Insight

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ADK Enterprises Pvt Ltd v Maldives Inland Revenue Authority (2019)

Summary

On what basis should capital allowance be claimed for assets held at the commencement of the BPT Act?

In the case of ADK Enterprises v MIRA[1], the Tax Appeal Tribunal ("TAT"), by unanimous decision, has held that companies must claim capital allowance on assets held at the commencement of the BPT Act based on the acquisition cost of such assets at the commencement date.

The dispute arose between MIRA and the taxpayer as the taxpayer had done a valuation of two of their buildings and claimed capital allowance based on the depreciated replacement value of the two buildings, while the MIRA argued that the cost of the buildings was known from the taxpayer's financial statements at the commencement of the BPT Act and hence the same should be the basis of claiming capital allowance.

[1] ADK Enterprises Pvt Ltd v Maldives Inland Revenue Authority (TAT-CA-B/2016/009)

Facts and Observations

Inaccuracy of financial statements and the need for a valuation

ADK Enterprises Private Limited ("ADK Enterprises") leased and developed two buildings - ADK Building and ADK Tower - prior to the commencement of the Tax Administration Act[2] (TAA) and Business Profit Tax Act[3] (BPTA). Following the commencement of the TAA and BPTA, ADK Enterprises commissioned valuation reports of the two buildings, which were completed on 30 September 2011 and 6 October 2011 respectively. ADK Enterprises, then, used the depreciated replacement value stipulated in the valuation reports to claim capital allowance with respect to the two buildings.

ADK Enterprises was subject to a BPT audit for tax year 2014. In concluding the audit conducted by the MIRA, capital allowance claimed in relation to the cost of the two buildings were revised in line with the MIRA's view that the actual cost of the buildings was reflected in the 2009 audited financial statements of the Appellant (which happened to be substantially lower than the estimated depreciated replacement value presented by the taxpayer) which were submitted to the Ministry of Economic Development, in accordance with the Companies Act[4], and thus, capital allowance cannot be claimed based on the revalued amount stipulated in the valuation reports.

In their arguments, ADK Enterprises argued that the cost of the buildings presented in the audited financial statements submitted to MED did not accurately portray the cost of the buildings - and hence, the need for a valuation of the buildings. They also argued that prior to the commencement of the BPT Act, there was no statutory requirement to maintain documentation pertaining to the actual cost of the two buildings. Furthering their argument regarding the inaccuracy of the audited financial statements, ADK Enterprises also submitted that the Directors of ADK Enterprises also incurred expenses for the development of the two buildings, which were not reflected in the financial statements.

[2] Law Number 3/2010
[3] Law Number 5/2011
[4] Law Number 10/96

Fair value stated in the valuation report cannot be used to claim capital allowance

The MIRA, in their counter-arguments, emphasised the importance of following Section 46(a)[5] and Section 46(c)[6] of the Business Profit Tax Regulation ("BPT Regulation") which required a notional adjustment to the cost of the asset to arrive at the value at the commencement date, and where the cost is unknown, to make a reasonable estimate of such cost. Though ADK Enterprises asserted that, in the absence of true and accurate documents showing the cost of the two buildings, the revalued amount of the two buildings qualify as a "reasonable estimate" as stated in Section 46(c) of the BPT Regulation. The MIRA also argued that the revalued amounts derived from valuation cannot be considered indicative of the actual cost of the assets as the company's financial statements submitted to the MED on 28 October 2010 - which is after the Tax Administration Act came into effect - had already stated the cost of the buildings in question. Furthermore, the MIRA noted that ADK Enterprises had not produced any evidence to show that the Directors had incurred expenses on the buildings, which were not reflected in the financial statements.

ADK Enterprises, in their supporting arguments, asserted that the depreciated replacement cost presented in the valuation report was the best reasonable estimate of the cost of the buildings, and further claimed that this value was in compliance with the requirements set out under Section 46(a), 46(c) and Section 50 of the BPT Regulation. The MIRA, disagreeing with their position, argued that the "fair value" of the buildings cannot be considered as the cost of the buildings as the fair value reflects the market value of the buildings up to the date of valuation of the buildings.

Held

Section 50 of the BPT Regulation refers to the cost of asset - not market value

In their decision, the Tribunal noted that Section 50 of the BPT Regulation is clear on applying the cost, or purchase price of the asset to the applicable rate of capital allowance. With reference to the pertinent phrasing in Section 50, the Tribunal noted that the "fair value" of the buildings, as calculated and presented in the valuation reports is not the actual cost of the buildings, but rather the market value of the buildings.

Regarding the contention raised by ADK Enterprises with respect to the inaccuracy of the cost of buildings as presented in the 2009 audited financial statements, the Tribunal noted that ADK Enterprises did not make a submission to MED to amend

[5] *"The value of a capital asset held by a Person at the commencement date of the Act shall be determined by writing down the cost price of the asset for each year of use (or part thereof) from the date of acquisition of the asset until the commencement date, by applying the relevant rate of capital allowance specified in Section 50 of this Regulation to the cost price of the asset."*

[6] *"For the purpose of subsection (a), where the cost price of the asset is unknown, a reasonable estimate of the cost price shall be made."*

any part of the financial statement. In addition to this, the Tribunal noted that even though ADK Enterprises claimed that the 2009 audited financial statements contained only expenses incurred by the company in the development of the buildings, and did not reflect any of the expenses incurred by the directors of the company, the company did not revise their financials to reflect those expenses in accordance with accounting standards and best practices.

No basis to disregard the previous financial statements

Further to this, the Tribunal noted that Section 63, Section 64, Section 65, and Section 66 of the Companies Act requires ADK Enterprises to maintain proper records pertaining to their income and expenses for a period of 3 (three) years, even though the Appellant claimed to the contrary. The Articles of Association of ADK Enterprises was also referred to by the Tribunal, stating that Article 26 further stipulates that it is the responsibility of the Board of Directors to keep true and accurate records of the income and expenses of all dealings of the company.

The Tribunal stated that even though Section 46 of the BPT Regulation stipulates that a reasonable estimate can be made where the cost of an asset is unknown, the Tribunal, in light of Section 66, and Section 77(b)(2) of the Companies Act and Section 14(b) of the Companies Regulation, stated that the financial statements for the year ending 31 March 2009, and the auditors report, which were prepared in line with the International Financial Reporting Standards show the actual cost of the buildings. As such, the Tribunal found no legal basis to amend the MIRA's decision.

Our Comments

The case is the first of its kind

This is the first reported case on the valuation of assets held at the commencement of the BPT Act. While the BPT Regulation is specific on the basis for claiming capital allowance (i.e. cost of the asset), the question in this case was regarding the basis of estimating such a cost (where the actual cost is unknown) and whether an estimated market value of the asset represents the actual cost of those assets.

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