New exchange of information versus tax solutions of equivalent effect – Luxembourg report

Banking secrecy has developed over many years in Luxembourg to protect the privacy of its banking clients. Over time it has appeared that the bank secrecy was also a very powerful commercial argument in the developing of the banking activities in Luxembourg. Therefore, Luxembourg’s tax policy traditionally consisted in denying any information exchange in tax matters. That position proved however to be untenable, as a result of increased peer pressure. Therefore, on March 13 2009, the Luxembourg government resolved to adopt going forward the OECD standards in information exchange. This led to a bill passed on March 31st 2010 (the “Bill”) where Parliament approved twenty tax treaties, which lifts the bank secrecy in tax matters. The Bill also addresses the procedural rules that will be needed for implementing the information exchange in practice (2). In order to fully appreciate the seismic change the Bill has generated, a brief review of the bank secrecy rules as existing in the past will be needed (1).

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2 5 new treaties and 15 revised existing tax treaties: Armenia; Austria; Bahrain; Belgium; Denmark; Finland; France; Germany; Iceland; Liechtenstein; Mexico; Monaco; the Netherlands; Norway; Qatar; Spain; Switzerland; Turkey; United Kingdom; USA; in detail on the consequences of the revised rules: FORT/JUNG/RUST, Luxembourg report, in: Exchange of information and the cross-border cooperation between tax authorities, IFA, 2013, p. 1 – 19 (in print).


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1 What once was ...: the old rules

Although the bank secrecy has been gradually relaxed over the years (1.1), the policy makers have made sure that it remained preserved for tax matters as far as income from savings is concerned (1.2).

1.1 Evolution of the Luxembourg bank secrecy rules

1.1.1 An Old Story

Contrary to what many believe, Luxembourg has not invented recently the bank secrecy in tax matters, in order to attract foreign capital. Bank secrecy is firmly enshrined in Luxembourg’s traditions. Its roots may be traced back to the French Penal Code of 1791 as subsequently amended by Luxembourg Parliament in 1879. The relevant provision was article 458 Penal Code which states that doctors and other persons that get entrusted with confidential information as a result of their activities may not divulge unless such a disclosure is compelled by law or made in the

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3 Specialists consider in fact the revocation of the edict of Nantes in 1685 by Louis XIV to be one of the key dates in the development of banking secrecy. It led more than 250,000 Protestants to flee France, with many transferring their wealth to Switzerland. From there, they discreetly continued to finance the French monarchy with Louis XIV as principal borrower. Discretion had to be assured, no one should find out that the French king was borrowing from “Protestant heretics”. Louis XIV even had a Swiss banker, Jacques Necker, as director general of French finances.
course of a court hearing. A non-authorised disclosure may be sentenced by a fine of up to € 5,000 and an imprisonment of up to 6 months⁴.

Although the banks were not specifically listed under article 458 Penal Code, it has never been doubted that this provision would also to be applicable to banks. Therefore, the banking bills of 1981 and 1993, when for the first time specifically stating the existence of the bank secrecy⁵, took great care in indicating that the specific bank secrecy merely was confirming for financial institutions the already existing rules; the intentions were clearly not to create a new regime. Parliament took the opportunity of the passing of the banking bill to further indicate that the bank secrecy rules would be part of Luxembourg public policy provisions ("ordre public"), and hence could only get lifted as a result of specific statute provisions to that effect. The public policy character of the banking secrecy rule is further evidenced by the fact that any breach of it constitutes a criminal offence subject to a fine and an imprisonment.

1.1.2 LIFTING OF BANK SECRECY IN CASE OF MONEY LAUNDERING …

A first uncontroversial hole in the bank secrecy was created via the anti-money laundering legislation. While the precise legal definition of money laundering varies across countries, the essence is the undertaking of transactions in order to disguise the true source of illegally acquired funds. As far as Luxembourg is concerned, that concept was initially limited to the financial aspects of organized crime, specifically drug money. Subsequently, that concept got broadened in order to cover the financial aspects of an enlarged list of criminal activities, including crimes such as corruption⁶. In case of money laundering, banks not only do have to cooperate to the fullest extent possible with the public authorities investigating the matter, but would furthermore have to denunciate to the public authorities any money laundering activities of their clients, if they had the suspicion for such activities to exist. In some countries, the definition of money laundering has been extended over time beyond this traditional understanding in order to also cover the laundering of the proceeds of tax, national insurance contributions or tax credit fraud, with particular emphasis on professionals who facilitate tax evasion. Noticeably however, Luxembourg Parliament never went as far as also including tax fraud on the list.

In principle, money laundering and tax evasion are conceptually quite distinct. There can be tax evasion without money laundering; no attempt being made to hide the nature of some income, but only its existence. And there can be money laundering

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⁵ Law of 17 June 1992 as amended: “All administrators, members of managing and supervisory bodies, directors, employees and other persons in the service of credit institutions, other professionals of the financial sector, settlement entities, central counterparties, clearing houses and foreign operators of systems authorised in Luxembourg, as referred to in Part I of this Law, shall be required to keep secret any information confided to them in the context of their professional activities. Disclosure of such information shall be punishable by the penalties laid down in Article 458 of the Penal Code.”
without tax evasion, as when income from some criminal activity is laundered into some legal but taxable form. The distinction between tax evasion and money laundering means that, despite what seems to be a common perception, tax havens are not necessarily centres of money laundering, or conversely.

There are, nevertheless, important links between the two⁷. Those who wish to spend the proceeds of tax evasion without drawing attention to that possibility of that evasion have an interest in laundering them so that they appear to arise from legitimate sources, with a further decision then as to whether these sources should be tax exempt (foreign bank loans, gifts, or inheritances ...) or taxable. More generally, both tax evasion and money laundering entail some form of concealment of income. In uncovering the ultimate source and routing of moneys, anti-money-laundering investigations may also uncover tax evasion. Indeed as a general rule income even from criminal activities is normally taxable, so that concealing criminal receipts also means evading tax.

From the tax perspective, a key question is whether information collected in the course of anti-money laundering investigations can be passed to tax authorities, both domestically and between countries. In some countries, if tax authorities have received information related to criminal tax matters from domestic anti-money laundering authorities, this may be shared through the country’s network of tax treaties. In Luxembourg however, as is the case for certain other countries, domestic fiscal authorities do not have access to the information from anti-money-laundering authorities and therefore cannot pass it on to foreign tax authorities.

1.1.3 ... AND IN PRESENCE OF CRIMINAL TAX FRAUD

In parallel to the introduction of the concept of money laundering, and its expansion to certain criminal activities, Luxembourg Parliament also modified the Luxembourg Tax Code in two meaningful ways.

First, the Tax Code got changed in a manner so as to ensure that under no circumstances the tax authorities would have the possibility to ask banks any financial information regarding taxpayers⁸. Not being able to lift the bank secrecy for its resident taxpayers, Luxembourg was as a consequence of it also exculpated from providing any information exchange to the foreign tax authorities under the relevant tax treaty, since, under article 26 § 3 of the Model OCDE Double Tax Convention on Income and Capital, Luxembourg is not bound to go beyond its own domestic laws in putting information at the disposal of its treaty partner⁹.

Second, and probably in order to mitigate the harshness of the general rule above, Luxembourg Parliament introduced a new concept in the Tax Code by distinguishing simple tax evasion (“fraude fiscale”) from aggravated tax fraud (“escroquerie

⁸ Règlement grand-ducal du 23 mars 1989, art. 1er : «Les administrations fiscales ne sont pas autorisées à exiger des établissements financiers des renseignements individuels sur leurs clients, sauf dans les cas prévus par la loi du 28 janvier 1948 tendant à assurer la juste et exacte perception des droits d’enregistrement et de succession. ».
⁹ “In no case shall the provisions of paragraph 1 and 2 be construed so as to impose on a Contracting State the obligation: (… b) to supply information which is not obtainable under the laws (...) of that (...) Contracting State (...).”
Whilst both have in common in that they characterize a taxpayer’s efforts to avoid paying taxes by illegal means, their difference resides in tax fraud being a tax evasion of a particular severity (in terms of amounts involved and strategies deployed by the taxpayer). Whilst in case of tax evasion the tax authorities still may not lift the bank secrecy, the public prosecutor, an emanation of the courts rather than of the tax authorities, on the contrary has the necessary powers in order to do so in case of aggravated tax fraud. Since however the public prosecutor is not part of the tax authorities in any sort of form, no information exchange under any tax treaties would be possible, even in case of tax fraud, since the information exchange only involves the tax authorities of the respective treaty partners and absent any exchange of information between the public prosecutor and the tax authorities within Luxembourg.

1.1.4 **European Convention on Mutual Assistance in Criminal Matters**

For the same reasons as to why no information exchange became applicable in tax matters, court assistance became possible under the European Convention on Mutual Assistance in Criminal Matters of 1959 (the “Convention”), in cases of aggravated tax fraud as defined above. Indeed, the Convention, although initially not covering tax offences, got modified by a protocol in 1978 according to which, under its article 1: “The Contracting Parties shall not exercise the right provided for in Article 2.a of the Convention to refuse assistance solely on the ground that the request concerns an offence which the requested Party considers a fiscal offence.” Luxembourg signed the protocol on 17 December 1997, Parliament approving it under a legislation called the “Law of 15 January 2001 approving the Convention of the Organisation for Economic Co-operation and Development on Combating Bribery of Foreign Public Officials in International Business Transactions and relating to misappropriation, destruction of documents and securities, dishonest receipt of money by a public officer, unlawful taking of interests and bribery and amending other legal provisions”.

When passing that bill, Parliament made clear that the court assistance under the Convention would be limited to *aggravated tax fraud* cases, provided the criminal offence would be seen as an aggravated tax fraud not only in the requesting State, but also in Luxembourg (so-called “double criminality”). When making its decision, the Luxembourg competent authority will consider whether in Luxembourg the objective elements of aggravated tax fraud would be given. Dual criminality does not mean however that Luxembourg and the requesting State must have identical penal provisions or that their provisions are aimed at protecting the same goods or values; it is sufficient if the facts described in the request fall under one provision of aggravated tax fraud in Luxembourg in case the fraud is hypothetically deemed to have occurred in Luxembourg. Aggravated tax fraud requires a certain form of ingenuity involving sophisticated strategies and payment chains. The mere non-declaration of taxable interest income, by hiding behind the bank secrecy, falls most probably short by quite some margin from this definition\(^{11}\). Constituting a case of tax evasion of a particular severity (in terms of amounts involved and strategies deployed by the taxpayer). Whilst in case of tax evasion the tax authorities still may not lift the bank secrecy, the public prosecutor, an emanation of the courts rather than of the tax authorities, on the contrary has the necessary powers in order to do so in case of aggravated tax fraud. Since however the public prosecutor is not part of the tax authorities in any sort of form, no information exchange under any tax treaties would be possible, even in case of tax fraud, since the information exchange only involves the tax authorities of the respective treaty partners and absent any exchange of information between the public prosecutor and the tax authorities within Luxembourg.

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\(^{11}\) Alain Steichen, *Le secret bancaire face aux autorités publiques nationales et étrangères*, *Bulletin Droit et Banque* n° 24, 1995, 24 et seq.
evasion rather than aggravated tax fraud, no assistance may be given under the Convention.

Assistance is granted under the condition that the authorities of the requesting State do not use the results of investigations for investigative purposes or introduce them as evidence in any proceeding relating to an offence for which assistance is not permissible. This principle of speciality of judicial assistance means that it will not be possible for the requesting State to obtain assistance in Luxembourg under the Convention in respect to a non-tax matter, in order to subsequently also use the information thus obtained in a tax matter. The reservation of speciality typically is formulated such that its effects are clear to the requesting foreign authority. This prevents a direct or indirect use of the documents and the information obtained under the Convention under any circumstances for tax administrative proceedings or for criminal proceedings based on purely tax elements (apart from aggravated tax fraud).

1.2 Luxembourg’s Exchange of Information Practice up to the Bill

1.2.1 INTERNATIONAL PROVISIONS FOR TAX INFORMATION EXCHANGE

Under the Luxembourg Tax code, the Luxembourg tax authorities may only exercise their powers for domestic purposes. Hence, as such, there is simply no room under Luxembourg domestic tax law for international tax information exchange. On the other hand, however, following constant case-law, international law, not just European law, always prevails over contrary domestic legislation. It hence is possible for the Luxembourg tax authorities to nevertheless grant information exchange internationally, also in tax matters, provided suitable international legislation exists to that effect.

Conceptually, exchange of information between the tax authorities of treaty partner may be done bilaterally or multilaterally. Luxembourg only practises the bilateral information exchange, since this often constitutes its most efficient bargaining tool in tax treaty negotiations. When done bilaterally, two main types of agreements are used in Luxembourg.

The first are Double Taxation Agreements (DTAs, also known as income tax treaties). These are comprehensive agreements between two States to prevent income or profits from international economic activity being taxed twice. A major reason why countries enter such agreements is to foster foreign investment. There are now over 2,000 such bilateral treaties between different States. The Organisation for Economic Cooperation and Development (OECD) plays an important role in shaping these treaties, because it produces a Model Convention that is frequently updated and serves as a template for many bilateral treaties. However, this model remains contested in the developing world because it favours rich nations by emphasising the rights of the investor’s resident state (usually a rich nation) to levy the taxes. A variant of this Model Convention has been produced by the UN Committee of Tax Experts, however, which is more amenable to developing countries’ interests because it prioritises the taxing rights of the state where the economic activity is actually undertaken, often a developing country. The provision for exchange of information in the OECD Model Convention is Article 26. This Article has been considerably revised and extended in recent years; the current version was agreed in 2005. It now provides for exchange of information which is ‘foreseeably
relevant’ for the ‘administration or enforcement of... taxes of every kind’. It now also requires each party to use its powers to obtain and provide such information even if it is not needed for its own tax purposes (Art. 26 § 4). Another major improvement in 2005 was to override banking secrecy: bank secrecy may no longer serve as a reason for categorical refusal to exchange information (Art. 26 § 5). Earlier versions were much weaker, and were limited to the exchange of information necessary for the purposes of the treaty, which many States interpreted as meaning only to prevent double taxation, but not to prevent tax evasion and avoidance. Luxembourg’s DTAs were traditionally modelled on the older version of article 26 (see 1.2.2).

The second type of treaty is the Tax Information Exchange Agreement (TIEA). TIEAs are intended for use with countries for which a DTA is not considered appropriate, mainly because they have no, or low, taxes on income or profits. While TIEAs are much narrower in scope than DTAs, they are more detailed than DTAs on the subject of information exchange. They specify the rules and procedures for how such information exchange is to occur. Today, TIEAs are based on an OECD Model Agreement which was published in 2002 by the Global Forum on Taxation, a loose institution formed in 2001 as a result of the OECD’s Harmful Tax Practices Project. This Forum includes many tax havens and secrecy jurisdictions such as Bermuda, the Cayman Islands, Cyprus, the Isle of Man, Malta, Mauritius, and the Netherlands Antilles. Since Luxembourg never was a tax haven in the technical sense, it did not engage into the signing of TIEAs, the information exchange being dealt with under the respective DTA.

### 1.2.2 Reservation on Article 26 § 5 Model OECD Tax Convention

As may be seen from the above, Luxembourg’s strategy as regards information exchange in tax matters involving banks was rather clear: tax authorities should not be in a position to obtain any information from banks, this only being a prerogative of the courts; court action, although possible in cases of aggravated tax fraud, does not cover the failure to disclose taxable income from savings at banks, since the latter constitutes a mere tax evasion.

This position proved however increasingly difficult to preserve, once article 26 of the Model OECD Tax Convention got updated in July 2005, at which time paragraphs 4 and 5 were added. These paragraphs make it clear that a treaty country cannot refuse a request for information solely because it has no domestic tax interest in the information (paragraph 4)\(^\text{12}\), or solely because it is held by a bank or other financial institution (paragraph 5)\(^\text{13}\). Consequently, Luxembourg, together with Austria, Belgium, and Switzerland entered reservations to Article 26, whereby they indicated that they would not apply paragraph 5 of article 26 in their tax treaty negotiations. Therefore, until the change of tax policy in March 2009 (see 2), no tax treaty entered into by Luxembourg would enable the tax authorities of any treaty country to...

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\(^{12}\) “If information is requested by a Contracting State (...), the other Contracting State shall its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. (...)”.

\(^{13}\) “In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, (...)”.

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request their Luxembourg counterparts to request information from Luxembourg banks in tax matters.

1.2.3 WITHHOLDING TAX UNDER THE SAVINGS DIRECTIVE

The last piece in the puzzle consisted in Luxembourg’s position under the EU Savings Directive. The EU Savings Directive original aim was that all Member States should automatically disclose interest earned by a resident of another EU Member State, in order to ensure that the interest was fully declared in the taxpayer’s country of residence. Luxembourg objected to the disclosure of account holders’ names on the grounds that such a disclosure would be contrary to its bank secrecy laws.

In the agreement that got struck, Luxembourg got entitled to levy a withholding tax rather than to exchange the account holder’s information, provided however for the account holder to remain entitled to, if he or she so wishes, to voluntarily elect to waive bank secrecy and authorise disclosure. There exist no statistics to date as to what percentage of taxpayers has opted for the information exchange. Clearly, as the withholding tax rate to be applied increases as time goes by, so does the incentive for the taxpayer to elect the information exchange route.

1.2.4 LUXEMBOURG’S ‘REALPOLITIK’ IN RESPECT TO TAXATION OF INCOME FROM SAVINGS

Luxembourg favoured and still favours a final flat withholding tax at moderate rates for taxing income from savings. The desire to achieve tax neutrality is the main driver behind the position of the Luxembourg government in this respect.

Indeed tax neutrality has its foundations in the principles of economic efficiency and equity. Tax neutrality is determined by three criteria. Capital-export neutrality is the criterion that an ideal tax should be effective in raising revenue for the government and not have any negative effects on the economic decision making process of the taxpayer. That is, a good tax is one that is efficient in raising tax revenue for the government and does not prevent economic resources from being allocated to their most appropriate use no matter where in the world the highest rate of return can be earned. Capital-import neutrality is considered superior though by Luxembourg government as a tax neutrality criterion. This criterion implies that the tax burden placed on the foreign subsidiary of a MNC by the host country should be the same regardless in which country the MNC is incorporated and the same as that placed on domestic firms. Applied to savings of individuals, the capital import neutrality justifies for the income to be taxed solely in the Source country, where the funds have been invested. By applying the same withholding tax on savings from resident and non-resident taxpayers Luxembourg would ensure this criterion gets met.

Tax equity is the principle that all similarly situated taxpayers should participate in the cost of operating the government according to the same rules. This means that regardless in which country an affiliate of a MNC earns taxable income, the same tax rate and tax due date apply. Or : individuals should contribute to the cost of public goods in the Source country by paying their taxes in that country rather than in the residence country.

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14 From 15% initially, it now is set at 20% and will increase to 35% as of July 2011.
Tax neutrality also has a temporal aspect which justifies an exemption of the income from savings. Indeed, proponents of a consumption tax rightfully argue that it is superior to an income tax because it achieves what tax economists call "temporal neutrality." A tax is "neutral" if it does not alter spending habits or behaviour patterns and thus does not distort the allocation of resources. The theoretical case for a consumption tax actually is a case against the income tax. The income tax does cause enormous long-term damage to the economy because it penalizes thrift by taxing away part of the return to saving. This tax wedge results in less saving, less investment, less innovation, and lower living standards than we would enjoy without a tax on saving. In other words, the income tax creates a bias in favour of current consumption at the expense of saving and future consumption.

Regrettably Luxembourg’s position appears largely isolated in an international context. Since it may not force other countries to adhere to its views, it was left with no option other than applying the above concepts domestically, by providing a flat 10% tax rate for interest income on savings as accruing to its residents, irrespective of whether the residents invest their monies locally or abroad. Luxembourg, in addition, applying the bank secrecy still in tax matters for its residents, there was no need for any tax amnesty as occasionally gets encountered in other countries.

1.2.5 PEER PRESSURE AND THREATS FROM VARIOUS COUNTRIES AND ORGANIZATIONS

The changes Luxembourg had to concede are largely due to the efforts undertaken by the OECD in that area\textsuperscript{15}. It started with the OECD’s report on the “Standards of Transparency and Exchange of Information”\textsuperscript{16}. The OECD’s work on Harmful Tax Practices further highlighted the negative welfare effects that may result from a lack of transparency, reliance on strict bank secrecy, and lack of effective exchange of information. In order to increase their pressure on countries such as Luxembourg that had been perceived as being un-cooperative in tax matters as a result of their bank secrecy rules, the G20 leaders agreed at their 2009 London Summit to “deploy sanctions to protect our public finances and financial systems”. Officials went as far as stating that “the era of banking secrecy is over”. With hindsight they appear to have been right on that one.

In parallel, countries like France and Germany were drafting legislation aiming at enabling the tax authorities of the respective countries to take unilateral actions against taxpayers located in un-cooperative countries: enhanced burden of proof in case of deductible payments to such taxpayers; or simply denial of any deductibility whatsoever, just to cite one of the many measures contemplated. Politicians of our neighbour countries did not mind either piling on additional pressure on Switzerland and Luxembourg. Indeed Germany’s former finance minister Peer Steinbrueck has been quoted as having said countries should use "the whip" on the Swiss to combat bank secrecy, while another German minister has waxed nostalgic about being able to send “troops” into Luxembourg like in the good old days. Strong stuff, and Jean-

\textsuperscript{15} A summary paper of the progress made in that respect as a result of the initiatives put forward by the OECD may be found at: OECD, Promoting Transparency and Exchange of Information for Tax Purposes, A Background Information Brief (Paris, 2010).

\textsuperscript{16} Additional pieces of the puzzle are the “Model Agreement on Exchange of Information on Tax Matters” as well as the report called “Improving Access to Bank Information for Tax Purposes”.

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Claude Juncker, prime minister of tax haven Luxembourg, told everyone interested in the matter that he didn't find it funny.

2 .... no longer is: the new rules

In light of the above witch-hunt, Luxembourg had no option but to notify to the OECD that it had decided to withdraw its reservation on Article 26. In order to demonstrate that its repeal would not just be a mere a lip service, but also and more importantly in order to satisfy the 12 treaties test put forward by the OECD, Luxembourg quickly renegotiated certain existing tax treaties and concluded some new tax treaties containing article 26 § 5 of the Model Tax Convention on Income and on Capital. Luxembourg government further indicated its willingness to renegotiate any other existing tax treaty on that basis and made further clear that article 26 § 5 would be part of its tax treaty policy going forward. As a consequence of these actions, Luxembourg became one of the first financial centres to be removed from the, so-called, “grey list” and got promoted to the “white list” of countries that comply with international tax cooperation standards.

In total, Luxembourg has signed 84 DTTs, of which 64 DTTs already are in force. Of the 84 DTTs, 44 contain the provisions of the revised article 26, and 26 out of the 64 DTTs presently in force already are applicable. DTTs that do not contain article 26 § 5, i.e. old DTTs that are non-compliant with OECD standards on exchange information, remain governed by the general provisions of Luxembourg law, implying that information can only be exchanged when it does not contravene the Luxembourg banking secrecy rules. This means in practice that no information exchange is available for those DDTs, since Luxembourg domestic law prevents a lifting of the bank secrecy in tax matters.

2.1 Key features

2.1.1 Taxes Covered

The most frequent source for information exchange is the one needed in order to secure the correct application of the relevant tax treaty. This could for instance be the case if the Source State was asking the Residence State, before applying a nil rate of withholding on certain royalty payments, to verify that the beneficiary of the income actually is a resident of the Residence State and beneficially owns the income flows. Similarly, the Residence State could be asking the Source State details regarding the net income claimed to have been realised in a permanent establishment there situated before exempting it in the Residence State.

Following article 26 § 1 of the Model Tax Convention, the scope of the information exchange however is not limited to such information as presumably is relevant for carrying out the provisions of the respective tax treaty. It also covers any information as may be relevant for the purposes of applying the domestic tax laws of the

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17 « The competent authorities of the Contracting States shall exchange such information as is foreseeable relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic tax laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2 ». 

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requesting treaty partner. Hence a treaty partner may use article 26 not only for income tax purposes regarding its residents, but equally if the taxpayer is a non-resident of the treaty partner.

Luxembourg did have in the past a mix of broadly 50% - 50% of tax treaties containing a narrow (information exchange only for the correct application of the tax treaty) or a broad (information exchange for the application of domestic tax laws) information exchange. Since the policy change in 2009, all tax treaties contain the wide information exchange provisions. This extension of the scope of taxpayers concerned by article 26 is hardly relevant in case of income derived from bank accounts. Indeed, under almost any tax system, non-resident taxpayers are only taxable in the country provided their income is derived from sources located within that country. Hence, there should be no need for any information exchange regarding bank information in such a case. Say Germany requests information exchange with Luxembourg regarding a non-resident taxpayer; since interest income and dividends may only be taxed in Germany regarding non-resident taxpayers, provided the income source is Germany, such a request has no basis, since the income, if any, derived from bank accounts held in Luxembourg anyway would not be taxable in Germany.

More relevant however is the material extension of the scope of taxes covered by article 26. Indeed, because of the broad wording of article 26 ("taxes of every kind"), the information to be exchanged is not limited to the taxes covered under the respective tax treaty as defined under article 2 of the Model OCDE Tax Convention. It would for instance also be possible for a treaty partner to request information concerning the levying of a local sales tax, or estate taxes, since such a situation would fall under the generic expression of the “administration or enforcement of the domestic laws concerning taxes of every kind (...) imposed on behalf of the Contracting States”. This may appear a little odd for the Luxembourg tax practitioner, since the competent authorities in Luxembourg for information exchange purposes normally are the direct tax authorities (Administration des contributions directes), whereas taxes such as the sales tax or estate duties are being levied by the indirect tax authorities (Administration de l’Enregistrement et des Domaines), excise taxes falling under the competence of the Customs and excise administration (Administration des douanes et accises). Consequently the Bill indicates (art. 2 § 1) that the information request is directed to the respective tax administration in charge of the levying of the tax for which the information exchange is being sought upon. The Bill also provides for a tie-breaker provision in case of taxes for which none of the three tax administrations would be competent; in that case, the request for information exchange is to be addressed to the tax administration normally competent for tax treaties, being the direct tax authorities (art. 2 § 2).

2.1.2 INFORMATION UPON REQUEST ONLY …

The Model OCDE Tax Convention as such allows information to be exchanged in three different ways: on request, automatically, or spontaneously. The most common form is information exchange upon request: information is transmitted in response to a specific request from the requesting country. The second form is automatic exchange of information, where the tax authorities of the source country periodically pass on to the residence country all tax-relevant information they have agreed to exchange. The third type, spontaneous information exchange, is that in
which the authorities of one country, on their own initiative, pass on tax information that they think may be of interest to the tax authorities of another country.

Luxembourg government has stated at numerous times that the only type of information exchange they would be agreeable to is the information on request. Under that procedure, the treaty partner has first to exhaust its domestic taxing powers in order to collect the relevant information (subsidiarity principle). If, at the end of that process, the information thus collected is deemed unsatisfactory, the treaty partner may request the Luxembourg tax authorities to lift the bank secrecy by providing the foreign treaty partner with the relevant bank information.

The information upon request falls short of expectations of certain countries that favour the automatic information exchange. Luxembourg government therefore requested the secretary general of the OECD, Angel Gurria, to specifically confirm this method being in conformity with OECD standards. Such a confirmation was given to it in a letter dated March 13, 2009, whereby the secretary general indicated: “the standard requires information exchange on request only”\(^\text{18}\). It is not a coincidence that the date of the letter is of the same date as the Luxembourg government’s declaration on the tax policy shift: the former was probably a condition precedent for the latter.

Luxembourg being often used for intentional tax planning purposes, it comes as no surprise that foreign tax authorities regularly request information from their Luxembourg colleagues under the information exchange provisions. This has led over time to steady increase of requests having to get dealt with by the Luxembourg tax authorities: in 2012 alone 592 requests have been addressed by Luxembourg; there exist no statistics as regards the average time of reply, nor as to whether the information exchange was based on a DTT or the EU Directive.

### 2.1.3 To the extent the information sought upon is foreseeably relevant for the requesting state: no fishing expeditions

Another area of concern for Luxembourg is the risk of being confronted with fishing expeditions, whereby tax authorities of treaty partners would be asking randomly bank information for all of their tax payers, whether or not such information actually was needed (‘to whom it may concern’). The secretary general of the OECD there as well gave comfort to the Luxembourg government by indicating in his March 13, 2009, letter that “where information is requested, it must be exchanged only where it is ‘foreseeably relevant’ to the administration or the enforcement of the domestic laws of the treaty partner. Countries are not at liberty to engage in ‘fishing expeditions’ or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. In formulating their requests, competent authorities should demonstrate the foreseeable relevance of the requested information. It would, for instance, not be possible for a State to request information randomly on bank accounts held by its residents in banks located in the other State.” This means that any request for information has to be specific, detailed and relevant to the tax affairs of the taxpayer in question. So a request does not mean a brief email containing the name and identifying information of the individual concerned. Instead, a sufficiently detailed case must be made, in line with the criteria as set out in a mutually agreed

\(^{18}\) See reprint under « Exposé des motifs », projet de loi n° 6072, 2\(°\) session extraordinaire 2009, p. 27.
to letter by the treaty partners which is attached and hence part of the new DTA or protocol. In effect, this means that the authorities requesting the information must already have a decent case before they request the information. Put differently: it should not be possible to follow up a suspicion without already having reasonable evidence.

This means in practice that the requesting tax authorities should disclose the name of the taxpayer; the tax purpose of the information sought upon; the grounds for believing that the information requested may be held in Luxembourg; the name of the bank where the information presumably is held. Surprisingly, the exact terms of the respective accompanying letter do vary a little from treaty to treaty, specifically as regards the degree of detailed knowledge that is required regarding the relevant bank in Luxembourg. In some tax treaties (ex.: Austria) the information may only be requested if the name of the actual bank is indicated in the request letter; whereas in most other cases, the name of the bank needs only to get disclosed ‘to the extent it is known’ to the tax authorities. This may be understood as meaning that in the latter cases the tax authorities may validly request the information exchange with a lesser degree of certainty than what is required in the former cases.

Following the coming into force of the new article 26 Model OCDE Tax Treaty a growing number of court cases had to deal with the drawing of the dividing line between a legitimate request for information and fishing for information. The leading case has been ruled upon by the Cour administrative (”CA”) on May 24, 2012, n°30251C. On the basis of the OECD commentaries and on the OECD manual on exchange of information, the CA ruled that an information request is foreseeable relevant if (i) it relates to one or several specific taxation cases or to given taxpayers and (ii) it states the identity of the person under tax investigation. Exchange of information can validly relate to a third party, but only to the extent that the information is relevant to the taxation of one given taxpayer and such taxpayer is identified in the request. Any request failing to satisfy these conditions is null.

The question is how the Luxembourg courts will deal in due course with so-called group requests. Indeed, the OECD recently has again amended its exchange of information standards: an update of the OECD Model Tax Convention was released on 18 July 2012, which amends article 26 (exchange of information) in such a way that it now explicitly allows for group requests. This means that based on the new Model, the tax authorities will be able to request information from a group of taxpayers, without naming them individually, to the extent the request is not a ‘fishing expedition’. For group requests being possible in the future in Luxembourg as regards existing revised DTTs the update to the OECD Model Tax Convention needs to be viewed as a mere clarification of already existing rather than a change of rules. In the latter case, according to constant Luxembourg-case law, the update may not be applied to existing treaties. Given the strict view applied by Luxembourg courts regarding the concept of ‘foreseeable relevance’ we would expect group requests to be possibly only in those cases where a new or revised DDT specifically foresees this possibility.

2.1.4 Subsidiarity Principle

The subsidiarity principle is a well-known principle under EU law. It was introduced by the Treaty of Maastricht and was further elaborated in a Protocol on the
application of the principle attached to the Treaty of Amsterdam\textsuperscript{19}. According to that principle, the EU may only act in areas of common interest where individual actions by the Member States are unable to meet the Member States objectives. EU action in that sense is a case by default.

The same principle also applies in the context of information exchange. It is foremost the duty of the tax authorities of each treaty country to do whatever they can in order to gather relevant information as regards their taxpayers. If that attempt proves to be unsuccessful, because the information is held abroad and the taxpayer refuses to provide the information directly to the relevant tax authorities, the information exchange procedure may be referred to. In order to ensure that this subsidiarity principle does not get forgotten in practice, the various accompanying letters to article 26 typically request the foreign tax authorities to confirm in their information request that they would have pursued all means available in their territory in order to obtain the information\textsuperscript{20}. The letter would also indicate that this rule may only be departed from if the foreign tax authorities would have faced disproportionate difficulties, had they been exhausting all domestic avenues and alleys. This leads to the interesting question as to whether Luxembourg as the requested State might use the same reasoning in order not to comply with an information exchange request, if the Luxembourg tax authorities reasonably demonstrate that its execution would lead to disproportionate difficulties on their end. It seems logical to grant the requested State should an excuse for following up on the information request.

\textit{2.2 Some specific aspects}

\textbf{2.2.1 Interaction with Luxembourg Bank Secrecy Rules for Luxembourg Residents}

At the same as Luxembourg implemented the EU Savings Directive into national law, it also modified the manner under which income from savings get assessed for Luxembourg residents. Rather than continuing to tax the income from savings at the marginal tax rate, Parliament decided to tax such income at a flat rate of 10\%. The reasons for this are manifold. On one hand, high net worth individuals (“HNWIs”) typically realise substantial portions of their net income through their savings. Since Luxembourg still aims at attracting HNWIs to Luxembourg, a suitable framework for taxing their main income source, being the income from savings, had to be developed. Since savings are generated with after tax income, a flat taxation of income from savings may also be seen as a rudimentary method for dealing with the double taxation aspects of income from savings, or put differently, as a device to

\begin{flushleft}
\textsuperscript{19} Today, the principle is defined in Article 5 TEU: “Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level. The institutions of the Union shall apply the principle of subsidiarity as laid down in the Protocol on the application of the principles of subsidiarity and proportionality. National Parliaments ensure compliance with the principle of subsidiarity in accordance with the procedure set out in that Protocol”.

\textsuperscript{20} Ex: Bahrain – Luxembourg tax treaty : “a statement that the applicant State has pursued all means available in its own territory to obtain the information, except those that would give rise to disproportionate difficulties”.
\end{flushleft}
eliminate the tax induced distortions between immediate and deferred consumption (saving). Finally, the effective tax rate of savings traditionally at best has been modest, as a result of taxpayers being able to hide behind the tight bank secrecy rules in order to evade taxes in that respect. In light of the future need for private savings to replace State pensions, once the State pension system has fallen into pieces by the mid-twentieth of this century, government and Parliament alike decided to stick with the bank secrecy in tax matters for domestic purposes.

Consequently the bank secrecy will only be lifted under **specific tax treaty provisions**. Preserving domestic bank secrecy rules whilst lifting them at the same time under tax treaties is perfectly possible, since under Luxembourg’s legal system, international law always supersedes contravening domestic law\(^\text{21}\). An interesting side effect of this policy decision is that Luxembourg’s tax authorities will not be able, under any tax treaty containing article 26 § 5 of the Model OCDE Tax Convention on Income and Capital, to request the treaty partner to provide the Luxembourg tax authorities with information held by banks located in the treaty country. That is so because article 26 § 3 b) permits the treaty country not to supply information which would anyway not be obtainable under the laws of Luxembourg as the requesting State\(^\text{22}\). Luxembourg may not force its treaty partner to do what it is itself unable to do domestically. The practical consequence of this is that art. 26 § 5 operates one way only, i.e. in situations where Luxembourg is the requested State.

The same rule obviously applies to the treaty partner: hence if the bank secrecy is protected in say Austria in a manner comparable to what is the case in Luxembourg, the Luxembourg tax authorities may turn down a request for information exchange on the grounds that such information may not be obtained in Austria in a purely domestic setting. Bearing that in mind, the Austria-Luxembourg protocol may carry no practical effect, since each treaty partner will be entitled to turn down information requests made by the other party if the information is held at a bank. Here the information exchange operates in no way.

### 2.2.2 No Information Exchange in Case of Stolen CD

In light of the recent practice by the German tax authorities to pay for stolen CD data in contravention to the banking secrecy rules of the foreign country, the question may be asked as to whether a request for an information exchange made on that basis by foreign tax authorities should be treated by the Luxembourg tax authorities like any other information exchange. So far the countries concerned by the stolen CD data were only Liechtenstein and Switzerland, though Luxembourg in view of its private banking activities and the management of foreign monies is a likely candidate to be put on that list in a not too distant future. A similar issue arises if the client data were put, as was the case for a Swiss bank, on the internet, on a platform such as Wikileaks.

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\(^{21}\) Conseil d’Etat 28 July 1951: “an international treaty incorporated into domestic legislation by way of a approval bill is a bill of superior nature of a higher origin than the will of an internal organ” (\(\text{\`Y qu’un trait\`e international incorpor\`e dans la l\`egislation interne par une loi approbative, est une loi d’essence sup\`erieure ayant une origine plus haute que la volont\`e d’un organe interne}^{21}\)).

\(^{22}\) Article 26 § 3 : “In no case shall the provisions of paragraph 3 be construed so as to impose on a Contracting State the obligation: b) to supply information which is not obtainable under the laws (..) of the other Contracting State (..)".
The foreign tax authorities as the requesting treaty partner may feel that paragraph 5 of article 26 of the Model OCDE Tax Convention should permit to request information to be exchanged, even if the basis for the request may be found in information contained on sources such as the ones indicated above. The reason for that being that paragraph 5 would be intended to ensure that the limitations of paragraph 3 of article 26 cannot be used to prevent the exchange of information held by banks and other financial institutions, no matter what. It certainly is correct to read paragraph 5 as an override of paragraph 3 in so far that paragraph 3 otherwise permits the requested treaty partner, here Luxembourg, to decline to supply information on the grounds of bank secrecy rules. The generality of the formulation used under paragraph 5 (“In no case shall the provisions of paragraph 3 be construed ...”) further supports this view.

However, this override should not be possible if the request for information exchange is based on an infringement of public policy provisions ('ordre public') such as in the above situations. Indeed, the public policy doctrine is generally understood as concerning the body of principles that underpin the operation of legal systems in each state. This addresses the social, moral and economic values that tie a society together: values that vary in different cultures and change over time. In conflict cases in international private law, no court would f.i. apply a “foreign” law, if the result of its application would be contrary to public policy. Similarly, foreign laws that are penal or territorial, such as the collecting of taxes due to another State, also do not get enforced extraterritorially, if the enforcement would contravene to the public policy of the requested State. This legitimate defence mechanism of the requested State may not be overturned by paragraph 5, since it would otherwise mean that Luxembourg would also have to assist the treaty partner in the exchange of information held by banks in cases where for instance the treaty partner would have in extreme cases incited criminal actions in Luxembourg, by offering for instance to pay for any relevant information provided to it. Just imagine say the German tax authorities posting an advertisement in the press indicating their willingness to pay a substantial sum for any stolen CD data regarding the clients of Luxembourg banking subsidiaries of German parents and requesting thereupon Luxembourg to verify at the relevant Luxembourg banking subsidiary the information thus obtained. Surely such a fraudulent behaviour by the German tax authorities would justify the Luxembourg tax authorities to deny the exchange of information. The ‘fraus omnia corrumpit’ principle would justify this position.

The situation obviously is a little different if the requesting treaty partner has obtained fortuitously the bank data (CD received in an anonymous envelope, download on an internet site, ...). The requesting treaty partner could not be seen in such a case to have acted inappropriately as regards Luxembourg, in so far as the acquisition of the data is concerned. Still Luxembourg should be entitled to deny any exchange of information in such a situation. On one hand it could be held that the requesting treaty partner should exercise self-restraint in respect to the bank data obtained as a ‘windfall profit’, since it would know that by definition such data could only have been transmitted to it in breach of Luxembourg’s bank secrecy rules. Fair enough if the treaty partner is able to use such data for domestic tax purposes, without any assistance by Luxembourg (e.g.: in Germany). The principle of
international courtesy, once advocated by Wolfgang Ritter\textsuperscript{23}, should lead the treaty partner to refrain from starting the information exchange request with Luxembourg, as an expression of respect for the legal system of the other State. On the other hand, and possibly even more convincingly, Luxembourg should be entitled to turn down any request of exchange of information in such a situation, on the basis of international public principles. Indeed, the \textit{Vienna Convention on the Law of Treaties}, in its articles 26 and 31 (1), states that international treaties such as tax treaties are to be interpreted (article 31 (1)) and performed (article 26) in \textit{‘good faith’}\textsuperscript{24}. The principle of good faith means that a third party, when interpreting a treaty, should draw inspiration of the parties intentions that animated them when they signed the treaty. Which is another way of stating that a tax treaty should be applied by Luxembourg in a manner consistent with what may have been Luxembourg’s reasonable state of mind and intentions at the time the tax treaty got negotiated. It seems very likely that Luxembourg government never intended to provide information held at banks under its tax treaties if the starting point of the procedure constitutes a breach of Luxembourg public provisions, such as the stealing of client data at banks.

As consequence Luxembourg should be entitled to turn any request for exchange of information in cases where the basis for the request may be found in information obtained in breach of the Luxembourg bank secrecy legislation, irrespective of whether or not the requesting treaty partner has been instrumental in the breach of Luxembourg laws.

The same result should be obtained under the European Convention on mutual assistance in criminal matters (the “Convention”) which has been adopted at Strasbourg on 20 April 1959 by the Member States of the Council of Europe. According to Art. 1, the Contracting Parties undertake to afford each other, in accordance with the provisions of the Convention, the widest measure of mutual assistance in proceedings in respect of offences the punishment of which, at the time of the request for assistance, falls within the jurisdiction of the judicial authorities of the requesting Party. The Convention in its article 2 however permits the requested party to refuse the assistance in case of tax matters (a) as well in case of contravention to its \textit{ordre public} (b)\textsuperscript{25}. Subsequently, in order to facilitate the application of the Convention in the field of tax offences, a supplement to the Convention has been agreed in 1978 in so far that under its article 1 the Contracting Parties undertake not to exercise the right provided for in Article 2.a of the Convention to refuse assistance solely on the ground that the request concerns an offence which the requested Party considers a tax offence. Luxembourg only adhered with some delay to the protocol of 1978. When it did, it handed in a


\textsuperscript{24} Elisabeth Zoller, \textit{La Bonne Foi en Droit International Public} (Paris, Pédone, 1977).

\textsuperscript{25} Art. 2: “Assistance may be refused: a) if the request concerns an offence which the requested Party considers a political offence, an offence connected with a political offence, or a fiscal offence; b) if the requested Party considers that execution of the request is likely to prejudice the sovereignty, security, \textit{ordre public} or other essential interests of its country.”
reservation limiting the assistance to those that constitute aggraved tax fraud under Luxembourg tax laws.  

Depending upon the amounts involved and strategies pursued by the respective taxpayer, it could be possible for the bank date contained on the CD and for which a foreign court would seek assistance to relate to an aggravated tax fraud matter (e.g.: income received into a Luxembourg bank account as a result of non-reported sales realised by a business). Although the reservation under the protocol of 1978 would not be obstacle, the Luxembourg courts should nevertheless be entitled to refuse their assistance as a result of the ordre public provision (art. 2 b). In order to determine whether an infringement to the ordre public indeed exists, it appears appropriate to consider as to whether Luxembourg courts in a purely domestic setting would be entitled to use the data contained on the CD in criminal proceedings. If that was indeed the case, there would be no basis for denying any mutual assistance internally. The Cour de Cassation, in a case involving an infringement to customs duties considered that the whole procedure would be void, if based on documents seized in a manner contravening to Luxembourg laws. The court would only be authorised to sanction the taxpayer for criminal offences in such a situation, provided the criminal offence may be proven on other grounds. The evidence obtained through illegal means (the “preuve ilégale”) would be dismissed by courts domestically which justifies Luxembourg not providing any legal assistance internally either as a result of the ordre public exception.

2.2.3 The tax laws and anti-money laundering legislation aiming at different situations, information obtained under the KYC rules may not be used in tax matters

Questions often arise in Luxembourg, typically for Private Banking, with regard to the term “beneficial ownership” as used in the Anti-Money Laundering legislation. The term “beneficial ownership” is used in anti-money laundering contexts, such as the Luxembourg legislation on the matter, to refer to that level of ownership in funds that, as a practical matter, equates with control over such funds or entitlement to such funds. “Control” or “entitlement” in this practical sense is to be distinguished from mere signature authority or mere legal title. The term reflects a recognition that a person in whose name an account is opened with a bank is not necessarily the person who ultimately controls such funds or who is ultimately entitled to such funds. This distinction is important because the focus of anti-money laundering legislation needs to be on the person who has this ultimate level of

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26 Reservation contained in a letter from the Permanent Representative of Luxembourg, dated 9 December 1994, handed to the Secretary General at the time of signature, on 9 December 1994 - Or. Fr. - confirmed and completed in a letter from the Permanent Representative of Luxembourg, dated 29 September 2000, handed at the time of deposit of the instrument of ratification, on 2 October 2000: “In accordance with the provisions of Article 8, paragraph 2, sub-paragraph a, the Government of the Grand Duchy of Luxembourg reserves itself the right to accept Chapter I of this Protocol only if the criminal fiscal offence constitutes a tax fraud within the meaning of paragraph 396, sub-paragraph 5, of the General Law on Taxes, or of paragraph 29, sub-paragraph 1, of the Law of 28 January 1948 aiming to ensure the correct and fair collection of registration and succession rights.”


control or entitlement. Placing the emphasis on this person is a necessary step in determining what the source of funds is. In case the beneficial owner uses several layers of companies, the Luxembourg will have to move up the chain all the way to the top until it hits the physical person controlling the top company, and hence, indirectly also, the bottom company whose origin of funds needs to get traced.

Applying this concept in tax matters would lead to a piecing of the corporate veil, irrespective of the company’s substance and activities. Such an approach may be correct under tax theory, since only individuals are able to be taxpayers in the economic sense, though does not reflect at all the practice of the tax legislator: a corporation is treated as a distinct taxpayer, such that its income may only be taxed at its level, a taxation at the ultimate ownership level only occurring upon dividend distribution all the way up to the chain. Concepts and objectives in KYC and tax legislation being totally different, there exists no scope for any domestic information exchange between the units dealing with money-laundering, and the tax authorities, not even in case of tax fraud.

2.2.4 JOINT TAX AUDITS

Collaboration between revenue authorities around the globe has been noticeably increasing. Many countries have been engaging in traditional information exchange under recent and long-standing tax treaties and agreements, as well as other collaborative activities. Countries have also been engaging in simultaneous tax audits which involve a situation where two or more countries examine a taxpayer simultaneously, each in its own territory, where there is a common or related interest and a view to exchange the information they obtain.

One of the fastest emerging trends with respect to audit techniques is the pursuit of joint audits where an individual or business is subject to a coordinated audit using a single audit team comprised of representatives from two or more jurisdictions ("Joint Audits"). This new approach stands in contrast to a more typical situation where the same taxpayer is subject to separate audits with respect to the same transaction or items of income or deduction by two or more countries. Joint Audits are the next step to even greater cooperation between taxing authorities; a new era of coordinated action.

Luxembourg appears not to be opposed to Joint Audits and has gained relevant experience in this area in the field of VAT. In a growing number of cases the Luxembourg taxpayer gets audited jointly by the Luxembourg tax authorities and the tax authorities of a DDT partner, most of the times from either Germany or France. Since the foreign tax authorities may not under law perform in Luxembourg any tax audits directly themselves, the Joint Audit takes the form of an audit run by the Luxembourg tax authorities as directed by the foreign tax authorities on those points they are seeking additional comfort.

2.2.5 PROCEDURAL ASPECTS AND TAXPAYER RIGHTS

The procedural aspects have led to a lively debate in Luxembourg, since government wanted to avoid any risks of undue delays in the execution of the information exchange requests, such delays possibly being seen abroad as the proof that Luxembourg would be dragging its feet in that area, despite the reiterated statement of government to ‘play ball’. On the other hand, taxpayers needed to be equally protected from undue requests emanating from foreign tax authorities. In this
balancing act, Parliament has resolved to provide for following rules (art. 2 – 7 of the Bill).

The Luxembourg tax authorities first need to verify whether the information exchange request has been made in conformity with the relevant treaty provisions (foreseeable relevance test, subsidiarity, etc.). If they believe that this test has been passed, they will notify the holder of the information, i.e. the bank, of their decision to ask for the relevant information. It will then be up to the bank to decide as to whether it should inform its client, i.e. the taxpayer. In all likelihood, it will.

Each of the bank and the taxpayer may decide to object to the information exchange within one month of notification. If no objection is being made, and the bank does not provide the tax authorities with the relevant information, it may be subject to a fine of € 250,000.

In case either the bank or the taxpayer decides to object to the information exchange request, the matter will be dealt with by the administrative courts under summary proceedings rules. This means that the number of papers that may be filed by the plaintiff and the tax authorities are limited to one (as opposed to two as under normal rules) and that the court has to render its judgment within one month of the last paper having been filed (normally there exists no time cap for court rulings). Appeal may be made against the court’s decision, under the same rules as above. Understandably, until the matter has been sorted out in court, no information has to be provided to the Luxembourg tax authorities. Consequently, in an international context, it should be possible for Luxembourg courts to consider that if they are unable to act themselves on the basis of a stolen CD, because this would be in conflict of Luxembourg’s overriding conception of fair trial and proper functioning of its legal system, it should be equally permitted to deny any mutual assistance on those grounds for contravention with Luxembourg’s ordre public. Similarly, it should not be possible for Luxembourg courts to use, in a domestic tax matter, bank data stolen in a foreign country in breach of that country’s bank secrecy legislation.

3 The landscape will change again in 2015: Luxembourg’s move toward automatic information exchange

3.1.1 The migration from withholding tax to automatic information exchange under the EU Savings Directive

The question may however be asked as to whether Luxembourg will be able to stop the tide coming in, now that the flood gates have been opened. It is indeed no secret that most treaty partners favour the automatic exchange of information, as do the European communities.

Under the European Savings Tax Directive the Member States of the European Union (EU) agreed to automatically exchange information with each other about customers who earn savings income in one EU Member State but reside in another (the automatic exchange of information). Whilst automatic exchange of information is the ultimate objective of the ESD, three EU Member States (Austria, Belgium and Luxembourg) have been allowed to opt to apply alternative arrangements during a

transitional period. Under these arrangements, tax will be deducted at source from income earned by EU resident individuals on savings held in other EU countries (the withholding tax option).

However, the Directive specifies that any jurisdiction implementing the withholding tax option will also need to provide a procedure which allows the relevant payee expressly to authorise a paying agent to report information to his/her Member State of residence so as to avoid the levying of the withholding tax. A growing number of taxpayers are making use in Luxembourg from that possibility in order to avoid the withholding tax of 35% they otherwise are incurring. Since the Luxembourg withholding tax typically is higher than the domestic marginal income tax rate on the income from savings, often taxed at a schedular rate of less than 30%, it makes sense from a tax management perspective to opt for the automatic information exchange.

In addition, the transitional period ends if and when the EU will have entered into an agreement, following an unanimous decision of the Council, with Switzerland, Liechtenstein, San Marino, Monaco and Andorra to exchange information upon request as defined in the OECD Model Agreement on Exchange of Information on Tax Matters released on 18 April 2002 in relation to interest payments. The Council furthermore has to agree by unanimity that the United States is committed to exchange of information upon request as defined in the 2002 OECD Model Agreement with all EU Member States in relation to interest payments.

It should therefore be expected for the transition period to end at some point in time in the future, albeit with some delay.

3.1.2 IMPACT OF THE 15 FEBRUARY 2011 EU DIRECTIVE

Further momentum has been gained as a result of the EU directive of 15 February 2011 which strengthens the administrative cooperation in the field of direct taxation so as to enable the Member States to better combat tax evasion and tax fraud. In the light of greater taxpayer mobility and a growing volume of cross-border transactions, the 2011 EU directive aims at fulfilling the perceived Member States’ growing need for mutual assistance, especially via the exchange of information, so as to enable them to better assess taxes due. The text provides for an overhaul of directive 77/799/EEC, on which administrative cooperation in the field of taxation has been based since 1977. The revised directive ensures that the OECD model tax convention on income and capital is implemented in the EU as regards the exchange of information on request. It will thus prevent a Member State from refusing to supply information concerning a taxpayer of another Member State on the sole grounds that the information is held by a bank or other financial institution. This is not so relevant anymore for Luxembourg, since it already has essentially implemented the forthcoming revised directive into its various tax treaties under the Bill.

The 2011 Directive also introduces provisions on the automatic exchange of information. The Council agreed on a step-by-step approach aimed at eventually ensuring unconditional exchange of information for eight categories of income and capital: employment income, pensions, directors’ fees, dividends, capital gains, royalties, certain life insurance products, and ownership of and income from immovable property. From 2015 onwards, Member States will have to communicate automatically information for a maximum of five categories, provided that information is readily available (they will however not be required to send more information than they receive in return). Those categories are: employment income,
pensions, directors’ fees, certain life insurance products, and ownership of and income from immovable property. In an initial phase, each Member State had to choose three income categories out of the five above for which it would apply the automatic information exchange. Luxembourg opted for following income categories: employment income, pensions, and directors’ fees. Consequently, bank data are not falling under the revised directive until at least 2017.

By 1 July 2017 however, the Commission will provide a report and, if need be, a proposal. When examining that proposal, the Council will examine the possibilities for removing the condition of availability and extending the number of categories from five to eight. Depending upon the outcome of those proposal, dividends and capital gains on shares as well as income from insurance products might fall under the automatic information exchange, thus only leaving out interest income on savings in its various forms.

Member States had to transpose this Directive by 1 January 2013; the transposition date for the mandatory automatic exchange of information provided for under Article 8 has however been extended to 1 January 2015. On 29 March 2013, the Luxembourg Parliament adopted the law transposing the Directive into national law, with the exception of those provisions relating to the mandatory automatic exchange of information, since this part of the Directive only has to be transposed by 1 January 2015. The law entered into force, as prescribed by the Directive, as from 1 January 2013.

3.1.3 Luxembourg finally has given up its resistance

Although the Luxembourg Government still considers withholding tax to be the most effective approach to guarantee effective taxation and client privacy, it now acknowledges that dialogue with its partners has shown that international developments, such as FATCA, point to a broader use of automatic exchange of information in tax matters.

Consequently, in his annual State of the Nation speech in April 2013, Prime Minister Jean-Claude Juncker announced that Luxembourg will apply the “automatic exchange of information” on interest payments on debt claims made by Luxembourg financial operators to individuals resident in another EU Member State with effect from 1 January 2015. The automatic exchange of information on interest payments will be limited to the exchange of information among competent tax authorities of EU Member States pursuant to the EU Savings Directive.

As of 1 January 2015, the option to deduct withholding tax from interest payments to EU-resident individuals will no longer be applied in the Grand Duchy. The fiscal regime for Luxembourg resident individuals will remain unchanged. Economic operators established in Luxembourg paying interest to individuals resident in other EU Member States, i.e., mostly banks, will transmit the information foreseen in the EU Savings Directive to the Luxembourg direct tax authorities, the Administration des Contributions Directes.

The Luxembourg tax authorities will then confidentially transmit the information to the corresponding tax authority in the EU Member State in which the beneficial owner is a resident. This automatic exchange of information is limited to an exchange of information among competent government tax authorities, and limited
to information regarding savings income in the form of interest payments on debt claims. Professional secrecy will continue to be applicable.

Information exchange with third countries, such as the United States, will be on a bilateral basis.

The above decision appears fully justified on the basis of the FATCA negotiations Luxembourg presently is engaged in with the United States. Indeed, under the current European framework for the automatic exchange of information, should an EU Member State (e.g., Luxembourg) provide a wider cooperation to a third country (e.g., the United States) than the cooperation defined in the Directive on administrative cooperation in the field of taxation, then that Member State must provide such wider cooperation to any other Member State that may request to enter into such mutual cooperation. Therefore, each time the US conclude bilateral agreements with EU Member States under FATCA, the latter would thus be required to provide such wider cooperation to any other Member State. Since Luxembourg expects to sign a FATCA within short\textsuperscript{30}, it may expect being requested by each Member State to provide a FATCA equivalent information exchange, so that within short the information exchange in respect to income from savings anyway would have become automatic for Luxembourg.

Finally, Luxembourg also is aware of the initiatives at an European level for moving towards automatic information exchange. Indeed, in order to avoid distortions between Member States, the European Council requested the EU Commission to elaborate a proposal of Directive creating a European regulation for the automatic exchange of information, i.e., “European FATCA”.

On 12 June 2013, the EU Commission issued thus a proposal of directive (the Proposal of directive)\textsuperscript{5} amending the Directive in order to fight more efficiently against tax evasion. The automatic exchange of information between the EU member states would indeed be extended to:

- Dividends
- Capital gains
- All other financial income
- Account balances

The scope of automatic exchange of information within EU Member States under the Proposal of directive will be the same as under US FATCA and will follow the same schedule, i.e., effective as from 1 January 2015. As a result, the availability of information to report should not come as an issue for financial institutions because of this Proposal of directive.

Further to the implementation of the proposed directive together with the EUSD and the Directive, almost any kind of income received by an EU resident would be subject to automatic exchange of information.

\textsuperscript{30} Luxembourg has chosen the Model I which will provide automatic exchange of information between the Luxembourg and American fiscal authorities on bank accounts held in Luxembourg by citizens and residents of the United States. Model II chosen by Switzerland has the local banks provide directly themselves that information to the IRS.
Taxable income as from financial year 2014 would thus be concerned by such automatic exchange of information if the proposed directive is adopted by the EU Parliament and the EU Council.

As a result of these changes, Luxembourg will effectively apply the following mechanisms as of fiscal year 2015:

- Automatic exchange of information as defined in the EU Savings Directive applicable to interest paid to individuals resident in an EU Member State other than Luxembourg
- Exchange of information upon request with other EU Member States, as effective since 1 January 2013 pursuant to the Law on administrative cooperation in the field of taxation
- Exchange of information upon request as agreed in double-tax treaties with third countries
- Automatic exchange of information with other EU Member States on specific categories of income, only to the extent such information is available to the Luxembourg tax authorities, and subject to conditions and procedures still to be defined and enacted
- Automatic exchange of information with other EU Member States on any kind of financial income and account balances (subject to the adoption of the Proposal of directive)
- Automatic exchange of information on US accounts with respect to the implementation of FATCA (Inter-Governmental Agreement (IGA) still under negotiation)
- Other bilateral arrangements with third countries, withholding tax on interest for Luxembourg residents as currently applicable.

3.1.4 Compatibility with data protection rules

The respect for private life and the protection of personal data is enshrined in the Luxembourg Constitution. Luxembourg’s first personal data legislation was the Act concerning the Use of Nominal Data in Computer Processing adopted in 1979. It has been rewritten and re-enforced as a result of the implementation of the Data Protection Directive of 1995 (95/46/EC).

Protecting personal data and providing for automatic information exchange does require some balancing act. Since the Savings Directive and the Mutual Assistance Directive provide for a safeguard in this respect, in so far that they both refer to the Data Protection Directive, no major issues should be expected. Still, certain areas remain grey and debatable. Therefore, Luxembourg attempts in its DTTs to insert certain provisions of its data protection legislation for dealing with situations such as the communication of incorrect data that needs to get deleted immediately, or the obligation to delete lawful data as soon as it no longer is needed (e.g. : the revised German-Luxembourg DTT).

4 Conclusion

Lately, news surrounding international bank secrecy has taken centre stage across various media outlets and government discussions. From the UBS probe to the
Liechtenstein CD bank data scandal, bank secrecy has been attacked and shrouded as illegal tax evasion or unsavoury business practice. While certain individuals use “offshore” bank secrecy to break laws, many taxpayers just seek bank secrecy for legitimate, legal reasons. Luxembourg is just one nation currently on the chopping block regarding its bank secrecy laws. Luxembourg officials have been playing for a while now a delicate balance of providing legal alternative banking options to protect the country’s interests, while complying with international economic laws to avoid criminal activity.

For many high-tax, big-government nations, like the U.S. and U.K., issues surrounding bank secrecy have always been controversial. When scandals arise, like the ex Deutsche Post CEO Klaus Zumwinkel of late, those who oppose bank secrecy come out in force. Historically, despite these many debates, little had changed. The reluctance to change mostly is due to the fact international commerce relies on competitive advantages each nation can provide. Because every nation needs these competitive advantages to continue, particularly if they are undersized nations such as Luxembourg, over the years, most discussions have ended in a stalemate.

This time however it is different. Several factors elevated the significance of bank secrecy laws as of late, drawing what is rarely more than a blurb on page 12 to the front page of major papers. First, this discussion came at the heat of multiple financial scandals which have been plaguing the world financial system. In a shortcut typical of today’s reasoning, the lack of financial transparency and misinformation which were at the heart of the Lehman collapse and which has nothing to do whatsoever with the bank secrecy in tax matters led to a requisitioning of the latter merely because both have in common their opacity, albeit in totally different areas. Additionally, a new Presidency in the U.S. has weighed in heavily on the issue of tax haven abuse; President Obama sponsored a bill as a Senator entitled the “Stop Tax Haven Abuse Act”. Finally, issues of private tax havens have been discussed in the recent G-20 summits. The larger countries really meant business this time ad there was no hiding anymore for countries such as Luxembourg. Because of these factors, the age-long question of legality of bank secrecy had again become a priority. Consequently, nations which had historically provided bank secrecy had to rethink their practices in order not to get put on black lists and other similar niceties.

Gordon Brown therefore felt entitled to hail the beginning of the end for tax havens, as Luxembourg and Switzerland opened up their legendary system of bank secrecy and agreed to hand over information on clients suspected of tax evasion and more generally in tax matters. “The devil is in the details,” responded French Finance Minister Christine Lagarde in Paris. “We must go all the way and see if banking secrecy is sufficiently lifted.” Future will tell us who of the two is right. The safer bet appears to be on Gordon Brown.