PROPOSED TAX REFORM 2023 ARUBA

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INTRODUCTION

During the year 2020 the Netherlands agreed to provide Aruba with financial support in order for Aruba to overcome the economic crisis brought on by the COVID-19 pandemic. In connection herewith a so-called "Landspakket" was agreed to between the Netherlands and Aruba containing various conditions and reforms that Aruba needs to implement in order to receive the necessary financial support from the Netherlands. One of the conditions included in the agreement was the execution of a comprehensive tax reform, which should focus on broadening the taxable base by incorporating a shift from direct to indirect taxation by means of the introduction of a VAT-system.

During the month of February of 2022 various stakeholder's meetings took place in which the Government of Aruba by way of the Tax Reform Committee announced the proposed changes for the upcoming tax reform. In the following months a second round of stakeholder's meetings took place in which different updates were given and multiple scenarios were also proposed which will be deliberated by the Government of Aruba before a definitive choice is made on the various items of the tax reform. The below article will discuss the latest information that is publicly known and is still only considered as proposals since no draft bills have been presented to the Parliament of Aruba as of the time of writing of this article.

THREE PHASE IMPLEMENTATION

The tax reform is proposed to be introduced in three distinct phases. Phase 1 is proposed for January 1, 2023. In this phase the 'foundation' will be set in which the main component of the reform will be implemented, which is the introduction of a value added tax system ("VAT") to replace the current turnover tax systems ("BBO & BAZV"). The implementation of the VAT-system will coincide with various other changes that mainly should revolve in reducing and broadening the direct taxes to compensate for the introduction of a more comprehensive indirect taxation system. Phase 2 of the reform is called "equalization" and is scheduled for implementation in 2025. This phase will consist of updating and modernizing the existing tax laws with the goal of improving the tax compliance. Lastly, phase 3 will take place in 2027 and is called the "innovation" phase. However, no further information has been shared on the exact contents of this last phase.

VAT TO REPLACE THE BBO & BAZV

The current indirect tax system which is the BBO & BAZV will be replaced by a VAT-system. The BBO & BAZV is a combined tax of 6% that is levied over the revenue realized through the sale of goods or the provision of services by an entrepreneur in the course of its business. The BBO & BAZV is an entrepreneur or production tax rather than a consumer tax. The BBO & BAZV is also a cumulative tax as there is no right of deduction for the entrepreneurs. Since 2019 it is not allowed anymore to mention the BBO & BAZV on the invoice. The entrepreneur charges the BBO & BAZV to the costumer as part of the business costs. The unwanted effect of the BBO & BAZV is that it influences the economic processes in Aruba. In order to avoid the BBO & BAZV, entrepreneurs could avoid steps in the production process. For example, an entrepreneur could decide to avoid buying from the wholesaler in Aruba and buys directly from the supplier abroad, to avoid the 6% BBO & BAZV which is due by the wholesaler. In indirect tax terms, the BBO & BAZV is not a "neutral tax system". The VAT is considered a neutral tax system. For this reason, Aruba has been advised by the IMF and The Netherlands to switch to a VAT system.

The original proposal was to repeal and replace the BBO & BAZV as of January 1, 2023 with a VAT-system. A total of three scenarios have been proposed for the VAT-system up to now. The first, regarded a two-rate system with a low rate of 6% which would only apply for food and non-alcoholic beverages and a high rate of max. 18% for all other goods and services, restaurant dining included. During the second round of stakeholder's meetings two additional scenarios were proposed, which solely regarded the rates. One of which included maintaining the two-rate system in which the high rate is maximized at 14% (this scenario would exclude casinos from the taxable base) and the other included a one-rate system of 12.5% (this scenario would include casinos in the taxable base). Furthermore, the VAT-system will also apply for the importation of goods by entrepreneurs and private persons, meaning that the VAT will be due to the Customs Authorities at the border on the importation of the goods. The basis for calculating the VAT due at import will be the CIF-value, which is the cost of goods, insurance and freight. It is not known as of yet how the taxation of imported services will take place, however it is likely that the implementation of a reverse charge mechanism, which is common in other VAT-systems, will be considered. This means that in case of business-to-business (B2B) services, the (Aruban) company receiving the services will have to report the taxable amount to the Tax Authorities and pay the VAT due.

In line with the aforementioned, the exportation of goods and services will be subject to a 0% rate. Because a VAT-system only aims to tax the added value in each chain of the supply chain, entrepreneurs will be able to offset their input VAT suffered on their purchases from the output VAT charged on their sales and the net remaining amount of VAT should be remitted to the Tax Authorities. In the event that the input VAT exceeds the output VAT during a specific period then the implementation of a carry forward (credit) system has been proposed instead of a refund system. It is not yet known whether the carry forward system will have a statute of limitations before the possibility to offset expires. Lastly, it has been proposed to maintain the already existing exemptions of the BBO & BAZV system for the VAT-system. This also includes the room revenue of resorts and lodges which will remain taxable with the tourist levy. The latter is not usual in a VAT-system as the hotel sector's main source of revenue consists of the room revenues. Therefore, it is not clear how these entrepreneurs are going to be able to offset the input VAT suffered during their normal course of business as there would be minimal output VAT in their case under such a scenario.

AMENDMENTS TO THE PERSONAL INCOME TAX

To compensate for the price increases as a consequence of the introduction of a VAT-system with higher rates, the Tax Reform Committee also proposes various amendments to the other existing direct taxes. One of them being the personal income tax. Various amendments have been proposed, both positive and negative for the personal income taxpayer. To start off with the positive amendments, it has been proposed to increase the tax-free sum from Afl. 28,861 to Afl. 36,000 while also adjusting the current tax brackets by narrowing these and reducing the applicable rates by a few percentage points. In addition, the purchasing power allowance and the financial aid and welfare sums will be increased slightly. The remaining amendments solely regard broadening of the taxable base and limitation or abolishment of certain tax benefits and deductions. Such as, the abolishment of the self-administered pension, limitation on the depreciation of real estate, including tips in the taxable base (tips under the current system are exempt from personal income tax), abolishment of the investment allowance and the introduction of a fictitious minimum wage for directors who are majority shareholders.

AMENDMENTS TO THE PROFIT TAX AND DIVIDEND WITHHOLDING TAX

Similar to the personal income tax, the amendments to the profit tax include both amendments to compensate for the additional indirect tax burden and amendments related to broadening the taxable base by abolishing beneficial tax regimes and allowances and limiting the deduction of expenses. The only compensating amendment regards a rate reduction of the current 25% profit tax rate to a rate of 22%. Other changes include, abolishment of the reformed IPC-regime (10-15% rates) for qualifying activities (such as hotels, holding, and financing to name a few) with a grandfathering period up to and including the year 2025. The old (2%) IPC-regime will remain grandfathered up to and including 2025. Also, the existing grandfathering period for the

Tax-Holiday regime will be abolished for any remaining entities applying this regime. Other changes include stricter requirements for deduction of expenses owed to related entities in combination with a more inclusive definition of the term "related entity". Lastly, some of the same changes already mentioned in the personal income tax also apply for the profit tax, which are the abolishment of the self-administered pension and the investment allowance and a limitation on the depreciation of real estate.

With regard to the dividend withholding tax, an abolishment of the 5% rate for stock exchange listed entities has been proposed.

OTHER PROPOSED AMENDMENTS

Other changes worth mentioning include changes to the transfer tax on real estate. The selling of shares in real estate companies would become subject to real estate transfer tax as of January 1, 2023. While the transfer of the economic ownership of real estate assets will also become subject to real estate transfer tax as of the aforementioned date. The tourist levy, cited earlier in this article, which is currently 9.5% over the room revenue realized from non-residents, will be increased to 12.5%. Furthermore, a simplification of the import duties is also being considered with respect to the different rates applicable per category. Currently, the import duties consist of 12 different rates, which would be reduced to either 7 or 5 depending on the chosen scenario. Depending on the choice, certain items will either have an increase or decrease in the rates. Worth mentioning is that the Tax Reform Committee also announced that it is the intention that the current beneficial policy of a reduced 12% import duty rate for the importation of furniture and fittings in connection with the renovation of a resort will be abolished. Another proposal is to introduce a new insurance tax of 6% on certain types of insurances, however no further information has been provided as yet. Lastly, the introduction of a mandatory notification obligation between the Tax Authority and financial institutions has also been put on the table for implementation as of January 1, 2023.

On August 18, 2022, the Government of Aruba held a press conference to announce that they will be postponing the introduction of the BTW until further notice (possibly January 1, 2024) and will opt to increase the current BBO/BAZV rate (possibly from 6% up to 7.5%). The Government also mentioned during the press conference that the rate hikes for the BBO/BAZV will be accompanied by compensating measures such as lower rates for the personal income tax and profit tax. No other specifics were mentioned nor has any legislation been presented up to the time of writing of this article. Therefore, it not clear as yet what tax payers can still expect from the original proposed tax reform or what exactly the Government of Aruba intends to introduce as of January 1, 2023.

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