

## OFFSHORE TERRITORIES: BASIC CONCEPTS OF FUNCTIONING

*Formulation of the problem.* At this point in time offshore business stills remains an under-researched phenomenon in the system of international economic relations. The scientists' attitude towards it is ambiguous and controversial. Therefore, the trends in its rapid development require a more detailed study. This necessity arises from the fact that the existence of offshore centers is an important factor in attracting foreign investment, in performing economic reforms and modernization of the management mechanism.

This theme has been chosen due to its general significance in the world and deals with several factors. At the present stage of economic relations development in the global economy no country is indifferent to the processes taking place all over the world, as for different economic agents the degree of accessibility and openness of various resources (human, financial, material) involved in the world reproduction increases. In this regard, there is a need to know more about offshore areas and be able to distinguish them from the territories of other kinds.

The aim of the article is to provide data on offshore areas, assessing to investigate their advantages and disadvantages, to study the state and trends in the development of the offshore business.

Offshore business has some specific features, in particular, special attention to privacy issues and the desire to "close" the information about ongoing operations, clientele, etc., is intended primarily to make such information in available for inspection by the state tax structures (mostly foreign ones), foreign intelligence services, independent auditors, etc.

Analysis of the research and publications on this issue. Among the native researchers one can name of this issue such scientists as: A. Ambartsumov, F. Sterlikov in their "Theory questions and answers" they were one of the first scientists who describe offshore territories, E. Saveliev, O. Bondarev, V. Kravchenko, N. Kucheryavenko, Z. Vasilchenko describe the problems of offshore zones, S. Chernyavsky has written about the offshore contradictions [1, p. 15], A. Bulatov, G. Golubkov, D. Gorbunov, M. Rubchenko was involved in the problem of offshore business foundation [2, p 45], M. Gutseriev, M. Korolyov, L. Fituni etc.

The problem in question was in the centre of the following scientist's attention: A. Cohen, K. Matridis, E. Shambost, S. Doggart, F. Bessinger, D. Mitchell, K. Kottke, R. Laulayaynen, R. Knapp, D. Scott. But despite the great number of native and foreign authors, the further analysis of international experience in conducting offshore

business and the attempts to find new legal ways to minimize taxes are going on.

Offshore territories appeared several thousand years ago. Originally they were the Commerce pirate cities of Phoenicia and Crete, that had long controlled and frightened the Mediterranean people. Offshore business even at that time was profitable, but remained quite risky. A good example was made by the experience of Athens. After the of the authorities had imposed a two percent import and export tax from Greece and other countries began to go pass around Athens to avoid paying taxes. Later on small island states, which did not impose taxes on traders, began to appear. They were a refuge for smuggled goods. Traders preferred to sell goods not in their own countries (for example, in England) but transported them to islands, where they were exempted from taxes.

Despite the centuries-old activities of traders, the term "offshore" in the modern meaning was appeared only in the late 1950's in the U.S., after some company managed to avoid state control of its activities by the principle of geographical selectivity, namely by changing the country of registration: the company took its activities out of the legal reach of the U.S. government. The basis for the definition was formed by the territorial principle.

There are different ways of rendering the term offshore into Russian. As far as it's spelling in Russian is concerned these is a form made by means of transcription "офшор" and the one made by of transliteration "офшор". In the given article the latter form is used apart from the term "offshore" itself in Russian there also exist a few synonymic word combinations such as "offshore centre", "offshore territory", "offshore business centre" and the like. It is interesting to admit that there are also some synonymic terms formed on the basis of metaphors which have their equivalents in English, for example "tax haven" themselves. As far the definitions themselves they also vary.

For example J. Volkova [3, p.43], defines this notion as follows: "Offshore are territories that provide preferred treatment for financial and credit transactions with foreign participants in foreign currency".

Professor A. Ambartsumov and F. Sterlikov [4, p.157] define offshore as: "A term used to characterize the world's financial centers, as well as certain types of banking transaction, it is a foreign company with the right to work only abroad. A company of international business is a special organizational-legal form of a legal person. It is mean to conduct international commercial activity by non-residents".

The most widespread abbreviations: LTD (Limited),

INC (Incorporated), PLC (Public Limited Company), Corp. (Corporation), LLC (Limited Liability Company), LDC (Limited Duration Company), IBC (International Business Company), Sole Proprietorship, General Partnership, Limited Partnership, C — Corporation, S-Corporation, Non-Profit Corporation.

Apart from the term offshore, in special literature, such phrase as “onshore” company. Is also found the names are very similar, they are often confused. One of the most important difference between them that there is no accountability in offshore companies. Offshore companies don't have to submit the absence bookkeeping and tax accounts to controlling bodies; (accounts be kept for internal control). Whereas onshore company must give in accounts at the place of registration.

Onshore companies are full taxpayers, while the offshore companies pay only a fixed annual fee. Offshore companies have private register of shareholders and directors. It means that this information is not available to third parties. The information about the register of shareholders and directors of the onshore companies is open, and any person can obtain the information about the company from some governmental organization.

But, despite all these “disadvantages”, a business using onshore companies is becoming more and more respectable. It like a foreign business, which seems to be “distant” from local businesses or residents. It gets the tinge of being removed from offshore territories and the reality of the external contractor. There appears an opportunity to enjoy the benefits of agreements on avoidance of double taxation. In international tax planning while using onshore company at first the taxes of this company itself, and then the groups of the customer's companies are optimized. Also in these countries the forms of business, which are fully exempt from corporate taxes can be organized (for instance, companies such as LLP in UK).

Nowadays in the world there are a few dozens of territories, declared their offshore status. Offshore centers exist on all the continents, both in developed and developing world. The conditions of their origin and operation the range and cost of benefits, the level of their development, the kind of specialization are different. Taking into account such diversity it is inevitable that the question of correlation and comparison of various offshore centers should be raised, that is, about a certain classification of offshore territories.

Similar problems arise in the analysis of the main player of offshore business — offshore companies. Therefore it is obviously to examine the necessary legal forms of organizational and types of offshore companies in order to facilitate the understanding of the mechanisms of offshore business.

In the Report of the Working Group on Offshore Centres there are typical indications of offshore companies[5, p.25]:

1) offshore companies may be engaged in any activity (except certain types of activities, which require licensing procedures);

2) limited liability: the owners are responsible for the obligations of the company only in the paid-up authorized capital for non-banking companies there are usually no restrictions on the minimum paid-up authorized capital;

3) in the country of registration the company must have a registered (legal) address and the agent, who may be a person, individuals or legal, whose duty is to actually be at the registered office and be the link between the state authorities of the country of registration and the company, and to maintain a real is not necessary;

4) the company has the right, to open up bank accounts in the world without any restriction, and if in the country of registration there no taxes, and obligatory audits are not, it is not demanded to inform the authorities about accounts in the country of registration are also acceptable;

5) The owners are determined by shares (registered or bearer), and in their turn they elect directors, and they already take all current solutions, such as opening accounts in a bank, borrowing or lending, and etc.; directors appoint the company a secretary of the company, whose signature certifies the reports of all assemblies and decisions of the board of directors and shareholders;

6) the owners may be any legal parties or individuals;

7) the most important criterion: the company must operate its activity only outside the country of registration and not have any source of income its territory, including having no deals with local legal parties or individuals.

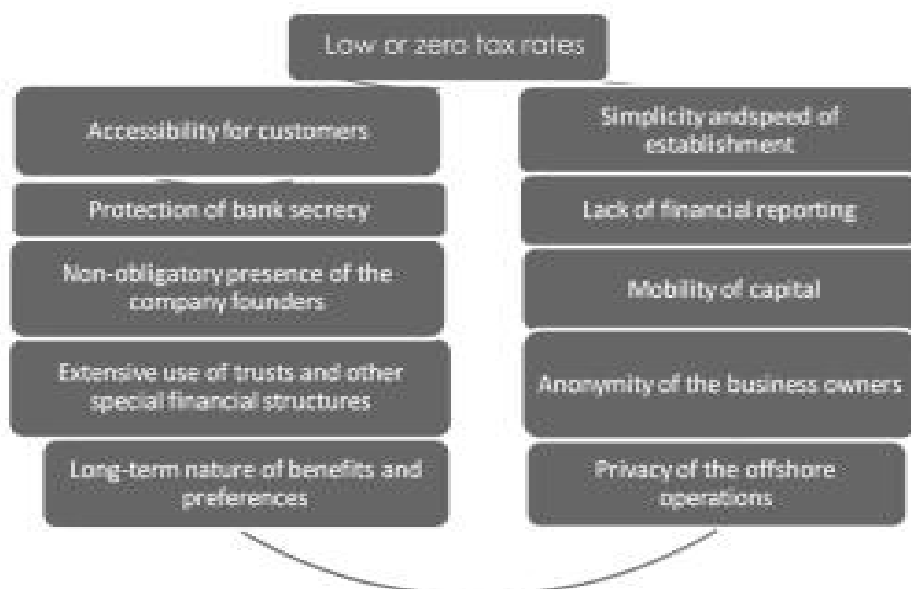
Figure 1 shows the principles of operation of offshore zones.

By creating an offshore territory, the state has the following purposes [6, c.28-34]: economic (foreign investment, increase of foreign exchange earnings to the economy of the country), social (the acceleration of the development of the country or a territory in its structure, increasing employment and income of the population, creation of a highly qualified workforce), scientific and technical (adoption of the leading foreign technologies in the field of modern telecommunications and banking). Such goals may vary depending on the particular situation and the type of an offshore jurisdiction (in the Netherlands and Luxembourg, the activity of holding jurisdictions has attracted additional funds into the economy, but the countries themselves have become the world's biggest investors)

The most widely-spread variants of using offshore companies look as follows:

1) For legal persons:

- using offshore territories in import-export operations;
- for working on foreign financial and stock markets;
- for active work at the equity market;
- for loaning from an offshore company;
- for transferring profit to an offshore company



**Fig. 1. Principles of offshore territories operating**

under a contract to provide information and consultancy services;

Good results are reached by the application of offshore companies in banking, insurance, construction and transport activities, navigation, purchasing real estate.

2) For individuals:

- to deposit money;
- for accumulation of cash assets received of providing services to foreign customers;
- for the registration of real estate for a foreign company or its subsidiaries [7, c.223-236].

Classification of offshore territories

The offshore territories can be classified into three main groups (Table 1):

Below on the world map (Figure 2.) the location of offshore jurisdictions is given. These include the classic offshore territories and the company in the EU.

As it is seen from the figure the largest accumulation of offshore territories is located in the district of Caribbean Sea, French Polynesia and Western Europe. This arrangement is due to historical background. Most of the zones belongs to the former and still existing British and French colonies.

There are also 51 Offshore LLC in the U.S. They are Idaho, Iowa, Alabama, Alaska, Arizona, Arkansas, Wyoming, Washington, Vermont, Virginia, Wisconsin, Hawaii, Delaware, Georgia, Virginia, Illinois, Indiana, California, Kansas, Kentucky, Colorado, Connecticut, Louisiana, Massachusetts, Minnesota, Mississippi, Missouri, Michigan, Montana, Maine, Maryland, Nebraska, Nevada, New Hampshire, New Jersey, New York, New Mexico, Ohio, Oklahoma, District Kolubiya (DC), Oregon, Pennsylvania, Rhode Island, North Dakota, North Carolina, Tennessee, Texas, Florida, South Dakota, South Carolina, Utah.

Offshore territories may be very different as far as

administrative conditions of offshore companies, reporting requirements, taxes and so forth. So, an offshore territory for the registration of an offshore company is selected according to a certain type of business, the particular offshore scheme, and sometimes accordance with certain financial transaction.

Table 2 presents the most popular offshore zones in the world.

More territories also attract researcher's attention. Gibraltar is an excellent area for business. Firstly, since July 1, 2009 there was a set corporate tax rate of 10 per cent for new companies that will allow it to compete with leading offshore territories. Secondly, even though it is a member of the EU, its territory is not included in the customs area, that is why the VAT is zero, there are no taxes on luxuries, will, property received as a present and capital gains. Thirdly, foreign companies are exempt from all taxes.

Another one of the prospective territories are Cyprus and Hong Kong. Regarding the latter, a territorial principle of taxation of the company is operates there. Income earned abroad, are not taxed, even if they focus on the accounts in the Hong Kong. It should be noted that the March 22, 2010 a comprehensive agreement between Hong Kong and the Netherlands on the avoidance of double taxation was signed, such action simplifies the cooperation between countries and prevent tax evasion [8].

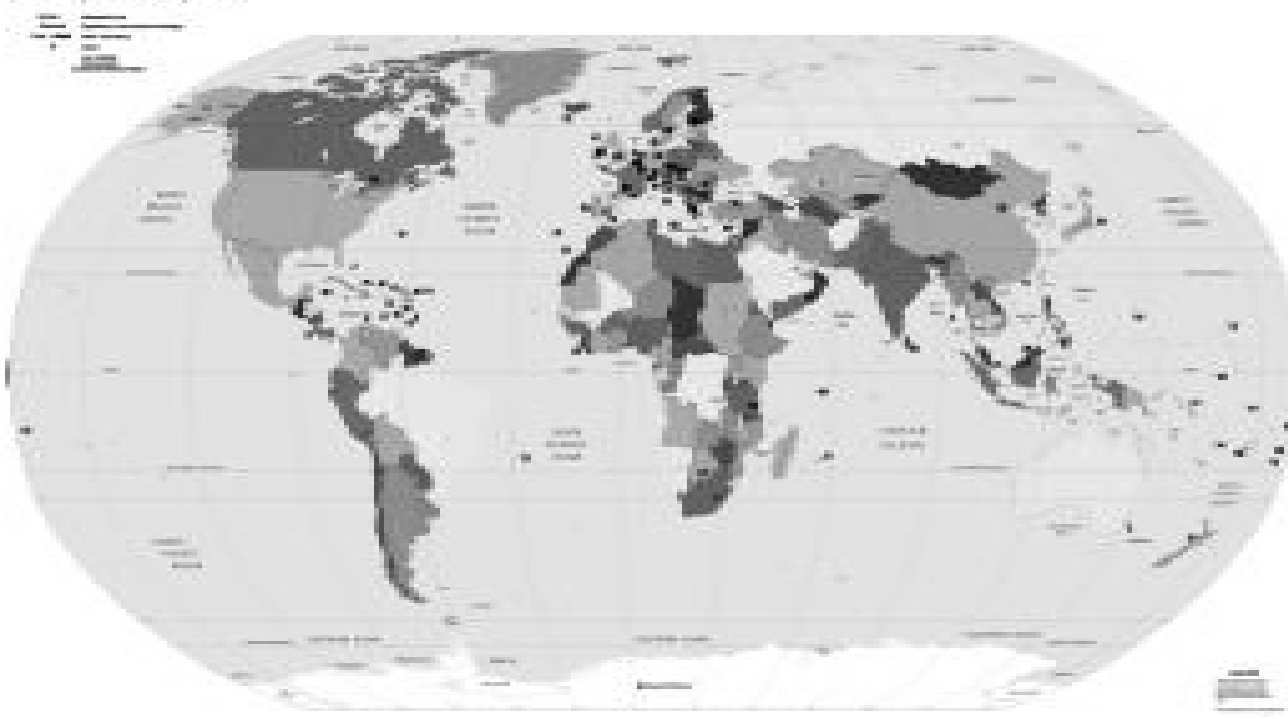
Most economists see the positive effect of offshore territories on the global economy which includes [9, p.12], [10], [11, p. 150]:

- Increasing cross-border financial flows;
- Accelerating the turnover of financial assets on an international scale
- Creating conditions for investment diversification, improved access to credit and better allocation of capital;

Table 1

Group	Discription	Country
1	Classic offshore territories. Countries which allow the offshore companies registered in them and which do not act on their territory, full exemption from taxes in exchange for a small fixed annual fee; these countries do not require to keep accounting records.	Bahamas, British Virgin islands (BVI), Belize, Mauritius, Nevis, Panama, Seychelles Islands, Turks and Caicos.
2	Countries that have low tax rates for certain types of companies or where such companies can receive significant tax benefits. As a rule, these states require the companies to conduct the accounting records. international community.	Cyprus Hungary, Hong Kong Gibraltar, Liechtenstein, Luxembourg, Uruguay
3	Countries that give the companies high respectability and in some cases providing them with, certain tax remissions under strict conditions	USA, UK, Switzerland

Indicate the type of the state, April 2008



#### OFFSHORE CLASSIC

- |                                    |                      |                    |                                   |                 |
|------------------------------------|----------------------|--------------------|-----------------------------------|-----------------|
| 1. Australia                       | 16. Gibraltar        | 34. Monaco         | 71. St. Kitts                     | 52. Belgium     |
| 2. Anguilla                        | 17. Hong Kong        | 35. Montenegro     | 72. St. Vincent and<br>Grenadines | 53. England     |
| 3. Andorra                         | 18. Grenada          | 36. Nauru          | 73. Singapore                     | 54. Hungary     |
| 4. Anzhuyan                        | 19. Guam Island      | 37. Netherlands    | 74. Solomon's                     | 55. Germany     |
| 5. Antigua                         | 20. Dominica         | 38. Niue           | 75. Turks and Caicos              | 56. Greece      |
| 6. Aruba                           | 21. Israel           | 39. New Zealand    | 76. Tonga                         | 57. Denmark     |
| 7. Bahamas                         | 22. Iceland          | 40. Nevis          | 77. Tuvalu                        | 58. Ireland     |
| 8. Barbados                        | 23. Spain            | 41. Isle of Man    | 78. Turkey                        | 59. Italy       |
| 9. Belize                          | 24. Canada           | 42. Cook Islands   | 79. Uruguay                       | 60. Cyprus      |
| 10. Bermudas                       | 25. Canaries         | 43. Panama         | 80. Fiji                          | 61. Luxembourg  |
| 11. Bulgaria                       | 26. China            | 44. Puerto Rico    | 81. Croatia                       | 62. Malta       |
| 12. Botswana                       | 27. Costa Rica       | 45. Romania        | 82. Switzerland                   | 63. Portugal    |
| 13. British Virgin Island<br>(BVI) | 28. Labuan           | 46. Samoa          | 83. Sri Lanka                     | 64. Slovakia    |
| 14. Vanuatu                        | 29. Liberia          | 47. St. Lucia      | 84. Japan                         | 65. Finland     |
| 15. Guernsey                       | 30. Liechtenstein    | 48. St. Marino     | <b>Companies in the EU</b>        | 66. France      |
|                                    | 31. Mauritius        | 49. Seychelles     | <b>(Readymade)</b>                | 67. Czech       |
|                                    | 32. Madeira          | 50. Cayman Islands | 51. Austria                       | 68. Sweden      |
|                                    | 33. Marshall Islands | 70. St. Helena     |                                   | 69. Switzerland |

Table 2

Jurisdiction	Total cost of incorporation and the first year of existence	The total cost of the annual supporting the second year beginning with	Requirements for annual reporting	Taxation	Brief description
British Virgin Island	1390	830	-	-	The time-proven offshore jurisdiction. Offshore are completely exempted from taxes. Recommended by BCS Europe.
Seychelles	1090	590	-	-	One of the best offshore territories. A simplified process of company registration, the complete absence of taxes and reporting. Complete confidentiality. Recommended by BCS Europe.
Dominica	1370	810	-	-	One of the best offshore territories. A rapidly growing offshore center. Offshore completely exempted from taxes. Recommended by BCS Europe.
Belize	1490	580	-	-	The offshore territories in Central America. Offshore completely exempted from taxes. Recommended by BCS Europe.
Gibraltar	1490	790	yes	-	One of the best offshore zones. Offshore completely exempted from taxes. Thanks to British protectorate has several advantages associated with its membership in the EU. Recommended BCS Europe.
Panama	1090	550	-	-	Offshore completely exempted from taxes.
The Isle of Man	3490	2590	yes	-	An interesting jurisdiction for business in Europe. Thanks to British protectorate has several advantages in connection with its membership in the EU. Offshore completely are exempted from taxes and pay only a fixed fee.
Mauritius	1490	690	-	-	The offshore zone in the Indian Ocean. Offshore completely exempted from taxes.
St. Kitts and Nevis	1290	650	-	-	Another offshore territory in the Caribbean. Flexible and clear legislation. Offshore completely exempted from taxes.
Bahamas	1490	890	-	-	In terms of offshore transactions Bahamas occupy one of the first places in the world. Offshore completely exempted from taxes.
USA (Delaware)	690	490	-	-	Low cost is the main advantage of incorporation in Delaware. In practice, when doing business outside the U.S., the company actually is exempted from taxes and tax reporting.
UK	1460	990	yes	yes	An interesting variant of company registration in the UK. May be used to open business and mixed offshore / onshore schemes.

- motivation to reduce the overall tax burden and on that basis stimulate the economic activity in the global economy;
- Reducing the risk of expropriation and the creation of conditions for the protection of property rights, which, in turn, may initiate increasing of economic growth, especially in donor countries;
- to promote the prosperity of those states, where offshore companies are located, that promotes more harmonious development of world economy as a whole;

- Improving the competitiveness of companies at the national and global levels using more flexible strategies of developing.

Among the negative aspects of offshore business economists and scientists mark the following [12, p.494], [13, p.30]:

- unfair tax competition, which takes away revenue from offshore countries;
- creating an element of instability in the global economy

and finances because of potential savings of large amounts of capital in offshore territories, especially speculative;

- to promote capital outflows;
- supporting of the shadow economy;
- reduction of the employment in the donor countries;
- providing undue competitive advantage to individual companies;
- adverse impact on the social situation in the donor countries associated with the negative assessment of tax evasion in public opinion.

Comparing these two lists shows: one and the same property of offshore territories can be treated as an advantage and a disadvantage, depending on the specific interests of investors.

Nowadays offshore is very popular in the world, but many businesses try to hide their real incomes and, consequently, the economy of states suffers. Banking secrecy, prevalent in the territories, preventing to trace the real cash flows. In this regard, in Toronto the summit of great 20 took place. At the summit, the reform of international banking institutions and the introduction of measures for greater control over them were actively discussed. Countries participants decided to assess the situation in the context of each country. Prime Minister of Canada Stephen Harper, summing up the summit, said that countries decided to assess the situation and by 2013 to reduce their budget deficits, at least in a half.

Despite some shortcomings, the offshore territories remains one of the best ways to legally avoid taxes, they help to development of small and medium businesses. However, it should be remembered that the offshore zone is not a way to get rich, but a means to raise and strengthen the economy.

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#### Kleshcheeva M. V. Offshore territories: basic concepts of functioning

In this article the author tries to bring the most vivid examples of the functioning of offshore zones (Problems and Prospects) and their impact on national economies as a whole. Study of the special status of offshore zones and modalities for a solution to the problems associated with the implementation of shadow operations in these centers.

*Key words:* Offshore, offshore centers, globalization, growth, factors, influential, theory, foreign investments.

#### Клещеева М. В. Оффшорні території: основні поняття функціонування

У статті автор намагається привести найбільш яскраві приклади функціонування офшорних зон (проблеми та перспективи) та їх вплив на економіку країн у цілому. Вивчення особливого статусу офшорних зон та умов їх функціонування може бути розв'язанням проблем пов'язаних зі здійсненням тіншових операцій у цих центрах.

*Ключові слова:* Оффшори, офшорні центри, глобалізація, економічне зростання, фактори, впливовість, теорія, іноземні інвестиції.

#### Клещеева М. В. Оффшорные территории: основные понятия функционирования

В этой статье автор старается привести наиболее яркие примеры функционирования офшорных зон (проблемы и перспективы) и их влияние на экономику стран в целом. Изучение особого статуса офшорных зон и условий их функционирования служит решением проблем связанных с осуществлением теневых операций в этих центрах.

*Ключевые слова:* Оффшоры, офшорные центры, глобализация, экономический рост, факторы, влияние, теория, иностранные инвестиции.

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