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# Luxembourg Banking Secrecy

Privacy tool or fraud facilitation?

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# Contents

<b>ABBREVIATIONS</b>	<b>1</b>
<b>SUMMARY</b>	<b>2</b>
<b>SAMMANFATTNING</b>	<b>4</b>
<b>PREFACE</b>	<b>6</b>
<b>1 INTRODUCTION</b>	<b>7</b>
1.1 Presentation of the subject	7
1.2 Purpose and Problem Formulation	9
1.3 Delimitations	9
1.4 Material and Method	9
1.5 Structure	10
<b>2 BANKING SECRECY IN SOCIETY</b>	<b>11</b>
2.1 Definition of banking secrecy	11
2.2 The scope of the duty	13
2.2.1 <i>The bank's duty of secrecy</i>	13
2.2.2 <i>The bank's duty of confidence</i>	13
2.2.3 <i>Qualifications to the duty</i>	14
2.2.3.1 Compulsion of law	14
2.2.3.2 Duty to the public	15
2.2.3.3 The bank's own interest	15
2.2.3.3.1 <i>Disclosure to group companies</i>	16
2.2.3.4 Information disclosed with customer's authority	16
<b>3 LUXEMBOURG BANKING SECRECY</b>	<b>18</b>
3.1 Overview of applicable legislation	18
3.1.1 <i>The Banking Act</i>	18
3.1.1.1 Penalties and damages	19
3.1.2 <i>Surveillance</i>	20
3.2 The banker's obligations and rights	20
3.2.1 <i>Obligation to act with discretion</i>	21
3.2.2 <i>Obligation to respect</i>	21
3.2.3 <i>Right to keep information secret</i>	23
3.2.3.1 The banker and the clients closely related	23

3.2.3.2	The banker and the tax authorities	23
3.2.3.3	The banker and investigators and/or prosecutors	24
<b>3.2.4</b>	<b><i>Discharge from the banking secrecy obligations</i></b>	<b>26</b>
<b>3.3</b>	<b>Disclosure of bank information</b>	<b>27</b>
<b>3.3.1</b>	<b><i>Duty to co-operate</i></b>	<b>27</b>
<b>3.3.2</b>	<b><i>Disclosure to foreign tax authorities</i></b>	<b>28</b>
3.3.2.1	Mutual assistance in judicial matters	28
3.3.2.2	Mutual assistance in administrative matters	29
3.3.2.2.1	<i>Direct taxes</i>	29
3.3.2.2.2	<i>Taxation of savings</i>	31
<b>4</b>	<b>CONCLUDING REMARKS</b>	<b>32</b>

# Abbreviations

ABBL	Association des Banques et Banquiers Luxembourg (The Luxembourg Bankers' Association)
CSSF	Le Commission de Surveillance du Secteur Financier (the Supervisory Commission of the Financial Sector)
LFF	Luxembourg for Finance (An agency for the development of the financial sector)
Codeplafi	Comité pour le développement de la Place Financière de Luxembourg (A committee for the development of the financial sector)
Legal Observatory	Observatoire Juridique de la Place Financière de Luxembourg (The "Observatoire Juridique" presents the legal environment of the Luxembourg financial center.)
Legilux	Le site Legilux est le portail juridique du Gouvernement du Grand-Duché de Luxembourg sur Internet. (The site Legilux is the Luxembourg governments legal portal on the Internet)
OECD	Organization for Economic Co-operation and Development
STATEC	Service central de la statistique et des études économiques (The national statistical institute of Luxembourg)

# Summary

Luxembourg has been able to build up a very rich financial centre due to the use of a strong legal framework, social and political stability in the Grand Duchy and long-standing economic openness to the outside world. It is the second largest investment fund centre in the world after the United States and the premier private banking centre in the Euro zone. As understood, it has attracted many wealthy clients from all over the world. However, it is not only because Luxembourg banks offers a global wealth structuring service which encompasses all the client's assets, the main reason is that Luxembourg laws lay down very strict rules regarding customer privacy. Only in Luxembourg, there is almost 1 trillion euro under banking secrecy. The philosophy of this professional secrecy is found in the Constitutional Law of Luxembourg, which is very protective of personal freedom in its regulation of the relationship between the state and its individuals. Banking secrecy, which is a broadened form of professional secrecy, is a legal concept under which banking institutions have a duty to keep entrusted information protected. The protecting legislation of banking secrecy is laid down in article 41 of the Banking Act and in article 458 of the Criminal Code. Article 41 stipulates that professionals, working in the financial sector, are required to keep the trusted information secret or penalty will be carried out according to either the Civil Code and / or the Criminal Code.

Banking secrecy, if used right, is a useful tool for banking institutions to attract clients who want to use the bank's services without getting too much insight in their private life. In some cases, however, too strict banking secrecy can be a problem as it is used as a tool for tax evaders. An attentive question, which has arisen during the financial crisis, is whether the disadvantages of the use Luxembourg banking secrecy are greater than the advantages.

The OECD has formed some basic rules which countries should follow so that exchange of information between tax authorities on request can be manageable. Exchange of information is an important tool in fighting non-compliance with the tax laws.

Professional secrecy, or duty of confidentiality, exists in different situations, for instance between doctor and patient (medical secrecy) or between banker and customer (banking secrecy). The differences between professional secrecy in different fields are specified in the legislation. For instance, solicitors are subject to an obligation of absolute professional secrecy and must not reveal any information pertaining to the client to a third party, whereas bankers, on the other hand, are subject to qualified professional secrecy. Qualified professional secrecy means that the information may be disclosed in some circumstances.

The banking secrecy gives the banker both an obligation and a right to keep information secret. The obligation means that the banker cannot under any

circumstance, except where the law gives it permission, disclose such information which has been confided to the banker. The laws concerning banking secrecy gives also, because of the obligations, a certain right for the banker to withhold information upon request from anybody, except from certain situations. The case against the businessman Weduwe, who was told to witness in the Belgian Court, is a good example to illustrate how strong the concept of banking secrecy is. The difficulties for national and international tax authorities are another good example of how difficult it is to receive information.

However, there exist of course situations when disclosure of banking secrecy is available. Banking secretes may be disclosed in the following four situations, which were stipulated in the well-known Tournier case: compulsion of law, public interest, the bank's own interest or where the client himself gives consent. The equilibrium between these situations is settled by the law in the country and mirrors a certain type of society. The public interest in Luxembourg is partly to protect the private interest but also to secure the public interest, meaning fighting criminal activities.

According to article 41 (2) of the Banking Act, the

“...obligation to maintain secrecy shall cease to exist where the disclosure of information is authorized or required by or pursuant to any legislative provision, even where the provision in question predates this law”

Disclosure of secret information can be made upon judicial authorization in criminal procedurals or if otherwise required by law. The exchange of information is however very restricted and, for example, instead of giving information about savings interests, Luxembourg applies withholding tax.

Concerning information about other issues, access might be available through bilateral or multilateral agreements, but only upon a very detailed request. The problem with the use of the law enforcement is that different legislation defines crimes in different ways. Luxembourg has a higher tolerance than other countries when it comes to, for example, tax fraud.

# Sammanfattning

Luxemburg har lyckats bygga upp ett rikt finansiellt centrum tack vare användning av konkurrenskraftig lagstiftning, social och politisk stabilitet i hertigdömet samt långvarig ekonomisk öppenhet gentemot omvärlden. Luxemburg är, efter USA, det största centra för investeringsfonder i världen samt det största centra för private banking i Euroområdet. Som förstått, har Luxemburg attraherat många förmögna klienter från världens alla hörn. Det är dock inte endast på grund av att bankerna i Luxemburg erbjuder global service inom private banking som välbärgade personer väljer att placera sitt kapital i det lilla landet, utan snarare på grund av att Luxemburgs banksekretess är attraherande. Bara i Luxemburg finns ungefär en triljon euro under banksekretessen. Grundtanken till varför Luxemburg önskar ha en så tungt beskyddande sekretesslagstiftning återfinns i Luxemburgs konstitution, som värdesätter det privata intresset över det offentliga. Banksekretess, som är en delklass av professionell sekretess, är ett juridiskt koncept där bankinstitutioner har en skyldighet att hålla viss information sekretessbelagd. Banksekretessen skyddas av artikel 41 i Banklagen (lagen om den finansiella sektorn) samt artikel 458 i Brottsbalken. Artikel 41 i Banklagen stipulerar att banktjänstemän är skyldiga att, inom ramen för sin verksamhet, hålla erhållen information konfidentiell. Om någon skulle yppa sådan information, utan skälig grund, riskerar denne böter enligt civilrättsliga (kontraktsenliga) regler och/eller påföljd enligt artikel 458 i Brottsbalken.

Banksekretessen, om den är rätt använd, är ett användbart redskap för bankinstitutioner att attrahera klienter som önskar ta del av bankens tjänster men som samtidigt önskar att insynen till varför personen ifråga placerar sitt kapital på visst sätt minimeras. Banksekretessen är så att säga till för att skydda personens privatliv. I vissa fall kan detta dock innebära problem då banksekretessen används av personer som ämnar undgå att betala skatt i hemlandet.

En fråga som blivit aktuell på sistone är huruvida nackdelarna med banksekretessen i Luxemburg är större än fördelarna. OECD har lagt fram några grundläggande regler för hur ett underlättande av informationsutbyte kan vara möjligt. Utbyte av information är en viktig del för bekämpning av skattebrott.

Professionell sekretess, eller tystnadsplikt, återfinns i olika situationer, bland annat mellan läkare och patient (läkarsekretess) eller mellan banktjänsteman och klient (banksekretess). Skillnaden mellan de olika sekretessområdena återfinns i landets lagstiftning. Mellan, för exempelvis, advokat och dennes klient används absolut sekretess vilket innebär att advokaten inte kan avslöja något till tredjeman, medan banksekretess, som är kvalificerad, innebär att banksekretessen upphör i vissa situationer.

Banksekretessen ger banktjänstemannen dels en skyldighet, dels en rättighet att hålla informationen hemlig. Med skyldighet avses att banktjänstemannen

bara i vissa specifika fall får yppa om den kännedom som han eller hon besitter om någon klient. Banksekretesslagstiftningen ger, på grund av skyldigheten, också en rättighet att iaktta sekretess i samtliga fall förutom då det publika intresset överväger. Målet mot affärsmannen Weduwe, som tvingades vittna i en belgisk domstol, är ett bra exempel på hur kraftfull banksekretessen är. Nationella och internationella skattemyndigheters svårighet att erhålla information under banksekretess är ett annat exempel på hur svåråtkomlig sekretessbelagd information inom banksektorn är.

Det finns dock situationer när banksekretessen måste ge vika. Dessa situationer, vilka etablerades i och med domen mot Tournier, är: skyldighet i lag, offentligt intresse, bankens eget intresse samt på begäran av klienten själv. Balansen mellan dessa intressen framgår av landets lagstiftning och avspeglar självklart vilken typ av samhälle det är frågan om. Det offentliga intresset i Luxemburg är att säkerställa det privat, men att samtidigt säkerställa det offentliga, vilket innebär att Luxemburg tillämpar flera regelverk för bekämpning av finansiella brott. Det påpekas på flertal ställen att banksekretess inte skyddar finansiella brott.

Enligt artikel 41(2) i Banklagen upphör banksekretessen att gälla om ett yppande är bemyndigat, fordrat av viss lagstiftning eller nödvändigt på grund av rättegångsförhandling i brottsmål. Bekämpning av penningtvätt är ett exempel på när det är beviljat av lagen. Utlämning av information är annars mycket restriktivt. Istället för att lämna ut kontrollinformation om klienter ränteintäkter i enlighet med Sparandedirektivet, tillämpar Luxemburg en särskild sorts källskatt. Andra uppgifter rörande skatt kan lämnas ut via bilaterala och multilaterala avtal, men endast efter att Luxemburg erhållit mycket detaljerade förfrågningar. Om dessa myndigheter ändå ämnar utfå sådan kan det bli problem eftersom olika lagstiftningar kan definiera brott på olika sätt. Luxemburg kräver exempelvis att det skall vara en relativt stor summa pengar som skall ha undanhållits för att skattebedrägeri skall komma i fråga.

# Preface

I want to express my deepest gratitude to my family who has supported me during these years of legal studies in Lund and in Luxembourg.

I also would like to thank my “Elephant” friends in Luxembourg. Without your support, it would have been very difficult to finish this interesting thesis. Thank you!

Finally, I would like to take the opportunity to thank my supervisor, Professor Per Samuelsson, for his support and many valuable comments and advices.

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Philip Sahlin

# 1 Introduction

## 1.1 Presentation of the subject

Luxembourg is one of the smallest countries in Europe, with only 493,500 inhabitants.<sup>1</sup> It has nevertheless a highly developed economy and has amongst the highest GDP per capita in the world.<sup>2</sup>

Due to the use of a strong legal framework, social and political stability in the Grand Duchy and long-standing economic openness to the outside world, Luxembourg has achieved to become an attractive financial centre in Europe. It is the second largest investment fund centre in the world after the United States and the premier private banking centre in the Euro zone. The financial sector is, by no means, the largest contributor to the wealthy Luxembourg economy. As one of many financial actors on the market, banks are very well represented in Luxembourg. There are over 155 banks, from 24 different countries<sup>3</sup>, established in Luxembourg. Only in Luxembourg, there is almost 1 trillion Euro under banking secrecy.<sup>4</sup>

Many wealthy clients have chosen to save their money in Luxembourg, partly because banking institutions offers a global wealth structuring service which encompasses all the client's assets (such as investments, life assurance and real estate) and includes optimized tax and heritage planning. However, the main reason is that Luxembourg laws lay down very strict rules regarding customer privacy. Banking secrecy is a legal concept under which banking institutions have a duty to keep entrusted information protected.

Banking secrecy, if used right, is a useful tool for banking institutions to attract clients who want to use the bank's services without getting too much insight in their private life. In some cases, however, too strict banking secrecy can be a problem as it is used as a tool for tax evaders<sup>5</sup> or criminals trying to commit money laundering or terrorist financing.

The global financial crisis and recent focus on tax havens have encouraged countries to work towards fairness and transparency of their tax systems. Removing practices that facilitate tax evasion is part of a broader drive to clean up one of the more controversial sides of a globalised economy. The

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<sup>1</sup> LFF, "*population*"

<sup>2</sup> STATEC, "*economy*"

<sup>3</sup> Number of banks established in Luxembourg by country of origin. The top 6 countries are: Germany (with 43 banks), Belgium/Luxembourg (21), France (15), Italy (13) and Switzerland (13). LFF, "*Key figures*", p. 9

<sup>4</sup> STATEC, *ibid.*

<sup>5</sup> Tax evasion is the general term for efforts by individuals, firms and other entities to evade taxes by illegal means. Tax evasion usually demands taxpayers to deliberately misrepresent or conceal the true state of their affairs to the tax authorities. This is done to reduce their tax liability. If one is trying to cheat out of their tax obligation, which includes dishonest tax reporting, he is committing a tax fraud. Source: Business Dictionary, "*tax evasion*"

OECD has formed some basic rules which countries should follow so that exchange of information between tax authorities on request can be manageable. Exchange of information is an important tool in fighting non-compliance with the tax laws, especially within EU where there is a free movement of capital but also in an increasingly borderless world.<sup>6</sup>

Article 26 of the OECD Model Tax Convention provides a legal basis for bilateral exchange of information concerning tax purposes. According to the article there is an obligation to exchange relevant information between contracting states. The article does not mean that countries are allowed to get engaged in “fishing expeditions” or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. In formulating their requests, the requesting state should prove the predictable relevance of the requested information. In addition, the requesting state should also have tried, in principle, all national means to access the requested information.

Article 26 was updated in July 2005, at which time paragraphs 5 were added. This paragraph stipulates that *a state cannot refuse a request for information solely because it is held by a bank or other financial institution*<sup>7</sup>. Meeting the criteria laid out in article 26 means that some exceptions to bank secrecy rules must be accepted, however, it does not mean it would undermine the confidence of citizens in the protection of their privacy. The exchanged information will remain subject to strict confidentiality rules. It is expressly provided in Article 26 that exchanged information shall be treated as secret and that it can only be used for the purposes provided for in the convention.

The current version of the OECD Model Tax Convention, last amended on 17 July 2008, indicates that Luxembourg have entered reservations to Article 26.<sup>8</sup> However, Luxembourg has now fully lived up to the OECD expectations to share information with other countries. This was done when Luxembourg signed the 12<sup>th</sup> double tax treaties, which took place 8<sup>th</sup> July 2009.<sup>9</sup>

An attentive question, which has arisen lately in several newspapers, because of the recently signed tax treaties, is whether the disadvantages of the use Luxembourg banking secrecy are greater than the advantages.

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<sup>6</sup> OECD, “*OECD work on tax evasion*”

<sup>7</sup> Emphasis added

<sup>8</sup> OECD, “*Article 26 of the OECD Model Tax Convention on income and capital*”

<sup>9</sup> LFF, “*Luxembourg on the white list*”

## 1.2 Purpose and Problem Formulation

In an article<sup>10</sup> relating to the discussion whether Luxembourg and Austria should, thanks to their strict banking secrecy, be seen as tax havens the countries' respectively Finance Ministers<sup>11</sup> confirmed that "...banking secrecy is an instrument for the protection of privacy and not a tool for tax fraud".

The purpose with this thesis is to answer the following question:

- Is Luxembourg banking secrecy only a tool for protecting private information about the customer or is it also an instrument for facilitating tax evasion?

## 1.3 Delimitations

The concept banking secrecy is sometimes, negatively, connected with accounts harbouring dirty money, moneys deriving from illegal activities. Money laundering, in connection with banking secrecy, has been a huge problem from the very first day banking secrecy was introduced by the Swiss Banking Act of 1934. To fight this issue, several anti-money laundering and terrorist financing regulations have been introduced and developed around the world. Anti-money laundering legislation is very strict in the Grand Duchy it has remained a priority for Luxembourg.<sup>12</sup> This thesis will, however, only focus on financial crimes such as tax evasion and tax fraud. Nevertheless, several legislations are focusing on all these crimes. For instance, the obligation to cooperate with the authorities is much stricter when it comes to money laundering than, for example, tax frauds.

## 1.4 Material and Method

To be able to write this thesis, a legal dogmatic method has been applied. Although this thesis is based on mostly Luxembourg law, some EC law has also been applied. I have also examined some preparatory work while explaining the relevant articles. Five main doctrinal works have been used to back up my answers in this thesis. These are "Principles of Banking Law", "Modern Banking Law", "Paget's Law of Banking", "Le secret bancaire – étude de droit compare" and "Le secret bancaire et l'entraide judiciaire internationale pénale au Grand-Duché de Luxembourg". These works have been used to describe the concept of banking secrecy. Lastly, many Internet

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<sup>10</sup> LFF, "*Luxembourg and Austria defend banking secrecy*"

<sup>11</sup> Mr. Luc Frieden, Luxembourg Minister of Treasure and Budget (2004-2009), and Mr. Josef Pröll, Austrian Minister of Finance.

<sup>12</sup> Zwick, Marco, "*Banking secrecy and money laundering*"

sources such as doctrinal articles (Bock, Georges, Laures, Gérard, CSSF, LFF and OECD), government reports, press notes, and other medial sources have been studied. I have chosen to illustrate the banking secrecy with the help of three national case laws, one case law from the ECJ and five case laws mentioned in the English books.

## 1.5 Structure

This thesis is divided into three main chapters, (i) Banking secrecy in general, (ii) Luxembourg banking secrecy and (iii) the conclusion.

(i)

*Banking secrecy in general* is divided into two subchapters. The first aims to give banking secrecy a definition. The second describes the scope of banking secrecy.

(ii)

*Luxembourg banking secrecy* is divided into three subchapters. The first subchapter describes the legislation in brief. The second explains the banker's obligations and rights. The third gives examples of when disclosure of bank information is allowed.

(iii)

*The conclusion* gives the answer to my question posed in the thesis.

## 2 Banking secrecy in society

### 2.1 Definition of banking secrecy

Before describing the concept of professional secrecy one should know the definition of the word “secrecy”. The word secrecy could be used as either an adjective or a noun. The noun “secrecy” is borrowed from the Latin word “secretus”, which itself is a perfect participle of the verb “secernere”, meaning to sort out or to separate.<sup>13</sup> Secrecy is defined as: a) the trait of keeping things secret or b) the condition of being concealed or hidden.<sup>14</sup> That which is kept hidden is known as the secret.

The term secrecy is sometimes distinguished as having certain similarities with the following notions: prevarication, mystery and anonymity. Prevarication differs from secrecy at that point one tries to give it a definition. Prevarication is said to be a lie or a bending of the truth told knowingly to mislead the other person. This differs from the pure meaning of secrecy, even though it is sometimes used by the one who wants to preserve a secret. The second notion, mystery, is sometimes recalled as something that cannot be fully understood by reason or appears to be unknown. Like secrecy, mystery is built on the idea to hide and be incomprehensible. However, where mystery is unknown for everybody secrecy is only unknown for some people. The third concept, anonymity, is described as something unknown or not acknowledged. Anonymity is getting closer to the definition of secrecy and is sometimes said to be a prolonging of secrecy, forming a secret of the secret. Yet, there is a difference between anonymity and secrecy. One can only talk about secrecy if there is: a) information, b) a person giving the information to somebody he can trust and c) a person (the banker or the doctor) who is receiving the information and who is keeping it secret. Secrecy requires intervention by a third person (the banker or the doctor).<sup>15</sup>

A synonym to secrecy is “privacy”. Most of us want to have some privacy from time to time, and we don’t like to share personal information without leaving our consent. It used to be said that one has “to live secret to live happy”. Life of today has become more and more transparent and the private sphere is shrinking from day to day. For instance, while talking the bus to work or passing by a certain building, there’s a surveillance camera watching every step we take or recording every word we say. The use of the camera is said to be for their and our protection but how much is properly speaking true about that? The secrecy of our lives is getting weaker. Another interesting point of view is that we sometimes give away information knowingly but without our direct consent. For instance:

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<sup>13</sup> Lasserre Capdeville, Jérôme, *ibid.* p.20-21

<sup>14</sup> The free dictionary, “*secrecy*”

<sup>15</sup> Lasserre Capdeville, Jérôme, *ibid.* p.22-23

information sent from our mobile phones can pin point where we are to within a few meters, Internet websites store information about what we like or dislike and credit cards record where we stop and shop and at what hotels we stay in. However, for some reason we sometimes choose to give away information with our consent. This happens when we give up personal information on a more regularly basis by using blogs or social communities on the Internet. Some people would say that they don't really care about this gathering of information, let it be what kind of pasta one likes or where in the world somebody are at the precise moment, but when it comes to more specific and private information, then we become much more aware of the information we give out. We also want to be ensured that this information does not leak out to any unauthorized person. The right to respect for private and family life is protected by articles 8 and 12 and protocol 7 to the European Convention for the Protection of Human Rights and Fundamental Freedoms. The European Commission has, briefly, defined private life as "... the right to privacy, the right to live as far as one wishes, protected from publicity"<sup>16</sup> For instance, a lawyer cannot help his client if the client doesn't reveal all relevant information. The client on the other hand will only provide this information if he knows that it stays secret. Practicing lawyer does therefore apply professional secrecy within their business. Professional secrecy, or duty of confidentiality, exists in many different situations, for instance between doctor and patient (medical secrecy) or between banker and customer (banking secrecy). The differences between professional secrecy in different fields are specified in the legislation. For instance, solicitors are subject to an obligation of absolute professional secrecy and must not reveal any information pertaining to the client to a third party, whereas bankers, on the other hand, are subject to qualified professional secrecy. The difference between the two – absolute and qualified – professional secrecy is that the latter one can be disclosed in some cases, which will be shown below.<sup>17</sup>

Note that banking secrecy should not be confused with business secrecy. A bank is a company like other companies and these companies have different business advantages or business knowledge to approach their business field. For instance, a company doesn't want other companies to know how they use their knowledge to increase their value, which methods they use to decrease the expenses or how to introduce a new product on to the market. This information concerns the banks business policies and is assured by the use of business secrecy. Banking secrecy on the other hand aims at providing protection of clients' information towards third parties, including other departments within the same company. It concerns banks and all other professionals of the finance sector (for example, brokers, investment advisers, etc.).

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<sup>16</sup> Icelandic Human Rights Center, "What is private life?"

<sup>17</sup> Ellinger, E.P., Lomnicka, E., Hooley, R.J.A., "Modern Banking Law", p. 135-136

## 2.2 The scope of the duty

### 2.2.1 The bank's duty of secrecy

Banking secrecy applies on information confided to the banker in the course of his or her professional activity. The leading case, which defined the scope of the bank's duty of secrecy, *Tournier v. National Provincial and Union Bank of England*, established that the duty is a legal one arising out of contract, not merely a moral one.<sup>18</sup> The claimant, Tournier, whose account with the defendant bank was heavily overdrawn, failed to meet the repayment demands made by the branch manager. On one occasion the branch manager noticed that a cheque, drawn to the claimant's order by another customer, was collected for the account of a bookmaker. The branch manager therefore rang up the claimant's employers in order to ascertain the claimant's private address. While speaking with one of the employers, the branch manager disclosed that the claimant's account was overdrawn and that he had dealings with bookmakers. The result of this was that the claimant's contract was not renewed by the employers upon its expiration. The Court of Appeal held that the bank was guilty of breach of duty of secrecy and awarded damages against it.

### 2.2.2 The bank's duty of confidence

The given information, which should be treated as secret will only be protected by banking secrecy if the client has agreed that it should be so, for instance when, signing the contract. In the *Tournier* case the implied duty of secrecy arose out of the account relationship between the bank and its customer. However, even though the client has not explicitly expressed that, the given information should stay secret; it is normally presumed that it should be so. Presumption can nevertheless be trusted. To be able to understand the nature of the bank's duty of confidence, one should start with the general principles governing breach of confidence. The leading English case on breach of confidence is *Attorney-General v. Guardian Newspapers Ltd. (No. 2)*, where Lord Goff summarized these principles as follows: "...a duty of confidence arises when confidential information comes to the knowledge of a person (the confidant) in circumstances where he has notice, or is held to have agreed, that the information is confidential, with the effect that it would be just in all the circumstances that he should be precluded from disclosing the information from others... The first... is that the principle of confidentiality only applies to information to the extent that it is confidential... The second limiting principle is that the duty of confidence applies neither to useless information, nor to trivia... The third limiting principle... is that, although the basis of the law's protection of confidence is that there is a public interest that confidences should be preserved and protected by the law, nevertheless that public interest may be outweighed by some other countervailing public interest which favours disclosure..."<sup>19</sup>

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<sup>18</sup> Ellinger, E.P., Lomnicka, E., Hooley, R.J.A., *ibid.*, p. 136-137, Cranston, Ross, "Principles of Banking Law", p.168-169 and Hapgood QC, Mark, "Paget's Law of Banking", p. 157-158

<sup>19</sup> Ellinger, E.P., Lomnicka, E., Hooley, R.J.A., *ibid.*, p. 142, Cranston, Ross, *ibid.*, p.172

With these principles in mind, it is easier to understand what kind of information that should be covered by the banking secrecy. From the Tournier-case, it was pointed out that the information, that the bank was obliged to treat as confidential, was not restricted to facts that it learnt from the state of the customer's account. It was also said that the bank's duty remained intact even after the account had been closed or ceased to be active. Other information that may be of interest to keep confidential is information that the bank acquires in the course of providing non-banking services. All confidential information that a bank keep in its records must be well protected, or the bank might be prosecuted for breach of duty. The bank's liability for misuse of confidential information is in general strict and negligence is not relevant to this type of duty. For instance, in today's reality where information are kept in the bank's server system, the bank is obliged to have the best security system available on the market. Whether the best security system is used goes to the issue of whether the bank has misused the information. It cannot, in principle, not be said so if the bank has done everything it could to protect the secrets.<sup>20</sup>

### **2.2.3 Qualifications to the duty**

The qualifications to the duty of confidentiality are regularly treated as those spelt out in the judgement of Banks LJ in the Tournier-case. These qualifications, which are almost universally regarded in the jurisprudence as *exceptions to the duty*, are incorporated as section 13.1 of the well-known Banking Code. The Banking Code is a "good banking code of practise", formed in 1992 by the British Banker's Association, the Building Society's Association and the Association for Payment Clearing Services<sup>21</sup>.

The qualifications are: (i) where disclosure is under compulsion of law, (ii) where there is a duty to the public to disclose, (iii) where the interests of the bank require disclosure and (iv) where the client had consented, even implicitly, to disclosure.

#### **2.2.3.1 Compulsion of law**

The classic example of compulsion of law is associated with court proceedings. The public interest in the administration of justice has requested that banks reveals information regardless of breach of confidentiality, for what confidence would people otherwise have towards courts if important evidence were withheld.<sup>22</sup> Orders to disclose secret information are mainly made (i) in aid of a third party tracing claim, or (ii) according to a specific statutory jurisdiction.<sup>23</sup> It shall though be noted that

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<sup>20</sup> Cranston, Ross, *ibid.*, p.172

<sup>21</sup> Hapgood QC, Mark, *ibid.*, p. 146

<sup>22</sup> Cranston, Ross, *ibid.*, p.176, Ellinger, E.P., Lomnicka, E., Hooley, R.J.A., *ibid.*, p. 143-152

<sup>23</sup> Hapgood QC, Mark, *ibid.*, p. 158

this qualification does not permit to be used for “fishing expeditions”. There are some case law on this section. According to one decision, *Bankers Trust v. Shapira*, more known as the so-called Shapira order, this section of qualifications enables a victim of fraud to obtain disclosure against a bank of confidential information concerning customers involved in the fraud. When a disclosure is mandatory by law, the bank does not have to demand the clients to access their information. There are several public-interest grounds where disclosure may be permitted. To mention some of the legitimate public concerns to which bank confidentiality must give way: banking supervision, tax evasion, company fraud, insider dealing, drug trafficking, fight against money laundering and terrorism. A remark, which demands attention, is that no information, which is revealed under these circumstances, becomes available to the public after that they have been disclosed. Those who obtain the information are under a similar duty of confidentiality. A last notice is that this qualification normally is permissive, not mandatory. A bank is normally permitted giving a hint to the police or law enforcement that they suspect that, for instance, certain funds are derived from terrorism before they actually disclose information.<sup>24</sup>

### **2.2.3.2 Duty to the public**

Duty to the public is the most difficult of Bankes LJ’s instances of where a bank might be justified in disclosing information. What does it mean that something must be disclosed to serve the public interest? There is of course a distinction between the public interest and what the public may be interested to know. Sometimes it is in the public’s interest to protect the private interest and assure that the private information should stay confident. In other situations, it is in the public’s interest to disclose such information. According to the case *Pharaon v. Bank of Credit and Commerce International SA (in liquidation)* it was held that the public interest in upholding the private interest, meaning the duty of confidentiality between banker and customer, was subject to being overridden by the greater public interest, meaning disclosure of information for the purpose of uncovering that fraud.<sup>25</sup> The public interest in preserving confidentiality is balanced against other public interests favouring disclosure. This equilibrium does of course reflect a certain type of society. The bank may therefore be in a dilemma: while disclosing information it will affect its reputation in some circles, but to be seen providing a shield for financial crimes it will damage public confidence.<sup>26</sup>

### **2.2.3.3 The bank’s own interest**

The third qualification is about the bank’s interest. *Sutherland v. Barclays Bank Ltd* is one case where the bank’s own interest in disclosing confidential information has been in focus, although it is very controversial.

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<sup>24</sup> Cranston, Ross, *ibid.*, p.177-178

<sup>25</sup> Hapgood QC, Mark, *ibid.*, p. 159, Ellinger, E.P., Lomnicka, E., Hooley, R.J.A., *ibid.*, p. 152-154

<sup>26</sup> Cranston, Ross, *ibid.*, p.178-179

The bank dishonoured the claimant's cheques on the reasons that they knew that the claimant was betting and that the account had insufficient credit balance. The claimant complained to her husband who, during a conversation with the bank, was told that most cheques passing through his wife's account were in favour of bookmakers. The wife then sued the bank for breach of duty to maintain secrecy. The Court thought the interest of the bank required disclosure and that it had, more or less, the customer's implied consent to reveal information. The bank had an interest in advising the husband that it had good reasons for refusing to meet the wife's cheques. The bank had to do so in order to protect its own reputation. However, some legal authors argue that the bank could have explained the reasons differently, without having to disclose the information about the bookmakers.<sup>27</sup> After all, the claimant did not suffer much damage.<sup>28</sup> It is interesting to know that in the *Tournier* case, the branch manager was held to have no justification for disclosing the claimant's gambling activities.

#### **2.2.3.3.1 Disclosure to group companies**

Questions which have arisen is whether a bank is allowed to pass on information about its clients to other groups within the same company, either to use the information for marketing purpose or to protect the other groups from the customer's default in repayment of indebtedness.

Concerning marketing purposes, disclosure means a huge profit for the branches. A bank's customers form a specialized market that can be targeted with a degree of precision, since the bank knows almost "everything" about its client. There are two points of view in this matter: On the one side, a disclosure would interfere with the concept of keeping information secret, on the other hand, some banks argue that such disclosure is part of the bank's interest and would therefore be acceptable. According to The Banking Code, disclosure of this type is not acceptable if the customer has not explicitly given his or her consent to it.

Concerning disclosure in order to protect a group member, it is not explicitly accepted but the Banking Code neither banishes it.<sup>29</sup>

Other legal authors have, however, concluded that a disclosure to another branch or subsidiary company would be treated as a breach of duty.<sup>30</sup>

#### **2.2.3.4 Information disclosed with customer's authority**

Disclosure with the customer's consent needs not many comments. Express consent to disclosure by a customer absolves a bank from responsibility for breach of confident. The case *Sutherland v. Barclays Bank Ltd* is said to be an example of this qualification.<sup>31</sup> The consent can be either general or

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<sup>27</sup> Ellinger, E.P., Lomnicka, E., Hooley, R.J.A., *ibid.*, p. 154

<sup>28</sup> Hapgood QC, Mark, *ibid.*, p. 159-160

<sup>29</sup> Hapgood QC, Mark, *ibid.*, p. 161

<sup>30</sup> Ellinger, E.P., Lomnicka, E., Hooley, R.J.A., *ibid.*, p. 154-156

<sup>31</sup> Hapgood QC, Mark, *ibid.*, p. 160

qualified. An example of the former case is when the customer accepts that his or her information may be used by other services provided by the bank. When the consent may be valid for a certain time only and / or in specific situations, it is called a qualified consent.

There are cases where the bank says that the client's consent should not count as a proper one. This would be the case when the client, while being in one country and at the court, is obliged to tell his or her bank in another jurisdiction to disclose information to a court. However, it shall be understood that it should not matter whether the client has given his consent voluntary or under compulsion of law, because when the client have given his or her consent, the confidence dissolves.<sup>32</sup>

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<sup>32</sup> Cranston, Ross, *ibid.*, p.179-181 and Ellinger, E.P., Lomnicka, E., Hooley, R.J.A., *ibid.*, p. 159-160

# 3 Luxembourg banking secrecy

As seen above, banking secrecy is an equilibrium between the interest of the state (public interest) and its individuals (private interest). This equilibrium reflects a certain type of society, depending on which interest is in priority.<sup>33</sup> The Luxembourg compliance and risk director Marco Zwick underlined in an article the importance of banking secrecy for the protection of privacy.

“The right for privacy and for protection of personal data is a key concept in liberal democracies. It does not imply that persons who benefit from this right would de facto have something to hide from any public authorities. It may occasionally mean that persons simply want to hide something from other individuals, collectivises or state authorities for various reasons. If we agree that banking secrecy and data protection rules must never be designed to offer immunity to criminals and their transactions, any waiver to these rules must, however, be granted in a controlled way.”<sup>34</sup>

Luxembourg has chosen to implement a strong professional secrecy because they want to make sure that protection of the person’s privacy is respected. The philosophy is found in the Luxembourg constitutional law, which is very protective of personal freedom in its regulation of the relationship between the state and its individuals. It is also due to this framework of protection of the rights of the individuals that banking secrecy in relation with third parties, including tax authorities, have developed. A restriction of the private interest may only be acceptable where criminal offences have been committed.<sup>35</sup>

Since most businesses within the banking sector relates to nonresidents, Luxembourg applies several preventive measures to fight financial crimes. For instance, it is prohibited to use anonymous accounts in Luxembourg and banks are, especially concerning anti-money laundering cases, obliged to identify its customer, without distinction between natural and legal persons and to keep these records for at least five years.<sup>36</sup>

## 3.1 Overview of applicable legislation

### 3.1.1 The Banking Act

The legislation of banking secrecy is found in article 41 of the Banking Act of 5 April 1993 on the Financial Sector (hereinafter Banking Act)<sup>37</sup>. The first paragraph stipulates that: “the directors, the individuals responsible for supervision, management, employees and other persons working for credit institutions and

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<sup>33</sup> Schmitt, Alex, “*Luxembourg: Clarification of bank secrecy in tax law*”

<sup>34</sup> Zwick, Marco, “*The ethical balance between data protection and banking secrecy as opposed to absolute transparency in the financial business, a success story?*”, p.15

<sup>35</sup> Schmitt, Alex, *ibid.*

<sup>36</sup> IMF, “*Luxembourg: Report on the observance of standards and codes*”, 2004, p.10

<sup>37</sup> CSSF, “*The nature and the scope of banking secrecy*”

other professionals in the financial sector... ..are required to keep secret all information confided to them in the course of their professional activity“.

According to the Luxembourgish doctrine, section 41(1) is applicable for both Luxembourgish and foreigner professionals working in Luxembourg.

The situations when banking secrecy ceases are found in the 2<sup>nd</sup> paragraph:  
“The obligation to maintain secrecy shall cease to exist where the disclosure of information is authorized or required by or pursuant to any legislative provision, even where the provision in question predates this law”.

Banking secrecy cannot be invoked in certain situations, which are found in subparagraphs 3-5. These have to do with cooperation between banking institutions and persons who must have access to bank information. Subparagraph 3, which has to do with surveillance of the financial sector, is the only one that will be mentioned in this thesis.

Section 41(7), below, stipulates that a person who is bound by the obligations in section 41(1) cannot, after having lawfully disclosed such information, be held responsible.

“No person bound by the obligation of secrecy referred to in paragraph 1 who lawfully discloses any information covered by that obligation shall, by reason of that disclosure alone, incur any criminal responsibility or civil liability.”

However, when such a disclosure has been made it must still be kept secret, according to article 41(6), and must not be used to other purposes than for which it has been disclosed.

“Subject to the rules applicable in penal matters, once any information of the kind referred to in paragraph 1 has been disclosed, it may not be used for any purposes other than those for which its disclosure is permitted by law.”

### **3.1.1.1 Penalties and damages**

The last paragraph of article 41(1) of the Banking Act stipulates that a non-respect of the Banking Act lead to the sanctions defined in section 458 of the Luxembourg Criminal Code, which is the general provision on professional secrecy in Luxembourg.

“Medical practitioners, surgeons, health officials, pharmacists, midwives and all other persons who are repositories, whether by reason of their capacity or occupation, of secrets which are entrusted to them and who disclose such secret, save where they are summoned to give evidence before the court or where the law requires them to reveal such secrets, shall be punished by a term of imprisonment of eight days to six months and a fine of EUR 500 - 5000. The above shall not apply in case where the person has held to stand as witness in court or where the law prescribes to disclose these secrets.”

As understood, a violation of the banking secrecy leads to a term of imprisonment of eight days to six months and a fine of EUR 500 – 5000. The person who commits the crime must however do it intentionally.

The penal sanction is only applicable on physical persons, although, debates have arisen whether it could be applicable on moral persons as well.<sup>38</sup>

The civil sanction is the same as for those concerning breach of contract in the Civil Code. Article 1382 stipulates that if anybody, with intention, causes damage to somebody else, he has to repay what he has caused. According to article 1383, the same obligation to repay shall apply if one has been negligent or imprudent.<sup>39</sup>

### 3.1.2 Surveillance

Section 41(3) stipulates that the banking secrecy does not apply on national authorities or foreign financial supervisory authorities when they are acting in the exercise of their legal powers. CSSF<sup>40</sup>, the Supervisory Commission of the Financial Sector, is the responsible authority for the supervision of the activities within the banking sector. The CSSF are regulated by the law 12 Mars 1998.<sup>41</sup>

The CSSF acts only in the public interest, ensures that the laws and regulations on the financial sector are enforced and observed and that international agreements and European Directives in the fields under its responsibility are implemented.

Note that all information CSSF receives within its business frame are protected by the professional secrecy laid down in article 44 of the Banking Act, and not article 41 which applies for the banking and financial section. However, article 44 is also linked to article 458 of the Criminal Code in case somebody at the CSSF is breaking the silence.<sup>42</sup>

## 3.2 The banker's obligations and rights

Banking secrecy is defined by maître Alain Steichen as the right and/or obligation for the banker to keep given information within its business secret.<sup>43</sup> The obligation means that the banker cannot under any circumstance, except where the law gives it permission, disclose such information that has been confided to the banker. The obligation is composed by two concepts: an obligation to act with discretion and an

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<sup>38</sup> Spielmann, Dean, "*Le secret bancaire et l'entraide judiciaire internationale pénale au Grand-Duché de Luxembourg*", p. 24

<sup>39</sup> Civil Code, "*Art. 1383*"

<sup>40</sup> CSSF, *ibid.*

<sup>41</sup> Legilux, "*Recueil de la législation sur la place financière Luxembourgeoise*", ch. 2

<sup>42</sup> Ludovissy, Guy, "*La surveillance du secteur financier*", p. 37-38

<sup>43</sup> The Luxembourgish Court of appeal decided, 1961-06-06, that the professional secrecy does not only constitute an obligation, but also a right. Worth noting is that this judgment was made before the professional secrecy was applied within the banking sector. Court of Appeal, 6 June 1961

obligation to respect the banking secrecy. The latter one is, historically, a new concept. The former obligation has however been used for a long time, on business affairs while writing contracts.

### 3.2.1 Obligation to act with discretion

When the banker helps a client to open an account he has normally to conclude a contract. By doing so, the banker, is imposed to act with discretion.<sup>44</sup> The breach of the banking secrecy is therefore partly seen as a breach of contract. This standpoint was also confirmed by the Luxemburgish tribunal, who said that in case the business relation between the bank and the client comes to an end, the banker must keep the information secret.<sup>45</sup>

One question may however arise. Does the contract need to include a paragraph mentioning the obligation to act with discretion or not?

A contract is normally based on the concept that the partners can decide its content themselves. However, there are some restrictions to this concept, especially when it comes to contracts involving banking secrecy. The obligations, which follow with the contract, must respect good manner and public order according to article 6 in the Civil Code<sup>46</sup>, and can thus not be set aside by the concluding partners. As long as this rule is followed they are free to choose whether they'll add such a paragraph in the contract or not. In some cases the bank chooses to use such a paragraph in another contract, i.e. the first contract to sign when opening an account. It should thus be noted that it is not very common to add a section mentioning the obligation to act with discretion in the contract today. The reason for this is, amongst others, the respect for the banking secrecy obligation.<sup>47</sup>

### 3.2.2 Obligation to respect

Since law only can set the obligation aside, it has sometimes been considered a rule of public order. At least, that was the intension from the legislator. In general, all obligations that are penalized by criminal law are deemed to be of public order. Public order crime is actions that has been criminalized because they are contrary to shared norms, social values, and customs.<sup>48</sup> As seen above, section 452 of the Criminal Code punishes the violation of any professional secrecy. According to one part, supported by the CSSF at the time the law was elaborated and lawyer Alain Steichen, banking secrecy has the character of public order because of the reason that one can only escape the obligation if supported by law. This was also the point of view that was mentioned in the preparatory work. According to

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<sup>44</sup> Lasserre Capdeville, Jérôme, *ibid.* p.58

<sup>45</sup> Schmitt, Alex, Omes, Elisabeth, "*La responsabilité du banquier en droit bancaire privé luxembourgeois*", p.63-65

<sup>46</sup> Civil Code, "*Titre préliminaire*", *article 6*

<sup>47</sup> Lasserre Capdeville, Jérôme, *ibid.* p.60-61

<sup>48</sup> Nationalencyklopedin, "*Brott mot allmän ordning*"

another theory, banking secrecy does not have the character of public order because the client or the state can easily levy it. It shall also be noted that a levy of information, which would be against the banking secrecy, can, in some situations, be justified. Even though the banking secrecy cannot entirely be seen as a rule of public order, it still has the effect of being one. A secret keeper who chooses not to keep the information secret must be aware of the risk to face the sanctions. The Luxembourg Court of Appeal has tried to precise the value of respect for the banking secret, and to decide whether it has the character of being a rule of public order. In a case<sup>49</sup> between the Belgian citizen S and the Kredit Bank of Luxembourg (KBL), the Court said that the law gives one, who has concluded a deposit contract with the bank, a right to be assured that the bank keeps the information secret. In this case, S had opened an account at KBL. Due to a theft organized by one or several employees at the KBL, documents concerning the account holders became public. When the Belgian tax authority got these documents they noticed that S had opened up an account just to avoid paying taxes in Belgium. Thanks to the documents a proceeding started between S and the tax authorities. At about the same time S took legal action against KBL due to their breach of contract. According to S, KBL must be held responsible for breach of contract since they, because of the violation of the banking secrecy, have not fulfilled their strict responsibility<sup>50</sup>. KBL, on the other hand, argued that moral persons only have a “best effort undertaking”-responsibility<sup>51</sup>, i.e. not strict liability, when it comes to keep information secret according to the banking secrecy rules, i.e. that the bank only has to take all necessary means to protect the given information. The Court concluded “...it is normally understood that information given during a conclusion of a deposit contract with a banker must be kept secret. It is not by hazard that the contract has its provisions and that the legislator chose to protect such information with punishments in the Criminal Code. The obligation to keep information secret within the banking field is therefore an “obligation to achieve a result”, meaning that the banker has a strict liability to keep the information secret”.<sup>52</sup> In this case it meant that the bank was held responsible due to their lack of protection. It does not matter how many measures or methods the bank had used to protect their clients entrusted information, they would still be held responsible for the loss, except for force majeure situations. The thing that the result of the obligation wasn’t fulfilled is enough to hold the bank responsibly for the breach of contract. This principle of protection of entrusted information, where only the law can cease the obligation to keep information secret, shows that it has a character of public order. Since the banking secrecy has a character<sup>53</sup> of being of public order, a very strict

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<sup>49</sup> Court of Appeal, “S vs. KBL”, 2 April 2003

<sup>50</sup> Obligation de résultat, “Art. 41, note 7(2), p.37”

<sup>51</sup> Obligation de moyens, which is opposed to obligation de résultat. Obligation de résultat means strict liability. The former criteria of evidence is less strict.

<sup>52</sup> Spielmann, Dean, *ibid.* p.27-28. My translation

<sup>53</sup> The question whether banking secrecy is public order or whether it has the character of being one has been a controversial question for a long time. So far the jurisprudence have come to the conclusion that it has a character of being one, which does not mean that it has the same status as a rule of public order. For more info read Spielmann, Dean, *ibid.* p.48

interpretation of section 41(1) and a very restrictive interpretation of 41(2-7) has to be done.<sup>54</sup>

### **3.2.3 Right to keep information secret**

It is obvious that the banker cannot oppose the secrecy to his own client, nor to any person representing the client, such as a guardian, mentor, lawyer, deputy, representative or other front person who is in charge for the client. The banking secrecy is not a tool for bankers to use against its clients.

The banking secrecy laws give however, because of the obligations, the banker a certain right to withhold information upon request from third parties. Three examples are (i) the relationship between the banker and the clients closely related, (ii) the relationship between the banker and the tax authorities and (iii) the relationship between the banker and investigators and/or prosecutors.

#### **3.2.3.1 The banker and the clients closely related**

Descendants of the client are authorized to get information about the account. To get all secret information revealed, the heirs have to prove that they are the real heirs of the client. The reason that the bank account has been closed down after the death of the client is not an excuse for not letting the heirs gain access to the bank account and the information about it.<sup>55</sup> According to article 11 of the commercial code, bankers are obliged to keep information about the account for ten years after it has been closed down.<sup>5657</sup>

If a married couple creates an account they are, in principle, both in charge over the account and can thus access all information. However, if the husband opens the account, the wife will not gain access to the information about the account, if they haven't decided to give her access. This means that the banking secrecy is protecting the client from his own wife/husband. The same rule applies to the client's creditors and their representatives.

#### **3.2.3.2 The banker and the tax authorities**

The banker does not have to disclose any information to the tax authorities, whether to the national or foreign tax authorities, unless the banker has to do it according to a procedural or an investigation.

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<sup>54</sup> Heymer, Heiko, *“La gestion internationale du risque bancaire face au secret professionnel à Luxembourg”*, p.20

<sup>55</sup> Legilux, *“Recueil de la législation sur la place financière Luxembourgeoise”*, ch. 3 :3, jurisprudence

<sup>56</sup> Tribunal d'arrondissement de Luxembourg, 24 avril 1991

<sup>57</sup> Criminal Code, “Art. 458, nr 12, p.23”

The national tax authorities are, according to the articles 2 and 4 of the Grand-Ducal Decree dated 24 March 1989<sup>58</sup>, not allowed to start an investigation or collect information from banks for the purpose of taxation of a specific taxpayer.<sup>59</sup>

“**Art 2.** The tax authorities are not empowered to request information, for tax inspection purposes, on all accounts in a given category or of a certain magnitude.”

“**Art 4.** A paragraph 178 bis, worded as follows, is inserted in the General Law on Taxation of 22 May 1931:

“No information pertaining to the taxation of taxpayers shall be requested from:

1. credit institutions;
2. other professionals of the financial sector...”

Article 3 strengthens the client’s protection.

“**Art. 3.** Inspection of the accounts and on-site checks of a financial institution shall not be used to gather information on the tax position of third-party account holders.”

Another question is of course if illegally obtained information, which was protected by banking secrecy, could be used as evidence in legal procedurals. The question has arisen but there are no clear answers other than the fact that the tax authorities are not allowed to use the information for tax purposes.

“**Art. 8.** Information obtained illicitly shall not be used or transmitted.”

### **3.2.3.3 The banker and investigators and/or prosecutors**

The banker could in the beginning of the 90’s, according to a court decision<sup>60</sup>, withhold information from investigators and prosecutors.

The right to withhold information towards other people causes a certain difficulty for the banker since the banker is obliged to keep the information secret at the same time that he or she has a right to keep the information secret. This two- sides-of-the-same-coin-phenomenon triggered of course a certain dilemma for the banker, who had no other option than to trust his own conscience when revealing information.<sup>61</sup>

The following case<sup>62</sup> brought before the European Court of Justice illustrates the strength of strict banking secrecy in Luxembourg. Note that the importance with the case is to show the reader how strong the protection of banking secrecy is. The case itself was about free movement of services according to article 49 of the EC Treaty.

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<sup>58</sup> Grand-Ducal Regulation of 24 March 1989, “*Dealing with bank secrecy in tax matters and determining the investigatory powers of the tax authorities*”

<sup>59</sup> Spielmann, Dean, *ibid.* p.80-81

<sup>60</sup> Tribunal d’arrondissement de Luxembourg, *ibid.*

<sup>61</sup> Schmitt, Alex, Omes, Elisabeth, *ibid.* P 65-67

<sup>62</sup> ECJ, “*Criminal procedural against Paul der Weduwe*”

The case was about Mr der Weduwe, a Dutch citizen living and working in Luxembourg. Weduwe worked for two banks established in Luxembourg while he at the same time recruited and helped clients from Belgium with tax evasion. He persuaded the clients to put their money in safe deposits in Luxembourg. Weduwe was then asked to act as a witness in Belgium where his clients were about to be prosecuted for tax evasion.

It is clear that article 458 of the Belgian criminal code, which provides that the breach of professional secrecy is a criminal offence, does not apply to the banking sector. On the other hand, under Luxembourg law, the criminal sanctions for breach of professional secrecy laid down in article 458 of the Luxembourg criminal code also apply to the banking sector thanks to article 41 of the Banking Act. Accordingly, unlike Belgian law, Luxembourg law makes the breach of banking secrecy a criminal offence. However, the Belgian court argued that since the case was handled under Belgian legislation, Weduwe should therefore set aside his banking secrecy rules and tell the court what he knew. At the trial Weduwe was asked, under oath, to give all information about these clients and their money, or face the punishment for breaking the Belgian code of criminal procedural. Weduwe refused to answer the questions put to him, invoking the obligation of banking secrecy, which Luxembourg law imposes, on employees in the financial sector. According to the national court, the Luxembourg provisions on banking secrecy seriously hindered the collection of evidence in judicial investigations into activities carried out in Belgium under the freedom to provide services. Employees of banks established in Luxembourg, which uses their right to provide services in another Member State in which a refusal to give evidence is a criminal offence, are faced with the dilemma of having to breach either the laws of the host Member State or the Luxembourg provisions on banking secrecy. The national court considered that the extra-territorial application of Luxembourg provisions on banking secrecy constituted a difficult impediment to cross-border banking activities. The national court considered therefore that the conflict between the extra-territorial scope of the Luxembourg provisions on banking secrecy and the provisions of the Belgian criminal code and code of criminal procedure, which alone are applicable in the main proceedings, constituted an obstacle to the collection of evidence in its judicial investigation.

One of the questions in the case was whether the Luxembourg provisions on banking secrecy had an extra-territorial scope. Since there was no Luxembourg case law on this issue at that time, the Belgian Government gave its opinion by proposing two alternative interpretations. Either disclosure of information outside Luxembourg territory is not punishable under Luxembourg law or those provisions have extra-territorial scope and therefore are punishable.

The problem raised in this case was that, since Luxembourg hadn't brought this question in front of their own national court, it would be impossible for the Belgian court to rule out an interpretation of the Luxembourg provisions, which would in that case be hypothetical.

Since ECJ can decline to rule on a question submitted by a national court where, for example, the problem is hypothetical, or where the Court does not have before it the factual or legal material necessary to give a helpful answer, the ECJ dismissed the case.

What exactly happened to the banker in this case is not clear but as far as I can see, the banker realized that it was better to break the Belgian law and get away with a softer penalty than to break the banking secrecy and be subject to much harder penalty. It shall thus be noted that the outcome of this case lead to some changes concerning bankers acting as a witnesses.

When the banker has to act as a witness, the law requires individuals concerned to give detailed information to the state prosecutor any fact that could indicate the presence of fiscal crimes. According to the Luxembourg Government the exemption from criminal liability for witnesses, giving evidence in judicial proceedings, provided for in the Luxembourg legal system, also has extra-territorial scope. According to that government, the concept of judicial authority in Article 458 of the Luxembourg Criminal Code covers not only Luxembourg judicial authorities but also those of other Member States. A defendant is therefore always entitled to disclose information covered by banking secrecy where that disclosure is made in judicial proceedings.<sup>63</sup>

### **3.2.4 Discharge from the banking secrecy obligations**

The question whether the client is able to discharge the banker from his obligation to keep information secret depends partly on the question that banking secrecy is seen as a rule of public order. However, one should not only rely on the question whether it has the character of public order. After all, since the client owns the information, the client himself must be questioned whether it is ok to reveal the information to any third person. According to an old judgment<sup>64</sup>, it has been noted "...the banker is a confidential information keeper who is forced to act under both the civil and the Criminal Code. His obligations, which are carried out under both private and public interests, must follow the information from the client"<sup>65</sup>.

Although there are no recent judgments pointing out the fact that clients are allowed to impose their bankers to reveal information, there are however cases, amongst them the judgment against the KBL mentioned above, which e contrario shows that the bank/banker who has revealed secret information without the clients consent, are found guilty for break of banking secrecy. Even though there is no information to be found in section 41 of the Banking Act per se concerning this issue, it has been said that section 41(2) may be used as a link to section 1134 in the Civil Code concerning the

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<sup>63</sup> See ECJ, "*Criminal procedural against Paul der Weduwe*"

<sup>64</sup> Tribunal d'arrondissement de Luxembourg, *ibid*

<sup>65</sup> Spielmann, Dean, *ibid*. p.48-49

effect of contract obligations.<sup>66</sup> As a conclusion one may say that it's very difficult to make the banker set aside his banking secrecy but it might not be impossible. In any case one has to remember that the information belongs to the client and the client is free to do whatever he wants to do with his information. If he wants to reveal information he may do so, but not through his banker.

### 3.3 Disclosure of bank information

There are, of course, certain exceptions when the banker is allowed to lift the banking secrecy and share information without being prosecuted<sup>67</sup>. Information falling under banking secrecy can be disclosed upon judicial authorization in criminal procedurals or if otherwise authorized<sup>68</sup> or required by law, according to the 2<sup>nd</sup> paragraph of article 41 of the Banking Act.

#### 3.3.1 Duty to co-operate

Moral persons in the financial sector are, according to article 40 of the Banking Act, obliged to cooperate with national and international authorities in criminal matters. This article is stricter used when fighting money laundering.

“Credit institutions and other financial sector professionals shall be required to provide the fullest possible response to, and cooperation with, any lawful demand which may be made to them by the authorities responsible for applying the law in the exercise by those authorities of their powers.”

This article can, in theory, be avoided. For instance, if a credit institution is requested to provide information to an authority, which has begun a criminal investigation in accordance with article 40, the banker may argue that he, as representative of the company (the moral person), is a physical person. He would continue arguing that since he is a physical person, article 40 cannot apply to him and he is therefore not obliged to provide the authority with information. He would then lean back on the banking secrecy rule in article 41 saying that he has a right and obligation to keep the information secret.<sup>69</sup>

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<sup>66</sup> Spielmann, Dean, *ibid.* p. 50

<sup>67</sup> The authorization to use this article for breaking the banking secrecy is justified by article 70 in the Criminal Code, which stipulates that there is no infraction when the action was made in line with the law and legally ruled by an authorized authority. Spielmann, Dean, *ibid.* p.30

<sup>68</sup> See for instance the Weduwe case: as a witness in court.

<sup>69</sup> Spielmann, Dean, *ibid.* p.30

### 3.3.2 Disclosure to foreign tax authorities

Since the national tax authority is not allowed to do researches concerning taxpayers, the Luxembourg attitude towards foreign tax authorities is of course very reserved. Although it is difficult to disclose banking secrecy in order to receive information about foreign taxpayers, there exist two alternative forms of exchange between tax authorities:

- mutual assistance in judicial matters; and
- mutual assistance in administrative matters

#### 3.3.2.1 Mutual assistance in judicial matters

Foreign tax authorities, like the national tax authorities, are not allowed to investigate directly at the level of Luxembourg banks, so they may only obtain information in retroactive manner, after consulting the law enforcement. The investigation by a Luxembourg investigating magistrate may be launched if it is based on a request of a rogatory commission by a foreign magistrate in accordance with international bilateral or multilateral judicial assistance agreements.<sup>70</sup> It shall be noted that neither the European Convention on Mutual Assistance in Criminal Matters (1959) nor the European Convention on Extradition (1957) can be used as a legal source to assistance in tax matters. The former one provides, in paragraph 2(a), that assistance may be refused in tax matters. The latter one has a similar approach in paragraph 5 of the Convention.<sup>71</sup>

A problem with this system, except that it takes a lot of time and is very expensive, is that it is sometime difficult to precise a definition for the crime in matter. Due to the different definition of criminal liability, a tax crime in one country might not be a tax crime in the other country and therefore not subject for criminal procedural.<sup>72</sup> Tax fraud, for instance, is a criminal offence for which a Luxembourg investigating magistrate could launch a criminal investigation. However, he or she would only do that if he or she knew that the case could be won.<sup>73</sup> Under Luxembourg law, the criminal must commit a fraud over a substantial amount before he or she can be charged for tax fraud. The *substantial amount* mentioned in the article below means that the fraud must be at least EUR 100 000 or when more than 25% of the total tax liability was evaded. Tax fraud is the only tax offence that is punished with imprisonment.<sup>74</sup> Tax fraud is defined, by

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<sup>70</sup> European Banking Federation, “*Banking secrecy report*” and Cranston, Ross, *ibid.*, p.454-457

<sup>71</sup> Bock, Georges, Laures, Gérard, “*The future of the Luxembourg Banking Secrecy*”, p.14, Council of Europe, “*European Convention on Extradition*”, art. 5, Basel Institute of Governance in Basel, Asset Recovery Knowledge Center, “*European Convention on Mutual Assistance in Criminal Matters*”, art. 2(a)

<sup>72</sup> OECD, Committee on Fiscal Affairs, “*Improving access to bank information for tax purposes*”, p.20

<sup>73</sup> Kauffman, Jacques, “*Le secret professionnel du banquier en droit luxembourgeois*”, p. 48-49

<sup>74</sup> Bock, Georges, Laures, Gérard, *ibid.*, p.11

article 396(5) of the General Tax Law as: “if the fraud is over a substantial amount, either in absolute terms or in relation to the annual tax liability and was committed through the use of systematic fraudulent methods with the object of concealing the relevant facts from the tax authorities or to convince these of incomplete facts, the act shall be punished as tax fraud with a term of imprisonment of one month to five years and a fine of EUR 1250 to the tenfold of the amount of evaded taxes”.

In any case, given the amount of assets managed in Luxembourg by non-residents, between 2006 and 2008 Luxembourg responded favourably to 1023 out of 1033 demands for legal cooperation that were addressed to it by foreign legal authorities.<sup>75</sup> It shall however be noted that Luxembourg does not accept access to bank information for civil tax purposes.<sup>76</sup>

### **3.3.2.2 Mutual assistance in administrative matters**

#### **3.3.2.2.1 Direct taxes**

Mutual assistance in administrative (including tax) matters may be carried out between public officers working for administrative authorities of two States (e.g. tax authorities). The purpose with this assistance is to supervise and check accuracy of tax documents and to make sure that concerned citizens pay their amount of tax to the state. The legal base for this information exchange of direct taxes includes the Council Directive 77/799/EEC with amendments and agreements on the avoidance of double taxation, double tax treaties.

There are three forms of exchange of information in administrative matters: either: *through automatic exchange, spontaneously or upon request.*

The first one means that the state’s competent authorities may automatically – without a prior request – exchange information on a certain type of income origination in a state other than the state of the recipient of this income.

Spontaneous exchange means when a competent authority transmitting information believes that this information might be interesting for another state.

The third alternative, request, is the one Luxembourg is using. The tax inspector/public officer of one state has to provide some evidences why he or she doubts whether the suspect taxpayer living in a certain country has declared the right income or capital taxes. The tax inspector must also dispose some kind of information according to which the taxpayer may have failed to declare income.<sup>77</sup> The former Luxembourg Minister of Treasury and Budget, Luc Frieden,<sup>78</sup> said at a conference that “... [e]xchange of information upon demands means that there can be no fishing expeditions”. A requesting state will not be able to pose the question: would you please let us know whether you have persons hiding money in your country? There

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<sup>75</sup> Bock, George, “*Luxembourg, a black hole in the international financial system?*”, p.2

<sup>76</sup> OECD, Committee on Fiscal Affairs, *ibid.*, p.22-23

<sup>77</sup> Bock, Georges, Laures, Gérard, *ibid.* p.6-7

<sup>78</sup> Luc Frieden was Minister of Treasury and Budget 2004-2009. Since 2009, he is Minister of Finance.

has to be a clear nexus linked to a crime, found out by the prosecutor in the home country before any information can be sent from Luxembourg.<sup>79</sup>

The OECD has formed some basic rules which countries should follow so that exchange of information between tax authorities on request can be manageable. Exchange of information is an important tool in fighting non-compliance with the tax laws, especially within EU where there is a free movement of capital but also in an increasingly borderless world.<sup>80</sup>

Article 26 of the OECD Model Tax Convention provides a legal basis for bilateral exchange of information concerning tax purposes. According to the article there is an obligation to exchange relevant information between contracting states. The article does not mean that countries are allowed to get engaged in “fishing expeditions” or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. In formulating their requests, the requesting state should prove the predictable relevance of the requested information. In addition, the requesting state should also have tried, in principle, all national means to access the requested information. There must of course be a certain degree of proportion. Article 26 was updated in July 2005, at which time paragraphs 5 were added. This paragraph stipulates that “...a state cannot refuse a request for information solely because it is held by a bank or other financial institution”<sup>81</sup>.

Meeting the criteria laid out in article 26 means that some exceptions to bank secrecy rules must be accepted, however, it does not mean it would undermine the confidence of citizens in the protection of their privacy. The exchanged information will remain subject to strict confidentiality rules. It is expressly provided in Article 26 that exchanged information shall be treated as secret and that it can only be used for the purposes provided for in the convention. The current version of the OECD Model Tax Convention, last amended on 17 July 2008, indicates that Luxembourg have entered reservations to Article 26.<sup>82</sup> Luxembourg has however now fully lived up to the OECD expectations to share information with other countries. This was done when Luxembourg signed the 12<sup>th</sup> double tax treaties, which took place 8<sup>th</sup> July 2009.<sup>83</sup> This will most probably mean that Luxembourg will participate in the exchange of information with foreign tax authorities, upon request, in precise cases and on the basis of concrete suspicion of a tax fraud. If it will work in practice remains to see.

With improved functionality in the mutual assistance in administrative matters, mutual assistance in judicial matters might decrease when information will be given without engaging the judicial authorities in the same way as today.

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<sup>79</sup> Frieden, Luc, “*Frieden on exchange of information*”

<sup>80</sup> OECD, “*OECD work on tax evasion*”

<sup>81</sup> Emphasis added

<sup>82</sup> OECD, “*Article 26 of the OECD Model Tax Convention on income and capital*”

<sup>83</sup> LFF, “*Luxembourg on the white list*”

### 3.3.2.2 Taxation of savings

The main field of application concerning automatic exchange of information concerns the European Savings Directive (EUSD). The EUSD is a legal framework, which was set up to ensure a standard minimum level of taxation of savings throughout Europe. It seeks to ensure that banks and other financial institutions either report interest income received by taxpayers resident in other EU member states (this is referred to as the “automatic exchange of information option”) or levy a withholding tax on the interest income received. Instead of lifting the banking secrecy and provide information to the citizen’s home tax authorities, Luxembourg have chosen to apply a withholding tax on interest income received by non-resident beneficiaries. Banks in Luxembourg applied an initial withholding tax of 15% on the interest paid to non-resident client accounts when it first was used. The tax increased to 20% in 2008 and is expected to increase to 35% in 2011. 75% of the tax collected is transferred to the state where the saver is a resident, while the remaining 25% goes to the country collecting the tax.<sup>84</sup>

However, there is an alternative option available for those clients who rather prefer to exchange information than to pay a withholding tax. Their information will be transferred as if there existed an automatic exchange. It shall thus be noted that Luxembourg will not automatically apply automatic exchange before any legislation has been amended. The automatic exchange of information according to article 9 of the European Savings Directive would violate the Luxembourg banking secrecy in its current form as defined in article 41 of the Banking Act<sup>85</sup>

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<sup>84</sup> ABBL, “*Taxation on savings*”

<sup>85</sup> Bock, Georges, Laures, Gérard, *ibid.* p.30

## 4 Concluding remarks

The question posed in the beginning of this thesis was whether the Luxembourg banking secrecy only was a tool for protecting private information about the customer or if it also was an instrument for facilitating tax evasion.

Banking secrecy, which is a broadened form of professional secrecy, applies on information confided to the banker in the course of his or her professional activity, and its purpose is of course to give the client some privacy due to that information. Luxembourg has chosen to implement a strong professional secrecy because they want to make sure that the protection of the person's privacy is well respected. The Weduwe case is an example how strong the banking secrecy is.

Luxembourg banking secrecy may be very protective of personal freedom. The banker's right to withhold information to the tax authorities, whether to the national or foreign tax authorities, is a good example. The exchange of information is further very restricted. Instead of giving information about savings interests, Luxembourg applies withholding tax. In other cases where international authorities would like to get information about direct taxes, information *may* be handed over, but only upon a very detailed request, where concrete proof of a suspicious tax crime must be sent to Luxembourg before they lift their banking secrecy.

However, to be able to answer the question whether Luxembourg facilitates tax fraud, one has to decide from which point-of-view one uses. From a Luxembourg point of view, banking secrecy does not protect financial crimes. Tax fraud is a criminal offence for which a Luxembourg investigating magistrate could launch a criminal investigation. There is also a duty to co-operate with the authorities and provide as detailed information as possible. However, from a non-Luxembourg view, Luxembourg banking secrecy might facilitate tax fraud since the investigating magistrate would only launch an investigation if the criteria for tax fraud were fulfilled. As seen above, under Luxembourg law, the criminal must commit a fraud over a substantial amount before he or she can be charged for tax fraud. The *substantial amount* mentioned in the article means that the fraud must be at least EUR 100 000 or when more than 25% of the total tax liability was evaded.

The conclusion would therefore be dependent on the definition of tax fraud. From a Luxembourg point-of-view, the answers would be first positive, yes, banking secrecy is a tool for the protection of private information (the private life of the customer) and then negative, no, banking secrecy does not facilitate tax fraud.

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