

The Regressivity of Consumption Tax in Aruba and the Case for VAT Refunds

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Aruba, like many other countries, relies heavily on consumption taxes such as BBO (Belasting op Bedrijfsomzetten) and BAZV (Bestemmingsheffing Algemene Ziektekostenverzekering) to finance public services. As Aruba prepares for a potential transition to a full Value-Added Tax (VAT) system, there is an opportunity—and a necessity—to examine the social consequences of this shift. One of the most pressing concerns is the regressivity of consumption taxes: their disproportionate impact on low-income households.

Understanding Regressivity

A regressive tax is a tax that takes a larger percentage of income from low-income earners than from high-income earners. VAT is considered a regressive tax. This is because people with lower incomes spend nearly all their earnings on consumption, which is subject to VAT. In contrast, individuals with higher incomes can save or invest a larger share of their income. This part of their income escapes consumption-based taxation.

To illustrate, consider two households: one earning Afl. 2,000 per month, the other earning Afl. 10,000 per month. The lower-income household spends virtually its entire income on goods and services—food, rent, electricity, transportation—most of which are subject to VAT. If the VAT rate were 21%, this household could be paying around Afl. 400 in VAT every month, or 20% of its income. The higher-income household may spend Afl. 5,000 and save the rest. Even if it pays Afl. 1,050 in VAT, this amounts to just over 10% of its income.

This kind of tax burden undermines fairness in the system and can deepen existing economic disparities.

Traditional Solutions: Limited in Effect

To address the regressive nature of VAT, many countries implement reduced tax rates or exemptions for essential goods. For instance, basic foods, medicines, and public transportation are often taxed at lower rates or not at all.

However, these policies have significant drawbacks:

1. They benefit everyone equally, including those who don't need the financial relief. A millionaire pays the same reduced VAT rate on bread and milk as someone living below the poverty line.
 2. They create administrative complexity. Applying different tax rates and exemptions to different goods requires detailed rules and classifications, which increase compliance burdens for businesses and enforcement costs for tax authorities.
 3. They reduce government revenues, which could otherwise be used for targeted social programs.
- In short, while reduced rates and exemptions offer some relief, they are blunt instruments that fail to adequately address regressivity.



A Smarter Alternative: VAT Refunds for Low-Income Households

An increasingly favored approach worldwide is the targeted VAT refund—a direct payment to lower-income households to compensate for the disproportionate share of VAT they pay. This method, sometimes described as a VAT cashback, bypasses the need for complex exemptions and delivers support exactly where it's needed. Several countries have implemented or are testing such systems:

- Colombia operates a program called Devolución del IVA, in which the government issues cash transfers to households in poverty three times per year. These payments are calculated to offset the average VAT burden for low-income families.
- Brazil is piloting systems that automatically refund part of the VAT (ICMS) paid by consumers, using national ID numbers (CPF) and digital payment data to identify eligible individuals and process refunds without requiring manual claims. This VAT refund can be paid directly into a digital wallet which is held by the individual. This money can be spent again directly by the individual.
- South Korea uses a VAT cashback model tied to electronic payments. Consumers who pay with cards or mobile wallets receive a percentage of their VAT payments back at the end of the fiscal year, particularly if they fall below a certain income threshold.
- New Zealand offers another instructive case. The country applies a flat GST (Goods and Services Tax) on nearly all goods and services, with virtually no exemptions. This simplicity makes the tax system transparent and easy to administer. However, to address regressivity, New Zealand uses income-based support systems such as Working for Families tax credits. Rather than adjusting the tax system itself, the government compensates low-income households through direct transfers. While not a direct VAT refund, it achieves similar redistribution goals in a clean and efficient manner.

These approaches demonstrate that targeted VAT refunds are not only feasible but also efficient and fair. The VAT refunds can be paid up to a certain maximum amount per month, per quarter or per year.



How Could It Work on Aruba?

Aruba could adopt a similar mechanism, tailored to its local context. Here are a few possible models:

- Quarterly flat-rate refunds: The government could pay Afl. 150 every three months to all residents earning below Afl. 2,500 per month. This would directly compensate for part of the VAT burden without requiring complicated application processes.
- Refunds linked to digital transactions: Consumers could register their AZV or SVB number (or other specific registration number) with payment providers. When they pay electronically, the system could track eligible consumers and refund (a portion of) the VAT automatically into a digital wallet up to a maximum amount of – for example – Afl. 200 per month. This amount can be spent again directly.

These models could be financed from VAT revenues themselves, creating a self-contained cycle of taxation and redistribution. Importantly, implementing such a system would allow Aruba to eliminate most product-based exemptions, simplifying the tax system while maintaining social fairness. Of course it is important to develop a reliable system to determine which low income households are eligible and to avoid abuse. Aruba can use best practices of other countries to develop these systems.

Conclusion

The transition to VAT presents both challenges and opportunities for Aruba. While VAT is an efficient revenue tool, its regressive nature must be addressed to avoid placing an undue burden on those least able to pay. Relying solely


on exemptions and reduced rates is inefficient and often ineffective.

A targeted VAT refund system offers a smarter, more equitable solution. It protects low-income households, simplifies the tax code, and ensures that VAT reform contributes not only to fiscal sustainability but also to social justice. Aruba has the chance to lead the region by adopting a modern, fair approach to consumption taxation —one that reflects both economic efficiency and human dignity.




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