

April 23, 2021

To the Minister of Finance, Economic Affairs and Culture
Her Excellency Mrs. mr. Xiomara J. Maduro
L.G. Smith Boulevard 76
Oranjestad, ARUBA

Subject: Recommendations for Value Added Tax (aka BTW)

Your Excellency,

In Aruba's "Landspakket" the shift from direct to indirect taxes and the introduction of a Value Added Tax (VAT) or a General Expenditure Tax ("Algemene Bestedingsbelasting", hereinafter: ABB) has been mentioned as one of the measures to be considered and discussed. Considering ATIA/AHATA/AVVB have not yet been invited to participate in the drafting of a tax reform plan, we hereby offer our suggestions.

VAT vs ABB

The IMF, in its working papers¹, has expressed its preference for a simple VAT system. And according to the "Uitvoeringsagenda Landenpakket", The Netherlands also seems to lean towards a VAT system for Aruba.

In this letter, we focus on the contours of a simple VAT system on Aruba since that is our preferred way for the future. However, proper development and implementation (including information campaign and digital integration between Tax office and Customs) is a requirement.

Goal of a VAT

The main goal of the Aruba VAT is tax revenue generation. The pitfalls of other Caribbean countries upon the introduction of a VAT should be avoided, being amongst others:

- VAT should not be used to shift the tax burden from one to another taxpayer (which should be done via e.g., individual income tax and subsidies);
- VAT should not influence consumer behavior (which should be done via import duties and excise taxes).

¹ IMF Working Paper Tax Administration Reforms in the Caribbean (WP/17/88) and IMF Country Report No. 18/363.

Benefits for Aruba of a simple VAT

The benefits of a VAT are numerous and include:

- High tax revenues generated for the Government, with which the Government can fund its activities.
- Compliance is increased because to claim a refund (deduction of VAT) on purchases, the entrepreneur will need to purchase from other registered entrepreneurs with supporting invoices. As such, the VAT is a self-regulatory system.
- The Tax Authorities can focus their attention on the provision of information and audits of the VAT taxpayers (which through the threshold are limited).
- Since a VAT is a non-cumulative system, taxpayers will no longer need to integrate the various steps in the process, which enhances economic activities.
- VAT compliance requires businesses to keep the records of all the accounts, taxes, and rest of the transactions. When these records are updated and free of any inaccuracies, the entrepreneur gets a chance to make projections and analyze the cash flows thoroughly.
- Prices do not increase because of a VAT (since it is a consumer tax, not an entrepreneurial tax).

Recommendations

The VAT should replace and assimilate a myriad of taxes/levies:

- BBO
- BAVP/BAZV
- Tourism levy;
- Environmental levy (“bijzondere belasting verblijf”)
- Car rental tax;
- Gaming tax;
- Import Duties;
- Transfer tax (on non-residential properties).
- Foreign exchange commission.

Assimilation of these taxes will simplify the Aruba tax system, lower the administrative burden of taxpayers, and increase compliance (the latter resulting in higher VAT revenues). We note that import duties can and should be levied only where local producers should be protected in accordance with WTO regulations.

Moreover, the first stage of VAT should be levied on import on all goods and services.

Contours of a VAT

The contours of a VAT for Aruba should be:

- Exemption for small businesses;
- Single rate;

- Broadest base possible (e.g., including utilities) and should include all chains in the (production) process, also imports;
- Tax authorities that can process and pay out a refund within 30 days after the filing of the return.

If any of these items are deviated from, the VAT may work distortionary, become complex and thus may lead to tax avoidance and creative invoicing. In the next paragraphs, we will examine each of these items in more detail.

Exemption for small businesses

Small entrepreneurs generally have a less cost-efficient structure due to scale. Auditing small entrepreneurs is time consuming and costly, while not generating a lot of additional tax revenues.

By including a turnover threshold before an entrepreneur becomes subject to VAT lessens the burden on the SME's and on the Tax Authorities. A turnover threshold of the current AWG 84,000 for BBO/BAVP/BAZV purposes is advised in our opinion.

One should keep in mind that such small entrepreneurs are not able to claim any VAT refunds on their purchases, i.e., the VAT charged to them is their contribution to the VAT revenues.

Single rate (except exports)

Administration is kept as simple as possible if only one rate is used. Furthermore, the advantage of a broad base and a single rate is that the rate can be kept lower. According to a recent publication by Professor Cnossen², and the prior mentioned IMF Report, a rate of 10% may suffice.

We explicitly note that having multiple rates for different goods and services greatly complicates a VAT by increasing the administrative burden of the taxpayers, lower compliance including tax avoidance, and increasing auditing difficulties for the Tax Authorities. As such, multiple rates should be avoided at all costs and any negative effects should be solved another way.

However, depending on the VAT rate for Aruba:

- VAT on hotel rooms should not exceed current level of taxation (tourism levy), so not to “over-tax” Aruba’s main source of income compared to the region. An increase from the current 9.5% to a 10% VAT is acceptable, if the environmental levy is abolished and included in the rate.
- Current gaming tax should be abolished and replaced with a 10% VAT for casinos on the “win” (the revenues after player pay-outs and before expenses).

² Modernizing General Consumption Taxes in the Caribbean, Tax Notes International, volume 100, December 14, 2020, pages 1291 through 1311).

Broadest base possible and in all stages of the process

All goods and services should be included in the tax base, whether sold domestically or imported. Furthermore, it should include all stages in the production and distribution process, therefore also the retail stage.

- An important – and politically sensitive – current exemption, being that of water- & electricity, should be abolished, implying these utilities will also be subject to VAT. Since the benefit of such an exemption is mainly for the larger consumers, there is no substantive reason to exempt these supplies. The lower income households can be compensated another way for their loss of spending power, e.g., by subsidies or lower payroll taxes.
- Sales proceeds of non-residential properties, should be included in the VAT.
- Politically sensitive: the current exemption on certain financial services should be abolished, implying these services will also be subject to VAT. It is a growing trend amongst other nations with a VAT-system to tax fee-based financial services.

As per the IMF, exemption should be limited to solely:

- Activities which only the Government can perform;
- Publicly financed health care and education, including health insurance premiums;
- Margin-based financial services, including life insurance;
- Rental and lease income, as well as sales proceeds of used residential properties to Aruban residents.

Refunds

As a prerequisite, the Tax Authorities should be able to refund/ offset all “negative” (VAT on purchases higher than VAT on sales) VAT returns filed by entrepreneurs within a maximum of 30 days after the date of filing the VAT return and be able to process the pay-out of the refund/ decree for offset within the same 30 days since otherwise it could result in cash-flow issues for the entrepreneur. In our opinion, this will be the biggest hurdle to take since the Tax Authorities have significant backlog that currently hinders economic development.

For certain projects (e.g., construction of a hotel) or branches (e.g. construction), a special provision should be included that deals with the “negative” VAT returns and the corresponding refunds (since VAT due on sales may be delayed, hence an offset may not be fully satisfactory).

Others

The VAT should be an invoice-based system, contrary to the current BBO/BAVP and BAZV. In addition, the VAT needs to be indicated on invoices and receipts.

Another important consideration is that the implementation and subsequent transitional law should account for ample time (e.g. minimum one year) to allow both the entrepreneurs and tax authorities to adjust their administrations.

Finally

There are many more aspects to consider, however in our opinion, if the VAT is designed with all the above recommendations incorporated, the VAT is the optimal system for Aruba.

We look forward to your feedback and to being included in the tax reform decisions for Aruba.

Sincerely,



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cc: H.E. Mrs. E. Wever-Croes, Prime Minister of Aruba
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