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ACCOUNTANCY TAX LEGAL & ADVISORY SERVICES

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Newsflash

# Formalization of beneficial tax policy, reduction of the corporate income tax rate, and introduction of payment of corporate income tax at filing

## Introduction

In our newsflash of June 2013, we informed you about a series of tax measures resulting from the Social Dialogue, introduced under the beneficial tax policy (begunstigend beleid) in anticipation of (phased) formalization into legislation. Last Wednesday the Parliament of Aruba adopted a bill to formalize certain elements of the beneficial tax policy into legislation. These measures concern the investment deduction facility, the deduction of interest relating to local participations, changes to the IPC regime, and the introduction of a reinvestment reserve facility for legal entities operating timeshare resorts. Parliament has also decided to reduce the corporate income tax rate effective January 1, 2016, and to replace the current system of levying corporate income tax by means of assessments with a system where taxpayers pay their corporate income tax when they file their returns ("VAS") effective 2014. The main points of those measures are explained below.

## Investment deduction facility

A temporary investment deduction facility was introduced on January 1, 2011 under which, if certain conditions are met, a deduction may be claimed for personal income tax and corporate income tax purposes of up to 6% of amounts invested in operating assets. One of the conditions is that the operating asset must have been acquired locally. Originally, this temporary investment deduction facility was to be offered for the years 2011 and 2012 only, however the beneficial tax policy extended the facility for investments made during the years 2013 and 2014 as well. Now the investment deduction facility has been given a legal basis for an indefinite period of time.

## Deductibility of interest relating to local participations

Dividends originating from ownership of shares are exempt from profit tax if certain conditions are met. The same is true of profits realized from sales of those shares. These facilities constitute what is commonly known as the "participation exemption". The flipside of this exemption was that interest paid to finance the acquisition of such participations was non-deductible.

Following the introduction of the beneficial tax policy, this has now been changed for interest relating to ownership of shares in Aruban companies. The interest paid during the first and second years after the shares were acquired is initially not deductible from profits; however, over the following three years it may as yet be deducted in equal portions. Interest paid during the third year and beyond is immediately and wholly deductible.
The possibility of deducting interest is applicable only with respect to participations acquired during the 2013 financial year or later, and only where deduction is not obstructed by other statutory limitations.

## Changes to the IPC regime

The "IPC regime", as it is commonly known, was introduced in 2003. It provided for imputation payments by the Country of Aruba to shareholders. Essentially, it offered a partial rebate on the corporate income tax paid by the company, bringing the effective tax rate to no more than 2%. The IPC regime applied to a small number of activity types, including commercial operation of luxury hotels. To qualify, the average consideration per hotel room ("RevPAR", or revenue per available room) had to be AWG 354.

In practice, few taxpayers made use of the IPC regime. Reasons included the numerous formalities involved and

the fact that only a small number of hotels in Aruba have a RevPAR of AWG 354. As such, it was decided to modify the IPC regime with effect from June 28, 2013. The imputation payments ceased, but the corporate income tax rate was lowered and taxpayers are now granted an exemption from dividend withholding tax.

For purposes of the modified IPC regime, hotels are divided into four categories, each with a separate rate for corporate income tax:

| Category | Status | Rate |
|---|---|---|
| I | RevPar USD 185 | 10% |
| II | RevPar USD 175 | 12% |
| III | RevPar USD 160 | 15% |
| IV | 4 diamond status | 12% |

These lower RevPAR requirements mean that many more hotels will qualify than was previously the case. However, to qualify they must satisfy two additional requirements: Firstly, the hotel must be certified by Earth Check or possess a similar certificate. Secondly, annual investments must be made that benefit the Aruban community. The amount that must be invested is linked to the category in which the hotel falls and depends in part on whether the hotel has more or fewer than 100 rooms:

| Category | More than 100 rooms | Fewer than 100 rooms |
|---|---|---|
| I | AWG 250.000 | AWG 120.000 |
| II | AWG 165.000 | AWG 75.000 |
| III | AWG 90.000 | AWG 45.000 |
| IV | AWG 165.000 | AWG 75.000 |

For these purposes, 1/3 of the amount invested must go toward sustainability and the environment. A further 1/3 of the investment must be spent on training local employees. The remainder of the investment must be used for purchasing products manufactured locally in Aruba. The investment does not need to be capitalized, but may be deducted in its entirety from the profit in the year of the investment.

Other types of activities besides hotel operation qualify for the modified IPC regime as well. The first group consists of the activities that, if certain conditions were met, similarly qualified for the former IPC regime, such as holding and financing activities, for example. Further qualifying activities will now be added, including activities aimed at promoting the knowledge economy and scientific activities. However, the decree to add these activities has yet to be published.

These activities are subject to corporate income tax at a rate of 10% and are exempt from dividend withholding tax.

The old IPC regime now ceases to exist in result of the formalization of the modified IPC regime into legislation. However, companies whose management notifies the Tax Inspector before the date of commencement of the ordinance (i.e., the day after publication in the Official Bulletin) that their shareholders will claim imputation payments will fall under a transitional arrangement until January 1, 2026. This transitional period terminates if the company decides to apply the modified IPC regime.

**Reinvestment reserve facility for timeshare resorts**

Timeshare resorts are generally operated on a not-for-profit basis: their only objective is to generate sufficient revenue to cover the costs in the long term. As a consequence, in many cases no profits are recorded on which profit tax can be levied.

The beneficial tax policy provides for the possibility to add a surplus from a particular year to a “reinvestment reserve”. The amounts reserved must then be used within 10 years for maintenance work on the timeshare resort. Any reserved amounts that are not used for that purpose will be released and added to the resort’s income.

Following the beneficial tax policy, it has now been formalized into legislation that legal entities operating timeshare resorts may add profits resulting from contributions for maintenance purposes from their members or shareholders, to a reinvestment reserve.

**Reduction in corporate income tax rate**

Effective January 1, 2016 the general corporate income tax rate will be reduced from 28% to 25%. The government has previously hinted that it intends to further reduce the rate on January 1, 2017 (to 20%).

**Payment of corporate income tax at filing (VAS)**

To date, corporate income taxpayers have been required to annually file their tax returns, based on which the Tax Inspector subsequently imposes a corporate income tax assessment. This system has been replaced from the year 2014 onwards with a system in which taxpayers pay their corporate income tax when they file their returns ("VAS").

In result of this new system, the corporate income tax return for the previous year must be filed no later than May 31, and the corporate income tax due must be paid immediately (i.e., without the Tax Inspector imposing a tax assessment first).

If the taxpayer is unable to file the final tax return within five months after the end of the financial year, it may submit a request for extension. This request must be accompanied by a provisional tax return declaring an amount in corporate income tax that equals at least the tax payable according to the most recent final tax return (in respect of the previous year). That corporate income tax must then be paid immediately. The maximum extension is six months (i.e., up to November 30).

The corporate income tax according to the final tax return may be less than the corporate income tax according to the provisional tax return. In that case, the company is entitled to a refund. This is granted within six months after the final tax return is filed. Conversely, if the Tax Inspector, for example in result of a tax audit, determines that the declared corporate income tax was too low, he may impose an additional tax assessment.

The deadline for filing the final corporate income tax return for the year 2014 has already expired. Therefore, this deadline has been extended by six months (i.e., until November 30, 2015). However, during discussions of the bill, the Minister of Finance, Communication, Utilities and Energy has promised an extension by one month under beneficial tax policy (i.e., until December 31, 2015). This may be further extended until February 28, 2016. To be eligible for this further extension, the taxpayer must file a provisional tax return – no later than December 31, 2015 – and pay the corporate income tax due in accordance with that return. Therefore, it is vital to act at short notice.

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# Newsflash

Taxpayers may already have received provisional tax assessments for the years 2014 and 2015. The corporate income tax payable in result of these assessments will be deducted from the corporate income tax due according to the tax return to be filed for those years.

*The information presented in this newsflash is of a general nature. For expert assistance with regards to the information contained in this newsflash, please feel free to contact our staff at ATLAS.*


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