

VAT for Aruba: Why and How?

November 22, 2024 - By Hans Ruiter, PhD Candidate in Indirect Taxes

On December 6, 2024, elections will take place in Aruba. In the party platforms of some political parties participating in the elections, VAT (BTW) is mentioned as a solution to the price increases that have occurred in Aruba over the past years. Below, we discuss why BBO should be replaced by VAT and highlight potential pitfalls. Specific topics will be addressed in future publications. This publication is intended as a general introduction.

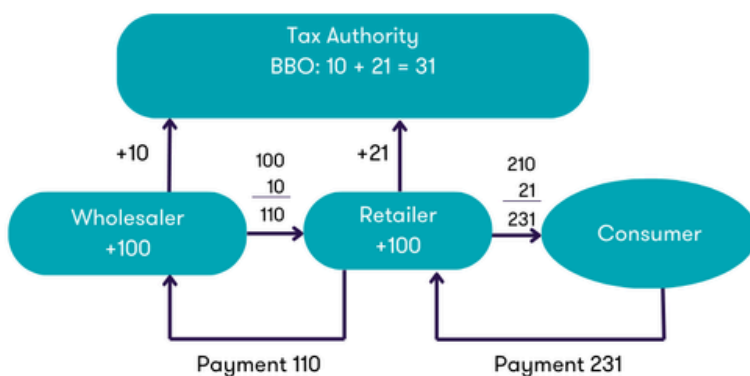
BBO stands for BBO/BAVP/BAZV (current tax systems in Aruba).

BBO

One of the causes of price increases in recent years is seen to be the cumulative BBO system. In the cumulative BBO system, BBO is charged at every stage of the production process. Since BBO is not deductible from the BBO already paid, it accumulates with each sale.

Since August 1, 2023, BBO has been levied at the border. In effect, the government has added an additional taxable stage to the production process. This border BBO is deductible if it concerns a trade good. However, if the good undergoes processing — for instance, in a restaurant — it is no longer considered a trade good, and the BBO becomes non-deductible. Based on initial experiences, the tax authorities interpret the right to deduct the import BBO restrictively. Additionally, the BBO rate was increased from 6% to 7% as of January 1, 2023.

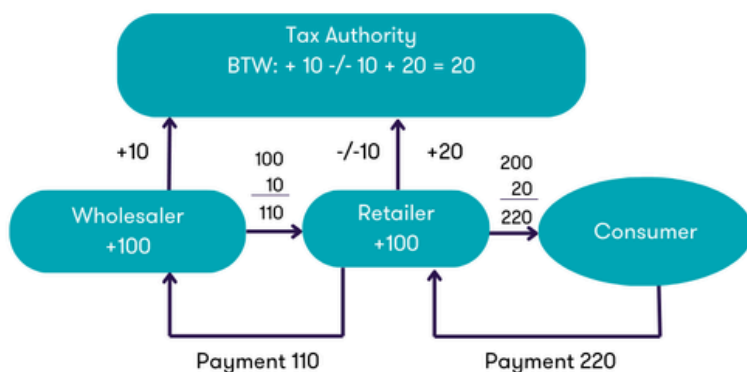
The following example clarifies how BBO is levied. For simplicity, the tax rate in this example is set at 10%.





VAT (BTW)

In a VAT system, every stage in the production process can deduct the VAT charged by the previous stage. Only the final consumer or non-business entity cannot deduct the VAT. As a result, there is no accumulation of taxes. This allows prices to remain lower. The following example illustrates this principle.



In this simple example, the consumer pays Afl 220 for the product under a VAT system, instead of Afl 231 under a BBO system. The tax authorities receive Afl 11 less and, in effect, bear the cost of this price reduction.

How can VAT be introduced?

A VAT must be visible on the invoice. Only then can the entrepreneur know the amount of VAT they can deduct. A concern for politicians is that VAT will be added on top of the current price, including the BBO. This would lead to further price increases instead of reductions.

Additionally, since 2019, it has been prohibited to list BBO on invoices, making it challenging to replace BBO with VAT. Therefore, the first step in implementing VAT must be to make BBO visible on invoices again. The prohibition on listing BBO on invoices must be abolished and replaced with a requirement to include BBO on invoices. Only then can it be ensured that VAT will not simply be added to the current price.

Moreover, Aruba has other indirect taxes besides BBO. The most significant of these is the tourist levy imposed on hotels, timeshares, and vacation rentals. The tourist levy must be replaced by VAT. If this does not happen, tax accumulation will still occur in the sectors subject to the tourist levy. Other indirect taxes should also eventually be incorporated under the VAT system.

Will prices decrease with the introduction of VAT?

Price increases have been caused by higher costs for businesses due to the cumulative effect of BBO. The introduction of VAT reduces these business costs. But does this automatically mean a price reduction? Unfortunately, that is not always the case. Ultimately, market forces will have to ensure lower prices.

If an entrepreneur wants to maintain a specific profit margin on a product, the cost reduction resulting from the introduction of VAT may influence the product's price.



What other advantages does VAT offer?

Most countries in the world use a VAT system, and for good reasons. VAT has several significant advantages, including:

a. Transparency:

VAT does not accumulate, creating a transparent indirect tax. The rate shown on the invoice is the tax paid by the consumer. There is no hidden cumulative turnover tax passed on to the consumer.

b. No market distortions:

Since VAT does not accumulate, it avoids market distortions. In a BBO system, entrepreneurs and consumers might try to skip stages in the production or supply chain.

c. Encourages compliance:

VAT deduction is only possible with a proper invoice. Entrepreneurs will require accurate invoices from other businesses, encouraging dealings with legitimate (bona fide) entrepreneurs. This helps reduce the gray and black economy. More businesses contribute to VAT revenues, potentially allowing lower VAT rates.

d. Economic transparency:

VAT provides the government and tax authorities with better insight into the economy and cash flows between businesses. For every VAT deduction, there is a corresponding payment. In a digital system, VAT deductions and payments become visible and verifiable. This is also valuable for enforcing other taxes.

Conclusion

Replacing BBO with VAT is a step in the right direction toward a fair and transparent tax system, ensuring that every entrepreneur contributes to tax revenues. It is commendable that several political parties have included VAT in their platforms. Hopefully, VAT will be implemented in the coming years.

In our next publication, we will delve deeper into other aspects of VAT.



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