government resources, the economy will struggle to grow no matter how much revenue is raised. Therefore, it is an issue that must be addressed in tandem with these reforms. However, from a tax policy perspective, elimi-

45. IMF Report, supra n. 8, at p. 53.
46. Id., at p. 58.
47. Krever, supra n. 24, at p. 19.
48. Sched. 1 GSTA.
49. See sched. 1 GSTA.
50. Krever, supra n. 24, at p. 20.
51. Id.
52. Id., at p. 10.
53. OECD, supra n. 17, at p. 51.
54. Id.
55. Krever, supra n. 24, at p. 18.
nating these concessions remains essential to raising the necessary revenue.

One of the most effective ways to combat initial public outrage and distrust of such policies would be to educate citizens. New Zealand’s extensive public education programme was one of the biggest drivers for their swift implementation of the purist system.\(^{58}\) Politicians should be encouraged to take the lead in such matters as they are in a unique and powerful position where they can educate as well as legislate. If lawmakers truly care about strengthening the GST, improving the public debt position and, finally, creating a more progressive system, they must use their voices to inform, educate and garner the public support necessary for such a change. It is in no way the role of the MIRA to step in the shoes of legislators in pushing forward policy matters.

Therefore, as demonstrated in this section, concessions are a “bug” in the GST system because they cause multiple problems and ultimately worsen the regressivity. The solutions put forward in this section can only be put into practice with the support of politicians and corruption being reduced. Nevertheless, economically, it is the best way forward.

### 3.3 The outdated registration threshold

Empirical evidence shows that a common problem faced by almost every country with a GST registration threshold is the “bunching phenomenon”.\(^{59}\) A cliff-edge exists where many businesses are bunched at the revenue range right before the threshold, and there is a steep drop in the number of businesses right after the threshold.\(^{60}\) Figure 5 illustrates the pattern in the United Kingdom.\(^{61}\) The GST threshold for the Maldives is set at MVR 1 million, which is roughly USD 64,700.\(^{62}\) This section highlights the importance of having a threshold regardless of the bunching phenomenon. It then analyses whether the current Maldivian threshold should be decreased, maintained, or

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\(^{61}\) Id., at p. 7.

\(^{62}\) Sec. 51(a)(a) and (2) GTSA.
increased. Finally, it concludes that the threshold should be increased to reflect the changes resulting from inflation as well as administrative and compliance costs.

### 3.3.1. Bunching phenomenon

Yige Zu put forward three types of behaviour that lead to the bunching phenomenon and are reactions to the threshold.63

1. delay expansion to remain input-taxed suppliers;
2. split up businesses with annual turnover above the threshold to smaller businesses;
3. fraudulently under-report the sales, which gives the illusion they are below the threshold.64

Firstly, small firms are likely to delay expansion and deliberately remain below the threshold if they know that, as soon as they reach the threshold, they will have to add tax on their pricing resulting in them losing sales. Their profit margin will decrease when they absorb the GST into their existing prices to remain competitive. The main problem of this behaviour is that businesses self-restraining growth will result in significant efficiency losses.65 Therefore, the potential total output of the economy is left unreached.

The main concern with the second behaviour type is that it diverts business resources to artificially splitting up the company instead of focusing on its core competencies and growth. For instance, in Commissioners of Customs and Excise v. Marner and Marner, in a pub, the revenue made from food and drink was attributed to two different owners to remain below the threshold.66 This represents revenue that has been artificially removed when, in reality, it should be within the GST system.67

The third type of behaviour is clearly illegal tax evasion.68 Most of these businesses make a proportion of their sales in cash but do not report these sales, which results in tax revenue losses. Unfortunately, it creates an unfair disadvantage to those compliant as well.

### 3.3.2. Changing the registration threshold

Although the previous section presents the flaws with a registration threshold itself, in this article, the author argues that a threshold is nevertheless necessary to nurture the growth of small businesses. The threshold essentially provides small businesses with training wheels. The government gives them a hand while they troubleshoot the various problems that inevitably arise for a start-up. Once they reach the significant milestone of MVR 1 million (USD 64,700) in revenue, the business would have grown enough for the training wheels to come off. However, knowing where to draw the line is vital in striking the right balance between providing free support and collect-

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64. Id.
65. See J. Harju et al., The Effects of Size-Based Regulation on Small Firms: Evidence from VAT Threshold (Working paper 75, Helsinki VATT Institute for Economic Research 2016).
67. Zu, supra n. 63, at p. 327.
68. Id., at p. 328.

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ing tax revenue. This section discusses the appropriateness of the current registration threshold and questions whether it should be decreased, maintained, or increased.

**Decrease**

In theory, the threshold should decrease as the administrative capacity of the tax office increases.69 For example, this can be due to new technological advances, such as e-filing, which help reduce the labour costs of the tax office. In fact, the MIRA invests heavily in technological infrastructure and works towards reducing administrative costs.70

Additionally, compliance costs will also reduce as businesses gain access to smarter software that can help automate their bookkeeping. Over the years, the MIRA has conducted various workshops to educate businesses on GST filing, which will also aid in reducing compliance costs.

Therefore, if administrative costs and compliance costs are falling, based on this alone, the threshold should be reduced.

**Maintain**

Contrary to the section above, the IMF Report recommends that the Maldives should maintain the GST threshold at the present level, and it should not be decreased.71 This is mainly to ensure that compliance costs for small businesses remain low.72 A study shows that compliance costs as a percentage of business revenue were estimated to be 30 times higher for small businesses than for large businesses.73 Additionally, the IMF Report states that the net revenue gain from reducing the threshold may be close to nil or even negative due to the marginal increase in administrative costs.74 Finally, the report states that other island economies and neighbouring countries have similar thresholds.75 Therefore, following these arguments, there is not much merit in reducing or increasing the threshold.

**Increase**

Even so, this section demonstrates that the threshold should change and be raised. The main reason for this is inflation. Economic growth and inflation would lead to a rise in nominal turnover for businesses. An increase in inflation results in the real value of money falling. Therefore, the breathing space small businesses had a decade ago at the current threshold is no longer applicable, and, in reality, the training wheels may come off too early. In the United Kingdom, the VAT registration threshold is increased annually based on inflation.76 As a result, the
current threshold level is 16.6 times higher than what it was when the VAT was established in 1973.77 However, this is a blanket approach to the problem and can be considered lazy. Indicators such as administrative costs and compliance costs should be considered as well. If the administrative costs and compliance costs are decreasing while the threshold increases every year, a superfluous free lunch is enjoyed by small businesses. It is recommended that a more sensible approach would be to periodically review and adjust the threshold to balance the changes in the real value of money and changes in the administrative and compliance costs.78

The MVR 1 million (USD 64,700) threshold was established in 2011 – over a decade ago. Unlike the United Kingdom, the Maldives has not seen even the slightest shift in the threshold during this time. The threshold should now be valued at MVR 1.31 million (USD 84,700) if the changes in inflation are accounted for.79 Therefore, it is desperately in need of a raise. The value calculated here merely accounts for the changes in inflation. However, the MIRA should make a recommendation to Parliament for the threshold to be changed, and an increased value should be calculated that takes inflation, administrative and compliance costs into account. This is yet another crucial step in strengthening the GST regime.

4. Stopping Base Erosion Caused by the Violation of the Destination Principle and Transfer Pricing

The Maldives is arguably one of the world’s top luxury travel destinations and is renowned for its natural beauty. Tourism is considered the lifeline of the Maldivian economy and accounted for 24.5% of the GDP in 2018.80 There were 1,484,274 tourist arrivals during that year alone.81 Additionally, due to the higher rate of tax imposed on the sector, the TGST raises over 61% of the total GST revenue, while it accounts for only 14.2% of the tax base.82 Despite the significance of the tourism sector, there are two serious tax leaks in the industry under the current system. Firstly, the destination principle is not implemented properly. As a result, a portion of consumption expenditure by tourists escapes TGST. Secondly, resorts and online travel agencies (OTAs) may have transfer pricing arrangements in place to purposefully avoid paying a portion of the TGST in the Maldives. This section explores how these leaks occur and presents ways to prevent this. Stopping the leaks in its most vital source of tax inflow is crucial in strengthening the GST system.

4.1. Violation of the destination principle

Many resorts in the Maldives sell their rooms directly to consumers. The TGST for this type of transaction is effortlessly captured. However, the issue arises when resorts sell rooms in bulk to OTAs at lower prices to manage their risk. These travel agencies then mark up the price and sell to customers abroad. This poses a problem because the full amount paid by the consumer is not captured by the MIRA, even though the consumer ultimately travels to the Maldives to enjoy the services being provided. The destination principle and the use-and-enjoyment rules argue that the GST should be charged where the service is consumed.83 This principle may be difficult to apply for most services, but the same cannot be said about tourism in the Maldives. To enjoy a fancy holiday in the Maldives, each tourist must pass the border. This provides clear documentation that can be used to identify their dates of arrival and departure. Additionally, despite it being glaringly self-evident, one simply cannot consume a vacation in the Maldives anywhere but in the Maldives. Therefore, both the duration and location of consumption can be indisputably identified with ease. The government should then levy the TGST on the total amount charged to the tourist, as this is where the consumption took place.84 It is critical that this payment is considered a payment for consumption in the Maldives rather than the export of a service by a resort.85 Unfortunately, the full cost of consumption is not always captured as the booking agent may be outside the jurisdiction.86 As a result, the value added by the booking company escapes the Maldivian tax net.

The outcome would be far too bleak for the MIRA if legislation left businesses free to do as they please. The allegations against Booking.com (an OTA) demonstrate the potential results of such a scenario.87 From 2013 to 2019, 896,500 property owners in Italy who worked with Booking.com did not pay any VAT.88 Moreover, Booking.com did not pay any VAT either.89 As per Italian law, Booking.com did have to pay VAT in Italy for this type of operation where they acted as an online intermediary to rent out Italian homes owned by private individuals to consumers worldwide.90 The total commissions made from Italy amounted to EUR 700 million, with EUR 153 million worth of unpaid VAT.91 This is a clear violation of the destination principle. Moreover, it is reported

84. IMF Report, supra n. 8, at p. 39.
85. Id.
86. Id.
89. Majorana, supra n. 87.
90. Id.
91. Parodi, supra n. 88.
that Booking.com did not pay this tax elsewhere either, so the sum payable has seemingly disappeared into thin air.\(^\text{92}\)

As a solution, in Europe, the Mini One-Stop Shop (MOSS) regime was extended to include obligations to platforms providing e-commerce services from 1 July 2021.\(^\text{93}\) Following this, the platform will have to send quarterly VAT returns electronically through an online portal and make payments in one Member State of the European Union where it is identified for VAT purposes.\(^\text{94}\) Therefore, the VAT of such OTAs can be captured through the electronic portal.

The Maldives is a luxury destination with high margins on tourism services, so OTAs will invariably make significant revenues by selling these resort rooms and packages. It would be in the Maldives’ best interest to identify the OTAs abroad that sell Maldivian tourism services and force them to register with the MIRA. The adverse effects of non-compliance by such companies are twofold. Firstly, the MIRA loses significant amounts of tax revenue from the existing tourism base. Secondly, if such leaks are not halted, domestic travel agencies are unfairly disadvantaged as foreign OTAs would be able to offer competitive prices because they do not have to add the 12% TGST on their price. So, similar to the European situation, filing should be made through the intermediaries, in this case the online portal. This will ensure the capture of a significant amount of revenue that should rightfully be included in the Maldivian GST system.

4.2. Transfer pricing schemes

A more insidious problem presents itself when the resort and the booking company are related. Resorts “sell” rooms to OTAs and the relationship between the two is sometimes difficult to determine.\(^\text{95}\) If they collude, this can create a mechanism for them to pay less GST via transfer pricing arrangements.\(^\text{96}\) The IMF Report stated that the value added by the booking company may not even be taxed elsewhere, depending on the rules on the export of services of that country.\(^\text{97}\) Therefore, although the Maldives has a lower TGST rate than other countries, the gap in the law gives these resorts the motivation and space to underprice when selling to the booking agent, while increasing the price at the final stage when the consumer gets charged. This would result in a considerable portion of the total revenue escaping the tax base.

To combat this, the IMF Report recommends obtaining arm’s length prices to find out the difference between the pricing of related companies of the resort and unrelated companies.\(^\text{98}\) The OECD Transfer Pricing Guidelines can be used to help determine this.\(^\text{99}\) The markup of unrelated parties will help show a more accurate reflection of what a normal markup is within the industry. This can be used to value the supply made by the resort to the related OTA.\(^\text{100}\) Consequently, the government would then be able to ascertain the total amount of TGST lost due to this.

To fully benefit from the revenues made from the Maldivian tourism industry, the leaks in the tax base must be reduced. The destination principle must be implemented properly, and those services consumed in the Maldives must be taxed completely in the Maldives, even if they may be sold abroad by a foreign company. Moreover, transfer pricing schemes must be identified, and such companies must be forced to apply arm’s length prices. If these practices are not halted, OTAs may evade paying tax anywhere in the world.

5. Conclusion

Since the inception of the Maldivian GST regime ten years ago, little has been done to improve it. Now, with a global crisis and a seemingly unsurmountable amount of public debt, the system is in dire need of an update to cope with the current economic conditions. The reforms suggested by the author in this article, including the modernization of the tax system through a unified rate without any exemptions, updating the registration threshold and stopping the leaks in the tax base, will go a long way in improving the performance of the GST system. To take the next step and implement these solutions in practice, the Maldivian Ministry of Finance and the MIRA must make these recommendations to the parliament. All these matters are of pressing urgency, and despite the risky timing, any further delays in action may result in too little being done too late. The Maldivian parliament has been pressing snooze on the pending system update for far too long; the time for action is now.

\(^{92}\) Majorana, supra n. 87.
\(^{93}\) Id.
\(^{94}\) Id.
\(^{95}\) IMF Report, supra n. 8, at p. 38.
\(^{96}\) Id.
\(^{97}\) Id., at p. 39.
\(^{100}\) IMF Report, supra n. 8, at p. 39.