Andorra: Exchange of Information and New Tax System in the Context of the OECD’s and EU’s Initiatives

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Andorra, a microstate located in the Pyrenees, between France and Spain, used to be characterized by strict bank secrecy and the absence of direct taxes on income. However, given the pressure exerted by the European Union and, especially, by the OECD, Andorra finally committed in 2009 to exchanging tax information upon request according to the OECD standards. Since then, Andorra has introduced important legal reforms following these standards, in a process which is still evolving and which may even lead to automatic exchange of information in the near future. Moreover, as a result of the crisis suffered in recent years, Andorra has also undergone a complete reform of its tax system and has approved, for the first time in the history of the country, a corporate and a personal income tax, even though the fiscal pressure is still very low. The aim of this article is to systematically analyse this major transformation of the Andorran legal framework in the context of the initiatives undertaken by the EU and the OECD in tax matters.

I INTRODUCTION

Andorra, an independent State located in the middle of the Pyrenees, between France and Spain, underwent a radical transformation during the second half of the twentieth century. Low taxation contributed to the expansion of the commercial sector, which attracted customers from the neighbouring countries. Moreover, banking secrecy was a key factor for the development of a solid financial sector. These two economic activities, together with tourism attracted by the ski resorts, as well as the construction sector, were the basis of Andorra’s economy.

In recent years, important changes have affected the rules on exchange of tax information and the configuration of the Andorran tax system. These reforms will be very relevant for the future of this State and for taxpayers from other countries who had preferred to deposit their wealth in Andorran banks or who are planning to invest in new businesses in Andorra. Thus, the aim of this article is to present the recent evolution of the Andorran legal framework on tax matters and exchange of information in a systematic way, in the context of the initiatives of the OECD and the EU in this field.

Consequently, the main sources which are considered are the Andorran legislation, the treaties signed by this country, EU law and the recommendations and publications of the OECD and, in particular, of the Global Forum on Transparency and Exchange of Information for Tax Purposes. With respect to the structure, the article will focus first on the changes which have affected the exchange of tax information with Andorra (section 2) and after that the reform of the tax system will be presented, commenting on the main taxes that have been introduced and the conventions for the avoidance of double taxation which are being negotiated (section 3).

2 THE LONG WAY TOWARDS AUTOMATIC EXCHANGE OF INFORMATION

2.1 The OECD and Exchange of Information upon Prior Request: First Initiatives

The establishment of exchange of information upon prior request as a global minimum standard in order to prevent tax avoidance and evasion has been the result of a long process. During the 1970s and 1980s, the OECD conducted several initiatives on this issue, such as the Recommendation of the Council on tax avoidance and evasion of 21 September 1977 (C(77)149/FINAL) and, especially, the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (1988), which was a joint initiative with the Council of Europe. However, the ratification process of this convention was very slow and the advances in this area were very modest in the following years.

A renewed effort was the publication by the OECD of the 1998 Report on Harmful Tax Competition. This project had been especially encouraged by the United

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States and by the main countries of the European Union since they feared that in a context of growing globalization the opportunities for tax avoidance would also flourish and this could seriously limit the revenue raised by traditional tax systems. Basically, the Report included several criteria in order to identify the countries which could be qualified as tax havens and made some recommendations regarding the changes that these countries should make, for instance, in relation to bank secrecy. Given that most of the affected countries were not OECD members, they had the impression that the OECD was trying to impose its views and limit their sovereignty without considering their opinion on the matter, generating a climate of confrontation. Even though the recommendations were not legally binding, these countries felt pressured due to the establishment of a Forum on Harmful Tax Competition in charge of verifying the degree of compliance with this soft law and to the possibility of being the object of countermeasures.

One of the first formal contacts of Andorra with the OECD in order to deal with its initiative on tax havens was a meeting held in February 2001 together with other countries of Europe and the Middle East. However, Andorra did not commit itself with the OECD recommendations and was one of the few countries which were included in the list of non-cooperative jurisdictions published in April 2002.

Before committing itself with the OECD standards, several reports of this international organization published in 2006, 2007, and 2008 had analysed the degree of compliance of the Andorran legal system with the OECD recommendations. Among the most relevant aspects, it should be highlighted that exchange of information was limited by the principle of double criminality, that is, the information to be exchanged had to deal with situations which could be qualified as a criminal offence not only according to the criteria of the State requiring the information, but also according to the Andorran legislation, which considered that tax crimes could only exist if documents had been falsified or in comparable situations.

Furthermore, the OECD noted that the Andorran legal system expressly protected the secrecy of bank information, which could only be accessed by the tax administration if this was authorized by a court in the framework of a criminal investigation. In the case of corporations, the OECD criticized the fact that in general they were not required to audit their accounts and to make them available at a public registry. However, this situation was corrected by the end of 2007 as a result of the reforms which affected several aspects of corporate law.

In year 2009, the OECD project received a renovated impetus. The reason was that due to the financial crisis, tax havens were seen as a serious problem not only by the G8 and the G20, but also by the public opinion. In this context, the OECD standards were redefined and the Global Forum on Transparency and Exchange of Information for Tax Purposes was established, including both OECD member and non-Member States. That same year, as a result of the international pressure, Andorra finally committed to the OECD standards.

Basically, the standards require exchange of information on request in line with the 2002 Model Agreement on Exchange of Information on Tax Matters and Article 26 of the OECD Model Convention on Income and on Capital. In order to be able to exchange the necessary information, States have to ensure that bank, accounting, and ownership information is kept by the corresponding entities and that it can be accessed by the public authorities. All these elements are the object of the peer reviews which are conducted by the Global Forum in order to ensure compliance with the standards. These reviews take place in two phases: the first one focuses on the legal framework and the second, on the practical implementation. Andorra has already been the object of
these reviews, whose main findings are commented on later.

2.2 The European Union and Exchange of Information on Savings Income: The Withholding Tax as an Alternative

With respect to the relationship between Andorra and the European Union on tax matters, the most relevant initiative was the Agreement between the European Community and the Principality of Andorra providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments, signed in Brussels on 15 November 2004 and in force since 1 June 2005. As is well known, the ‘savings directive’ tried to ensure the effective taxation of savings income in the form of interest payments and with this objective it required the automatic exchange of information between the State where interests arose and the State of residence of the taxpayer, or the application of a withholding tax, which was the option initially followed by Austria, Belgium, and Luxemburg.

In the case of Andorra, a withholding tax with revenue sharing is currently applied, unless the beneficiary voluntarily agrees on the supply of information to the tax authority of his or her country of residence. The Agreement with Andorra also introduced the possibility of exchanging information upon request (Article 12), but only in cases which could constitute a crime of tax fraud under the law of the requested State, and not just according to the legislation of the State making the request. This international agreement has been implemented in Andorra through Law 11/2005 of 13 June 2005.

2.3 The Commitment with the OECD Standard of Exchange of Information upon Prior Request

On 10 March 2009, Andorra finally committed itself through a public declaration to reforming its legislation on bank secrecy by 15 November 2009, which gave rise to an important series of legal changes. During September 2009, a new law regulating exchange of information upon prior request was passed (Law 3/2009 of 7 September 2009) with the main aim of approaching the Andorran legal framework to the recommendations of the OECD. This can be clearly observed in its preamble, where it is stated that the increasing international pressure on the countries which had no legal instruments to exchange information on tax matters required the introduction of legislative reforms in order to avoid the inclusion of Andorra in the ‘black list’ prepared by the OECD. Moreover, Article 1 of the aforementioned law also states that the new legislation follows the OECD principles of transparency and exchange of information and, in particular, Article 26 on exchange of information of the OECD Model Convention on Income and on Capital.

Another relevant development which took place during the last months of 2009 and which continued during 2010 was the signature of Tax Information Exchange Agreements (TIEAs) with several countries. In particular, it is important to note that Andorra signed agreements with its neighbouring States: France and Spain. The TIEA with France was signed on 22 September 2009 and entered into force on 22 December 2010, while the TIEA with Spain was signed on 14 January 2010 and entered into force on 10 February 2011.

According to these treaties, the ministries of finance will exchange, on request, the information that is foreseeable relevant to the determination, assessment and collection of the taxes covered by the treaty, the recovery and enforcement of tax claims, or the investigation or prosecution of tax matters. Even though criminal tax matters are also covered by these agreements, exchange of information for non-tax purposes between judicial authorities (for instance, in order to combat crimes such as money laundering and corruption) may be subject to certain restrictions according to the existing legislation on international mutual assistance for criminal matters.

Despite the new approach of Andorra towards exchange of tax information, the peer review report published in 201113 identified several aspects of the legal framework that had to be revised in order to comply with the OECD standards, such as the absence of sanctions in the cases in which legal entities did not update the information on ownership in the corresponding public registries.14 Moreover, the report also criticized that the obligation to notify the affected parties in advance could prevent or seriously delay the exchange of information.15 Other aspects had already been corrected by 2011 and, for instance, the legislation was amended in order to allow the identification of the person under investigation not only

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12 With respect to the limitations of the OECD standards, see para. 12.3 of the Commentary to the update to Art. 26 of the OECD Model approved in 2012. In the case of Andorra, judicial authorities can exchange information which may be of criminal relevance subject to the limitations foreseen by the Law for International Cooperation on Criminal Matters and the Combat against the Laundering of Money or Securities arising from International Crime of 29 Dec. 2000. This law was the object of an important reform in 2008 and of several amendments in 2011, 2013 and 2014.
14 Ibid., at 32.
15 Ibid., at 49.
through the name and address, but also through other relevant elements.

During the following years, Andorra continued its process of legal reforms to ensure an effective exchange of tax information and the current situation has been recently analysed by the peer review report published in August 2014.16

For instance, a modification in the line of the OECD recommendations was the introduction of a system of sanctions for the cases in which ownership of legal entities was not kept up to date in the public registries. Another important development was the signature by Andorra, on 5 November 2013, of the Convention on Mutual Administrative Assistance in Tax Matters promoted by the OECD and the Council of Europe, as amended by the Protocol of 2010, even though it has not been ratified yet and therefore it has not entered into force in relation to Andorra. The ratification of this convention would be a very relevant step since this would allow the exchange of information with many countries which have not signed a specific TIEA with Andorra.

According to the peer review report published in 2014, Andorra is considered in general terms to be partly compliant with the OECD standards. Consequently, by August 2015 a new review will be conducted to verify if the necessary reforms have been made. For instance, it is necessary to improve the system of oversight which ensures that corporations keep full accounting records, including their underlying documentation; it should be ensured that the existence of joint bank accounts does not become an obstacle for the exchange of information; and the competent authority should fully exercise its access powers to obtain accounting information from companies or other persons. Moreover, the prior notification to the affected parties should be excepted if the information has to be urgently provided or if the notification could undermine the success of the investigations conducted by the requesting jurisdiction; and Andorra should also correct the fact that currently the persons under investigation can inspect the file containing the request and all the information which will be exchanged, which could endanger the confidentiality of the information.

Finally, the Peer Review Group has also noted that Andorra should improve the timeframe for answering the requests, which was considered to be too slow. During 2011 Andorra received twelve requests of information, which in 80% of the cases were answered after more than one year. According to Andorra, these late responses were due to the lack of experience and administrative resources. After the creation of a unit exclusively dedicated to exchange of information, the situation during 2013 and the first half of 2014 has been improved, but Andorra should review its procedures to ensure that a timely reply can always be provided.

One of the aspects criticized by the peer review reports of 2011 and 2014, the requirement to notify the affected taxpayer in all cases, was in fact corrected shortly before the publication of the 2014 report. In particular, Law 3/2009, on exchange of information upon prior request, was amended by Law 12/2014 of 26 June 2014 in order to introduce certain exceptions. In the current version of Law 3/2009, the information request will remain confidential if the State asking for the information argues that otherwise its investigation could be endangered and that the request relates to a serious offence according to its domestic legislation. However, the taxpayer affected must be notified in all cases within six months of the delivery of the information to the requesting State.

With respect to the aspects whose application has been more controversial, a reference should be made to the interpretation of the provisions of the TIEAs dealing with their entry into force. If the new treaties could affect information originated beforehand, this could imply that they could have, at least partially, some retroactive effects. In general, according to the OECD standards it is necessary to exchange information related to a taxable period following the entry into force of the agreement, even if that information originated before this date.

Taking as an example the TIEA with Spain, Andorra’s most important trading partner, it can be observed that it was signed on 14 January 2010, and it entered into force on 10 February 2011. According to Article 12(3) of the Agreement, it will have effect for criminal tax matters from the date of entry into force, and for all other matters covered by the Agreement, in respect of the taxable periods beginning on or after that date, or where there is no taxable period, all charges to tax arising on or after that date. Consequently, given that the Agreement entered into force on 10 February 2011, in relation to the personal income tax, for instance, the first fiscal year which would fall within the scope of the Agreement would be 2012, since fiscal year 2011 had already begun when the treaty entered into force.

In this sense, the Commentary on Article 15 of the 2002 Model Agreement on Exchange of Information, on which the Agreement between Andorra and Spain is based, clarifies that it is possible to request information which is previous to the date of entry into force as long as it relates to a taxable period or chargeable event following that date. However, in such a case, the commentary notes that the requested party will not be in violation of the agreement if it is unable to obtain that information on the grounds that it was not required to be maintained at that time and consequently it is not available. In practice, the

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Andorrán authorities follow the interpretation of the commentaries and accept the possibility of exchanging information which originated before the entry into force of the agreement but which relates to taxable periods initiated after that date.17

In the case of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which has already been signed by Andorra but which has not entered into force yet, its temporal application is different. Article 28(7) states that for tax matters involving intentional conduct which is liable to prosecution under the criminal laws of the applicant party, the Convention will also have effect from the date of entry into force in respect of a party in relation to earlier taxable periods or charges to tax. Consequently, the peer review report published in August 2014 noted that before ratifying the Multilateral Convention on Mutual Administrative Assistance, Andorra should reform its law on exchange of information, whose second final provision states that the requested information has to be in relation to taxable periods beginning after the date of signature of the treaties which allow for the exchange of information.18

2.4 Automatic Exchange of Information in the Framework of the OECD and the European Union

After establishing exchange of information upon prior request as a generally accepted standard, the efforts of the OECD have focused on automatic exchange of information.

The interest of many countries for this form of exchange of information has been promoted by the enactment of the United States of the Foreign Account Tax Compliance Act (FATCA), which in principle required foreign financial institutions to report to the US tax administration directly and automatically the information on accounts held by US clients. In many cases, however, it has been agreed that, instead of exchanging the information directly, the financial institutions will provide the information to their tax administrations and, in turn, these will send the information to the American authorities. With this first experience of automatic exchange of information, many countries were soon interested in promoting cooperation at a multilateral level and, at the request of the G20, the OECD has been working on a global standard on automatic exchange of information.

On 6 May 2014, the Declaration on Automatic Exchange of Information in Tax Matters [C/MIN(2014)5/FINAL] was adopted by the Ministers and representatives of the OECD member countries, several non-members (such as Argentina, China, Brazil, Colombia, Saudi Arabia, and Singapore), and the European Union. In this Declaration, the signatories welcome the OECD Standard for Automatic Exchange of Financial Account Information, express their intention to progressively implement the new standard on a reciprocal basis and request the OECD to develop by mid-2014 a commentary on the application of the standard and further technical guidance. Moreover, the parties to this Declaration also consider that the Global Forum should establish a mechanism to monitor and review the implementation of the new standard.

The OECD delivered in a timely manner the required additional guidance and in July 2014 it published the complete report on the Standard for Automatic Exchange of Financial Account Information in Tax Matters, which includes a Model Competent Authority Agreement and a Common Reporting Standard, together with their corresponding commentaries.19

This Standard for Automatic Exchange of Financial Account Information in Tax Matters was the object of the Recommendation of the OECD Council of 15 July 2014 [C(2014)81/FINAL]. In particular, OECD Member States and non-members which have adhered to it are recommended to make all the necessary changes in their domestic law to implement the new standard and to interpret their national legislation according to the commentaries approved by the Committee on Fiscal Affairs.

Such a recommendation, adopted according to Article 5(b) of the Convention on the OECD, is not legally binding and OECD Member States could depart from it without breaching any legal obligation, which is even clearer in the case of non-Member States, especially those which have not adhered to it. However, OECD members (which unanimously voted in favour of the recommendation) and non-members which adhered to it are clearly expected to comply with the standard, especially taking into account that the Recommendation invites the Global Forum on Transparency and Exchange of Information for Tax Purposes to monitor its implementation.

In this sense, it is important to note that on 16 June 2014, Andorra joined the Declaration on Automatic Exchange of Information for Tax Matters, which shows the commitment of this country with the new standard. The implementation will still require several years, but a significant number of countries integrated in the Early Adopters Group have already committed themselves to exchanging information automatically by 2017.

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17 Ibid., at 88.
18 Ibid., at 89.
With respect to the development of automatic exchange of information in the context of the European Union, Council Directive 2005/61/EC was amended by Council Directive 2014/48/EU of 24 March 2014 in order to close the existing loopholes and prevent tax evasion more effectively. The directive has to be transposed now by the Member States and it will not be fully applicable until 2017. The European Commission also expects to soon reach an agreement with Andorra, Liechtenstein, Monaco, San Marino, and Switzerland in order to update the existing agreements on savings taxation, which should be in accordance with the standard on automatic exchange of information which is currently promoted by the OECD. As it happened in the case of the 2004 agreement with Andorra, its update will probably follow the same criteria which are first agreed with Switzerland, the country with a stronger negotiating position.

3 Reform of the Tax System

In recent years, besides the changes which affected bank secrecy, Andorra has initiated an important reform of its tax system. Traditionally, the country relied mainly on indirect taxes and direct taxation played a very limited role (for instance, the 2014 budget foresaw that direct taxes would generate a revenue of EUR 48.5 million, compared to the EUR 277.8 million of indirect taxes). However, the economic crisis which has affected its neighbouring countries has also had a direct impact on the number of visitors to Andorra and on their consumption in the country. According to the budget of 2008, the revenue derived from indirect taxes was expected to amount to EUR 319.8 million, which shows that in recent years a significant reduction has taken place. As a result, a general reform of the Andorran tax system was necessary in order to diversify the sources of income and ensure the financial sustainability of the country.

Before presenting the changes which have affected the main taxes which are levied in Andorra, reference will also be made to the reforms concerning closely related areas of the legal system of this country, such as corporate, accounting and investment legislation. Some of these reforms have been essential for the application of the new taxes since, for instance, the corporate income tax could only be levied once Andorra had approved its own accounting rules. In the following sections, the four taxes that since January 2015 constitute the pillars of the tax system will be presented in the order in which they have become applicable. A reference will also be made to the double tax treaties that Andorra is currently negotiating.

3.1 Modernization of Corporate, Accounting and Investment Legislation

The new Law on companies (Law 20/2007 of 18 October 2007) brought several innovations, such as a clearer regulation of director’s general duties as well as their liability regime. Moreover, this legal reform introduced accounting obligations, including the obligation of auditing the annual accounts in certain cases and of making them accessible to third parties through the corresponding public registry. In order to apply these new accounting obligations, it was necessary to adopt the Accounting Law (Law 30/2007 of 20 December 2007), together with a General Accounting Plan providing the specific rules which have to be followed for the preparation of the financial statements.

The regulation of foreign investment has also been the object of important reforms in 2008 (Law 2/2008 of 8 April 2008) and 2012 (Law 10/2012 of 21 June 2012). Traditionally, foreign investors were only allowed to acquire up to 33% of the shares of an Andorran corporation. The reform of 2008 introduced an important liberalization of the economy, even though foreign direct investment in several economic sectors was subject to certain restrictions. The current Foreign Investment Law adopted in 2012 continues the liberalization trend initiated in 2008. Currently, it is possible for non-residents to control 100% of the share capital or voting rights of an Andorran corporation, but foreign investments require an Administrative authorization. This requirement should be nonetheless easy to fulfil as long as the investment is in accordance with the Andorran legal framework and makes a positive contribution to the economy of the country, that is, as long as, among other aspects, it does not have a negative impact on the sovereignty of the country, on economic competition, on the labour market, on the environment, or on public health.

3.2 Tax on Income Obtained by Non-residents and Withholding Tax on Savings Income Obtained by Residents in the European Union

The tax on income obtained by non-residents (natural persons or legal entities) was introduced by Law 94/2010 of 29 December 2010, which has been amended by Law 18/2011 of 1 December 2011. Even though the law introducing this new tax was adopted on the same day as the law establishing the corporate income tax, the tax on

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21 Several amendments have been introduced during recent years and the current consolidated version has been published by the Legislative Decree of 26 Feb. 2014.
Corporate income tax


and since accounting profit, which is the object of several fiscal compute the taxable base, the starting point is the that the tax rate is relatively low (10%). In order to European Union and the OECD, with the particularity corporate income which exist in most countries of the time in relation to fiscal year 2012. The structure of the 17/2011 of 1 December 2011, and was levied for the first operation is taxed following to a large extent the rules foreseen by the corporate income tax. On the contrary, if non-residents obtain income without having a permanent establishment, each operation is taxed individually (Article 16). The general tax rate is 10% (Article 20), the same which is applied by the corporate income tax.

It is important to note that the Andorran tax on income obtained by non-residents does not have to be paid in the case of salaries obtained by non-residents who are employed in Andorra and pay the contributions to the Andorran social security system (Article 15(a)). Moreover, Article 15(b) foresees the exemption of dividends, interest payments, and other types of income from movable capital obtained by non-residents.

However, it should be remembered that in the case of savings income obtained by residents of a country of the European Union who have not voluntarily disclosed that income to the tax authorities of their country of residence, it will be necessary to apply the 35% withholding tax foreseen in Article 7 of the Agreement between the European Community and the Principality of Andorra providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments, signed in Brussels on 15 November 2004. The revenue obtained thanks to the withholding tax will be distributed between Andorra (which will retain the 25%) and the country of residence of the beneficial owner.

3.3 Corporate Income Tax

The corporate income tax was introduced by Law 95/2010 of 29 December 2010, which has been amended by Law 17/2011 of 1 December 2011, and was levied for the first time in relation to fiscal year 2012. The structure of the Andorran tax is also very similar to that of taxes on corporate income which exist in most countries of the European Union and the OECD, with the particularity that the tax rate is relatively low (10%). In order to compute the taxable base, the starting point is the accounting profit, which is the object of several fiscal adjustments, such as those necessary to value transactions between related parties at arm’s length, following the OECD recommendations.

An important characteristic of the Andorran corporate tax law is the introduction of several particular regimes with a lower tax burden in order to attract certain economic activities to Andorra. In the case of companies dedicated to the international exploitation of intangible assets (patent rights, industrial designs, etc.) or to international trade (even if the commercialized products do not enter Andorra), the tax base is reduced by 80% (Article 23). Similarly, the same reduction applies in the case of intra-group investment companies (Article 24). Finally, in the case of holding companies, the dividends that they receive or the gains that they obtain from the transmission of shares are exempt from taxation (Article 38).

However, Andorra is not the only European country to apply a low tax pressure on corporations, since low nominal tax rates can also be found in countries such as Ireland, Cyprus, and Liechtenstein and the special regimes foreseen by the Andorran legislation are also very common. Therefore, the possibility of attracting new companies thanks to mere tax reasons is uncertain, especially taking into account that they would have to compensate the traditional disadvantages of Andorra, such as its isolation and the limited land available for new buildings given the mountainous nature of the country, or the fact that service companies operating internationally may prefer English-speaking countries or other locations with bigger job markets in which highly skilled professionals are easier to recruit.

3.4 General Indirect Tax

Law 11/2012, on the general indirect tax (abbreviated as IGI in Catalan), was adopted on 21 June 2012, and since January 2013 this new tax has substituted several indirect taxes which were previously levied on the consumption of different types of goods and services. In order to ensure the compatibility with the tax systems of the neighbouring countries, the new general indirect tax follows to a large extent Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax. The main difference is the lower fiscal pressure which is applied in Andorra. In particular, the general tax rate is only 4.5% and the legislation foresees reduced rates for certain goods and services, such as cultural activities (2.5%), food and books (1%) and medical and educational services (0%). This shows that the Andorran authorities are interested in maintaining the country as an attractive shopping destination which traditionally has received consumers from the neighbouring countries. In fact, Andorra has

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become more attractive as a result of the increase in the VAT rates which has taken place in recent years in many European countries.

3.5 Personal Income Tax

One of the most recent developments has been the adoption on 29 April 2014 of Law 5/2014, on the personal income tax. For the first time in Andorra, natural persons are subject to a comprehensive income tax since 1 January 2015. Until fiscal year 2014, direct taxation of income obtained by Andorran residents was limited to the tax on economic activities performed by natural persons (introduced by Law 96/2010 of 29 December 2009), but this tax is repealed with effects as from 1 January 2015, and income from these activities will be taxed in a very similar way in the framework of the new general personal income tax.

With respect to the main characteristics of the new income tax, it is levied on the worldwide income of the persons with fiscal residence in Andorra, which includes all those persons spending there more than 183 days per year or having in this country their main economic interests. However, cross-border workers who move daily from France or Spain are not considered to be residents of Andorra (Article 7).

The new tax distinguishes two groups of income: general income (which includes income from salaried activities, income from economic activities, and real estate income) and savings income (including income from movable capital, such as interest and dividends, and capital gains and losses). A general reduction of EUR 24,000 is applicable to the general tax base (which is increased to EUR 40,000 in case of married couples in which only one of the partners obtains income), while in the case of the savings base it is possible to apply a reduction of EUR 3,000 (Articles 35(1) and 37). Moreover, there are some additional reductions which take into account the familiar circumstances of the taxpayer (Article 35(2)) or which promote the acquisition of the main residence (Article 38) or the contributions to pension schemes (Article 39).

After the application of these reductions, a single tax rate of 10% is levied both on the general and the savings base (Article 43). The resulting tax payable can still be reduced by several measures. First of all, taxpayers can apply a rebate amounting to 50% of the tax payable (which results from the application of the 10% rate to the general tax base, after the application of the general reduction of EUR 24,000), with a limit of EUR 800 (Article 46). This means that, in practice, the tax rate applied to the general tax base between EUR 24,001 and EUR 40,000 is only 5%. Consequently, even though the income tax law only foresees a flat tax rate of 10%, in practice the effective tax rate increases with the level of income. Given that high-income individuals pay a larger percentage from their income than low-income taxpayers, the Andorran income tax can be considered to be progressive, which is relevant since Article 37 of the Andorran Constitution establishes that the tax system should be in accordance with the ability to pay principle.

Moreover, the income tax law includes measures to avoid double taxation, both at the national level (in relation to certain minor local taxes) and with respect to taxes paid abroad (Articles 47 and 48). Finally, taxpayers who perform economic activities in Andorra can apply an additional tax credit if they increase their number of employees or make additional investments.

An important characteristic of the new income tax is the intention of the Andorran legislator of minimizing the administrative costs for the taxpayer. With this aim, a withholding tax system is foreseen and taxpayers who only obtain income from salaried activities and from movable capital will not be obliged to file a tax return (Articles 52 and 55). Despite this intention, in many cases the retention will probably not completely match the tax to be paid, such as in the situations in which the taxpayer wants to make use of the tax benefits foreseen by the law or if there have been changes in his familiar circumstances. Consequently, the administration for the first time of a tax which may affect a large proportion of the population could be a serious challenge for the Andorran authorities.

Another relevant aspect related to the new personal income tax is the fact that in recent years Andorra has followed an immigration policy aimed at attracting high-net-worth individuals. In particular, Andorra offers the possibility of obtaining a residence permit without the right of performing economic activities in the country with the condition, among other requirements, of investing at least EUR 400,000 in assets such as real estate, corporate shares or public debt (Articles 95 and 96 of the Immigration Law). 23 The reason why some persons may have been interested in obtaining such a residence permit was, logically, the absence of a personal income tax in Andorra. In order to protect the expectations of the persons who had obtained this residence permit prior to the entry into force of the new personal income tax law, a transitional arrangement applicable during three years has been introduced giving these persons the option to pay EUR 30,000 instead of the quantity which would result from the normal application of the income tax, even though in such a case the taxpayers will not be able to benefit from the advantages derived from the tax treaties which Andorra may have signed.

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23 The consolidated version of the Immigration Law (Llei qualificada 9/2012 of 31 May 2012) has been recently published by the Legislative Decree of 26 Mar. 2014.
3.6 Other Taxes

Besides the four main taxes previously commented, the Andorran tax system includes other taxes. Among the most relevant it is possible to cite the tax on capital transfers (abbreviated as ITP in Catalan), which is levied on the second and subsequent transfers of immovable property at a rate of 4% (the first transfer is subject to the general indirect tax); the tax on the increase in value of real estate properties; excise duties on alcohol, tobacco and fuel; the tax on insurances; and customs duties. However, in Andorra taxes on wealth and inheritances do not exist and they are not expected to be introduced.

3.7 Conventions for the Avoidance of Double Taxation

In the context of the new tax system, in which direct taxes on income play a more relevant role, the Andorran government is interested in signing conventions for the avoidance of double taxation with its main partners. Even though the Andorran legislation already contains unilateral measures for the prevention of double taxation, double tax conventions would probably increase legal certainty for foreign investors.

The first double tax convention was signed with France on 2 April 2013 and, more recently, another was signed with Luxemburg on 2 June 2014, even though none of them is yet in force. If we focus on the convention with France, Andorra’s second largest trading partner after Spain, in general it can be observed that it follows the OECD Model very closely, for instance with respect to basic aspects such as the definition of permanent establishment. The convention allows the taxation at source of dividends (5% at most if the beneficial owner holds at least 10% of the capital of the corporation paying the dividends, and 15% otherwise), interest (5% at most) and royalties (5% at most). Taking into account that Andorra is most probably a net capital importer with respect to France, especially after the reforms of the legislation which completely opened the economy of the country to foreign investments, Andorra would particularly benefit from the provisions which allow for the taxation at source of certain types of income, such as dividends, interest and royalties. However, Andorra has declared the exemption of dividends and interest and, consequently, the effects of the convention in this area will not be so relevant.

One original characteristic of the convention is the introduction of several singular anti-avoidance provisions. For instance, the convention establishes that in order to qualify as a resident in Andorra it is necessary to be present in this country for more than 183 days or to have in Andorra the centre of the economic interests, which cannot be presumed from the mere fact of having the Andorran nationality or having obtained a residence permit. Moreover, taxpayers will not be able to benefit from the advantages of the convention if the main objective or one of the main objectives of their behaviour or of that of a related party is to benefit from those advantages; or if an operation is structured so that income is not directly received by its beneficial owner in order to reduce the fiscal pressure that would have been applied if income had been directly received (Article 25(1)(a) and (b)).

Another significant specificity of the convention between Andorra and France is the introduction of a provision stating that France could decide to tax natural persons of French nationality who are residents of Andorra as if the convention did not exist, in which case an agreement between the two States would be sought on how to proceed (Article 25(1)(d)). As has been noted by Collet and Rozant, the purpose of such a measure is to open the door to the future taxation of French nationals who change their place of residence for tax reasons. In fact, a measure in this sense was applied for some time by Spain, since until 2011 Andorra was qualified as a tax haven by the Spanish authorities and Article 8(2) of the Spanish personal income tax foresees that Spanish nationals which move their residence from Spain to a country considered as a tax haven are subject to the Spanish income tax during the four fiscal years following their change of country of residence.

Finally, with respect to exchange of information, the convention does not introduce any innovation and simply refers to the existing TIEA between Andorra and France.

This double tax convention with France is also relevant since it could influence the content of the conventions which may result from the negotiations which Andorra is currently conducting with Belgium, Portugal, and Spain. In this sense, the signature of a tax treaty with Spain is expected to take place at the beginning of 2015.

4 Conclusions

Andorra was traditionally very reluctant to exchange tax information, which is not surprising taking into account that the successful development of its financial sector was mainly due to the strict protection of bank secrecy. However, the growing international pressure obliged Andorra to commit itself in 2009 with the OECD standard of exchange of information upon prior request. During recent years, Andorra has introduced important
legal reforms following the recommendations of the OECD. A fundamental step has been the signature of TIEAs with some of its most relevant partners, such as France and Spain, a process which in general has been positively valued by the peer review reports which have been conducted in the context of the Global Forum on Transparency and Exchange of Information.

More recently, Andorra has taken a step forward and has committed to the new OECD standard on automatic exchange of information. Moreover, negotiations with the European Union are also currently being carried out with respect to the implementation of the new directive on savings taxation and could also lead to a system of automatic exchange of information which would substitute the existing withholding tax. This would constitute a very significant change with respect to the present situation and the banking sector would probably have to reorient its business.

With respect to the tax reform which has taken place in Andorra, the new general indirect tax and the direct taxes on income are in line with the existing international standards and, in particular, they seem to have taken the Spanish tax legislation as a model, with the peculiarity that the fiscal pressure remains very low. This modernization of the tax system has to be welcome, since the new regulation is more comprehensible for foreign investors and contributes to the application of the ability to pay principle foreseen in the Andorran Constitution and to the soundness of public finances.

In general, all these reforms are in line with the recommendations of the OECD and the European Union. As an independent State, Andorra is free to establish the fiscal pressure that it may prefer. However, the international consensus developed during recent years requires all countries to cooperate in the fight against tax avoidance and evasion.