The “OpenLux revelations”: Who is to be blamed?

Katerina Pantazatou[*]

1. Introduction

In February 2021 the prestigious French journal, “Le Monde”, published the results of an investigation conducted by it and other media into Luxembourg’s beneficial ownership register.[1] This inquiry revealed, *inter alia*, that more than half of the companies registered in Luxembourg had not declared their beneficial owners on the public register, while others had given contradictory information. Furthermore, it found out that approximately 90% of the companies in the register were owned by non-residents in Luxembourg and that approximately 33% of these companies were participation or holding companies that were used by very wealthy individuals to structure their assets and investments through these companies in Luxembourg, in order to benefit from a favourable tax regime. The revelations were given the name “OpenLux” and preceded the much larger in scale revelations named ‘Pandora Papers’ that disclosed the hidden wealth of very wealthy persons offshore.[2]

The allegations against Luxembourg in OpenLux, revolve, in brief, around two main points; 1) that Luxembourg facilitates money laundering and 2) that Luxembourg facilitates or encourages tax evasion, this is why it is a ‘de facto’ tax haven.[3] The two points are interrelated in that tax and financial authorities are keen to know the provenance and the destination of the funds in order to combat financial crime, to tax them respectively and to curtail tax avoidance. They are also distinct in terms of the applicable (EU) legislation and framework; the first point relates much more to questions of financial crime and money laundering, while the latter one pertains to tax

[*] Associate Professor in Tax law, University of Luxembourg. The author can be contacted at Aikaterini.pantazatou@Uni.lu. This contribution is loosely based on a statement the author gave to the European Parliament’s Committee on Tax Matters (FISC) in relation to “OpenLux”.

[1] Le Monde, « Enquête sur le Luxembourg, coffre-fort de l’Europe » (8 February 2021), available at : https://www.lemonde.fr/les-decodeurs/visuel/2021/02/08/openlux-enquete-sur-le-luxembourg-coffre-fort-de-l-europe_6069132_4355770.html (last accessed on 5 January 2022).

[2] International Consortium of Investigative Journalists (ICIJ), “Pandora Papers: Offshore havens and hidden riches of world leaders and billionaires exposed in unprecedented leak”, (3 October 2021), available at: https://www.icij.org/investigations/pandora-papers/global-investigation-tax-havens-offshore/.

[3] This is not the first time Luxembourg makes headlines as a “*de facto*” tax haven or a “tax haven by administrative practices”. Indicatively after the “LuxLeaks” revelations in November 2014, Luxembourg was once again caught in the eye of the storm for its tax practices. However, following this scandal, Luxembourg amended its legislation with regard to tax transparency. As a result, it was rated, in 2019, as “largely compliant” with the international standard of transparency and exchange of information on request by the OECD Global Forum Peer Review Group on transparency and exchange of information for tax purposes.

law. In the following section, I will attempt to address and deconstruct the aforementioned allegations, with emphasis on the tax law aspects.

2. Beneficial ownership registers in the EU and Luxembourg: Background

The fourth Anti-Money Laundering directive (4th AMLD) required all Member States to establish beneficial ownership registers by June 2017.[4] The directive was followed by the 5th AMLD[5] according to which, Member States should ensure that the information on the beneficial ownership is accessible in all cases to: (a) competent authorities and Financial Intelligence Units (FIUs), without any restriction; (b) obliged entities, within the framework of customer due diligence; and (c) any member of the general public.[6] Prior to the 5th AMLD, directive 2016/2258 ('DAC 5') provided that tax authorities should have access to beneficial ownership information collected pursuant to the anti-money laundering legislation.[7] Luxembourg implemented the 4th AMLD with the Law of 13 January 2019,[8] with effect from 1 March 2019. It implemented the 5th AMLD one year later.[9]

According to the AML EU legal framework, the responsibility for entering and updating the information in the beneficial ownership registers lies with the reporting/registered entities. Luxembourg has introduced criminal sanctions ranging between EUR 1,250 and EUR 1,250,000, in case of failure by the registered entity to provide the necessary, accurate and up to date information within the necessary time limits. As in all Member States, Luxembourg has in place not only sanctions in case of non-compliance, but also appropriate 'watchdogs' to ensure the correct application and enforcement of the law. These watchdogs include the public prosecutor's office, the "Commission de surveillance du secteur financier" (CSSF), the "Cellule de renseignement financier" (CRF) and the police. However, the main responsibility of tipping off

[4] Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC, OJ L 141, 5.6.2015, p. 73-117.

[5] Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU, OJ L 156, 19.6.2018, p. 43-74. Note that for trusts the applicable deadline was 10 March 2020.

[6] The general public should be permitted to access at least the name, the month and year of birth and the country of residence and nationality of the beneficial owner as well as the nature and extent of the beneficial interest held. Member States, according to the directive, may introduce a small fee for access to this information.

[7] Council Directive (EU) 2016/2258 of 6 December 2016 amending Directive 2011/16/EU as regards access to anti-money-laundering information by tax authorities, OJ L 342, 16.12.2016, p. 1-3

[8] Loi du 13 janvier 2019 instituant un Registre des bénéficiaires effectifs et portant 1° transposition des dispositions de l'article 30 de la directive (UE) 2015/849 du Parlement européen et du Conseil du 20 mai 2015 relative à la prévention de l'utilisation du système financier aux fins du blanchiment de capitaux ou du financement du terrorisme […], *Mém. A* n° 15 de 2019.

[9] Loi du 25 mars 2020 portant modification de : 1° la loi modifiée du 12 novembre 2004 relative à la lutte contre le blanchiment et contre le financement du terrorisme ;[…], *Mém. A* n° 194 de 2020.

the authorities, lies with the professionals. According to the Luxembourg government, at the end of 2020, the completeness rate of the register was around 90%.[10]

3. Complementary EU anti-tax avoidance and anti-abuse framework in Luxembourg

Complementary to the aforementioned EU legal framework is "DAC 6", according to which, intermediaries that design or set up cross-border arrangements that could be considered as potentially aggressive tax planning schemes, have to report to the tax authorities reportable cross border arrangements that fall under one of the hallmarks provided in the directive.[11] Under hallmark D, arrangements which may have the effect of undermining the reporting obligations enshrined in EU law or other international agreements and arrangements involving a non-transparent legal or beneficial ownership chain with the use of persons, legal arrangements or structures: (a) that do not carry on a substantive economic activity supported by adequate staff, equipment, assets and premises; and (b) that are incorporated, managed, resident, controlled or established in any jurisdiction other than the jurisdiction of residence of one or more of the beneficial owners of the assets held by such persons, legal arrangements or structures; and (c) where the beneficial owners of such persons are made unidentifiable must be disclosed to the relevant tax authorities. In case of failure to do so, the penalty may amount up to EUR 250,000.[12]

As it becomes apparent the multiple secondary EU law instruments described above are complementary to each other towards two main goals; "chasing" illegal money and ensuring that tax avoidance and tax evasion are minimized. Having established that Luxembourg has implemented this legal framework, one has to examine whether Luxembourg has been in breach of any of the aforementioned directives, pursuant to the OpenLux allegations. The European Commission has not opened any infringement proceedings with regard to either of these directives, thus, one can only conclude that Luxembourg has implemented them, at least in theory, correctly. However, as already stated, the allegations vary from a poor or lack of enforcement of the directive, evinced by the fact, according to OpenLux, that in February 2021, one year after the creation of the beneficial ownership register, only half of Luxembourg companies had declared at least one ultimate beneficial owner, while only one fifth of investment funds based there had done so.[13]

If both these statements hold true, then Luxembourg encounters an enforcement problem. The OpenLux investigation suggests that no sanctions are imposed by Luxembourg, facilitating, thus, non-compliance with the law requirements. According to the prosecutor's office, 18,966 non-

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[10] https://gouvernement.lu/dam-assets/fr/dossiers/openlux/doc-faq-ajour/Openlux-FAQ-UBO-EN.pdf

[11] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, OJ L 139, 5.6.2018, p. 1-13

[12] Luxembourg has implemented "DAC 6" with the Loi du 25 mars 2020, *supra*, n. 9.

[13] https://www.occrp.org/en/openlux/shedding-light-on-big-secrets-in-tiny-luxembourg. Note that the government of Luxembourg had contested these findings.

compliant entities were reported to the State Attorney by January 2020; while the office received a further 1,325 between February and end of November 2020 and 293 between January and March 2021.[14] Currently a draft bill is being discussed in Luxembourg, that would allow the register to impose fines autonomously to non-compliant entities,[15] as opposed to the current situation where such sanctions are imposed by the courts. With respect to the fines imposed by courts, very little jurisprudence exists and therein, the imposable criminal penalties can be characterized as "low" For instance, the competent Luxembourg court imposed to a reportable entity a EUR 2,500 penalty for failure to report information on the beneficial owners within the given deadlines.[16] At the same time, the CSSF has highlighted different ways to improve controls designed to curb money laundering and the financing of terrorism, including applying a risk-based approach and name screening on targeted financial sanctions.[17]

However, besides the enforcement issues that may ensue and are currently being addressed at local level, two other issues, not Luxembourg-specific, could have contributed to limiting the effectiveness of the directives. The first one pertains to the concept of beneficial ownership itself which is far from clear. Different countries, different institutions and international organizations opt for different understandings of the concept; varying from a purely legal approach, to an economic approach as well as a hybrid approach.[18] The concept was clarified by the CJEU in the Danish beneficial ownership cases[19] where the CJEU drew inspiration from the OECD MC in defining the beneficial ownership concept in the context of the Interest and Royalty Directive (IRD). The understandings of the concept at these two levels (EU and OECD) are not identical but they have converged, especially in what concerns, *inter alia*, the broad interpretation of the term and its interpretation following an economic approach.[20] However, the remaining variations, in turn, mean that the concept may be different in a tax treaty context and an EU law/ secondary EU tax law context. Even more so, two beneficial ownership concepts may even co-exist within the same EU Member State, one for intra-EU situations (where the IRD would apply) and one for other cases. The first point, thus, to be made is that while it is possible that the absence of a clear definition of beneficial ownership and its different interpretations, depending on the legal and factual context, may have been used as a scapegoat to deliberately conceal the identities of the

[14] Delano, New powers to enforce beneficial owners register (15 March 2021), available at: https://delano.lu/article/delano_new-powers-enforce-beneficial-owners-register

[15] Draft bill no 7785.

[16] Jugement du Tribunal d'Arrondissement du 16 juillet 2020, n° 328/2020.

[17] https://mfin.gouvernement.lu/en/dossiers/2018/sanctions-financiaires-internationales.html

[18] For a critical analysis of the different approaches in the past, see A. M. Jiménez, "Beneficial Ownership: Current Trends", *World Tax Journal*, 2010, pp. 35-63.

[19] CJEU, Judgment of 26 February 2019, Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16, N Luxembourg I, X Denmark, C Danmark I and Z Denmark v. Skatteministeriet, ECLI:EU: C:2019:134; CJEU, Judgment of 26 February 2019, Joined Cases C-116/16 and C-117/17, Skatteministeriet v. T Danmark and Y Denmark, ECLI:EU:C:2019:135.

[20] For an analysis see C. Hamra and J. J.A.M. Korving, "Beneficial Ownership Interpreted, To What Extent Are the OECD and the EU on the Same Wavelength?", *49 Intertax*, 2021, pp. 254-277. Note, however, that the Court's approach that suggests that the beneficial owner of a payment is the one who benefits from an economic perspective from it, deviates from the OECD definition and the Unconnected Obligations and the De Facto On payments carve-outs.

ultimate beneficial owners, it may have also genuinely contributed to the observed poor outcomes in the implementation of the EU legal framework.

4. 'Ghost' companies and substance

The second revelation in the context of OpenLux suggests that approximately 1/3 of the registered entities are merely holding companies, alleging that those companies are often "ghost companies" with no substance in Luxembourg. The answer to this allegation presupposes an answer to other fundamental questions, notably, what is substance, whether it is needed and if so, what means are there in place to ensure that those entities meet the substance requirement.

Luxembourg, indeed, offers an attractive regime for holding companies. It is important to note from the outset that the Luxembourg Income tax code provides that entities that *either* have their *registered office or* their central administration in Luxembourg are subject to corporate income tax on their profits in Luxembourg.[21] The possible use of the place of incorporation to define tax residence, obviously, favours the creation of letterbox companies. Furthermore, Luxembourg has a very broad tax treaty network and it applies – under conditions – the participation exemption regime. Despite, however, this favourable regime, Luxembourg has certain safeguards in place – many of those dictated by recent global and EU developments, to ensure that tax avoidance strategies are minimized. In this context, it is bound by the beneficial ownership clause that exists in its tax treaties and the EU tax directive in respect of passive income, (2) it has amended its domestic general and specific anti-avoidance rules in agreement with the ATAD, including introducing CFC rules.[22] Indicatively, the "new" GAAR in Luxembourg law targets all non-genuine transactions to the extent that they are not put in place for valid commercial reasons that reflect economic reality that is performed in a domestic or a cross-border situation. Furthermore, Luxembourg has opted to apply the principal purpose test ("PPT") to all its Covered Tax Agreements by the Multilateral Instrument ("MLI") and it has amended its legislation to comply with all Commission's recommendations to disallow the deductibility of interest and royalties payable to related corporate entities in EU's list of non-cooperative jurisdictions for tax purposes. In light of the above, it is doubtful how a holding company that merely acts as a conduit company could escape these rules.

When the OpenLux revelations argue that Luxembourg has in place "ghost" companies that allow its owners to benefit from a "favourable tax regime", essentially, they criticize the lack of substance of these holding companies. Luxembourg, as many other states, traditionally convincingly rebuts this argument by stating that these holding companies do not require significant physical presence. The "substance requirement" is another requirement to curb abusive practices, yet it is difficult to be defined. Substance figures in different contexts, from substance in transactions to physical and economic substance expressed also via the substance

[21] Article 159 of the Income Tax Law (« loi concernant l'impôt sur le revenu »).

[22] See also A. SILVESTRI, "Holding Companies in the BEPS Era", *Intertax,* 2017, pp. 482-488, 482.

over form doctrine, which allows the tax authorities to ignore the legal form of an arrangement and to look to its actual substance in order to prevent artificial structures form being used for tax avoidance purposes. In the famous Danish beneficial ownership cases, the "lack of economic substance" was considered by the CJEU as one of the indicia that national courts must take into account in assessing whether a transaction is abusive.[23] In this context, one could reasonably argue that in light of the continuously increasing anti-avoidance legal framework, both at EU level and at international level, substance becomes of less significance, in particular because it does not constitute a sufficient factor to prove anti abuse practices.[24]

5. The ATAD 3 proposal

Despite the numerous possibilities offered by EU secondary legislation and the CJEU to counter abusive practices, the European Commission published very recently its ATAD 3 (or "Unshell") proposal that aims to counter the abusive use of shell companies[25]. As explained in the draft proposal, "legal entities with no minimal substance and economic activity continue to pose a risk of being used for improper tax purposes, such as tax evasion and avoidance, as confirmed by recent massive media revelations."[26] OpenLux and the Pandora papers, as explained by the Commission, made, thus, the concept of substance (again) central in the EU fight against tax avoidance and evasion. However, as revealed by the stakeholder consultations, respondents consisting mostly of business and professional associations, noted that "defining what is a shell entity is challenging and that assessing lack of substance depends on the facts and circumstances of each specific entity."[27] By acknowledging thus, that substance is a matter of facts and circumstances, the Commission decided to include *indicators* of minimum substance for undertakings in Member States and rules regarding the treatment for tax purposes of those undertakings that do not meet these indicators.[28]

The ATAD 3 is significant in relation to the OpenLux revelations for two reasons: First, because it acknowledges the existence of shell companies with no substance as a fundamental problem in the EU. In this sense, it indirectly recognizes that the existing extended EU anti-abuse legal framework (the EU secondary law framework exemplified not only by the ATAD and the DACs but also, for instance, the Parent-Subsidiary Directive and the IRD) and the case law of the CJEU, do not suffice to tackle the abusive practices shell companies may engage in, making this a pan-European or universal problem. Second, it becomes clear that substance is a concept difficult to be defined, hence, the directive proposes instead of a definition a series of indicators that would

[23] See N. Luxembourg I et al., *supra* n. 19, paras. 124-133 and T. Danmark et al., *supra* n. 19, paras. 97-114.
[24] See also A. Silvestri, *supra*, n. 22, at 484.
[25] European Commission, Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU, COM(2021) 565 final (22.12.2021).
[26] *Ibid*, at 1.
[27] *Ibid*, at. 5.
[28] *Ibid*, Article 1.

ensure minimum substance. As with beneficial ownership, the more difficult it is for a concept to be defined, the easier it is to be circumvented.

6. Conclusion

This contribution aimed to show that Luxembourg has fully implemented the EU legal framework and it has also complied with the BEPS standards in its tax treaty framework. As the OpenLux revelations allege, this does not necessarily mean that potential abusive practices are completely eradicated. Their persistence, as explained, may be due to an enforcement problem, like the non-application of existing sanctions or the absence of (sufficient and/or efficient) watchdogs.

Even if Luxembourg suffers from an enforcement problem, this article has exposed that another reason for the aforementioned situation could be a definitional problem. Fundamental concepts in the questions that have arisen in the context of OpenLux, like substance and beneficial ownership, remain hard to be defined and accordingly, easy to be circumvented. Related to this is the inadequacy – according to the ATAD 3 proposal - of the EU legal framework, as it currently stands, to address (possible) tax avoidance practices, like the establishment of holding companies that exist only to carry out artificial transactions. On the occasion of OpenLux, the first step to address this problem is the very recent "Unshell" proposal by the European Commission.

Finally, the OpenLux investigations suggest that by facilitating tax avoidance (often, mixed up with tax evasion), Luxembourg is a motor in depriving revenue from other countries and, therefore, it is a tax haven. With regard to this point, I would like to focus on the transparency and exchange of information aspects of Luxembourg, two very important key factors in the definition of tax havens.[29] Luxembourg, as it is obliged, has implemented all Directives on exchange of information, the famous DACs.[30] It has, however, gone well beyond this minimum through its domestic courts that seek the CJEU's guidance on issues like the limits of data protection, taxpayers' rights, tax transparency and the concept of foreseeable relevance, as this is provided in DAC 1. It is believed that if Luxembourg were to promote tax secrecy, it would not have been the most active Member State in sending tax transparency related references for preliminary rulings to the CJEU.

[29] OECD Report, "Harmful Tax Competition: An Emerging Global Issue" (1998), where the OECD set out a number of factors for identifying tax havens. The four key factors were: 1) No or nominal tax on the relevant income; 2) Lack of effective exchange of information; 3) Lack of transparency; 4) No substantial activities.

[30] Luxembourg has implemented all DACs whose implementation deadline is now over. That includes DAC 1 – DAC 6.