

Conference Paper

Analysis of the Dynamics of Offshore Procedures

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Abstract

Today offshore operations play a crucial role in building the economy of the country. During the lifetime of the offshore operations the offshore schemes, the geography of the jurisdictions themselves and legislation have changed. The relevance of this article is that it discusses both the positive and negative sides of offshore.

Keywords: Offshore, offshore jurisdictions, capital investment, tax resident.

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1. Introduction

The term "offshore" appeared in the late 50-s of the last century on the East coast of the United States in one of the newspapers. It was then a financial organization, which escaped the control of governmental bodies using geographical selectivity, moving its activities to the territory with a favorable tax climate. Because this term includes both legal concept, and economic-geographical, in terms of the law, there is still no consensus about what can be considered «offshore». The word itself (offshore -"beyond the shore", "manufactured abroad") has several spellings, both in English and in Russian, so there is no consensus on how it is to write "offshore" or "offshore", both options are used equally, however, the "offshore" in everyday life appeared first. In the original you can also find "offshore" and "off-shore" separate writing "off shore" is very seldom found.

Opinions about offshore areas throughout their history have changed many times and there are both supporters and opponents of offshore jurisdictions. Previously, offshore advocates considered protection against raiders and property protection against political risks as one of advantages of offshores, that is currently not so important. Nowadays the positive sides of offshore zones include a major role in international trade, as financial centers with good reputation. Saying this offshore supporters do not forget to mention about tax-exempt structure that optimize cash flow and risk

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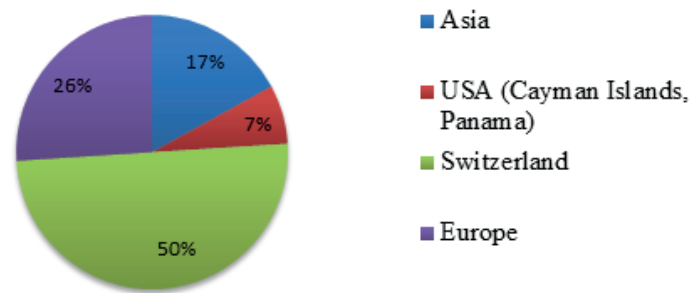


Figure 1: The share of offshore countries in 2005 year.

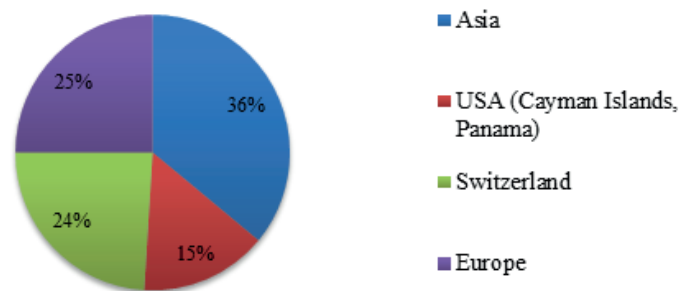


Figure 2: The share of offshore countries in year 2016.

management. Also for the organization of such zones simplify tax planning. For opponents offshore jurisdictions have always been associated with suspicious or even illegal activities. Until recently, all opponents of offshore only classified the possibility of money laundering through a variety of schemes in which the main filter was an offshore company or bank as a disadvantage. The use of offshore leads to irretrievable investments and capital flight from the country. Now with the evolution of Internet ability to remotely sell many products, ranging from music and software and ending with any consulting and Internet services, in this case, developed countries can easily use any measures to limit this activity. Because of the variety of offshore zones, individual entrepreneurs and corporations can use them for a variety of purposes, some of which may be illegal, but offshore guarantees anonymity to the owner that relieves him from any problems.

As for the geography of offshore jurisdictions, it has also undergone changes during their lifetime. At the beginning the 21st century leading positions in the number of offshore jurisdictions was occupied by Europe, in particular Switzerland due to the large number of offshore banks, a small share of the market was occupied by the Cayman

Islands, Panama (United States) and Asian countries (Fig.1). However, over the past ten years, the European market has lost its leading position to Asia (Fig. 2).

Since the beginning of the twenty-first century offshore jurisdictions are under scrutiny. In April 2006 at a meeting of the G-20 the decision was made to exchange information on jurisdictions, in particular on the offshore areas, which are uncooperative; also for them 49 recommendations were developed. Under the influence of the FATF, the OECD and the International Monetary Fund, many offshore jurisdictions have decided to strengthen legislation to prevent money-laundering and other illegal transactions. And after six years on the island of Jersey (offshore jurisdiction of the Channel Islands) 44 of the proposed recommendations were executed, which at the time exceeded the number of executable recommendations any other offshore zone. However, due to the constant growth of taxes in developed countries the number of offshore jurisdictions is growing even faster, and by year 2013, almost half of all the world's money was in offshore. According to the legislation of the Russian Federation relations with the companies, located in offshore zones are spelled out in many legal acts. Relationships in banking sphere are set by federal law No. 395-1 "on banks and banking activities" [3], article 28 "interbank operations" describes how to interact with foreign banks, including banks in offshore jurisdictions. Tax code of the Russian Federation also regulates transactions with residents of offshore zones (art. 105.14) [1]. For the purposes of anti-money laundering in August 2001 Federal Act No. 115-FZ (ed. by 29.07.2017) "on counteracting the legalization (laundering) of proceeds received by criminal way and terrorism financing" [2], was adopted and is still in force. In 2005 in his annual address to the Federal Assembly the Russian President announced the necessity to stimulate capital flows of citizens, including those in offshore jurisdictions to the national economy of Russia. Because the money accumulated in the offshore areas, *ibid.* is passed, and even inherited, but is not returned to Russia. The President proposed measures to address these issues. Legally order the President was enshrined in federal law No. 269-FZ of 30.12.2006 «on simplified procedure for declaring the income of persons» [4], which entered into force from March 2007 onwards. In November of the same year the Ministry of Finance adopted order No. 108 n from 13.11.2007 "on approval of the list of the States and territories providing preferential tax treatment and (or) assessment of non-disclosure and provision of information while conducting financial operations" [5], which listed 41 offshore jurisdiction, agreements with which are given special attention. Similar lists have been drawn up by the tax authorities, and CBR.

According to the analysis of Sberbank the annual capital output at the moment is about 75% of national income, about 700 billion dollars. At that, total financial assets of Russians: deposits, insurance, pension and other savings are approximately 500 billion dollars. Such inequality could stimulate economic growth, however, the majority of assets are not invested in the country's economy, creating jobs and expanding middle class, but "leak" to offshore. According to experts, due to tightening of sanctions against the Russian Federation, derived capital might return, but at the moment good conditions are not created for investments, there is nothing to invest in or it is too risky [9].

In May 2016 year Russia joined the automatic exchange of information, to combat offshore which was launched by the world developed economies. This agreement was signed on May 12 in Beijing, at the OECD Forum, it was joined by about 60 jurisdictions, including most of the offshore (Man, Jersey, British Virgin Islands, Bermuda, Gibraltar and others). To date, information is exchanged only for individual requests about a specific person or organization, and often the answer comes only a few months. However, from the year 2018 it is planned to receive absolutely any information gathered from all the countries participating in the Exchange. The agreement also provides the possibility of a spontaneous exchange of information, foreign tax authorities will inform the Federal Tax Service of Russia on suspicion of violation of the order of payment of taxes by the Russian resident. Many owners of controlled foreign companies related to the Bill were skeptical, however, they fall in the risk zone. Primarily companies receiving purely passive income not engaged in vigorous activity will be payed attention to [8]. But it will hardly affect the offshore business greatly. For example, the largest companies of the Russian Federation and the United States, whose share capital is in offshore jurisdictions, are far from having passive activities. In particular, they are the largest mining and steel companies, IT-corporations, pharmaceutical, financial, energy companies and other (table 1).

Also trusts fall under the agreement, if the account of the company is open for actual beneficiaries, the tax authorities will have access to information about these individuals. Business is forced to adapt to the current situation, given the toughened customer verification by foreign banks, the exchange of tax information, the disclosure of the beneficial persons and more. Primarily to combat offshore agreements have been developed in order to avoid double taxation that would allow withdrawal of capital from offshore jurisdictions at the lowest possible cost. Earlier information on the operations of Federal offshore tax services was impossible to get. Now, according to lawyers, risks from offshore-related schemes far exceed the received benefit, because

TABLE 1: The scope of activity of the largest companies with share capital in offshore.

Russian Federation		United States	
Company	Sphere of activity	Company	Sphere of activity
OA0 Rusal	<i>Mining company (aluminum)</i>	Apple Inc.	<i>Electronics, IT-technologies</i>
X 5 Retail Group	<i>Services (retail)</i>	Microsoft Corp.	
Jsc Hc "Metallinvest"	<i>Gorno-metallurgicheskaya Kompaniya</i>	General Electric	<i>The diversified Corporation</i>
OJSC "Magnitogorsk iron and steel works"		PFIZER	<i>Pharmaceuticals</i>
Novolipetsk iron and Steel Corp.		MERCK	
Jsc "Mechel"		Johnson & Johnson	
EVRAZ		CISCO System	<i>Network equipment</i>
Jsc Mmc Norilsk Nickel		EXXON MOBIL	<i>Energy</i>
Jsc "Severstal"	<i>Steel mining company</i>	GOOGLE	<i>Internet technology</i>
Mototrest		CITIGROUP	<i>Finance</i>

the structure of cash flows, their owners, as well as the location of the assets may become known to the tax office. However, consultants are ready to offer businesses new schemes, insurance wrappers for investment portfolios, cunning funds and more, however, these solutions are either too expensive or not save from all tax risks [8]. One option to shelter from taxes is tax the residency in another country (offshore jurisdictions). It is easy enough to get, as a rule, it is determined by the number of days spent in a country or ownership of property or permanent registration. However, for example, there is a possibility to be recognized as a tax resident in Switzerland, not even while in the country, the same is true for Italy. The reform is being prepared on the island of Cyprus, according to which it will be enough to spend 60 days in the country, engaging in commercial activities to obtain a tax residency. And in the United Arab Emirates one and a half months is enough for this [6].

Every year the pressure on offshore intensifies, many countries unite their efforts in programs to prevent tax crimes, Swiss banks which have always been considered reliable financial shelter for anonymous contributors, as well as offshore banks jurisdictions began to disclose the data of their clients. In this regard, fewer places remain where the Organization could keep their capital, without revealing the name of the owner, therefore, offshore lose their attractiveness for medium and large businesses.

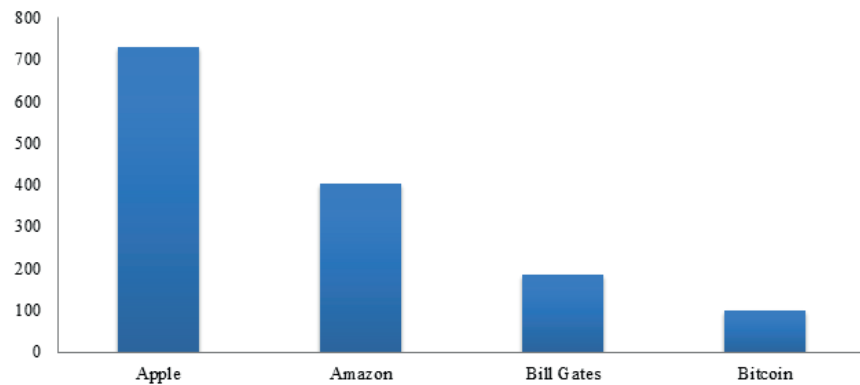


Figure 3: assets of the securities market (billion United States dollars).

According to some specialists in the field of law soon offshore may be replaced by a "super tax sanctuary" – crypto-currency. E-wallets are not subject to any particular state, and are not taxed, no organization has the opportunity to reveal the affiliation of this account of any organization or person. Crypto-currency is quite a convenient way of paying for goods and services, for both individuals and organizations, since all payments are carried out in conditions of complete anonymity, only correspondence with the supplier can be subject to disclosure, however, such problem is easily solved through the use of secure email services. Using crypto-currency opens huge space for financial organizations; it can even be used in complex commercial transactions with dummies, working with local currencies, as agents [11].

On the other hand it is argued that crypto-currency can not only replace but improve offshore, making them more open to the public. Because technologies of crypto-currency are decentralized and capture all the information, none of the parties has an opportunity to upload false data. Thus, through crypto-currency public may have authentic and open history of financial transactions. However, these technologies are not required to be public, as there is a possibility of implementing particular cases in their application. Crypto-currency, unlike a lot of other ways of guaranteeing the privacy of the owners, shall disclose all phases while maintaining anonymity by using the keys. In other words crypto-currency technology guarantees anonymity, revealing all financial processes for stakeholders [12].

At the moment, none of the States there has working mechanisms to regulate the crypto-currency operation, there is also no mechanism to control transactions using crypto-currency. And it is difficult to judge exactly how regulation of operations with crypto-currency can be enshrined into law. Therefore, whatever the effect of crypto-currency on the offshore jurisdictions, in our time, this prospect is accompanied by high risks.

It is also worth noting that the market of the largest crypto-currency in the world (Bitcoin) has a very low level of capitalization (fig. 3). At this point it is around 100 billion dollars, much lower than the cost of many other popular assets [10].

Summing up, it should be said that for many years of the offshore procedures existence specialists always named both the advantages and disadvantages of such activities. Geography has changed, the Asian market has expanded offshore jurisdictions. Legal regulation of offshore operations has changed and developed. At this point, most of the States of the world are closely watching offshore, agreement on automatic exchange of information facilitates it. But offshore schemes operations that allow you to evade taxes, up to providing tax residency in offshore jurisdictions, are not inactive. According to law experts, the demand for offshore projects is an unstable phenomenon. Some believe that legislative changes affect the number of offshores only temporarily, while others think that most organizations have already made their choice. Offshore schemes will not disappear, but to register a company in the territory of an offshore jurisdiction becomes much harder. For full elimination of offshore in Russia it is necessary to strengthen and stabilize the judiciary in protecting capital and to develop investment market [7].

One should not forget about developing market of crypto-currency, opinions on which also differ. It is difficult to judge whether crypto-currency will replace offshore or will make them more transparent. In any case, at this point, operations with crypto-currency are not legislatively enshrined, indicating high risk of such a prospect, and the market has a too low level of capitalization among other significant assets in the world.

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