Tax Reform phase 2 – the highlights

The Government of Aruba recently has sent the draft legislation for the tax reform phase 2 to the Aruba Parliament. According to the Government of Aruba, the second phase intends to simplify, tighten and redistribute the tax burden. The proposed measures, however, seem mainly aimed at increasing tax revenues on short term, and without sufficiently considering the long-term effects of these measures on the economy. All changes are intended to enter into effect as per April 1, 2020 unless otherwise mentioned.

Turnover taxes (consisting of BBO, BAVP and BAZV)

<u>The proposed changes</u>

- 6% turnover taxes (TOT) due on import of goods by entrepreneurs and non-entrepreneurs;
    - If an existing exemption on import duties applies, no TOT on import will be levied.
    - Taxable base is equal to the CIF value.
    - Offset of TOT paid on import in a month with TOT due on turnover in the same month only in case the goods imported are intended for resale (trade goods, e.g. wholesalers or supermarkets), and provided the entrepreneurs' invoices or cash register receipts comply with the law.
        - In case the TOT paid on import exceeds the amount of TOT due in a month, the remainder can be rolled over to the next month(s).
        - The Minister of Finance can create additional regulations or conditions relating to the resale of goods or can deem certain goods similar as a good for resale. It is not clear what kind of goods can be deemed similar to trade goods.

<u>Effect of the measure:</u>

- It will result in an increase in costs for many entrepreneurs, especially for non-trade goods.

<u>Technical observations</u>

- Contrary to the stakeholders meeting of September 4 and 5, 2019, the BAVP and BAZV have not been integrated into the BBO. The reasons are not clear.
- Goods for resale have not been defined. Based on the explanatory notes, if the good is in any way modified, added upon, or integrated into another good, the right to deduct the TOT paid on import does not deem to apply.
- Local producers that import goods for use in their products will face increased costs, unless these goods fall under an exemption of import duties.
- No transitional regulation has been created for either commitments already entered into or goods already purchased, but not yet arrived on Aruba.

Corporate income tax

<u>The proposed changes</u>

- IPC regime introduced per 2015 will be abolished without any transitional regulation, and the transitional regulation for old style IPC's (running until 2025) will also be abolished.
- Investment allowance is increased from 6% to 10% and can again be claimed on all investments in fixed assets made including purchases abroad.
- Limitations in the deduction of payment:
    - Now applies to (i) payments to entities (current) as well as (ii) individuals (new).
    - Now also applies on payments made to entities which shares are directly or indirectly, for at least 50% of the shares and voting rights, listed at a qualified stock exchange.

L.G. Smith Boulevard 26
Oranjestad
ARUBA

Office: +297 528 6336
Fax: +297 582 5256

www.bdoaruba.com
www.bdo.global

  - The payment must be included in the tax base of the recipient and should be subject to a nominal tax rate of at least 15% (was: effectively 15% tax should have been paid on the payment by the recipient).
  - Abolishment of the safe harbor rule (75% deduction in case the recipient of the payment was subject to taxation on the profit but was not paying at least 15% tax on the payment).
  - A relation is now deemed to exist in case of an interest of 5% (was: 33.33%) or more.
- Deductibility of depreciation expenses on real estate is maximized on the difference between the book value and the registered value (in Dutch: “leggerwaarde”) or, in the absence thereof, the value as per article 6, paragraph 1, of the Ground Tax Act being the market value.
- Corporate income tax rate will be reduced, as of April 1, 2020, to 23% (was: 25%).

Effect of the measures

- General: Increment in corporate income tax base due to further limitation of deductibility of expenses will result in an increase of the effective tax burden for many entrepreneurs.
- IPC: Abolishment of IPC regime will have a major impact on high-end hotels and thus on Aruba’s economy. We refer to IPC table shown on page 5.
- Investment allowance: Increase in percentage and broadening of its application may stimulate the economy and is in line with the IMF Report. This additional 4% increase of investment allowance will not be sufficient to mitigate the increase in effective tax burden.
- Limitations in deduction of payments: Will apply much sooner and are much stricter, hence will also lead to an increase of the effective tax burden.
- Depreciation on real estate: Many entrepreneurs will no longer be able to, for tax purposes, depreciate on their buildings, which will not only effectively increase the tax base, but may also negatively affect cashflow for future remodeling and maintenance.
- Corporate income tax rate: the 2% reduction of the rate may not be sufficient to offset the increase in the tax base.

Technical observations

- IPC: It is not clear why the existing transitional regulation for the old IPC’s will be abolished. From an OECD perspective the hotel sector is currently complying with the economic substance criteria.
- Investment allowance: Discussions may arise about moment of entering into a commitment or investment (before or after April 1, 2020). Furthermore, the own establishment costs (in Dutch: “voortbrengingskosten”, e.g. own employee costs related to the investment) are still excluded from the investment base.
- Depreciation on real estate: There are many uncertainties on how the changes should be interpreted. For example, if book value is less than registered value, should a revaluation occur? And if the book value is 100, and the registered value 80, in how many years should the remaining deprecation capacity of 20 be taken?
- Corporate income tax rate: It is not clear how the profit subject to the old rate (January – March 2020: 25%) and new rate (April 2020 – December 2020: 23%) should be calculated? Pro rata by P&L split or two sets of books are required?

Dividend withholding tax

The proposed changes

- Rate reduction of 10% to 5% is abolished for dividends paid to entities which shares are directly or indirectly, for at least 50% of the shares and voting rights, listed at a qualified stock exchange.
- IPC’s applying the new regime as of 2015 will as of March 31, 2020 no longer be exempt from dividend withholding tax and will fall under the 5%, 7.5% or 10% rate, depending on their corporate structure. Profits generated until March 31, 2020 will be grandfathered against 0%.
- Abolishment of the 0% rate on dividends of companies with retained earnings derived from the tax holiday period. As per April 2020 these companies can no longer apply the 0% rate provided upon the introduction of the dividend withholding tax in 2003.

Effect of the measures

- Increase in effective tax rate of new IPC's (beside the increase in corporate income tax rate) with at least 5%. For stock exchange listed companies, a similar increase may occur depending on their shareholders' structure.
- Increase in effective tax rate with 5% up to 10 % for companies with tax holiday retained earnings.

Technical observations

- The Government of Aruba should respect grandfathered periods. The confidence in Aruba's tax and legal system should prevail over short term income generation.

Personal income tax non-entrepreneurs (entrepreneurs: see corporate income tax)

The proposed changes

- Pension buy offs will, as of 2021, be subject to the progressive personal income tax rates up to 52% (was: 25%, and between January-June 2020: 10%).
- Rate categories I and II are abolished retroactively to January 1, 2019.

Effect of the measures

- Pension buy off: Progressive tax rates will apply as of January 1, 2021 on any pension buy off.

Technical observations

- None.

General Tax Act

The proposed change

- Certain tax returns can, on instruction of the Director of Taxes, only be filed electronically.

Effect of the measure

- Administrative burden and downtime (standing in line) should decrease.

Technical observations

- It is assumed this will relate to payroll taxes and TOT but has not been defined further. Although it is to be applauded that online returns can be filed, it can be questioned if this should be done of certain taxes. Especially older employers or older entrepreneurs may still prefer a paper return .

Foreign Exchange Commission

The proposed change

- The rate will be increased from 1.3% to 1.9%.

Effect of the measure

- The costs of exchange of currencies and transfers abroad will increase with almost 50%. This may have a negative effect on Aruba's economy in the long run.

Technical observations

- None.

Tourist levy

The proposed change

- Annually, the Ministers of Finance and Tourism can allocate a percentage or amount to the Aruba Tourism Authority.

Effect of the measure

- The tourist levy will now partially be used for general purposes of the Government of Aruba and no longer allocated to the marketing & promotion of Aruba. This may have a long-term negative effect on tourism and thus the economy of Aruba.

Technical observation

- None.

Stamp Act

The proposed change

- Requests for an establishment license at the Department of Economic Affairs no longer require a stamp.

Effect of the measure

- This will mitigate the administrative burden of entrepreneurs but has an insignificant financial impact.

Technical observations

- None.

Others

The proposed changes

- Penalties raised due to non-compliance with the exchange of information can be collected by the Tax Collector.
- The transitional regulation for old IPC's will be abolished per April 1, 2020.
- The 0% dividend withholding tax rate on tax holiday profits will be abolished per April 1, 2020.
- If investments were made on which 6% investment allowance was claimed, the disinvestment recapture (if applicable) will also be against 6%.

Effect of the measures

- Penalties: This is a formality since it was already collected by the Tax Collector.
- Transitional regulation old IPC's: This may result in potential claims on Land Aruba since many IPC's have prepared long term business plans based on the lower tax rates, and an insufficient notification period is applied.
- 0% rate tax holiday profits: This will have a significant effect on old tax holiday companies since their dividend withholding tax burden will increase to 5% or even 10% depending on their corporate structure.
- Disinvestment recapture: No significant impact.

Technical observations

- None.

IPC's for hotel sector and others

The impact of the changes in the corporate income tax and dividend withholding tax increases the effective tax rate of existing IPC's (old and new regime) by at least 91% up to almost 290%. A simplified summary as presented below shows us the impact of increases in effective tax rate as per April 2020 (not considering the increase in tax basis due to e.g. limitations in deduction of payments and depreciation on real estate nor the additional 4% investment allowance on investments in fixed assets) :

Regular companies	Corporate income tax	Dividend withholding tax	Effective tax rate
- Shareholder within Dutch Kingdom owning at least 25% of the shares in Aruba entity	23.00%	5.00%	26.85%
- Shareholder within Dutch Kingdom owning at least 25% of the shares in Aruba entity but subject to less than 5.5% tax	23.00%	7.50%	28.78%
- All others	23.00%	10.00%	30.70%

IPC regime old	Corporate income tax	Dividend withholding tax	Effective tax rate	Increase in effective tax rate
- Shareholder within Dutch Kingdom owning at least 25% of the shares in Aruba entity	2.00%	5.00%	6.90%	289.13%
- Shareholder within Dutch Kingdom owning at least 25% of the shares in Aruba entity but subject to less than 5.5% tax	2.00%	7.50%	9.35%	207.75%
- All others	2.00%	10.00%	11.80%	160.17%

IPC regime new	Corporate income tax	Dividend withholding tax	Effective tax rate	Increase in effective tax rate (maximum)	Increase in effective tax rate (minimum)
- Hotels Category I	10.00%	0.00%	10.00%	207.00%	187.50%
- Hotels Category II and IV	12.00%	0.00%	12.00%	155.83%	139.58%
- Hotels Category III	15.00%	0.00%	15.00%	104.67%	91.67%
- Other activities	10.00%	0.00%	10.00%	207.00%	187.50%

Substantial interest holders and self-administered pensions

<u>The proposed changes</u>

- Self-administered pension plans are abolished as of April 1, 2020.
- The General Pension Act no longer applies to substantial interest holders.

<u>Effect of the measures</u>

- Increase in effective tax rate of all entrepreneurs with self-administered pension plans.
- Personal income tax:
  - Pension premiums paid by employee are no longer tax deductible.
  - Pension premiums paid by employer will be considered taxable wage.
  - The above implies the pension grant (in Dutch: “aanspraak”) will be taxed, but the actual payment out of that pension grant in the future will be tax exempt.
- Corporate income tax: Employer’s premium will remain tax deductible, but due to personal income tax treatment, effectively no pension grant will take place anymore (too expensive).

<u>Technical observations</u>

- Complete abolishment is insufficiently substantiated.
  - Although pensions are indeed technically complex, actuarial calculations support most of the pension provisions.
  - Should the deduction of pension premiums for self-administered pension plans are deemed too high, other measures that mitigate the deductibility of premiums but still safeguards an entrepreneurs’ pension would have been simple to introduce.
- Because the substantial interest holder is excluded from the General Pension Act, the substantial interest holder will also no longer be able to deduct premiums for a pension insured at an insurance company since due to the exclusion from the General Pension Act, any pension insured no longer has a mandatory character. Premiums for life insurance products will be only deductible up to AWG 10,000 per year.
- Premiums contributions paid by the employer will subsequently be taxable; but payments will be exempted.
- Since pension insurers are generally no longer willing to insure defined benefit plans, with this measure only civil servants are entitled to defined benefit plans. Beside the fact that this type of pension incurs a significant expense for the Government of Aruba, it creates further market distortions between the public and private sector when looking at secondary benefits. It would have been advisable to consider, when abolishing the self-administered pensions, at the same time convert the pension plans of civil servants to a defined contribution plan to create a level playing field and at the same time reduce Government of Aruba’s expenses, while at the same time facilitating civil servants shifting to the private sector.

Finally

The above is based on the draft text of the law sent to Parliament on March 6, 2020. The final text of the law may be subject to change.

BDO Aruba has a dedicated team of professionals that are at your service should you have any questions relating to the above or require personalized assistance. You can reach BDO Aruba at our offices at L.G. Smith Boulevard 26, via telephone +297 5286336, or via e-mail:

wolter.cari@bdoaruba.com
statia.charitza@bdoaruba.com
kock.christine@bdoaruba.com
snijders.frank@bdoaruba.com
martis.anushka@bdoaruba.com
kock.jakemar@bdoaruba.com