ANDORRA: A TAX HAVEN AS SOLID AS LIECHTENSTEIN AND SWITZERLAND

Juan Hdez. Vigueras.
Tax Justice Network-European Steering Committee.

Introduction.

"Andorra is a very small country with just six banks. However, due to its geographical location in the Pyrenees, its relatively strong financial system and the free movement of money across its frontiers, Andorra is an attractive destination for those seeking to undertake money laundering operations". That is the introduction in the last strategic report on Andorra released by the US Bureau for International Narcotics and Law Enforcement Affairs in the State Department.

1. - A European medieval microstate.

The Principality of Andorra, whose capital is a little town, Andorra la Vella, is a small country landlocked in the Pyrenees Mountains between France and Spain, with an extension of 468 square kilometers and a population of 68,400 inhabitants, whose official language is Catalan, although French and Spanish are also fluently spoken; and this enclave retains as its heads of state a co-principality; the two princes are the president the Republic of France and the catholic bishop of Seo de Urgel, Spain, who are represented locally by co-princes' representatives.

For nearly 800 years, Andorrans lived under a unique feudal system that was modified in 1993 with the titular heads of state retained, but the government transformed into a parliamentary democracy. Long isolated and impoverished, mountainous this small country achieved considerable prosperity since World War II through its tourist industry. Many immigrants (legal and illegal) are attracted to the thriving economy with its lack of income taxes. In fact, as it happens in most small countries, an elite and an oligarchy - that designs rules in its own interest - govern Andorra. That is one of the common characteristics of tax havens that has been revealed through my five years investigations and published in three books; others conclusions referred to the EU policies that are designed to help all those offshore financial centers in the continent and elsewhere. This oligarchy, for example, managed to dissolve the active Attac group of people who emerged around 2001.

Tourism, the mainstay of Andorra's tiny, well-to-do economy, accounts for more than 80% of GDP, attracted by its duty-free status and by its summer and winter resorts. Andorra's comparative advantage has recently eroded as the economies of neighboring France and Spain have been opened up, providing broader availability of goods and lower tariffs. Agricultural production is limited - only 2% of the land is arable and most food has to be imported. The principal livestock activity is sheep raising. Manufacturing output consists mainly of cigarettes, cigars, and furniture. Bur the banking sector contributes substantially to the economy, according to the CIA.[1]

2. - <u>An Offshore Tax Haven in action</u>

Andorra does not have income tax and corporate tax; individuals and corporations have only to pay low fees to register and a low municipal tax.[2] The term offshore is not found in its legislation, because there are no particular rules for non-residents. As we know, OECD applied its tax haven concept to those countries and territories that the IMF called offshore financial centers (OFCs), that is to say when there is a sector for non-residents financial activities, which enjoy special rules like null or low taxes. Andorra was included among the 35 tax havens on the black official list published by OECD in 2000 and remained as uncooperative tax haven until 2005. But – as I did explained in an article for TJN - Andorra has joined OECD Global Forum on transparency and exchange of information.[3]

On February 2005, the OECD welcomed an announcement by this Principality that it has accepted an invitation to participate in the next meeting of the Global Forum on Taxation reviewing issues of transparency and effective exchange of information. The OECD Global Forum on Taxation brings together representatives of more than 60 OECD and non-OECD governments sharing a common objective of achieving a global level playing field – so they say - based on high standards of transparency and effective exchange of information in tax matters. "*We are very pleased to hear that Andorra will join OECD countries and other major financial centers in the discussions on international standards of transparency and information exchange in tax matters*," said Bill McCloskey, Chair of the OECD's Committee on Fiscal Affairs and Co-Chair of the Global Forum. "*We see this as a positive step towards better cooperation and look forward to Andorra's participation in the process*." Andorra has not at that stage made a commitment to implement transparency and effective exchange of information, neither have most of other offshore jurisdictions that are working with the OECD to curb harmful tax practices. However, Andorra and other financial centers have been invited by Global Forum participants to join in its work in order to widen the endless dialogue now under way. [4]

3. – <u>An Offshore Banking Center.</u>

According to the local law, to register a company, it is required that two thirds of ownership should belong to Andorran nationals whether to operate inside the Principality or outside. This legal limitation means real income for leading local people and besides the company shares can be transferred to or hired by local professional to manage; those people are nominees and they are called in Catalan "prestanoms". And according to the CIA, "*the banking sector, with its partial "tax haven" status, also contributes substantially to the economy*". The 2007 IMF report states that Andorra government has denied information about Spanish customers due to the local secrecy rules and practice but without condemning such conduct because that international institution is not concerned by tax fraud or money laundering but with financial stability.

The Andorran banking system is small and highly concentrated, with seven licensed banks, which offer traditional banking services through a network of about 55 branches, including both locally and foreign owned entities. Banking total assets and customer deposits amounted to 11.3 billion euros and 9.3 billion euros in 2005, respectively. About 2.7 billion euros out of 8.9 billion euros of total loans in 2005 were loans to nonresidents, mostly from Europe and North America, and a significant share of deposits from nonresidents, primarily from the European Union (EU). Andorran banks have branches in Bahamas and Uruguay and a representative office in Panama, but these operations represent a very small share of the business of the banking groups. The system is based on a universal banking model, without losing sight of specialized banking services. Andorran banks can, therefore, offer all banking services, including credit operations, asset management and investment counseling, liability operations (current, savings and term accounts), stock transactions, financial analysis and other banking services (credit cards, transfers, standing orders, etc.). Insurance companies controlled by banks also carry out the majority of the life insurance business.

The banking system has significant links to Spain, albeit these links have decreased. With the sales of BBVA's participation in the Inter-Mora bank to the Andorran shareholders in early 2006, currently, only three of the seven banks authorized to operate in Andorra have Spanish participation. These banks account for about 45 percent of assets and deposits of the banking system, down from around 71 percent in 2001. In September 2006, the Caixa d'Estalvis i Pensions de Barcelona (*la Caixa*) announced the sale of its shares in Credit Andorra to the Andorran shareholders of this bank. Once this operation is finalized only one Spanish Bank, amounting to about 4 percent of assets and deposits of the banking system will remain operating in Andorra, according to the IMF report. Nowadays, a significant increasing portion of off-balance sheet items is mainly driven by the growth of securities and other instruments in custody and derivatives operations (61.1 percent growth in 2005). Bank managed third party' assets and assets of investment funds held in custody by banks amounted to 19.2 billion euros. The significant growth of derivatives operations corresponds to currency hedging instruments to cover customers' exposure to currency risk. Parallel to this pattern there has been a slow decline of on-balance sheet items.

The *Institut Nacional Andorrà de Finances* (INAF) is the supervisor for the financial sector, including banks and nonblank financial companies, while insurance supervision is the responsibility of the MF. The UPB has exclusive jurisdiction over money laundering investigations and supervision in Andorra. According to the IMF evaluation, Andorra has made significant improvements in banking regulation and supervision but additional efforts are needed and consider that most notably, INAF's independence and ability to cooperate with foreign supervisors has been strengthened by the approval of its new charter, though its powers should be further enhanced to undertake all sanctions, including those classified as "very serious." INAF is able to facilitate nominative information of large exposures and to conduct joint onsite examinations and "*the charter allows INAF to sign agreements with foreign supervisors, but efforts to reach an agreement with the Bank of Spain (Banco de España) have not been successful due to restrictions on the access of supervisors of foreign banks to nominative information of these banks' customers*", says the IMF. Thus it is obvious that Andorra does not help the Spanish government to pursue the camping against tax dodgers.

As usual, the IMF recommend that INAF be also empowered to share with the home country supervisor information about the local operations of the foreign banks necessary to conduct effective supervision of these banks, provided its confidentiality is protected. The development of INAF's on-site supervisory capacity is under way and full on-site inspections were expected to start, after the new staff has completed a thorough training program and additional hirings because its staff is still lean and so IMAF has to rely on external auditors.[5] So you have a mini State to supervise a big money market.

4. <u>Money laundering in Andorra.</u>

In 2003, Andorra was able to obtain its first money laundering conviction as well as its first asset confiscation; on February 26, 2003, three Spaniards were convicted for a major money laundering offense in connection with drug-trafficking in Spain, as it is stated in the last report from The US Bureau for International Narcotics and Law Enforcement. Two of the convicted received five years' imprisonment and a fine of 150,000 euros, and the third received three years' imprisonment and a 50,000 euros penalty. Andorra also invoked provisional measures, freezing three bank accounts totaling 20 million euros and another bank account of 1.3 million euros, and seizing an additional bank account along with a building. In July 2004, the Spanish and the Andorran police uncovered a drug trafficking network involving more than 20 people, the majority of them Spanish nationals. Drugs were seized in Spain and Andorra's UPB froze a 14 million Euro bank account held in Andorra; and the case is still under investigation.

It is obvious that Andorra legal practices attracts money to be laundered from all over Europe, though Andorra has the ordinary legislation against money laundering which it is described in the referred report. But as a matter of fact, it is demonstrated that combating money laundering is impossible without any kind of border control over financial transactions between UE countries and a third country. The police work closely with the Unit for the Prevention of Laundering Operations (UPB), Andorra's financial intelligence unit, and the law authorizes the use of telephone taps and undercover officers in money laundering investigations. The UPB can freeze assets administratively for five days without a judicial order or can seek a judicial order, if the assets need to be held for a longer period.

Predicate offenses for money laundering are defined in the Criminal Code and include drug trafficking, hostage taking, sales of illegal arms, prostitution, and terrorism. Andorra complies with the FATF 40 Recommendations plus the Special Recommendations on Terrorist Financing. The law imposes reporting obligations upon Andorran financial institutions, insurance and re-insurance companies, and natural persons or entities whose professions or business activities involve the movement of money or securities that may be susceptible to laundering. It specifically covers external accountants and tax advisors, real estate agents, notaries, and other legal professionals when they are acting in certain professional capacities, as well as casinos and dealers in precious stones and metals. Reports of suspicious transactions are made to the UPB); customer identification, including identification of the beneficial owner, is required at the time a business relationship is established and before any applicable transaction. Records verifying identity must be kept for a period of at least ten years from the date when the business relationship ends.

In 2003, Andorra set up a legislative commission that reviewed the Criminal Code and anti-money laundering laws. The explicit criminalization of terrorism financing was included in this review, as were general modifications to hone the banking sector regulations. "*Despite its progress and cooperation concerning money laundering, the OECD continues to cite Andorra as a *tax haven* due to its low or nonexistent taxes, and maintains that Andorra still needs to make its banking system more transparent*."[6]

5. - Andorra protection from the European Union[7]

In fact, Andorra is considered by the European Union as an associated country; but even it is not a EU full fledged-member is a member of the EU Customs Union and is treated as an EU member for trade in manufactured goods (no tariffs) and as a non-EU member for agricultural products and it is allowed to use the euro as its official money. In an interview by a Spanish newspaper[1], the Andorran prime minister declared that Andorra did not want to enter into the EU and that its bank secrecy was "*intocable*", untouchable, it could not be removed.

Relations with the European Union are regulated by contractual relations with Andorra are based on an Agreement between the European Economic Community and the Principality of Andorra which was signed on 28 June 1990. In addition, a Cooperation Agreement, covering a wide range of issues: environment, communications, information, culture, transport, regional and cross-border cooperation, and social issues. Following the pattern established with Switzerland and other European tax havens to settle up the saving tax Directive, on 15 November 2004 a bilateral Agreement was signed with the European Commission that entered into force on 1 July 2005.

So Andorra is just an example of how European States and some European policies favor offshore tax havens. When we say European offshore tax havens, we are talking mainly of some 18 countries and territories linked to the EU plus Switzerland and Luxemburg, the City of London, Holland and some countries and territories with undeclared harmful tax policies to compete better. Because tax competition is a working principle in practice among the EU member states since the freedom of movements for financial funds was introduced, contrary of the intentions of the fathers of the Common Market who signed the Treaty of Rome. Now the fact is that the EU is just *a financial area without* borders for capital flows. The EC Treaty prohibits any restrictions con capital movements in and out the Common market, that is to say, not only inside the common market but in and out third countries doing business with EU member states, as has shown the financial crisis from the US subprime mortgages that backed assets.[8]

6. Andorra as part of the *Europe opaque for finances*

To put it in a nutshell, the tiny Principality of Andorra is part of a global financial world of which the EU is only a big part. Thus why the question raised by my book entitled *"La Europa opaca de las finanzas"* (Icaria-Barcelona, 2008) is *"Do finance control the European Union dynamics?*

This book shows that certain European policies protect some countries and territories catalogued by the OECD as tax havens which thanks to its opaque financial specialties and its little or null taxation, compete advantageously as the euro zone second clients after the U.S.A.

Because the configuration of the Union like a simple "*area*" for the world-wide financial markets, turns it into a big commercial center for wholesale banking, insuring and financial organizations, many of them domiciled in Switzerland, Jersey, the Cayman Islands or any other offshore financial center; a simple market-place where sometimes financial capitals pass through like *"plagues of lobsters"*, going in and out without restrictions after devouring stock-exchange capital gains without paying taxes and without any communitarian supervision.

Consequently, the EU make its member States and its economies more and more vulnerable in front of the uncontrolled global finance, as the crisis of the subprime mortgages generated by Wall Street reveals. Because the present European institutionalization, besides accentuating the competition between the partners to decrease taxes on capital, generates losses on fiscal revenues so as to threaten the welfare state model, reduces its ability to protect small savers and disables the effective combat against the international money laundering from drug trafficking and real estate corruption." [9]   20/5/2008

NOTES

[1] CIA web page updated in August 2007.
[2] See *La fiscalite en Principaute d'Andorre* in the web site http://www.andorra.be/fr/3.4.htm#1.
[3] To understand the real meaning of this, I suggest my two briefings on the 2004 OECD progress report & the Global Forum on Taxation as a substitute for the 1998 OECD Project against harmful tax competition practices on www.taxjustice.net
[4] International Narcotics Control Strategy Report -2005. US Department. Released by the Bureau for International Narcotics and Law Enforcement Affairs March 2005.
[5] International Monetary Fund February 2007. IMFCountry Report No. 07/69. Andorra: Assessment of Financial Sector Supervision and Regulation.
[6] El País 27/8/2006.
[7] http://ec.europa.eu/external_relations/andorra/intro/index.htm

[8] http://ec.europa.eu/external_relations/andorra/intro/index.htm
[9] See more in Spanish http://laeuropaopacadelasfinanzas.blogspot.com/