

**Czech University of Life Sciences Prague**

**Faculty of Economics and Management**

**Department of Economics**



**Bachelor Thesis**

**Offshore financial markets analysis - Case study of Russia.**

**Valentina Ryzhova**

# CZECH UNIVERSITY OF LIFE SCIENCES PRAGUE

Faculty of Economics and Management

## BACHELOR THESIS ASSIGNMENT

Valentina Ryzhova

Business Administration

Thesis title

Offshore financial markets analysis – Case study of Russia

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### Objectives of thesis

The aim of the thesis is to analyze how offshore business affects global economic development processes with focus on Russian companies. And to study the principles of functioning offshore zones and companies.

### Methodology

Theoretical part consists of explanations of considerable theoretical aspects received by analyzing of literature and information, including determination the nature of offshore zones, identifying the main reasons and motives of using offshore companies, analyzing the mechanism of using offshore companies, examination the current state of the market of offshore services.

In the practical part, analytical method was used to analyze and interpret the curves and the factors causing the economy of Russia.

Graphs, figures and statistical tables were used to better understanding and visualization of presentation of the results of research.

**The proposed extent of the thesis**

40 – 60 pages

**Keywords**

offshore companies, Russia, economic performance, capital outflow, finance outflow, export, import

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Babanin V.: *Analyz mezhdunarodnogo opyta vedeniya i regulirovaniya ofshornogo biznesa (Analysis of international experience in conducting and regulating offshore business)* // *Financial Management*. 2004. 96 p. №1

Kredisov I.: *Upravlenie vneshneekonomicheskoy deyatelnostyu (Management of foreign economic activity: a textbook for high schools)*, Kiev: VIRA-R, 2001. 632 p.

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**Declaration**

I declare that I have worked on my bachelor thesis titled "Offshore financial markets analysis - Case study of Russia." by myself and I have used only the sources mentioned at the end of the thesis. As the author of the bachelor thesis, I declare that the thesis does not break copyrights of any their person.

In Prague 14th of March \_\_\_\_\_

## **Offshore finanční trhy analýza - Případová studie Ruska.**

### **Souhrn**

Cílem této práce je analýza vlivu offshore podnikání na procesy globálního ekonomického rozvoje se zaměřením na ruské offshore společnosti. Dalším cílem je zkoumání principů fungování offshore zón a společností.

Tato práce se skládá ze dvou částí. První část, teoretická, popisuje obecně proces offshoringu, stanoví hlavní důvody a motivy vytvoření offshore společností a analyzuje současný stav trhu offshore služeb.

V druhé části se zkoumá vliv offshore společností na ruskou ekonomiku. Podle odhadů, offshore společnosti tvoří 70-80% ruské ekonomiky a tento podíl neustále roste.

**Klíčová slova:** offshore společnosti, Rusko, ekonomické výkonnosti, odliv kapitálu, odliv financí, export, import.

## **Offshore financial markets analysis - Case study of Russia.**

### **Summary**

The aim of the thesis is to analyze how offshore business affects global economic development processes with focus on Russian companies. The aim of this thesis is to study the principles of functioning offshore zones and companies.

The thesis is divided into two parts. First part is the theoretical part including determination the nature of offshore zones, identifying the main reasons and motives of using offshore companies, analyzing the mechanism of using offshore companies, examination the current state of the market of offshore services.

The second part will analyze the impact of using offshore companies on Russian economy. Right now it is estimated that 70-80% of the Russian economy is managed from offshores and their amount is steadily growing.

**Key words:** offshore companies, Russia, economic performance, capital outflow, finance outflow, export, import.

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## **1. Introduction.**

Rapid growing globalization of the world economy has led to occurrence of such phenomena as the development of offshore activities. These activities are expressed in various forms: the creation of offshore jurisdictions, the expansion of offshore companies, rapid growth of offshore services. Companies established in offshore areas are becoming one of the the global economic area components.

Offshore business directly affects global economic development processes. The using of offshore tools in international investment and foreign trade activity is widespread among Russian companies. This is caused by the relevance of the chosen topic. This phenomenon resulted in choosing current topic for the thesis.

The aim of this thesis is to study the principles of functioning offshore zones and companies.

To achieve this goal it is necessary to solve the following tasks:

- to determine the nature of the offshore zones;
- to identify the main reasons and motives of using offshore companies;
- to analyze the mechanism of using offshore companies;
- to examine the current state of the market of offshore services;
- to identify Trends and Prospects of offshore zones.

The subject of study is the work of offshore companies and their jurisdictions.

## **2. Objectives and Methodology**

### **2.1 Objectives**

The aim of the thesis is to analyze how offshore business affects global economic development processes with focus on Russian companies. And to study the principles of functioning offshore zones and companies.

### **2.2. Methodology**

Theoretical part consists of explanations of considerable theoretical aspects received by analyzing of literature and information, including determination the nature of offshore zones, identifying the main reasons and motives of using offshore companies, analyzing the mechanism of using offshore companies, examination the current state of the market of offshore services.

In the practical part, analytical method was used to analyze and interpret the curves and the factors causing the economy of Russia.

Graphs, figures and statistical tables were used to better understanding and visualization of presentation of the results of research.

### **3. Theoretical Foundation.**

#### **3.1. Offshore companies in the international economic system.**

##### **3.1.1 Definition and typology of offshore zones.**

Offshore zones are countries and/or regions that perform registration of companies, whose activities extend preferential tax treatment. Companies registered in offshore centers are under the jurisdiction of the host country and must strictly abide by local laws.<sup>1</sup>

Offshores give companies the following advantages: tax benefits, considerable freedom in the management of accounting reports, the absence of foreign exchange controls, the ability to conduct transactions with residents in any foreign currency, debt costs on the spot, anonymity, secrecy of financial transactions (there is only requirement to inform the authorities about suspicious transactions related to the drug trade). The internal loan market area is isolated from residents' accounts. Classic offshore option involves economic and financial activity in the offshore non-residents only. It follows that the offshore is economical and organizational concept, means the way of doing business, tax planning tool. Legal or not legal are offshore activities can be defined only within the law.<sup>2</sup>

There is a simplified registration procedure in offshore zones. The minimum capital is usually not installed. In most offshore zones it is not required to provide a report of the management of accounts or tax declarations. External auditors are required not in all offshore zones. Company's accounts can be checked only by owner's permission. The only form of reporting in the majority offshore zones is the annual financial report.<sup>3</sup>

The total number of offshore zones in the world can be determined only provisionally, as every year some of them disappear or cease to function, and others appear. The geography of offshore zones is quite extensive: British Virgin Islands, Belize, Gibraltar, Panama, Seychelles, Dominica. Offshore exist even in Russia, although it is called differently - preferential tax zone. However, offshore within a state, which is not a territory with low tax, are not uncommon. Thus, there are internal offshore zones in the United States: states of Delaware, Nevada and Wyoming; there are also offshores in Switzerland - Nematel, Fribourg, and Zug cantons; in the United Kingdom the internal offshore is the Isle of Man, Guernsey and Jersey. Less known is Portuguese offshore - the

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<sup>1</sup> Prihodko S., Volovik N.: *Osobyje Economicheskie zony (Special economic zones)*. Moscow: IEPP, 2007. 268 p. ISBN 978 5 93255 229 2.

<sup>2</sup> Offshore zones. Available at: <http://www.megarela.ru/rabota/offshore.html>

<sup>3</sup> The concept of the offshore zone and the global experience of functioning. Available at: <http://russeca.kent.edu/InternationalBusiness/Chapter10/T10P31.html>

island of Madeira; in Italy it is town of Campione and others. Of course, each offshore zone has its own policy including economic, and its requirements to the companies and their owners.

Offshore areas are taken into account on the list of national banks of different countries and the International Monetary Fund (IMF). In Russia it is the Central Bank of Russian Federation. Russian list is very similar to the list according to the International Monetary Fund, but is more advanced due to some states and territories, which are not recognized by the IMF as offshore. List of the Central Bank of the Russian Federation is divided into 3 zones. This distinction is explained by the degree of confidence in the regulation of financial transactions. Areas belonging to the first group, do not require a reservation of funds to carry them out, in the second group needs a reserve of 25%, in the third - 50%.

Offshore jurisdictions are divided on two main criteria (according to the requirements of reporting and the tax regime and the possibility of identifying the real owners) into three groups.

The first type is those areas that do not require any reporting. They have a high degree of confidentiality of the real owners. More than 1/3 of all existing offshore companies registered in countries of this group. To register a company in this area, there must not be any commercial activity in the jurisdiction. In offshore jurisdictions of the first group include such areas as: Panama, British Virgin Islands (BVI), Bahamas. The cost of establishing usually includes the minimum service. It is necessary to maintain the secretarial office. The opening an offshore does not require a lot of time. On average, it takes two weeks.

The second group is the areas in which the activity of the companies is subject to strict control. But in these areas there are significant tax benefits. Higher requirements for offshores increase the level of loyalty in business, and this, in turn, allows to find a more long-term partners, because multinational companies and banks are reluctant to deal with organizations that are registered in offshore zones of the first type. The second group of offshore jurisdictions includes Gibraltar, Ireland and Seychelles. Although it is necessary to provide reports in a particular country or not, information about companies and entrepreneurs is subject to obligatory registration.

The third group is, in fact, not offshore. In these countries foreign companies have the opportunity to engage commercial activities with significant tax benefits. Often, it is used the term onshore to indicate companies, which are registered in these countries. The offshore jurisdiction of the third group includes the United States, England and Cyprus. For example, in the United States, there is an opportunity not to pay federal taxes for non-residents, if their activities are not connected with transactions within the country. If the violation was observed, the company loses its offshore

status. There are common offshore schemes in England: the office can be located in the UK, but the branch, through which conducted operations, is located in Cyprus. Taxes in the UK are high, but if the profit is not large, they are lower than the nominal value of 30%, or even tend to zero. Because of the legislative changes, Cyprus is no longer so attractive for Russian business as it was in the 1990s. But the absence of double taxation of companies in the area of international business is a very strong argument to open a business there.<sup>4</sup>

Each offshore area, as well as each offshore company has its own specifics. According to the specifics there are several types of offshore zones:

1. Classical offshore zone - the area in which the company pays a fixed fee for a licensee for activity. The company is exempted from other taxes (Panama, Bahamas, British Virgin Islands, etc.).
2. The low taxation zone - the area in which the company enjoys significant tax benefits at the taxation (Cyprus, Hungary, etc.).
3. Other areas with favorable conditions for tax and financial planning - company tax can be minimized by constructing financial schemes taking into account the features of legislation in this zone (United Kingdom, and others).<sup>5</sup>

The most important criterion for the classification of offshore companies can be their image (prestige) in the eyes of the international community. The reputation of offshore defines the relationships of trade and financial partners to registered offshore companies. Historically, offshore jurisdictions that are located in the territory of EU Member States, belong to the so-called respectable (white) offshores.

There are many nuances in the tax legislation of offshore countries. For example, the company's activity, which is conducted within the country, may be taxed, and the rest of the activity is not subject to taxation. Or instead of a traditional tax can be a fixed annual fee. Or certain types of companies are taxed and others are exempted from tax payments.

In Russia there are also regions in which the tax incentives. For example, companies located in the territory of Evenkia are exempt from local taxes. For difference Russian companies with preferential taxation from foreign companies with preferential taxation, is accepted to call first as

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<sup>4</sup> Classification of offshores. Available at: [http://www.ajsconsulting.ru/article/klass\\_ofzone/](http://www.ajsconsulting.ru/article/klass_ofzone/)

<sup>5</sup> Babanin V.: *Analyz mezhdunarodnogo opyta vedeniya i regulirovaniya ofshornogo biznesa (Analysis of international experience in conducting and regulating offshore business)* // *Financial Management*. 2004. 96 p. №1

low-tax companies, and the second as offshore companies. For completeness, it should be noted that there is a different terminology, where offshore companies are called companies which are completely exempt from taxes and fee paying, and low-tax companies are companies enjoying tax benefits. Advantages of Russian low-tax companies consist mainly in location on the territory of the Russian Federation. Firstly, foreign ownership of offshore often compromises its owner. On the other side Russian company in the eyes of others just looks like a Russian company which is carrying out its normal activities and not to evade taxes. Secondly, the geographic proximity makes managing of the company easier. Besides, the management of a foreign company is always connected with the language barrier. Thirdly, managing a foreign company, it is easier to make a mistake, it is easier to misunderstand something, it is easier to become deceived.

### **3.1.2 Reasons for the creation and direction of development of offshore zones**

The laws of some countries provide the creation in some areas of special favorable treatment of the work, which is created for foreign companies (and sometimes resident companies) tax preferences and other benefits, providing in some cases a complete tax exemption.

The reason for the creation of offshore zones is the following: it is known that any state cannot exist without an appropriate financial base. The state must contain the control apparatus, the army, the police, the justice system, as well as to finance other expenditures. Necessary for these needs money the state receives in the form of tax payments that collects from citizens and companies operating in the territory of that state. However, to collect a sufficient amount of money to finance all the state needs is not always possible, because some states are very small, its population is also small, and there are not a lot of high-yielding large enterprises. In this case the government of such a state has an important problem of financing public expenditures. There is a possibility of obtaining financial resources in addition to taxes.

They are as follows:

- To finance public expenditures it is possible to use emission mechanism. In this case the state refuses to tax collection and staff employees, who carry out this function. Instead of this, the state carries out the budget funding from the unsecured emission of money. The result of this budget policy is inflation. If the budget costs are relatively low, inflation will be at an acceptable level;
- The state can avoid taxes if it is received sufficient payments from another state for any service, such as the transit through its territory of oil or gas, or the provision of its territory under foreign military base;

- The government can obtain the necessary financing from foreign citizens and companies (non-residents), if will create for them a comfortable and favorable business environment. If the government will create the necessary conditions on its territory, it gets the name of the offshore zone or offshore jurisdiction. Offshores are received capitals at the expense of registration and annual fees from offshore companies, as well as tax payments. By making easier or fully canceling the tax payments, an offshore area attracts foreign companies, which have benefit from opening a new firm or its affiliates in the offshore jurisdiction.

Such working conditions of offshore companies in recent years have attracted more and more participants. Currently, about half of the international migration of capital in one form or another goes through offshore companies.

In today's economy the most important goal of establishing offshore jurisdictions is to attract financial business. Switzerland is the first modern model of financial secrecy jurisdiction, created as a haven for foreign capital. In the 18th century the City Council of Geneva (Switzerland) passed a law that required bankers to keep records of the accounts of its customers, but forbade them to disclose the records to anyone else without the express consent of the City Council.

The opening of offshore is expedient for a wide range of business activities: in the field of securities market and investment, trust operations, the formation of holding companies, ship-owning companies, commercial banks, companies providing professional services and many others.<sup>6</sup>

Since the 1990s, the offshore business in Russia was widespread. Thousands of domestic commercial banks, investment and industrial companies involved in the international offshore business, began to create offshore holding companies and their subsidiaries. In addition, some republics within the Russian Federation, formed in their territory offshore zones in order to attract funding from outside.

It is natural that Russian government can not remain indifferent to such vital economic processes that directly affect its interests. These interests are follows. In the offshore business there are three interested parties: the offshore company, offshore zone and the State, whose company is registered in an offshore jurisdiction. For the first two participants business relations are mutually beneficial character: offshore jurisdiction solves their financial problems at the expense of charges for non-resident companies and companies receive an effective tool to reduce tax payments and maximize

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<sup>6</sup> Kredisov I.: Upravlenie vneshneekonomicheskoy deyatelnostyu (Management of foreign economic activity: a textbook for high schools), Kiev: VIRA-R, 2001. 632 p.

profits. As for the the third member, the State, whose companies are registered in an offshore zone, benefits do not have an obvious character. Therefore, when the State gives a legislative permission of offshore business, it is necessarily to take into account two diverse reasons: firstly, offshore status allows domestic firms to operate in international markets anonymously and with minimal tax losses, which certainly increases their competitiveness. But at the same time it should be considered the second important fact: the status of the offshore partly or completely findings of the national companies from tax-free, and allows almost uncontrollably to carry out international capital migration, which can turn to the state considerable financial losses.

Currently operating regulatory system in Russia of foreign economic activity does not interfere with the operation of the offshore business. However, it contains a number of restrictions, allowing to control this type of business in order to avoid abuses in this area. The main laws and regulations in the field of regulation of offshore business are contained in the Law of Russian Federation "About Currency Regulation" - the whole package of taxation laws, about foreign investment and production sharing, regulations and instructions of the Ministry of Taxes and Duties, as well as the Russian Central Bank. Despite the diversity of all these laws and regulations, all of them in one way or another are trying to protect the state's interests and to reduce financial losses, that may bring uncontrolled offshore business. Among these measures, the most important place is occupied by supranational (international) legal acts and agreements - in particular the agreement on avoidance of double taxation. The meaning of such agreements is to try to streamline tax collection and fair their section.

There are two basic approaches to this problem. The first approach is in full exemption enterprise from taxes, which has already paid taxes or charges in one of the participating States the treaty on avoidance of double taxation. It is obvious that such a system, in generally, adhere to the States, with have an equal balance of fees for non-resident companies. System of exemption from taxes is used in the Netherlands, Austria, Switzerland, France, Norway and Russia.

The second approach to the regulation of taxes and fees is when a company has paid tax abroad, it would be counted this company while paying of internal taxes. Thus, if a foreign company has paid an amount in excess of domestic payments, it is completely exempt from tax; if the external payments less then internal, then company pays the difference in its country. This system is called



a tax credit system and is used in the United States, Japan, Ireland, Greece and several other countries.<sup>7</sup>

Now the fundamental changes take place in the domestic business. Companies tend to use all available mechanisms for raising capital, and their owners are aware of the benefits of openness. As a result, the using of offshore schemes become less common and popular. Gradually large companies give it up, this trend also seen in the mid-market. Of course, the policy of developed countries, which are consistently fighting with offshores, also affects on it.

In the past two years the important changes in the offshore areas occur: under the pressure of the European Union taxes are raised. But along with the appearing with "normal" companies, necessary for tax evasion, a new type of foreign subsidiaries structure began to appear. Which was designed to serve the expansion of Russian companies in the western markets and to attract "real" foreign investments.

Today the foreign structures are created by Russian groups not for the purpose of tax evasion, but to solve other problems. The main ones are the attraction of cheap financing, doing business abroad and the reduction of political risk. Of course, in solving the above problems, taxpayers also take into account issues related to the minimization of taxation.

Russian companies are entering to the European markets and to do so they need the strong basis. Unfortunately, due to the fact that there are no normal business laws in the Russian legislation, offshore companies are the way out of the situation. First of all, these structures help to solve issues relating to wills and inheritance transfer of property. In addition, one of the reasons for the establishment of offshore companies is practically absence in Russia such things as "holding companies", which, in fact, do not carry out direct operation, but only own shares and stakes in subsidiaries. These structures assume different tax and accounting system. Many large companies create subsidiaries (and not only in offshore areas) including the convenience of working in foreign markets, as well as for equity loans.<sup>8</sup>

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<sup>7</sup> Galkin V.: The causes and principles of offshore business. Available at: <http://vadim-galkin.ru/articles/offshore-business/2/>

<sup>8</sup> Why money are hidden in offshores. Available at: [offshore.jofo.ru/18301.html](http://offshore.jofo.ru/18301.html)

### **3.1.3 Features of functioning of offshore zones**

The special features of offshore zones, which are so attractive to foreign investors, include the following:

1. The registration procedure is simplified in the offshore areas: usually the minimum size of the authorized capital is not set, but if it was set, it can be unpaid; identity and names of owners of companies can not be disclosed to third parties;
2. The income tax in offshore areas absents or does not exceed 1-4%. In some cases it can be replaced by an annual fee regardless of the size of income. The export income taxes (like dividends, royalty payments, interest rates, etc.) usually also absents.
3. There are no restrictions on the import and export of currency in the offshore areas. Offshore companies are free to open their deposits in any currency and in any foreign bank.
4. Most States of offshore areas are not considered a violation of the customs and tax legislation as a criminal offense. The bookkeeping is not required and checking company accounts is possible only by the decision of the local court or the owner. The only type of reporting is the the annual financial report.
5. The company management is extremely simplified process. The control is carried out with the help of the secretary with the company proxy holder. Some offshore owner's anonymity is ensured by the possibility of issuing bearer shares.

The creating an offshore company and working with it is different from the creation of legal entities in domestic legislation. Upon registration of offshore, the first step is to determine the goals that are pursued by using this non-resident company. Most often the offshore companies follow these aims: minimization of taxation of Russian companies; using an offshore company as an intermediary in the import-export operations; using an offshore company to accumulate monetary funds and international payments. Depending on the goals, the work with offshore companies has its own specifics.

### **3.1.4 The usage of tax benefits of offshore zones**

Tax laws in some areas suggest a low taxation for certain groups of investors (usually foreign). The reducing of income tax of enterprises sometimes achieved by using conditions of international agreements on avoidance of double taxation or residency of companies. Characteristics of offshore zones, in terms of the concessions granted to offshore companies, is presented in the table below.

**Table 1. Characteristics of offshore zones, in terms of the concessions granted to offshore companies.**

Type of offshore	Features	Jurisdiction
Limited offshores, requiring reporting	The presence of favorable conditions for taxation of offshore companies.	Cyprus
Offshores, giving tax cuts to a specific type of activity	Certain activities are taxed at lower rates. Usually, the benefits for the holding companies of banks.	Gibraltar, Luxembourg, Guernsey, Maine, Austria
Jurisdictions, providing some benefits to non-residents	The standard conditions of taxation for residents. some benefits to non-residents and certain types of companies	UK, Netherlands

Source: own processing

In general, despite the concessional taxation, certain offshore jurisdictions significantly different in provided tax benefits. If companies with special tax status (exemption or zero tax rate applies if the income source is located outside of these areas) low or zero level of taxation exists in almost all jurisdictions, for the other types of companies, including non-residents, the tax rate is vary enough.

However, there is a strict control by governments of usage the such benefits by companies; they work closely with the international organizations.

The using of offshore areas in order to optimize the tax depends on the type of activity:

1. In order to import and export.

This scheme involves the usage of various offshore jurisdictions, and it is the most common in Russia. Exporting, buying goods at the lowest price, and then, realizing it to final buyer, offshore company leaves a tax-free and not controlled by local authorities difference. When an entrepreneur buys goods in Russia for export, VAT is already paid, and a refund of it will be only the next year. Buying product directly on behalf of the foreign company, entrepreneur does not pay VAT. Controlling price of a contract between their companies, the entrepreneur takes on a minimum profit of Russia, concentrates the main profit in the offshore, thereby optimizes the size of tax payments.

## 2. The offshore contracting company.

As it is known, the income tax in any State is the difference between the gross revenue and the amount of expenses, which is deducted from the gross revenue. It turns out that there are two methods of reducing the income tax: decreasing in gross revenue or increasing costs. As a contractor company can perform the following functions: to provide jurisdiction, information, auditing and marketing services, lending, in this case the money that was paid to offshore company will be transfer to a foreign account and spent amount will reduce the income tax of Russian company.

## 3. Investment activities of offshore companies.

There are offshore zones, which are not taxed on the capital gains. Choosing the right jurisdiction, the client creates favorable conditions for his capital: it is subject to a low rate in the country with a high level of taxation. Offshore trusts and corporations often involved in dealing with transactions to transfer investments in subsidiaries, private or public companies. In this case capital is also not taxed. To reduce the tax on dividends gravely also allows the usage of an offshore company, which is registered in the region with zero taxation.

Offshore jurisdictions is a favorable area to start insurance activities. The company can deal with insurance or reinsurance of risks of affiliates of own organization or affiliated companies. The advantage of this insurance company is easy and convenient access to the market of reinsurance services. Another positive thing is an opportunity not only to keep the funds of the company, but also funds of premium and investment funds in a foreign bank, depending on preference. Thus, the tax base can be optimized, or taxation can be eliminated.<sup>9</sup>

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<sup>9</sup> Goncharov A.: *Ofshornue pravovye modeli i ih primeneniye* (Offshore legal models and their use). Moscow: Data-Skver. 2009. 192 p. ISBN: 978 5 91772 011 2

It is worth mentioning a common way to transfer funds abroad, as a reinsurance contract. For reinsurance of their own risks of offshore insurance company, a Russian insurance company transfer funds abroad. Or a more complicated scheme where the Russian insurance company enters into a reinsurance contract with a foreign offshore company - an insurance broker, who reinsures the insurance risk in the normal foreign insurance company. It is not a secret that in the conducting of business in the territory of the Russian Federation, leaders of companies are faced with problems that can be solved by using offshore companies.

One of the problems mentioned above is that in case of admission to the account in a Russian bank revenue, it is immediately taxable. Even Russian offshore companies, ie a company registered in the Russian offshore areas, are not eliminated from the hard taxation, although they can help to significantly reduce the taxation of commercial activity.

Moreover, the Russian offshore companies are forced to open accounts in Russian banks and to disclose information about the directors and founders of the offshore company. Therefore, at opening an account for an offshore company it is necessarily to resort to all sorts of tricks in order to hide real name from the bank and the tax authorities, who can request information about the directors and owners at any time. It is not difficult for tax authorities to obtain the required information.

The essence of the method is the usage a bank account opened in a foreign bank for payments with partners and customers. Entrepreneur's calculations are divided into two parts: official and confidential. The official is carrying out calculations at reduced prices, either by cashless transfer or own bills. Advantage of bills calculation is that taxation occurs only when entering a bill funds. And if the money is not received on the bill (and they do not), then the tax will not arise. Also the version of official calculations can be barter supply of goods.

The most important part of a confidential method is to conduct payments through foreign bank accounts, opened to an offshore company of the client and the company of his counterpart, between which the calculation happened. Internal banking calculations are carried out without paying any tariffs. A great advantage of this type of calculation is that the client can calculate not only in rubles, but also in any hard currency. Multi-currency accounts in these banks allow to make similar operations regularly. And there is no need to provide reports to tax authorities in this case. Client

costs are reduced due to the fact that there is no need to pay any taxes and pay for accountant services.<sup>10</sup>

The competent usage of offshore schemes ensures the availability of different options, a variety of which make easier to choose the best one for business, organize it well. If the company is engaged in international trading activities, the using of offshore company allows to significantly reduce the tax base by registering the company in one of the offshore jurisdictions.

### **3.1.5 Offshore companies in business today.**

Offshore company is called enterprise with specific organizational and legal status, which provides it with lower tax payments and the anonymity of the conduct of the business. The basis of the usage of offshore companies is the foundations of international law, according to which this company is an independent entity that is engaged in its activity according to the laws of the country where it is registered.

An offshore company in terms of legal registration is identical to an ordinary company, has all the necessary attributes of a legal entity, the respective rights and obligations. Offshore companies have their own registration documents and statutes, bank accounts, the trademarks and trade names may issue its own securities, act as agents and dealers of other companies, etc. The specific of offshore companies is only in their non-resident status, the anonymity of control and methods of accounting. These features are very important for understanding the operation of offshore business as a whole, therefore, it is necessarily to focus on this aspect in more detail.

#### **1. Non-resident status.**

The main task for the state, in whose territory the offshore regime acts, is to receive the revenue in the budget. The most optimal way is to work with foreign legal entities and individuals (non-residents) who buy preferential terms, paying one-time charges. Providing the status of offshore to local companies and individuals often impractical due to the fact that the state with offshore status does not cancel tax payments for its citizens. Thus, if the state allows the residents to use the tax preferences under the auspices of the offshore company, it can cause damage to financial and budgetary system. In connection with this feature the majority of offshore jurisdictions prohibit offshore companies and its citizens to enter into a business relationship.

#### **2. Anonymity control (ownership).**

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<sup>10</sup> Apel A., Gunko V., Sokolov I.: Obnalichivanie i ofshorniy biznes v schemah (Cashing out and offshore business schemes). Saint-Petersburg: Piter, 2002, 196 p.

Some offshore zones in order to attract the largest possible number of non-residents provide the right of registration without the original names of owners of the company. Such working conditions are profitable for companies which would hide their commercial intentions for a variety of reasons:

- 1) The political reason. When the company would like to work or act on the territory of the state, with which it has not got any diplomatic and other relations;
- 2) The economic reason. Confidentiality is extremely desirable for reasons of access to world financial markets and securities markets, in terms of joint ventures, penetration into new markets, as well as in competition;
- 3) The social and national reasons. Offshore status allows the company to operate effectively in those markets where the aggravated social and national contradictions. Offshore in this context appears as impersonal, a supranational organization, which is neutral to the national and social collisions. This, in turn, helps to avoid attacks by the warring factions and fully focus on business.

In the registration documents of offshore company there are not the real names of owners of the company, but persons acting by proxy, ie nominees. In the offshore jurisdiction that provides anonymous status to non-residents, there is a market of companies offering services of nominee ownership. Such companies are called secretarial.

### 3. Financial statements.

The specifics of accounting in offshore companies is, as a rule, to simplify the procedure and reduce it to a minimum. Some offshore zones allow registered companies do not keep accounting records at all. The reason for this attitude of the authorities is clear: if the offshore company pays only a one-time annual fee, regardless of the volume of the firm's profits, the financial statements in this case loses its commercial importance for government authorities, and can only be useful as the statistical material.

Typology of offshore companies depends on the objectives pursued by its leader. So, the first group of offshore companies includes offshores used to minimize tax payments. The second group is companies, which are intermediaries in the import-export operations. The third group includes the offshores for accumulating funds and international payments. Of course, one offshore company can perform all three functions at once. Therefore, the offshore division to such groups is very conditional.

It is possible to classify offshore companies by type of activity:

- 1) Trading company. This type of a company can buy or sell something, it can produce, engage in cargo transportation, provide any services, to engage in wide commercial activity.
- 2) Holding company. This company owns securities and other values of other companies, distributes and places it in other enterprises, as well as finances its subsidiaries.
- 3) Insurance company. These companies are established by large enterprises to accumulate reserve funds for insurance cases.
- 4) Trust company. The founder or settlor transfers property to trust manager with the condition for the requirements of the founder. Thus, there is property management, whose owner cannot manage this property by himself for any reason. And through the transfer of assets in the management of the company, located in the offshore zone, tax payments regulated.
- 5) Transport company. It is about the registration of ships and yachts, which are taxed in Russia. In addition, there is more stringent requirements for their maintenance state in Russian Federation.

According to the status level of taxation there are four types of offshore companies:

- 1) International Business Company—IBC;
- 2) Exempt Company;
- 3) Non-resident Company;
- 4) Qualified Company.

The International Business Company does not differ from the joint stock company: the shareholders have limited liability, the capital is divided into shares, the management structure is also similar to the corporate. The only difference lies in the specific restrictions imposed on the activities of IBC. Under the laws of most countries, which adopted this form, IBC may only conduct business outside its state of registration and only with foreign in relation to that state citizens and companies. This, in essence, is actually an offshore company.

Exempt company is a company registered in the usual form of local companies, but later received from the authorities the special exemption. This exemption is given if the company declares that it will not conduct any affairs in the state of registration, nor even with its residents. Exemption is often made in the form of a special certificate of exemption, which is given for a certain period and then can be renewed. Exempt companies have proliferated in response to the adopted by some countries tax laws according to which the foreign company should not have to pay taxes in the



country, where it receives the income, if it is subject to taxation in the country of registration. Thus, in order not to be taxed in the country, a company must demonstrate that it is obliged to pay taxes at home. The trick is that, although exempt company is subject to taxation, it is exempted from it.

Non-resident company. In contrast an exempted company, non-resident company is exempt from tax by virtue of the fact of creation. Envisaged that the company should be created by non-residents, controlled from abroad and conducts business only abroad. Non-resident company is quite popular form of the enterprise, although somewhat less flexible than Exempt Company. Non-resident companies have proliferated in the Isle of Man, Gibraltar, Ireland and other offshore areas.

Qualified Company. The peculiarity of such companies is that they can choose their own tax rate. This is due to the fact that some countries (eg UK) are exempt from local taxes income of foreign companies, if in a foreign country, such companies pay tax at a rate comparable to the large tax rates of these countries themselves. United Kingdom considers the threshold of "comparability" half of its regular tax rate, which means that under certain conditions the company, paying at home 17% of the profits will be exempt from UK taxes to 25% and even 33% of the tax. Countries this type of companies are: Gibraltar, US Virgin Islands, the Isle of Man.

According to experts, the main reason for the creation of offshore companies is precisely the reduction of tax. Very often it happens that offshore companies not only reduce the amount of tax, but also reduce it to zero. Also offshore companies are used for the purpose of mastering the trademarks, copyright, patents and intellectual property. Another feature of the offshore companies is confidentiality information. Many offshore jurisdictions adhere to this rule, all the information about the owners of companies is not transferred to third parties and is closed.

## **3.2. The modern market of offshore services**

### **3.2.1 The mechanism of functioning of the world offshore business**

Most offshore companies are created with a special trust. Lawyers and consultants of the trust on behalf of an anonymous client create for him a company-cover, which employees are unaware of the name of its true owner. The largest wholesalers can create several hundred offshore companies for a week. As a rule, preference is given to tax havens with political stability, relatively low cost of services, modern infrastructure and efficient service organization. It is no accident, that a large

number of companies are established in the West Indies in the British Virgin Islands. This offshore area by many parameters favorably differs from other tax havens.<sup>11</sup>

With the development of information technology it is possible to register an offshore company without visiting the tax haven. It is possible to register it online, for example, in one of the States of the Caribbean or the Pacific through the Moscow office of an international trust company. Representatives of the company will send the documents by courier to any geographical point. For receiving documents it is necessarily to fill out an application and send it to the office, which representatives will send to client a list of ready-made companies. It remains to choose a suitable name, pay for services and send fax confirmation. After receiving the money the registration of the company is started. The company registration usually takes 3-4 weeks. Ready-made companies are registered to bearer shares with a minimum authorized capital of a few hundred dollars and with a nominee director - legal entity. The client receives a package of documents, including a charter, certificate of tax exemption, memorandum, protocol appointment of the executive director, a power of attorney from the director on the management of the company, printing and others. The total cost of company, including state fee for registration and exemption of taxes, the payment of secretarial services and nominee director, issue a power of attorney costs from two thousand dollars.

The process of buying an offshore company is quite simple: the first step is choosing the company from the proposed price list; the second step is payment. The process of registering of an offshore company does not take long time, it is necessary to operate the following instructions: select the name of the company, select directors and founders, the establishment and registration of the Charter of the offshore company and Memorandum of Association, the distribution of shares, warrants issue, etc.<sup>12</sup>

One of the way of organization of an offshore company is construction of holding structures and schemes. However, it is very complicated and costly process with many nuances and intricacies. The classical scheme of creating a holding company structure is follows: the Russian company registers an offshore company, after registration the newly established offshore company creates a so-called transfer companies that establish a holding company, formally becoming the parent companies. This classical scheme is commonly used in UK, Netherlands and Austria. Holding can accumulate profits, to buy up shares of companies, to receive income in the form of dividends, to own property. The sole purpose of the creation of the holding structure is to minimize the tax base

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<sup>11</sup> Dergachev V., *Geoeconomika (Goeconomy)*, Kiev: VIRA-R, 2002, 512 p. ISBN: 966-7807-15-0

<sup>12</sup> Offshore companies in modern business. Available at: <http://www.uba.ru/>

and legally take away business from offshore. Thus, the beneficiary owns the entire structure of the group of companies, and this scheme can avoid the risk of property loss.

From a legal point of view, an offshore company does not differ from other companies, being a full subject of economic relations, and can carry out its activities on an equal basis with other legal entities.<sup>13</sup>

### **3.2.2 The main features of the modern market of offshore services**

Offshore business gained on the market today not the last place. Its capabilities have attracted a huge amount of entrepreneurs, who want to get rid of the high taxation and issues of confidentiality. A variety of restrictions for offshore companies began to impose. To carry out their activities in all countries of the world, some offshore areas have signed agreements with the special organizations in developed countries. Now they can provide a full range of services, but they lost the right to the privacy for their customers. If there is a need to provide any information, the offshore areas will be forced to announce it. Being registered in offshore zones, which are not cooperate with these organizations, the entrepreneur can completely stop the payment of taxes, as provided in the legislation. But to carry out the business activity will be permitted only in the countries that are not related to the developed countries. Thus, the range of activities is considerably narrowed. Some offshore areas, which are not associated with any organizations, forbid foreign companies registered in their jurisdiction, to carry out trade activity there. Thus, it becomes smaller at one more point.

In many countries it is forbidden to engage any activities, requiring a special licence. Typically, these include the sale of alcoholic beverages, cigarettes, valuable species of fish, jewels, etc.<sup>14</sup>

In addition, each offshore zone has its own limitations. Most of them are directed to the features of realization of money and trade operations. Information offshore cross-border services are in practice almost always associated with outsourcing, ie the separation of a single enterprise on the interconnected units, connected only by contractual relations.

The point is that developing countries have two major competitive advantages over developed countries: lower prices for labor and lower land prices. Both of these benefits caused by lower

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<sup>13</sup> Offshore mechanisms in international taxation: basics. Available at: <http://economy.info/offshorniye-myehanimi-v-myejdunarodnom-nalogooblojyeni-osnovniye-polojyeniya/>

<sup>14</sup> New restrictions for offshore companies. Expert Magazine, 2009, №11.

capital intensity (which can be considered a defining characteristic of a developing country) and, consequently, lower productivity.<sup>15</sup>

The using of foreign offshore companies in the commercial operations of Russian entrepreneurs is constantly expanding. The schemes of operations involving offshore companies, become more complicated.

One feature of the modern offshore market could be called a competition. Countries under offshore jurisdictions are interested in expanding the network of similar companies, because this business brings money to the state budget. In order to attract customers, they make legislation less strict. This is reflected in the fact, for example, that companies that are exempt from tax, are allowed to have a real working office and carry out the offshore operations. The governments of offshore countries also try to interest limited companies. In addition to large companies, they want to attract small business forms. They adapt the form of business partnerships for the formation of various types of offshore structures. Many offshore centers of the world have already achieved success in economic development, but in any world economy, sooner or later a downturn begins, that is why some offshore companies may soon expect the recession due to corruption in offshore jurisdictions.

Some offshore jurisdictions such as the Bahamas already had experience with the development and downturn. Once there the Bahamas was one of the most popular offshore jurisdiction, but for many reasons (including corruption) many entrepreneurs transferred their business to Bermuda or the Cayman Islands. Now it can happen something similar, but with Bermuda or the Cayman Islands.<sup>16</sup>

According to research by experts in the field of economics, it is a tough competition among offshore centers leads to instability in global financial market.<sup>17</sup>

Although in some states there are anti-offshore laws, such companies have possibilities for the implementation of even the most ambitious projects. This business is very perspective. It operates as an investment, as well as emissions. The list of countries, that allow the turnover of shares and bonds issued by offshore companies on their financial markets, is expanded. In Russia the

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<sup>15</sup> Serebryannikov P.: *Mezhdunarodnaya trgovlya na rynkah uslug* (International trade in the market), 2005. 364 p. ISBN 5-901901-40-1.

<sup>16</sup> Offshores suffer from competition. Available at: <http://offshorr.com/2008/03/13/offshoryi-stradayut-ot-konkurentsii/>

<sup>17</sup> The competition will destroy offshore companies. Available at: <http://offshorka.com/konkurenciya-pogubit-offshornye-kompanii.html>

expansion of the volume of offshore services and the growth of this business is related to indicators of other states.<sup>18</sup>

The opinions about influence of the crisis in the offshore zone are different. On the one hand, if a company closes, it does not make sense for owner to continue to remain offshore and pay annual payments.

On the other hand, it is necessary to store the working capital somewhere; people buy offshore companies to place money through it in any european bank. It is not still clear, which trend will predominate. In the jurisdictions with zero taxation the number of registrations should increase.

Experts note that all major companies that want to withdraw their business in offshore, have already done it. An offshore company is not always suitable for medium-sized businesses - the service is quite expensive. A surge of interest on the part of Russian companies in the offshore has not happened. Offshore countries, however, do not suffer from this, they do not care what kind of turnover, and the amount of companies has not decreased, the dynamics of their growth remains.<sup>19</sup>

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<sup>18</sup> Offshore companies: advantages and risks. Available at: <http://www.rinfin.ru/news/offshornie-kompanii-preimuschestva-i-riski>

<sup>19</sup> Taxes under the hot sun. Available at: [www.nakanune.ru](http://www.nakanune.ru)

## 4. Analytical Part

### 4.1 The current state of the market of offshore services

Analysis of use of offshore companies is rational, based on their classification. Offshore zones are classified depending on their loyalty to the tax on a fully exempted from payment of taxes and decreasing the amount of taxes. There is no one list of offshore zones.

Forbes magazine ranks offshore zones in terms of corporate income tax. Special financial secrecy index (FSI) is calculated since 2011 and provides information about the territories that provide the tax havens (Table 1). FSI index evaluates degree of confidentiality of the financial sector for wealthy clients. In fact the leading positions in the ranking are occupied by the state, not wishing to make tax co-operation and are maximally private.

**Table 2. The leading states according to Financial Secrecy Index (FSI) in 2015.**

Rank	Secrecy Jurisdiction	FSI - Value	Secrecy Score	Global Scale Weight
1	Switzerland	1,466.1	73	5.625
2	Hong Kong	1,259.4	72	3.842
3	USA	1,254.7	60	19.603
4	Singapore	1,147.1	69	4.280
5	Cayman Islands	1,013.1	65	4.857
6	Luxemburg	816.9	55	11.630
7	Lebanon	760.2	79	0.377
8	Germany	701.8	56	6.026
9	Bahrain	471.3	74	0.164
10	United Arab Emirates	440.7	77	0.085

Source: Financial Secrecy Index - 2015: <http://www.financialsecrecyindex.com/introduction/fsi-2015-results>

Global offshore areas are separated by geography and by the process of optimization of tax expenses (Table 3):

**Table 3. Classification of offshore zones in the current global economy.**

Criterion	Type	Characteristics
Tax cost optimization method	Classic offshore zones	The cost of registering offshore in this area is usually low. Taxation and the requirements for accounting and financial accounting are completely absent. The owner of the offshore company is obliged to pay to the budget of the offshore state annual fee. This group usually includes small countries with a low level of economic development, but with a fairly high level of political stability, a simple registration system and a zero tax rates (Seychelles, Vanuatu, British Virgin Islands, Bahamas, etc.).
	Low-tax areas	Taxation of these offshore zones is usually carried out at very low rates. Requirements for accounting and financial reporting are officially regulated.
	Offshores with preferential taxation	The benefit of offshore companies in these areas is the proper use of the advantages of local commercial and financial legislation.
	Offshore zones in some US states	Offshore zones in the US states: Arkansas, Delaware, Kentucky, Colorado and Oregon. Companies pay a fixed mandatory federal tax, but their owners do not pay taxes on income earned outside the state.
The geographical criterion	Island offshore zones	Islands and archipelagos in the Pacific, Indian and the Caribbean Oceans. Usually these are small states with poorly developed economy, but with the high level of political stability. They have a high level of confidentiality, the complete absence of taxes and requirements for keeping records. The only requirement is an annual, fixed payment to the state treasury. Most often, companies with a dubious reputation with the help of the offshore data, store capital and commit financial frauds. Examples can be: the Seychelles, Bahamas, British Virgin, Marshall Islands, and so on.
	Some European countries	On their territory there are offshore and onshore conventional companies owned by non-residents. Preferential tax-exempt status of these companies is confirmed by the reports and annual audits. To exercise control over the activities of these enterprises, the state legislation provides the registry of the

		founders, directors and shareholders. Therefore, the privacy in this case is not guaranteed, but the prestige of the companies is much higher than in the first variant. Examples of such countries can be Cyprus, Gibraltar, Luxembourg and Switzerland.
	Administrative-territorial areas in onshore countries	For example, Canada, United Kingdom, United States.

Source: designed according to Nexus Financial Consulting data.

Comparative characteristics of various offshore areas of the first and second types of some basic factors are displayed in Table 4:

**Table 4. A comparative analysis of offshore zones**

Jurisdiction	British Virgin Islands	Bahamas	Panama	Ireland	Cyprus	Delaware (USA)
Taxation of profits	-				+	-
					(12,5%)	
The disclosure of beneficiaries	-			+	+	-
Availability of bearer shares	+				-	-
Declared capital (standard)	\$50,000	\$5,000	\$10,000	€2	€5,000	-
Currency of declared capital	any currency				€	\$
The minimum number of shareholders / directors	1/1	1/1	1/3	1/2	2/1	2/1



Availability of Corporate Directors	+	-	+	-
Secretary	-	+		-
Directors Registration (public)	-	+		-
The need for annual reporting and auditing	-		+	

Source: comparative analysis of offshore zones according data of Tax House, 2013.

Offshore areas also include those of the states or territories of the states where the activity of enterprises is stimulated by country through the use of tax incentives, reduction or absence of requirements to audit or accounting, reduction of trade restrictions or customs. The owners of these companies are mainly foreign nationals.

The main condition that is applied to offshore, is a liberal taxation, economic and political stability. Crises and major political changes have a negative impact on the economic situation and are unacceptable for offshore zone. The additional factors that affect the popularity of offshore zone are: a significant level of development of the transport system, the spread of the international language of communication, telecommunication, guarantees of confidentiality of commercial data, the absence or presence of currency restrictions.

The International Monetary Fund and the central banks of various countries form a classification of offshore zones. To classes of offshore zones are included offshores and midshores. The difference between them is the use of certain tax laws, as well as aspects affecting the position of the institution midshore or offshore company in the world. By standard offshore zones are generally considered jurisdictions, offer tax-free regime for non-resident companies registered in the offshore center. In addition, the main privilege of the classic offshore zones is generally considered a significant level of confidentiality of corporate and personal information.

But over the past few years the amount of the standard offshore jurisdictions has begun to decrease in the global market. This happened after the EU and the US have started to address the diversion of the capital from the state and tax evaders, many classic offshore companies have been subjected of aggression criticism and accusations of concealing information. This led to the signing of

various agreements on the exchange of data with the leading states of the world and the extinction of a standard offshore, offshore jurisdictions such as the British Virgin Islands, the Cayman Islands, Bermuda, Turks and Caicos Islands and Anguilla. All these states are part of the UK, which is a major activist in the fight against tax evaders. The data of jurisdictions is considered as offshore, but the fact of cooperation with foreign jurisdictions on matters of confidential data makes these jurisdictions no longer attractive to the secure establishment of business in the offshore.

It is estimated that offshore companies are most used in industries such as real estate (79.5% of the industry), investment and finance (61%), banking (57%), fuel and energy (49%), the enterprise of telecommunications services (44%) and retail trade (43%).<sup>20</sup>

For the Russian Federation is important that offshore companies are allowed to get access to cheap loans, avoid raider attacks, the corrupted administrative actions on the part of various officials, the imperfection of the domestic judicial system and to protect property rights.

The Central Bank of Russian Federation annually publishes the list of offshore zones, where listed all jurisdictions, which with trade is categorized as suspicious, that any goods crossing borders, checked for offshore character very carefully. It is remarkable, that since January 2013 by Russian Ministry of Finance from this list was excluded Cyprus - the most popular offshore zone for russian entrepreneurs.

The main activities of offshore companies can be divided into: financial; trade and brokerage; holding type companies that own real estate, intellectual property, and investment companies. On the basis of the main type of activity of registering organization, jurisdiction will be selected. For example, for financial enterprises is typically selected offshore zone with low taxes on income and the distribution of bank interest. As for the insurance companies, they are opened in jurisdictions with a simplified system of licensing of insurance activity.

The main institutional factors shaping the offshore business in the national economy should be considered: high political risks and lack of confidence to the financial system of the state; weak tax and currency settlement, the high level of taxation; the inaccuracy of the currency legislation of the wording, the presence of different approaches to the understanding of the offshore companies; the vulnerability of the country's borders, that opens up channels for the importation of contraband goods, not agreed with the Central Bank countries shares and promissory notes); the

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<sup>20</sup> Which industries are most used by offshores. Available at: <http://www.vestifinance.ru/infographics/2984>

criminalization of economic activity, high level of corruption, the lack of security; significant efficiency income legalization, which is obtained during the illegal or criminal activities by foreign trade operations for the official control of the transmission or inherited; weak formation of private business in the state.

In other words, states with a high degree of corruption, raiding, unstable currencies have all economic preconditions for the existence of permanent offshore business as part of the national economy. Often the flight of capital made through offshore companies with a different set of schemes, legalized in the non-resident State and then reinvested back into the State of origin as a foreign direct investment.

Offshore business is essential for many small countries, that it is the basis, for example, of the economy of Vanuatu, Samoa, the Marshall Islands, Dominica. Usually, in countries that have offshores, there are no high military spending and bureaucracy is minimized. It is because of all this, they are able to conduct preferential policies on taxation in relation to non-residents. At the same time the sources of their income are very limited. In general, their income are taxes of local business (mostly tourism) and the export of agricultural products and minerals. Therefore, means of registration of offshore companies, annual tax revenues of organizations and enterprises, the annual payment of the license form about 80% of the income of such countries. Thanks to an offshore jurisdiction regime in these countries the employment and qualification of the workforce are increasing, there is a trend towards more intensive inflow of foreign investments.

But for the states from which capital is exported, offshore business is a significant threat to their economies. It is obvious, that taxes in each country play a big role. Most of the businessmen in the implementation of the business tend to hide the net income and evade taxes. Because of this, many of them conduct business through offshore companies considering that offshore is perfect and fair way of doing business in a country that does not support and does not form it. In some offshore states, the law allows not to pay taxes or be partially liberated from them.

In globalization process the world market of offshore services was formed, which represents a collection of all offshore areas of the world on a large scale. Its functions are shown in Table 5<sup>21</sup>:

**Table 5. Functions of the world market of offshore services**

Function	Contents
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<sup>21</sup> Antonec O.: The offshore industry is on the verge of change. Where companies and rich people will hide their money tomorrow? RBK, 2013, №12. Available at: <http://rbcdaily.ru/magazine/trends/562949989661642>

Integration	the merging the spheres of production and consumption of services;  the merging intermediaries and traders in the realization of offshore services;  the strengthening of economic integration in the world economy
Infrastructure	the development of a system of institutions that serve the market of offshore services (service and audit companies, commercial banks, information technology)
Trade and intermediary	the minimization of transaction costs in the implementation of offshore business
Stimulating	the full realization of the interests of all participants in the offshore business
Control	Determination of compliance with the quality customer needs and the number of products on the market

Source: Antonec, O.: The offshore industry is on the verge of change. Where companies and rich people will hide their money tomorrow? RBK, 2013.

The problem of finance export in the offshore zones has become a global problem for some states. The countries from which capital was exported, incur significant financial losses. In international practice, there were many attempts to fight against tax havens, but they were generally ineffectual. It is well known that, for example, the share of the banking business in Luxembourg is approximately 22%, while in Cyprus before the tax scandal it was at the level of 5.5%.

American organization Global Financial Integrity published a report, which characterized the scale of illegal export of finance by various states for the period of 2004-2013 years. The study covers more than 150 countries. In this list of countries Russia was in the second place after China.

**Table 6. The leading states of the world by volume of illegal export of finance at 2004-2013 years, in bln. of dollars USA.**

№	Country	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2006-2015	average annual volume
1.	China	81.5	82.5	88.4	107.4	105.0	138.9	172.4	133.8	223.8	258.6	1392.3	139.2
2.	Russia	46.1	53.3	66.3	81.2	107.8	125.1	136.6	182.5	129.5	120.3	1049.8	105.0
3.	Mexico	34.2	35.4	40.4	46.4	51.5	38.4	67.5	63.3	73.7	77.6	528.4	52.8
4.	India	19.4	20.3	27.8	34.5	47.2	29.2	70.3	85.6	92.9	83.0	510.3	51.0
5.	Malaysia	26.6	35.3	36.6	36.5	40.8	34.4	62.2	50.2	47.8	48.3	418.5	41.9

6.	Brazil	15.7	17.2	10.6	16.5	21.9	22.1	30.8	31.1	32.7	28.2	226.7	22.7
7.	South Africa	12.1	13.6	15.9	28.3	22.5	29.6	24.6	23.0	26.1	17.4	209.2	20.9
8.	Thailand	7.1	11.9	11.4	10.3	20.5	14.7	24.1	27.4	31.3	33.0	191.8	19.2
9.	Indonesia	18.5	13.3	16.0	18.4	27.2	20.5	14.6	18.3	19.2	14.6	180.7	18.1
10	Nigeria	1.7	17.9	19.2	19.3	24.2	26.4	19.4	18.3	5.0	26.7	178.0	17.8
A total of 10 countries		263.0	300.6	329.5	397.9	468.6	479.3	622.4	634.5	682.1	707.8	4885.7	488.6
A total of 10 countries,% of the total illegal export of capital in the world		56.5	57.3	60.6	56.9	56.6	64.2	68.7	63.0	65.8	64.9	62.3	
A total, the developing countries		465.3	524.6	543.5	699.1	828.0	747.0	906.6	1007.7	1035.9	1090.1	7847.9	784.8

Source: according to Kar, D. Illicit Financial Flows from Developing Countries: 2004-2013 / D. Kar, J. Spanjers. - Global Financial Integrity, December 2015. - 72 p. - P. 8.

In this case the biggest outflows of finance in the offshores throughout the world are typical for the Russian Federation, East Asia and Latin America, Table 7:

**Table 7. The dynamics of capital outflows to the offshore regions of the world, 2010-2014.**

Region	The volume of capital outflows, bln. dollars		The average annual growth rate, %
	2010 y.	2014 y.	
East Asia	3102	4317	6,9
Near East	2365	2934	3,7
Latin America	1427	1973	6,7
Russia and the former Soviet Union countries	1319	1913	7,9
Africa	587	710	3,1
South Asia	190	253	5,7

Source: according to The Global Haven Industry Progress Report: - Quantifying Kleptocracy. - JSH, 09.05.2016. - P. 35 (online): <http://www.taxjustice.net/2016/05/09/17103/>

Only two or three decades ago, there were just a few offshore centers in the world, but in recent years, under the influence of telecommunications and technological revolution, the use of offshore

tools became available. Now, according to expert estimations, there are from 35 to 40 countries that are specialized as offshore jurisdictions. Their part of the global GDP is quite low (1.2%). However, about half of the total international financial transfers go through offshore zones. In particular, in the United States up to 40% of the total transactions of funds in favor of foreign residents are directed to these countries. In a general view, offshore investment matrix with the percentage of foreign economic operations in relation to the offshore, is displayed in the Table 7. It follows from this, that offshore accounts for 8% of foreign direct investment in the world.

**Table 8. Matrix of offshore investment, according to UNCTAD methodology, % of accumulated foreign direct investments in the world.**

<i>Investors</i>	<i>Recipients</i>			
		<i>Onshores</i>	<i>The countries with preferential taxation</i>	<i>Offshores</i>
<i>Onshores</i>		51%	15%	8%
<i>The countries with preferential taxation</i>		13%	3%	1%
<i>Offshores</i>		8%	1%	0%

Source: according to World Investment Report 2015 – UNCTAD, 2015. – P. 189.

A pretty large is the proportion of offshore and offshore-conductive states in international banking transactions (Table 9):

**Table 9. The proportion of offshore and offshore-conductive states in international banking operations in 2015, %.**

	The proportion of offshore countries	The proportion of the offshore-conductive states
International bank assets	14.0	23.9
International liabilities of banks	17.3	27.0
International loans	15.6	22.4
International deposits	19.1	25.2
International financial assets	4.6	8.0

Source: according to Statistical release: BIS international banking statistics at end September 2015. 26 p.

In 2013, an International organization Oxfam announced that, according to the calculations, in the offshore areas have been hidden about 18 bln. USD, depriving their countries of tax revenues in the amount of more than 156 bln. USD. In 2012, the independent organization Tax Justice Network estimated the amount of hidden assets, which were in offshores, as the amount of 21 trillions USD. The above estimations are quite conservative. There is a question only of the financial means in offshore bank accounts. But the addition of assets which are materialized in an offshore real estate, as well as various personal property, then hiding from taxes reaches about 32 bln. USD. As for the above real estate objects, they are hiding through trusts and other offshore structures. In recent 48 years, 1.189 trillion USD flowed to offshore zones from China; from Russia for 20 years - 796 billion USD, from South Korea - 779 billion USD.

Is necessary to note, that the negative effects of offshore zones lead to the destabilization of the situation in the economy, but at the same time, the benefits of offshore zones create a favorable environment for doing business and improving investment attractiveness. Because of this, taking into account the pros and cons of offshore zones, it is desirable to implement economic policies, aimed on minimization of capital export from states.

In fact, it is can not be declared, that offshore business is illegal phenomenon. According to the OECD methodology, certain functions and the use of offshore companies represent some danger for the global tax system in general and for certain countries in particular, showing a manifestation of unfair tax competition between developing and developed countries. However, offshore business is partly related to the invisible hand of the market, to the factor of competition, a process for of free movement of capital in the global economy, and because of this ban on its content contradicts the principles of a market economy.

According to some of expert assessments of international organizations combating money laundering, the total amount of funds that are kept in the offshore, exceeded 18.5 trillion USD, which in absolute more than the US GDP. This statistical information determines the need for urgent measures to combat this phenomenon, but the dual nature of of offshore companies generates internal and international conflicts in this matter.

#### **4.2 The impact of offshore financial networks to the development of the Russian economy**

The economic sanctions of the European Union, which entered in Russia in 2014, and a significant devaluation of the ruble, led to a substantial outflow of capital from Russia. According to Central

Bank data, in 2014 the volume of the extracted capital amounted to \$ 151 billion, while the World Bank's methodology of calculation to recordly for the Russian Federation \$ 200 billion. Because of this it can be seen that economic and political instability of the country is quite a strong motive for the use of offshore companies, in particular, to reduce the currency risk, which significantly affects the amount of movement of capital and, consequently, on the economic sustainability.

It created a certain circle, which is based on the outflow of funds that could possibly work efficiently in the domestic economy. Most of the russian economy depends on exports of oil and gas, and, as a consequence of fluctuations in the situation on the commodity markets also significantly affects the desire of private business owners to withdraw capital abroad even in the form of reserve funds.

Also quite important reason for the formation of offshore business is the high level of corruption of officials. It is known that russian offshores are characterized of legalization of "kickbacks", which are obtained in the territory of Russian Federation. Offshore-Leaks and the Panama scandal called the names of local officials of the middle and lower level in the state apparatus, who owns offshore companies with large sums in bank accounts, and this despite the fact that in 2013, it is prohibited to have an unlicensed property abroad for officials.

Incidentally, the information database of Panama archive contains information about 6,285 russian individuals and legal persons who are related to the 11,516 offshore companies. In total, there are 7,319 offshore companies registered from the Russian Federation and owned by the 2,229 residents of Russia. Moreover, the 16 billionaires from Russia were recognized the ultimate beneficiaries of 50 offshores, the majority of which are registered in an offshore jurisdiction of the British Virgin Islands. Two of the remaining offshore companies are officially registered in the Bahamas, and one in the Seychelles.

Most of these enterprises in 2013-2015 years acquired the status of inactive or closed, and only 20 of them continue to work until today. This distribution indicates a decrease in investment attractiveness of Cyprus as an offshore zone for russian entrepreneurs and a reduction of capital market volumes between these two countries. Offshore companies, which are created in Cyprus, are characterized by small and medium enterprises, while holdings or subsidiaries of large multinational enterprises are mainly created in the British Virgin Islands in spite of the not so much high part of the export-import turnover of the Russian Federation with the state. That will be discussed in more detail below.



It is remarkable, that The New Times publication indicates that 1,226 offshore companies in Moscow region owned by 6,700 different real estate objects (Table 9). Is necessary to note, that these are objects in the elite areas of the so-called 'gold hectare'.

**Table 10. Ownership of real estate near Moscow of offshore companies.**

The jurisdiction where the offshore company is registered	The amount of offshore companies	Real estate owned by offshore companies
Cyprus	767	4254
British Virgin Islands	308	1809
Panama	43	488
Belize	50	246
Seychelles	49	146
Marshall Islands	2	8

Source: according to The New Times (online): <http://newtimes.ru/articles/detail/110539>

On the popularity of offshore business among russian entrepreneurs also the criminalization of the economy affectes, in particular, raiding and corporate blackmail. This bad situation in the private sector stimulates entrepreneurs to strive for complete privacy for the actual owners, that offshores offer. A good example of this is Domodedovo airport, the legal owner of which was pretty difficult to find. Anyway, it is estimated that 70-80% of the russian economy is managed from offshores: de jure to 9/10 of large private enterprises are owned by holding offshore structures.

One of the characteristics of the russian offshore business is the repatriation of capital. Table 11 shows the statistics of the geographical structure of the outflow of finance of the Russian Federation, as well as the inflow of foreign investments into the Russian economy. In general, according to the data of the table, direction of finance outflows of the Russian Federation and its inflows as foreign investments are the same.

**Table 11. Structure of finance outflow from Russia and the inflow of foreign investments in the total amount of accumulated foreign investment in Russia in 2015, %.**

Countries	The share of investments directed from Russia abroad	Countries	The share of foreign investments in Russia
Total:	100	Total:	100
Cyprus	41.6	Cyprus	25.7
Switzerland	12.3	Bahamas	16.5
Bermudas	5.3	British Virgin Islands	11.1
Netherlands	4.0	Switzerland	10.8
United Kingdom	3.4	France	9.1
Spain	3.3	China	5.6
USA	2.9	Netherlands	5.4
Turkey	2.1	Austria	3.7
Austria	2.0	USA	3.1
Hong Kong	1.9	Bermudas	2.3

*Source: Statistical Yearbook, Moscow: Federal State Statistics Service, 2015.*

The table shows how large part of investments, which are sent to Cyprus, despite the negative economic situation in the country. Special attention deserves also the export of finance to Switzerland, mainly in the banking sector. On the other hand, as capital exporters to Russia, the key jurisdictions are Bahamas and the British Virgin Islands. While the Russian balance of payments says that in these states capitals are output in smaller quantities, which means a very long chain of offshore schemes, which are carried out with the participation of indicated jurisdictions. As the result, a certain part of the extracted capital is reinvested, and another one remains on the offshore accounts.

It should be noted, that the statistics looks like a pretty favorable, however this information should be treated very carefully, because most of the FDI in Russia come as a result of round-tripping, when coming into the state FDI are the result of returning finances which were previously withdrawn to offshore zone. Therefore, to talk about the real deoffshorization of Russian economy

is very premature. Investments from offshores still owns a substantial part of total inflow in the state of foreign investments.

From the standpoint of the formal criterion, the investments from Cyprus are no longer considered as offshore. In practice, however, Russian companies continue to use structures in the form of holding companies, which are registered in Cyprus, in all sorts of optimization schemes for direct investment operations. The financial crisis in Cyprus, the acute phase of which was in the first half of 2013, contributed to increasing of the risks in the optimization schemes, but did not reduce FDI of Cyprus directed to the Russian Federation. Because of this, in regions of the state as Dagestan, Kalmykia, Tuva and Chukotka Autonomous District, the FDI inflow by 100% was provided by investors who are registered in offshore zones. At the same time for 8 Russian subjects contribution of offshores to the total FDI inflows was zero, which shows the real interest of investors of the work in these regions.

There is also a problem regarding to the size of local investments, which are accumulated abroad. Of the total volume of \$158.4 billions for four offshore zones, which are leaders in the volume of accumulated investments from the Russian Federation (Luxembourg, the Netherlands, Cyprus and the British Virgin Islands) was accounted for 73% of the total investment, or \$128.4 billion, including: direct investments were accounted for \$107.1 billion, the portfolio of \$7.0; on the other - \$14.3<sup>22</sup>. If, in addition to consider Austria, Great Britain, the USA and Switzerland, the share of this group will increase to 86%. It is necessarily to note, that only these companies presented statistical reports; the settlement of monetary authorities and commercial banks, which generally explains the relatively small value of portfolio investments, is not taken into account. This situation means that the government of Russian Federation does not know, who manages and owns the Russian companies. Moreover, Russian companies, which are controlled from offshore jurisdictions by unknown persons, can manage and own other Russian companies.

A subsequent analysis of investments shows a significant prevalence of other investments (84%) over the direct (15.4%) and portfolio investment (0.6%). Moreover, a major part of other investments is trade (19.2%) and other loans (79.6%), so-called short, or hot money that can be deduced from the state at any time. It can be assumed, that their substantial part consists of the finance from offshore and offshore-conductive states.

It should also be noted, that the involvement of foreign investment not only increases the vulnerability of the national economy of the Russian Federation from various financial shocks

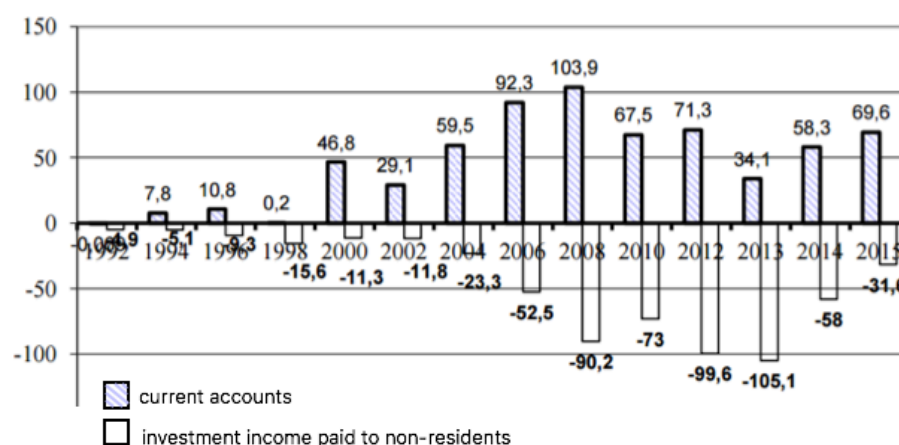
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<sup>22</sup>According to the Central Bank of Russian Federation

from the global market. Quite a serious problem for the Russian financial sector is a significant corporate external debt, with 80% of these commitments have three major state enterprises - JSC 'VTB Bank', JSC 'Gazprom' and JSC 'Rosneft'. Significant part of this debt was created by loans of companies and banks from offshore zones and states, which were involved in offshore financial schemes. The increase in external debt led to an increase in income from investments, paid to non-residents, thereby forming an additional burden on the balance of payments of the Russian Federation in the future (Fig. 1). Russian investments abroad, in turn, are almost not profitable.

**Figure 1. The ratio of the dynamics of the current account balance of payments of the Russian Federation with the proceeds of the investment to be paid to non-residents in the years 1992-2015, bln. USD.**

**Note: The paid income from investments are listed with the sign '-'.**



Source: according to External sector statistics (online): <http://cbr.ru/statistics/?PrId=svs>

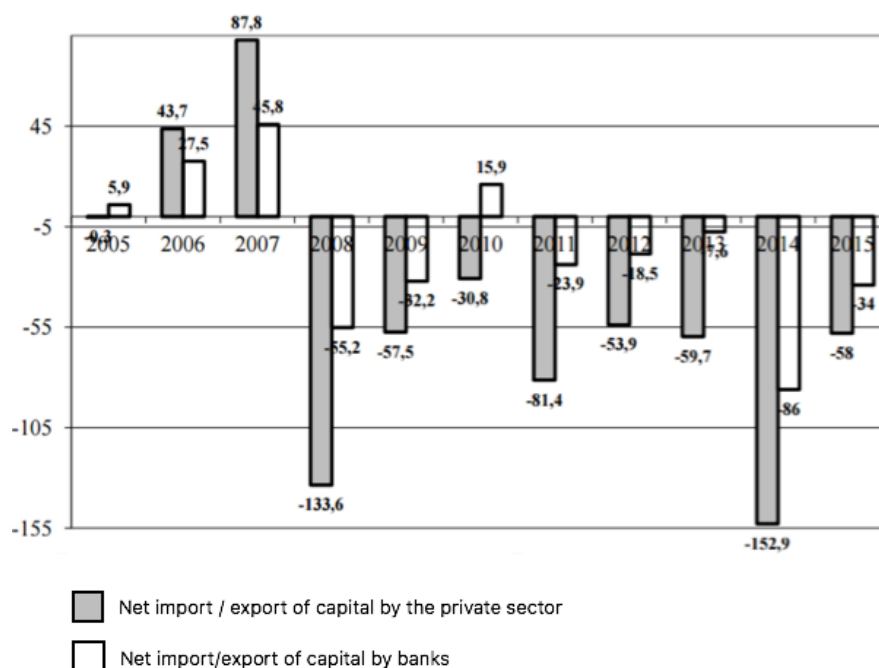
The specificity of Russian offshore business is a one-sided formation in the national economy, that is the active use of offshore companies by fatherly entrepreneurs and getting them profit, while at the state level tax incentives to non-residents of the state have not received the desired distribution. The Russian Federation is an exporter of offshore finance, without getting an offshore annuity. On the other hand, the policy of the country is now directed precisely at countering the offshore business, of course, the effect of offshore zones has to be limited.

Due to the characteristics of the domestic offshore business it should be the formation of optimal systems of settlement of offshore business, as well as the improvement of existing ones, focused on Russian economy.

For Russian Federation offshore problem has a very important practical meaning, because the majority of private enterprises in country are controlled by holding companies, and they, in turn, are in direct area of operation of offshore financial centers and networks. It also should be considered, that in the Russian economy in recent years the trend of increasing the outflow of finance of the private sector and banks has exacerbated (Fig. 2).

**Fig. 2. Dynamics of the net import/export of capital by the private sector in 2005-2015.**

**Note: the sign '-' means the export of capital, '+' - the import.**

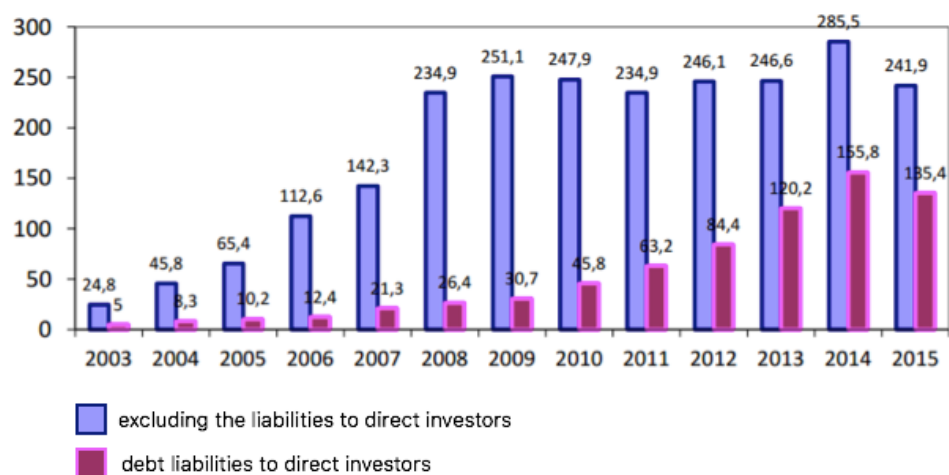


Source: according to Net import/export of capital by the private sector in the years 2000-2015 and 1st quarter of 2016 (online): <http://cbr.ru/statistics/?PrId=svs>

It should be considered, that a large-scale and chronic capital outflows led to an aggravation of the external debt of domestic corporations, which rose from \$29.8 in 2003 to \$441.3 billion in 2014. This debt is represented by foreign loans for the purchase of foreign assets. In the structure of the gross external debt of corporations, the part of liabilities to direct investors increased (from 10%

in 2008 to 35% in 2014). In particular, in this case is meant internal corporate lending, but it is also a major factor of increasing of the external corporate debt recent times.

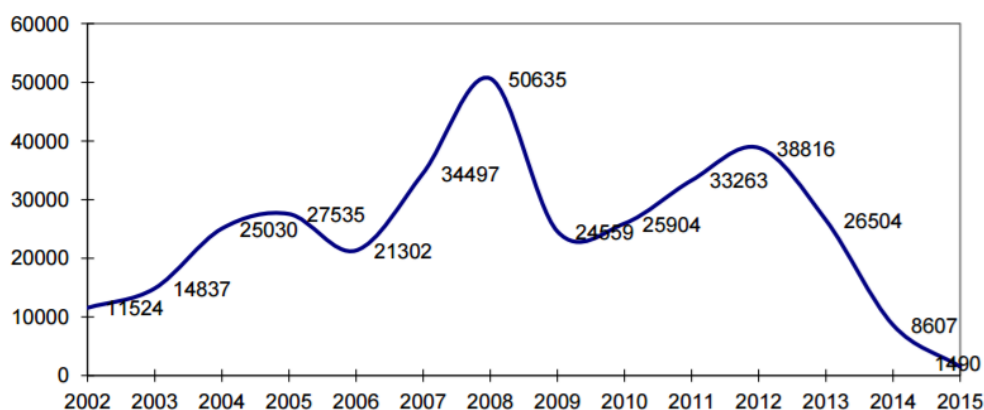
**Fig. 3. The external debt of Russian corporations in the years 2003-2015 (in bln. USD).**



Source: according to The external debt of the Russian Federation, 2016 (online): [http://cbr.ru/statistics/?Prtid=svs&ch=itm\\_47538#CheckedItem](http://cbr.ru/statistics/?Prtid=svs&ch=itm_47538#CheckedItem)

In analyzing the escape of finances it should be mentioned, that it is calculated in various ways and is not always true, because it is based on expert assessments, which are quite subjective. The data for its calculation is not always available. But more often the finance escape is counted according to balance of payments based on data in columns 'shortfall export earnings' and 'net errors and omissions'. For this the Bank of Russia calculates the volume of suspicious transactions, which are carried out with deliberate violations of the rules and procedures of these operations. Peak values of these transactions were in the years 2008 and 2012, although in recent years their volume has considerably decreased.

**Fig. 4. Dynamics of suspicious transactions, reflected in the the balance payment of Russia in 2002-2015 (in mln. USD).**



Source: according to External sector statistics, 2016 (online): <http://cbr.ru/statistics/?PrfId=svs>

The dynamics of the provided information shows that the volume of suspicious transactions in the state is reduced, therefore, the amount of 'laundered' funds is also reduced.

The economic instability in 2014-2015, which was manifested primarily in the decline and stagnation of the domestic economy and a substantial devaluation of the ruble, led to an increase in the rate of outflow of state finances. It is possible to make a certain assumption, that a large part of the funds were forwarded to offshore companies to the leveling effect of the economic and currency risks, which means that now this category of motives for private entrepreneurs in the use of offshore business is a priority. The official estimates of the Russian Central Bank claimed about other causes of this large value output by private equity sector in 2014: a significant part of the amount was aimed at the repayment of Russian debt. It should be noted, that the external debt of the state is really decreased by 30% - from 729 billion dollars in 2014 to 522 billion dollars at the beginning of 2016.

On the other hand, the amount of net outflow of finance in 2015 was only 58.1 billion dollars, and the amount of capital under the balance of payments 'net errors and omissions' for this period has decreased from \$8 billion in 2014 to \$5 billion, all of which suggests a significant decrease of the extracted capital in offshore companies. Partly this reduction speaks about increasing the effectiveness of deoffshorization policy, but that probably is due to the disappearance of the motives for the withdrawal of finance, as, according to the balance of payments, a significant part has already left Russia's economy in 2014.

In 2016, according to forecasts of the Central Bank and Ministry of Finance is expected to decline in the subsequent investment from 3 to 3.5%, and the outflow of finance for export-import foreign economic operations is predicted in \$30-40 billion, which is considerably less than the previous period. According to statistics from the Central Bank, the net outflow of private sector of finance in the 1st quarter of 2016 amounted to \$7 billions, which is 4.5 times lower than the value of investment losses in the same period last year, while outflows from the funds, that invest in the domestic stock market from the 31st of March to 6th of April last year amounted to \$7.6 millions, against the inflow of \$8.2 millions a week earlier, according to the expert opinion of Emerging Portfolio Fund Research, which in general confirms the trend to reduce the outflow of investment and finance market volumes in Russia.

In the future, this could have a positive impact on the national currency, but as the external economic transactions with offshore jurisdictions are conducted in dollars or euros, and part of the offshore companies in the export-import operations is quite high and did not undergo any significant changes during the last quarter of 2015, then to expect such impact on the ruble is not worth.

### **4.3 Development of offshore financial markets**

#### **4.3.1 Perspectives of offshores development**

One of the most promising forms of offshore business is the creation of offshore insurance companies. To registered insurance company in the areas of tax benefits is usually more difficult than, for example, trade and mediation company. To register for the insurance company, as a rule, it requires a license of the authorized body. As in most cases entails the provision of a realistic business plan, information about directors and founders. It also requires making substantial statutory fund. And despite the such difficulties, this direction of the offshore business is rapidly developing. In some jurisdictions, it is possible to create an insurance jurisdictions, for which the license is not required. Russian law prevents the direct use of services of foreign insurers. However, for insurance with a private insurance company are opened transport, foreign trade, insurance, many types of businesses and assets abroad, as well as a wide range of reinsurance operations.

Another perspective area of the creation of offshore companies is providing reinsurance operations. First of all, it concerns the Russian insurance companies. Part of their risks they can reinsure in reinsurance company in the offshore zone. At the same time a subsidiary of an insurance company may reinsure risks in the insurance companies of international level. As a



result, the volume of the Russian company risk insurance can be significantly increased. Reinsurance of risks through an offshore reinsurance company creates opportunities for a whole group of perspective commercial operations. Russian insurance company with the help of the insurance company can greatly expand the range of their operations, including in the international reinsurance system of services. Insurance company in the areas of tax benefits may reinsure their risks in a world class insurance company. At the same time it can become an insurer of risks for the Russian insurance company.

For the development of the offshore business, it is necessary to create appropriate conditions and prerequisites in the Russian economy:

- at the macro level, such a tool can be free economic zones of innovative type, created in the form of technology parks;

- at the meso level, the focus should be on the necessity of developing of national offshore companies controlled by the state in the interests of economic security;

- at the micro level is necessary to ensure the development of new technologies and the promotion of offshore activities of individual companies, which are due to this could be the kind of growth points and in general contribute to the economic development and growth across the country.

#### **4.3.2 Offshore business in Russia and problems of its control.**

The popularity of offshore companies in Russia is growing, as evidenced by the statistics. Currently, from 70% to 90% of domestic companies belonging to the large business, are owned by offshore companies. According to experts, every year from the Russian economy the offshores receive from 40 to 50 billion dollars, and the substantial amount of money has not returned back.

The main offshore zone for Russian businessmen is Cyprus. According to experts, one billion dollars is monthly translated to this island from Russia and from other countries. There are about two thousand Russian companies and a dozen banks in Cyprus. Statistics indicates that in the accounts of the offshore banks, that are located on the island, are registered about 950 million of dollars. In opinion of the Cypriot bankers, Russian money is deposited not just in Cyprus but also in other countries. In particular, in the UK, where they are invested in real estate.

During recent years the Russian government undertook and other action to limit the use of offshore schemes for illegal export of capital. In particular, the Central Bank of Cyprus was offered to consult with the Central Bank of Russia in dealing with issuing a license or authorization to open

an account for Russian firms. This claim was rejected by the Central Bank of Cyprus. From the point of view of the Cypriot bankers, this practice, whether it will be implemented, would seriously undermine the competitiveness of Cyprus to attract financial business.

The Central Bank of Russia tightens control over the activities of offshore structures on the territory of Russia. The main purpose is to limit the possibility of illegal export of capital from Russia. Offshore schemes play an important role in this process.

The result of the appearance of these regulations has been a dramatic drop in demand for the registration of companies in offshore zones, included in the 'black list'. However, to achieve a radical change in the situation in this area is difficult enough by these restrictions. Practice has shown that are beginning to be used a number of little-known offshore zones, were not included in the list of the Central Bank of Russian Federation. As perspective area is considered, for example, Montenegro. Another trend of offshore business is the using composite schemes involving both offshore and onshore companies. For example, the Russian company may have a contract with the company from quite a respectable country, but in fact this company is only intermediate recipient and the final is an offshore company. UK company can act as an agent of the company from the British Virgin Islands. The British company is working on a modest fee, and the main income is concentrated in the offshore company. According to experts, the using of complex schemes is quite an objective trend of development of offshore schemes. For normal operation it is necessarily at least three or four companies. Usually Germany is used, England in conjunction with the classic offshore companies and Russian firms in order to have a comfortable environment to work in Russia, and in Europe, to have solid requisites, the account of normal European banks and are not arouse suspicion that it is an offshore company. This scheme is designed for continuous solid job. Moreover, the movement of capital is calculated so as to avoid paying high taxes in the UK or Germany, to the movement of funds was held with minimal losses. Of course, such schemes are quite expensive: for working a chain of companies it is necessarily to pay minimum ten or twenty thousand dollars. This scheme is for serious, large and rich structures.

Russian or other countries restrictions are not able to eradicate offshore business. There will be new offshores and new schemes of work. However, the tightening of restrictions for registrars of offshore firms or opening a bank account for it, will require a more highly qualified specialists, lead to an increased risk, and ultimately cause an increase in the prices of similar services.

The main condition for the functioning of offshore jurisdictions is that companies registered in the offshore zone, but not leading economic activity and not using local resources in the territory of this country, are entitled to the payment of taxes at reduced rates. Therefore, the essence of the using of an offshore mechanism is the legal transfer of the objects from the jurisdiction with a high tax jurisdiction to a jurisdiction with low level. Legal prerequisite for the using of offshore mechanisms and capital preservation by the national tax is the territorial limitations of the tax sovereignty of the state. During the purchase of offshore companies, as well as during the registration of offshore companies, businessmen have a possibility not only to minimize taxes, but also clearly structure their activities in the field of foreign trade.

In general, fiscal policy in offshore areas depends on their location, level and quality of life. As a rule, in the moderately and relatively poor states a tax-free regime is established, but in highly developed European countries, where holding of the company is prestigious, are established preferential taxes.

The creation of offshore financial chains is one of the most important tendencies of development of modern globalized business and the main motive of international tax planning. Specific examples of sparring offshore jurisdictions included in financial networks, are the Netherlands or the United Kingdom, where registered companies operate in tandem with offshore companies.

Currently, there is a tendency to intensify the fight with offshore zones. The most effective way to deal with offshores is still the creation a favorable investment climate in the domestic economy, promoting the legalization of exported capital.

## **5. Conclusion**

The main condition for the functioning of offshore jurisdictions is that companies registered in the offshore zone, but not leading economic activity and not using local resources in the territory of this country, are entitled to the payment of taxes at reduced rates. Therefore, the essence of the using of an offshore mechanism is the legal transfer of the objects from the jurisdiction with a high tax jurisdiction to a jurisdiction with low level. Legal prerequisite for the using of offshore mechanisms and capital preservation by the national tax is the territorial limitations of the tax sovereignty of the state. During the purchase of offshore companies, as well as during the registration of offshore companies, businessmen have a possibility not only to minimize taxes, but also clearly structure their activities in the field of foreign trade.

There are some methods of making country an offshore zone: 1) complete elimination of taxes; 2) establishment of a fixed annual tax payment; 3) establishing low tax rates; 4) introduction of other special conditions in the absence of taxes (eg. fees for opening a bank account), and others.

In general, fiscal policy in offshore areas depends on their location, level and quality of life. As a rule, in the moderately and relatively poor states a tax-free regime is established, but in highly developed European countries, where holding of the company is prestigious, are established preferential taxes.

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## **7. List of Acronyms**

*FATF* - Financial Action Task Force on Money Laundering

*FDI* - Foreign Direct Investment

*FSI* - Financial Secrecy Index

*GDP* - Gross Domestic Product

*IBC* - International Business Company

*IMF* - International Monetary Fund

*JSC* - Joint-stock company

*TJN* - Tax Justice Network

*VAT* - Value Added Tax