CURRENT CHALLENGES TO THE OFFSHORE BUSINESS

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Abstract: Offshore business is such an integral part of the financial sector that we can hardly imagine the world of money without it. Today we are as accustomed to offshore business as people were to slavery in the 18th and the 19th century when slave labour was considered normal and natural. However, it goes without saying that just like slavery, offshore zones are doomed to gradual decline because they function is parasitic. According to a study conducted by the international confederation Oxfam, offshore companies evade taxes for nearly $ 200 billion each year. In fact about 50% of Russia's assets, 57% of the Arab Emirates' oil funds, and 30% of Africa's funds are hidden in offshore zones. According to the above report, 1% of the world population now have more wealth than the other 99%. The richest sixty people have more money than three and a half billion poor people. Such inequality is possible only through the cooperation of offshore zones. The US National Bureau of Economic Research estimates that about $ 5.6 trillion is kept in offshore zones around the world. This amount represents 8% of the global equity or 10% of the world's gross domestic product.[2]

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Introduction:

We come across the terms "offshore business", "offshore zone", "offshore company", or other similar terms quite often in our daily life. They are associated with something not entirely legal and generally refer to fraudulent activities to the benefit of a certain groups of people.

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[2] http://www.mediapool.bg/v-ofshorni-zoni-po-sveta-ima-56-triliona-dolara-news273343.html

Notwithstanding the terminological variations, offshore business encompasses various institutions, regulations, mechanisms, and relationships that pose a challenge to those who are engaged to ensure its most valuable advantages – owner's confidentiality and low (or zero) tax rates.

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The most explicit feature of offshore companies is that they are registered outside the jurisdiction of the country in which they conduct their core business, i.e. they operate in countries that differ from the country of their registration. For example, Samsung and Sony operate in Bulgaria as offshore companies because they are registered as legal entities in other countries.

Later on the meaning of the term "offshore company" was narrowed to refer to companies registered in offshore financial zones and regions that offer certain privileges for foreign firms, such as low or sometimes zero tax rates and registration fees, strict bank-client confidentiality and financial privacy, and low registration barriers. Usually such companies are exempt from corporate income tax and pay only a fixed annual fee. Their owners are not subject to personal income tax and are allowed to transfer their incomes abroad. An important condition, however, is that such a zone should be economically viable and easily accessible in terms of telecommunications and transportation. Currency control is usually extremely low. In fact, one of the most important advantages of the offshore centres is not their taxation regulations, but the opportunity for registration of a company through a natural person or an authorized law firm without revealing the identity of the actual owner, i.e. owner's anonymity.

To be considered a tax haven, the country must provide certain benefits to the companies registered under its jurisdiction. Most offshore zones have specific characteristics - they offer advantageous financial and banking services and thus attract huge funds.

In recent years, they have been subject to increasing pressure and scrutiny from the largest developed economies worldwide. They are referred to as non-cooperating countries because of their lack of transparency and reluctance to cooperate in money laundering investigations. Therefore, the Organization for Economic Cooperation and Development has set up a special "blacklist" of uncooperative tax havens.

Classic examples of offshore zones are the tropical islands – the Republic of Dominica, the Virgin Islands, the Cayman Islands, Mauritius, the Bahamas, the Seychelles, Cyprus, New Zealand, etc.

The most common reason for establishing an offshore company is tax optimization. A properly structured offshore company may provide the following benefits: anonymity and data protection, confidentiality, protection

from creditors, court receivables and distraints, cost optimization, significantly simplified accounting requirements, and low bureaucracy.

Tax havens have for many years been used by individual and corporate foreign investors to avoid taxation in the countries where their main business is conducted. This is why governments and mass media are often critical to offshore jurisdictions and the services they provide.

Note, however, that each citizen of a given country has the legal right to register and run an offshore company. Most of the small island nations that are referred to as tax havens provide such an opportunity. In this respect the term "offshore business" is used with reference to international businesses and international taxation and planning.

The above advantages of the tax havens attract not only large corporations but also an increasing number of medium and small-size companies. Most of these companies aim to evade taxation in their own countries or seek refuge from political and financial instability using tax legislation loopholes. Although tax havens are often associated with money laundered by global criminal organizations, virtually all transnational companies own legal entities registered in offshore zones.

The low corporate income tax is the most typical feature of offshore zones. A company incorporated in the Bahamas is levied a lower income tax than a company registered in Bulgaria although all other taxes and fees may be the same. Let's consider a company trading in computer equipment and registered in Mauritius (a popular offshore zone). The company operates and generates profits in Bulgaria. Were the company registered in Bulgaria, it would be subject to corporate income tax at a rate of 10%. In fact, should the owners of the company decide to distribute the profit through dividends, they would also be liable to additional 5% personal income tax. However, in Mauritius the rate of the income tax is zero and the owner will not pay any taxes. The obvious question is whether this is legal. The answer to this question is quite difficult and ambiguous. According to our legislation, a 10% corporate income tax should be levied on the profits of all foreign companies operating in Bulgaria. By selling the computer equipment on the territory of our country, the company should be liable to pay the due tax. In reality, however, using various accounting techniques and legal loopholes the owner can opt for taxation in Mauritius and thus avoid or reduce the due taxes. This process is known as tax optimisation.

Another significant benefit of offshore zones is owner's anonymity. A business owner may want to keep his identity secret for a variety of reasons, such as business and financial risks, bad reputation, indebtedness, etc.

Consider a person who has accumulated a large debt in our country and owns a real estate that that can be claimed and sold to satisfy his credi-

tors. The owner is aware of what will happen and has transferred the title to this property to his company registered in Bulgaria. This, however, is not a solution to the problem because the creditors can look up the Commercial Register at any time and find out that he is the owner of the company and then make a legal claim for the asset anyway. This can be done by either declaring the acquisition of the asset to be null and void or by obtaining a writ of attachment for the person's equity in the company. Such a case would be quite different in Mauritius because there isn't a public commercial register and the creditors cannot identify the actual owner of the company. Generally, the offshore zones would not disclose the identity of the owners of companies under their jurisdiction and therefore, even with the assistance of the state, the likelihood of identifying and bringing these owners to justice is very low.

This is why, apart from political and economic stability, the third most important common feature of all offshore zones is their strict banking secrecy. Thus, by having liberal banking legislation that provides for unhindered registration of bank accounts on the one hand and an unconditional bank secrecy on the other, these zones guarantee maximum security and confidentiality of bank transactions. The abolition of bank laws often involves a limitation of international financial activities. The main segment - banking is the extraterritorial status that prevents it from any inconveniences and limitations. Countries with such policies are called banking havens. The legislation in these countries not only guarantees the secrecy of bank accounts but also the confidentiality of the identity of the owners of these accounts. The disclosure of such information is considered illegal, and therefore it is very difficult to identify the account holders in these countries. It is even more difficult to identify the owners of the banks themselves. By providing complete banking secrecy to their clients, they enable them to accumulate wealth without paying any taxes. Bank secrecy is rooted in the centuries-old tradition of most Anglo-Saxon countries for a tacit non-disclosure agreement between the bank and its client. Banks are liable under the civil and criminal law for any breach of this agreement. A historical example of such a strict banking secrecy are the financial services in Switzerland. Any employee of a Swiss bank who discloses information about international financial transactions and/or account holders is subject to criminal prosecution. This regulation dates back to the 1940s when the German refugees transferred their funds to Swiss bank accounts to protect them from the Nazis. However, the bank secrecy regulation resulted in the protection of all accounts with German account holders regardless of whether they were members of the ruling Nazi party or the opposition.

According to the Swiss legislation, banks must unconditionally provide the law enforcement authorities with information about their clients in cases of criminal proceedings. However, for civil cases the provision of such

information falls within the competence of the regional authorities. As a rule, foreign citizens are not entitled to require information about the clients of Swiss banks.

The difference between Switzerland's legislation and the legislation in the other developed countries is that Swiss tax authorities do not have direct access to bank account information. They can obtain information about taxpayers' bank accounts only if they request it directly from them rather than the management of the bank.

However, the high degree of secrecy does not mean that Swiss banks receive less information than their foreign counterparts. A lot of money-laundering operations have led to tougher requirements on bank supervision and client identification. The banks may provide information about their clients to the law enforcement authorities if the bank management is convinced that the client is involved in criminal activities.

A significant part of the funds (about 40% of all transactions) transferred into Switzerland come from other offshore zones. To maintain the utmost secrecy and confidentiality of bank operations, the banks implemented special procedures with options for opening a bank account to an ID number or a nickname chosen by the client. This option increases the level of trust but does not make these accounts completely anonymous. The account holder’s identity is always known to the bank. Over the last decades, Switzerland has weakened the requirements for bank deposit secrecy.

The level of banking secrecy varies according to the country. In all EU member-states, with the exception of Austria and Luxembourg, the breach of banking secrecy does not result in criminal prosecution. In Austria, pursuant to a special law enforced in 1979, a bank employee may be sentenced to a year's imprisonment or pay a fine equivalent to one year's salary for disclosure of information about a depositor. However, the bank may only provide client-related data if requested by the court. In Luxembourg, a banking secrecy law enforced in 1981 allows banks to disclose client information in the event of a criminal case, but only with the consent of the Minister of Finance.

Another characteristic of the offshore zones is the absence of limits on the amounts of currency exchanged and transferred. Foreign currency transfers are not subject to control provided the funds are transferred from a source outside the offshore zone. If there are any limits, the clients are mainly interested in free transfer of funds held in accounts of other banks except offshore. It is fundamentally impossible to combine both tax evasion and the complete lack of risk of losing a deposit.

The above characteristics of offshore zones cannot exist without modern communication centres and reliable operation, which require a well-developed infrastructure. The attractiveness of the offshore zones largely de-

pends on the level and quality of communications services. Generally, these centres have modern telecommunication equipment that provide the communication needed for financial transactions.

The transportation infrastructure and means must be well-developed and modern as well. For example, there are two daily flights between the Cayman Islands and Florida. Many charter flights from the United States are used to ship large amounts of cash to offshore banks in the Bahamas. Similar transport and telecommunications services exist in the offshore zones of Panama and Hong Kong.

However, even a full set of all the above characteristics would not be sufficient for the successful operation of an offshore zone if it does not have the right legislation. The choice of a location for the company's headquarters as well as the legal form of the entity and its main activities is crucial.

The general law allows for greater freedom of entrepreneurship, but at the same time almost always requires the assistance of a lawyer, as the legal system is quite sophisticated. However, it provides many opportunities for transfer of title to property rights from one country to another, which is particularly important for offshore clients.

The last characteristic of offshore zones is the degree of satisfaction of the individual needs of the clients, namely: domestic transportation, medical services, adequate accommodation, personnel that speak foreign languages, availability of qualified specialists such as lawyers, notaries, accountants, IT specialists, etc.

Registration fees vary from 3000 to 5000 USD depending on the type of company registered. They cover bank account, address, and office registration, a company logo and stamp, etc. The company is registered through proxies. There are more than 20 companies in Bulgaria that provide offshore registration services. They are representatives of law firms that actually register such companies in the offshore zones. Once established in an offshore zone, the company is exempt from local taxes. Such companies are convenient for provision of tourist services, international commerce, and international shipping services.

There are certain restrictions to the operations of offshore companies in our country. Offshore companies cannot operate in some of the most important sectors, such as insurance, banking, social and pension insurance, sports, gambling, financial auditing, etc. These restrictions apply not only to offshore companies but also to affiliated companies. For example, if someone wants to run a football club and owns a company registered in Mauritius, he will not be granted a license for this activity. In such case the offshore company may register a subsidiary in Bulgaria and the subsidiary will get a license. However, according to our legislation this will not happen because the parent company and the subsidiary are affiliated entities.

However, there are certain exceptions from this rule. Offshore companies established in countries with which our country has signed tax treaties are not likely to evade taxes and are allowed to perform the above activities. The

same applies to companies whose owners are publicly known because they are listed on regulated financial and capital markets. Another exception are the printed media companies. Offshore companies may issue magazines provided that they have disclosed the identity of their owners.

Offshore companies that are not subject to restrictions are listed in the Commercial Register and anyone can obtain information about their actual owners.

After ten months of investigations, the European Union created and disclosed a “blacklist” of 17 countries designated as tax havens. In December 2017, following a meeting in Brussels, EU finance ministers announced that South Korea, American Samoa, Macao, Bahrain, Panama, Barbados, Grenada, Guam, Marshall Islands, Tunisia, Mongolia, United Arab Emirates, Namibia, Saint Lucia, Samoa, Trinidad and Tobago do not apply minimum global standards against tax avoidance and that the EU will update the list at least once a year.

The last list does not include a number of British overseas territories such as the Cayman Islands and the Bermuda Islands, which were on the previous "blacklist” published in June 2015. This was very important for the United Kingdom. The disputes over the methodology of the list resulted in its subsequent revision. The lack of unconditionally proved tax havens in the list is an argument for some MEPs and tax consultancy companies to denounce it as a "whitewash” and “sweeping of previous errors under the carpet.”

The current list was drawn up by a group of finance ministers from the EU Member States, including the United Kingdom, on the basis of the European Council's Code of Conduct. The main criterion for inclusion in the blacklist is the facilitation of tax avoidance. Although this is a step in the right direction, the EU leaders did not include too many tax havens in the list to everyone’s detriment.

Tax evasion means less government spending on healthcare, education and anti-poverty measures.

About 50 other countries are included in the so-called gray list of countries that do not comply with EU tax standards but are committed to change their rules on tax transparency as soon as possible. These countries will have to adopt EU rules by the end of 2018 and the developing countries will have to do so by 2019. This is their only chance to avoid inclusion in the main blacklist of countries used as tax havens. This initiative has already proved its effectiveness, as many countries have committed to meet the deadlines for compliance with the European criteria. The EU will regularly review and update the list in the coming years to ensure that good tax governance is provided for by the national regulations in the countries currently included in the EU lists. The compilation and publication of the first blacklist was an important achievement in the process for transparency and fairness. However, the process should not stop at this point. The listed countries should be put under increasing pressure to change their tax governance. All blacklisted jurisdictions should face certain sanctions and restrictions and the graylisted

ones should keep their commitment to achieve the set goals quickly and effectively.

Members of the European Parliament and activists, however, criticize the exclusion of some countries from the lists. They believe that this undermines the EU's credibility and that the member states have made certain concessions regarding the tax havens included in the black list by leaving out the most important ones. The exclusion of major financial centres, such as the United States of America, makes the list politically biased. Other activists criticize the list of tax havens that was originally intended to be based on an objective set of criteria. The list seems to be a political decision for EU members who choose to "name and shame" the most disadvantaged countries. The result of this process is a bureaucratic list that includes only economically weak and politically unaffiliated regions.

This list is also criticized by the fact that some EU member states, such as Luxembourg, Ireland and the Netherlands, are excluded from it, although they are the largest profit transfer centres. Moreover, the United Kingdom is trying to exclude its overseas dominions from the blacklist.

More than 50 jurisdictions have already made serious commitments to undertake reforms. Countries on this list are advised to take certain legislative measures regarding individual and corporate holders of offshore accounts.

While recognizing that the EU blacklisting criteria fail to capture all corporate tax havens, Oxfam has conducted a fairly conservative assessment showing which countries should at the very least be expected to appear on the EU blacklist of tax havens if the EU were to objectively apply its own criteria and not bow to any political pressure.

Oxfam evaluated the 92 jurisdictions being screened by the EU listing process, against the EU's three criteria:

• Criterion 1: Tax transparency: Countries are exchanging information automatically and on request; countries are part of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

• Criterion 2: Fair taxation: Countries have no harmful preferential tax measures; countries do not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction. Zero percent tax rate is used as an indicator. It is important to note that the EU did not disclose the exact methodology for how it will assess this criterion. Oxfam therefore used economic indicators aiming at only capturing countries granting tax advantages without any real economic activity taking place in that country. However, the EU should have more information than is publicly available and could therefore list more countries than Oxfam does in this assessment;

• Criterion 3: Implementation of anti-BEPS measures: Countries apply or commit to OECD anti-BEPS (Base erosion and profit shifting) minimum standards. This assessment resulted in a list of 27 countries that should appear on the EU blacklist, as shown in Table 1:

Table 1
Countries that should appear on the EU blacklist according to the three criteria

Jurisdiction	Fails criterion 1: Tax transparency	Fails criterion 2: Fair taxation	Fails criterion 3: Implementation of anti-BEPS measures
Albania			X
Anguilla			X
Antigua and Barbuda	X		X
Aruba			X
Bahamas		X	X
Bermuda		X	
Bosnia and Herzegovina	X		X
British Virgin Islands		X	
Cook Islands			X
Cayman Islands		X	
Curaçao		X	
Macedonia	X		X
Gibraltar			X
Hong Kong		X	
Jersey		X	
Mauritius		X	
Montenegro	X		X
Nauru			X
Niue			X
Oman	X		X
Serbia	X		
Switzerland		X	
Taiwan	X		X
US Virgin Islands	X		X
Vanuatu	X		X
Faroe Islands			X
New Caledonia	X		X

EU finance ministers urge countries to ratify the European list of tax havens and claim that such a list should be imposed with credible and meaningful sanctions. The potential sanctions that could be imposed on the listed countries are expected to be agreed upon shortly. This is an important step in the ongoing war against tax evasion and avoidance on a global scale.

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At the ECOFIN meeting held in January 2018 the Bulgarian Finance Minister Vladislav Goranov stated that Bulgaria was ready to implement a common methodology for calculation of corporate income tax base, i.e. to harmonize its tax legislation with the other EU member states. Until recently, our country was opposed to this measure because the corporate income tax rate in Bulgarian is lower 10%) although the tax base is wider than in other countries and there are fewer tax concessions and exemptions as well as recognized costs. Should a narrower base is adopted, this could lead to a correction of tax rates in Bulgaria as well. Moreover, the adoption of a common tax base will lead to the next step – profit consolidation, which means that companies will be liable to pay the tax in the country where they actually operate instead of the country of their registration. This will effectively prevent tax avoidance by means of transferring profits to tax havens. Despite the low corporate tax rate in Bulgaria, few companies have taken advantage of our jurisdiction. Instead, many companies registered in the country prefer to transfer their profits to other jurisdictions seeking the protection of "anonymous" ownership and the privilege to accumulate capital resources at low or zero taxes.

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