Corporate Tax - Cyprus

Government responds to OECD assessment of non-compliance

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There has been considerable publicity in the financial media regarding the fact that Cyprus – together with the British Virgin Islands, Luxembourg and the Seychelles – has been assessed as non-compliant with international information exchange standards by the the Organisation for Economic Cooperation and Development (OECD) Global Forum on Transparency and Exchange of Information for Tax Purposes. However, it is important to put this issue into a proper context.

Compliance framework

Compliance with international information exchange standards is assessed in two phases. The Phase One assessment focuses on whether the requisite legal and institutional infrastructure and procedures are in place for effective information exchange to be possible. Phase Two focuses on the practical implementation of the procedures. Only countries that have satisfactorily passed the Phase One assessment can progress to Phase Two. Cyprus underwent the Phase One assessment in 2011 and the Phase Two assessment was concluded in March 2013, at the peak of the banking crisis. The respective reports were published on April 5 2012 and November 22 2013.

Cyprus is one of only 50 jurisdictions that have undergone a Phase Two assessment. A further 50 jurisdictions have undergone only a Phase One assessment. More than half (29 of the 50) have been found to lack at least one essential element, and in more than one-quarter (14 of the 50) the deficiencies were sufficiently serious to prevent admission to the second phase until they had been dealt with. These 14 include Switzerland, where significant new legislation is required in order to put the essential legal infrastructure in place.

The Phase Two assessment evaluates compliance against 10 criteria. Cyprus was found to be fully compliant in five of these, largely compliant (ie, showing only minor failings) in one, partially compliant in two and non-compliant in two. Austria, Jamaica and Mauritius, which achieved full compliance in fewer areas than Cyprus, were nevertheless excluded from the list of non-compliant jurisdictions.

Cyprus assessment

The areas in which the OECD found Cyprus to be non-compliant concerned:

- the availability of historic accounting records; and
- the use of compulsory powers to obtain information.

In the case of accounting records, the report acknowledged that one of the two reasons for the non-compliant rating was that for most of the monitoring period, trusts had been under no obligation to maintain the information concerned, but that new legislation had recently been introduced to require this. The other reason was a failure by companies to comply with the legal requirement to submit financial information. In their response the Cyprus authorities pointed out that delay in obtaining information had occurred in only 10 out of 650 cases examined, and that in nine of those 10 cases the information had subsequently been obtained and in the sole outstanding case legal proceedings had been instituted. The authorities also pointed out that personnel numbers and procedures in the relevant department had been significantly strengthened, leading to a substantial improvement in its performance in responding to requests for information, and that this had been noted in the report, but not taken into account in the assessment.

The principal reason for the non-compliant rating regarding the use of compulsory powers was that until the end of 2011, the authorities did not pursue enquiries until a tax return had been submitted. As the report acknowledged, this policy was changed from the end of 2011. However, this was not reflected in the assessment of compliance. The other reason for the non-compliant rating was a perceived failure to use the powers under the law effectively. In their response, the Cyprus authorities pointed out that around 2,000 prosecutions are undertaken each year, which they consider to be an effective and proportionate response. The authorities also noted that the apparently low compliance rate in the filing of annual returns is due in part to the high proportion of inactive companies in the total population.

Comment

While the OECD rating is undoubtedly a disappointment, it does not affect the effectiveness of Cyprus holding and financing structures and must be viewed in the context that only 18 of the 50 jurisdictions assessed were found to be fully compliant. Several internationally significant finance centres fell short of full compliance, including the Channel Islands, Germany, Hong Kong, Malta, the Netherlands, Singapore, the United Kingdom and the United States.

It is likely that following the banking crisis and the allegations of laxity in the Cyprus regulatory environment that preceded it, there was a general reluctance to give Cyprus the benefit of the doubt. However, the Cyprus authorities have contended that the non-compliant rating is unduly harsh and does not reflect the situation as it is today. The government has announced that the tax authorities are working with the accounting and legal professions and other relevant bodies in order to rectify all the reported deficiencies, and is confident that significant improvements will be noted at the next review, which is due to take place in 2014.

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