

ASIAN DEVELOPMENT BANK

TAR: MLD 35380

TECHNICAL ASSISTANCE
(Financed by the Japan Special Fund)

TO THE

REPUBLIC OF THE MALDIVES

FOR

REVENUE DIVERSIFICATION

September 2002

CURRENCY EQUIVALENTS

(as of 31 August 2002)

Currency Unit	–	rufiyaa (Rf)
Rf1.00	=	\$0.078125
\$1.00	=	Rf12.80

ABBREVIATIONS

ADB	–	Asian Development Bank
BPT	–	business profit tax
CFTC	–	Commonwealth Fund for Technical Cooperation
DIR	–	Department of Inland Revenue
IMF	–	International Monetary Fund
MOFT	–	Ministry of Finance and Treasury
PRVT	–	property rentals value tax
TA	–	technical assistance

NOTES

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

I. INTRODUCTION

1. During the 2001 Country Strategy and Program Formulation Mission, the Government of the Maldives requested the Asian Development Bank (ADB) to provide technical assistance (TA) for Revenue Diversification¹ and the TA was incorporated in the Country Strategy and Program for 2002-2004. This TA will complement the Government's growth and poverty reduction strategy with a strong macroeconomic framework and good governance. The Fact-Finding Mission² from ADB visited the Maldives from 17 to 20 February 2002. The Mission reached an understanding with the Government on the justification and priority for the TA, its objectives and scope, and implementation details including the terms of reference for the TA consultants. The project framework is given in Appendix 1.

II. ISSUES

2. The fiscal revenue base of the Maldives is limited primarily to income from tourism, import duties, and dividends from public enterprises. According to the latest figures available for 2000, tourism taxes and resort lease rents comprised 29.8%, import duties accounted for 28.2% and receipts from public enterprises for 18% of total Government revenue.³ Traditional direct taxes on income and profits (viz., personal and corporate income taxes), on domestic goods and services (viz., sales taxes or value-added tax), and on wealth (viz., capital gains or asset transfer taxes) are neither well defined nor widely implemented.

3. However, skewed dependence of the economy on tourism has rendered it highly vulnerable to external shocks, and adverse developments in international demand have had a debilitating effect on the fiscal position of the Government. In addition, the nascent developments in international trade will have to be addressed. Foremost are the concerns that the World Trade Organization valuation rule on imports based on transaction value, to be introduced in the second half of 2002, may constrain import duty revenue, and about the extent to which the South Asia Free Trade Area regional cooperation agreement, currently under consideration, will reduce import tariffs. Moreover, the planned divestiture and corporatization of public enterprises will further limit the nontax revenue of the Government. In the context of these considerations, reforming the revenue structure has been a major policy objective of the Government.

4. The Government was assisted by the International Monetary Fund (IMF) in its preliminary considerations of revenue diversification. IMF conducted a feasibility study in 1994⁴ and provided various recommendations for reform of the revenue structure to the Government. Acting on these recommendations, the Department of Inland Revenue (DIR) was established under the Ministry of Finance and Treasury (MOFT) in December 1996.⁵ The objective of DIR was to centralize tax and nontax revenue administration. With a view to broadening and rationalizing the revenue base, DIR took over the assessment and collection of 25 existing taxes, fees, and other charges since its advent. In addition, a Revenue Board (the Board) was

¹ The TA first appeared in *ADB Business Opportunities* on 4 March 2002.

² The Mission comprised J. Tsunoda, Mission Leader/ Financial Markets Specialist, SAGF.

³ The balance came from various minor sources, such as stamp duty revenues, administrative fees and charges, royalties and interest income.

⁴ *Toward Reform of the Revenue Structure*, IMF Fiscal Affairs Department, 1994. The Mission discussed the objectives and scope of the TA with IMF representatives and received supportive comments on the TA.

⁵ Assisted by IMF's Preparatory Work for Creating Inland Revenue Department and for Enacting Laws on Taxation of Business Profits, Taxation of Property Rental Value, and Measures for Implementation, 1995. *A Strategy to Establish an Inland Revenue Department*, IMF Fiscal Affairs Department Report, 1997. Department of Inland Revenue-Implementation Report, Part I and Part II, 1997.

established under MOFT in 1997. Comprising six high-level government officials and two sector representatives, the Board was mandated to formulate revenue policies. Since 1997, the Board has been mandated to introduce the business profit tax (BPT) and the property rentals value tax (PRVT), in line with the 1994 IMF recommendations.

5. The BPT is to be charged on the net profits of any business establishment based on self-assessment determined through commercial accounts or on a presumptive basis. The BPT aims for equity and efficiency and for broadening the revenue base. The PRVT is a tax to be levied on monthly gross rental income. The PRVT aims for income redistribution from upper income households that own rental property, especially in Male, where the shortage of habitable rooms and space has been a serious constraint. A preliminary study⁶ on revenue impact indicates that the BPT is expected to increase tax revenue by Rf125 million, whereas the PRVT is expected to yield an additional Rf40 million, which are 5.3% and 1.7% of the Government's total revenue in year 2000.

6. IMF and the Commonwealth Fund for Technical Cooperation (CFTC) also assisted in drafting legislation on the two new taxes, namely the BPT bill and the PRVT bill developing the tax administration bill and regulations⁷ and preparing a tax administration manual.⁸ However, these tax bills are yet to be enacted, and the necessary implementation planning for operational and administrative capacity building is needed at DIR. Given ADB's role as the lead multilateral aid agency in this sector in the Maldives, the Government has requested TA support. This TA is in line with the key thrusts of ADB's country strategy for Maldives, one of which is to build the capacity of government institutions for better public sector management.

7. In particular, the TA will assist the Government in preparing an implementation plan for introducing the BPT and PRVT; providing hands-on institutional strengthening and capacity building at DIR; and preparing for submission of the BPT bill, PRVT bill, tax administration bill and regulations to the People's Majlis.⁹ The TA proposal is in line with IMF recommendations.

III. THE TECHNICAL ASSISTANCE

A. Purpose and Output

8. The main objectives of this TA are to assist the Government in (i) devising an implementation plan for the BPT and the PRVT, and (ii) supporting the enactment of relevant legislation and regulations. The goal is to broaden the revenue base of the Government to enable faster growth through more prudent fiscal and macroeconomic management based on a wider revenue base.

9. The TA will support DIR and MOFT by (i) conducting a study on how operational and administrative capacity could be enhanced for the effective management of the BPT and the PRVT; (ii) submitting the BPT bill, the PRVT bill, the tax administration bill, and regulations to the People's Majlis for consideration and enactment; and (iii) conducting a thorough assessment of the computerized tax management database and exploring synergies with the ADB-assisted

⁶ Wadhwa, S.R., CFTC's Tax Advisor, 1997. *Calculation of the Revenue Effects of BPT and PRVT*.

⁷ Commonwealth Secretariat, 1998. *Draft Laws and Regulations of Business Profits and Property Rent Taxation*.

⁸ Commonwealth Secretariat, 1998. *Tax (Training) Manual*. Department of Inland Revenue.

⁹ People's Majlis is the National Assembly of the Republic of the Maldives.

Information Technology Development Project¹⁰ in collecting revenue, to ensure that the required hardware facilities to support the new revenue management system exist.

B. Methodology and Key Activities

10. After reviewing materials and manuals prepared by other aid agencies, and assessing the existing human resources capacity and requirements of DIR, the consultant team will conduct requirement studies on tax administration and database management to prepare an implementation schedule and an overall plan for introducing the BPT incorporating the status of the existing capacity level of DIR and necessary capacity-building measures to be introduced. The consultant team will also provide skill transfer and capacity building through on the job training and internal seminars at DIR. At the same time, the consultant team will assist DIR in preparing draft legislation for the BPT, the PRVT, the tax administration bill, and regulations and in passing the legislation.

11. Strong dedication by MOFT in introducing the BPT and the PRVT; and DIR staff involvement in preparing the studies, the implementation plan, and draft legislation, especially in the Dhivehi language are considered critical for successful implementation.

C. Cost and Financing

12. The total cost of the TA is estimated to be \$415,000 equivalent, comprising \$328,000 in foreign exchange and \$87,000 equivalent in local currency costs (Appendix 2). ADB will finance the entire foreign exchange cost and \$22,000 equivalent of the local currency cost. ADB financing will be provided on a grant basis from the Japan Special Fund of the Government of Japan. The Government of the Maldives will finance the remaining \$65,000 equivalent of project cost in local currency.

D. Implementation Arrangements

13. MOFT will be the executing agency for the TA. MOFT will provide full-time counterpart staff to facilitate timely and full access of the consultant team to relevant information. A steering committee, formed by MOFT, will be the implementing agency for the TA. The steering committee will be staffed by the Director of DIR, a representative each from the Audit Office and the Maldives Customs Service, as well as other staff from MOFT as necessary. The steering committee will be responsible for overall TA implementation, especially during the translation of the draft legislation and regulations of the BPT and PRVT from English to Dhivehi in close coordination with the Law Commission.

14. The TA will be carried out with the assistance of international and domestic consultants. International consultants will be engaged for a total of 11 person-months, while a domestic consultant will be engaged for 2 person-months. Selection and engagement of consultants through a consultancy firm will follow ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB on the engagement of domestic consultants. The consultant team will comprise a tax administration specialist/team leader (international, 5 person-months), a tax legal specialist (international, 3 person-months), a tax database management specialist (international, 3 person-months), and a legal specialist (domestic, 2 person-months).

¹⁰ ADB. 2001. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of the Maldives for Information Technology Development*. Manila.

15. The tax administration specialist will develop a time-bound implementation schedule and an overall requirement plan for the BPT and the PRVT in consultation with the Government, as well as recommending tax rates with simulation figures and reviewing the administrative manual and probable impact of the two new taxes. The tax administration specialist will also review and assess the organizational structure for tax administration; assist the tax legal specialist in redrafting existing legislation and regulations; and design public awareness programs and in-house training, workshops and seminars on the new tax administration. The tax legal specialist will review the existing drafts of the BPT and the PRVT and will coordinate with the Law Commission in submitting draft legislation to the People's Majlis for consideration. The domestic legal specialist, who will be primarily responsible for translating all bills into Dhivehi, will assist them. The tax database management specialist will explore how database management at DIR can be enhanced, identify the specification for database and tax administration software required for the new management system, and assess how the interface with the existing collection system under the Maldives Customs Service can be achieved in conjunction with the ADB-assisted Information Technology Development Project. The outline terms of reference for consultants is provided in Appendix 3.

16. The TA is expected to commence in November 2002 and to be completed by May 2003. The consultants will prepare an inception report within 15 days, and an interim report within 2 months from the start of consulting services. The consultants will submit the draft final report 2 weeks before the end of the assignment. The recommendations of the report will be discussed in a tripartite meeting among the consultant team, the steering committee, and ADB representatives. The consultant team will submit hard and soft copies of the reports to Executing Agency and the ADB. An outline for the final report is attached as Appendix 4.

IV. THE PRESIDENT'S DECISION

17. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$350,000 on a grant basis to the Government of the Maldives for Revenue Diversification, and hereby reports this action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Goal</p> <p>To broaden the revenue base of the Government for conducting more prudent fiscal policy and macroeconomic management, to foster economic growth and facilitate poverty reduction</p>			
<p>Purpose</p> <p>To assist the Government in developing the capacity for introducing the business profit tax (BPT) and the property rentals value Tax (PRVT), especially with regards to tax administration, legislative framework, and database management</p>	<ul style="list-style-type: none"> • Setting up a steering committee for the TA • The Government will critically assess and, upon finding satisfactory, will adopt the implementation plan prepared by TA consultants. • Submission of draft legislation of BPT bill, PRVT bill, and Tax administration bill to the People's Majlis and issuing related regulations. 	<ul style="list-style-type: none"> • Acceptance by the People's Majlis • Adoption by the Ministry of Finance and Treasury (MOFT) of the implementation plan • Consultant's draft final report • Tripartite meeting 	<ul style="list-style-type: none"> • Commitments by MOFT in introducing BPT and PRVT • Department of Inland Revenue (DIR) staffs' involvement in preparing the studies, implementation plan, and draft legislation • Macroeconomic conditions are favorable. • Sufficient public campaign and awareness • Effective policy dialogue with the Government
<p>Outputs</p> <ul style="list-style-type: none"> • A time bound implementation schedule and overall plan for introducing BPT and PRVT including building up operation and administration capacity and human resources development for managing BPT and PRVT • Draft legislation for BPT bill, PRVT bill, and tax administration bill and related regulations 	<ul style="list-style-type: none"> • The Government's commitment to adopt the recommendation as an implementation plan for enhancing DIR capacity for managing BPT and PRVT • Submission of draft legislation of BPT bill, PRVT bill, and tax administration bill to the People's Majlis and issuing related regulations • The Government's commitment to adopt 	<ul style="list-style-type: none"> • Adoption by MOFT as an implementation plan • Consultant's draft final report • Tripartite meeting 	<ul style="list-style-type: none"> • Commitments by MOFT in introducing BPT and PRVT • DIR staff involvement in preparing the studies, an implementation plan, and draft legislation especially in the Dhivehi language • Stable macroeconomic conditions • Sufficient public campaign and awareness • Effective policy dialogues with the Government

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<ul style="list-style-type: none"> A plan for computerized database tax management and linkage with the ADB-assisted Information Technology Development Project 	<p>the recommendation as an implementation plan for enhancing database management of DIR</p>		
<p>Activities</p> <ul style="list-style-type: none"> Reviewing materials and manuals prepared by other aid agencies Reviewing and re-drafting the existing drafts for BPT bill, PRVT bill, tax administration bill and related regulations Assessing the existing human resources capacity and requirement at DIR Conducting requirement studies on tax administration and database management Providing skills transfer and capacity building through on- the-job training and internal seminars at DIR; preparing draft legislation for BPT bill, PRVT bill, tax administration bill, and regulations for submission to the People's Majlis 	<ul style="list-style-type: none"> The Government's commitment to adopt the recommendation as an implementation plan for enhancing DIR for managing BPT and PRVT Submission of draft legislation of BPT bill, PRVT bill, and tax administration bill to the People's Majlis and issuing related regulations The Government's commitment to adopt the recommendation as an implementation plan for enhancing database management of DIR 	<ul style="list-style-type: none"> Adoption by MOFT and other relevant agencies as an implementation plan Consultant's draft final report Tripartite meeting 	<ul style="list-style-type: none"> Commitments by MOFT in introducing BPT and PRVT DIR staff involvement in preparing an implementation plan and draft legislation Macroeconomic conditions are favorable. Sufficient public campaign and awareness Effective policy dialogues with the Government
<p>Inputs</p> <ul style="list-style-type: none"> Supervisory support from steering committee and ADB professional staff International consultants for 11 person-months Domestic consultants for 2 person-months 			

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
A. Asian Development Bank Financing^a			
1. Consultants			
a. Remuneration and Per Diem			
i. Remuneration	209.0	10.0	219.0
ii. Per Diem	48.0	0.0	48.0
b. International and Local Transportation	15.0	2.0	17.0
c. Communications	2.0	2.0	4.0
2. Workshops, Manuals, and Reports	5.0	5.0	10.0
3. Contract Negotiation Participation from the Executing Agency	5.0	0.0	5.0
4. Contingency	44.0	3.0	47.0
Subtotal (A)	328.0	22.0	350.0
B. Government Financing			
1. Office, Secretarial, and Related Services	0.0	25.0	25.0
2. Local Counterpart	0.0	10.0	10.0
3. Reports, Workshops, and Communications	0.0	10.0	10.0
4. Local Travel	0.0	10.0	10.0
5. Contingency	0.0	10.0	10.0
Subtotal (B)	0.0	65.0	65.0
Total	328.0	87.0	415.0

^aFinanced by the Japan Special Fund
Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. International Consultants

1. Tax Administration Specialist/Team Leader (5 person-months)

1. The tax administration specialist will have at least 10 years experience in taxation-related projects, and prior demonstrated skills as a team leader. His/her tasks and responsibilities under the technical assistance (TA) will be to

- (i) develop a government view of and prepare a time bound implementation schedule and overall requirement plan for introducing the business profit tax (BPT) and property rentals value tax (PRVT);
- (ii) recommend tax rates to be applied to the BPT and the PRVT with simulation figures for justification, and conduct an impact study on estimation of revenue increase;
- (iii) conduct a complementarity and exclusivity study between the BPT and the PRVT;
- (iv) review and assess the existing tax administration manual for the BPT and the PRVT prepared by the Commonwealth Fund for Technical Cooperation (CFTC); and recommend further required provisions to be incorporated into the manual including a provision to develop a property valuation system in the Maldives;
- (v) assist the tax legal specialist in redrafting the existing version of legislation and regulation composing of the BPT bill, the PRVT bill, the tax administration bill and tax administration regulations; and assist the steering committee in coordinating with the Law Commission for submitting the draft legislation to the People's Majlis for consideration and resolution;
- (vi) review and assess the organizational structure for tax administration, identifying the necessary human resources and procedures in accordance with the new tax legislation and planned computerization of tax database management including tax forms, tax collecting procedure, tax audits, commercial accounting, control of tax administration, and information requirements of a computer system; recommend further provisions, if needed;
- (vii) prepare the human resources development plan of the Department of Inland Revenue (DIR) for introducing the BPT and the PRVT;
- (viii) design in-house training, workshops, and seminars including the new tax administration and the public awareness program; and
- (ix) liaise with the steering committee, DIR, the Law Commission, and the Asian Development Bank (ADB) as needed to ensure smooth implementation of the TA, and provide regular status reports on the progress of the TA.

2. Tax Legal Specialist (3 person-months)

2. The tax legal specialist will be a counsel, specializing in tax law, with at least 5 years experience. His/her tasks under this TA will include the following:

- (i) review the existing drafts of the PRVT bill, BPT bill, tax administration bill, and tax administration regulations;
- (ii) work with the domestic legal specialist to translate the draft legislation into Dhivehi and assist the steering committee to coordinate with the Law Commission for submitting the draft legislation to the People's Majlis for consideration; and
- (iii) work with tax administration specialist in designing in-house training, workshops, and seminars.

3. Tax Database Management Specialist (3 person-months)

3. The tax database management specialist will have at least 3 years experience in developing and managing tax databases. Under the TA, he/she will be tasked to

- (i) conduct a requirement study for enhancing the database management at DIR by reviewing and assessing the existing system for a taxpayer master file, database system, and tax administrative information system prepared by the CFTC consultants;
- (ii) identify the specification for database and tax administrative software in line with the necessary designed system; and produce cost estimates for developing such software, or explore the possibility of procuring it from outside sources;
- (iii) identify the specifications for necessary hardware and conduct cost estimates;
- (iv) conduct a preliminary study on linkages with the Maldives Customs Service's existing collection system; and
- (v) conduct a study on linkages with the ADB-assisted Information Technology Development Project.

B. Domestic Consultant–Legal Specialist (2 person-months)

4. The legal specialist will be a counsel, with at least 5 years of experience in drafting/translating and interpreting legal provisions relating to tax law. He/she will

- (i) prepare the necessary translations of the BPT bill, the PRVT bill, the tax administration bill, and tax administration regulations in the legal format required by the Law Commission; and
- (ii) assist the steering committee in its interactions with the Law Commission in submitting the draft legislation to the People's Majlis for consideration and enactment.

OUTLINE OF THE FINAL REPORT

1. The report will include the following components:
 - (i) time-bound implementation schedule and overall plan for introducing the business profit tax (BPT) and the property rentals value tax (PRVT);
 - (ii) simulation figures for recommended tax rates to be applied to the BPT and the PRVT;
 - (iii) probable impact on the revenue base;
 - (iv) complementarity and exclusivity between the BPT and the PRVT;
 - (v) review and assessment of the existing tax administration manual prepared by the Commonwealth Fund for Technical Cooperation (CFTC);
 - (vi) review and assessment of the organizational structure of tax administration, identifying the necessary human resources and procedures in accordance with the new tax legislation including tax forms, tax collecting procedures, tax audits, commercial accounting, control of tax administration and information requirements of a computer system;
 - (vii) a human resources development requirement study including the estimated staff requirements and positions, skill requirements for each position, and a chart indicating the timing of staff requirements; and
 - (viii) design of in-house training, workshops, and seminars including the new tax administration and the public awareness program as well as the human resources development plan of the Department of Inland Revenue for introducing the BPT and the PRVT.

2. In preparing the study for enhancing database management, the consultant team will
 - (i) review and assess the existing system design for a taxpayer master file, database system, and tax administrative information system prepared by CFTC experts, and recommend further provisions needed;
 - (ii) identify the specifications for database and tax administrative software in line with the designed system;
 - (iii) conduct cost estimates for developing such software, or explore the possibility of procuring it from outside sources;
 - (iv) identify the specifications for necessary hardware and conduct cost estimates;
 - (v) conduct a preliminary study on linkages with the Maldives Customs Service's existing collection system; and
 - (vi) conduct a study on linkages with the Asian Development Bank-assisted Information Technology Development Project.