AUDIT OF GRANTING OF THE CYPRIOT CITIZENSHIP WITHIN THE FRAMEWORK OF THE CYPRUS INVESTMENT PROGRAMME

AUDIT OFFICE OF THE REPUBLIC OF CYPRUS
SPECIAL REPORT no. ΥΠΕΣ/01/2020

24 September 2020

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AUDITED ENTITIES

MINISTRY OF INTERIOR

TAX DEPARTMENT

1. Executive Summary

Within the framework of measures taken to encourage direct foreign investments and attract natural persons of high income levels to establish themselves and their businesses in Cyprus, in 2013, the Council of Ministers radically reviewed the programme that had been effective since 2007 and devised the "Cyprus Investment Programme" in order to grant Cypriot citizenship, through naturalization by exception to non-Cypriot investors/businesspersons. Amendments to the Programme followed in 2014, 2016, 2018, 2019 and 2020, which gradually made the programme stricter in regard to the investigations carried out, but more relaxed in regard to the economic criteria concerning the investment in immovable properties, developments and infrastructure projects. The last amendment to the Programme was introduced recently after the House of Representatives voted the relevant Regulations which were published in August 2020.

This compliance audit was carried out within the framework of the constitutional responsibilities of the Auditor General for the audit of government revenues, but due to obstacles set by the Ministry of Interior with regard to access to the necessary data, the audit was restricted to only a fraction of what was originally planned.

From the audit of the data obtained, the main findings were as follows:

Approvals of applications

From the data given to us in excel form, it transpires that of the 1.597 applications submitted after 21.5.2018, 917 were approved, namely a percentage of 57.4% (out of which the approval date is not noted on the excel sheet for 169 of them), 635 are pending, namely a percentage of 39.8%, 35 were rejected (a percentage of 2.2%) and 10 were withdrawn (a percentage of 0.6%).

Pending applications

Out of a total of 1.597 applications, there are 635 applications pending. For 91 of these, the officers handling the excel sheet have recorded notes regarding money laundering, forged data/documents, high risk applicants (PEP etc.), possible criminal cases, doubtful source of income, fraud, tax evasion, bribery, accusations of forgery, convictions in their countries of origin, inclusion in the Panama Papers, etc.

In our view, it appears from the information we had available for these applications, many of which were submitted over 15 months ago, that they should have already been rejected, something we could have already confirmed if our access for further audit had not been restricted.

Data indicating possible intervention of the former Minister of Interior in order to speed up the examination time of certain applications

From the 748 applications that have been approved, there has been a clear discrimination for 23 of the applications on which there are "Instructions by the Minister of Interior to speed up the process."

After analyzing the relevant data, it appears that the average processing time for these 23 applications was 169 days (with the minimum processing time being 101 days and the maximum being 283), compared to the remaining 725 applications for which the respective average time was 327 days (with the minimum processing time being 215 days and the maximum being 716).

We have recorded the matter as we have found it, stressing that this issue concerns only the President of the Republic within the framework of his own exclusive constitutional responsibilities and consequently our Office, apart from recording the facts, does not make any recommendations on this issue.

Naturalization of family members of a great number of foreign businesspersons and investors, without this being provided for in the relevant Law

In subparagraph (2) of the newly-introduced article 111A of the Civil Registry Law of 30.4.2013, the Council of Ministers was given the power to , under such terms as would be specified for each individual case, be able to allow the naturalization, by exception, of foreign businesspersons and investors. The power given to the Council of Ministers pertains to foreign businesspersons and investors and not their family members. However, in all its Decisions the Council of Ministers extended the possibility of naturalization to cover not only the foreign businesspersons and investors, but also their family members.

But, it is known that, every divergence from the framework provided by the enabling Law, constitutes misuse of power.

It is our opinion that this issue, which does not regard only the cases examined in this Report but possibly thousands of cases where Cypriot citizenship has been granted to family members of foreign businesspersons and investors that have been naturalized from 2013 until today, is a highly legal matter and consequently we are limited in our furtherance of it. In our view, this issue should be taken up by the Independent Examination Committee for Deprivation of Citizenship that has been established based on article 113 of the Civil Registry Law.

We stress the economic consequences from the granting of Cypriot citizenship to possibly thousands of persons that have not invested even a single euro towards Cyprus' economy.

Also, in three out of the five cases we examined, there is reasonable suspicion that the real investor was the husband, but the application was submitted by his spouse, probably because the investor, who was a person with a high-risk profile, would not need to explain the source of origin of his money. Consequently, providing the means for the naturalization of spouses, without their effectuating any investment, increases the risks of the Programme.

A similar issue, even though for fewer cases, also transpires from the Decision of the Council of Ministers, dated 4.1.2011, for the naturalization of family members of persons naturalized on the basis of the then effective legal framework allowing naturalization of foreigners in extremely exceptional cases based upon the provision of high-level services to the Republic, for reasons of public interest.

The Council of Ministers, through the passing of the Civil Registry (Amendment) (No. 2) Law of 2020, has now been given the legal power to naturalize the family members of foreign businesspersons and investors.

In connection to this, we note that in our Special Report titled "Audit of the Army Conscription System of the National Guard (ΥΠΑΜ-ΓΕΕΦ-01-2019)" we had highlighted one more case where the Council of Ministers had taken a Decision regarding naturalized foreign businessmen/investors in diversion of the framework set out by the relevant authorizing Law, which in that case also constituted misuse of power. Specifically, we had found that the Council of Ministers, in its meeting dated 23.5.2014, decided to exempt foreign businesspersons/investors and their male children who are naturalized by exception as Cypriot citizens, from the call for enlistment in the Force, for reasons of public interest, based on criteria and terms that had been specified in its previous decisions. The above decision was taken so that military service in the National Guard would not be a deterrent for foreign investors. However, as we determined, the specific Decision of the Council of Ministers did not comply with the provisions of the National Guard Law (N.19(I)/2011).

Recommendation:

- **Taking into account the serious drawbacks found in the Programme due to the current policy which allows the naturalization of persons due to the fact that they are family members of a naturalized businessperson or investor, without having made any investments, the necessity of its possible revision must be examined.**
- **In our view, the Independent Examination Committee for Deprivation of Citizenship must examine the, possibly, thousands of naturalizations of family members of naturalized persons that have already been made.**

Naturalization of five persons as family members of foreign businesspersons and investors examined in this Report

Out of five files examined, it was found that, along with the five naturalized foreign businesspersons and investors, five more persons were also naturalized, and specifically, in one case these were the spouse of the naturalized person and their adult child, in two cases this was the spouse and in one case this was the unmarried partner.

For two of the five naturalizations of family members of the naturalized persons, it was found that not even the criteria set out by the Council of Ministers were fulfilled. We also determined that another such problematic case is pending.

Recommendation:

The above two cases must concern the Independent Examination Committee for Deprivation of Citizenship.

No provision of a clear criminal record certificate

In one case, a clear criminal record certificate was submitted by the three applicants (investor and family members) from the country of their habitual residence and from a country where they appear to also have citizenship, but a clear criminal record certificate was not found from their country of origin (a country outside the EU). From the existing data, it seems that they could not secure such a certificate from their country of origin.

Recommendation:

In our view, this case must concern the Independent Examination Committee for Deprivation of Citizenship.

No ownership of a main permanent residence

According to the terms that had been included in the Decisions of the Council of Ministers dated 24.5.2013, 19.3.2014 and 13.9.2016, there was a requirement for the applicants to own a permanent private residence in Cyprus. We found three cases where the applicant did not fulfil this term but he/she was granted the Cypriot citizenship.

Recommendation:

The possibility of the revision of the relevant Regulations (RAA 379/2020) must be examined which calls for the applicant to be the owner of a permanent residence at the time of issuance of the Certificate of Naturalization. Alternatively, in case it is deemed appropriate to maintain the current policy and allow the permanent residence to be under construction, then to allow for the application to be submitted and approved conditionally, the Certificate of Naturalization should be issued only after the completion of the construction of the residence, in order to eliminate the administrative monitoring costs.

Also, in our view, the above cases must concern the Independent Examination Committee for Deprivation of Citizenship.

Failure to ensure the origin of money from abroad

According to the Decision of the Council of Ministers dated 13.9.2016, for the investment in immovable property, developments and infrastructure projects and the purchase of a permanent private residence, the applicant must produce receipts of payment of the agreed purchase price and evidence that the relevant remittances regarding the investment have come from abroad to the Cypriot commercial bank institution, in the name of the seller or the company. We have found that in four out of five naturalization applications examined, the origin of money from abroad was not adequately ensured.

Recommendation:

The above cases must concern the Independent Examination Committee for Deprivation of Citizenship, the Unit for Combating Money Laundering (MOKAS) and the Central Bank of Cyprus.

Naturalization of persons whose investment can be considered as high risk for money laundering

In the first case, one of the applicants was a politically exposed person, which is a fact that was not mentioned in his curriculum vitae. In the second case, for one of the applicants there were negative publications and he was included in the list of sanctions of the European Union. In the third case, it was recorded in the curriculum vitae of one of the applicants that he was a politically exposed person, but this does not seem to have been taken into account. In the fourth case, for one of the applicants there was an investigation pending by Interpol from his country of origin for offences of a financial nature.

For the above cases, the House of Representatives was not informed as provided for in the relevant legislation.

Recommendation:

The above cases must concern the Independent Examination Committee for Deprivation of Citizenship, MOKAS and the Central Bank of Cyprus.

Findings regarding data showing the existence of dubious transactions

We found three cases where the repayment of the agreed amount was made at the initial stages of the construction of the residence, before the delivery of the property. This does not constitute normal practice in the market and may indicate a dubious transaction.

In one case, the value of the five properties acquired, in terms of general valuation prices dated 1.1.2018 of the Department of Lands and Surveys, amounted to €877.800, which compared to the stated purchase price (€2.070.000) is lower by €1.192.200, a fact that may imply a dubious transaction.

Also, according to the data we have received from the Ministry of Interior, the remuneration of the Service Providers does not appear anywhere. We believe that this must be made obligatory.

Recommendation:

In our view, the above cases must concern MOKAS and the Central Bank of Cyprus.

Also, in our view, the Regulations on Honorary Naturalization for Reasons of Public Interest and Naturalization of Foreign Business-Owners or Investors (RAA 379/2020) should be amended in order for the written agreement between the investor and the Service Provider that is provided in Regulation 14 to be simultaneously submitted, for reasons of transparency and adequate taxation, along with the application of the investor to the Ministry of Interior.

Findings regarding the non-fulfilment of investment criteria and loss of tax and other kinds of revenues

We have identified three cases where naturalization was approved without the investment criteria being fulfilled, or without any documentation regarding their fulfilment. In one of the cases, there was alienation of immovable properties after the naturalization and before the lapse of the specified three-year period of retaining the investment.

In three cases, the company of the seller had not submitted income statements for some of the years 2016, 2017 and 2018 and consequently any taxable profit occurring from the sale of the immovable properties has not yet been declared

In one case, the company that the investor established did not submit income statements for the years 2017 and 2018.

In one case, the company of the seller submitted zero turnover for the year during which the sale was made. In another case, the company of the seller stated zero turnover for VAT for the period of the transaction.

In one case, the purchase receipts were not tax receipts.

In one case, the seller's company did not appear to be registered in the VAT register, even though the company was declaring a significant turnover in its income statements.

In one case, the investor made use of the reduced VAT rate (5%) for purchase of a first residence. We do not agree with the decision of the Tax Department, as general rule, to use the reduced VAT rate for the purchase of or construction of a residence for naturalization purposes. The purchase of a permanent residence is in essence an investment, and according to the relevant interpretative circular, the implementation of reduced VAT rate by persons purchasing or constructing a residence in the Republic for investment or for leasing to other persons or exercising any business is not implemented. The Tax Department expressed a different opinion from our Office. However, according to the relevant European Directive, using the reduced VAT rate is only allowed within the framework of social policy. We believe that it is clear that the investments of wealthy foreign investors do not fall under this framework.

We noted that a company which is one of the shareholders of a company of one of the sellers, has published the Programme on its webpage, in contrast to the Decision of the Ministerial Council dated 9.1.2018 that prohibits its promotion.

Recommendation:

In our view, the above cases must concern the Independent Examination Committee for Deprivation of Citizenship and the Tax Department.

2. General conclusions

This audit constitutes a compliance audit and not a performance audit and consequently, within its framework, we have not examined whether the Programme safeguards government revenues in an economic, efficient and effective way, and therefore we have not examined whether the benefit from the Programme for government revenues outweighs or fall short of any loss caused.

From this compliance audit, questions arose that are recorded in Paragraph 4 of the Special Report published on our website on 24.9.2020 and for which we consider that measures should be taken by the executive and legislative power. Specifically, apart from the issues of accountability and the possible revocation of naturalizations, which the Independent Examination Committee for Deprivation of Citizenship would have to examine, as well as the issues that, depending on the case, the Tax Department, MOKAS or the Central Bank of Cyprus should have to examine, we have

noted the following significant drawbacks of the Programme, and which we recommend be handled by the executive and legislative power:

- The alteration of the nature of the Programme by introducing, as of August 2020 through legislation, the discretion to naturalize the family members of investors, without any essential economic benefit to the Republic.
- The absence of appropriate strategies that would ensure transparency and the tax revenues of the State as to the remunerations of the Service Providers.
- The weakness to monitor and the huge administrative burden imposed as a result of the Programme's discretion to invest in immovable property under construction.
- The absence of satisfactory control mechanisms that would reduce the possibility of fictitious investments or their premature abandonment..

Our Office highlights the negative image that has been created, within and beyond Cyprus, as to the implementation of the Programme, an image that has recently been exacerbated after the publications of the foreign television network Al Jazeera. The especially negative findings included in this Report, as well as the equally negative findings that seem to be included in the result of the tripartite Investigating Committee that have recently been published in detail, can constitute the means to restore this negative image.

In particular, the audit carried out by the Supreme Audit Institution of our country, and our statement of intention that we will carry out a follow up audit, if the Programme continues, that will be planned and executed by the end of 2021, in order to reliably establish whether satisfactory corrective measures have been taken, we consider contributes to ensuring the prestige of the Republic and the protection of the Programme. In addition, transparency in managing state revenues has been intertwined, since the era of the Athenian Republic, with the rule of law and the accountability principles that must govern it. The finding however, through constitutionally-specified external audit, of any losses in the revenues of the state and the careful publication of the findings on specific cases, not only does not harm, but benefits, public interest.