CHAPTER 8

Whistleblowing on Luxembourg's Tax Practices

Antoine Deltour
Lux Leaks whistleblower

The Lux Leaks case is the name given by the International Consortium of Investigative Journalism (ICIJ) to the revelation, by dozens of media outlets around the world, of tax agreements, implemented by Luxembourg, with major audit firms on behalf of their clients. This case brought to light the extent of aggressive tax optimization at the heart of the European Union. Its media coverage has resulted in strong public outcry and therefore political pressure. The scandal has thus had several repercussions on legal and regulatory frameworks, in particular by speeding up the tax reform agenda in Europe. The case also resulted in legal proceedings in Luxembourg against the two whistleblowers and the journalist who initiated the revelations.

In this article, I will tell the story of this case by showing on the one hand how it questions the opacity of the tax practices of multinationals, and on the other hand by analyzing the conditions for citizens' access to information, which is absolutely necessary for the exercise of democratic control.

The Lux Leaks affair can be understood as a narrow problem, that of the issue, at a given time and by the Luxembourg tax administration, of advance tax agreements (or tax rulings) that are a little too permissive

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and a little too opaque. The case would boil down to the narrative of an administrative practice that has gradually developed under pressure from tax advisors, and with the complicity of policymakers. I will, of course, explain the problems posed by these tax agreements. However, it must be borne in mind that this Luxembourg system is only one illustration, among others, of what can be achieved in an international context that is unfortunately still relevant today.

In a globalized economy, each territory competes with others to attract investment. This competition also includes taxation, since each nation is sovereign in this matter. This leads to a race to the bottom in the name of fiscal attractiveness, and the Luxembourg "tax rulings" are only one manifestation of this. This context benefits mobile taxpayers, multinationals and high net worth individuals to the detriment of others, small businesses and the middle class. In addition to this blatant injustice, the limited capacity of the latter to take on additional burdens also leads to a de facto limitation of the possible scope of public policies.

This contextual reminder being made, we can return in more detail to the practice of tax rulings. This practice has a certain legitimacy because it gives the applicant company legal certainty as to how its often complex operations will be taxed in the future. The administration merely makes an agreement: "Yes, according to the way you present your transactions, we believe that you correctly interpret the tax legislation in force". To this end, each tax ruling contains very rich and highly confidential information: it presents in detail all the tax optimization mechanisms used by the company. The problem with this arises when the interpretation of the regulatory framework results in a virtual absence of taxation, which is very common in Luxembourg. As an auditor, I worked for a client with an effective tax rate of about 3%. And journalists who surveyed the other documents calculated an effective rate of 0.0156 per cent, or zero.

Another problematic aspect of such rulings is the quasi-industrial scale of this practice. Luxembourg granted several dozen tax rulings per day, all validated by a single civil servant. Most multinationals operating in Europe therefore have a Luxembourg tax ruling. A company that agrees to pay 33% of its income taxes would be at a significant disadvantage compared to competitors who pay virtually nothing by exploiting all the regulatory loopholes. In addition, a large number of tax-friendly jurisdictions are mentioned in the rulings. The systemic nature of this situation stems from the tax competition environment described above. If the ruling is not in Luxembourg, it is Dutch; if the holding company is not located in the Grand Duchy, it is in Malta or in Ireland, etc.

Finally, the third problem with advance tax rulings is their very high opacity. These documents interpret tax regulations in a creative way, which makes them potentially contentious. The European Commission has opened proceedings against the Luxembourg rulings for Fiat, Amazon, Engie and Mc Donald's. In order to limit litigation risks, the circulation of tax rulings is extremely restricted and regulated. The Lux Leaks trial revealed that PwC, the main audit firm involved in this case, was itself responsible for archiving the rulings, and refused to send a complete copy to the beneficiary clients. The auditors were also instructed not to cooperate with customs authorities in the event of checks being carried out while they were on the move. All these elements are likely to lead employees to question the legitimacy of their employer's activities.

This led me, when I resigned, to extract hundreds of advance tax agreements from my firm in the hope of starting a debate on these practices. A flaw in the firm's otherwise very strict computer procedures made these documents easy to access: I could simply copy/paste. However, the logging of everything that happens on the computer network allowed the company to find traces of my copying two years after the events. I then had to step out of anonymity and take my actions before the courts. The numerous lawsuits and appeals concluded with the recognition by the Luxembourg Supreme Court of the right to whistleblow according to the case law of the European Court of Human Rights. This is an undeniable victory for the right to information, but it is feared that the length of the legal battle may deter other potential whistleblowers, still employed and having scruples about their professional practices. Self-censorship is probably a more powerful barrier to information access than all technical barriers.

The Lux Leaks have had several political repercussions, including an early agreement by all EU member states to automatically exchange information on advance tax rulings. This is a step forward, but the only tax rulings made public so far are those revealed by the ICIJ. Even the European Commission does not have access to the information exchanged, although it is the only institution that has launched proceedings against these tax practices. Moreover, the effectiveness of this relative transparency depends on the assumption of peer pressure: member states would refrain from undermining their partners' tax revenues too much, since they are informed of this. First, we can doubt the effectiveness of this pressure, since automatic exchange does not really prohibit any tax practice, and each state remains sovereign in tax matters. Second, the very existence of this peer pressure is questionable. Prior to the automatic exchange, the member states already had a fairly general knowledge of the tax practices of their European partners, and a certain hypocrisy can be suspected in their declared willingness to tackle the most damaging practices. The advantageous tax arrangements also benefit their national champions. For example, is Sweden really determined to end the tax systems beneficial to Ikea in the Netherlands, Belgium and Luxembourg?

Fortunately, the tax reform agenda has not yet been exhausted. Particularly worth mentioning is the Common Consolidated Corporate Tax Base. This provision could be effective in combating harmful tax practices in Europe, as it would make it possible to break out of the framework of tax competition between sovereign states. But that is precisely what makes some states still too reluctant. Moreover, such a measure could only be effective for increasing tax revenue if it is accompanied by a framework of tax rates. Here again, political agreement seems far away. In fact, the proposal was made to remove taxation from the unanimity rule, but in order to decide on it, we would need … a unanimous agreement.

Concerning access to information, the protection granted to whistleblowers can play an important role. This is a very important democratic issue, because without information the people and their representatives cannot exercise their power properly. The protection offered by the European Court of Human Rights is only indirect. Retaliation and exhaustion of all national remedies are often the first steps before being able to gain access to this supranational court. A European directive is therefore needed to strengthen this protection.

In addition, ensuring public access to information would also avoid the risk of whistleblowers endangering themselves. An important measure for transparency, public country-by-country reporting continues to make progress. The text currently in force does not yet make it public, but the European Parliament, which unfortunately does not have the power of initiative, has expressed its support. This measure would make it possible to quickly identify companies and countries that do not play by the rules. However, this would require considerable resources to be able to process very large volumes of information. And it would only be a first step in highlighting the practices that should then be banned or regulated. Public reporting on a country-by-country basis could also have a favorable impact on reputation risk management. Some companies may adopt virtuous practices on their own for fear of scandal. But this is only true for those who have a brand image to preserve, i.e. mainly "B to C" companies that target consumers directly.

In conclusion, the succession of tax scandals involving whistleblowers and journalists has the great merit of fueling public debate and increasing the pressure on political and economic leaders. But there is also the danger of creating a feeling of weariness or even despair. The repetitive nature of the scandals shows that none of them have given rise to an adequate response. And this inertia to implement effective solutions can eventually turn into a misdirected revolt and, for example, into populist votes. The lack of ambition in the responses to Lux Leaks, the slowness of European reforms and the complexity of the OECD's plans, whose limits have been shown by the Paradise Papers, raise doubts that international cooperation is really putting an end to harmful tax practices. The fundamental problem is that of an inequitable scale: economic actors are global, but no political body is large enough to impose rules and limits. I interpret the Lux Leaks case as only one example of the threat that liberal globalization poses to democratic sovereignty. I believe that the best solution is to develop a more local economy, whose scale makes it possible to understand all the consequences, and which would also have the merit of being more resilient to future shocks.