

**INFLUENCE OF CAPITAL EXTRACT ON OFFSHORE ZONES ON UKRAINIAN ECONOMY****Khudoley L. V., Zachepylo D. A.***Zaporizhzhia National University  
Ukraine, 69600, Zaporizhzhia, Zhukovsky str., 66*

lina\_kozobash@ukr.net, zachepylo2909@ukr.net

ORCID 0000-0003-0910-6816, 0000-0001-5536-9495

**Key words:**

offshore zones, capital, efficiency, investments, capital outflow.

The article deals with the main aspects of capital outflow to offshore zones. The essence of the concept of "offshore zones", "capital outflow" and "free economic zones" are investigated. The volumes of attracted direct investments and their use in 2018 and 2019 are compared. The classification of offshore zones by degree of reliability is determined. The factors of influence of activity of offshore zones on the economy of the state are specified. Offshore zones such as Cyprus and the British Virgin Islands have been analyzed. A set of measures to reduce capital outflow from Ukraine has been developed and proposed. The negative and positive effects of offshore zones activity on the economy of our country are highlighted. The proposals for improving the investment situation in Ukraine have been identified. Have been identified which offshore areas are flowing out of the country, as well as a list of countries that are the largest investors. The most influential offshore zones, such as Cyprus and the British Virgin Islands, have been characterized. A set of measures to reduce capital flight from Ukraine was formed also.

**ВПЛИВ ВІДТОКУ КАПІТАЛУ ДО ОФШОРНИХ ЗОН НА ЕКОНОМІКУ УКРАЇНИ****Худолей Л. В., Зачепило Д. А.***Запорізький національний університет  
Україна, 69600, м. Запоріжжя, вул. Жуковського, 66***Ключові слова:**

офшорні зони, капітал, ефективність, інвестиції, відплив капіталу.

У статті розглянуто основні аспекти відтоку капіталу до офшорних зон. Досліджено сутність поняття «офшорні зони», «відтік капіталу» та «вільні економічні зони». Порівняно обсяги залучених прямих інвестицій і їх використання у 2018 та 2019 рр. Визначено класифікації офшорних зон за ступенем надійності. Зазначено фактори впливу діяльності офшорних зон на економіку держави. Проведено аналіз таких офшорних зон, як Кіпр та Британські Віргінські острови. Розроблено та запропоновано комплекс заходів для зменшення відтоку капіталу з України. Виокремлено негативні та позитивні наслідки діяльності офшорних зон для економіки нашої країни. Обґрунтовано пропозиції щодо покращення інвестиційного стану в Україні. Визначено, до яких офшорних зон йде відплив капіталу з країни, а також наведено перелік держав, які є найбільшими інвесторами. Надано характеристику найбільш впливовим на економіку України офшорним зонам – Кіпру та Британським Віргінським островам. Сформовано комплекс заходів для зменшення відпливу капіталу з України.

**Statement of the problem**

The majority of business enterprises is made to seek the ways to save their income by the significant taxation, high corruption rates, volatile political environment and local military operations in the East of Ukraine, thus offshore areas are the optimum alternative to satisfy their requirements. The budget failure is the result of the capital extraction and later a budgetary gap runs. Therefore, one of the most important problems of the economy is the outflow of funds to offshore tax havens, and through this process the effective governmental regulation on the basis of legislative acts and other state instruments is necessary to form and use.

Modern business development is inextricably connected with the economic globalization, i.e. the free flow of capital and increased foreign investment provide an opportunity to analyze offshore zones. Today, the outflow of capital to these zones has a negative impact on the

Ukrainian economy, because it influences the amount and the level of tax revenues to the country's budget and leads to a decrease in the efficiency of the state economy. As a consequence, the volume and structure of capital outflows to offshore is to be under investigation in order to identify the roots of this process and to establish control tools to prevent these economic actions.

**Analysis of recent studies and publications**

Many economists have given opinions on the existence and performance of offshore tax havens and the outflow of capital from enterprises and organizations. It is worth noting that today the subject of offshore companies and the host of problems associated with the emergence and functioning of offshore areas are the subject of research by many academic economists. Top scientists studied the impact of tax havens upon Ukrainian economic situation. Baimuratov M. O. [1] studied the use of offshore in commercial activity of corporate taxpayers and analyzed the legal framework of taxation of offshore entities. Zorina

S. I. [2] studied tax regulation of offshore usage in economic activity. Bozulenko O. K. [3] considered the role of offshore financial activity in the world financial system. Sidnenko M. V. and Popovich M. I. [4] in their study evaluated the international experience of international offshore business and the possibility of applying its principles in Ukraine. However, the extent and the structure of capital outflows and the implications of these processes have not yet been determined.

**Objectives of the article**

The aim of the research is to analyze the tax havens' activity and determine its negative and positive impact on the economy of Ukraine.

**The main material of the research**

Globalization processes in the economy and deepening of international economic relations, in particular the development of international lending and capital markets and currency exchange cause the emergence of offshore jurisdictions.

Offshore is a specific territory of a country or a separate part of a country where non-resident companies (companies operating in the territory of one country but permanently incorporated and operating in another country) have a special registration and activity procedure. In other words, it is an area where a simplified tax treatment exists and operates.

In our country, Ukrainian business pays 135 different types of taxes, that is why our country features in 'the most complex tax system countries'.

The tax haven zone is a type of free economic zone, where there is a special mode and a high level of protection of banking and trade secrets is guaranteed, and simplified state regulation has place.

There are more than 60 countries in the world whose legislation provides tax advantages for offshore companies.

The most popular offshore zones among international companies are Cyprus, British Virgin Islands, Baileys, etc. [1, p. 140-141].

The advantages of activities in offshore areas include:

1. The income tax is absent or does not exceed the level of 1-2%.
2. Simplified registration procedure.
3. The amount of currency in circulation and repatriation is not limited.
4. Local legislation is loyal to violations of the customs legislation.

The indirect influence of offshore activity is reflected in following spheres of Ukrainian economy (Fig. 1).

Offshore zones are classified by degree of reliability:

Group 1 includes Luxembourg, Switzerland, Dublin and others

Group 2 comprises Andorra, Gibraltar, Monaco and more

Group 3 contains Belize, Liechtenstein, Cayman Islands.

Ukrainian companies register in the third group offshores, which are off-limits to EU law enforcement agencies.

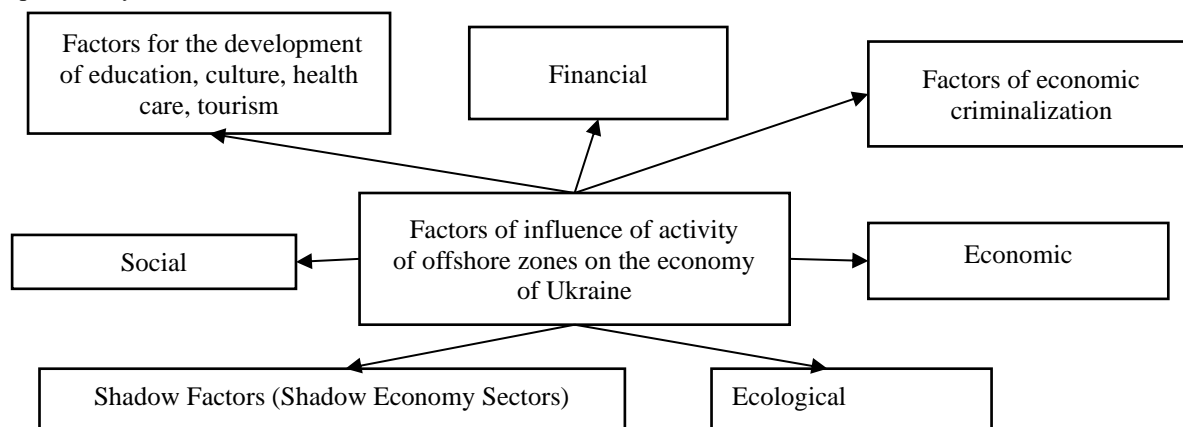


Fig. 1. Factors of influence of offshore zones activity on the economy of Ukraine

Source: compiled by authors, based on [2]

At present, about 60% of the total value of world capital is concentrated in tax havens and half of which are all financial operations. The volumes of direct investments into the economy of Ukraine are given in Table. 1.

Table 1 – Volume of direct investments in 2019 compared to 2018.

Countries	Direct investment volumes as of January 1, 2019.	The change for 2018 million dollars
Cyprus	8880	-53
Netherlands	7061	666
Great Britain	1956	12
Germany	1668	-15
Switzerland	1541	25
Virgin Islands	1311	-47
Russian Federation	1008	211
Australia	1006	-33
France	636	-87
Poland	594	23

Source: Compiled by authors [5]

According to the National Statistics of Ukraine, as of January 1, 2019, the EU countries were the largest investors in the Ukrainian economy. They invested \$ 24.743 million, including Cyprus – \$ 8.880 million, the Netherlands – \$ 7.061 million, the United Kingdom – \$ 1

956 million, and Germany – \$ 1 668 million. A total of 138 countries invest in Ukraine.

The factors that contribute to the hidden outflow of a capital are shown on the Fig. 2.

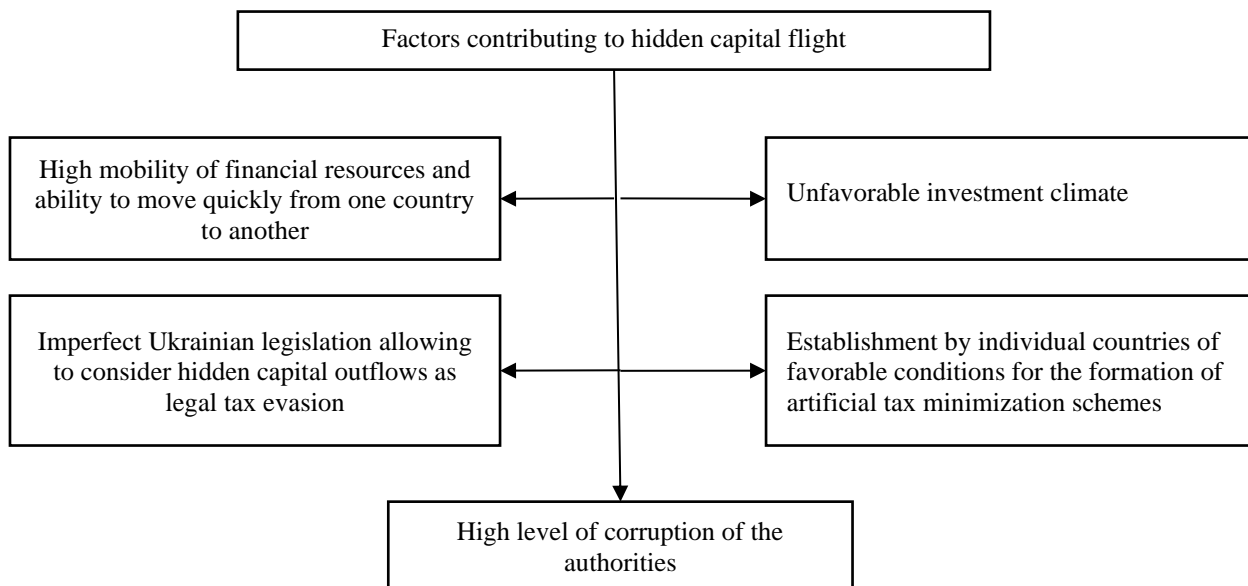


Fig. 2. Factors contributing to the hidden capital outflow  
Source: Compiled by authors [6]

The vast majority of large foreign banks and investment firms use offshore to conduct financial transactions. In our country, nearly 80% of the offshore investments are made

by Ukrainians. Contracts, credit lines, subsidiaries and joint ventures are used for this purpose. Foreign investments can contribute in the form of equipment and technologies as financial backing (Table 2).

Table 2 – Direct investment in the world in 2019

Countries	Volumes as of			
	01.01.2019		01.07.2019	
	\$ million USA	In % to as a result	\$ million USA	In % to as a result
altogether	6294,2	100	6271,9	100
Cyprus	5931,9	94,2	5931,8	94,6
Virgin Islands	59,9	1,0	33,7	0,5
Russian Federation	117,7	1,9	123	2,0
Netherlands	11,8	0,2	11,7	0,2
Germany	3,4	0,1	3,4	0,1
Latvia	72,5	1,2	72,1	1,1

Source: compiled by the authors on the basis of [5].

The business in Ukraine does not receive proper support from the state, the tax burden is only increasing in a down economy, it should be noted that more than 90% of Ukrainian capital was transferred to Cyprus.

More than 85% of the total direct investment from Ukraine to Cyprus was made as a result of an assets upgrading process with the help of a transfer of shares of other Ukrainian companies by corporate parent (i.e. a legal entity that holds a controlling stake and controls another legal entity).

The force of Cyprus attraction comes from the fact that there is a double tax treaty between Ukraine and this tax haven. It should be noted that, from a legal point of view,

Cyprus is not an offshore entity, but the authorities have established a profitable tax system in order not to lose profits from operations [5].

The attractiveness of the British Virgin Islands stems from the fact that in order to place shares of a company on the well-known London Stock Exchange, it is necessary to involve only a legal entity that owns a controlling stake in a Ukrainian company. Thus, this holding company will operate under British law and this is critical for investors. However, the Parliament of Ukraine approved the Protocol amending the Convention between the Government of our country and the Government of the

Republic of Cyprus on the avoidance of double taxation and the prevention of tax evasion as for income taxes [7].

The Protocol provides:

1. Dividend taxation will be at the rate of 5%.
2. The rate of taxation is increased from 2% to 5%.
3. Changes regarding the taxation of the proceeds from the condemned shares in companies whose share in the value of real estate is more than 50% of the value of all property were made.

We can outline 4 main ways to solve problems related to free economic zones on reflection of the information:

1. An effective legislative framework for offshore zones is needed to be established and implemented.
2. The number of government instruments must be increased to control offshore business.
3. Proper tax burden is necessary to be optimized that it could vary depending on the market activity.
4. Ukrainian legislation ought to work closely with various international organizations in order to be optimized.

### Conclusions

Given the current economic situation in Ukraine, absolute depletion of certain types of economic resources is very expectable. Therefore, not only favorable climate for attracting investments is necessary to be created, but also special mechanisms and tools are wanted to block the possibility of withdrawing the capital of enterprises to tax havens. This requires the development and implementation of harsh policies that could monitor and control the offshore financial sector and establish a system of penalties and sanctions against countries and companies in cases of breaches in accordance with established provisions.

Among required measures to reduce the impact of offshore zones on the economy of Ukraine are the following:

– a proper set of actions have to be worked out and performed to provide effective data on the financial position of foreign partners for domestic producers of goods and services;

– amendments to the Law of Ukraine "On State Registration of Legal Entities and Individual Entrepreneurs" are to be introduced, this will set out a clear algorithm for registration of tax haven companies;

– restrictions on non-resident companies investing from offshore and granting non-resident companies paying taxes in full are needed;

– it is required to pick up criminal groups and suspend their functioning in the field of banking, regional economy; there the considerable opportunities for combating money laundering obtained by criminal means are concentrated;

– the decentralization program ought to be completed;

– it is essential to create a state mechanism to guarantee the protection of the rights of investors, creditors and shareholders.

Offshore companies need to be transformed from profit, capital and property rights areas into assets of the Ukrainian jurisdiction, using them as branches or as a stepping stone to conquer highly competitive overseas markets for Ukraine. This will allow Ukraine to obtain significant financial and investment flows, improve its social and economic situation.

All identified ways to solve the problem of tax havens require the active involvement of the state administration and close international cooperation to create a common legislative framework and apply effective tools to harmonize the tax system and the system of penalties to reduce the outflow of capital from the state.

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