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Russia's Offshore Money Looks Set to Stay There

By Kristen Blyth

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Russia is set to enact an amnesty on offshore assets next month, but disagreement and lack of clarity over the terms of the pardon threaten not only to render the measure impotent, but undermine the government's very drive to lure overseas money back home.

The capital amnesty, part of a long-term initiative by President Vladimir Putin to "de-offshorize" the Russian economy, was ordered by the president in December during his annual address to the Federal Assembly.

At the end of a year in which Russia's net capital outflow reportedly more than doubled to $151.5 billion, Putin spoke during the meeting of a "full amnesty" on all offshore assets from criminal culpability.

"Let's do it now, but [only] once," he said, according the state news channel Channel One.

Initially scheduled to take effect in April, the start of the amnesty has now been delayed until

June as the State Duma struggles to hammer out terms without violating international anti-money laundering regulations.

A draft of the pardon submitted to the Duma at the end of March envisions a full excuse from criminal, administrative and tax responsibility for Russians voluntarily declaring offshore property, bank accounts and foreign companies controlled by him or her. The opportunity to declare foreign holdings will be open until Dec. 31.

The assets won't be subject to a one-time tax, according to the draft, and cannot be used as evidence in any investigation against the declarant. The origin of the funds and property won't be questioned.

In fact, Russians won't even be required to move them back home, Prime Minister Dmitry Medvedev told the government in a meeting at the end of March, according to newspaper Vedomosti.

The assets must only be registered in a "transparent" jurisdiction that has a double-tax treaty in place with Russia and is not blacklisted by the Financial Action Task Force (FATF), a global money laundering watchdog, Vedomosti reported.

As the currently drafted rules of the amnesty stand, however, questions remain about the measure's efficacy and implications.

For one, there are only five countries on the FATF blacklist: Iran, North Korea, Algeria, Ecuador and Myanmar. Russia is also party to double-taxation agreements with many countries around the world.

According to the conditions described by Medvedev, therefore, the amnesty would effectively pardon assets in countries like Cyprus, an offshore jurisdiction well-known to be an investment favorite for Russians, while providing no incentive to transfer them back to Russia: the basis for the de-offshorization drive in the first place.

The Duma noted this apparent contradiction with Putin's initial order, which proposed the return of foreign assets back to Russian territory, when discussing the first draft of the bill. However, the conflict between what Putin wants and what he may apparently be getting has not yet been addressed in the language of the legislation.

Also, though various government officials have assured Russian media that the amnesty will not pardon assets linked to fraud, corruption or financial crimes, the law as written so far provides no method for identifying these genuinely criminal funds.

If it will not conduct even a cursory examination of where declared offshore money came from, the Russian government has no grounds for determining its legality.

Medvedev indicated in the March meeting that the amnesty terms would not preclude potential criminal prosecution, according to the Vedomosti article, but did not specify where the line between a full and partial pardon for financial crimes may fall.

The prospect of a full Russian amnesty on questionable cash has meanwhile raised some concerns with FATF, with Russian media quoting some experts as saying such a move could

risk Russia itself landing on the watchdog's blacklist.

Weaknesses of the capital amnesty, however, reach far beyond the terms of the proposed pardon.

First, this strategy fails to address the catalysts for why many wealthy Russians move assets abroad in the first place. In contrast to many developed countries, where use of offshore structures may be driven by a desire for greater tax efficiency, Russian companies and individuals often hold assets offshore to avoid the risks associated with keeping them in Russia.

High levels of bureaucracy, the threat of hostile corporate takeovers, widespread corruption and lack of trust in a government with a demonstrated propensity for appropriating private assets have all been cited as motivations for Russian businessmen to keep their holdings outside national borders.

Economic crime, manifested in forms from bribe-taking to accounting fraud, is pervasive and a leading barrier to doing business in Russia. Last year, Russia was the world leader in economic crime in a survey conducted by professional services firm PricewaterhouseCoopers, with 60 percent of companies polled in the country reporting that they had experienced the problem in the last two years.

Several major Russian conglomerates, some of them headed by friends of Putin, have announced the repatriation of their business activities since the president's de-offshorization drive has intensified.

In general, however, Russians have a low incentive for participating in the amnesty, partly because there is no great punishment for neglecting to do so. The country has a reputation for being lax on corruption and money laundering — an image that Putin has taken steps to amend, but with arguably sparse results so far.

By way of example, an ex-Defense Ministry official accused of stealing 3 billion rubles ($59 million) was recently found guilty of fraud — but prosecutors asked for just a 1 million ruble fine ($19,500) and a suspended sentence as punishment. Putin joked in 2011 that the positive side of bribery in Russia was that it showed people had money to spend.

These days, though, Russians have less money to spend. In a carrot-or-stick proposal to convince businessmen to move their assets and corporate holdings back home, the government wields only a small stick, and even less of a carrot — and until that dynamic changes, a great deal of Russian cash can be expected to remain firmly offshore.

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