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Offshore schemes as an effective tax planning tool of enterprises' innovative activities

Abstract. The authors explore basic tax planning tools and offshore companies use as one of the most popular methods of tax planning. The analysis of the effectiveness of the tools used to stimulate the activities of enterprises is based at economic literature review and statistical data. The authors have studied the main offshore schemes which are used in the modern world and consider offshore being effective means of tax planning. The choice of an offshore zone and offshore schemes depends primarily on the challenges that face a company. The authors have provided recommendations on further promotion of innovative activity of economic entities applying tax instruments.

Keywords: Tax Planning Tools; Taxation; Tax Regimes; Offshore; Innovative Activity

JEL Classification: H20

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Оффшоры как эффективный инструмент налогового планирования инновационной деятельности предприятий
Аннотация. В статье рассмотрены основные инструменты налогового планирования. Проанализированы оффшоры как один из наиболее эффективных способов налогового планирования. Представлены рекомендации по стимулированию инновационной деятельности хозяйствующих субъектов с использованием налоговых инструментов.

Ключевые слова: инновационная деятельность; инструменты налогового планирования; налогообложение; налоговые режимы; оффшоры.

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Офшори як ефективний інструмент податкового планування інноваційної діяльності підприємств
Анотація. У статті розглянуто основні інструменти податкового планування. Проаналізовано офшори як один з найбільш ефективних способів податкового планування. Представлено рекомендації щодо стимулювання інноваційної діяльності господарюючих суб'єктів з використанням податкових інструментів.

Ключові слова: інноваційна діяльність; інструменти податкового планування; податкові режими; офшори.

1. Introduction

Last century was marked by radical changes, the cornerstone of which was two waves of innovations initiated by the scientific revolutions at the beginning and in the middle of the 20th century. The mechanisms of the innovative dynamics were disclosed and the fundamentals of the innovations theory were placed as the foundation for the cyclic regularities in various areas of human activity.

Today, the need for innovative development and stimulation of the economic entities' innovative activity are still actual and unquestionable in academic circles and among business representatives. Recently, special attention has been paid to the tax tools with regard to the effective stimulation of business innovative activities.

2. Brief Literature Overview

In economic and social fields of study the conceptual framework of innovations is covered in the works of N. Kondratiev (Kondratiev, 1984) [1], J. Shumpeter (Shumpeter, 1961) [2], Y. Yakovets (1999) [3], S. Glaziev (Glaziev, 1993) [4], A. Nechaev (Nechaev, 2013; 2015) [5; 6], S. Kuznets (1955) [7], P. Druker (Druker, 1985; 2013) [8; 9], M. Porter (Porter, 1985) [10] and many others.

Special attention with regard to the stimulation of innovative activity is to be paid to tax tools which constitute an integral part of taxation. The main aspects of the innovative processes related to tax stimulation are considered in the works of Yu. Ananiashvili (Ananiashvili, 2010) [11], A. Laffer (Laffer, 1979; 2008) [12; 13], N. Ivanova (Ivanova, 2009) [14], S. Uvarova (Uvarova, 2011) [15], P. Krugman (Krugman, 2008) [16], A. Taganov (Taganov, 2005) [17], P. Palazzi, (Palazzi, 2011) [18], D. Shevchuk (Shevchuk, 2007) [19].

3. The purpose of the research is to investigate basic tax planning tools; to study the use of offshore schemes as one of the most known methods of the tax planning; to develop recommendations on the use of more effective tax instruments for the stimulation of economic entities' innovative activity.

4. Results

An analysis of economic literature makes it possible to allocate some of the main groups of tax planning tools.

The first group is the various tax modes used by economic entities in the course of tax planning. According to the existing legislation of the Russian Federation, special tax modes present a system of taxation for agricultural producers (the uniform agricultural tax); a simplified system of taxation; a system of taxation in the form of the uniform income tax relevant to certain types of activities; a system of taxation related to the implementation of production sharing agreements; the patent system of taxation.

The second group represents various privileges which can be applicable to certain types of business activities to provide tax optimization.

The third group includes the tax privileges secured under international laws with the exception of the double taxation (Ananiashvili, 2010) [11].

Thus, a company can independently choose certain methods of tax planning to promote minimization of taxes and tax optimization, depending on the type of business activity of an economic entity.

Offshore zones are of special value and interest in the field of studies related to the stimulation of innovative business activity.

An offshore zone is a territory of a state or its part within the borders of which there exist a particular preferential mode of registration, licensing and taxation for non-resident companies provided that their business activity is carried out outside this state.

Firstly, it should be noted that the process of registration is simplified and expedited for non-residents in an offshore zone and an insignificant sum of money is paid for it. Secondly, non-residents pay reduced income tax rates and individual income tax. Thirdly, confidentiality of the offshore companies' activity is guaranteed and they are exempted from the state currency control.

The main reasons to use offshore zones by Russian companies are shown in Figure 1.

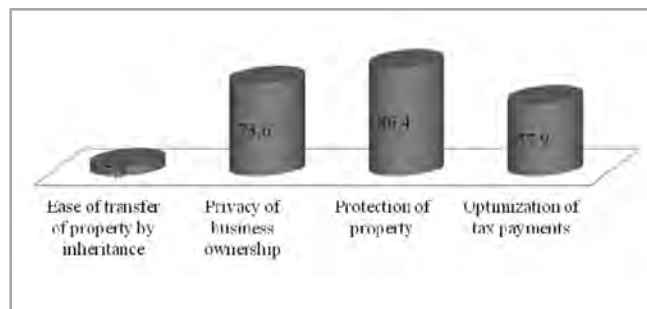


Fig. 1: Reasons to use offshore by Russian companies (%)

Source: Compiled by the authors based at [14; 15; 20]

Today, there are more than 60 countries that provide tax privileges (up to complete tax exemption) for the companies registered in them, provided the companies conduct no activity in their territory.

There are some groups of offshore jurisdictions. The classic offshore zones or the offshores belong to the first group. These countries provide complete tax exemption in exchange for a small fixed annual fee and demand no delivery of any accounting reports to the offshore companies registered in them, provided they conduct no activity in their territories. The Bahamas, the British Virgin Islands (BVI), the Seychelles are the most known among them.

The second group includes the jurisdictions where low tax rates are established for certain types of companies. They are often ranked as «offshores» and the companies registered in them can be called offshore companies. Such jurisdictions demand that companies maintain financial statements and, in some cases, pay minimum taxes on their activities. The most indicative examples of such countries are Cyprus, Gibraltar, Hong Kong, etc.

The jurisdictions which have a high respectability belong to the third group. They provide various tax privileges under certain conditions and they aren't offshore zones at all. Such jurisdictions are chosen to improve business image and to have a higher level of respectability, which will give a possibility of a subsequent entry into the financial markets of developed countries. The Netherlands, the USA, Great Britain are among such countries.

The offshore zones and other jurisdictions are quite different according to their administrative operating conditions for companies, the need for reporting, tax rates, etc. Traditionally, the low cost and the simplicity of registration and maintenance of companies are the main criteria that determine the choice of a jurisdiction, on the one hand, and the image of the country on the other.

There are various offshore schemes which make it possible to reduce the number of taxes paid with the use of offshore zones. The choice of an offshore zone and the offshore scheme depends more on the task which the company sets to fulfill. We will analyze the main offshore schemes used in the modern world.

The classical offshore scheme assumes that the offshore company acts as an intermediary between the supplier of goods and the real buyer.

In case of export of goods or services from a country through an offshore zone the price is underestimated to the smallest possible sum; then the company resells it to the real buyer at the valid price. Consequently, all the profit remains in the offshore company (Figure 2).

In case of import of goods to a country through an offshore zone the price is usually underestimated to minimize the sum of the paid customs duties and the VAT. Besides, it is necessary to consider the customs value because if the value is too low, it will lead to an increase in the income tax and if the value is too high, it will result in customs payments. In each case, it is possible to consider a value which will minimize the total amount of payments to the state. Also it is necessary to consider that the amount of income tax can be reduced by listing the payments

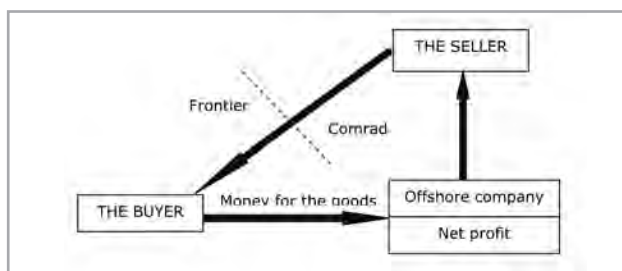


Fig. 2: Export offshore scheme

Source: Compiled by the authors based on the analysis of the literature [12; 14; 20]

for the services to the firms which pay the uniform tax or to the ones which are registered with regard to a simplified system of taxation of the economic activity.

Conducting business activities through offshore zones also allows carrying out VAT planning. In Russia, purchasing goods intended for export makes it necessary to pay VAT which the state returns after some time (the tax credit). Nevertheless, if a contract is concluded on behalf of a foreign offshore company, the VAT is not to be paid.

The agent scheme assumes that an offshore company employs as an agent any firm in the country where it plans to conduct the primary activity and it acts according to the orders of the employer. As a result the company pays the tax only on its small remuneration (generally, it is a fixed payment or a percentage of the value of goods). The example of the agent scheme is presented in Figure 3.

The agency contract is signed between an English limited liability company and an offshore company. The English limited liability company pays taxes on the agency fee which makes 5% of the turnover. The net profit is submitted to the account of the offshore company.

It should be noted that that the English limited liability company is a registered company which hands over the tax reports in due time.

Under the manufacturing scheme, an offshore company pays for raw materials and services of the producer. As a rule, the production services are rendered at minimum quotations. The producer ships goods to the agent. The agent sells goods to the end buyer earning thus the agency a fee. Then the money and the profit are returned to the offshore company (Figure 4).

The tax policy promotes the provision of the state with financial resources with the effective distribution of the tax burden and the replenishment of state revenues due to economic growth assuming an increase in taxpayers' income and the property.

The characteristic feature of the modern economy is the leading role of innovations and innovative practice strengthening, as well as improvement of the efficiency of innovative processes. Thus, taxation is one of the most effective tools of economic regulation and international economic processes (Ananiashvili, 2010) [11].

The tax levers impact on the globalised economy gain increasing value as it influences economic growth and foreign economic relations efficiency among the states (Uvarova, 2011) [15].

For example, in Germany the tax burden on the small and medium-sized businesses has decreased due to the considerable reduction of the individual income tax rates.

In Great Britain the tax credits for the innovative development are the important component of the innovative growth package along with other forms of support for business.

There are two main types of tax discount used in the USA. They are the special mode of the depreciation charges within the tax depreciation and the tax credit in the form of the discount for an already added tax payment (Ivanova, 2009) [14].

Thus, the most pressing challenge is modernization and provision of innovative economic development. It is impossible to meet the challenge without forming a system of tax support for innovative processes, which demands the development of tax mechanisms. It is necessary to consider the previous experience in the area of tax support for enterprises and organizations, not to repeat the mistakes made in the past and focus on the influence of the tax system on the support for the existing branches and generation of new economic forms.

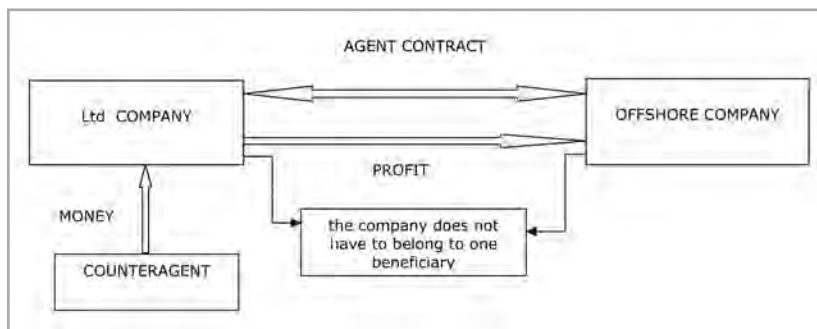


Fig. 3: Offshore agent scheme

Source: Compiled by the authors based on the analysis of the literature [12; 14; 20]

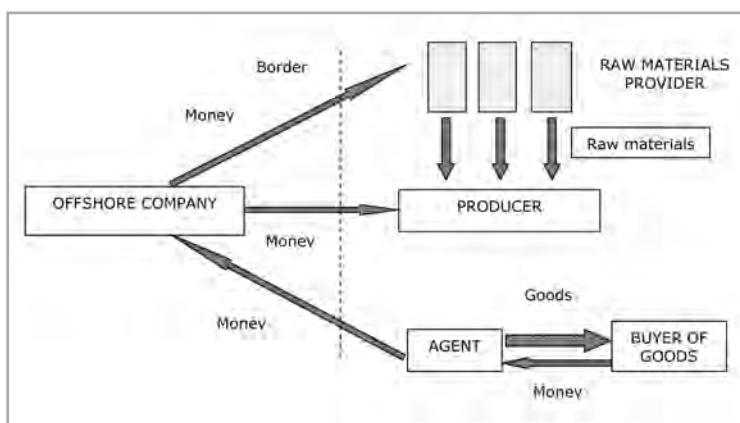


Fig. 4: Offshore manufacturing scheme

Source: Compiled by the authors based on the analysis of the literature [11; 13; 16]

5. Conclusions

It is important for the modern Russian science and practice to define the most essential domestic economic trends in the development of the offshore services market and the main problems relevant to this process. The offshore business is one of the ways to attract monetary resources to stimulate economic development. As experience has shown, the countries with the developed offshore services market are characterized by a larger financial stability, reduced macroeconomic risks and social shocks. In this regard, some aspects of the use of offshore zones have been analyzed in the article as one of the best known and effective tax planning methods.

Further researches in the field of the innovative activity and tax incentives should address the following problems: firstly, the specification of the conceptual framework concerning the tax incentives tools with regard to the innovative activity of economic entities; secondly, the systematization of the tax incentives tools related to the innovative processes both in Russia and abroad; thirdly, the assessment of the tax incentives relevant to the innovative activity of business enterprises.

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