



# Tax Alert

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## TAX RULING B64: THIN CAPITALISATION

The ruling issued on 26 April 2018 stipulates thin capitalization rules concerning interest payments on loans and other debt instruments and financing arrangements.

The general rule under the BPT Act is that interest paid to banks and financial institutions approved by the MIRA are deductible in full while interest payments towards loans from any other party is capped at 6% per annum. This Ruling imposes additional restrictions on the deduction of both these types of interest.

In short, the Ruling has put a cap on the total interest expense deductible in a given tax year at 25% of the tax-EBITDA. Tax-EBITDA is the taxable profit for the period, calculated before the deduction of loss relief, interest expense and capital allowances.

### Definition of debt

The term, "debt" in the Ruling takes a very broad view, and is meant to refer to any loan, financial instrument, finance lease, financial derivative, or arrangement that gives rise to interest, coupons, discounts or any other finance charges deductible.

### Types of payments classifiable as interest

The Ruling also elaborates on the definition of interest for the purpose of the Ruling and encompasses interest payments as interest on all forms of debt, or payments economically equivalent to interest, and other fees paid in connection with raising of finance such as arrangement fees and guarantee fees. As such, it is likely that the MIRA would also categorically include premiums for options, discounts, finance cost element of finance lease payments and similar types of payments under the heading of interest.

### Our comments

The new rule is similar to the Fixed Ratio Rule proposed under Action 4 of the Base Erosion and Profit Shifting (BEPS) Project by the OECD.

Debt financing has been a common practice amongst even the biggest businesses in the Maldives, one of

the reasons for which could be that the Companies Act of the Maldives requires a minimal amount of equity. As the Ruling becomes effective from tax year 2018, it should not affect the deductibility of interest relating to periods prior to 1 January 2018 - meaning that businesses should be able to claim deductions regardless of their tax-EBITDA. Of course one needs to take into account the rules on transfer pricing and other related limitations.

The Ruling does not allow taxpayers to carry forward the excess interest or unused capacity to be deducted against the unused capacity of future years.

The Ruling states that interest would also include "payments economically equivalent to interest". Considering the OECD's approach, it is likely to include amounts such as payments under alternative financing arrangements like islamic finance, finance cost element of finance lease payments, and arrangement fees and similar costs related to borrowing of funds.

## **TAX RULING B65: EMPLOYMENT UNDER A CONTRACT OF SERVICE**

This Ruling sets out the rules, which comes into effect from tax year 2018, in determining whether an individual is employed or if the person's activities falls within the definition of business. The definition of business, as stated in the BPT Act, is quite broad and covers any activity carried on with a view to making profits. An exception, however, is given to those employed under a contract of service.

### **Attributes of an employer-employee relationship**

For a person to be considered as an employee (i.e. working under a contract of service), the Ruling requires a total of 7 attributes to be present in the employer-employee relationship. These attributes are:

1. the employer has the right to control and direct the employee's work;
2. the employee works exclusively for the employer;
3. the employee does not have the authority to hire

that employee's own helpers;

4. the employee does not have the authority to outsource the work assigned to that employee;
5. the employee does not have the authority to delegate the performance of that employee's job to another person, unless approved by the employer;
6. the employee is entitled to all the employment benefits as per the Maldives Employment Act (Law Number 2/2008);
7. the employee does not have the authority to control the resources and methods of that employee's work.

If any of the attributes are missing, the employee will be considered as conducting a business and will be required to account for BPT on their income.

As the Ruling is subject to Ruling A11, individuals who fail to meet all the attributes mentioned above would be required to register as a taxpayer with the MIRA provided, inter alia, that they earn a monthly income of more than MVR 40,000 from all their activities.

### **Withholding Tax implications**

As income from employment is exempt from WHT even if the recipient is a non-resident, the question of whether or not a person is an employee is critical.

With this Ruling, if an employee's relationship does not include any of the attributes listed in the Ruling, the payment to that employee will be subject to WHT. Of course, this is provided that the payment is one that is within the ambit of Section 6(a) of the BPT Act - for instance, a fee for a technical or personal service. For example, if a non-resident employee providing a technical service to their employer also works for another employer, WHT may be imposed on the payment made to the employee.

### **Our comments**

Generally the primary test of determining whether a person is an employee is the existence of an employment contract. However, with this Ruling, an employment contract would not suffice - instead, the test is solely on whether the relationship has all

the attributes stated in paragraph 5 of the Ruling. For instance, if an employee does not work solely for an employer (i.e. the employee works for more than one employers at a given point in time) even if the employee is employed under an employment agreement, the employee may be considered as doing business and therefore under the BPT regime.

The Ruling has put an exception to the rule where the MIRA may consider a person as being an employee although all the attributes stated in the Ruling are not met but it believes that the arrangement serves a bona fide purpose. In practice, this exception may be difficult to apply especially with respect to WHT as the employer's decision to deduct WHT depends, inter alia, on whether or not the employee also works for another person - a fact that the employer may find difficult to verify.

## **TAX RULING B66: FIFTEENTH AMENDMENT TO THE BPT REGULATION**

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This Ruling repeals Section 37 of the BPT Regulation under which loss sharing within group companies was allowed. The rules on loss sharing within the group allowed holding companies and subsidiaries to share the loss within the group provided that certain other criteria was met.

The Ruling applies to tax year 2018 onwards. This means that this change will have no effect on tax return for 2017 which is due this month.

Companies would still be able to carry forward their own losses for a period of 5 years, as allowed in the BPT Act. The Ruling does not affect claiming of loss relief by individuals and partnerships either.

### **About us**

CTL Strategies LLP is a firm specialised in providing tax and legal advisory services to businesses. Our tax advisory services include tax related business planning, tax compliance reviews, managing tax audits and controversies, and local and international tax planning.

Tax disputes are the mainstay of our practice and our tax disputes team, comprising of tax attorneys and tax advisors, can represent and assist you in tax audits and investigations by the MIRA, filing tax objections, filing appeals with the Tax Appeal Tribunal and at every stage of tax controversies.

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