



Insight

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Traders Hotel Male' v MIRA (2019)

Summary

Sale of assets or a business combination? Is acquisition of leasehold rights eligible for capital allowance?

In the case of *Traders Hotel Male' v MIRA*¹, the Tax Appeal Tribunal ("TAT"), by unanimous decision, upheld the decision of the MIRA that the sale transaction between Traders Hotel Pvt Ltd ("Traders Hotel") and Male' Hotel Associates Pvt Ltd is that of a sale of a business and not the sale of business assets. The TAT also held that expenses incurred to acquire the leasehold rights by the Appellant did not constitute the acquisition of land, and hence is eligible for claiming capital allowance as per Section 51 of the BPT Regulation².

The transaction at the centre of the dispute is the acquisition of leasehold rights, buildings, and various assets by Traders Hotel, where Traders Hotel has claimed capital allowance on the value attributed to these individual assets based on the total acquisition price. However, the MIRA took the view that Traders Hotel must claim capital allowance on the written down value of the assets as the MIRA viewed the transaction as the sale of a business which should be treated in accordance with IFRS 3 *Business Combination*.

¹ *Traders Hotel Male' Pvt Ltd v Maldives Inland Revenue Authority (TAT-CA-B/2016/005)*

² Business Profit Tax Regulation (Regulation Number 2011/R-47)

Facts and Observations

The transaction

Traders Hotel Pvt. Ltd., on 30 September 2010, concluded a Sale and Purchase Agreement with Maldives Hotel Association for the acquisition of leasehold rights of the land located in H. Ameenage, buildings, and other property specified in the Sale and Purchase Agreement. MIRA carried out an assessment of Traders Hotel for tax year 2011 and 2012 and found that the cost, or price of the capital asset as denoted in their return was not the actual cost price of the asset. Based on records provided by Traders Hotel it was, instead, found to be the total amount determined after the valuation of the business acquired by Traders Hotel, then attributed into separate “asset classes”. The MIRA determined that capital allowance cannot be claimed based on those values but should be based on the written down value of the assets from the books of the seller: Maldives Hotel Association.

Basis of appeal

The appeal filed by Traders Hotel was based on three main points; Firstly, the Appellant argued that the MIRA has no legal authority to order the appellant to record the transaction in accordance with International Financial Reporting Standards as the sale transaction was concluded prior to the commencement of the BPT Act³; Secondly, MIRA has ordered the Appellant to apply IFRS 3 *Business Combinations* to the transaction, which is in violation of accounting standards; and Thirdly, MIRA has erred in its application of Section 50 of the BPT Regulation by prohibiting the Appellant from claiming capital allowance on the sum paid for acquiring leasehold rights of the land.

The Appellant argued that MIRA’s application of the law violated their rights under Article 59(a) of the Constitution of the Maldives - Retrospective Legislation. The Appellant contended that all records pertaining to the transaction, which took place in September 2010, were maintained in accordance with the Companies Act⁴ and regulations made pursuant to the Act. As there was no specific legislation on maintaining financial records, and the Companies Act was the prevailing legislation relevant to maintaining financial records, and the BPT Act commenced on 18 July 2011, the appellant was not legally obliged to maintain their financial records in accordance with IFRS standards. The transaction was instead, recorded in accordance with IAS 16 *Plant, Property and Equipment*. It was pointed out by the Appellant that the Financial Statements (with respect to the transaction, recorded in accordance with IAS 16) was submitted to the Ministry of Economic Development and no issues were raised by the authorities. The MIRA, defending their position, argued that for tax purposes, the Appellant was required to maintain their financial records in accordance with IFRS standards or any other financial standard

³ Law Number 5/2011

⁴ Law Number 10/96

acceptable to the MIRA. Citing Section 4 and Section 8 of the BPT Act, the MIRA further claimed that the transaction would fall under IFRS 3 *Business Combination* rather than IAS 16.

MIRA: Sale and Purchase Agreement indicates a business was purchased

The MIRA relied upon the Sale and Purchase Agreement provided by the Appellant, during the audit, as evidence to support their argument; vis. that the terms of the agreement indicated the acquisition of a business by the Appellant. With reference to the relevant provisions, the MIRA indicated that Parties agree for the sale and purchase of assets, all leasehold rights pertaining to the land and buildings, titles, fixtures, financial books, shares, and business permits. Thus, the MIRA opined that the transaction in 2010 fulfilled the standards set out in IFRS 3 - that is to say, the transaction was for the acquisition of a business by three identifying elements - inputs, processes, outputs.

The Appellant, in response to MIRA's position, argued that they did not acquire control over any business or businesses, no employees were transferred, no intellectual property, brands, names or trademarks were acquired, no rights were assigned nor were any liabilities assumed by Traders Hotel. Furthermore, the assets purchased by Traders Hotel, by itself, could not be used for the operation of a hotel. Rather, the Traders Hotel acquired several types of assets under the Sale and Purchase Agreement to conduct their own business.

Cost price v sellers written down value

The Appellant stated that once an asset is purchased, it can be recorded in the books in one of two ways; cost price, or if the cost price is unknown, fair market value. Even when applying IFRS 3, the Appellant argued that the standard requires the use of the fair market value. The Appellant, in furthering their position, noted that if Traders Hotel had not recorded the cost price of the business assets in 2010, then the cost price must be the market value of the assets as indicated in the Sale and Purchase Agreement. As Traders Hotel relied upon IAS 16 in determining the cost price, the assets purchased under the Sale and Purchase Agreement were capitalised based on the value derived in accordance with IAS 16.5. The MIRA, used the seller's written down value to capitalise the assets under the Sale and Purchase Agreement, though, as the Appellant informed the Tribunal that the MIRA had no legal authority to do so. The argument put forward by the MIRA was that the transaction was the acquisition of a business and as such, the seller's written down value must be used to capitalise the assets acquired by the Appellant.

Capitalising leasehold rights

Traders Hotel paid a lump sum amount as the land lease rent for the land on which the hotel is located. The MIRA, however, disallowed capital allowance on this amount on the basis that the payment was not for the leasehold rights of the land but rather, for the acquisition of the land itself. As such, MIRA opined that Section

50 of the BPT Regulation was not applicable with respect to the value of the land denoted in capital allowance breakdown found in the business valuation schedule of the valuation report.

The Appellant contended that this lump sum payment has been recorded in their books in accordance with IAS 38; the total amount paid for the leasehold rights divided by the number of years - which is the same accounting treatment applied by head leaseholders of tourist resorts. The Appellant argued that, as leasehold rights are an intangible property, Section 50 of the BPT Regulation permits capitalising payments made for the acquisition of those rights.

Held

Acquisition of leasehold rights is eligible for capital allowance

By unanimous decision, the Tribunal upheld part of the decision in the MIRA's Objection Review Report, and ordered the MIRA to permit the appellant to capitalise the amount paid for the leasehold rights of the land under the Sale and Purchase Agreement and claim capital allowance in accordance with Section 51 of the BPT Regulation.

In support of MIRA's decision in the Objection Review Report the Tribunal referred to Section 66 of the Companies Act, which indicated that every company must maintain records of income and expenses, profit and loss, annual financials and balance sheets. Further Section 14(b) of the Companies Act also specifies that records must be maintained in accordance with international best practices. The aforementioned Sections were read in cohesion with Section 4 and Section 8 of the BPT Regulation, which gave the understanding that the Regulation requires all taxpayers to maintain their accounts and records in accordance with IFRS or other accounting standards approved by the MIRA. The Tribunal, in their ratio-decendi, noted that the tax implications of the transaction between Traders Hotel and Maldives Hotel Associates did not conclude in 2010, and the resulting capital allowance was to be allocated accordingly in the tax years that followed. As such, the Tribunal found that imposing tax rules on a transaction which has a tax impact in a tax year is compulsory and valuing an asset at the commencement of the BPT Act, in accordance with the existing tax rules, cannot be considered a retrospective application of the law.

*Conditions under IFRS 3
are met*

In determining whether the Appellant acquired a business, or acquired assets, the Tribunal referred to the Sale and Purchase Agreement and other relevant submissions made by both the Appellant and MIRA. Prior to the transaction under the Sale and Purchase Agreements, evidence submitted to the Tribunal made it clear that the seller, Maldives Hotel Associates, had made arrangements to transfer over agreements with the suppliers and other businesses to the Appellant. The Sale also included acquisition of all rights with respect fixtures, financial statements, share and business permits, and leasehold rights for land and buildings. The Tribunal was of the opinion that the transaction fulfilled the three main conditions under IFRS 3; namely the presence of inputs, processes and outputs. Further, the Tribunal noted that the group that the Appellant belonged to had the processes already in place to produce the outputs as explained under IFRS 3.

The Tribunal also noted that the apportionment of value under the Valuation Report which was annexed to the Sale and Purchase Agreement indicated “the values presented in the report are not the actual costs incurred for the purchase of assets, but the value of the total business purchased divided into asset classes”. As such, the value determined in the valuation was an estimated value based on the income of the business, and there is no room to unequivocally claim that the valuation report shows the cost of the assets. Furthermore, the cost of the assets acquired from the transfer of the business could be determined by perusing the records of the seller, which were also received by the appellant as part of the Sale and Purchase transaction.

The Tribunal, having affirmed part of the MIRA’s decision, also held that payment made for leasehold rights acquired by the Appellant can be capitalised and claimed capital allowance under Section 50 of the BPT Regulation. The Tribunal noted that Maldives Hotel Associates had leased the land from the owner of the land, and sold those leasehold rights to Traders Hotel and it is plainly understood that Maldives Hotel Associates cannot sell a right it has not acquired; ownership of the land. As such, it is clear that this transaction does not comprise of a sale of land, but rather a sale of leasehold rights for the land of which the value is stipulated in the valuation report attached with the Sale and Purchase Agreement. Additionally, Section 18 of the Maldives Land Act makes it clear that land may only be owned by 100% Maldivian companies. Traders Hotel, however, is a re-registered company and does not have the right to acquire land in the Maldives.

Our Comments

*Section 50 of the BPT
Regulation should not be
read literally*

This is one of the cases which the Tribunal has taken the longest as yet to reach a decision; the case was filed in July 2016 and a decision was made almost three years later, in June 2019.

This case has made the scope of Section 50 of the BPT Regulation more clear. The need to differentiate between the acquisition of business and acquisition of business assets for the purpose of claiming capital allowance on those assets has been made clear. Further, the MIRA has, in the past, taken a rather literal view on the claimability of capital allowance on expenses incurred to acquire leasehold rights, holding the view that such expenses are not eligible for capital allowance as the same has not been explicitly stated in the BPT Regulation. The Honorable members of the Tribunal have considered that such a literal interpretation is not necessary in the given circumstances.

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