

## CYPRUS AS A TAX HAVEN AND ITS BANK ACCOUNTS HAIRCUT

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### 1. INTRODUCTION

The combination of the financial crisis along with the debt crisis and sluggish economic development contributes to an increase of (a plethora of) phenomena such as tax evasion, tax fraud and tax avoidance which all together create one of the biggest economic problem of the 21<sup>st</sup> century<sup>1</sup>. Nowadays, it is not difficult for the wealthy people not to declare their affluence at home and to transfer it to offshore bank accounts in low-tax jurisdictions well known as tax haven countries<sup>2</sup>. It was correctly claimed that ‘the recent history of tax havens is neither continuous nor linear but rather built on ruptures and mutations in different places and times’<sup>3</sup>. In the last thirty years, it has been noticed that tax havens have extended exponentially in figures and significance<sup>4</sup>. This growth was the product of ‘the liberalization and deregulation of the financial sphere that began in the early 1980s’<sup>5</sup>. The absence of transparency regulations makes it feasible for beneficiaries and owners to utilise trusteeships in order to stay anonymous<sup>6</sup>. This capital flight is also assisted by the auditing companies and private banks which are presented in all important tax havens<sup>7</sup>. In the segment of corporations, internationalisation eases global companies to move their incomes to tax haven countries and so to reduce their tax bill. Almost with no exclusion, multinational and famous corporations such as Apple, Amazon, Google, Starbucks, Ikea etc. have been reported in the media ‘for their aggressive tax planning’<sup>8</sup>. Researches show that ‘two thirds of cross border trade already take place within corporations and more than half of world trade flows go through tax havens’<sup>9</sup>. Thus, the international

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<sup>1</sup>Farny Otto, Franz Michael, Gerhartinger Philipp, Lunzer Gertraud, Neuwirth Martina and Saringer Martin, ‘Tax Avoidance, Tax Evasion and Tax Havens’ (2015) AK Wien 02Z34648 M <[https://media.arbeiterkammer.at/wien/PDF/studien/Studie\\_tax\\_avoidance.pdf](https://media.arbeiterkammer.at/wien/PDF/studien/Studie_tax_avoidance.pdf)> accessed 17 November 2017

<sup>2</sup> Ibid

<sup>3</sup>Ana Margarida Raposo and Paulo Reis Mourão, ‘Tax havens or tax hells? A discussion of the historical roots and present consequences of tax havens’ (2013) 314

<sup>4</sup> Ibid

<sup>5</sup>Palan R and Chavagneux C, ‘Les Paradis Fiscaux. Paris: La Découverte’ (2007) 43

<sup>6</sup> Ibid (n 1)

<sup>7</sup> Ibid

<sup>8</sup> Ibid

<sup>9</sup> Ibid (n 1)

community should be alarmed by these percentages in order to develop efficient measures regarding fair taxation<sup>10</sup>.

An interesting story of tax haven is the Cypriot example which like several other small islands, ‘has found that turning itself into a tax haven (and money-laundering centre) is a pretty lucrative business’<sup>11</sup>. Although, while it is true that some countries do benefit from their situation as tax havens, some others suffer losses<sup>12</sup> and Cyprus is one of those tax haven countries which has recently experienced damage. This essay will examine the so controversial case of Cyprus as a tax haven and the implication that this had to its economy. In doing so, it is essential to explain what the tax havens countries are and how they operate in terms of taxes. Subsequently, this essay will emphasise on Cyprus as a tax haven and the catastrophic consequence that the particular status caused on the Cyprus bank accounts and the Cyprus economy in general. Namely, the paper will explain the well-known Cyprus haircut by discussing its causes, its consequences and its legality. At the end, it will be debated why and how the particular incident can be considered as a lesson for all the tax haven countries and more broadly, for the world’s economy.

## 2. TAX HAVEN COUNTRIES

### 2.1. The meaning of Tax Haven Countries

Tax havens are rightly considered controversial as there is no standard term to define them<sup>13</sup>. International institutions have given several definitions to the notion tax haven and although those particular definitions distribute various features, no agreement has been reached to a single and predominant definition<sup>14</sup>. This ambiguity is also proven in the diversity of names given to this phenomenon, ‘including “tax haven” (OECD), “offshore financial centre” (FMI), and “states without taxation” or “states with low taxation” (KPMG)’<sup>15</sup>. Adding to the above controversy, Raposo and Mourão declared that ‘[the] term tax haven currently evokes images of tropical islands located at the

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<sup>10</sup> Ibid

<sup>11</sup>Matthew O'brien, ‘Everything You Need to Know About the Cyprus Bank Disaster’ (*The Atlantic*, 18 March 2013) <<https://www.theatlantic.com/business/archive/2013/03/everything-you-need-to-know-about-the-cyprus-bank-disaster/274096/>> accessed 5 November 2017

<sup>12</sup>Ibid (n 3) 312

<sup>13</sup> Ibid (n 1) 2

<sup>14</sup> Ibid (n 3) 313

<sup>15</sup> Ibid

end of the world, where there are palm trees and sun and multimillionaires can get rich while relaxing<sup>16</sup>. This dreamlike concept is completely illusive and fake as it will be explained below.

In order to realise the meaning of tax haven, it is essential to discuss the descriptions that have already given for them. To start with, Geoffrey Colin Powell stated that ‘What (...) identifies an area as a tax haven is the existence of a composite tax structure established deliberately to take advantage of, and exploit, a worldwide demand for opportunities to engage in tax avoidance’<sup>17</sup>. This definition was considered incomplete by The Economist as it still discounts some jurisdictions which traditionally believed as tax havens<sup>18</sup>. Likewise, an Australian journalist supported that any state which alters its tax regulations in order to tempt external capital could be thought a tax haven<sup>19</sup>.

Generally, a principal feature that is found in almost all the relevant definitions of tax haven is that the laws and other regulations of a tax haven can be utilised to evade the tax laws and principles of other jurisdictions<sup>20</sup>. Similarly, Raposo and Mourão asserted that these kind of territories have one characteristic in common, that they allow corporations of unidentified backgrounds to be founded in their borders, securing the owner’s personality within a warranty of absolute secrecy<sup>21</sup>. They proceeded with observing that this capacity to function beyond the domestic and international jurisdiction is what makes tax havens so special<sup>22</sup>. In a 2008 report of the United States Government Accountability Office regarding the use of tax havens by US companies, it was also declared that ‘there is no agreed-upon definition of a tax haven or agreed-upon list of jurisdictions that should be considered tax havens’ but that ‘various governmental, international, and academic sources used similar characteristics to define and identify tax havens’<sup>23</sup>. Those characteristics involved: ‘no or

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<sup>16</sup> Ibid

<sup>17</sup> Caroline Doggart, *Tax Havens and Their Uses* (10<sup>th</sup> edn, Economist Intelligence Unit 2002)

<sup>18</sup> Ibid

<sup>19</sup> Sinclair Davidson, ‘The Truth About Tax Havens’ (*Theage.com.au.*, 16 October 2007)

<<http://www.theage.com.au/news/business/here-is-the-truth-about-tax-havens/2007/10/15/1192300685572.html>> accessed 12 November 2017

<sup>20</sup> ‘Identifying Tax Havens and Offshore Finance Centres’ (tax justice network, 28 December 2007)

<[http://www.taxjustice.net/cms/upload/pdf/Identifying\\_Tax\\_Havens\\_Jul\\_07.pdf](http://www.taxjustice.net/cms/upload/pdf/Identifying_Tax_Havens_Jul_07.pdf)> accessed 10 November 2017

<sup>21</sup> Ibid (n 3) 313

<sup>22</sup> Ibid

<sup>23</sup> United States Government Accountability Office, ‘International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdiction’ (2008) GAO-09-157 <<https://www.gao.gov/assets/290/284522.pdf>> accessed 13 November 2017

nominal taxes; a lack of effective exchange of information with foreign tax authorities; and a lack of transparency in legislative, legal, or administrative provisions<sup>24</sup>.

It is also worth mentioning here the four criteria set out by the Organisation for Economic Co-operation and Development (OECD) in determining whether a country is a tax haven or not<sup>25</sup>. The first criterion indicates that a tax haven imposes no or only nominal axes and then three other factors are to be considered: 'whether there is a lack of transparency; whether there are laws or administrative practices that prevent the effective exchange of information for tax purposes with other governments on taxpayers benefiting from the no or nominal taxation'; and finally, 'whether there is an absence of a requirement that the activity be substantial'<sup>26</sup>. The aim of these established criteria is to recognise general features of tax systems which support financial or other monetary activities in specific places and subsequently distort investment and commerce or generally destabilise the trust in tax regimes<sup>27</sup>.

Another approach that may be useful for identifying what a tax haven may be, is the three tax haven types which formed the tax avoidance strategy Dutch Sandwich and which is used by corporations in an attempt to reduce their tax liability<sup>28</sup>. The first tax havens type involves the 'Primary tax havens' which are countries where the economic capital ends up<sup>29</sup>. Subsidiary companies there have gained rights to receive incomes from corporate intellectual property by their parent's transfers<sup>30</sup>. 'Semi-tax havens' are the second category and involves countries which manufacture products for redemptions and have elastic principles to promote employability<sup>31</sup>. The final type is the 'Conduit tax havens' where profit from trades, mainly made outside their borders, is collected, and subsequently allocated<sup>32</sup>. Overall, 'a tax haven is a country or also just part of a country that offers low tax rates or even no taxes

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<sup>24</sup> Ibid

<sup>25</sup> OECD, 'Tax Haven Criteria' (*OECD Better policies for better lived*) <[https://web.archive.org/web/20120512074208/http://www.oecd.org/document/63/0,3343,en\\_2649\\_37427\\_30575447\\_1\\_1\\_1\\_37427,00.html](https://web.archive.org/web/20120512074208/http://www.oecd.org/document/63/0,3343,en_2649_37427_30575447_1_1_1_37427,00.html)> accessed 16 November 2017

<sup>26</sup> Ibid

<sup>27</sup> Ibid (n 1)

<sup>28</sup> Jesse Drucker, 'The Tax Haven that is Saving Google Billions' (*Bloomberg Business Week*, 21 October 2010) <<https://www.bloomberg.com/news/articles/2010-10-21/the-tax-haven-thats-saving-google-billions>> accessed 18 November 2017

<sup>29</sup> Ibid

<sup>30</sup> Ibid

<sup>31</sup> Ibid

<sup>32</sup> Ibid

at all for foreign investors'<sup>33</sup>. These countries 'themselves are in competition for the far more mobile finance capital'<sup>34</sup>. This tax competition is harmful as it causes negative consequences on the independent nation states and in a worldwide context, the competition between countries to reduce tax rates is also problematic<sup>35</sup>.

## 2.2. Cyprus as a tax haven

As it was mentioned above, this essay focuses on a particular tax haven country, the island of Cyprus. After gaining its independence in 1960, Cyprus had to be restructured by setting the foundations for economic growth and prosperity. The island had (and still has until today) limited prospective for industry and little agriculture but as a popular tourist destination, it could economically rely on tourism<sup>36</sup>. In fact, though, tourism alone is not adequate enough for a country's economy and so, 'for Cyprus, establishing itself as an international centre for business and finance has been an important point on the political agenda particularly since the invasion of the northern parts of the island by Turkey in 1974'<sup>37</sup>. And indeed, Cyprus with its low taxes managed to attract businesses and investors and gradually to become 'a well-developed country which is well sought as an offshore tax haven'<sup>38</sup>.

The story of Cyprus as a tax haven has actually started around 1990s when the country applied for European Union (EU) membership and the application arose the need to alter its tax system<sup>39</sup>. Goerge Vassiliou who was the main negotiator of the EU accession informed that when the negotiations started, 'the EU told (...) that there is no way that a country can join [the EU] with a 4,5% corporation tax system'<sup>40</sup>. At that time, a 4,5% corporation tax constituted a typical offshore tax system<sup>41</sup>. Consequently, in 2001, Dr. Wolfgang Gassner, a chairman of the accounting firm Deloitte & Touche in Austria and lecturer at Vienna University of Economics, was engaged by the Ministry of Finance to

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<sup>33</sup> Ibid (n 1)

<sup>34</sup> Ibid

<sup>35</sup> Ibid

<sup>36</sup> John Christensen, 'The story of a tax haven: Cyprus' (*TAX JUSTICE NETWORK*, 26 October 2017) <<https://www.taxjustice.net/2017/10/26/21561/>> accessed 20 November 2017

<sup>37</sup> Ibid (n 36)

<sup>38</sup> 'Tax Haven Cyprus' (*TaxHavens.biz*)

<[http://www.taxhavens.biz/european\\_tax\\_havens/tax\\_haven\\_cyprus/](http://www.taxhavens.biz/european_tax_havens/tax_haven_cyprus/)> accessed 15 November 2017

<sup>39</sup> Ibid (n 36)

<sup>40</sup> Ibid

<sup>41</sup> Ibid

give advices regarding the amendment of the tax system<sup>42</sup>. His aim was to create a new tax system which would be compatible with EU Law and the ‘Acquis Communautaire’ (an accumulated body which comprises all the EU’s treaties and legislation) and which would also satisfy the OECD’s suggestions against harmful tax competition<sup>43</sup>.

Although the overall aim was to diminish the popularity of Cyprus as a tax haven, the collateral benefits and advantages from the Cyprus’ entrance in the EU in 2004 along with the changes of the new tax system, flourished that popularity rather than eliminated it<sup>44</sup>. The relevant factors which augmented the attractiveness of Cyprus at that time were the Cyprus’ tax rate which remained attractively low (when Cyprus entered the EU, the 10% income tax rate of Cyprus was the lowest in any EU country)<sup>45</sup>; the ‘dividend receivable exemption system’ which developed and could well make Cyprus a crucial place for holding corporations; the company groups which were able, by satisfying a 75% holding, to get advantage from group relief permitting the move of losses between group members, based on assured conditions; and the ‘payments of dividends, interest and royalties to non-residents whether or not in a tax treaty jurisdiction’ which exempted from withholding tax<sup>46</sup>. Other new provisions that assisted Cyprus in attracting foreign investment were the non-imposition of taxes on profits which made by the disposal of securities for corporations and residents of Cyprus; the ‘exemption from capital gains tax on capital gains realised on immovable property held outside Cyprus’; the exemption, under certain circumstances, from company tax for incomes gained from an institution established permanently abroad; and finally the entrance to the EC Merger Directive which allowed any reformations, unifications, acquisitions and incorporations of companies to be exempted from taxes<sup>47</sup>.

Thus, it is obvious that all the above changes which arose from the EU accession and the new tax system ensured ‘the role of Cyprus as a very lucrative destination to place business, investments and capital for corporations and individuals from EU countries, and a strategic gateway to the European

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<sup>42</sup> Ibid

<sup>43</sup> Ibid

<sup>44</sup> ‘Cyprus Tax Reform – July 2002’ (Total Serve, 2003) NO.20

<[http://www.totalserve.eu/Assets/Images/uploadedContent/CMS/documents/Images/informationSheet\\_no201460442756.pdf](http://www.totalserve.eu/Assets/Images/uploadedContent/CMS/documents/Images/informationSheet_no201460442756.pdf)> accessed 13 November 2017

<sup>45</sup> Ibid (n 36)

<sup>46</sup> Ibid (n 44)

<sup>47</sup> Ibid

markets for outsiders'<sup>48</sup>. These elements, which attracted capital and investments from abroad and absorbed a great amount of the potential national credit, led to an increase in the growth rate of Cypriot banks in the period after the EU accession<sup>49</sup>. An example here is the growth of assets in Cypriot banks from above '450% in 2005 to 896% in 2010'<sup>50</sup>. Moreover, the country's proximity to Russia and Europe and its strict privacy law along with its low tax rate, increased the popularity of Cyprus as a tax haven<sup>51</sup>. Although the aforementioned factors enhanced the development in the financial segment, the enlarged growth of the Cypriot banking system extended also the exposure of Cyprus to many risks<sup>52</sup>. Consequently, 'the banking industry boomed in Cyprus, growing to become nine times larger than the country's economy by 2009'<sup>53</sup>. The Cyprus' financial crisis which led to a harmful bail out will be explained in detail below.

### 3. CYPRUS HAIRCUT

#### 3.1. Causes

The subprime mortgage crisis of the United States in 2007-2008 provoked a domino effect of adverse results in the worldwide economy involving of course the EU. Inevitably, this global economic crisis could not leave unaffected the small tax haven island of Cyprus. In 2009, Cyprus got into economic recession as the economy falling by 1.67%<sup>54</sup> with major reductions particularly in the shipping and tourism sectors which in turn caused growing unemployment<sup>55</sup>. Between 2010 and 2012, financial development of Cyprus was feeble and could not reach the levels before 2009<sup>56</sup>. The values of commercial property reduced by almost 30% while the non-performing loans ascended to 6.1% in

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<sup>48</sup> Ibid (n 36)

<sup>49</sup> Ibid

<sup>50</sup> Ibid (n 36)

<sup>51</sup> Jeff Krohnfeldt, 'Is Cyprus considered a tax haven?' (*INVESTOPEDIA*, 6 June 2016) <<https://www.investopedia.com/ask/answers/060616/cyprus-considered-tax-haven.asp>> accessed 15 November 2017

<sup>52</sup> Ibid (n 36)

<sup>53</sup> Ibid (n 51)

<sup>54</sup> 'Cyprus: Economic Growth, Cyprus GDP growth rate' (*TheGlobalEconomy.com*, 25 February 2013) <<http://www.theglobaleconomy.com/Cyprus/indicator-NY.GDP.MKTP.KD.ZG/>> accessed 18 November 2017

<sup>55</sup> 'Cyprus Unemployment rate' (*index mundi*, 9 July 2017)

<[https://www.indexmundi.com/cyprus/unemployment\\_rate.html](https://www.indexmundi.com/cyprus/unemployment_rate.html)> accessed 18 November 2017

<sup>56</sup> Ibid (n 54)

2011, augmenting the pressure of the banks<sup>57</sup>. This essay argues that the root of evil for all the above issues which affected negatively and importantly the economy of Cyprus and at the same time provoked immediate legal effects, was the fact that Cyprus was a tax haven. That financial crisis of Cyprus occurred mainly because that small country could not control the large amount of money gathered in Cypriot banks due to its low tax system. Namely, 'Cypriot banks [became] too big for Cyprus to save'.

Explicitly, Cyprus attracted the money of Russian oligarchs who poured their money in Cyprus bank accounts in order to avoid the taxes imposed in their home<sup>58</sup>. That money has inflated the Cypriot bank accounts much more than the government could bail out<sup>59</sup>. The banks of Cyprus have reached the point where their assets were approximately eight times the Cyprus Gross Domestic Product (GDP)<sup>60</sup>. Thus, what Cyprus banks found it good idea to do was to invest a big amount of this money in Greece where they believed they would have had a competitive benefit<sup>61</sup>. The facts that Cyprus is ethnically Greek and the economy of Greece is 12 times bigger that the economy of Cyprus were thought to be beneficial<sup>62</sup>. However, the loans of Cyprus to the Greek corporations and government 'have opened black holes on bank balance sheets'<sup>63</sup>. Only in 2012, the Cyprus Popular (also known as Laiki Bank) and the Bank of Cyprus, which were two of the biggest banks in Cyprus, lost the merged amount of €3.5 billion on Greek bonds<sup>64</sup>. That amount was above 10% of the country's GDP<sup>65</sup>. Cypriot banks needed immediately money and unless the European Central Bank (ECB) had approved the 'emergency liquidity assistance' (ELA) by the National Central Bank of Cyprus, the banking system of Cyprus would has collapsed much earlier<sup>66</sup>. In 2008, the Central Bank of Cyprus entered the Eurozone group of central banks where each member should follow the financial policies set out by the ECB<sup>67</sup>. These national central banks can lend money to a euro bank by accepting any collateral

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<sup>57</sup>'Bank nonperforming loans to total gross loans (%)' (*The World Bank*, 14 April 2013) <<https://data.worldbank.org/indicator/FB.AST.NPER.ZS>>accessed 19 November 2017

<sup>58</sup> Ibid (n 11)

<sup>59</sup> Ibid

<sup>60</sup> Ibid

<sup>61</sup> Ibid

<sup>62</sup> Ibid

<sup>63</sup> Ibid

<sup>64</sup> Ibid

<sup>65</sup> Ibid

<sup>66</sup> Ibid

<sup>67</sup> Ibid



and by obtaining the acceptance of the ECB<sup>68</sup>. In that essence, the Cypriot banks got a loan by the Central Bank and they extremely relied on its financing to remain afloat<sup>69</sup>.

In summer 2012, the Cypriot Government asked for a bailout from the European Financial Stability Facility or the European Stability Mechanism declaring its weakness to support its banking system due to its banks' heavy exposure to the Greek debt<sup>70</sup>. Afterwards, representatives of the Troika (consisted by the European Commission, the International Monetary Fund and the European Central Bank) came in Cyprus to investigate the island's economic problems and offered the terms for the bailout of Cyprus<sup>71</sup>. The government of Cyprus disagreed with these terms and in the following months, the Cypriot governance continued discussions with Troika regarding possible changes to the particular terms<sup>72</sup>.

However, it was observed that the Social Left-Wing government (at the time) delayed the negotiations with the EU<sup>73</sup>. Some journalists and the opposition insisted on that the president of Cyprus avoided to discuss any bailout as any harmful solution would be negative for his campaign for the upcoming presidential elections on February 2013<sup>74</sup>. On that point, Medley Global Advisors added that this extended delay of the negotiations with Troika, 'the intransigence of communist President Demetris Christofias and the outsized presence of Russian savers in Cypriot banks have all given rise to speculation that the government will either be allowed to default or face haircuts on sovereign or bank bonds or even deposits'<sup>75</sup>. Adding to the above, the German Chancellor, Angela Merkel, played

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<sup>68</sup> Ibid (n 11)

<sup>69</sup> Ibid

<sup>70</sup> 'Cyprus asks EU for financial bailout – Europe' (*Al Jazeera*, 26 June 2012) <<http://www.aljazeera.com/news/europe/2012/06/201262517189248721.html>> accessed 19 November 2017

<sup>71</sup> 'Shiarly: troika will be here very soon' (*Cyprus Mail*, 2 November 2012) <<https://web.archive.org/web/20121102084708/http://www.cyprus-mail.com/cyprus/shiarly-troika-will-be-here-very-soon/20121102>> accessed 18 November 2017

<sup>72</sup> Elias Hazou, 'Troika leaves no stone unturned' (*CyprusMail*, 14 September 2012) <<https://web.archive.org/web/20120914093932/http://www.cyprus-mail.com/ecofin/troika-leaves-no-stone-unturned/20120914>> accessed 18 November 2017

<sup>73</sup> 'Q&A: Cyprus deal' (*BBC*, 28 March 2013) <<http://www.bbc.co.uk/news/business-21922110>> accessed 17 November 2017

<sup>74</sup> Athanasios Orphanides, 'What Happened in Cyprus? The Economic Consequences of the Last Communist Government in Europe' (ISSN 1359-9151-232, 2014) <<http://www.lse.ac.uk/fmg/dp/specialPapers/PDF/SP232-Final.pdf>> accessed 5 November 2017

<sup>75</sup> Medley Global Advisors, 'EU Walking on Eggshells' (17 January 2013)

a crucial rule in the negotiations process with Troika<sup>76</sup>. Merkel stated that ‘Cyprus should not expect special treatment over its bailout deal’ as there are common rules in EU that should be followed<sup>77</sup>. In the past, German media had criticised the status of Cyprus as a famous tax haven for rich Russians<sup>78</sup> and so, it was totally awaited that Merkel would be unwilling to help the banks of Cyprus and consequently to bail out Russian oligarchs in an election year<sup>79</sup>. Thus, it is observed that the status of Cyprus as a tax haven has influenced again the attitude of a country towards Cyprus. While Cyprus as a tax haven was beneficial for Russians, at the same time, it was annoying for Germans and so each of these two country treated differently the Cypriot issues.

Finally, on 25 March, the Cypriot Government and the Eurogroup agreed, with the support of the European Commission (EC), ECB and International Monetary Fund (IMF), on the key measures which considered essential to repair the viability of the banking sector<sup>80</sup>. In order to set that agreement, Cyprus and Troika 2 decided the conclusive terms of a Memorandum of understanding, usually known as the Bailout programme<sup>81</sup>. In broad terms, they agreed on that Cyprus would obtain a loan of up to €10 billions and that it would restructure its financial sector through the dissolution of Laiki Bank (which at that time, it was the second-largest bank), and the recapitalization of Bank of Cyprus (the largest bank)<sup>82</sup>. Moreover, they agreed to establish the anti-money laundering system in Cypriot economic institutions; financial consolidation to assist drop the county’s budget deficit; organisational amendments to reinstate macroeconomic imbalances and competitiveness; and privatization. On 30 April 2013, this Economic Adjustment Programme was formally endorsed by the Cypriot House of

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<sup>76</sup> ‘Merkel Can’t Contain Anger over Cyprus’ (Spiegel, 22 March 2013) <<http://www.spiegel.de/international/germany/chancellor-merkel-angry-with-cyprus-as-euro-crisis-intensifies-a-890453.html>> accessed 16 November 2017

<sup>77</sup> ‘Angela Merkel: no special treatment for Cyprus’ (*The Telegraph*, 10 January 2013) <<http://www.telegraph.co.uk/finance/financialcrisis/9792143/Angela-Merkel-no-special-treatment-for-Cyprus.html>> accessed 16 November 2017

<sup>78</sup> Ibid

<sup>79</sup> Ibid (n 11)

<sup>80</sup> European Commission, ‘The Economic Adjustment Programme for Cyprus’ (2013) Occasional Papers 149 ISSN 1725-3209 <[http://ec.europa.eu/economy\\_finance/publications/occasional\\_paper/2013/pdf/ocp149\\_en.pdf](http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/pdf/ocp149_en.pdf)> accessed 12 November 2017

<sup>81</sup> Ernst&Young, ‘Cyprus and Troika reach agreement on the final terms to implement the Cyprus-Eurogroup agreement’ (3 April 2013) <[http://www.ey.com/Publication/vwLUAssets/Tax-and-Legal-Newsletter-April-3-Eng-Cyprus/\\$FILE/Tax-and-Legal-Newsletter-April-3-Eng-Cyprus.pdf](http://www.ey.com/Publication/vwLUAssets/Tax-and-Legal-Newsletter-April-3-Eng-Cyprus/$FILE/Tax-and-Legal-Newsletter-April-3-Eng-Cyprus.pdf)> accessed 12 November 2017

<sup>82</sup> Ibid (n 81)

Representatives<sup>83</sup>. More precisely, in terms of the future of the Laiki Bank and the Bank of Cyprus, the following actions were decided:

All insured deposits at Cyprus Popular Bank, together with Cypriot and UK assets were moved to Bank of Cyprus. Uninsured deposits, together with the remaining assets and the foreign subsidiaries remained in the legacy part of Cyprus Popular Bank, which is to be liquidated over time. Simultaneously, uninsured deposits at the Bank of Cyprus were subject to an immediate bail-in of 37.5%, implying a deposit-to-share swap. Another 22.5% of the uninsured deposits were frozen with the view to ensuring that all capital needs of the institution will be entirely covered by the own contributions of large depositors. Should the bank turn out to be over-capitalised, i.e. have its Core Tier 1 over 9%, due to this measure, the excess will be unfrozen and returned to the depositors.<sup>84</sup>

### 3.2. Criticism and Consequences

It is worth questioning here whether the Northern Europeans and the Eurogroup could have provided a better solution for the bailout of Cypriot banks. James Meek answered positively to that question by declaring that ‘they could have rescued the Cypriot banks directly, from pooled European funds, as a trial of what is due to happen in future Eurozone bank emergencies’<sup>85</sup>. However, he continued by stating that ‘there was never the will in Northern Europe to do this’<sup>86</sup>. It seems that the intention of Dijsselbloem (president of the Eurogroup in 2013) was to make the case of Cyprus haircut, an example to other tax havens of the Eurozone like Malta and Luxemburg<sup>87</sup>. The message he wanted to convey was: ‘deal with it before you get into trouble; [strengthen] your banks, fix your balance sheets, and realise that if a bank gets into trouble, the response will no longer automatically be that we’ll come and take away your problem’<sup>88</sup>.

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<sup>83</sup> Ibid (n 80) 39

<sup>84</sup> Ibid 42

<sup>85</sup> James Meek, ‘The Depositor Haircut’ (2013) 35 LRB 11

<sup>86</sup> Ibid

<sup>87</sup> Ibid

<sup>88</sup> Ibid

Even if that was the goal of the Eurogroup, it was absolutely unfair for Cyprus to be treated like that in order to exemplify other tax havens. As the Cyprus' former foreign minister Nicos Rolandis stated, the bank accounts haircut was an extreme measure which harmed innocent individuals who have worked hard in order to accumulate some life savings<sup>89</sup>. This unprecedented decision which dictated the haircut on depositors caught the world's attention as until then, such measures were considered inconceivable<sup>90</sup>. Indeed, the big challenge after the haircut on depositors was to maintain in Cyprus as many foreign corporations as possible<sup>91</sup>. Professionals working in the economic sector revealed that officers in Malta, Luxemburg and Lichtenstein have approached them in order to convince moneyed depositors to transfer their properties outside Cyprus<sup>92</sup>. Particularly, Christos Neophytou, whose specialism as a lawyer is to register foreign corporations on Cyprus, stated one day after the final decision on 25<sup>th</sup> of March that he 'received three emails today and that's just from Malta' telling that they were 'even offering financial incentives to try to convince clients to move out of Cyprus'<sup>93</sup>. The dramatic irony here is that the president of the Eurogroup declared (as it was mentioned above) that with the Cyprus haircut aimed to give a message to other tax haven countries, whereas, at the same time, small tax haven countries tried to attract the Cyprus' big investors without being ready for such changes. It is a fact that human beings sacrifice everything on the altar of money, they become reckless when they have the chance to obtain more and more money and finally, they are being lead to disastrous actions. Here though, it is not absolutely clear whether the president made such a declaration in order to warn and help other tax haven countries or to try to justify the dramatic bailout.

Then, it is the drama of people that should be considered. When the final decision reached, 'the bleak mood turned to anger with furious bank [depositors] demonstrating outside the Bank of Cyprus headquarters in Nicosia' while 'students took to the streets to denounce the troika's policies'<sup>94</sup>. One of the banners held by protesters said 'You have destroyed our future'<sup>95</sup> and that was the honest true.

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<sup>89</sup>Helena Smith, 'Cyprus in restive post-bailout mood' (*theguardian*, 26 March 2013)  
<<https://www.theguardian.com/business/2013/mar/26/cyprus-post-bailout-haircut-bank-chairman-resigns>>accessed 5 November 2017

<sup>90</sup>Shock in Cyprus as bailout brings bank account haircut [update]' (*ekathimerini.com*, 16 March 2013)  
<<http://www.ekathimerini.com/149355/article/ekathimerini/business/shock-in-cyprus-as-bailout-brings-bank-account-haircut-update>>accessed 5 November 2017

<sup>91</sup> Ibid (n 89)

<sup>92</sup> Ibid

<sup>93</sup> Ibid (n 89)

<sup>94</sup>Ibid

<sup>95</sup>Ibid

Imagine how painful and at the same time destructive was the deposits haircut for the ‘ordinary’ people, namely for the people who have worked hard to save a relatively good amount of money so that to have a better future. Imagine that those people had every right to make plans and dreams with their money. Imagine that those people woke up one day to realise that their ‘bank account has been raided by another country’s government’.<sup>96</sup> That other country was of course Germany. Many politicians and scholars have noticed that Germany showed its antipathy towards Cyprus’ financial issue from the very beginning of the negotiations. In November, just a few months after Cyprus asking for help, a German weekly news magazine accused ‘Cyprus of being a centre for laundering billions of euros’ worth of dirty Russian cash, despite its repeated denials’<sup>97</sup>. As it has already noted briefly above, the punishment of Russians oligarchs became part of Merkel’s campaign for re-election<sup>98</sup>. By punishing indiscriminately all the allegedly rich depositors of Cypriot banks was the way that Angela Merkel used in order to show ‘German voters and her rivals that she was ready to stand up for the ordinary German against what was consistently portrayed as a sinister Mediterranean outpost of Slavic sleaze’<sup>99</sup>. Thus, the small island of Cyprus was used once again for the purposes of the foreign and domestic policy issues of other countries and their intergovernmental rivalries. To be more illustrative, after ‘ordinary’ people losing their money in Cyprus (and not just the wealthy Russian depositors), many other catastrophic consequences have been followed such as unemployment, depression and suicides. Thus, it seems undoubtedly unfair to use human lives in order to serve political interests, isn’t it? Banking system in Cyprus was indeed in a great need of reform but deposit haircut was not the ideal bailout.

The predictions after the bailout were that the island’s economic centre would be damaged, the investors would lose their confidence towards Cyprus and so, the country would stop be a successful global business centre<sup>100</sup>. Undeniably, Cypriots noticed a large withdrawal of foreign companies after the haircut of the bank accounts, but when investors experienced other jurisdictions, they soon realised why first brought their businesses in Cyprus<sup>101</sup>. Even though Cyprus’ status as an economic

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<sup>96</sup> Ibid (n 11)

<sup>97</sup> Ibid (n 85)

<sup>98</sup> Ibid (n 85)

<sup>99</sup> Ibid

<sup>100</sup> ‘Cyprus Banking Crisis: Causes and Consequences’ (*Cyprus Profile*, 10 July 2014) <<http://www.cyprusprofile.com/en/articles/view/cyprus-banking-crisis-causes-and-consequences-bailout>> accessed 13 November 2017

<sup>101</sup> Ibid

centre has unquestionably been wounded many times, the country's experience in company structure and the offer of privileged access to developed markets like Europe, China and Russia have remained intact<sup>102</sup>. Cyprus managed to return dynamically to international markets and became again attractive for business operations<sup>103</sup>. Its legal framework, its EU-harmonised tax and the fact that its corporate tax rates continue to be of the lowest and most competitive in EU have assisted to its come back<sup>104</sup>. It appears that, 'the small Eastern Mediterranean island is determined to succeed, and if there ever was one, Cyprus could be held up as a bail-out success story at the end of this painful three-year economic reform process'<sup>105</sup>.

### 3.3. The legality of Cyprus haircut

The case of Cyprus has raised the interest of lawyers who understand better than any other profession that the haircut of bank accounts involves problematic aspects regarding the rule of law and the esteem of Human Rights<sup>106</sup>. The controversial question here is whether there was an immediate need for financial bailout, as extremely terrible as it may be, can validate such a comprehensive infringement on the rights of individuals' property and such a blatant declination from the global doctrines on which the EU is based<sup>107</sup>. Kypros Chrysostomides who is a Cypriot (qualified) lawyer responded negatively to the aforementioned question<sup>108</sup>. His answer is based not only on moral grounds, that would certainly discard such encroachment of human rights, but totally on legal grounds<sup>109</sup>. It is essential to remind here that the EU Treaties have repeatedly declared that the EU member states are pledged to 'their attachment to the principles of liberty, democracy and respect of human rights and fundamental freedoms and of the rule of law' and interestingly, their stated wish to 'deepen the solidarity between their peoples...'<sup>110</sup>. Moreover, in the Charter of Fundamental Rights of the EU is declared in Article 1 that: 'Human dignity is inviolable. It must be respected and protected'<sup>111</sup>. The Charter is a primary EU law and also supranational law and in the case of Cyprus haircut, it seems

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<sup>102</sup> Ibid

<sup>103</sup> Ibid

<sup>104</sup> Ibid (n 100)

<sup>105</sup> Ibid

<sup>106</sup> Kypros Chrysostomides, 'CYPRUS – THE TEST OF... ILLEGALITY' <<http://www.chrysostomides.com/assets/modules/chr/publications/27/docs/CYPRUS-THE%20TEST%20OF%20ILLEGALITY.pdf>> accessed 5 November 2017

<sup>107</sup> Ibid

<sup>108</sup> Ibid

<sup>109</sup> Ibid

<sup>110</sup> Ibid

<sup>111</sup> Article 1 of the Charter of Fundamental Rights of the European Union

that it had not been considered by the Europeans themselves and the relevant EU organs and authorities.

The lawyer Chrysostomides identified which legal principles have been obviously breached by the harmful haircut of the Cypriot bank accounts.<sup>112</sup> Particularly, he supported that the deposits haircut infringed the right of property as preserved in the Article 17(1)<sup>113</sup> of the EU Charter of Fundamental Rights which is founded on Article 1 of Protocol 1 of the European Convention of Human Rights and that is also binding to the EU institutions<sup>114</sup>. He continued by claiming that the doctrine of non-discrimination, which is also found in EU law, has been also breached<sup>115</sup>. Article 20 of the Charter states that ‘everyone is equal before the law’ and Article 21(1) includes a general forbiddance of discrimination<sup>116</sup>. In the case of Cyprus, he correctly justified that the harm of the depositors and the shareholders of the Bank of Cyprus and Laiki Bank is involved ‘incidents of unprecedented discrimination’<sup>117</sup>. For instance, no other local banks have affected by the bailout and also, only the depositors in the branches of Cyprus were subjected to haircut<sup>118</sup>. Moreover, the banks’ shareholders in any other Eurozone state (like Ireland, Greece and Spain which also suffered from financial crisis) have not experienced any damage like that<sup>119</sup>. Finally, Chrysostomides informed that the bank deposits haircut has caused disadvantageous consequences on other freedoms like the right to select a job and the freedom to involve in work under Article 15 of the Charter<sup>120</sup>; the right to run a business under Article 16 of the Charter<sup>121</sup>; and lastly, the fundamental freedoms of movement of persons, services and capital as preserved in the Treaty on the Functioning of the European Union (TFEU)<sup>122</sup>.

In order to determine that a breach of the aforementioned principles has indeed occurred, there should be a manifest violation of the rule of law by the EU<sup>123</sup>. Chrysostomides justifiably argued that

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<sup>112</sup> Ibid (n 106)

<sup>113</sup> Article 17 of the Charter of Fundamental Rights of the European Union

<sup>114</sup> Ibid (n 106)

<sup>115</sup> Ibid

<sup>116</sup> Ibid (n 111)

<sup>117</sup> Ibid (n 106)

<sup>118</sup> Ibid

<sup>119</sup> Ibid

<sup>120</sup> Article 15 of the Charter of Fundamental Rights of the European Union

<sup>121</sup> Article 16 of the Charter of Fundamental Rights of the European Union

<sup>122</sup> Treaty on the Functioning of the European Union

<sup>123</sup> Ibid (n 106)

in the particular case, the EU organs obviously violated the rule of law and overreached each boundary of proportionality<sup>124</sup>. Specifically, he explained that:

In the process [the EU organs] have condemned 75% of the population of Cyprus (that is more than 400.000 European citizens) to unemployment and poverty in the short and long term, despite the pronouncement in the Charter that ‘human dignity should be inviolable and be respected and protected’”. In my view all the above show a gross violation of the EU law and should be subject to review by ECJ.<sup>125</sup>

Accordingly, around four thousands judicial review procedures were submitted by the depositors who suffered losses after the haircut of Bank of Cyprus and Laiki. They requested from the Supreme Court to withdraw the measures of the deposits haircut by claiming that the haircut was unconditional, the provisions were discriminatory, the judgment made by the Central Bank of Cyprus and the Government was improper and other reasons<sup>126</sup>. The Supreme Court issued its majority decision on the 7<sup>th</sup> of July. The court ruled that the particular proceedings cannot be decided within the provisional jurisdiction of the Supreme Court. It was held that whether or not the rights of depositors have adversely affected by the deposits haircut, do not come within the scope of public law but it was an issue to be decided under the ambit of private law. From the above judgment arose that anyone who wish to contest the bailout measures should take a civil action under the District Courts demanding damages from the relevant banks and/or organisations or the involved authorities of the government.

For those who desired to take an action to the European Court of Human Rights by claiming an infringement of human rights, it was first needed to expend all domestic remedies. Many Cypriots and one Cypriot company went before the European Court of Justice to claim compensation against the EC and the ECB. The Court dismissed their claims on the grounds that ‘the signing of the Memorandum of Understanding (bailout) for Cyprus was in the context of the public interest as aimed by the EU’ and ‘the haircut of private deposits did not violate the right to property, as it did not disproportionately and unacceptably interfere with the substance of depositors’ property rights’. It is

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<sup>124</sup> Ibid

<sup>125</sup> Ibid

<sup>126</sup> ‘Legal Actions in Cyprus following the Haircut’ (*George Y. Yiangou L.L.C*)  
<<http://yiangou.com.cy/news-read/80>>accessed 5 November 2017



worth observing here that although the haircut of the Cypriot bank accounts had undoubtedly legal implications, the harmed depositors could not successfully claim any compensation. The Cyprus bailout was the last resort solution agreed between the Cyprus Republic and the EU organisations and bodies before it would be too late. That is exactly the reason why it is too difficult for Cypriots and Cypriot companies to go against the bailout measures. Neither the courts of Cyprus nor the courts of Europe will ever accept to go against the bailout programme as at the same time they will open the Pandora's box having to compensate the furious depositors who they themselves have left with less money in their accounts.

#### **4. CYPRUS AS A TAX HAVEN; A LESSON FOR ALL TAX HAVEN COUNTRIES AND FOR THE WORLD'S ECONOMY**

The unprecedented bailout of Cyprus which attracted the world's attention will stay forever as a remarkable point in history. The harmful results of the bank accounts haircut and its legal implications should educate the humanity and especially the politicians and specialists from the financial sector so as not to repeat the same mistakes. The very first lesson from the bailout of Cyprus was that 'hiding money in tax havens can turn into hide and seek'<sup>127</sup>. Angela Merkel stated the Cyprus economic business status, in which capital of the banks were eight times bigger than the state's GDP, as 'dead'<sup>128</sup>. This should be realised as 'a warning shot to rich tax-dodgers everywhere' namely that 'if you park your money in offshore havens, it's at risk'<sup>129</sup>. Nonetheless, Cyprus is not alone<sup>130</sup>. There are many countries that run as tax havens and their bank assets are a big multiple of their GDP<sup>131</sup>. At the time of the Cyprus bailout, Luxembourg had bank capital 22.5 times the size of its GDP and so the disproportionality between Luxembourg's economy and its bank assets was greater than that of Cyprus<sup>132</sup>. Similarly, the banking sectors of Malta and Ireland were also relatively bigger than their economies<sup>133</sup>. These tax havens should learn from the 'success story' of Cyprus which was destroyed

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<sup>127</sup>Patrick Collinson, '10 lessons from the Cyprus bailout' (*theguardian*, 29 March 2013) <<https://www.theguardian.com/money/2013/mar/29/10-lessons-cyprus-bailout>> accessed 5 November 2017

<sup>128</sup> Ibid (n 127)

<sup>129</sup> Ibid

<sup>130</sup> Ibid

<sup>131</sup> Ibid

<sup>132</sup> Ibid

<sup>133</sup> Ibid

in less than a month by the unprecedented haircut<sup>134</sup>. They should realise that being a tax haven is not all the time beneficial.

Moreover, it was appeared from Cyprus' indecisiveness and delays on the process of finding a bailout programme that many economic and social problems can occur due to postponement and inactiveness<sup>135</sup>. By denying to face the financial realities or by not implementing measures in expecting of a less hurting resolution, the situation can only get worse<sup>136</sup>. The financial growths are rapid, especially when confidence and credibility start to gradually corrode 'and the downturn may take a geometrically negative spiral effect'<sup>137</sup>. Thus, politicians should obtain preventive or corrective actions in a timely manner in order to avoid any harmful consequence<sup>138</sup>. Another lesson from the Cyprus haircut is that structural reforms may be painful at the time of their implementation but in the meantime, they do work by overcoming the problem even in the short-term<sup>139</sup>. They indeed perform as a catalyst for restoring the country's lost credibility and confidence in a short term<sup>140</sup>. Furthermore, it was appeared from the Cyprus case that the conception that fiscal consolidation always causes greater recession is incorrect<sup>141</sup>. However, the ideal would be to have available a painless structural reform which could resolve the problem in the same way. This is objectively impossible, though.

In addition, the big contribution of the EU in construing a bailout for the Cyprus financial issues proved once again the desire of the eurozone to 'stay the course' and its capability to draft imperfect but workable conciliations<sup>142</sup>. Correspondingly, the most interesting and at the same time problematic lesson which arose from the Cyprus bailout is political<sup>143</sup>. At the time of the Cyprus haircut, it was clearly proved that the Europe's future lies upon the will of Germany<sup>144</sup>. There is no doubt that

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<sup>134</sup> Jacques Mistral, 'Cyprus as Another Euro-Solution' (*Brookings*, 27 March 2013) <<https://www.brookings.edu/opinions/cyprus-as-another-euro-solution/>> accessed on 7 November 2017

<sup>135</sup> 'The Cypriot Economy and Lessons for Europe' (*GreekNews*, 29 September 2015) <<http://www.greeknewsonline.com/the-cypriot-economy-and-lessons-for-europe/>> accessed 16 November 2017

<sup>136</sup> Ibid

<sup>137</sup> Ibid

<sup>138</sup> Ibid

<sup>139</sup> Ibid (n 135)

<sup>140</sup> Ibid

<sup>141</sup> Ibid

<sup>142</sup> Ibid (n 134)

<sup>143</sup> Ibid

<sup>144</sup> Ibid

Germany has financially moved forward at every aspect and it has a decisive voice in the EU's affairs<sup>145</sup>. Therefore, it is reasonable for the small fish of the EU to obey under the instructions of the dangerous sharks. Until today, nothing can change this controversial relationship. Cyprus and any other small tax haven country of the EU may end up in the hands of Germany's decisions. That may sound weird and unfair or even scary, but that is the sole absolute truth and that what happened in Cyprus. Thus, tax havens and any other small country with financial issues in the EU should be careful.

## 5. CONCLUSION

Interestingly, it is worth stating the well-known comment made by Economist Richard D. Wolff regarding the Cyprus bailout agreement. He particularly declared that:

This is blackmail. This is basically the officials of the banks and the political leaders going to the mass of people and saying to them, 'This awful deal that makes you, who have nothing to do with the crisis and didn't get any bailout, pay the costs of the crisis and the bailout. You must do this, because if you don't, we will do even more damage to you and your economy. So give us your deposits, give us your money, pay more taxes, suffer fewer social programs, because if you don't, we will impose even worse on you.' It's the basic idea of austerity across the board and in our country, too. And I think it's the confrontation of a system that does not work with the mass of the people, saying, 'We will go down and take you with us, unless you bail us out.'<sup>146</sup>

This is a harsh interpretation of what happened in Cyprus in 2013. In reality, what happened to the Cypriot bank accounts was not such unexpected. Everyone in EU among with the Cypriot politicians knew that Cyprus 'was faced with an imminent economic collapse'<sup>147</sup>. Everyone apart from depositors (located in Cyprus).

Cyprus was a developed state with low taxes and an excellent offshore economic sector that attracted many foreign investors. Cyprus as a tax haven managed to collect bank assets eight times the size of its GDP at the end of 2000s. This may sound great and someone could say that Cyprus is the ideal

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<sup>145</sup> Ibid

<sup>146</sup> John Theodore, Jonathan Theodore, *Download Cyprus and the Financial Crisis: The Controversial Bailout* (Palgrave Macmillan 2015)

<sup>147</sup> Ibid (n 135)

place for investing and living. However, this was the beginning of the end of an era. Cyprus invested money in Greece due to its surplus and then, this created serious financial problems during the Greek government-debt crisis; the German chancellor, due to the elections in Germany, wanted to punish the wealthy Russians who 'hid' their money in Cypriot banks; and the Cypriot politicians while knowing that the country's financial situation was going from bad to the worse, they delayed any negotiations due to the presidential elections too. The aforementioned were the major reasons which led Cyprus to the harmful bailout programme at the end of March in 2013. Behind of each of the above factors, it can be observed one common thing, that all the above have occurred due to the Cyprus status as tax haven. Namely, the overall reason for the bank accounts haircut was that Cyprus was a tax haven. And somehow like that, 'in just two years this tax haven has become a tax hell'<sup>148</sup>. This should be a lesson for the world and especially for all other tax havens. After that financial crisis, though, the Cypriot economy managed to gradually recover by using similar financial mechanisms with those before the bailout. Therefore, the controversial question that remains unanswered here is whether the financial growth that tax haven countries enjoy prevails upon the risks and the disastrous consequences that may arise after a crisis. By analysing the case of Cyprus, no answer can be given to this.

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<sup>148</sup>Hermes Solomon, 'From tax haven to tax hell' (*CyprusMail*, 10 August 2014) <<http://cyprus-mail.com/2014/08/10/from-tax-haven-to-tax-hell/>> accessed 15 November 2017

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