The Greens | European Free Alliance
in the European Parliament

PANA hearing of Jean-Claude Juncker (30 May 2017)

How Luxembourg resisted European tax cooperation and made money with its circumvention

Author: Sven Giegold, MEP

Greens/EFA in the European Parliament
Tax Justice Priority
Rue Wiertz
B-1047 Bruxelles

INTRODUCTION

"Mister Clean" Jean-Claude Juncker has not always been at the forefront of fighters against tax evasion and tax avoidance

There was a time, not so long ago, where fighting tax evasion and tax avoidance was not such a high priority in the European Union and the perspective of having to reach unanimous agreement between all Member States had discouraged more than one to present ambitious tax reforms.

Tax scandals like Offshore Leaks (2013), Lux Leaks (2014), Swiss Leaks (2015), Panama Papers (2016), Bahamas Leaks (2016) and the Malta Files (2017) revealed how worldwide a new business sector of systematic tax evasion and tax avoidance as well as money laundering has emerged over time. Although the complicity of some European Member States in this game was proven in the Special Committees TAXE I[i] and TAXE II[ii] of the European Parliament and other inquiries, so far nobody has been held accountable for these scandals. Even "Mister Clean" Jean-Claude Juncker, former Finance and Prime Minister of Luxembourg, refused any responsibility whilst it is generally recognized that Luxembourg issued tailored tax rulings to multinational corporations and thus actively helped to dodge taxes elsewhere. While recently the story of tax rulings has been widely discussed, the role of Luxembourg and its long-term Finance Minister and Prime Minister in helping individuals to evade taxes on capital income has been widely neglected.

In 2014, the European Union revised its Directive on Administrative Cooperation (DAC2[iii]) to implement the international standard of automatic exchange of tax information[iv] between tax authorities, agreed by the G20. This game changer – though still containing some flaws[v] - will normally allow for bank secrecy towards the tax authorities to be over.

These past years progress would almost make people forget that automatic information exchange already existed in the European Union before being adopted by the G20. Indeed, the European Savings Tax Directive (EUSTD) was adopted on 3rd June 2003[vi] and entered into effect on 1st July 2005. The EUSTD required the automatic exchange of information between Member States on a limited information: interest paid on savings held by private persons. The objective of this proposal was to ensure interest payments made in one Member States to residents of other Member States were fully declared to the country of residence and taxed in accordance with the law of that state of residence. In other words, to prevent tax evasion.

Many non-EU states also agreed to introduce similar measures. These countries included the UK crown dependencies (Guernsey, Isle of Man and Jersey), British Overseas Territories (Anguilla, British Virgin Islands, Cayman Islands, Gibraltar, Montserrat and Turks and Caicos Islands), Dutch overseas territories (Aruba, Curaçao and Sint Maarten) as well as Switzerland, Andorra, Liechtenstein, Monaco and San Marino.

However, some countries were granted a special treatment, thanks to intensive blocking and lobbying in the Council of Member States. This paper details how Luxembourg obtained a concession in the EUSTD. Instead of automatically exchanging information, it was authorised to levy a withholding tax deducted from interest earned in Luxembourg, partially passed on to the EU country of residence.

(Chapter 1). Austria and Belgium also benefited from this special clause, together with several other covered non-EU countries[vii]. In a nutshell, Luxembourg and other jurisdictions not exchanging information automatically with other countries allowed tax evaders to hide their money from the tax authorities of their residence. Until today Luxembourg does not cooperate effectively in order to help its partner countries to bring their tax evaders to justice. The behaviour of Luxembourg is even more detrimental to its neighbours as the Grand Duchy tolerated the creation of a tax avoidance business on its territory helping wealthy individuals to formally move the ownership of their funds into offshore companies located in tax havens and thus escaping the scope of the EUSTD.

Based on data from the Bank of International Settlements, this paper aims at identifying how Luxembourg has become an attractive place for individuals willing to circumvent the EUSTD, which mechanisms were used and provides a conservative approach to quantify the cost of these circumventions (Chapter 2).

Finally, this paper demonstrates how Luxembourg has not grasped the scale of the problem, by continuing to block a reform of the EUSTD until 2014 (Chapter 3) and by refusing cooperation with its neighbour countries to investigate the systematic circumvention of the EUSTD (Chapter 4). Chapter 5 provides some recommendations for the European Commission and Member States today.

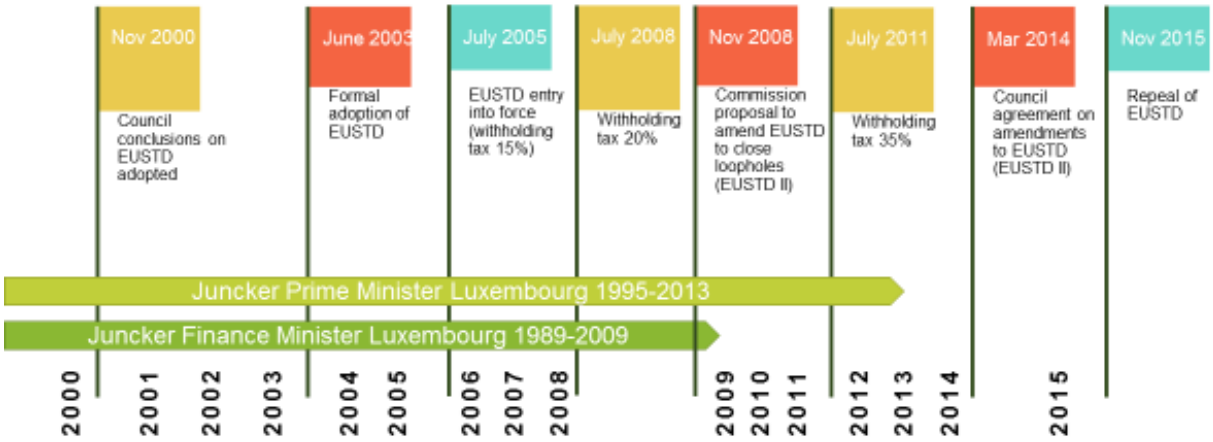
CHAPTER 1
LUXEMBOURG AS A TAX REFORM BLOCKER

Jean-Claude Juncker is currently the President of the European Commission, after being Luxembourg's Finance Minister from 1989 to 2009 and Prime Minister from 1995 to 2013. As he explained during a European Parliament hearing in September 2015 of the Special Committee investigating the Luxleaks scandal[viii] he has not discovered tax matters when moving to Brussels. He mentioned the role of the Luxembourg Presidency in 1997 in establishing the European Code of Conduct on Business Taxation and in starting discussions on the future Savings Tax Directive, to harmonise the taxation of savings in Europe.

What Mr Juncker failed to mention in September 2015 is how Luxembourg has been fighting tooth and nails against an ambitious EUSTD proposal, until it obtained a narrow scope and the possibility of not exchanging tax information with other European countries in exchange of levying a withholding tax.

In a Council meeting in October 2000[ix] – a few weeks before the European Finance Ministers agreed on a common declaration presenting the main aspects of the future EUSTD – Luxembourg was promoting an extreme position. It was already clear from the past months of negotiations that the Grand Duchy did not want to automatically exchange information with their counterparts and called for levying a withholding tax instead as a fall-back option[x]. However, Member States still needed to agree on the rate of this withholding tax and most national delegations expressed the view that it should be at least 20% to 25% in order to be meaningful. **While Belgium argued for a 15% tax rate, Luxembourg was the country asking for the lowest rate, at 10% only**. In the end, Luxembourg lost the case – thanks to the determination of countries like France and Italy – and was forced to agree on a gradual approach: 15% withholding tax from 1st of July 2005, 20% from 1st July 2008 and finally 35% from 1st January 2011.[xi]

EUSTD TIME LINE



COUNCIL OF THE EUROPEAN UNION

Brussels, 31 October 2000 (06.11) (OR. FR)

12765/00

LIMITE

FISC 170

OUTCOME OF PROCEEDINGS

of :	High-Level Working Party on Tax Questions (Direct Taxation)
on :	25 October 2000
No. prev. doc. :	12578/00 FISC 163
Subject :	Taxation of savings – Scope of the Directive – Capitalisation products – Arrangements for the exchange of information and deduction at source

6. THE RATE OF THE WITHHOLDING TAX

Most delegations expressed the view that the rate of the withholding tax ought to be at least 20 to 25%, a position that most of them had adopted in Feira.

The Belgian and Greek delegations considered 20% too high a rate. The Belgian delegation pointed out that the present rate for residents was 15% and it did not want a rate for non-residents that was very different.

The Luxembourg delegation was in favour of 10%.

The Austrian delegation pointed out that its position on the level of the rate would depend on the Council's decision on the final or non-final nature of the withholding tax. In fact, Austria would prefer a lower rate and a non-final withholding tax rather than a higher rate and a final withholding tax. At present Austria had a final withholding tax of 25% but did not rule out the possibility of adopting a rate of less than 20% in the Directive, although would not adopt a final position on that point.

The Commission representative pointed out that the Commission had proposed a minimum rate of 20%.

In another meeting early November 2000[xii], Luxembourg was one of the countries – often together with Austria, which was also trying to protect its banking secrecy – fighting hard to limit the scope of the EUSTD. For example, Luxembourg considered unacceptable the possibility to exchange information on capital gains tax, it also wanted to exclude statutory funds from the scope of the future directive and claimed that the withholding to be levied (or the exchange of information) should only be done on the amount of interest received (not on the total amount in bank accounts).

COUNCIL OF THE EUROPEAN UNION

Brussels, 6 November 2000 (14.11) (OR. fr)

12847/00

LIMITE

FISC 176

OUTCOME OF PROCEEDINGS

of :	Working Party on Tax Questions – Direct Taxation
on :	19 and 20 October 2000
No. prev. doc. :	12379/00 FISC 157
Subject :	Taxation of savings Scope of the Directive – capitalisation financial instruments CIU and similar structures Establishing the identity and place of residence of the beneficial owner

1.2. Solutions to take into account capitalised interest

1. General case

The Presidency suggested that, as a matter of principle, under the exchange of information model provided for in the Feira European Council conclusions, the Member States would communicate the overall amount of transfers of rate products. The addressee States could either tax the accrued interest or tax globally the capital gain under the capital gains transfer rules.

The majority of delegations (D/DK/F/FIN/IRL/NL/S and UK) agreed with the Presidency.

Six delegations (A [1]/B/E/EL/I and L) did not agree.

The A and L delegations were of the opinion that the paying agent should calculate the interest and apply the withholding tax on the amount of interest calculated or exchange information on that same amount of interest.

The L delegation considered that it was unacceptable to apply tax to capital gains.

3.1 Capitalisation UCITS invested exclusively in rate securities

- *exchange of information: on the total amount of transfers (or redemptions) of the units or shares of the UCITS*
- *withholding tax: on the difference between the transfer or redemption price of the UCITS securities and their purchase or subscription price. The paying agent would have to collect such information directly from the subscriber.*

Four delegations were opposed (A/B/EL and L).

The L delegation reiterated its position on excluding statutory funds from the scope of the Directive and stated that the withholding tax or information exchange should apply to the amount of interest.

This adds to a previous meeting (September 2000[xiii]) where Luxembourg insisted that the future EUSTD should only apply to natural persons receiving interest in their private capacity. Luxembourg was pretty isolated in holding this position, as many countries wanted the directive to apply to natural persons in general (no matter if interests were received in a private capacity or in a business capacity), some countries like Germany, going even further by proposing to ensure that partnerships would also be covered. Luxembourg was only supported by the Netherlands and Greece at the time.

COUNCIL OF THE EUROPEAN UNION

Brussels, 14 September 2000 (21.09) (OR. fr)

11146/00

LIMITE

FISC 115

OUTCOME OF PROCEEDINGS

of :	Working Party on Financial Questions (Direct Taxation)
on :	5 and 6 September 2000
No. prev. doc. :	10947/00 FISC 113
Subject :	Taxation of savings – Paying agent and beneficial owner

2. Beneficial owner

(a) Inclusion of individuals:

Most delegations (B/D/E/IRL/I/A/S/UK) felt that the Directive should apply to all natural persons, with no distinction between those receiving interest in their private capacity and those receiving interest in their business capacity. In addition, the D and A delegations asked that partnerships also be covered; the A delegation, however, entered a scrutiny reservation on those partnerships where taxation would fall within a Member States' option right. To this end, the D delegation asked to clarify the wording of Article 3(a) in the following way: "… all persons other than legal persons…"

Three delegations (EL/L/NL) thought that the Directive should only apply to natural persons receiving interest in their private capacity.

In the end, three European Member States – Luxembourg, Austria and Belgium – opposed the principle of automatic information, even in the long term. This resulted in the Article 11 of the EUSTD granting a 'transitional period' for the trio, allowed to apply a withholding tax instead of exchanging information until they decided otherwise. That 'transitional' period terminated in 2009 for Belgium, but only ended in 2014 for Luxembourg and Austria, once the United States' unilateral moved to oblige countries to exchange information – through its Foreign Account Tax Compliance Act (FATCA) – created an international dynamic to revise the global standards of tax transparency. On top, the EU Directive on Administrative Cooperation (2011/16/EU) adopted in 2011 contained a most favoured nation clause: if a Member State provides wider cooperation to a third country than that provided for under the Directive, it may not refuse such wider cooperation to another Member State that requests it on its own behalf. Facing increasing international pressure, Austria and Luxembourg had no choice but to abandon their banking secrecy towards tax authorities.

But before this global shift towards automatic information exchange the resistance of these three Member States had a significant impact on compliance by non-European countries covered by the EUSTD. Once preferential treatment was granted to some Member States, it was impossible to refuse it for non-European jurisdictions. This led to a long list of countries decided to opt-in for the withholding tax option: Andorra, British Virgin Islands, Curaçao, Guernsey, Isle of Man, Jersey, Liechtenstein, Monaco, San Marino, Sint Maarten, Switzerland and Turks and Caicos Islands[xiv]. If one can judge the efficiency of a legislation by the limited number of its exemptions, it was clear that the EUSTD was in a bad way from the start.

Similarly, other countries like Singapore, Hong Kong, Macao, Bermuda and Barbados have been asked back in the days to implement similar measures as in the EUSTD but always refused to do so.

Exchanging tax information or levying a withholding tax could hardly – even a decade ago – be considered equivalent measures. The purpose of automatic information exchange was to ensure that the adequate amount of tax was paid by an individual in his/her country of tax residency. Levying a withholding tax was only a bad compromise – to pass the obstacle of obtaining a unanimous agreement among the Member States – with no intention to seriously fight tax evasion. In fact, the low rate applied at the beginning was actually probably still bearable by many tax evaders, who were facing higher tax rates should the taxes have been paid in their country of residence. In addition, the withholding tax countries were allowed to keep 25% of the withholding tax levied, only redistributing 75% to the country of residence.

The Tax Justice Network concluded that as a result of this 'preferential treatment', for example only 50% of all relevant accounts in Jersey were subject to information exchange by the end of 2006 (18 months after the entry into force of the EUSTD).[xv]

CHAPTER 2
HOW LUXEMBOURG TOLERATED THE CIRCUMVENTION OF THE EUROPEAN SAVINGS TAX DIRECTIVE TO THE DETRIMENT OF OTHER EU MEMBER STATES

Size of the phenomenon

The phenomenon of circumventing the law is manifold. In the Committee of Inquiry into Money Laundering, Tax Avoidance and Tax Evasion (PANA) of the European Parliament, the German police informed the deputies about real world cases of circumvention methods through converting private bank accounts into bank accounts held by offshore companies from Panama; Cayman Islands, Seychelles or the British Virgin Islands. Hearings of the Belgian Committee of Inquiry into the Panama Papers confirmed the widespread business-like dimension of selling such conversions from money in private bank accounts to money held by offshore companies or tailor-made life insurances in Luxembourg. In the meantime, at least three German banks including Commerzbank Luxembourg, HSH.Nordbank and HypoVereinsbank were given sentences for enabling tax avoidance and the French bank Société Générale so far has not been able to clarify whether it has done the same. The press has repeatedly reported about money of tax evaders being transferred from Switzerland into the financial centre of Singapore.

From the very beginning, the EUSTD was not a perfect instrument to ensure tax transparency. However, the effectiveness of this blunt sword has even been weakened by Luxembourg's government who tolerated the circumvention of the EUSTD by a tax avoidance sector exploiting the loopholes in the law as a systematic business practice. The ignorance of the political decision-makers in Luxembourg resulting in substantial losses in tax income of other EU Member States has to be considered as a serious infringement of the duty of sincere cooperation laid down in Article 4(3) of the Lisbon Treaty.

Beyond the possibility not to exchange information but to levy withholding tax, an easy way to circumvent the Directive was to create a layer between the individual and the bank account by placing the deposits into a foreign limited company, a trust or a foundation. This magic trick works as Luxembourg does not levy withholding tax on interest paid to non-residents. Thanks to the veto from Luxembourg, the EUSTD only applied to natural persons and not to legal entities. Putting a private person's money into a legal entity or arrangement thus prevented having your information automatically exchanged or to pay a withholding tax. Jurisdictions with low requirements for enterprise creations like Cayman Islands, Jersey, Guernsey and Panama were favoured countries of destination to conceal the real beneficiaries of funds. Another option to circumvent the EUSTD was to move formal ownership of the funds into a company not covered by EUSTD obligations and protected by the secrecy of an offshore tax haven as business location. With the progressive rise in withholding tax from 15% in 2005, 20% in 2008 to 35% in 2011, secret money was allocated increasingly to letterbox companies in jurisdictions like Bahamas, Singapore and Hong Kong.

Thanks to its bank secrecy, Luxembourg has been an attractive financial centre for tax evaders since many decades. However, with the perspective of

automatic exchange of information being introduced among EU Member States via the EUSTD, putting deposits into Luxembourg became even more attractive for natural persons as the Grand Duchy would not participate in the information exchange but would only levy withholding tax. As figure 1 shows, the amount of deposits and loans held by other countries in Luxembourg started to increase just after the introduction of the EUSTD including special treatment for Luxembourg, Austria and Belgium was foreseeable in late 2000. The rise of foreign money stored in Luxembourg continued until the outbreak of the financial crisis end of 2007.

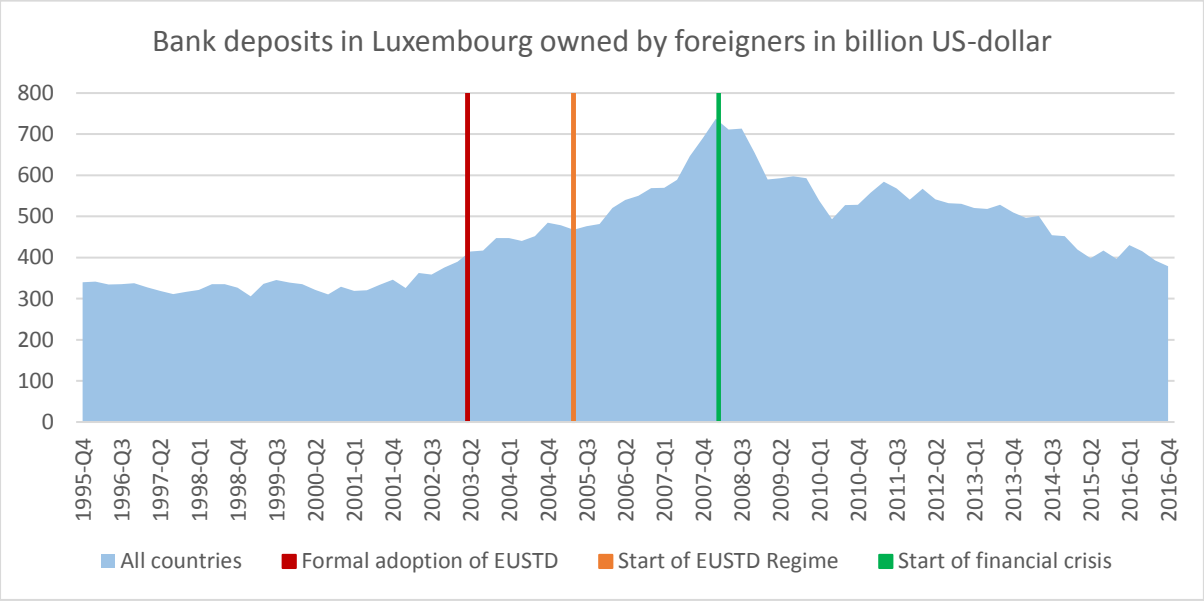


Figure 1: Bank deposits and loans in Luxembourg owned by foreigners in billion US-dollar (Source: Bank of International Settlements data).

Broken down by country, it becomes obvious that Luxembourg served as “tax haven” in particular for German wealthy people. As figure 2 impressively shows, bank deposits of Germans in Luxembourg increased by more than 250% from circa 100 billion US-Dollar in 2000 to around 264 billion US-Dollar in the fourth quarter of 2007.

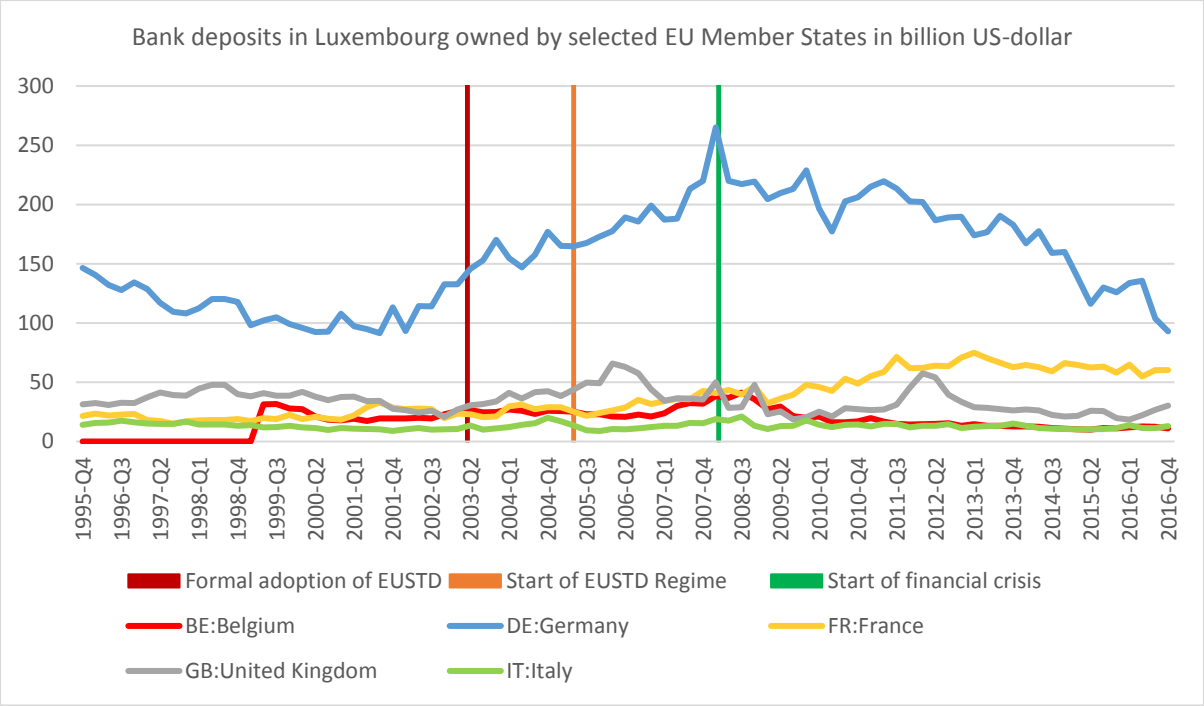


Figure 2: Bank deposits in Luxembourg owned by EU Member States with significant volumes in billion US-dollar (Source: Bank of International Settlements data).

As outlined above, a major loophole of the EUSTD was that it only applied to tax income of natural persons. Even worse, the EUSTD did not require to look through a legal entity or arrangement to identify the real beneficial owner behind. To escape the withholding tax in Luxembourg, it was sufficient to put the money into a company being a legal person.

Figure 3 shows that the creation of offshore companies via Mossack-Fonseca by Luxembourg reached an all-time high of almost 1300 in 2005, the year when the EUSTD entered into force. Given the enormous and sudden increase in company creations, one can conclude that a real tax avoidance and tax evasion industry has emerged in Luxembourg. The data of Mossack-Fonseca is only one, and not even the largest intermediary, in the global tax evasion sector. But it is the only one whose data is publically accessible for analysis. Looking at the obvious numbers, it is hard to believe that the government of Luxembourg was not aware of the systematic circumvention of European law.

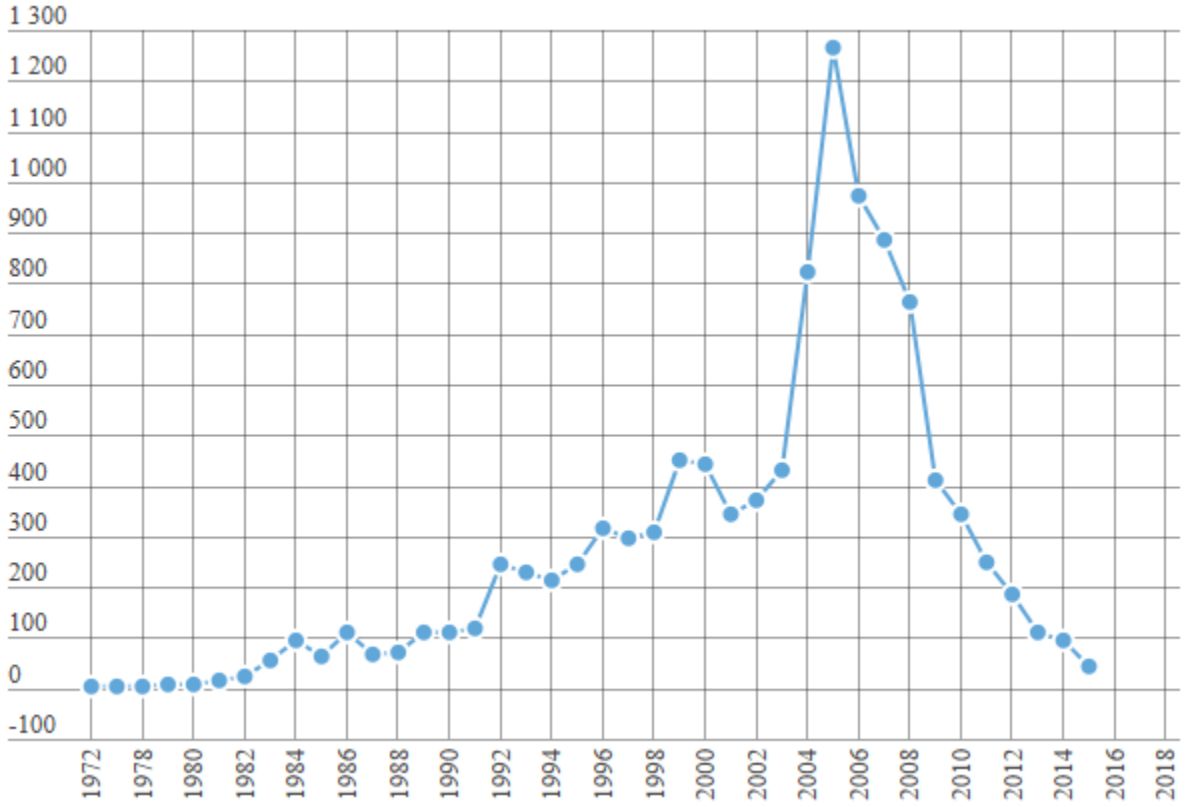


Figure 3: Incorporation of companies via Mossack-Fonseca in Luxembourg (based on ICIJ data/Panama Papers). Source: https://www.wort.lu/de/business/panama-papers-les-societes-offshore-n-appartiennent-pas-toutes-au-passe-5732464fac730ff4e7f6039e

Wealthy people did not only use companies in Luxembourg to escape the withholding tax levied by Luxembourg but made also use of other jurisdictions offering low standards for company creations and an additional layer of secrecy.

Figure 4 shows that after the entry into force of the EUSTD in July 2005, deposits with formal ownership in the Cayman Islands and Panama progressively increased. Both countries are famous for the easy and rapid creation of shell companies. From Figure 4 one can also retrieve that with the progressive increase in withholding tax from 15% in 2005 and 20% in 2008 to 35% in 2011, ownership of deposits in Luxembourg went to countries like Hong Kong, Singapore and Bahamas. By only applying to natural persons and lacking a requirement to look through a company to identify the real beneficial owner, the EUSTD did not apply to interest payments to shell companies situated in a tax haven. All of these jurisdictions are not among the 'early adopters' of the OECD common reporting standards and committed to implement automatic information exchange in 2018 only.[xvi]

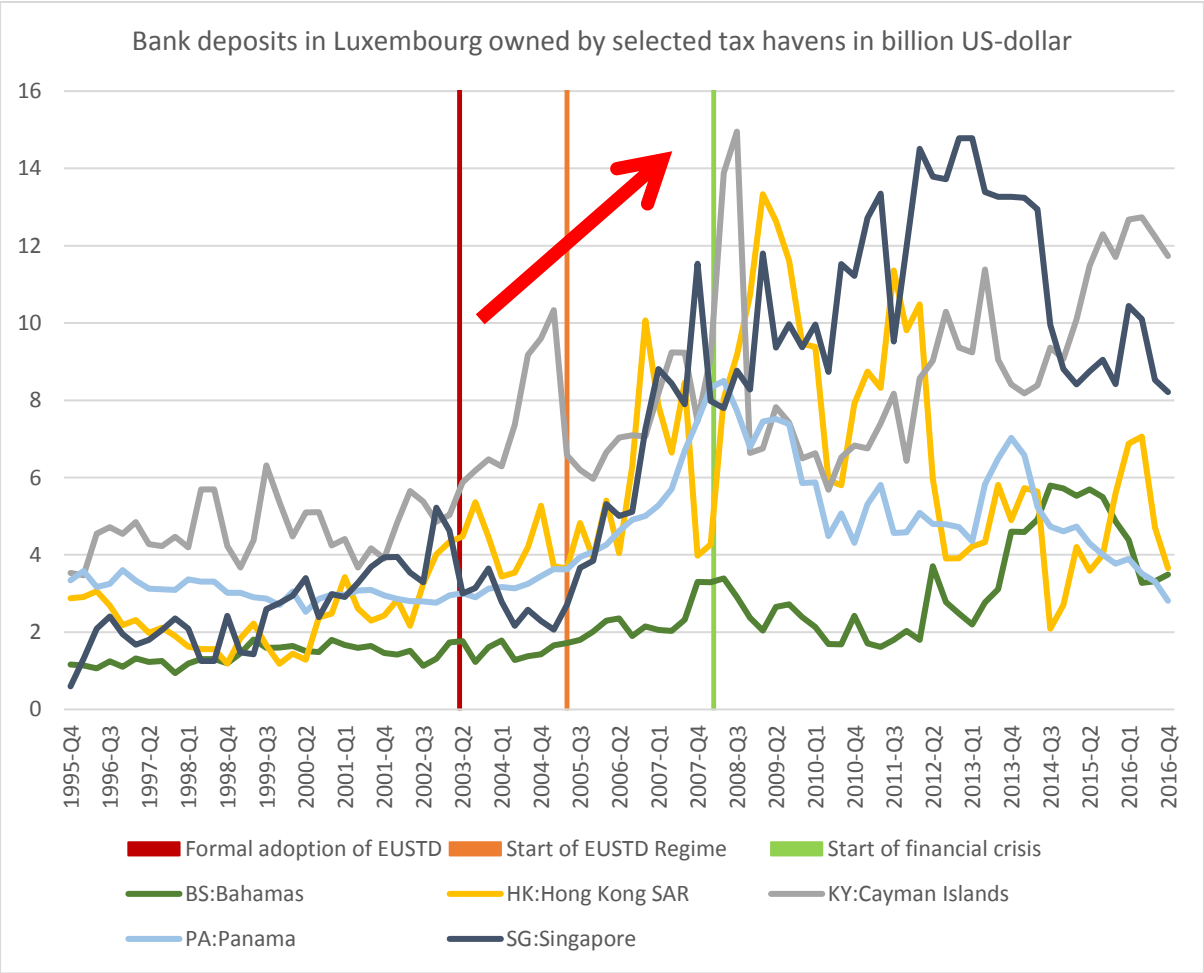


Figure 4: Bank deposits in Luxembourg owned by selected tax havens in billion US-dollar (Source: Bank of International Settlements data).

Estimation of losses in interest tax income

Given the obvious circumvention of the EUSTD by setting up legal entities and arrangements in offshore financial centres, we try to carefully estimate the losses in tax revenue incurred by money leaving the scope of the EUSTD (for Methodology, see Annex 1). We calculate the losses for the ten EU Member States owning the highest volumes in bank deposits in Luxembourg. The Panama Papers and the inquiries of the European and the Belgium Parliaments revealed that existing customers of banks in Luxembourg were advised to keep their money in Luxembourg but to create an offshore company as a layer between the real beneficial owner and the bank account to avoid their interest income being charged with withholding tax in Luxembourg (15% from 1 July 2005, 20% from 1 July 2008, 35% from 1 July 2011 onwards).

Our conservative estimation is based on the assumption that the real ownership structure of bank deposits in Luxembourg has not changed since the adoption of the EUSTD on 3rd June 2003. By allocating the increase in deposits with formal ownership in tax havens since the 3rd June 2003 to EU Member States following the distribution key of the second quarter of 2003, we calculate their respective deposits and interest earnings which should have been charged with withholding tax in Luxembourg. By Luxembourg allowing the formal ownership of bank deposits to change from EU Member States to offshore jurisdictions, the interest income on these bank deposits was not taxed in Luxembourg, neither in the home country of the real beneficial owner. We conclude that since the introduction of the EUSTD on 1 July 2005, EU Member States have lost more than 300 million US-dollar in tax income. Luxembourg itself has lost more than 100 million US-dollar as the EUSTD prescribes that Luxembourg keeps 25% of the withholding tax, the rest (75%) goes to the home country.

The losses shown in Table 1 are only a cautious estimate as we do not include the loss in tax income incurred by home countries because of citizens transferring their money into Luxembourg so as to avoid paying higher taxes in their home country. Carefully, we assume the withholding tax as final although higher taxes were often due for affluent tax payers. Likewise, due to lack of data, we are not able to estimate the damage incurred by other circumvention methods evidenced by tax and criminal inspections throughout Europe such as transferring money into life insurance contracts or possibly into investment funds. Consequently, the losses shown are only the tip of the iceberg.

	Total loss	**Loss home country (75%)**	**Loss Luxembourg (25%)**
BE: Belgium	47,94	35,95	11,98
DE:Germany	263,99	197,99	66,00
DK:Denmark	10,23	7,67	2,56
ES:Spain	2,05	1,54	0,51
FR:France	41,60	31,20	10,40
GB:United Kingdom	55,54	41,65	13,88
IT:Italy	24,64	18,48	6,16
NL:Netherlands	15,45	11,59	3,86
PT:Portugal	7,29	5,47	1,82
SE:Sweden	3,23	2,43	0,81
Total loss	**471,96**	**353,97**	**117,99**

Table 1: Losses in EUSTD tax income from 1 July 2005 to 31 Dec 2016 in million US-dollar (own calculations based on BIS data).

CHAPTER 3
HOW LUXEMBOURG DID EVERYTHING IT CAN TO BLOCK THE SECOND DIRECTIVE (AGAIN)

Article 18 of the Savings Directive created an obligation on the European Commission to report to the Council, every three years, on the implementation of the legislation. This is why the Commission services prepared a first assessment report in September 2008[xvii] and a second one in 2011[xviii]. If deemed appropriate, the Commission was also empowered to propose amendment to the legislation to better ensure effective taxation of savings incomes.

It was clear very early on, to organisations like Tax Justice Network[xix] that the EUSTD needed to be revised, in order to remove the withholding tax option – making automatic information exchange the standard in all cases and in order to cover beneficial owners of all legal entities (especially private companies and trusts – too often used as escape routes by tax evaders). Many also raised the need for a revised EUSTD to include all forms of investment income and insurance based products (not just interest on bank deposits) to avoid moving the interest into another form of investment, not covered in the scope of the Directive.

In its first assessment report from 2008, the European Commission looked at the economic impact of the EUSTD and noticed that "*the major part of revenue from the withholding tax in 2005 and 2006 was raised in Switzerland and Luxembourg, which respectively accounted for more than 45% and 22% of the total revenue*"[xx]. This confirms our findings that Luxembourg, by not exchanging tax information, was an interesting country for people looking to hide from the tax authority in their country of residence.

The European Commission confirmed also what we calculated from the figures: that Luxembourg was mostly used by Germans and Belgians to avoid declaring their interest income in their respective countries. The same evaluation report indeed mentions: *"In the tax years 2005 and 2006, the largest beneficiaries of withholding tax revenues were Germany (€192.7 million) and Italy (€112.9 million). Belgium received more than €71 million, mainly from Luxemburg (74% of the total)."*

Based on its assessment report, the European Commission concluded to the need to revise the EUSTD and presented an amended proposal to this effect in November 2008.[xxi] The proposal highlighted concerns confirmed to the Inquiry Committee investigating alleged breach of EU law related to money laundering, tax evasion and tax avoidance during a hearing on 14 November 2016[xxii]. Mr Norbert Naulin, Head of the Investigation Group Organised Crime – Tax Fraud (EOKS) of the North-Rhine Westphalia tax authorities explained to Members of the European Parliament that data they received from a whistleblower had demonstrated how banks transferred interest received by individuals to companies and life insurance schemes to escape the EUSTD[xxiii].

The 2008 revised proposal from the European Commission spotted the same risk: *"It appears from the first report on the application of Directive 2003/48/EC that it may be circumvented by the use of financial instruments which, having regard to the level of risk, flexibility and agreed return, are equivalent to debt claims. It is therefore necessary to ensure that it covers not only interest but also other substantially equivalent income. Similarly, life insurance contracts containing a guarantee of income return or whose performance is at more than 40 % linked to income from debt claims or equivalent income covered by Directive 2003/48/EC*

should be included in the scope of that Directive."

However, this time again, Luxembourg – supported by Austria – used its veto power to block the agreement of the revised EUSTD in the Council until the 24th of March 2014 when an agreement to amend the EUSTD was finally adopted[xxiv]. For another five years, Luxembourg was among those blocking the adoption of the revised EUSTD, as demonstrated for example at the EU Finance Ministers meeting in December 2013.[xxv] Pierre Gramegna, newly appointed Finance Minister for Luxembourg, despite affirming his country's commitment to automatic exchange of tax information, raised again the same two concerns for not agreeing to the new European proposal. He argued that as long as there was no level playing field, namely with the non-EU countries the European Commission was negotiating at the time for equivalent measures, Luxembourg could not agree to a revision. More ironically maybe, he raised the importance of coherence with international standards (e.g. the newly agreed Common Reporting Standards in the OECD) and legal certainty to justify not implementing a proposal his country had been blocking for five years.

Luxembourg and Austria finally only gave up on their banking secrecy once they were forced to by the US (under the FATCA agreement) and once European Heads of State had recognised in May 2013 the efforts from the G8, G20 and the Organisation for Economic Cooperation and Development (OECD) to develop a global standard for automatic exchange of tax information. The obligation of sincere cooperation falling on all European Member States as clearly mentioned in the EU treaty was not sufficient to make Luxembourg and Austria giving up on their unfair tax privileges.
In the end, Luxembourg and Austria managed to block the revision of the EUSTD for so long, that this one never got the chance to be properly implemented and was repealed on 10 November 2015, before entering into force.[xxvi]

The repeal of the EUSTD occurred because the European Union has revised its directive on administrative cooperation (DAC2) to provide for automatic information exchange between European tax authorities on a much larger set of income and for a wider category of owners. This is a huge progress in European tax cooperation which was unthinkable only a few years ago. Honesty requires to admit that this was not achieved through the spirit of European cooperation but by American pressure which made it impossible for Luxembourg and Austria (as well as Switzerland) to grant America a higher level of cooperation than their EU partners. However, criticisms and shortcomings have already been expressed and loopholes highlighted in the global standard on automatic information exchange and its implementation into EU legislation[xxvii]. This raises the fear that once again, legislators adopt a standard while knowing they leave a backroom door for tax evaders – and complicit states letting it happen – to freely escape taxation in their country of residence. As the first automatic exchange of tax information will take place in September 2017, we can only encourage the European Commission and the Member States to adapt DAC2 in order to close all loopholes, and not wait several years as they did with the EUSTD.

CHAPTER 4
LUXEMBOURG PREVENTING ITS NEIGHBOURS FROM INVESTIGATING INTO THE SYSTEMATIC CIRCUMVENTION OF THE EUSTD

While waiting for the entry into force of DAC2 providing automatic exchange of information from September 2017 onwards, Luxembourg is not keen on helping other Member States to investigate in the cases of circumvention and to recover the losses incurred. As far as administrative cooperation among Member States' tax authorities is concerned, Luxembourg has not made any attempts to systematically investigate in the circumvention business which was set up on its territory. Likewise, Luxembourg refuses to answer group requests ("fishing expeditions") to search systematically for tax evaders. Regarding criminal matters, cooperation has been blocked due to the fact that tax fraud below a certain threshold has not been a criminal offence under the law of Luxembourg since 1993, when a new concept of tax fraud, the tax swindling, was introduced into domestic law. From this point, the Luxembourg law used to distinguish between two main tax offences: the tax fraud (fraude fiscale) which was no more treated as a criminal offence, and the tax swindling which became a criminal offence. This changed only recently, when the new government in Luxembourg enacted the law implementing the 2017 tax reform (bill of law n°7020 of 23 December 2016) which extends the money laundering predicate offence to aggravated tax fraud (fraude fiscale aggravée) and tax swindling (escroquerie fiscale).[xxviii] Nevertheless, there has still no way be established which ensures that EU member states are supported to find out which of their citizens exploited the loopholes in the EUSTD in order to evade taxes. There is also no obligation under EU law to help partner countries in all cases of cross border tax evasion. This leaves EU states little alternatives than to use data from other sources such as whistleblowers or data traders in order to hold tax evaders accountable and restore tax justice.

CHAPTER 5
RECOMMENDATIONS

This paper summarised how one country of the European Union - Luxembourg - managed to weaken and block European tax reforms in the 2000s and then made a business model of circumventing these European rules, at the expense of their neighbours and the principle of sincere cooperation in the European Union.

As Mister Juncker moved from Luxembourg to Brussels, no one should forget that the lack of progress for tax justice at the European level has primarily been the lack of political will of the Member States, as some turned into tax havens to develop their economies and others turn a blind eye on these unfair practices.

On 30th of May, Mr Juncker comes to address the European Parliament inquiry committee on money laundering, tax evasion and tax avoidance (PANA) created after the Panama Papers scandal in 2016. On this occasion, we would like to address - to him and to other European governments - the following recommendations:

1. Shade lights on practices of the past: Mr Juncker must honestly explain to the European Parliament how much he was aware of the shady tax practices of Luxembourg during his time in office. Citizens are expecting politicians to make amend for mistakes of the past and this is worth for Luxembourg's tax rulings practices (revealed by the Luxleaks scandal) as for its role in circumventing the Savings Tax Directive.

2. Promote full cooperation between tax administrations, with support from the European Commission: It is extremely important for all European countries to investigate all cases of circumventions exposed in this paper. Luxembourg should proactively exchange information with other European tax authorities, which need to investigate possible tax evasion cases. While efforts have been noticed in Germany and France to go after tax evaders, other European countries must step up their activities and start prosecutions. The European Commission should have a coordination role and help tax authorities get access to the necessary data. All EU member states should make systematic efforts to make group requests to their partner countries in order to get the details of their citizens who evaded taxes through EU member states. Such requests can be made on the basis of double taxation agreements, administrative or legal cooperation as well as cooperation in the fight against money laundering. In order to ensure full cooperation benefitting all EU member states, the European Commission should propose a "tax justice enforcement directive" that obliges all Member States to answer fully group requests to help all EU member states to hold tax evaders accountable across European borders.

3. Carefully assess the implementation and enforcement of the revised directive on administrative cooperation: Starting in September 2017, Member States will automatically exchange information on financial accounts from EU residents. This exchange of information should be carefully analysed by the European Commission as soon as possible, in order to identify any loopholes or gaps, which would prevent the realisation of the legislation's objectives (as for the EUSTD).

4. Stop the double discourse on tax havens: the European Union is currently working on its common list of tax havens but only assesses third countries. As recently shown by the Luxleaks or Malta Files revelations, several tax practices from European Member States are

questionable and would not pass the "blush test" if exposed to citizens. Such unfair practices must be addressed in the same way and with the same conviction as those from non-European countries. Member States and the European Commission will never appear credible if they also do not tackle the issue at home.

5. Stop the hypocrisy and act in the Council: Member States are good at repeating that they are committed to act against tax evasion and tax avoidance but always find many excuses for not adopting new reforms (or watering down proposals to keep maintaining the status quo). Just last week, some Finance Ministers expressed strong concerns on the idea of a Common Consolidated Corporate Tax Base,[xxix] which would actually help the European Union fight corporate tax avoidance. European governments must put an end to this double discourse and walk the talk. Mister Juncker, as President of the European Commission, now has the opportunity to be part of this and help recover the damages he did in the past. Citizens are waiting and watching.

ANNEX I
METHODOLOGY TO ESTIMATE LOSSES BY EU MEMBER STATES THROUGH CIRCUMVENTION OF THE EUROPEAN SAVINGS TAX DIRECTIVE TOLERATED BY LUXEMBOURG

Data source

The data used for figures 1, 2, 4 and for the calculation of losses can be retrieved from the Bank of International Settlements (BIS) providing quarterly data for Luxembourg bank deposits attributed to foreign countries (Luxembourg is "reporting country", jurisdictions holding money in Luxembourg are "counterparty countries", no differentiation between deposits of natural persons and legal entities).

Link: http://stats.bis.org/bis-stats-tool/org.bis.stats.ui.StatsApplication/StatsApplication.html?query=eJxlkFFuwyAMhh02rdraanvYW0%2FRhx0ACElpCVBwVKUvvspOt3PsKHOSqiNqJGL88YPtH6C6yu%2FtFj6UzRejSEvM%2BmA6AztOM3JKTmWqKfaKaomyceFSwfStfvi35vjL8aUa6QbeHSUTSUl%2FIhyiYVhBJeHVUWdk7tON5JGMSo3DRITrYe1I9yktLm4cRZmMx3%2Fl1xFWjqzPmGZVC2%2BsCtmiDX5GDp6bZM5zcr6dFw%2F78Yna%2BNBN%2BROG%2FVQ%2BUjYaQyrKM9Oh95jG8p8g9AFEk0C0LQiLIPZXbt6CUIZXxyuD6Jhb3kuOpwFEZm2rOGoQUYI4slYzr8d2QExGzg0XRt07XPiyNOTB78LWcujSoLt5DwMvp%2F0DrDpqrA%3D%3D

Estimation of losses in interest tax revenue

In order to estimate the losses in tax revenue incurred by EU Member States, we make the following conservative assumptions. We calculate the losses for the nine EU Member States automatically exchanging information under the EUSTD regime and owning the highest volumes in bank deposits in Luxembourg.

Our estimation is only based on the most obvious circumvention method of setting up legal entities and arrangements in offshore financial centres. By this, money is leaving the scope of the EUSTD which applied only to natural persons situated in one of the EU Member States or in a EUSTD treaty country. This magic trick works as Luxembourg does not levy withholding tax on interest paid to non-residents. The Panama Papers revealed that existing customers of banks in Luxembourg were advised to keep their money in Luxembourg but to create an offshore company as a layer between the real beneficial owner and the bank account to avoid their interest income being charged with withholding tax in Luxembourg (15% from 1 July 2005, 20% from 1 July 2008, 35% from 1 July 2011 onwards). Consequently, we do not include the loss in tax income incurred by for example Germany because of Germans transferring their money into Luxembourg so as to avoid paying higher taxes in Germany. We only look at the loss in tax income because of Luxembourg tolerating that EU citizens' money changed formally ownership. Likewise, due to lack of data, we are not able to estimate the damage incurred by other circumvention methods evidenced by tax and criminal inspections throughout Europe such as transferring money into life insurance contracts or into investment funds. Consequently, the losses shown herein are only the tip of the iceberg.

We assume that the real ownership structure of bank deposits in Luxembourg has not changed since the adoption of the EUSTD on 3rd June 2003. We therefore take the second

quarter of 2003 as basis to calculate the distribution key of bank deposits in Luxembourg owned by foreigners.

	Share in Luxembourg bank deposits owned by those foreign countries in the EUSTD regime & with the highest shares as of Q2 2003
BE: Belgium	6,38%
DE:Germany	35,15%
DK:Denmark	1,36%
ES:Spain	0,27%
FR:France	5,54%
GB:United Kingdom	7,39%
IT:Italy	3,28%
NL:Netherlands	2,06%
PT:Portugal	0,97%
SE:Sweden	0,43%

Source: Own calculations based on BIS data

Assuming that bank deposits owned by offshore countries were not biased when the EUSTD was adopted on 3 June 2003, we take the second quarter of 2003 also as the basis to calculate the increase in deposits owned by offshore countries.

The BIS provides data for many offshore jurisdictions but in order to have a meaningful sample of tax havens, we only chose the following countries holding significant amounts of bank deposits in Luxembourg:

BM:Bermuda
BS:Bahamas
GG:Guernsey
HK:Hong Kong SAR
JE:Jersey
KY:Cayman Islands
LI:Liechtenstein
PA:Panama
SG:Singapore

All of these tax havens are on national lists of uncooperative tax jurisdictions established by EU Member States.

Link to national lists of tax havens:
https://ec.europa.eu/taxation_customs/business/company-tax/tax-good-governance/tax-good-governance-world-seen-eu-countries_en

For each of the quarters beginning with the third quarter of 2005 (the EUSTD entered into force on 1 July 2005) we then allocate the increase in deposits with formal ownership in tax havens to EU Member States following the distribution key of the second quarter of 2003. By this, we calculate their respective deposits. Remember: The interest earnings on these deposits should have been charged with withholding tax in Luxembourg but they escaped any taxation because their ownership has been moved to offshore jurisdictions.

For each quarter, we multiply the bank deposits attributed to EU Member States with the interest rate offered at that time in Luxembourg in order to calculate the fictitious interest earnings. By using the official interest rates reported by the ECB, we once again make a

cautious assumption for the calculation of losses incurred to EU Member States as account holders with considerable bank deposits should be able to negotiate higher interest yields.

Link:
http://sdw.ecb.europa.eu/browseTable.do?node=SEARCHRESULTS&type=series&SERIES_KEY=124.MIR.M.LU.B.L22.A.R.A.2250.EUR.O&start=&end=&submitOptions.x=0&submitOptions.y=0&trans=AF&q=bank+interest+rates+deposits+luxembourg&type=series

ECB data on interest rates:
Interest rates for households deposits (Annual frequency)
Dataset name: MFI Interest Rate Statistics
Frequency: Monthly
Reference area: Luxembourg
BS reference sector breakdown: Credit and other institutions (MFI except MMFs and central banks)
Balance sheet item: Deposits with agreed maturity
Original maturity/Period of notice/Initial rate fixation: Total
MFI interest rate data type: Annualised agreed rate (AAR) / Narrowly defined effective rate (NDER)
Amount category: Total
BS counterpart sector: Households and non-profit institutions serving households (S.14 and S.15)
Currency of transaction: Euro
IR business coverage: Outstanding amount

Year	Average interest rate yearly basis	Average interest rate quarterly basis
2005	1,86%	0,47%
2006	2,53%	0,63%
2007	3,58%	0,90%
2008	4,14%	1,04%
2009	1,49%	0,37%
2010	0,99%	0,25%
2011	1,35%	0,34%
2012	1,24%	0,31%
2013	1,12%	0,28%
2014	1,13%	0,28%
2015	1,13%	0,28%
2016	1,08%	0,27%

The quarterly fictitious interest earnings are then multiplied by the applicable withholding tax in order to calculate the total loss in tax income because these interest earnings escaped any taxation.

Time period (Q=quarter)	Withholding tax in Luxembourg
Q3 2005 - Q2 2008	15,00%
Q3 2008 - Q2 2011	20,00%
Q3 2011 - Q4 2016	35,00%

The resulting losses are then attributed to the EU home country (75%) and Luxembourg (25%).

	Total loss	**Loss home country (75%)**	**Loss Luxembourg (25%)**
BE: Belgium	47,94	35,95	11,98

DE:Germany	263,99	197,99	66,00
DK:Denmark	10,23	7,67	2,56
ES:Spain	2,05	1,54	0,51
FR:France	41,60	31,20	10,40
GB:United Kingdom	55,54	41,65	13,88
IT:Italy	24,64	18,48	6,16
NL:Netherlands	15,45	11,59	3,86
PT:Portugal	7,29	5,47	1,82
SE:Sweden	3,23	2,43	0,81
Total loss	**471,96**	**353,97**	**117,99**

Losses in EUSTD tax income between 1 July 2005 and 31 Dec 2016 in million US-dollar (own calculations based on BIS data).

ENDNOTES

[i] http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2015-0408+0+DOC+XML+V0//EN&language=EN

[ii] http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2016-0310+0+DOC+XML+V0//EN&language=EN

[iii] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0107&from=FR

[iv] http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/

[v] See here for example: http://www.taxjustice.net/wp-content/uploads/2013/04/TJN-141124-CRS-AIE-End-of-Banking-Secrecy.pdf

[vi] Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:157:0038:0048:en:PDF

[vii] The withholding tax regimes was applied by Belgium (until December 2009), Guernsey (until 30 June 2011), Isle of Man (until 30 June 2011), British Virgin Islands (until December 2011), Turks and Caicos Islands (until 30 June 2012), Jersey (until December 2014), Luxembourg (until December 2014), Austria, Switzerland, Andorra, Monaco, Lichtenstein, San Marino, Curacao and Sint Marteen.

[viii] http://www.europarl.europa.eu/news/en/news-room/20150910IPR92671/committees-taxeecon

[ix] Council Working Party on Tax Questions Brussels, 31 October 2000

[x] Council High Level Group meeting, Brussels, 10 May 2000

[xi] See Article 11 of the EUSTD: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:157:0038:0048:en:PDF

[xii] Council Working Party on Tax Questions Brussels, 6 November 2000

[xiii] Council Working Party on Financial Questions Brussels, 14 September 2000

[xiv] http://ec.europa.eu/taxation_customs/individuals/personal-taxation/taxation-savings-income/international-developments_en

[xv] https://www.taxjustice.net/cms/upload/pdf/European_Union_Savings_Tax_Directive_March_08.pdf

[xvi] https://www.oecd.org/tax/transparency/AEOI-commitments.pdf

[xvii] https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_18.pdf

[xviii] http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/swd_2012_16_en.pdf

[xix] https://www.taxjustice.net/cms/upload/pdf/European_Union_Savings_Tax_Directive_March_08.pdf

[xx] See Page 4 http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008DC0552&from=fr

[xxi] http://europa.eu/rapid/press-release_IP-08-1697_en.htm?locale=en

[xxii] http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fNONSGML%2bCOMPARL%2bPE-595.589%2b01%2bDOC%2bPDF%2bV0%2f%2fEN

[xxiii] http://www.europarl.europa.eu/ep-live/en/committees/video?event=20161114-1500-COMMITTEE-PANA

[xxiv] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0048&from=EN

[xxv] http://video.consilium.europa.eu/en/webcast/a63bea97-0148-4334-aab3-f72d59f84bcc

[xxvi] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015L2060&from=EN

[xxvii] http://www.the-best-of-both-worlds.com/support-files/oecd-crs-loopholes-report.pdf

[xxviii] http://www.cms-lawnow.com/ealerts/2017/02/new-cssf-circular-17650-widens-the-application-of-amltf-legislation-to-certain-primary-tax-offences

[xxix] http://video.consilium.europa.eu/en/webcast/044d6f5d-a5ee-49e3-9d07-e7890b4103bb