Report on Luxembourg

Luxembourg is ranked at third position on the 2011 Financial Secrecy Index. This ranking is based on a combination of its secrecy score and a scale weighting based on its share of the global market for offshore financial services.

Luxembourg has been assessed with 68 secrecy points out of a potential 100, which places it in the mid range of the secrecy scale (see chart 1 below).

Luxembourg accounts for slightly over 13 per cent of the global market for offshore financial services, making it a huge player compared with other secrecy jurisdictions (see chart 2 below).

Chart 1 - How Secretive?

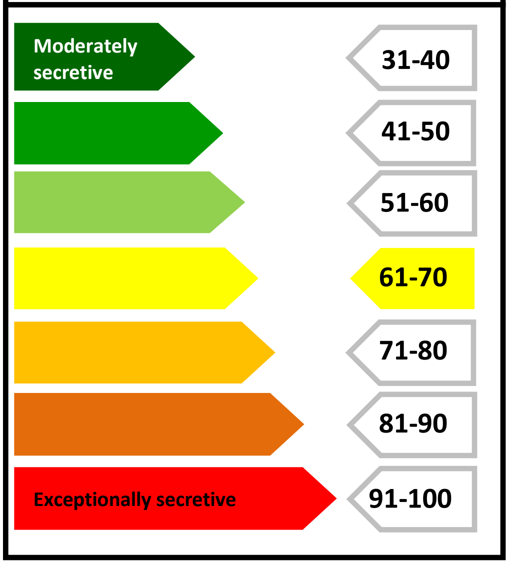
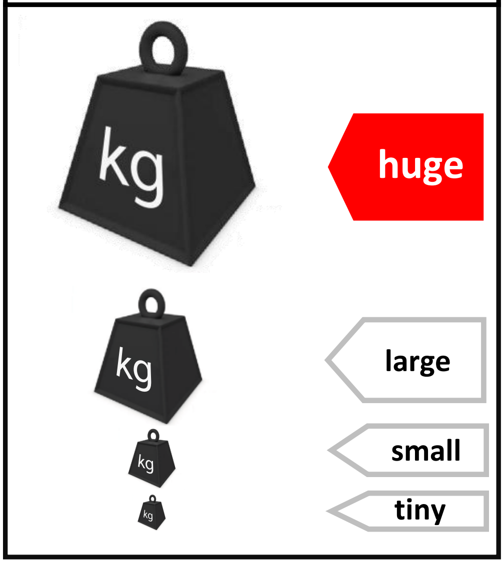


Chart 2 - How Big?



Part 1: Telling the story

The Luxembourg financial centre: history and background

Overview

Luxembourg is one of the world's top secrecy jurisdictions. It works actively and aggressively to defend financial secrecy, in the face of European efforts to promote transparency.

Its history as a financial centre stems from three main developments: first, tax-free facilities for non-resident corporations, dating from 1929; second, the emergence of offshore Eurodollar and 'Eurobond' activity in the 1960s, attracted by Luxembourg's regulatory laxity and tax-free status; and third, tight secrecy rules, first enshrined in the Banking Law of 1981.

Breaking secrecy laws can result in a prison sentence, and Luxembourg's secrecy score of 68, putting it towards the 'dirty' end of our spectrum, is fully deserved.

Underpinning the financial sector, as with its competitor Switzerland, is the country's political stability, underpinned by its neutrality and bolstered by the fact that politics has been dominated for the past half-century by a right-wing political party, the Chrëschtlesch Sozial Vollekspartei (CSV) which has strongly supported financial secrecy and the financial centre. Like Ireland, another competitor for global financial services, Luxembourg not only provides most of the offerings of 'traditional' tax havens like the Cayman Islands but its membership of the European Union (and its wide range of tax treaties) gives it better access to European and international markets than is available to traditional tax havens.

Luxembourg has historically offered a wide range of international and offshore services, particularly banking, fund administration, global custody services and hosting holding companies. It is the world's second largest mutual fund market after the U.S., with over 3,700 registered funds holding €2.2 trillion euros in assets in June 2011; it is the biggest private banking centre in the Eurozone and the biggest captive reinsurance market in the European Union; and the Luxembourg stock exchange is the biggest in Europe for the listing of international bonds, with over 40 percent of the total. The landlocked country even has a shipping registry.

Banking secrecy is based most importantly on the secrecy of professional lawyer-client relationships; however other forms of secrecy are provided. Currently the Luxembourg Bankers' Association (ABBL) is lobbying (p23) for a new private foundation regime for philanthropic foundations that would allow founders "to access capital placed in a foundation" – a common secrecy and tax evasion facility – and to allow for the creation of trusts under Luxembourg law.

Hosting large tax-evading and other criminal assets from around the world, Luxembourg has flown under the radar, attracting far less criticism than Switzerland. Luxembourg has a well resourced lobbying network that has actively sought to undermine criticism of its role as a secrecy jurisdiction, with repeated claims that it is 'not a tax haven' and sometimes repressive moves against its few domestic critics. TJN's director John Christensen has called Luxembourg the "Death Star" of financial secrecy inside Europe because of its leading role, in close political partnership with Switzerland and Austria, in fighting against information-sharing schemes in Europe.

History

Although Luxembourg today rivals Switzerland in size and scope as a European secrecy jurisdiction, the origins of its financial sector are far younger. Emerging as a neutral and partly independent (impoverished) nation only in 1867, Luxembourg did not gain its own independent ruling family until 1890. Rapid economic growth for much of the early part of the 20th Century was based on large iron ore deposits and the emergence of a strong iron and steel industry.

In 1929 Luxembourg took its first steps as an offshore financial centre, with a new regime for holding companies, under which multinational corporations could set up 'holding company' subsidiaries in Luxembourg (set up purely to own assets elsewhere) that would be exempt from income and capital gains tax. Although justified as a way to help multinational corporations avoid getting taxed twice (once in their 'home' country and then again in the country where they were investing,) in reality they were used increasingly to achieve double *non*-taxation: that is, to escape tax in both countries.

In the 1960s, the Luxembourg financial industry really took off. The big milestone – a top Luxembourg financier suggested this was Luxembourg's financial "Big Bang" – was the launch in July 1963 of the world's first ever offshore Eurobond (for the Italian motorways company Autostrade.) Though the deal was hammered together in the City of London, it was listed on the Luxembourg stock exchange: partly for tax reasons, and partly due to Luxembourg's regulatory laxity (for example, the bond issue did not even require a prospectus,). By the year's end there were already 93 bonds listed there (and four decades later, that figure had grown to about 20,000.)

Eurobonds were bearer bonds: classic tax evasion and secrecy instruments because no witholding tax was charged, and whoever physically held them in their hands was entitled to the income and capital. [Note: confusingly, the term 'Eurobond' has recently come to mean pan-European bonds jointly underwritten by all European governments; but for this report 'Eurobond' has its classical meaning: offshore, untaxed, lightly regulated bonds; part of the Euromarkets.] The Euromarkets got a large boost in 1965 when U.S. President Johnson, worried about Vietnam-era deficits, tried to restrain U.S. companies sending capital abroad to invest overseas: in response, U.S. corporate giants started seeking funding from the Euromarkets, including in Luxembourg.

Meanwhile, Luxembourg banks enjoyed a growing stream of individual customers from the neighbouring Germany, Belgium and France: they would present their bonds and attached coupons at local banks and be paid in cash, no questions asked. Beth Krall, a banker who worked in a Luxembourg bank's back office in the Eurodollar boom years, gave a flavour (p216) of those times:

> 'We were dealing with those "Belgian dentists" who keep bonds under the mattresses,' Krall remembers. 'Sometimes they all came in at once – what we called the coupon bus would arrive. They came from Belgium, Germany, the Netherlands, filling the lobby, spilling out the door, getting angry, waving their coupons and getting their cheques.' The vaults held, among other things, *enveloppes scellées* (sealed envelopes) relating to 'Henwees' – HNWIs or high net worth individuals. 'We didn't know what the hell was in there,' she said. 'The private bankers and relationship managers put those things in there – we never had an inkling.'

Clients increasingly came from further afield too: American banks, along with German and Swedish ones (and others) rapidly moved in. Parallel to the Eurobond markets, Luxembourg widened its spectrum of activities to private banking and investment funds in particular.

Luxembourg's regulatory laxity, tolerance for bearer bonds, secrecy and tax-free benefits has attracted significant criminality over the years. The global fraudster Bernie Cornfeld established his first mutual fund in Luxembourg in 1962. Later, the Bank of Credit and Commerce International (BCCI), widely regarded as the most corrupt bank in history, incorporated itself jointly in Luxembourg and Cayman, (with headquarters in London.) Each centre provided the tax-free status and required lack of scrutiny – allowing BCCI to get involved in the finance of terrorism, drugs smuggling, slavery, tax evasion, fraud, racketeering and much more. In March 2010, newspapers reported that Luxembourg hosted US$4 billion in assets for North Korean leader Kim Jong-Il, which had shifted there after Swiss banks tightened up procedures. As the Telegraph newspaper reported:

> "Mr Kim's operatives then withdrew the money - in cash, in order not to leave a paper trail - and transferred it to banks in Luxembourg. The money is the profits from impoverished North Korea selling its nuclear and missile technology, dealing in narcotics, insurance fraud, the use of forced labour in its vast gulag system, and the counterfeiting of foreign currency."

Luxembourg For Finance, the financial industry's lobbying arm, told TJN in an interview that the reports are entirely false. There are even questions about Luxembourg's role in the secret financing of U.S. political campaigns.

Luxembourg: Europe's "Death Star" of financial secrecy

The European Union has for some years been trying to boost financial transparency through its Savings Tax Directive, under which member states (and other participants) automatically share information with each other on certain types of cross-border income, or withhold tax. The Directive is full of holes, but these are being tackled. Nearly all EU members have agreed to the gold standard of automatic information exchange, but EU members Luxembourg and Austria have refused. A complex political dance has emerged with Switzerland and Luxembourg allied in efforts to hold up further EU progress on transparency: Switzerland says it will not yield on secrecy unless Luxembourg and others do; meanwhile Luxembourg has cited recent bilateral Swiss deals with the UK and Germany, which politically undermine the directive, as a reason for blocking further progress. Read more about this dance of the secrecy jurisdictions here.

Luxembourg premier Jean-Claude Juncker has publicly expressed his preference for European financial policies to be conducted only in 'secret, dark debates'. In discussions about progress in Europe on transparency, he has notably said, in a testament to Luxembourg's skillful use of delaying tactics to prevent transparency: "I look forward to many years of fascinating and fundamental discussions." Luxembourg has also lobbied hard to preserve its tax loopholes in the face of European efforts to close them down.

Mouldy political governance, repression of critics

Like many small secrecy jurisdictions, Luxembourg has poor political governance. The Luxembourg analyst Jérome Turquey describes "an insulated culture that systematically excludes any information that could contradict its reigning picture of reality," adding that "dishonest professionals fail to be pushed out of business, in large part because of Luxembourg's small size where 'everybody knows everyone else' – and this creates conflicts of interest."

Luxembourg has at times proven to be quite harsh when its financial sector is criticised. The media very rarely dares speak out against finance or financial secrecy, and numerous examples exist of the repression of alternative views. For example, in October 2008 Arlette Chabot, information director for French TV station France 2, had to write a craven apology to Luxembourg after airing a programme (which was admittedly rather short on specifics) critical of its financial secrecy. In July 2009, when a group of non-governmental organisations (NGOs), the Cercle de Coopération, published a report in July 2009 critical of Luxembourg's status as a secrecy jurisdiction, and pointing out a deep conflict with its foreign aid policies, the response was ferocious. Prime Minister Jean-Claude Juncker in a long speech lambasted it as a 'primitive study' and told the NGOs that they should refrain from criticising the financial sector; the Cercle was forced to withdraw the study within a week. (The Luxembourg Bankers' Association cited 'inaccuracies' in the report yet has so far failed to offer correct statistics when challanged to do so.) The German NGO WEED has made the study available here.

Perhaps the best known victim of Luxembourg's approach is Denis Robert, a French journalist whose 2001 book *Revelation$* about the Luxembourg-based clearing house Clearstream, alleging its role in facilitating money-laundering and flows of dirty money, led to him being subjected to almost sixty lawsuits in French, Belgian and Luxembourg courts. French courts in 2004 and 2008 ruled that he had failed to prove his allegations and that he should pay multiple damages; his French publisher estimated that the claims for damages exceeded its annual turnover. Important evidence that would have supported Robert's case was removed (and presumably destroyed) in Luxembourg police raids on the family homes and workplace of Regis Hempel, one of the key players in the affair.

Robert won a final victory in the French Court de Cassation in February 2011 which ruled that he was protected by freedom of speech and of the press. (When Robert, fresh from his victory, staged an art exhibition in a Luxembourg shop, the owner complained that passersby had spat at his window.) Later, in August 2011, the Wall St. Journal reported that a group of nearly 1,000 U.S. victims of terrorism were suing Clearstream for helping Iran move money connected to the 1983 bombing of a U.S. Marine Corps barracks in Beirut.

In a testament to Luxembourg's willingness to accommodate financial interests in whatever they want – a classic feature of any secrecy jurisdiction – the Luxembourg Bankers' Association (ABBL) boasts that one of Luxembourg's core strengths is "easy access to decision-makers; limited red tape." The authoritative Progressive Tax Blog added:

> "It is well known jibe within the industry that favourable low-tax deals with the Luxembourg tax authorities can be reached over dinner (Michelin starred of course.)"

While researching this report, a Luxembourg-based correspondent added these striking words:

> "One very important aspect of the Luxembourg financial centre is the absolutely scandalous discrepancy between the texts of the law, and their application in everyday judicial life. . . . while international pressure managed to force Luxembourg to adapt stricter legal constraints to the financial activities under its jurisdiction, looking into the lack of judicial application of said constraints becomes even more important.
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> . . .
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> Unlike in larger countries, there is no such thing as an independent representation of any civil interests in a tiny country like Luxembourg. You just don't make it in this country unless you've proven your absolute loyalty to the system in place, including being ok (if not more) with all of its malpractices."

Read more:

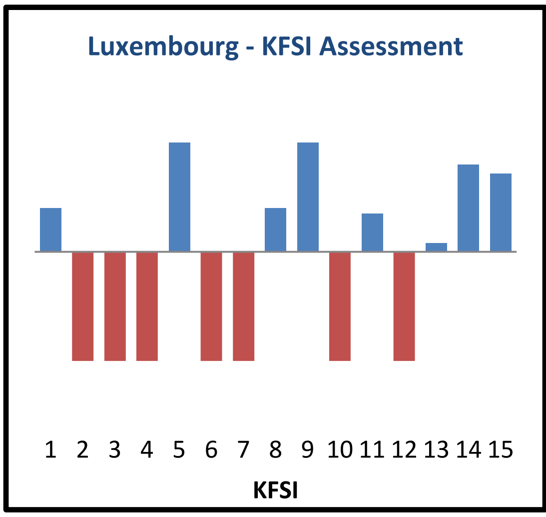
- This 2007 New York Times story, looking at Luxembourg's lobbying in defence of special tax privileges enjoyed by the likes of iTunes, Skype, eBay, AOL, Amazon and other big Internet companies, provides an example of its role (and to see a photo of itunes' massive European holding company, illustrating its 'letter box' nature, click here.)
- For a technical description of how Luxembourg is used to escape tax, see the Progressive Tax Blog's exploration of the UK's Vodafone case.
- *Fragen aus entwicklungspolitischer Sicht*, Cercle de Coopération a.s.b.l., July 23, 2009

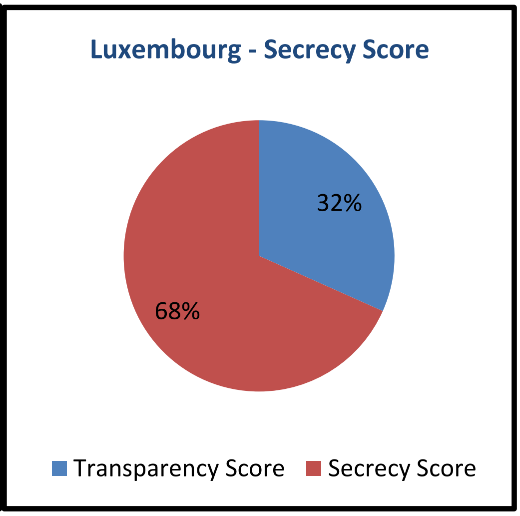
Next steps for Luxembourg

Luxembourg's 68 per cent secrecy score shows that it must still make major progress in offering satisfactory financial transparency[1]. If it wishes to play a full part in the modern financial community and to impede and deter illicit financial flows, including flows originating from tax evasion, aggressive tax avoidance practices, corrupt practices and criminal activities, it should take action on the points noted where it falls short of acceptable international standards. See part 2 below for details of Luxembourg's shortcomings on transparency. See this link http://www.secrecyjurisdictions.com/kfsi for an overview of how each of these shortcomings can be fixed.

Part 2: Secrecy Scores

The secrecy score of 68 per cent for Luxembourg has been computed by assessing the jurisdiction's performance on the 15 Key Financial Secrecy Indicators, listed below.





The numbers on the horizontal axis of the bar chart on the left refer to the Key Financial Secrecy Indicators (KFSI). The presence of a blue bar indicates a positive answer, as does blue text in the KFSI list below. The presence of a red bar indicates a negative answer, as does red text in the KFSI list. Where the jurisdiction's performance partly, but not fully complies with a Key Financial Secrecy Indicator, the text is coloured violet in the list below (combination of red and blue).

This paper draws on key data collected on Luxembourg. Our data sources include regulatory reports, legislation, regulation and news available at 31.12.2010[2]. The full data set is available here[3]. Our assessment is based on the 15 Key Financial Secrecy Indicators (KFSIs, below), reflecting the legal and financial arrangements of Luxembourg. Details of these indicators are noted in the following table and all background data can be found on the Mapping Financial Secrecy web site[4]. This data is the basis on which the Financial Secrecy Index[5] is compiled.

The Key Financial Secrecy Indicators and the performance of Luxembourg are:

TRANSPARENCY OF BENEFICIAL OWNERSHIP – LUXEMBOURG	
1.	Banking secrecy: Does the jurisdiction have banking secrecy? **Luxembourg does not adequately curtail banking secrecy**
2.	Trust and Foundations Register: Is there a public register of Trusts and Foundations?

	Luxembourg does not put details of trusts on public record
3.	Recorded Company Ownership: Does the relevant authority obtain and keep updated details of the beneficial ownership of companies? **Luxembourg does not maintain company ownership details in official records**
KEY ASPECTS OF CORPORATE TRANSPARENCY REGULATION – LUXEMBOURG	
4.	Public Company Ownership: Does the relevant authority make details of ownership of companies available on public record online for less than US$10? **Luxembourg does not require that ownership of companies is put on public record**
5.	Public Company Accounts: Does the relevant authority require that company accounts are made available for inspection by anyone for a fee of less than US$10? **Luxembourg does require that company accounts be available on public record**
6.	Country-by-Country Reporting: Are companies required to comply with country-by-country financial reporting?? **Luxembourg does not require country-by-country financial reporting by companies**
EFFICIENCY OF TAX AND FINANCIAL REGULATION – LUXEMBOURG	
7.	Fit for Information Exchange: Are resident paying agents required to report to the domestic tax administration information on payments to non-residents? **Luxembourg does not require resident paying agents to tell the domestic tax authorities about payments to non-residents**
8.	Efficiency of Tax Administration: Does the tax administration use taxpayer identifiers for analysing information effectively, and is there a large taxpayer unit? **Luxembourg partly uses appropriate tools for effectively analysing tax related information**
9.	Avoids Promoting Tax Evasion: Does the jurisdiction grant unilateral tax credits for foreign tax payments? **Luxembourg avoids promoting tax evasion via a tax credit system**
10.	Harmful Legal Vehicles: Does the jurisdiction allow cell companies and trusts with flee clauses? **Luxembourg does allow harmful legal vehicles**

INTERNATIONAL STANDARDS AND COOPERATION – LUXEMBOURG	
11.	Anti-Money Laundering: Does the jurisdiction comply with the FATF recommendations? **Luxembourg partly complies with international anti-money laundering standards**
12.	Automatic Information Exchange: Does the jurisdiction participate fully in Automatic Information Exchange such as the European Savings Tax Directive? **Luxembourg does not participate fully in Automatic Information Exchange**
13.	Bilateral Treaties: Does the jurisdiction have at least 60 bilateral treaties providing for broad information exchange, covering all tax matters, or is it part of the European Council/OECD convention? **As of June 30, 2010, Luxembourg had few tax information sharing agreements complying with basic OECD requirements**
14.	International Transparency Commitments: Has the jurisdiction ratified the five most relevant international treaties relating to financial transparency? **Luxembourg has partly ratified relevant international treaties relating to financial transparency**
15.	International Judicial Cooperation: Does the jurisdiction cooperate with other states on money laundering and other criminal issues? **Luxembourg partly cooperates with other states on money laundering and other criminal issues**

[1] Our definition of financial transparency can be found here: http://www.secrecyjurisdictions.com/PDF/FinancialTransparency.pdf.

[2] With the exception of KFSI 13 for which the cut-off date is 30.6.2010. For more details, look at the endnote number 2 in the corresponding KFSI-paper here: http://www.secrecyjurisdictions.com/PDF/13-Bilateral-Treaties.pdf.

[3] That data is available here: http://www.secrecyjurisdictions.com/sj_database/menu.xml.

[4] http://www.secrecyjurisdictions.com.

[5] http://www.financialsecrecyindex.com/.