

Tax Administration Reform in the Maldives

May 2015 | Issue 63

Maldives | Governance

THE GOOD OF TAXATION

A tax is a direct or indirect compulsory contribution to state revenue, levied on individuals, businesses, and properties or added to the cost of traded items.¹ The primary purpose of taxes is to raise revenue, to finance government expenditure on public goods and services, including welfare, that markets would not likely deliver.² (Other than taxes, the main sources of government revenue are non-tax revenue, e.g., grants such as aid and donations, fees, fines, rents, user fees, etc. and capital receipts, e.g., government bonds, provident funds, sales of state assets, etc.)

In 2012, tax revenue made up just under 90% of total government revenue in the European Union. The fact that tax revenue is the main source of government revenue underscores its importance: with stable tax revenue, governments can, for example, construct infrastructure; extend education, health systems, and social safety nets; render justice; maintain economic stability; protect the environment; and organize defense.

And so, taxes are the lifeblood of the state. If government is—on balance—a very positive force in society, then so are taxes: they are obligations we must deliver to enjoy vital services and benefits that governments offer in myriad ways; in sum, taxes raise the quality of life.

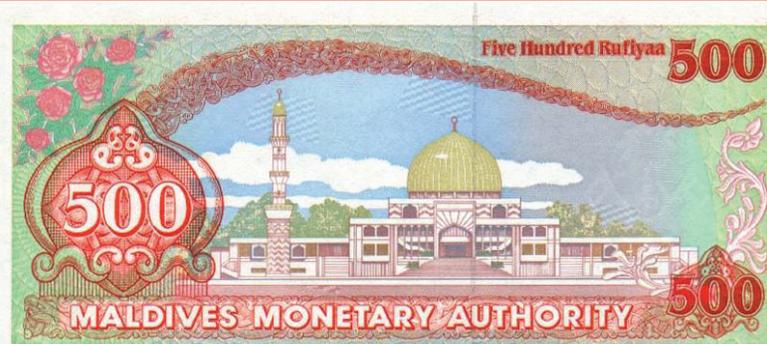
THE PREDICAMENT OF THE MALDIVES

The Maldives consists of 1,190 small, tropical islands grouped in 26 low-lying coral atolls spanning approximately 900 kilometers along the Indian Ocean. Only 188 of these islands are inhabited—for an estimated total population of 341,200 in 2014—and only 19 of them have more than 2,000 inhabitants. The archipelagic nature of the Maldives with a small population scattered across distant atolls represents a further challenge to the economy as the resulting per person cost of service delivery is very high.

The Maldives is a small economy;³ but, it is unavoidably open too and therefore vulnerable to shocks. Tourism accounts for

Highlights

- Taxes provide the funding that makes it possible for government to function. They are dues we must pay with respect to welfare and public services governments extend each day.
- The Maldives is a small, open economy. Tourism is, unequivocally, the driving force behind recent progress. But, in the absence of any significant other source of revenue, this makes the country extremely vulnerable to external shocks.
- In 2009, with help from the Asian Development Bank, the Maldives launched ambitious and transformational reforms toward modern taxation.



Source: Maldives Monetary Authority.

nearly 30% of gross domestic product and more than 60% of foreign exchange receipts: fluctuations in tourist arrivals—as in the aftermath of the 2004 Indian Ocean earthquake and tsunami and at the onset of the Global Economic Crisis of 2007–2008—can undermine macroeconomic stability.⁴ Increases in the prices of key commodities such as food and fuel, both of which are largely imported, hurt the population. On top, because 80% of the islands are less than 1 meter above mean sea-level, the likely consequences of climate change and associated sea level rise represent an existential threat over the long run.

In such circumstances, it helps to mobilize revenue for fiscal resilience, this to cushion against economic and other reversals and, especially, enlarge opportunity.

ENHANCING TAX ADMINISTRATION IN THE MALDIVES

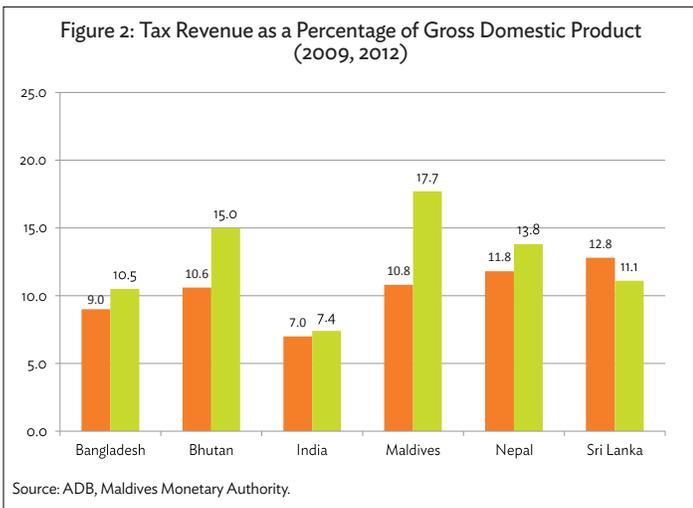
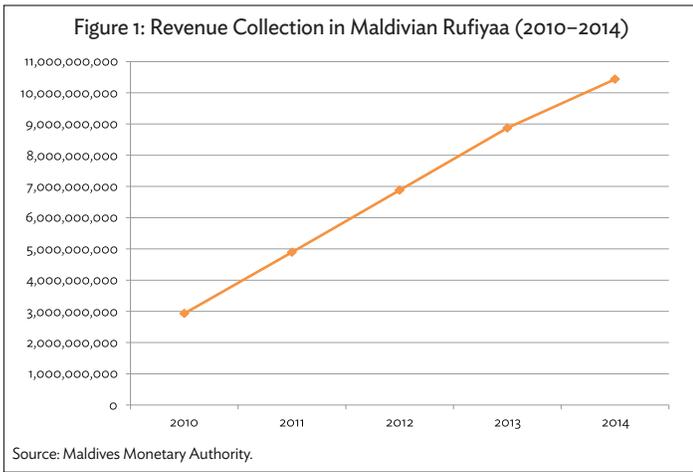
By 2008, lower-than-expected tourist arrivals and fish exports, combined with high government spending on social needs, subsidies, and public sector wages, had engendered structural problems and a balance of payments crisis. In 2009, the Government of the Maldives and the Asian Development Bank (ADB) linked arms to push an economic recovery program. The outcome, validated as successful by independent evaluation in 2014, was greater fiscal space in the budget and financial flexibility through a more diversified tax base and rationalized expenditure, better debt management, more efficient

¹ Taxes are most commonly classified as either direct or indirect: an example of the former is an income tax; an example of the latter is a sales tax. Most kinds of taxes fall into three basic categories: taxes on income, taxes on property, and taxes on goods and services. The (main) taxes paid by individuals are income taxes, property taxes, and consumptive taxes; those paid by businesses are corporate taxes and payroll taxes; other types of taxes are capital gains taxes and inheritance (or estate) taxes.

² Besides the familiar objective of resource allocation, governments can also use taxation to encourage (or discourage) certain economic activities. Five commonly cited principles of sound tax policy are equity, adequacy, simplicity, exportability, and neutrality (sometimes called efficiency).

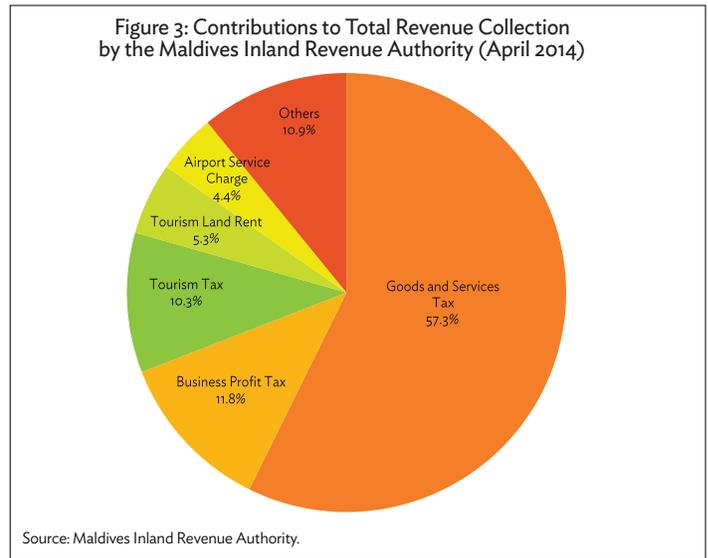
³ The mainstays of the economy are luxury tourism and fisheries, both intrinsically related to the coral reefs. The fisheries were the dominant sector until 1985 and continue to engage about 20% of the population, even if the fish catch has dropped sharply in recent years.

⁴ The human resources of the Maldives are not sufficiently developed to sustain a dynamic, knowledge-based economy. Moreover, the domestic market per se is too small to appreciably stimulate economic growth.



privatization of state-owned enterprises, and deepening of the financial market with the issuance of treasury bills and bonds.

To diversify the tax base and help build a more resilient economy less prone to downside risks from external shocks, the program drove policy actions for the introduction of a Tax Administration Act (2010), Business Profit Tax (2011), and Goods and Services Tax (2011) as well as an increase in the Airport Passenger Service Charge (2009). Importantly, the Maldives Inland Revenue Authority was established in 2010 as an independent legal entity under the Tax Administration Act, with a mission to deliver effective and fair administration



of the tax laws, promote voluntary compliance, and provide quality services to taxpayers. In 2011, ADB extended technical assistance to develop a revenue administration management information system, a customized information technology platform to support tax collection through greater tax compliance and efficient tax administration. A very novel feature of the tax modernization drive was the development of public awareness campaigns to encourage tax compliance and improved dissemination through social media. In 2013, ADB extended further technical assistance, drawing on the Japan Fund for Poverty Reduction, to enhance the Maldives Inland Revenue Authority's capacities in tax policy and tax audit.

Related Links

- ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan, and Technical Assistance Grant for the Economic Reform Program in the Republic of Maldives*. Manila. Available: www.adb.org/projects/documents/economic-recovery-program-rpp
- ADB. 2011. *Technical Assistance to the Republic of the Maldives for Developing the Revenue Administration Management Information System*. Manila. Available: www.adb.org/projects/documents/developing-revenue-administration-management-information-system
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