

Russia's Anti-Offshore Policy in the Global Economic System

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Abstract

Role of offshores in the global economy is rather controversial. It depends on effectiveness of national policy. In whole, offshores have started playing a critical part in global capital and assets flow. In the estimation of specialists, in 1990-s offshores have controlled nearly 20% of total world wealth, and almost 22% of external bank assets have been placed there. Today up to 60% of world money are located in offshore zones, nearly half of financial transactions passes through these zones. World experience has shown that offshore capital is not going to disappear in the foreseeable future. It will undergo essential transformation, growing more transparent and predictable. Yet tax competition and investment potential of certain jurisdictions will keep on determining capital flow in the world economy. Under WTO conditions the authors' suggestions to develop free and special economic zones, using the world experience, will allow Russia to develop regional social infrastructure, to attract investments, including foreign investments, into national economy.

Keywords: *offshores, globalization, special economic zone, taxes, global economy, finance.*

1. Introduction

At current stage of the world economy development, offshore zones have taken global form, being the consistent part of national economies both in developed and developing countries. In the last 20 year classical offshores have started playing a critical role in global capital and assets flow.

Thus, urgency of the research issue is stipulated by the following main reasons:

In the first place, foreign practice has shown that offshores in global financial system activate cross-border financial flows and expedite financial asset turnover on an international scale, encourage development of financial markets, provide conditions for diversification of investments, expand access to credits, and facilitate better capital allocation.

In the second place, offshores encourage tax burden reduction, stimulating economic activity in the global economy.

In the third place, application of flexible development strategies leads to increase of competitive power of companies at the domestic and global levels.

In the fourth place, formation of instability element in the world economy and finance, contributing to capital outflow, leading to possible accumulation in offshore zones of substantial capital volume, speculative for the most part.

2. Economic Relations of Offshore Zones

The following may be referred to positive effects of offshores:

- activation of cross-border financial flows and acceleration of financial assets turnover on an international scale, promotion of financial markets, arrangement of conditions for diversification of investments, expansion of access to credits, and better capital allocation;
- encouragement of tax burden reduction, and stimulation of economic activity in the global economy;

- decrease of expropriation risk, arrangement of conditions for property rights protection, which in turn may initiate acceleration of economical growth, particularly in donor countries;
- - prosperity promotion of countries with offshore zones. This encourages more harmonious development of the global economy in whole.
- increase of competitive power of companies at the domestic and global levels due to application of flexible development strategies .

Negative sides of offshores are as follows:

- unfair tax competition, depriving onshore countries of income;
- formation of instability element in the world economy and finance due to possible accumulation in offshore zones of substantial capital volume, speculative for the most part;
- promotion of capital outflow;
- shadow economy support;
- reduction of employment in donor-countries;
- unjustified competitive advantages to certain companies;
- adverse influence on social situation in donor-countries, connected with negative public assessment of tax avoidance.

Comparison of these two lists proves: one and the same feature of offshores can be treated both as advantage and disadvantage depending on specific and sometimes opposing interests of private investors, national authorities (tax authorities in particular), international institutions. Thus, offshores can be treated as the distinctive feature of the modern stage of globalization development of the global economy. . In our opinion, offshore – is specific financial institution-intermediary, providing financial advantages for legal entities and natural persons in the process of conversion of savings and other monetary funds into investments.

Offshores should be characterized with consideration of specific level of economic relations: for macro- and meso-level (i.e. offshore zone of offshore region) specific business status lies in "offshore environment"; for micro-level (offshore company) - in specific features of business dealing; mega-level (global offshore market) can be characterized by combination of the first and the second levels on a global basis.

Comparative analysis of "popular" countries, where offshore company can be established, is given in the Table 1.

According to the Table 1 the countries where offshore companies are registered can be conditionally divided in several categories:

- ministates, islands with low level of development of national economy, but with high political stability (Bahamas, British Virgin Islands, Vanuatu, Seychelles, etc.). Generally these states do not specify any requirements to financial reporting, the only requirement is to make fixed contribution to treasury. On the Marshall Islands, one can establish the company without payment of the authorized capital, but with issue of bearer shares. Usually in these countries no registers of shareholders and directors are maintained, confidentiality of such company ownership is very high. Usually these companies are used for financial transactions;
- countries where in addition to offshore companies there also exist general onshore companies, that can be owned by non-residents, however, in case of any business activity within this country they can lose preferential tax exempt status. In these countries the company must be annually audited and submit reports in order to prove that it didn't carry on any such activity. Control on the part of the government in these countries is more strict as compared to the first category, registers of directors and shareholders are maintained there, though status of such companies is higher. These are Ireland, Gibraltar, Malta, Luxembourg, Switzerland, Isle of Man, etc.;
- countries which are difficult to define as offshores, but in accordance with legislative requirements of these countries, one can work in major company and pay rather low taxes. Let's call them "pseudo-offshores". These are USA, Great Britain, Canada, etc. These countries are characterized by high level of business transparency, payment of taxes and dues, maintenance of registers of shareholders and directors are mandatory requirements. Though there are some legal organizational forms paying only fixed charges. These companies are good both for reputable business and simply for keeping of cash assets.

Table 1. Comparative analysis of operational climate of offshore companies in different countries.

Jurisdiction	British Virgin Islands	Bahamas	Panama	Ireland	Delaware llc	Delaware corporation
Official language	English		English, Spanish	English	English	
Profit taxation	none	none	none	none	none	none
Disclosure of beneficial owners	none	none	none	yes	none	none
Bearer shares	yes	yes	yes	yes	none	none
Minimal paid up capital	none	none	none	EUR 2	none	USD 1
Standard stated capital	USD 50000	USD 5000	USD 10000	EUR 100 000	none	USD 150 000
Currency of stated capital	any	any	any	any	USD	any
Minimal number of shareholders	1	1	1	1	2	1
Minimal number of directors	1	1	3	2	1	1
Corporate directors	yes	yes	none	none	none	none
Secretary	none	none	yes	yes	none	yes
Public registration of directors	none	none	yes	yes	none	none
Public registration of shareholders	none	none	none	yes	none	none
Required annual audit	none	none	none	yes	yes	yes
Required annual report	none	none	none	yes	yes	yes

For instance, companies, registered in the USA in Delaware State, that are not engaged in any transaction within the State, are exempted from all local taxes and charges, except for so-called "franchise tax", which is rather low and depends only on number of the authorized shares (i.e. authorized capital). However, all companies registered in the United States must pay federal taxes, including corporate tax on income received by the company in any other country of the world. Moreover, financial statements are obligatory for all companies registered in any State of the country. American jurisdictions are the most inexpensive, besides most often the companies operation within these territories is notable for incorrectness, consequences whereof are not estimated.

The report by Boston Consulting Group (BCG) contains estimates on the world private assets dynamics. In 2006 assets under management (AuM), concentrated in offshores have been estimated at 6.7 tln. dollars, or 6.9% of total cost. Persian Gulf countries have held in offshores nearly 40% of their assets; countries of Latin America, Middle East and Northern Africa - nearly 30%. As regards European countries, this figure makes 9%, and in Northern America and Japan - 2-3% [3]. In other words, in countries with developed public institutions and civil society, transparency of economy is higher, economical and political situation is more stable, interest in specific offshore environments is lower.

3. Russia's Policy towards Offshore Jurisdictions

Priority in contemporary policy of Russian government is obviously placed on prohibitive and restrictive measures. Thus, plans of the Federal Tax Service of the Russian Federation provide for systematic break-up of taxation optimization schemes, review of double taxation conventions with offshore territories, and introduction of pricing policy agreements between the Federal Tax Service and major companies. Double taxation conventions between Russia and foreign countries provide functioning of legal tax avoidance schemes with participation of offshore jurisdictions. As of January 1, 2014, there are 78 current agreements with the Russian Federation.

Main anti-offshore novation suggested by the Ministry of Finance consists in treatment of income of the controlled foreign company (registered in offshore affiliated company of the Russian company) as income received by Russian parent company, and accordingly imposition of tax in Russia. In order to follow relations of Russian companies with offshore there has been suggested to lay the companies under obligations to state in tax statements information about all affiliated foreign companies, specifying the interest. Thus the Ministry of Finance can declare a company registered in offshore zone as tax resident of the Russian Federation. In this case offshore company must pay to the Russian budget tax on income from amounts saved due to lower tax rate of the country of incorporation. Thus, businessmen who draw income through affiliated companies in offshores (above mentioned list of 41 jurisdictions) from the year 2008 must pay income tax if profit taxation in offshore is less than two thirds of the Russian 20%.

Besides, it is planned to sign agreements with certain countries and territories concerning interchange of information required for identification of shareholders of offshore companies and calculation of the earned income. At present Russia has concluded agreements with 33 countries concerning combating money laundering. There are only three countries among them (Liechtenstein, Luxembourg, Monaco), that are traditionally referred to offshore jurisdictions.

It is planned to step up struggle with inland offshores and fly-by-night companies that are widely used for outflow of capital to foreign offshores and tax avoidance. Strengthening of control over transfer prices is a part of this policy.

All these changes contribute to struggle with illegal outflow of capital from Russia, and with legal tax avoidance via offshores. However, it is difficult to foretell any results of such novations.

Integrated approach is required to deal with these problems. Refining of tax policy, reduction of administrative barriers and arrangement of favourable conditions for business activity in Russia, competing with those in offshores, must become prime directions of this struggle.

Current offshore jurisdictions are notable both for tax remissions and top positions in different world ratings with respect to conditions for capital. For instance, from 1998 till 2011 Hong-Kong has been ranked first in the annual rating Economic Freedom of the World, made by The Wall Street Journal and Heritage Foundation [4]. In 2011 Hong-Kong was given 89.7 points out of 100, particularly noting the existing low-tax environment and flexible labour market. The second position of this rating among 183 countries has been held by Singapore with 87.2 points. Switzerland, Luxembourg, Ireland, Mauritius, Panama, Bahamas, Bahrain and some other countries connected with offshore business also maintain good positions in this rating.

In the ratings developed by experts of well-known PriceWaterhouseCoopers and the World Bank, in the world top twenty on general tax environment the leading positions are maintained by offshore jurisdictions and countries with offshore taxation environment. For instance, in the top six there are four such jurisdictions. According to this integrated rate, Russia is the 130th due to its rather low effective tax rate [5].

Efficient national policy will determine to a considerable extent whether offshores become complimentary elements of Russian economic area, contributing to growth of international competitive power of Russian companies, or remain "black channels" for cross-border migration of tax receipts and outflow of capital.

Establishment of free and special economic zones (FEZ and SEZ) of different type is considered the way to secure national economic growth. FEZ-s were intended to forward solution of such tasks as quick integration into the world economy, attraction of foreign investments, development of advanced innovative and technological experience. Though lack of unified national policy in this sphere, lack of federal law about special economic zones, direct imitation of foreign experience without regard to conditions of Russian economy, spreading of conditions of free economic zone within territorial and administrative borders, coincidence of these zones formation with protracted economy crisis in Russia have had an adverse effect on development of FEZs.

Russia is known to be the actual participant of international relations, however, its strategic mission lies in changes of essential mechanisms of national economy integration into the global economy by gradual reduction of raw-material orientation of export, compensated by high technologies development, strengthening of financial institutes, infrastructural industries and information sector. Institutes of special economic zones, prefigured by free economic zones, may become the tools of integration into the system of the world economic relations on conditions that allow competition with foreign states at internal and international markets.

At present time, expansion of integration process is conditioned by development of service zones, including offshore zones, complex and international SEZs. Such SEZs are called the zones of the fourth generation - integration-type SEZs. Special economic zone is understood to be complex integrated reproduction economic system including territorial and organizational structure, administrative machinery, tax preferences system, the aggregate of operating enterprises-residents. Mechanisms of SEZs allow establishment of new or renewal of existing relations between economic entities based on congruence of their economic interests, formation of competitive capacity, participation in redeployment of the world economy resources, levelling-out of lags in development of allied and related industries, effective participation in interstate production cooperation.

Thereby, establishment of new production and other infrastructure in SEZ leads to introduction to particular national economy of unusual methods of productions, connected primarily with forms of business activity. SEZs differ from the rest of the country territory in financing and productions-and-sales activity, economic relations connected with production and distribution of added-value formed in SEZ. These relations are connected with the system of economic incentives: tax, currency, customs, monetary and other, that can be treated as intentionally modified as compared to the prevalent ones in the given country.

4. SEZs as the Instrument of Investment Capacity Building of Russian Regions

Our interest is conditioned by the way of development of special economic zones in the Russian Federation till the end of 2015.

We have applied Box-Jenkins method for prediction of development of special economic zones for the Russian

Federation for the variable "number of residents operating within these zones".

Time series "number of residents registered in free (special) economic zones in the Russian Federation" for the years 1990-2012 has been used as the basis for prediction. In the Figure 1 the time series is represented by a diagram.

Within Box-Jenkins procedure, in the GRETL package there has been applied optimal for prediction non-seasonal ARIMA model with 3 years period (1,2,1).

As shown by the Figure 1, there is light growth dynamics till the year 2004, considering that the main objectives declared at establishment of FEZ have not been accomplished, because in most cases the companies were registered on corresponding territory, enjoyed preferential benefits, yet conducted activities outside the territory. Thus, those zones operated actually as offshores, and only SEZs established on legislative level in Kaliningrad and Magadan regions are currently functioning.

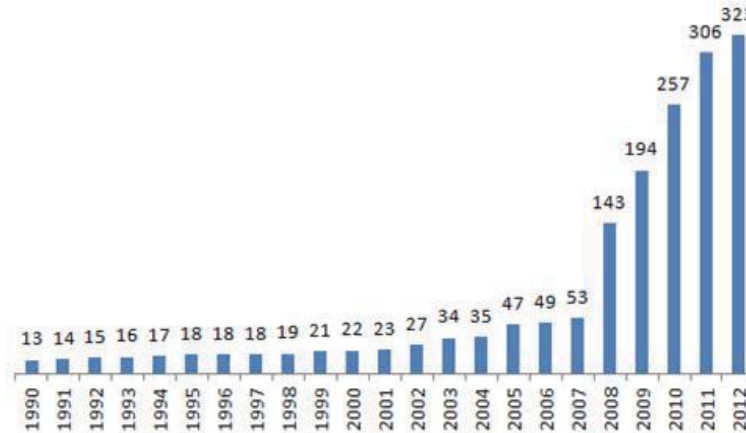


Fig. 1 Number of residents registered in free (special) economic zones in Russia.

The result of 3 year prediction by application of ARIMA model (1,2,1) is given in the Table 2, column "prediction". Anticipated number of residents by the year 2015 according to the model data is 401, and with 95% probability we may state that by the year 2015 number of registered residents of special economic zones in the Russian Federation will make 313-541. Thus, mistakes made in the process of implementation of normative legal acts regulating functioning of the former economic zones in Russia, have enabled to some extent to expedite re-thinking of national industrial policy.

Table 2. Prediction of the dynamics of number of residents registered in special economic zones in the Russian Federation, by the end of 2014.

Observation	Prediction	St. Error	95% confidence interval
2013	346.13	33.459	280.55 – 411.71
2014	386.34	46.053	296.08 – 476.60
2015	401.20	58.647	313.31 – 541.49

The Table 3 shows the results of ARIMA model (1,2,1) parameters estimation. Student statistics for each parameter are rather high in absolute magnitude, that is all model parameters given in the column "coefficient" have high significance.

Russia has established or plans to establish SEZs of nearly all main types widely-spread all over the world: industrial production, technology development, tourism and recreation, and port zones.

The world experience has proved that establishment of SEZs in economically safe regions enables the most efficient application of public funds, attraction of private capital. Such enterprises, in turn, provide prompt and greater return, including in form of tax liabilities. Consequently, Russian authorities have taken decision about establishment of SEZs at first in economically strong regions, as distinguished, for instance, from China that has gained wealth of experience in establishment of such enclaves. Initially, selection of territories for SEZs in the People's Republic of China was conditioned by their geographic position - nearly all of them are isolated from the other parts of the country by mountain groups or are located on islands or peninsulas. In China provision of state tax privileges and other benefits to the residents of free zones was of major importance for successful operation of these zones.

Table 3. ARIMA model (1,2,1) parameters estimation results

Parameters	Coefficient	St. Error	t-statistics	P-value
const	2.62901	3.12828	0.8404	0.4007
phi_1	0.46789	1.03787	0.449	0.6564
theta_1	-0.9999	0.220059	-4.544	5,51e-06

Mean of Dependent Variable	5.235294	St. Deviate of Dep. Variable	21.23243
Mean of Innovations	-2.484685	St.dev. of Innovations	18.89178
Log Likelihood	-75.07144	Akaike Criterion	158.1429
Schwarz Criterion	161.4757	Hannan-Quinn Criterion	158.4742

Foreign experience has proved that exemptions for income tax, property tax, value-added tax, local taxes contribute to reduction of production costs and business operations risk, development of competitive environment, expansion of business relations, trade facilitation, renovation of main production facilities, attraction of investments into production and social sphere. Accordingly, the specified benefits are widely applied in different types of SEZs.

In industrial production and scientific-industrial zones for promotion of export activity for all participants there have been permitted duty-free import and export of goods, applied low income tax rates, preferential customs tariffs for transportation; all these contribute to currency inflow, development of industrial production, new jobs creation, new technologies development, introduction of modern management techniques. In industrial production zones there is a practice to grant tax allowances and subsidies in the form of refund of VAT, excise taxes, export duties, taxes for purchase of domestic raw materials and components, grants, tax refunds, and premium price cancellation. These measures stimulate establishment of industrial relations of SEZs' enterprises with other parts of national economy, consolidate export potential, improve its integration into the world economy.

In technology development SEZs with the purpose to stimulate attraction of investments, priority structural investing, and production modernization there are widely applied tax holidays for property tax, income tax, reduced rates for returns on sales of patents, licenses, benefits for new jobs creation. In undeveloped and depressed regions such measures provide for population employment, growth and modernization of production. In many countries for all types of SEZs there are granted deductions from taxable income for expenditures connected with infrastructure arrangement, subsidies. Such measures are intended to stimulate investment projects, development of social and production spheres, increase of consumer goods output, activation of regional economic activity, local budgetary recharge.

In the global practice there appear some differences between SEZs in developed and developing countries. In developed countries, the prime objective is technical re-equipment of production based on new technologies, therefore mainly tax remissions are granted. In developing countries, in addition to economy modernization, the priority objectives are to attract foreign capital and to gain advanced managerial experience, therefore benefits are provided not only in respect of taxation, but also for land lease, labour utilization. Bearing in mind, that in Russia tax and customs preferences are third among basic instruments of government regulation of SEZs (after state support of infrastructure development in SEZs territories and introduction of facilitated administration form), it may be concluded that we have followed the path of developing countries.

5. Conclusion

While setting the objective to create favourable investment climate, one should not overestimate contribution of foreign investments into regional economy - international practice has shown that in developing countries investors prefer to invest funds into short-term fast-payback projects, following which they leave SEZs, and just minor amounts are spent on development of infrastructure and provision of necessary facilities. Besides, there is a widely-spread practice to hide the income by means of mechanisms of intra-firm trade with application of transfer pricing. The same is the purpose of payment to the parent company of interests on credits, rents, payments for use of technical innovations, trademarks (royalty payments). Experience of developing countries also has shown that efficiency of SEZs is connected to a great extent with correct location of such zones. In Russia the boundary regions having well-established economic relations with neighbouring states have the most favourable positions.

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