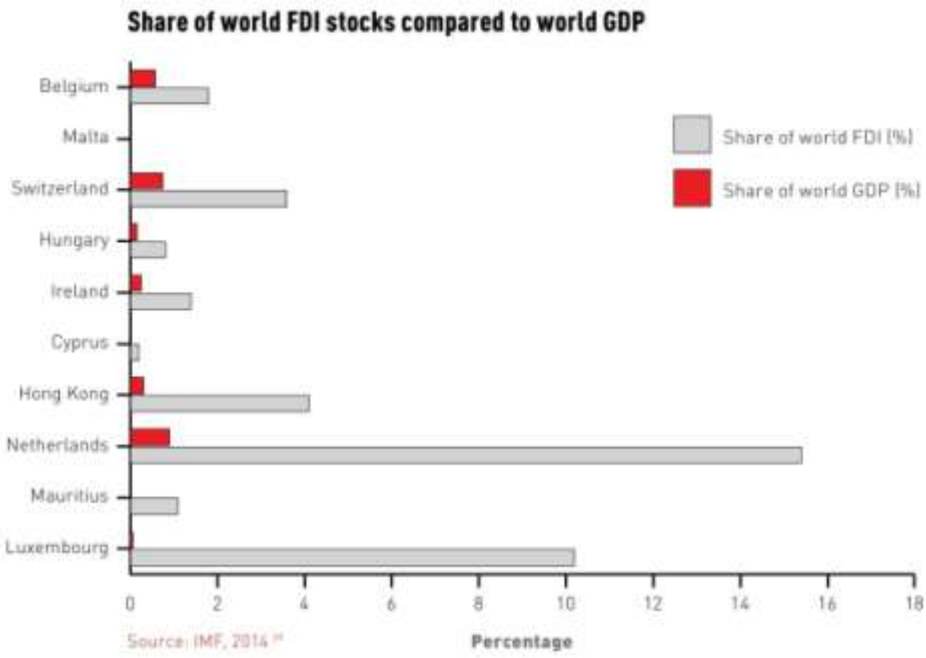
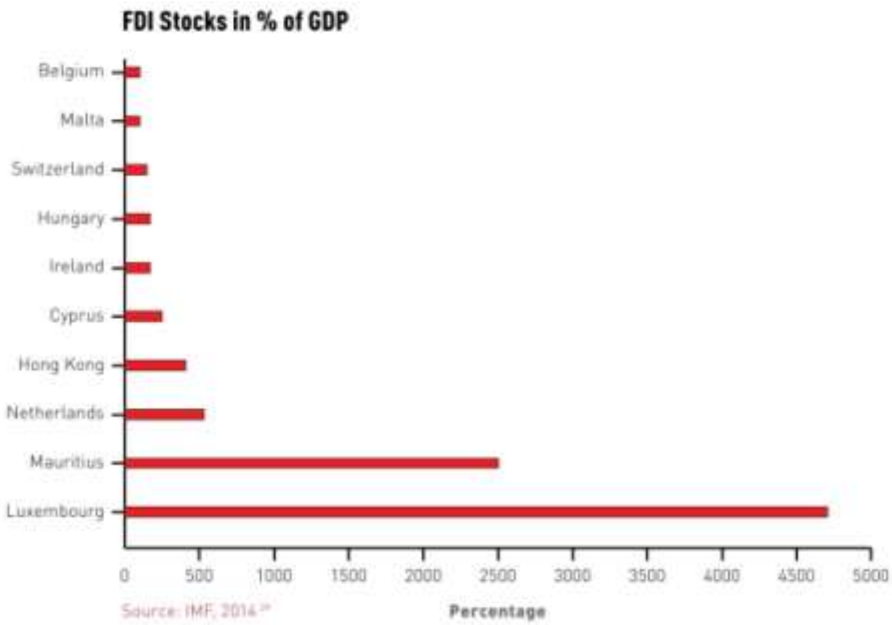
BRIEFING ON LUXEMBOURG FOR THE TAXE DELEGATION

The Luxembourg tax system as seen through three graphs

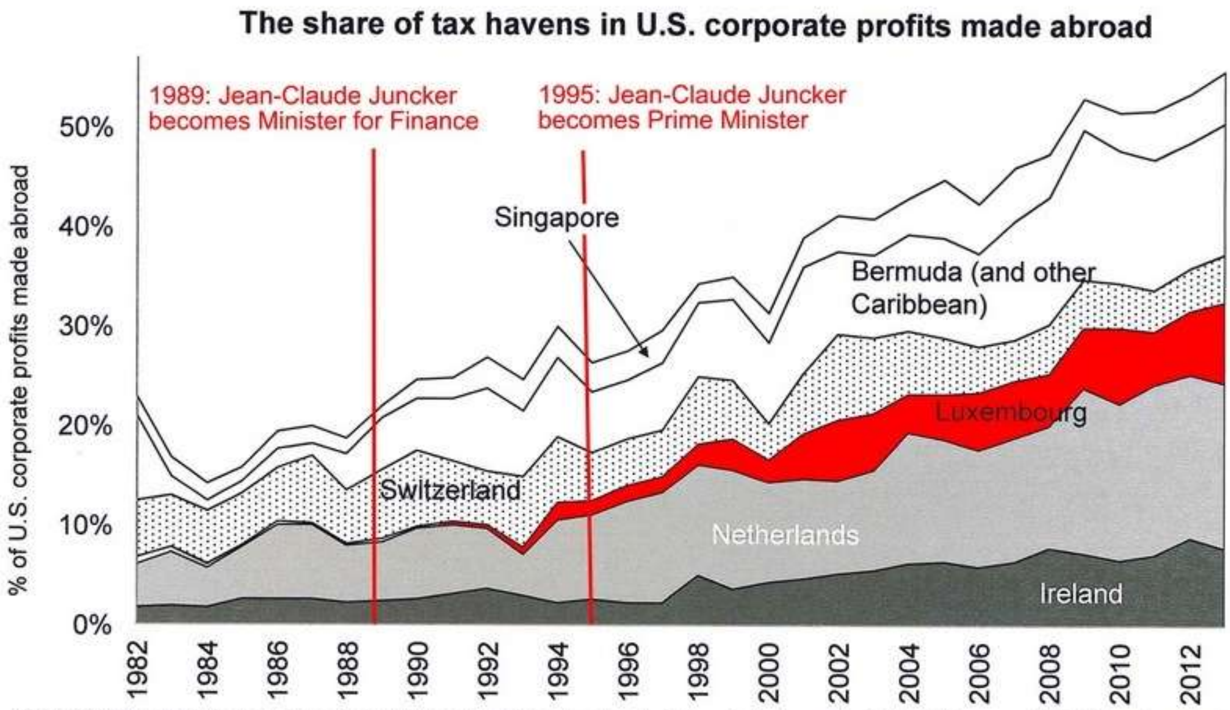
The two below figures show that Luxembourg accounts for more than 10 percent of global FDI stocks, corresponding to more than 4500 times Luxembourg's annual GDP.





This demonstrates one of the major characteristics of the Luxembourg economy – its famous 'letterbox' holding companies and their use to route investment. According to OECD figures, around 95 percent of all Luxembourg FDI stock is handled by holding companies (so-called Special Purpose Entities SPEs).[i] These holding companies are only subject to an annual subscription tax of between 0.01-0.05 per cent of the company's assets. If dividends are paid from the holding company to foreign investors, it is exempt from withholding tax, and there is no tax on interest or capital gains.[ii] The motive for routing FDI through Luxembourg is largely tax driven.

The third graph below shows the share of profits that US corporations book in various jurisdictions. It shows that Luxembourg's rise as a preferred tax jurisdiction for multinational companies is closely aligned with Juncker's leadership first as Minister for Finance and later as Prime Minister[iii]:



Notes: This figure charts the share of income on U.S. direct investment abroad made in the main tax havens. In 2013, total income on U.S.DI abroad was about $500bn. 17% came from the Netherlands, 8% from Luxembourg, etc. Source: author's computations using balance of payments data, see Online Appendix.

Apart from MNCs booking profits there and using the country as a conduit for routing FDI, the country is also used by individuals to store their wealth in a low-tax environment. The authorities in Luxembourg estimate that USD 370 bn. is held by foreign households in Luxembourg (compared to the Duchy's GDP which stands at USD 35 bn.).[iv]

Questions to ask stakeholders in Luxembourg:

- It seems that Luxembourg effectively operates two tax systems. One for SMEs which are taxed at a high rate and a ring-fenced tax system for foreign investors who get away with hardly paying any tax. How do you see the distributional fairness of the Luxembourg tax system?
- To what extend can Juncker be said to be the architect of the Luxembourg economic model?

VAT MOSS REFORM: A SIGN OF LUXEMBOURG HYPOCRISY?

From January 2015 the EU changed the basis on which e-books and other e-commerce is taxed. Previously, these products were subject to VAT in the residence state (where the supplier was incorporated) but with the new changes VAT will be applied at the point of sale instead. Luxembourg has previously benefited tremendously from the residence taxation as it applied the lowest VAT rate in the world on e-commerce at 3 percent. Because of this low rate, Luxembourg had managed to attract most of the big e-commerce companies - including Amazon – who used Luxembourg as a hub to sell to the European market. It is estimated that the changed VAT rules will result in an annual tax revenue loss for Luxembourg of about 700 million Euros (1.5 percent of GDP).[v]

Although little official confirmation exists from the EU or the Luxembourg government it has been widely discussed on various blogs and tax news sites that Luxembourg negotiated a deal whereby the EU member states will have to compensate Luxembourg for its tax revenue loss by paying out 1.1bn Euro to Luxembourg over a four year period.[vi] The deal was apparently reached in December 2014 shortly after Juncker assumed the EC Presidency. The compensation was supposedly necessary for Luxembourg to agree to the changes to the VAT rules at EU level. This story raises a number of issues.

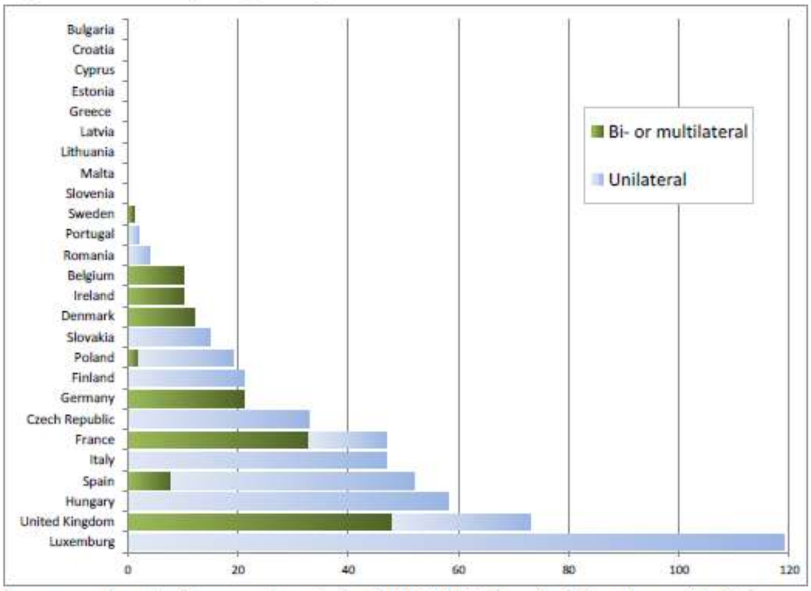
Questions to ask stakeholders in Luxembourg:

- Could you confirm that a deal exists where Luxembourg will be compensated by EU member states for its VAT revenue loss as a result of the changes in EU rules on e-commerce?
- If such a deal exists: The compensation paid out to Luxembourg seems to indicate that the government of Luxembourg on the one hand expects the European taxpayers to compensate it when tax rules that are unfavorable to its tax base are passed, while on the other hand systematically denying any responsibility for its own tax rules' eroding effect on the tax bases of all other European Member States. Would you characterise such a stance as fair and reasonable to the citizens of the EU?

LUXEMBOURG'S TAX RULING SYSTEM

According to statistics from the European Commission's Joint Transfer Pricing Forum (JTPF) expert group Luxembourg is by far the most active jurisdiction in the EU in terms of issuing tax rulings. The graph below illustrates this, even though it only shows a selected type of tax rulings (Advanced Pricing Agreements)[vii]:

Figure 2: Advance pricing arrangements at the end of 2013



Source: Based on European Commission 2014, EU Joint Transfer Pricing Forum, "Statistics on APAs at the end of 2013", JTPF/007/2014/EN

Annotation: Date from Austria and Netherlands inconclusive, thus omitted from this figure

Reportedly, Luxembourg's office for tax rulings had a staff size of less than 10 people. ICIJ has reported that the department responsible for tax rulings in Luxembourg could approve as many as 39 tax rulings in one day.[viii] Despite being the most active member state on tax rulings it is noteworthy that until December 2014 Luxembourg has not had a legal framework for its tax rulings. The Luxembourg government often explains its success in attracting investors as based on a stable regulatory environment and strong rule of law. The fact that hundreds, perhaps thousands of tax rulings have been issued in Luxembourg without any firm legal basis and with little oversight seems to suggest that this cannot be the explanation.

Questions to ask stakeholders in Luxembourg:

- Given the low number of staff and many rulings being issued, what steps did the authorities in Luxembourg take to ensure that the Advance Pricing Agreements were based on the arm's length principle[1]?
- Most country that make use of Advance Pricing Agreements have done so through bi- or multilateral agreements. Luxembourg seems to have solely relied on unilateral rulings[2]. Why is that?

---

[1] This is the principle that any intra-group trade has to be priced as if it was happening between unrelated entitites, e.g. at market costs. A breach of this principle is what can make the tax rulings be considered a form of state aid.

[2] In bi- or multilateral rulings the countries that are affected by the rulings are involved/informed about the ruling. In unilateral rulings only the country that grants the ruling is involved. See the above graph on APAs for the distinction.

Luxembourg at the helm of the EU

On July 1 Luxembourg takes over the EU Council presidency. In this period a number of important tax questions are expected to be discussed and negotiated on. The visit could be used to put pressure on Luxembourg ahead of their presidency. These questions are primarily meant for the session with the Minister of Finance.

Questions:

- During the Luxembourg presidency the Commission it is likely that the question of public country by country reporting will become a major topic. First through the Shareholders Rights Directive which the European Parliament is voting on in June, and second through the European Commission´s impact assessment on public country by country reporting which is expected to be published towards the end of the year. Should the Parliament and Commission support public country by country reporting can we trust the Government of Luxembourg to be an ally of more tax transparency as head of the Council?
- While Luxembourg assumes the EU Presidency in July the cases brought against the LuxLeaks whistleblower and a journalist are likely to be initiated. We feel that Luxembourg cannot represent the EU with any legitimacy while persecuting people who have exposed these activities. Do you feel that Luxembourg can legitimately represent the EU while insisting on charging these individuals?

One thing to add:

I am sure that your delegation will be told time and time again that Luxembourg has changed their way and that they are now a much more "clean" financial centre based on agreed international standards etc. Note that this is to some degree true. Luxembourg has done much to comply with FATF and OECD guidelines on money laundering and exchange of tax information, and have agreed to automatic exchange of information. But that is only one part of the story. While this has been ongoing Luxembourg has established a Freeport and new trust legislation which are both useful tax planning structures. And the reforms of recent years have not altered the holding company regime which is so vital to Luxembourg's position as a leading tax planning jurisdiction. In short, while Luxembourg is reforming to get rid of the most egregious practices that would attract dirty money and outright tax evasion, it has not initiated a similar reform process to change the regulation that make it attractive for tax planning purposes and has instead enacted new measures that expand the tax planning opportunities. So when you hear that they have changed, please do confront them with the Freeport, the trust legislation and the holding companies etc..

---

[i] http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_luxembourg_en.pdf, p.15

[ii] Global Forum on Transparency and Exchange of Information for Tax Purposes. (2013). Peer Review Report Phase 2 – Implementation of the Standard in Practice: Luxembourg, OECD, p31-32

[iii] The source of the graph is Zucman (2014), p.128: gabriel-zucman.eu/files/Zucman2014JEP.pdf, the additions of Juncker's "reign" are from TJN: http://www.taxjustice.net/2015/01/30/jean-claude-juncker-tax-haven-luxembourg-picture/

[iv] Zucman (2014), p.139: gabriel-zucman.eu/files/Zucman2014JEP.pdf

[v] http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_luxembourg_en.pdf, p.15

[vi] See for example: http://www.vatlive.com/european-news/luxembourg-wins-e1-1bn-eu-states-vat-moss-compensation/, http://www.tax-news.com/news/Luxembourg_To_Be_Compensated_For_EU_VAT_Change____66746.html,

[vii] EC (2015), p.35: https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&cad=rja&uact=8&ved=0CCwQFjAC&url=http%3A%2F%2Fwww.ipex.eu%2FIPEXL-WEB%2Fdossier%2Ffiles%2Fdownload%2F082dbcc54c2f5559014c318ced4d01f3.do&ei=C2RXVbmKN6ndywPW64GQBw&usg=AFQjCNFDb4gJmrL2TjDEZWoZ9rBaihYqUA&bvm=bv.93564037,d.bGg

[viii] http://www.icij.org/project/luxembourg-leaks/leaked-documents-expose-global-companies-secret-tax-deals-luxembourg