

Every Decent Nation Has Its Own Offshore Zone

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According to Prime Minister Dmitry Medvedev, "The proposal to turn the Far East into an offshore zone is not an emotional reaction to the crisis in the eurozone but a very sensible idea on which the Russian government is currently working." This recent statement was made on the heels of several previous statements by Russian officials on the subject of reducing the economy's exposure to offshore holdings and the need for an analysis of the problem and a search for solutions.

The commonly held understanding is that an offshore jurisdiction is simply a way to evade high taxes at home by paying low or no taxes there. In reality, a true offshore offers much more. Nicholas Shaxson sums it up well in his book "Treasure Islands: Uncovering the Damage of Offshore Banking and Tax Havens." Shaxson writes that offshore zones are "places that try to attract business by offering physical and legal entities politically stable opportunities to circumvent the rules, laws and standards in force in other jurisdictions."

Below are the top five positive results if Russia were to transform the Far East into a full-

fledged offshore.

1. **Stability.** Commercial entities are attracted by any jurisdiction that can guarantee a stable business environment, whether or not that jurisdiction positions itself as an offshore. It is only possible to attract investors with favorable terms of registration, rules governing financial transactions, confidentiality and low taxes. Moreover, investors must be 100 percent confident that the guarantees offered are reliable.

Other important considerations are political stability, a lack of unresolved disputes and fair enforcement of the law. It was precisely because the republics of Abkhazia and South Ossetia could not offer political stability or guarantee property rights that they did not become generally recognized offshores. This also explains why former Libyan leader Moammar Gadhafi's announcement in March 2011 that the country was canceling all taxes did not elicit any enthusiasm from the global business elite.

2. **A legal system that the typical investor can understand.** As a rule, leading international financial centers adhere to English common law. That legal system is not only more convenient for transactions and protecting the rights of the parties involved on a global scale, but it also contains the very important element of the trust. Similarly, it provides for an institutionalized system for owning and managing a business without creating a corporation. This allows the person who is actually running the business to effectively "hide" behind the manager. Russia's legal system, like that in most countries using civil law, does not provide such mechanisms.

3. **Minimum or no obligations to disclose or store information about business owners and beneficiaries, trusts and bank accounts.** Offshores typically have no requirement to file accounting reports and make it possible to maintain secrecy concerning bank audit and legal information. The main advantage of offshores is not so much that they allow for any financial transaction with a minimum tax obligation but that all information about those dealings can remain undisclosed. Such confidentiality is advantageous for participants in transactions that wish to remain concealed for various reasons.

4. **Minimum or zero tax burden.** Offshores generally do not tax company revenues earned overseas. This applies particularly to "passive" revenue from interest, dividends, royalties and also proceeds from securities and derivative financial instruments. But that alone is not enough. The offshore should also provide agreements on the avoidance of double taxation, allowing a company to avoid paying taxes on revenues both in the offshore jurisdiction and in the country where the money was earned.

5. **Physical access and convenience.** In today's world, offshore operations do not provide for complete anonymity. To create a business in an offshore, the owner or an authorized representative is generally required to appear before an authorized agency and provide a signature. To maintain unchallenged status as a tax resident in an offshore jurisdiction, corporations must keep a postal address there and conduct a minimum of required activity.

All of this necessitates that offshore jurisdictions offer regular flights directly to the world's major economic centers, minimal or no visa requirements and a lack of administrative obstacles, such as registration and work permits, so that foreign citizens can easily stay or work in the offshore jurisdiction. Offshores typically offer yet another major perk: a pleasant,

warm climate.

Unfortunately, it would be extremely difficult to meet these requirements in Russia. First, it would require changes to the articles of the Constitution declaring the territorial and economic integrity of the country. In addition, it is unclear how a single state could apply different sets of laws in different regions, or how Russia could continue to comply with existing international agreements. After all, it is possible that the countries that have signed agreements with Russia on excluding double taxation would not prefer working with a classic offshore jurisdiction. What's more, Russia is a signatory to a number of international agreements requiring that it adhere to prescribed standards of transparency and disclosure concerning taxes, and these are largely incompatible with the operations of an offshore.

Therefore, a second and more realistic option for creating an effective Russian offshore might theoretically involve granting sovereignty to one part of the country's territory, enabling it to create an independent legal system with all of the necessary characteristics — from English common law, confidentiality concerning transactions and the disclosure of information about corporations, trusts and bank accounts to a territorial system of taxes that places no burden on overseas earnings. Thus, concluding agreements with offshore jurisdictions on the avoidance of double taxation or the provision of equivalent certificates to its tax residents would move Russia closer to the ideal to which Medvedev referred when he said "every decent country has its own offshore."

Granted, only Russia's top leadership has the right and power to make such major political decisions, but ordinary citizens might well ask themselves what elements of an offshore would be worth implementing nationwide in addition to the obvious benefits of secrecy and lack of disclosure. Would it not be to Russia's advantage to have a legal system based on law or precedent and simple enough for the investors to understand? Would it not be to Russia's advantage if its major cities were connected by direct flights to the world's financial centers and if administrative barriers to working in this country were minimized?

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