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Offshore Financial Centers in Global Capital Flow

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"The avoidance of taxes is the only intellectual pursuit that still carries any reward"
J. M. Keynes

ABSTRACT. The article is dedicated to investigation of the place and role of offshore financial centers in financial globalization system, and of the reasons for using offshores in assets securitization mechanism. Numerous offshore and other preferential zones enabling to avoid the effective national and governmental tax regime are important attributes of global financial system and redistributive links of world financial flows. At present, around 70 countries and territories offer their offshore services for foreign capital, bank transactions, profitability from activities in financial markets proper. The global offshore business concentrates large amounts often having no relation to the country of origin, the so-called cosmopolitan capital (wandering). Although in the early 80's of the XXth century offshore companies were considered to control approximately 500 billion dollars, it was already in the early 90's that this amount doubled and was estimated as 1 trillion dollars. Today, from ⅓ to half of the world capital turnover goes through offshore business channels, and therefore, almost half of non-resident bank deposits are concentrated in world offshore centers.

These are the world financial centers comprising international capital markets that provide for the accumulation and redistribution of world capital. From the process of reproduction (circulation of capital), the world financial centers plunge out the most homogeneous and mobile element – money, and freely manipulating with them, concentrate huge economic power in their hands. The role of world financial centers was also enhanced by the latest achievements in computer science, allowing execution of instant transactions and movement of huge amounts to any point of the world within the shortest possible time. The world financial centers consist not only of powerful banks and financial institutions operating on the international scene, but also have currency, stock and other exchanges as their integral parts concertedly working under increasingly unified rules. The world financial centers are establishing new criteria for economic activity, modifying its motivation and priorities. Basically, these changes are aimed at shortening the activities timing and advancing profitability over all other criteria. As a result, substantial portion of funds is directed not to production, but to purely financial transactions. The matter is not only that with significant financial resources available, the volume of competitive production facilities according to international standards is limited and often burdened with increased political risk. The financial sector itself is artificially creating particularly favorable conditions for itself, at the same time generating risks to be mitigated and securitized.

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Introduction

Financial activity is becoming increasingly integrated, gaining in some cases a transcontinental nature with pre-expressed regionalization. The process of globalization through the prism of internationalization, in fact, represents a huge redistribution of economic potential on a global scale. It is the internationalization gaining transnational (transcontinental) forms and global scale that transforms individual economies into parts of unified world economy system, at the same time enhancing the mutual influence and interconnectedness of world financial markets. Capital flow keeps increasing its importance in these processes. World capital market possesses certain geographic localization. It includes a range of international financial centers accumulating huge amounts of debt capital around the world. They comprise numerous credit and financial institutions serving the world trade and capital migration, exercise the lion's share of all international currency, credit, deposit, issuing and insurance transactions.

An integral element of ensuring free international capital flow is the favorable tax climate, which may have many manifestations and may be exercised at different levels and stages of capital flow. Choosing particular tax climate format depends upon the current and target state of economy of the country involved or intending to be involved in international capital flow. Furthermore, the country tax climate affects not only the attraction of international capital, but also the outflow of national (domestic) capital. That is why one of the main elements of the modern global financial system is the variety of complicated tax optimization mechanisms providing for benefits of preferential tax regimes (fiscal oases), offshores and tax havens.

The article is aimed at analyzing the features, reasons, advantages and disadvantages of offshore usage in financial globalization system implying cross-border securitization, as well as the integration of Ukraine into this system.

Taking into account consistent outflow of both foreign and domestic capital from Ukraine due to a number of economic and political reasons, the investigation of tax aspects of international capital flow involving financial innovations, and the determination of Ukraine level of integration into these processes, is relevant.

Analysis of studies and publications Among scientific papers devoted to the analysis of trends and specific features of offshore activity development and efficiency of its functioning, the attention is drawn to scientific works of domestic and foreign scientists, including: O. Bozulenko, N. Bloom, V. Burov, D. Verlan, A. Vozniuk, V.A. Dergachev, K. Joeneel, V. Egert, O. Erlov, A. Jerome, M. Karlin, D. Carr, P. J. Keyne, J. M. Keynes, R. Knapp, Yu. Kozak, E. Limban, F. R. Lane, V. I. Liashenko, G. M. Milesi-Ferretti, D. Mitchell, R. Murfey, R. Palan, S. Paley, R. Pelen, G. Robinson, Sala-i-Martин, D. K. Smith, B. A. Heifets, A. G. Hopkins, A. V. Shamrayev, N. Shekson and others.

Description of Offshore and Financial Centers

The intensive development of contemporary financial system is influenced by globalization, being an objective law in terms of society development. Financial globalization has become a catalyst for many processes, including the creation of financial and legal asymmetries by certain countries to attract financial resources on the international capital market, on the one hand, and the search for such asymmetries by other countries, on the other. Existence of the asymmetries involves the use of a range of tools and mechanisms, among which: special credit, currency, investment and tax regimes[2]. In terms of attracting financial resources, the most effective is a tax regime providing such asymmetry [3] that can be aimed at ensuring the fulfilment of both fiscal and incentive function[4].

The tax asymmetry consists in existence of differences between the tax systems of different countries or specific territories thereof. Taking into account the significant impact of tax expenditure on the overall financial result of international activity, potential capital flow initiators are struggling to structure their own agreements to minimize the tax burden. The respective role in this process belongs to special jurisdictions (Lat. juris – court, legal proceedings) meaning territories of whole countries or separate parts thereof, where specific rights of courts or administrative authorities, including tax-related ones, are wide-spread[5].

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[2] Liashenko, V. I. *Fynansovo-rehuliatornye rezhymy stymulyrovanyia ekonomycheskoho razvytyia: vvedenye v ekonomycheskuiu rezhymolohyiu*. Monohr NAN Ukrayny, In-t ekonomyky prom-sty. Donetsk, 2012. [In Russian].; "Tax effects on foreign direct investment. Recent evidence and policy analysis". *OECD Publishing*. http://dx.doi.org/ 10.1787/9789264038387-en

[3] Bloom, N., Griffith, R.and J. Van Reenen, *Do R&D Tax Credits Work Evidence from a Panel Data of Countries 1979-1997*. https://core.ac.uk/download/pdf/6240129.pdf.

[4] Liashenko, V. I. *Fynansovo-rehuliatornye rezhymy stymulyrovanyia ekonomycheskoho razvytyia: vvedenye v ekonomycheskuiu rezhymolohyiu*. Monohr NAN Ukrayny, In-t ekonomyky prom-sty. Donetsk, 2012: 176 [In Russian].

[5] Hejfec, B. A. *Ofshornye jurisdikcii v global'noj i nacional'noj jekonomike*. M.: Jekonomika, 2008: 13 [In Russian]

Summarizing the specific features of financial services provided by jurisdictions with favourable tax climate, these may be grouped, in particular, as follows: international banking services, insurance, trust services, project financing, structural financing including securitization.

Such jurisdictions play a significant role in the process of international capital flow. In such way, according to the Bank for International Settlements data, international financial relations of banks indicate that the main flows in USD take place between the United States and offshores in the Caribbean Islands (USD 3.7 trillion), the United States and Great Britain (USD 2.5 trillion)USA) including its own offshores, the United States and the European Union countries (USD 1.3 trillion). In respect of international banking connections in Euro, the most significant flow (EUR 3.5 trillion) is established between Great Britain and the European Union countries (Fig. 1)[6]. In June 2017, offshore financial centers accounted for USD 4,305.6 trillion [7].

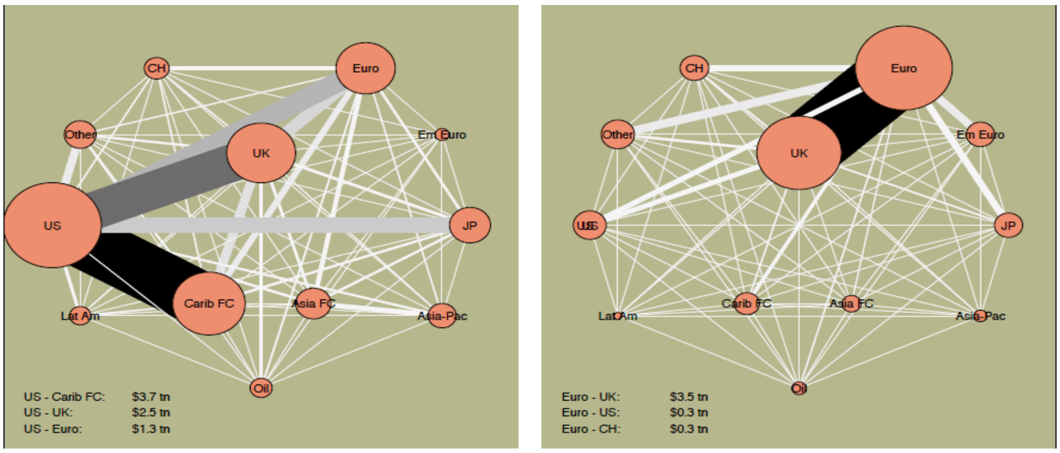

Fig. 1. Interrelations Within the International Banking System in US Dollars and Euro
(as at the end of the first quarter of 2010)[8]

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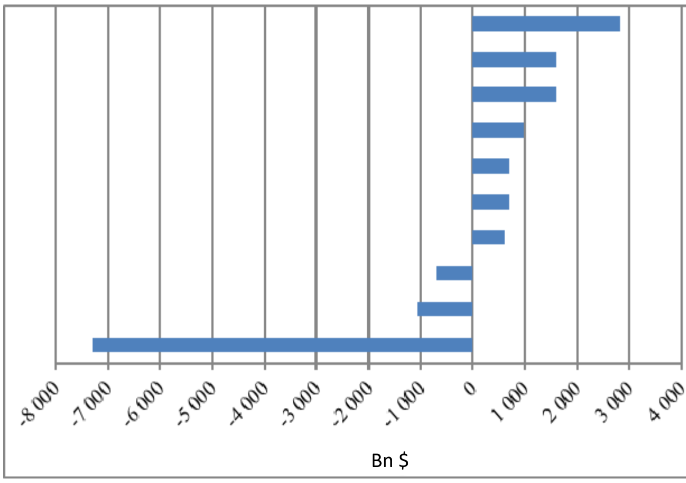
[6] Krasavyn, I. V. "Ofshory kak nehosudarstvennye aktory myrovoj polytyky" *Vestnyk MGIMO Unyversyteta*2 no.29. (2013): 62-7. [In Russian]; Fender, I. and P. McGuire. "Bank structure, funding risk and the transmission of shocks across countries: concepts and measurement". *BIS Quarterly Review*. http://www.bis.org/publ/qtrpdf/r_qt1009h.pdf.

[7] https://www.bis.org/statistics/bankstats.htm

[8] Fender, I. and P. McGuire. "Bank structure, funding risk and the transmission of shocks across countries: concepts and measurement". *BIS Quarterly Review*. http://www.bis.org/publ/qtrpdf/r_qt1009h.pdf.

As estimated by the IMF, in 2010 the balance sheets of small island financial centers (excluding Switzerland) amounted to USD 18 trillion [9], i.e.24.1% of world GDP for 2010 (USD 65,612 trillion) [10]. And the handling capacity of certain territories, for example, the Cayman Islands, may reach USD 1.7 trillion, thus exceeding the value of banking system assets of some countries in the Group of Seven (G7)[11].



Japan	$ 2,815,000,000
Germany	$ 1,607,000,000
China	$ 1,597,000,000
Hong Kong	$ 979,000,000
Norwav	$ 704,000,000
Saudi Arabia	$ 703,000,000
Switzerland	$ 614,000,000
Australia	$ 699,000,000
Spain	$ 1,053,000,000
United States	$ 7,281,000,000

Fig. 2. Net Investment Positions as at the End of 2015[12]

Therefore, it is evident that such jurisdictions as the Cayman Islands play a significant role in investment processes. As assessed by the Tax Justice Network (TJN), the volume of financial services provided by eighty similar territories ranges from USD 21 to 32 trillion as of 2010[13]. However, when considering the net investment position of countries, it becomes obvious that the island states perform only a connecting function. In such way, according to the results of year 2006, during which the net cross-border capital flow reached USD 8.2 trillion, the main final recipient of financial resources are the United States, whose negative net investment position has increased from USD 2.6 trillion in

[9] Bain, D. *IMF finds «Trillions» in Undeclared Wealth*. http://www.taxjustice.net/cms/upload/pdf/IMF_100315_Trillions.pdf.
[10] "Global GDP". *The World Bank*. http://data.worldbank.org/indicator/NY.GDP.MKTP.CD .
[11] Philip, R. Lane and Gian Maria Milesi-Ferretti, "The History of Tax Havens: Cross-Border Investment in Small International Financial Center"s". *IMF Working Paper*. https://www.imf.org/external/pubs/ft/wp/2010/wp1038.pdf .
[12] Composed by *Net International Investment Position*. http://data.imf.org/?sk=7A51304B-6426-40C0-83DD-CA473CA1FD52&ss=1440014571113.
[13] Henry, J. S. "The price of offshore revisited". *Tax Justice Network*. http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore_Revisited_120722.pdf .

2006 to USD 7.3 trillion in 2015 and USD 8.1 trillion in June 2017. At the same time, the main donor of financial resources has been Japan, net investment position of which has increased from USD 1.8 trillion in 2006 to USD 2.8 trillion in 2015[14]. According to the International Monetary Fund, capital flows to emerging markets were stable in the first few months of 2017 with a notable increase of inflow of portfolio investments by non-residents.

The above statistics shows that notwithstanding significant amounts of financial flows going through small jurisdictions, the primary principals and ultimate beneficiaries are entirely different territories, which fact raises a number of issues, the main among which is a conflict of interest regarding the regulation of activities in such financial units integrated into the global financial network with the purpose of financial flows transit. The largest among the ones involved in such processes are: the Cayman Islands, Bailiwick of Jersey, British Virgin Islands, Liechtenstein, the Bermuda Islands, Ireland and Luxembourg[15]. These territories, not always having high reputation, have been acting as a party in a plenty of bilateral relations with rather prestigious jurisdictions, which, according to Thomson Reuters Lipper, include: the USA, Great Britain, France, Germany, Japan, Spain, the Netherlands, Italy[16]. These relations are visualized in the IMF study "Interpretation of Financial Interdependence" (Fig. 3), describing complex financial interactions between economically developed countries involving binding jurisdictions (e.g. Liechtenstein, Switzerland and Luxembourg) with the function of broadcasting cash flows to the United States, Great Britain, France, Italy, Spain, the Netherlands, where these are absorbed by the respective real sectors.

Jurisdictions with doubtful reputation acting as cash flow transmitters are often called offshore or offshore financial centers or tax havens. Despite the synonymity of these terms, there is rather significant difference between them requiring deeper understanding for the effective movement of international capital.

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14 *Net International Investment Position*. http://data.imf.org/?sk=7A51304B-6426-40C0-83DD-CA473CA1FD52&ss=1440014571113; Stewart, J. "Shadow regulation and the shadow banking system: The Role of the Dublin international financial services center", *Tax Justice Focus*. http://www.taxjustice.net/cms/upload/pdf/TJF_4-2_AABA_-_Research.pdf.

15 *Tax avoidance and offshore finance*. http://www.uniglobalunion.org/sites/default/files/files/news/tax_avoidance_and_offshore_finance.pdf .

16 "Understanding financial interconnectedness". *International Monetary Fund*. http://www.imf.org/external/np/pp/eng/2010/100410.pdf.

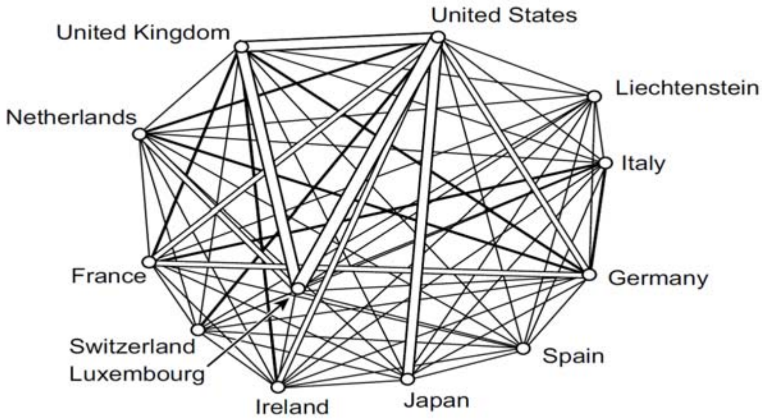

Fig. 3. Cross-Border Flows[17]

Offshores (English – off the shore or beyond the border) or offshore financial centers (hereinafter referred to as "OFCs") used to denote transit jurisdictions or those the ratio of external financial positions to GDP of which is significantly higher than the world average (at least thrice)[18]. Jan Fichtner[19] has analyzed in detail the financial indicators of jurisdictions most frequently recognized as offshores. The analysis is based on three principal segments of the financial system: foreign bank deposits, direct foreign investments and portfolio foreign investments, the volumes of which in 2013 amounted to USD 21.6 trillion, USD 27.9 trillion and USD 46.6 trillion, respectively (in aggregate comprising USD 96.1 trillion, this exceeding world GDP for the relevant period by 25%).

Thus, the most intensive jurisdictions in terms of the ratio of the size of financial segments to GDP, being an indispensable attribute of the OFCs, are: the Cayman Islands, British Virgin Islands (hereinafter referred to as BVI), the Bermuda Islands, the Marshall Islands, Bailiwick of Jersey, Luxembourg, Guernsey, West Indies, Curacao and Samoa. High values are also shown by: the Bahamas, Cyprus, Barbados, Mauritius, Gibraltar, Maine, Ireland, Belize, Hong Kong, the Netherlands, Liberia, Switzerland, Singapore, the United Kingdom and Panama.

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[17] Composed by *Net International Investment Position*. http://data.imf.org/?sk=7A51304B-6426-40C0-83DD-CA473CA1FD52&ss=1440014571113

[18] Zoromé, A., "Concept of offshore financial centers: in search of an operational definition", *International Monetary Fund*. https://www.imf.org/external/pubs/ft/wp/2007/wp0787.pdf.

[19] Fichtner, J. *The offshore-intensity ratio identifying the strongest magnets for foreign capital*. https://www.city.ac.uk/__data/assets/pdf_file/0011/287138/CITYPERC-WPS-201502.pdf.

Table 1 **The Most Active Jurisdictions in Cross-Border Global Finance (as of 2013)**[20]

No.	Jurisdiction	GDP value, USD billion USA	Ratio of segments to GDP value, %		
			Foreign bank deposits	Direct foreign investments	Portfolio investments
1	Cayman Islands (Great Britain)	2.7	607	137	801
2	British Virgin Islands (Great Britain)	1.1	0	886	114
3	Bermuda Islands (Great Britain)	5.6	15	87	83
4	Marshall Islands (USA)	0.2	55	0	120
5	Jersey (Great Britain)	6.2	58	6	46
6	Luxembourg	60.1	13	35	44
7	Guernsey (Great Britain)	3.6	34	6	30
8	West Indies	3.3	70	0	0
9	Curacao (Netherlands)	5.6	11	15	26
10	Samoa	0.8	14	38	0

In addition to high cash flow capacity, offshores are known as the most effective tax optimization method[21], that is, the reduction of tax liabilities by virtue of tax asymmetries only available to residents operating outside the relevant offshore.

At the same time, these definitions are non-exhaustive. Offshores also possess other features, including:

- the highest confidentiality applicable not only to bank accounts, but also to the common corporate ties "principal-agent";
- application of case law;
- simplified and quick procedure for incorporation of companies and securities issue;
- ability to avoid trade restrictions by using buffer jurisdictions;
- evasion from currency and banking regulation, financial monitoring (measures in the field of preventing and counteracting legalization of criminal proceeds or terrorism financing).

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[20] Composed by Fichtner, J. *The offshore-intensity ratio identifying the strongest magnets for foreign capital*. https://www.city.ac.uk/__data/assets/pdf_file/0011/287138/CITYPERC-WPS-201502.pdf.

[21] Shabejkina, Ja. A. "Offshornye kompanii kak metod optimizacii nalogoblozhenija". *Science Time*4 no.4 (2014): 290-3. [In Russian].

In their turn, tax havens are countries or separate territories targeting attraction of financial resources and business using favourable tax climate covering all companies, in comparison to offshore companies providing benefits only to companies performing their activities outside the haven.

That is what determines their popularity among businesses, since the capital moves to where it will be most effective; this is impossible to achieve in jurisdictions with high taxes, as opposed to the OFCs and havens (hereinafter referred to as "financial centers") providing tax incentives or completely abolishing taxes, replacing them with fixed fees. It is worth recalling the statements of the National Financial and Audit Office of Great Britain in 2007 that one-third of the 700 largest companies in the country have not paid any taxes to the state budget for 2006 at all due to involvement of financial centers[22].

Introduction of asymmetries opened the doors for foreign capital, but the question remained about the regulation of outflow of funds from the capital jurisdictions of origin. This situation became a fertile ground for expansion of shadow banking system, incorporated into global financial system, the members of which performed the functions of classic banks in complete absence of any bank regulation. The most popular companies registered in such jurisdictions are trusts and special purpose vehicles engaged in course of cross-border securitization[23]. In support of this fact, the Financial Stability Board indicates that shadow banks of Europe, the United States and the United Kingdom in 2013 had aggregate assets amounting to USD 34.3 trillion, or 80% of global non-bank assets, as compared to 53% of banking systems of these territories[24].

Thus, offshore financial centers have appeared in response to tax pressure and rigid regulation, and all and any features acquired in course of evolution of these institutions are related to searching for asymmetries in other jurisdictions.

Genesis of the Tax Avoidance Process

The most important feature – tax avoidance – dates back to the time of ancient Greece (in the 2nd century BC), when, in response to taxation on the island of Rhodes, the trade began to shift to Delos Island, resulting in 85% loss of Rhodes trade turnover. A similar

[22] Houlder, V. *One-third of biggest UK businesses pay no tax.* https://www.ft.com/content/b5517a7e-54d2-11dc-890c-0000779fd2ac

[23] "Paradis fiscaux: bilan du G20 en 12 questions". *CCFD-Terre Solidaire.* http://ccfd-terresolidaire.org/IMG/pdf/ccfd-rapport-g20-2011-net.pdf.

[24] "Global shadow banking monitoring report 2014". *Financial Stability Board*. http://www.fsb.org/wp-content/uploads/r_141030.pdf .

mechanism was subsequently used in other countries. In such way, when two percent taxation of imports and exports was introduced in Athens to fill the treasury, smart merchants moved their trade to the neighbouring islands where there were no similar taxes, and from there – as smuggling, the goods went to Athens. In the Middle Ages, for avoiding taxation such cities as Venice, Genoa, Livorno, Trieste and Campione were used. In the XVth century, due to tax advantages, goods were delivered to Flanders instead of England (territory of modern France, Belgium and the Netherlands). And in the United States, starting from the XVIIIth century, for avoiding English the trading way was paved through Latin America[25].

The difference between the taxation of residents and non-residents began to expose in the XII-XVth centuries in course of taxation of foreign traders, and since the XVIth century free trade zones started to emerge in Gibraltar and the Isle of Man.

Such important feature as confidentiality of financial centers is due to Switzerland, having adopted a law equating disclosure of bank secrecy to a criminal offense in 1934[26].

Furthermore, the establishment of the OFCs and tax havens was contributed by the acquisition within 1950-1990s of a full or conditional (gaining a special status) independence by many territories, providing for the own resolution of problems concerning the search for sources for budget filling by such territories. This process may be conventionally divided into four periods[27]:

- before 1970s: Austria, the Antilles, the Bahamas, Delaware (USA), Liechtenstein, Luxembourg, Monaco, Uruguay, Switzerland;
- 1970s: Barbados, Bahrain, BVI, Vanuatu, Gibraltar, Hong Kong, Grenada, the Grenadnes, the Cayman Islands, Costa Rica, Liberia, Nauru, the Channel Islands, Panama, Singapore, Saint Kitts, Saint Vincent;
- 1980s: Anguilla, Antigua and Barbuda, Aruba and Western Samoa, Belize, the Bermudas, the Virgin Islands (USA), Dublin (Republic of Ireland), Turks and Caicos Islands, Madeira Island (Portugal), Mauritius, Malta, Nevis;
- 1990s: the Dominican Republic, Iceland, the Canary Islands (Spain), Labuan, Macao, the Marshall Islands, Niuz, the Seychelles.

The avoidance of trade restrictions through involvement of buffer jurisdictions was introduced in the XXth century, as demonstrated by

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[25] Matusevych, A. P. "Ofshornye zony: istoryia, tendentsyy razvytyia, vlyianye na rossyjskuiu ekonomyku". *Vestnyk Mezhdunarodnoho instytuta ekonomyky y prava*1 no.10 (2013): 37-48. [In Russian].

[26] "HSBC files: how a 1934 Swiss law enshrined secrecy". *The Guardian*. https://www.theguardian.com/business/2015/feb/08/hsbc-files-1934-swiss-law-secrecy .

[27] Hejfec, B. A. *Ofshornye jurisdikcii v global'noj i nacional'noj jekonomike*. M.: Jekonomika, 2008: 43. [In Russian].

the example of the USSR trading with Western Europe, for which, since mid-1950s, various transit points were used. And since 1980s, treaties on avoiding double taxation have been entered into with the aim of outflowing capital to European countries (with Cyprus in 1983, with Spain and Japan in 1986, with Malaysia in 1987)[28].

In its contemporary meaning, the term "offshore" was first used in 1950s, when one company managed to avoid regulation of the US government by changing the place of registration, and was interpreted as "going beyond".

Classification of Offshore Financial Centers

At present, there are several classifications contributing to systematization of the available information about OFCs and tax havens.

The first classification relates to affiliation of jurisdictions to complex financial networks divided into four groups: British zone, European zone, US zone and peripheral zone.

The first group (the British zone) is the largest one and covers almost the entire territory of the former British Empire with its center in London and three outer circles, including dependent territories and former colonies, the main function of which is to maintain the bridge between Great Britain and countries incapable to cooperate directly in financing or legalization of criminal proceeds.

As previously noted, the center of the British zone is in London, but it is not about the whole city, but only about its separate part having special status (not subject to the government of Great Britain and having its own government), – the City of London – a territory and administrative formation (ceremonial county) in the center of London with an area of 1.22 square miles, associated with the ancient Roman city Londinium.

The first circle of the British zone includes the Isle of Man and the largest of the Channel Islands – Jersey and Guernsey, being Crown holdings in the UK and remaining the closest ones to the City of London in terms of financial flows. In such way, during the second quarter of 2009, the City of London received USD 332.5 billion from crown holdings [29]. Furthermore, in open sources Jersey Island is referred to as an extension of the City of London[30].

[28] Matusevych, A. P. "Ofshornye zony: istoryia, tendentsyy razvytyia, vlyianye na rossyjskuiu ekonomyku". *Vestnyk Mezhdunarodnoho instytuta ekonomyky y prava*1 no.10 (2013): 37-48. [In Russian].

[29] Foot, M. *Final report of the independent Review of British offshore financial centres*. https://www.gov.im/media/624053/footreport.pdf.

[30] "Jersey: for Banking Jersey's finance industry delivers innovative banking services in a stable jurisdiction". *Jersey Finance: voice of the international finance Centre.* https://www.jerseyfinance.je/media/PDF-Brochures/Jersey%20for%20Banking.pdf .

The second circle includes overseas territories of Great Britain: Gibraltar, BVI, the Bermudas, the Cayman Islands, Turks and Caicos Islands.

The second circle includes dependent territories of Great Britain: the Bahamas, Hong Kong, Ireland, the UAE, Singapore and others.

The second group (the European zone) started to emerge during the First World War due to increased taxes aimed at financing military budgets. It includes Andorra, Ireland, Cyprus, Liechtenstein, Luxembourg, Madeira Island (Portugal), Malta, Monaco, the Netherlands (namely, the islands of Aruba, Curacao, Saint Martin, formerly known as the Netherlands Antilles), Switzerland. In this respect, it should be noted that these jurisdictions tend to stronger countries to which they are historically and culturally related. In such way, for instance, Switzerland tends to Germany, Liechtenstein – to Austria, Luxembourg – to Belgium, Monaco – to France, Andorra – to Spain and France.

Among the enlisted jurisdictions, Luxembourg and the Netherlands are the most interesting in terms of our study. Luxembourg is one of the largest tax havens and a center of international scandals. For example, in 2010, The Daily Telegraph published the data according to which Kim Jong-il concealed USD 4 billion in Luxembourg after severization of compliance requirements in Switzerland and start of information exchange with other countries[31]. As for the Netherlands, according to the Central Bank of the Netherlands, in 2008 their offshore companies handled the amount approximately comprising EUR 12.3 trillion and 20 times exceeding the country GDP[32].

The third group (the US zone) is comprised of two circles: internal and external one.

The first circle includes the internal states: Delaware, Wyoming, New Jersey, Nevada and Florida. Creation of OFCs and/or tax havens within a prestigious jurisdiction (similarly to the Channel Islands in the UK, the former Antilles in the Netherlands, and the Cantons of Neuchвtel, Friborg and Zug in Switzerland) results in distorting the picture of real belonging of individual jurisdictions to financial centers.[33]. Delaware deserves particular attention, as its policy has become the subject of many journalistic investigations. In 2012 The New

[31] Arlow, O. “Kim Jong-il keeps $4bn 'emergency fund' in European banks”. *The Daily Telegraph*, http://www.telegraph.co.uk/news/worldnews/asia/northkorea/7442188/Kim-Jong-il-keeps-4bn-emergency-fund-in-European-banks.html.

[32] Drucker, J. “U.S. Companies Dodge $60 Billion in Taxes with Global Odyssey”. *Bloomberg*. http://www.bloomberg.com/news/2010-05-13/american-companies-dodge-60-billion-in-taxes-even-tea-party-would-condemn.html.

[33] Palan, R., Murphy, R. and C. Chavagneux. *Tax Havens: How Globalization Really Works (Cornell Studies in Money)*. Ithaca, NY: Cornell University Press., 2009: 11.

York Times published the data on domestic offshores, according to which:[34]:

- almost half of all state corporations were registered in Delaware;
- in the city of Wilmington (Delaware) more than 285,000 enterprises were registered at only one address (North Orange Street 1209);
- in 2011, the number of enterprises exceeded the population – 945.3 thousand and 898 thousand, respectively.

The second circle includes satellite jurisdictions: the Virgin Islands, Puerto Rico, the Marshall Islands and Panama, which has acquired its significant role in the international movement of capital in 1919 due to complete absence of regulation. As described by a representative of the US Customs Department, Panama has become a black hole and the dirtiest money laundering facility filled with dishonest lawyers, bankers and companies.[35].

A specific feature of the third group is that the US government periodically tries to counteract offshore, at least officially. Such attempts were made by Presidents Kennedy in 1961 (by declaring the necessity to take all measures to close all tax havens) and Obama in 2007 (by initiating a bill to combat abuses within tax havens)[36]. Such attempts on the part of the United States usually did not achieve desired result, and ended with a temporary reorientation of local financiers to jurisdictions comprising the British zone.

The fourth group (peripheral zone) includes jurisdictions having little weight or having no obvious historical and cultural ties with economically developed countries.

Thus, the majority of OFCs and tax havens are not just a number of jurisdictions independently determining their tax policies, but, on the contrary, are completely or conditionally dependent on economically developed countries. A similar classification is provided in the work of B. A. Heifets[37], according to which offshores may be classified as: independent territories, countries associated with larger countries, jurisdictions within countries having broad autonomy, federated states.

The third classification may be arranged according to jurisdiction offshorization level[38]:

- classic offshore companies exempting residents operating outside the jurisdiction against payment of fixed fees and absence of strict reporting requirements;

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[34] Wayne, L., "How Delaware thrives as a corporate tax haven". *The New York Times*. http://www.nytimes.com/2012/07/01/business/how-delaware-thrives-as-a-corporate-tax-haven.html?_r=1

[35] Robinson, J. *The stink: how banks, lawyers and accountant finance terrorism and crime – and why governments can't stop them*. London: Constable and Robinson, 2004: 63.

[36] *Stop tax haven abuse act*. https://www.govtrack.us/congress/bills/110/s681

[37] Hejfec, B. A. *Ofshornye jurisdikcii v global'noj i nacional'noj jekonomike*. M.: Jekonomika, 2008: 57 [In Russian]

[38] Ibid. Pp. 60-67.

- conventional offshores (Gibraltar, Singapore, Hong Kong) charging minimum taxes and imposing higher reporting requirements;
- prestigious offshores being jurisdictions with high standards of reporting, but ready for concessions to attract financial resources. Such offshores include the United Kingdom, the United States, Ireland, Switzerland, Luxembourg, Liechtenstein and others. Sometimes prestigious offshores (such as the UK, the Netherlands, Austria, Denmark, New Zealand) may act as sparring offshores[39], i.e. jurisdictions co-operating with other offshores as capital transmitters. Sometimes a financial chain may imply simultaneous attraction of several sparring offshores possessing sovereign investment-grade ratings determined by international rating agencies Standard & Poor's, Fitch Ratings and Moody's[40]. In this respect, rather frequently used are such schemes as US-Luxembourgh-classic offshores, Great Britain-Luxembourg-classic offshores and the Netherlands-Luxembourg-classic offshores [41].

Mechanism of Functioning of Offshore Financial Centers

It should be noted that individual jurisdictions or entire zones tend to each other and form single complex global financial network. Fig. 4 illustrates bilateral financial relations between 34 territories having had the largest cross-border flows in 2012(USD 81.6 trillion).

Size of the circles indicates the volume of cross-border financial flows, and the colour – the offshorization level (grey – jurisdictions not recognized as OFCs, yellow – potential OFCs, red – obvious OFCs). The largest bilateral relations in total amounting to USD 4.7 trillion exist between the United States and Great Britain, an important role also belongs to the Netherlands, Luxembourg, Ireland, Hong Kong, the Cayman Islands, the Bermudas and British Virgin Islands.

As mentioned earlier, OFCs and tax havens are used for numerous purposes, among which the most popular one is to reduce the business tax burden through using a large number of schemes and mechanisms, including the following most well-known ones:

- stepping stone method, consisting in dividing the assets between different jurisdictions, in which each asset acquires its own legal and financial content, or in diffusing the tax base by means of payments to contractors located in jurisdictions providing tax incentives;

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[39] Ibid. Pp. 63

[40] Ibid. Pp. 68-70.

[41] "Investment flows through offshore financial hubs declined but remain at high level", *UNCTAD's Global Investment Trend*. http://unctad.org/en/PublicationsLibrary/webdiaeia2016d2_en.pdf

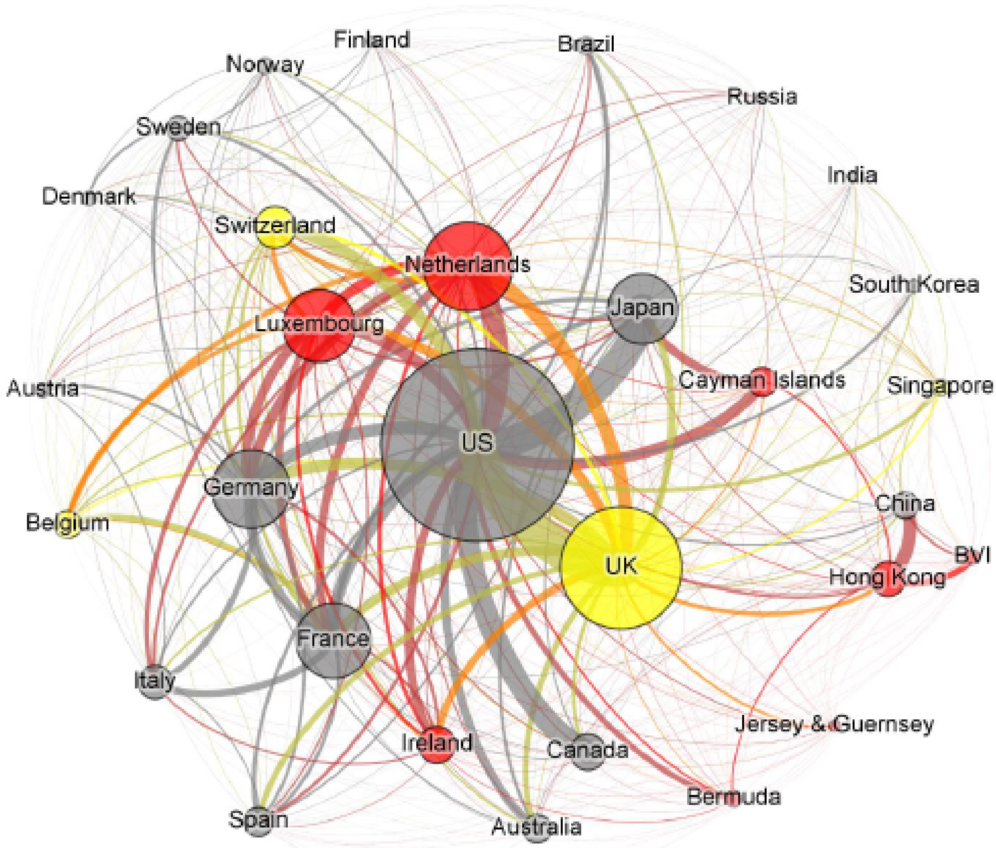

Fig. 4. Position of the Largest OFCs in Cross-Border Financial Flows (2012)[42]

- loan scheme, consisting in provision of interest-bearing loan funds enabling the outflow of funds to offshores. In such case, however, the loan resources may be completely not used for current activity, and the amount of outflowing funds may be regulated by two variables: loan amount and interest rate. The scheme overestimating loans volume against the minimum share capital, is called "thin capitalization"[43], and the scheme envisaging overestimation of the interest rate is a part of transfer pricing scheme;
- transfer pricing, providing for underpriced sale of goods to residents of the OFCs for further resale in order to receive the profit, subject to reporting in the OFC proper (trading scheme). This scheme is

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[42] Composed by Fichtner, J. *The offshore-intensity ratio identifying the strongest magnets for foreign capital.* https://www.city.ac.uk/__data/assets/pdf_file/0011/287138/CITYPERC-WPS-201502.pdf

[43] "Thin capitalisation legislation: A background paper for country tax administrations", *OECD Publishing*. http://www.oecd.org/ctp/tax-global/5.%20thin_capitalization_background.pdf.

used provided that the purpose is to generate profits outside the jurisdiction of the business involving the export of the goods. Where business profits are generated within a high tax jurisdiction, a scheme of services (legal, consulting, auditing), a construction scheme, a production scheme or a transport scheme with overpriced terms for outflowing of funds from such territory is used;

- payment of royalties, consisting in the registration of copyright with the subsequent transfer of rights to a resident of high tax jurisdiction against the respective payments;
- engagement of tax hybrids, i.e. companies that may be registered in a high tax jurisdiction with being a tax resident (reporting and paying taxes) of a low tax jurisdiction[44].

These methods and schemes only applicable between jurisdictions operating under conventions on avoiding double taxation may be integrated into more sophisticated mechanisms. The most well-known mechanism simultaneously embracing a few methods is the "Double Irish" or its modification, "Double Irish with a Dutch sandwich", schematically provided in Fig. 5. The milestones of this mechanism are:

- a hybrid company (Company X) is incorporated in Ireland with its tax residence in an OFC, registers copyrights and sublicenses these in favour of a company established in the Netherlands (Company Y);
- the Dutch company (Company Y) sublicenses the rights to the second Irish company, being a full resident of Ireland (Company Z) and created by the first company (Company X);
- Company Z sublicenses companies in all other jurisdictions where copyright is used by real business;
- the royalties return in the same way until they reach the OFC, where these are exempt from taxation.

This mechanism is used by such companies as Facebook, Apple, Google, Amazon, Hewlett-Packard and Microsoft. According to US tax authorities, Apple Corporation, using the "Double Irish and Dutch Sandwich", reduced its tax liability in 2011 by USD 2.4 billion against its profit amounting to USD 34.2 billion and USD 3.3 billion taxes paid (accounting for 9.8% of the profit versus the corporate tax of 35%)[45]. And according to the US Senate, during 2009-2012, Apple Corporation paid USD 44 billion less taxes than it would have been due without involving optimization mechanisms[46]. Popularity of this

[44] "Addressing offshore tax avoidance without harming the international competitiveness of U.S. businesses", *The National Foreign Trade Council*, http://www.nftc.org/default/Tax%20Policy/International%20Tax/Final%20NFTC%20Paper%20addressing%20tax%20haven%20issues.pdf

[45] Duhigg, C. and D. Kocieniewski. "How Apple sidesteps billions in taxes". *The New York Times*. http://www.nytimes.com/2012/04/29/business/apples-tax-strategy-aims-at-low-tax-states-and-nations.html.

[46] *Nalohovaia optymyzatsyia: retsept ot mul'tynatsyonal'nykh kompanyj* http://www.bakertilly.ua/ru/news/id369 [In Russian].

mechanism attracted the attention of the US government and ensued high-profile investigations of tax schemes and pressure on governments of other countries aimed at prevention of using these mechanisms. The result was not slow to arrive, and in 2014 Michael Noonan (Minister of Finance of Ireland) announced the abolition of the disputed tax structure. Following the decision, the mechanism became inaccessible to new customers from January 1, 2015, and is supposed to be wound up by old customers by 2020.[47].

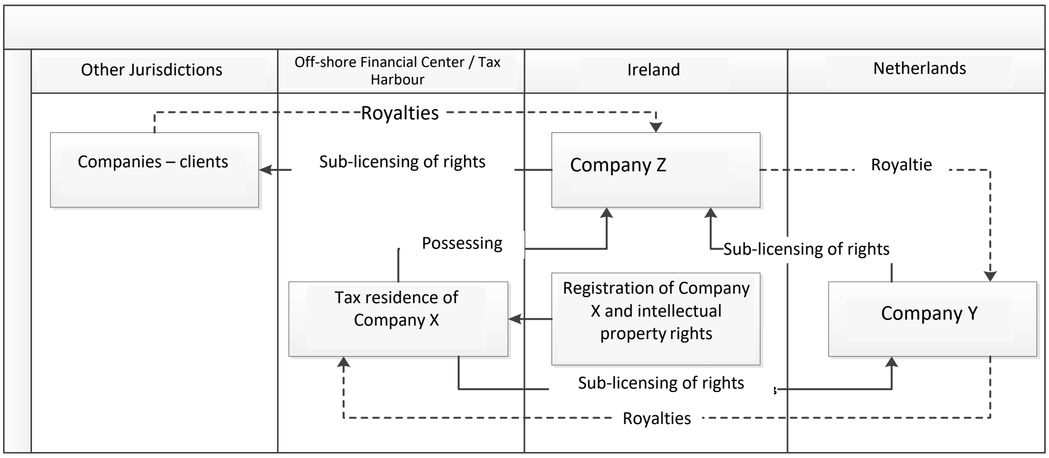

Fig. 5. "Double Irish with a Dutch Sandwich" Mechanism[48]

However, these mechanisms are not isolated or unique. After some schemes were wound up, other ones started to unfold and spin up. As reported by UNCTAD, in 2015, companies avoided taxation by transferring USD 221 billion to OFCs and tax havens, against USD 233 billion in 2014[49]. Such mechanisms are structured through both standard (regular tax planning) and aggressive technologies (with possible violations of laws and international standards). Regular tax planning involves the use of clear and permissible tax regulations, and does not cause significant concern for tax authorities. The users of such planning are small and medium-sized business. Aggressive tax planning, impossible without advisors, audit firms and tax divisions of investment

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[47] Campbell, J. *Irish budget: Michael Noonan is to abolish 'Double Irish' tax structure.* http://www.bbc.com/news/world-europe-29613065.

[48] Composed by Campbell, J. *Irish budget: Michael Noonan is to abolish 'Double Irish' tax structure.* http://www.bbc.com/news/world-europe-29613065.

[49] *OON: krupnye kompanyy perevely v ofshory 221 mlrd dollarov v 2015 hodu:* https://www.rbc.ua/rus/news/oon-krupnye-kompanii-pereveli-ofshory-221-1462341875.html [In Russian]. "U.N. says tax-avoiding investment flows eased slightly in 2015". *The Wall Street Journal.* http://www.wsj.com/articles/u-n-says-tax-avoiding-investment-flows-eased-slightly-in-2015-1462280415.

banks, consists in the intended use of dual interpretation of laws (which is entirely legal) and, in some cases, may allow a violation of the applicable law[50]. The users of such technology are large business and wealthy individuals.

Under such circumstances, the issues may be raised on diligence, fulfilment of civil obligations and compliance with business etiquette by those using financial centers. However, it should be noted that in globalized environment, resulting in gradual blurring of state borders, and with existence of fiduciary obligations of top managers to shareholders, providing for maximization of profits of the latter, the issue of morality is secondary one.

Another negative feature of the OFCs is the consent to conceal illegal funds, including those obtained in a criminal way. This feature is used by corrupt governments, politicians and businessmen seeking to withdraw financial resources from the regulation of the jurisdiction of the capital origin (this target is especially expressive during financial and political crises). As reported by international research organization Global Financial Integrity (GFI), the largest illegal outflows of capital over the past 10 years are demonstrated by China (USD 1.4 trillion and Russia (USD 1.05 trillion). In this rating, Ukraine occupies the 14th place with its USD 116.8 billion (Table 2).

To legalize criminal proceeds, circulation of capital through OFCs is employed (Fig. 6) termed as "base erosion and profit shifting" BEPS) and exercised in the following sequence:

- at the first stage, it is required to use the existing possibilities for money laundering to the OFC. With this purpose, overpriced trading operations, fictitious transactions, foreign investments may fit;
- at the second stage (which is not obligatory), the funds are forwarded from the OFC to prestigious jurisdictions, where these are used in a number of agreements disguising the origin;
- at the third stage, the capital beneficiary may choose the way for further using of the funds: leaving these in prestigious jurisdiction for successors or secure old age, or returning these to the capital country of origin in the form of investments, direct loans and fiduciary deposits, which, in conjunction with observing the confidentiality rules by the OFC, distorts the correct perception of the capital origin;
- at the fourth stage, another round of capital erosion is taking place – residents of the country of true origin of capital pay dividends on direct investments and interest on debt obligations. Usually, countries provide state guarantees for returning foreign investments and repaying international debts, allowing many businessmen and corrupted

[50] "Corporate Loss Utilisation through Aggressive Tax Planning". *OECD Publishing.* http://uscib.org/docs/Corporate_Loss_Utilisation_through_Aggressive_Tax_Planning.pdf.

politicians to "close their positions" should the political or financial situation in the country escalate.

Table 2 **Countries with the Highest Capital Outflow within 2004-2013**[51]

No.	Country	Average annual outflow (billions USD)
1	China (Mainland)	139,228
2	Russian Federation	104,977
3	Mexico	52,844
4	India	51,029
5	Malaysia	41,854
6	Brazil	22,667
7	South Africa	20,922
8	Thailand	19,177
10	Nigeria	17,804
11	Kazakhstan	16,740
12	Turkey	15,450
13	Venezuela	12,394
14	Ukraine	11,676

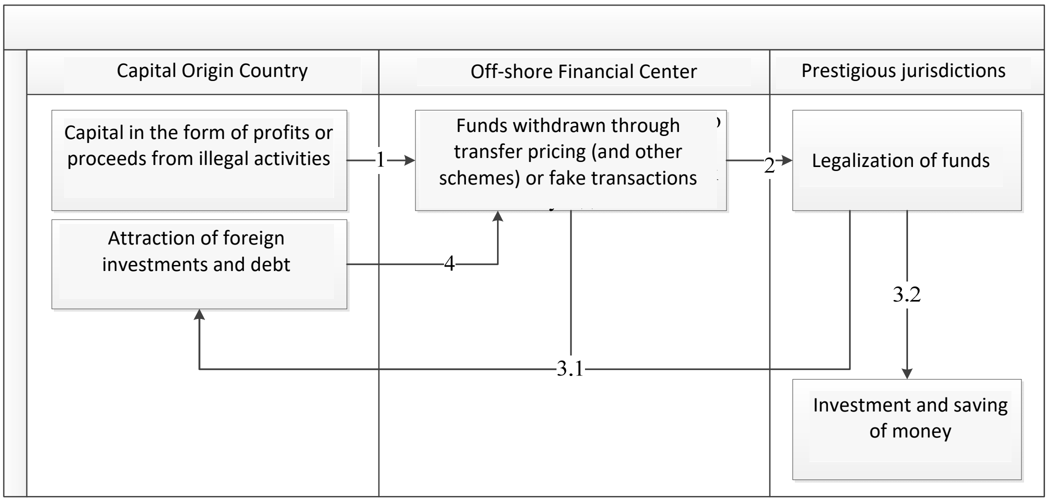

Fig. 6. General Mechanism of Capital Circulation through OFCs

[51] Composed by Kar, D. and J. Spanjers. "Illicit Financial Flows from Developing Countries: 2004-2013". *Global Financial Integrity.* http://www.gfintegrity.org/wp-content/uploads/2015/12/IFF-Update_2015-Final-1.pdf

The main adverse consequences for economies of countries allowing the erosion of capital are inefficient investment (with funds being attracted not by the most efficient business, but by the one belonging to the real owner of capital) and suppression of competition within the country due to unequal conditions for taxation of profits[52].

This statement may be illustrated by taking Ukraine as an example. As reported by the State Statistics Service of Ukraine, as of July 1, 2016, the main donor countries of direct investment in Ukraine are Cyprus (24.8%) and the Netherlands (12.9%). At the same time, the main recipient country of direct investment from Ukraine is also Cyprus, accounting for 93.4% of all direct investments.

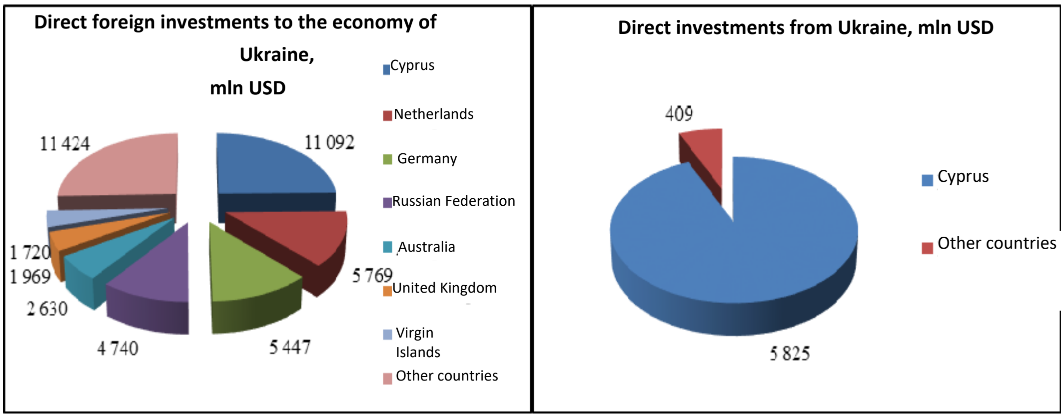

Fig. 7. Investment Positions of Ukraine as of July 1, 2016[53]

Summarizing this OFCs feature, it should be pointed out that economically developed countries use double standards in counteracting such jurisdictions. In this respect, if funds from the US or Europe are outflown to OFCs, all possible measures are taken to prevent the use of money laundering schemes, including pressure on foreign governments, but if any funds are outflown to OFCs from other countries, economically developed countries do not take any measures, since the are going to be the final recipients of the financial resources in most cases. In support of this position,a publication of the National Foreign Trade Council (NFTC) may be referred, outlining the Government

[52] Serebrians'kyj, D. M. and P. O. Selezen'. *Kampaniia schodo borot'by z rozmyvanniam bazy opodatkuvannia ta peremischenniam prybutkiv: vysnovky dlia Ukrainy* [naukovo-analitychna dopovid'] Irpin': NDI finansovoho prava, 2015. [In Ukrainian]

[53] "Priami inozemni investytsii (aktsionernyj kapital) z krain svitu v ekonomitsi Ukrainy". *Upravlinnia derzhavnoi statystyky Ukrainy*. http://www.ukrstat.gov.ua/operativ/operativ2016/zd/ivu/ivu_u/ivu0216.html [In Ukrainian].

position on possible reasons for the US business employing such jurisdictions, namely [54]:

- access to countries with well-developed legal conditions with the aim of protection from uncooperative environment in the country of capital absorption;
- protection from foreign laws, excessive regulation or unstable currencies;
- provision of simplified procedure for investments returning;
- promotion of effective business financing through the use of cross-border securitization.

In addition to tax incentives, financial centers provide asymmetries in terms of banking and currency regulation, being quite attractive for structuring complex financial mechanisms, including cross-border securitization[55]. That is why such centers are used to incorporate special purpose vehicles. In such way, almost 32% of all special purpose vehicles used by the US banks are located in offshores[56]. A consequence of such asymmetries was the competition among financial centers in creating the most attractive conditions for business, ensuing total rejection of regulation and the inducement of potential investors to borrow funds in their jurisdictions with the purpose of transferring thereof to financial centers for further investment. Similar actions caused a situation in which the scale of individual companies or even entire jurisdictions reached such proportions where their collapse could lead to destruction of the entire global system (a phenomenon known as "too big to fail").

Other features of using OFCs and tax havens are also ambiguous. In such way, high confidentiality level is used by a large number of businessmen to protect their own companies from raider attacks inherent to corrupt countries. The reverse side of this feature is the threat to the economic security of the countries due to that governments may be not aware of who is owning their strategic objects in absence of the information exchange between jurisdictions. Therewith, the information exchange may be totally absent or may be conducted unilaterally (for example, Great Britain does not disclose any information about its overseas territories). It is also an interesting fact that the agreement between the OECD and the European Union "On Exchange of

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[54] "Addressing offshore tax avoidance without harming the international competitiveness of U.S. businesses", *The National Foreign Trade Council*, http://www.nftc.org/default/Tax%20Policy/International%20Tax/Final%20NFTC%20Paper%20addressing%20tax%20haven%20issues.pdf

[55] Murphy, R. and J. Christensen. "Tax havens will sabotage attempts to re-regulate global finance. Democracy demands we tackle them". *The Guardian*. https://www.theguardian.com/commentisfree/2008/oct/10/tax-banking

[56] Philip, R. Lane and Gian Maria Milesi-Ferretti, "The History of Tax Havens: Cross-Border Investment in Small International Financial Center"s". *IMF Working Paper*. https://www.imf.org/external/pubs/ft/wp/2010/wp1038.pdf .

Information on Tax Matters" stipulates disclosure of information only to members of these organizations[57].

Taking into account the importance of financial centers and their inherent disadvantages, it is obvious that the activities of such jurisdictions should be the subject of international and local regulation effected by the countries themselves through tax authorities and central banks. At present, the international regulation is carried out by three organizations:

- The Financial Action Task Force on Money Laundering (FATF), established in 1989, being an intergovernmental body advising on identification of beneficiaries, counteraction against money laundering and terrorist financing;
- The Organization for Economic Cooperation and Development, conducting the analysis and classification of jurisdictions in terms of transparency and compliance with international tax standards, and providing recommendations for social and economic policies;
- The integrated European system for counteracting avoidance of taxes (Eurofisc), being a system for prevention of fraud in the area of VAT payment.

Supported by international organizations, the following were the most important steps in the struggle against financial centers:

– developing a plan to combat tax minimization and profit-sharing,[58], outlining the factors expected to contribute to identification of wrongful tax regimes, namely: taxation at zero or low rates, country isolation, absence of transparency and information exchange, artificial tax base formation, refusal to comply with international transfer pricing standards, tax exemption from taxation at the source, negotiable tax rate regulation, availability of confidentiality clauses, wide network of treaties on avoiding double taxation;

– struggle against aggressive tax planning, implying registration and control of tax intermediaries activities, employment of "controlled operations" principle, disclosure (information exchange), conclusion of statutory compliance agreements (Ireland, Switzerland, the Netherlands, the USA)[59], establishment of liability mechanisms (Australia, Canada, New Zealand)[60];

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[57] Derhachev, V. A. *Vlyianye offshornoho byznesa na ekonomyku Ukrayny*. http://irbis-nbuv.gov.ua/cgi-bin/irbis_nbuv/cgiirbis_64.exe?C21COM=2&I21DBN=UJRN&P21DBN=UJRN&IMAGE_FILE_DOWNLOAD=1&Image_file_name=PDF/ecinn_2013_52_8.pdf [In Russian].

[58] "Proekt plana dejstvyj po bor'be s mynymyzatsyej nalohooblozhenyia y vyvedenyem prybyly".*OECD Publishing* http://oecdru.org/zip/2313338e.pdf [In Russian].

[59] "Corporate Loss Utilisation through Aggressive Tax Planning". *OECD Publishing.* http://uscib.org/docs/Corporate_Loss_Utilisation_through_Aggressive_Tax_Planning.pdf.

[60] Ibid.

– adoption of model convention on avoiding double taxation[61];

– development of principles for identifying ultimate beneficiaries and piercing the corporate veil, i.e. removing of barriers separating beneficiaries from legal entities and preventing owners from being held liable[62];

– determination of maximum permissible level of thin capitalization and adjustment of the financial result to the amount of overtime interest expense;

– combat against legalization of criminal proceeds.

As for the struggle with financial centers at individual country level, it is revived only during financial crises, when the question of filling the budget arises. For example, in the United States (the most persistent fighter), measures to increase the pressure on financial centers in the near retrospect were commenced in 2001 (dot-com bubble), and since 2008 (the first crisis of securitization) were extended to cover those avoiding taxes. This kind of struggle was temporary, and only ensued the increase of value of financial schemes and enlarging the staff of consultants and auditors, as confirmed by the third place of the US in the ranking of jurisdictions with the highest financial secrecy (Table 3) published by the Tax Law Network and taking into account the analysis of the legal base of jurisdiction in terms of banking secrecy, registration of companies, trusts, foundations and partnerships, compliance with international standards for counteracting money laundering, etc.

Table 3 **Indices of Financial Secrecy of Countries and Territories for 2015**[63]

No.	Secret jurisdiction	Index of financial secrecy	Number of secrecy points	Share in world financial services export, %
1	Switzerland	1466.1	73	5.625
2	Hong Kong	1259.4	72	3.842
3	USA	1254.7	60	19.603
4	Singapore	1147.1	69	4.280
5	The Cayman Islands	1013.1	65	4.857
6	Luxembourg	816.9	55	11.630

[61] Shynkarenko, I. V. "Rol' OON u vrehuliuvanni podatkovykh vidnosyn mizh rozvynenymy krainamy ta krainamy, scho rozvyvaiut'sia". *Aktual'ni problemy mizhnarodnykh vidnosyn, zhurnal*2 no. 96 (2011): 69-75. [In Ukrainian].

[62] Hydyrym, V. A. "Kontseptsyia "benefytsyarnoj sobstvennosty" v mezhdunarodnom nalohooblozhenyy" *International Tax Services, Ernst & Young Middle East, Saudi Arabia.* http://e-notabene.ru/wl/article_10812.html [In Russian].

[63] Composed by *Financial Secrecy Index – 2015 Results.* http://www.financialsecrecyindex.com/introduction/fsi-2015-results.

Notwithstanding the US controlling almost 20% of the world export of financial services, they are not taking any steps to implement the OECD reporting standards, and the registration of shell companies in the US is easier than in the rest of the world[64].

The problem, therefore, is that financial centers, often being criticized, exist due to economically developed countries that themselves do not adhere to transparency principles.

In this context, Ukraine, at first glance trying to implement the majority of international norms and standards ("controlled operations" principle, income repatriation taxation, determination of beneficiary owners, restriction of interest expense through thin capitalization) [65] is not an exception, while approving and revising the list of territories considered offshores [66] to complicate involvement thereof.

On this occasion, it would be appropriate to mention, that in April 2005, by virtue of the Order of the Cabinet of Ministers (signed by Yu. V. Tymoshenko) Panama has been excluded from the list of offshore zones (thereafter having become actively used by Ukrainian politicians, as known from the scandal called "The Panama Papers"), Cyprus has been added (complicating the schemes of many authorities and businessmen)[67]. However, in less than a year (February 1, 2006), at the times of the new Prime Minister (Yu. I. Yekhanurov), Cyprus has been excluded from the list of offshores[68]. Furthermore, Ukraine is a party of 69 treaties (including 4 treaties signed at the time of the USSR) on avoiding double taxation with other countries[69], the provisions of which prevail over the ones of the Tax Code of Ukraine (in accordance with clause 3.2 of Article 3 of the Tax Code[70]). Among the existing bilateral agreements, the most favourable terms of cooperation are established with Great Britain, Kuwait, the Netherlands, the UAE, the United States, Spain and Cyprus.

Thus, financial centers can be used by businesses and governments to achieve both legal and illegal goals. From the point of view of

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[64] Knobel, A. *The role of the U.S. as a tax haven implications for Europe.* http://www.greens-efa.eu/fileadmin/dam/Documents/TAXE_committee/The_US_as_a_tax_haven_Implications_for_Europe_11_May_FINAL.pdf .

[65] *Podatkovyj kodeks Ukrainy* // zatv. VRU vid 02.12.2010 № 2755-VI (zi zminamy ta dopovnenniamy): http://zakon3.rada.gov.ua/laws/show/2755-17. [In Ukrainian]

[66] "Rozporiadzhennia «Pro perelik ofshornykh zon»" *Rozporiadzhennia Kabinetu Ministriv Ukrainy vid 23 liutoho 2011r. № 143-r Kyiv.* http://zakon3.rada.gov.ua/laws/show/143-2011-p [In Ukrainian].

[67] *Rozporiadzhennia Kabinetu Ministriv Ukrainy vid 1 kvitnia 2005 r. №82-r.* http://zakon4.rada.gov.ua/laws/show/82-2005-p [In Ukrainian].

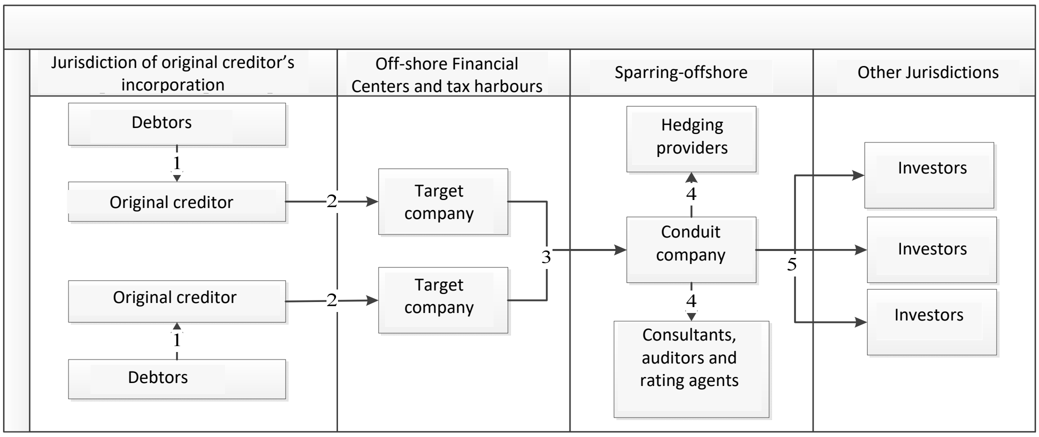
[68] *Rozporiadzhennia Kabinetu Ministriv Ukrainy vid 01.02.2006 r. №44-r.* http://zakon4.rada.gov.ua/laws/show/44-2006-p [In Ukrainian].

[69] *Rekomendatsii schodo zastosuvannia polozhen' konventsij (uhod) pro unyknennia podvijnoho opodatkuvannia dokhodiv i majna (kapitalu)* http://sfs.gov.ua/diyalnist-/mijnarodne-/normativno-pravovi-atty/80816.html [In Ukrainian].

[70] *Podatkovyj kodeks Ukrainy* // zatv. VRU vid 02.12.2010 № 2755-VI (zi zminamy ta dopovnenniamy): http://zakon3.rada.gov.ua/laws/show/2755-17. [In Ukrainian]

legislation and business etiquette, the most purposeful use of financial centers is the promotion of cross-border securitization, being a mechanism for financing or refinancing the assets of a primary creditor by transferring the benefits and/or risks to the holders of securities issued by special purpose vehicles[71].

Initiators of cross-border securitization use financial centers to avoid requirements for mandatory disclosure, complicated company registration procedures and securities issue, currency and banking regulation. At the same time, attracting offshore financial centers as joint jurisdictions is only feasible where tax neutrality is ensured, since application of additional tax liabilities reduces all possible benefits.



1	Debtors repay debts to the Original Creditor
2	Translation of cash flow by the Original Creditors to the Target Companies
3	Translation of cash flow by the Target Companies to the Conduit Company
4	To pay remuneration to Hedging Providers, Auditors and Rating Agencies
5	Translation of cash flow by the Conduit Company to the investors according to the class of securities

Fig. 8. Sequence of Payments in Cross-Border Securitization[72]

Securitization is recognized as cross-border one, where at least one of the following conditions is fulfilled[73]:

[71] Fursova, V. A. and S. H. Zinchenko "Analiz fundamental'nykh pidkhodiv schodo vyznachennia sutnosti sek'iurytyzatsii" *Visnyk ekonomiky transportu i promyslovosti*37 (2012): 82-5. [In Ukrainian].

[72] Fursova, V. A. and S. H. Zinchenko "Analiz fundamental'nykh pidkhodiv schodo vyznachennia sutnosti sek'iurytyzatsii" *Visnyk ekonomiky transportu i promyslovosti*37 (2012): 82-5. [In Ukrainian].; Shamraev, A. V. *Mezhdunarodnoe i zarubezhnoe finansovoe regulirovanie: instituty, sdelki, infrastruktura.* M.: KNORUS: CIPSiR, 2014. [In Russian].

- the primary creditor and the special purpose vehicle are located in different jurisdictions;
- the primary creditor and the debtors are located in different jurisdictions;
- the assignment of monetary claim rights and the issue of securities by the special purpose vehicle take place in different jurisdictions;
- difference of currencies within assignment of monetary claim rights and issue of securities;
- cross-border payments in favour of investors.

In terms of tax analysis, the process of securitization arrangement consists of three stages[74]: selection of jurisdictions to be involved in securitization; definition of laws applicable to entities and operations; structuring of the transaction.

The following aspects are analyzed to determine the appropriate jurisdictions in terms of effective securitization: stability of national currencies, rules of investor protection, political stability, presence of institutional investors. Therewith, transit jurisdictions should ensure neutrality, and the jurisdictions of the primary creditor and investors should be asymmetrical. In this respect, the jurisdictions of primary creditors incorporation should feature: legality of the effective sale of financial assets or the use of credit derivatives, liberal banking legislation, stable national currency, state guarantees for return of foreign investments and repayment of debt obligations, broad network of double taxation conventions. For the jurisdiction where special purpose vehicle (and/or conduit company) is supposed to be incorporated, the optimal features are: tax neutrality, liberal currency regulation, availability of high-skilled specialists, quick and easy registration of special purpose vehicle and issue of securities. Jurisdictions with their taxpayers being investors, should have the following features: protection of investors interests, option for obtaining a permit for foreign investment, wide network of conventions on avoiding double taxation.

At the second stage, during which regulatory requirements are defined, it is necessary to investigate the options for signing agreements with tax authorities[75], the features of permissible transactions by individual entities, the existence of special legislation on securitization, currency restrictions and tax incentives.

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[73] Shamraev, A. V. *Mezhdunarodnoe i zarubezhnoe finansovoe regulirovanie: instituty, sdelki, infrastruktura.* M.: KNORUS: CIPSiR, 2014. [In Russian].

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[75] Burov, V. *Pravovye rezhymy y nalohooblozhenye sdelok sek'iurytyzatsyy v nekotorykh razvytykh stranakh.* http://rusipoteka.ru/files/articles/burov-1.pdf [In Russian].

At the final stage, the agreement is structured, with testing the cash flows from the debtors through the primary creditor, the special purpose vehicle and the conduit company to investors. The main issues potentially faced during the securitization process are:[76]:

– *in respect of the primary creditor*: disputed actual sale of assets, taxation of assets transfer, effect of a securitization transaction on thin capitalization and transfer pricing regime, disputed application of rules of conventions on avoiding double taxation through recognition of a foreign special purpose vehicle as permanent representation office in the territory of incorporation of the primary creditor[77];

– *in respect of special purpose vehicle and conduit company*: withholding of income repatriation tax (tax from the source of payment) through the primary creditor, impossibility of using tax neutrality, disputed application of rules of conventions on avoiding double taxation;

– *in respect of investors*: withholding of income repatriation tax (tax from the source of payment) through special purpose vehicle.

Thus, the main objective of tax analysis of a securitization transaction is to establish its neutrality, i.e. to confirm that the transaction does not lead to additional tax expenses due to tax exemption or permission to reduce the financial result by the amount of expenditure.

Conclusions

The contemporary level of financial markets globalization resulted in active engagement of offshore financial centers and tax havens for ensuring efficiency of international capital movement. The use of such jurisdictions may have both positive and negative consequences for all parties of capital movement, ensuing increased regulation by international organizations and governments of economically developed countries, losing their tax revenues due to the exercise of aggressive tax planning. The main positive aspect of using offshore financial centers is the provision of tax neutrality for the parties of cross-border securitization, being an effective mechanism for attracting financial resources in the international capital market.

For further research, prospective are the assessment of other asymmetries used in the process of attracting financial resources in the international capital market through securitization of assets, as well as

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[76] *Securitisation – achieving tax neutrality*. https://www.pwc.com/gx/en/structured-finance/pdf/pwc-publications-securitisation-tax-neutrality.pdf.

[77] Burov, V. *Pravovye rezhymy y nalohooblozhenye sdelok sek'iurytyzatsyy v nekotorykh razvytykh stranakh*. http://rusipoteka.ru/files/articles/burov-1.pdf [In Russian].

determination of procedure for selecting assets to form a reference portfolio subject to securitization.

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