

Beneficial Ownership Chain And Its Evaluation Arrangement

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ABSTRACT

This paper presents a beneficial ownership chain. Nowadays international environment, there is an intensification of the movement of financial flows, which is inextricably linked to the checks on persons of business owners by the Controlling Authorities. Applying an effective valuation methodology and the availability of interconnected databases on corporate ownership becomes the only way to ensure the prosperity of business law and the ultimate beneficiary. Authors of the article consider the theoretical foundations of the conceptual framework of the final beneficial owner, which is a key link in the chain of ownership. The specification of the beneficial ownership chain and the methodology for calculating the beneficial property index are explained, and it proves the existence or absence of the final beneficiary.

Keywords: Beneficiary; beneficial ownership chain; beneficial ownership structure management; ownership targeting; BEPS.

JEL classification: C65, D24, O12, G32

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1. Introduction

Nowadays, the issue of ensuring the prosperity of legal corporate property rights is given considerable attention by the scientific community and practitioners among business structures, the issues of promoting transparency of information about the ultimate beneficial owner, who is a key link in the ownership chain. To this end, a set of information should be collected and processed for all participants in the beneficiary structure. Identification of the ultimate beneficial owner influences the behavioral aspects and management decisions of all members of the value chain. The main objectives of this study are:

(a) to present the characteristics of the beneficiary property chain and the evaluation arrangement according to the methodology for calculating the beneficial property index;

(b) demonstrate a real case in on corporate ownership becomes and provide values that could illustrate the applicability of the methodology for calculating the beneficial property index.

2. Literature review

Considerable interest has been found in scientific research, namely, those issues relating to the relationship between property rights and the leading role of the beneficiary in managerial decision-making and its impact on the property chain, using the example of the Mass media sphere. The study, through a survey of 258 respondents among the editors of daily newspapers, revealed that online newspaper editors are more exposed to activist activities than their independent colleagues. A trend towards the growth of activist values was identified along with an increase in the size of the ownership chain. At the same time, it was noted that with the increase in the volume of Mass media, the need for editors of activist values and their manifestations is growing faster than that of editors of smaller Mass media. In other words, the impact of having a beneficiary in the ownership chain has a positive impact on the activities of Mass media organizations (Roya Akhavan-Majid and Timothy Boudreau 1995) [1].

Ohlsson J. (2012) [2] has written considerable amount of scientific research has been written about the elusiveness of ownership effects and the importance of property control, using the example of the media and the impact of ownership on the newspaper's activities. Dzhezdzhula V. and Yepifanova I. (2018) proposed to use hybrid neural networks to predict economic processes [3]. Hybrid neural networks allow to draw logical conclusions by means of fuzzy logic, and tuning of membership functions occurs by means of neural networks. Hybrid networks not only combine the quantitative and qualitative characteristics of the object being studied, but also the learning, that is, as the parameters of the object change, the forecast of its characteristics obtained through the network changes. Such features of hybrid neural networks provide the proposed method of modeling an advantage over the classical theory of fuzzy logic, where the information of knowledge bases generated by experts is finite.

Knobel Andres et al. (2019) [4] in the paper «Beneficial ownership verification: ensuring the truthfulness and accuracy of registered ownership information» argues that inaccurate and false information regarding beneficial ownership is harmful in the context of counteracting illegal financial flows related to corruption, money laundering or terrorist financing. In connection with these authors, we propose an IT system that should be used by governments to automatically cross-verify proprietary information, both in terms of reality and in terms of advanced analytics for redflagging purposes.

The paper Gontareva I. et al. (2019) presents the mechanism of determining the factors of effectiveness of control and information and communication support for sustainable development on the example of higher education institutions [5]. This paper presents an analytical assessment of the components of sustainable development and enables control over the stages of achieving a «sustainable» state. The paper Ramazanov S. et al. (2019) presents a complex model of stochastic dynamics, which is focused on detailing the stages of the management chain of the socially-environmentally-oriented innovation economy [6].

Dun & Bradstreet believes that the need for modern disclosure and transparency of ownership is

associated with significant reputational and financial risks for both corporations and individuals. In this context, the company has argued that the use of transparent data supply chain (a set of analytical technologies and timely, accurate and reliable data sources that combine a global corporate network of private equity entities) can help improve the speed and accuracy of final beneficiary identification accordingly reduce the reputational risk of individual companies (2017) [7]. Continuing this idea, the purpose of the Guide to Beneficial Ownership Information: Legal Entities and Legal Arrangements is to assist country-specific investigators in gathering information that is accessible to natural persons who control legal entities or otherwise play an important role in managing a legal entity. The guide also outlines the conditions that must be met in order to have access to such information (2017) [8]. Work prepared by the Inter-American Development Bank and the Organization for Economic Cooperation and Development also highlights the role of transparency of property information in preventing tax evasion, corruption and other related activities. This paper provides tools that can be used by countries around the world to implement regulatory and regulatory frameworks to identify and collect beneficial ownership information, which is now required by international standards (2019) [9].

3. Results and discussion

The question of determining the share of beneficial ownership in complex ownership chains remains unresolved. Based on studies of economic chains of ownership (beneficiary chains), a methodology for determining property rights, values and value-added produced based on innovation or intangible assets operating in the economic system is laid down. The analytical methodology determines the identification and economic and mathematical calculation of the shares of the property having a common beneficiary.

An exemption from taxation or a change in the tax rate on the basis of international treaties shall be made directly upon payment of income to a non-resident only provided that such non-resident is a beneficial (actual) recipient (owner) of income, such right is granted by n. 103.2 Tax Code of Ukraine. (2010) [10].

According to the requirements of the FATF (Financial Action Task Force on Money Laundering), in October 2014, the Parliament of Ukraine adopted the Law «On Prevention and Counteraction of Money Laundering, Terrorism Financing and Financing of Proliferation of Weapons of Mass Destruction» No. 1702-VII, which sets forth the conceptual norms and their definitions [11].

The final beneficial owner (controller) is an individual, regardless of formal ownership, which has the ability to exercise decisive influence on the management or economic activity of the legal entity directly or through other persons, carried out, in particular, through the exercise of the right to own or use all assets or a significant share thereof, the right of decisive influence on the formation of the composition, voting results, which provide an opportunity to determine the conditions of economic activity, to give mandatory instructions or perform the functions of a management, or which has the ability to influence through direct or indirect (through another individual or legal entity) ownership of one person alone or jointly with related individuals and / or legal entities with a share in the legal entity in the amount of 25 percent or more of the authorized capital or voting rights in the legal entity (2014) [12]. The Law also discloses the concept of «beneficiary, as a person in whose benefit or in whose interests a financial transaction is conducted» (2014) and singles out that the verification of an impeccable business reputation of persons who are to carry out or carry out management, intend to acquire significant participation (or are the ultimate person with a benefit) from the subjects of primary financial monitoring. That is, they separate the ultimate beneficial owner (controller) and the beneficiary. Formal character of 25 and more percent of the share capital or voting rights in a legal entity does not give grounds to consider it the ultimate beneficial owner (controller). Such entity is considered to be an agent or nominee holder (nominee owner) or is only an intermediary in the chain of corporate rights ownership. For example, the early Model Convention of the Organization for Economic Cooperation and Development (1977) and the United Nations Model Double Taxation Convention between Developed and Developing Countries stated that a legal person transferring all

its income to another person was an agent and therefore not considered a beneficiary. Since 2012, the "all" rules had been revised and, accordingly, if the entity covered its own debt, it might not pass the beneficial owner test.

With the implementation of the BEPS Action Plan in Ukraine, it is difficult to understand the identification of the subject as the ultimate beneficial owner. Thus, the following distribution of interpretation of the concept has been introduced:

- for legal entities - any natural person exercising ultimate decisive influence (control) over a legal entity (including through a chain of control / ownership);

- for trusts - the founder, trustee, protector (if any), beneficiary or class of persons in whose primary interest the trusts are created or operates, or any other natural person exercising ultimate decisive control (influence) over the trust (including through the control / ownership chain);

- for other legal forms similar to trusts - a person with a status equivalent or similar to that of a trust.

Since 2017, Ukraine has joined Transparency International's initiative on enterprise data transparency and anti-corruption by opening a database of final beneficiaries in the corporate rights chain. The beneficial ownership data standard (BODS - BO Data Services) is developed in cooperation with dozens of international experts in technical standards development. This will ensure transparency and interoperability among beneficiaries, intensification and ease of doing business. However, there is a certain legal conflict in the Law of Ukraine «On Amendments to Certain Legislative Acts of Ukraine Concerning the Determination of Final Beneficiary of Legal Entities and Public Persons» (2015) [13], on the obligation to disclose information about the beneficiary in whose favor the transactions are conducted, not the beneficial owners. This creates a certain discussion field.

For the first time in Ukraine, in December 2018, the State Service for Financial Monitoring remembered in official documents the chain of control / ownership of corporate rights to the ultimate beneficial owner and beneficiary. However, no clear distinguishing features of the chain are mentioned. It is considered in the context of identifying the ultimate beneficial owner (controller).

Already in 2002 of the Decree of the National Bank of Ukraine No. 297 [14] defines the chain of possession of corporate rights of a legal entity, which means information on the composition of key participants of the legal entity, including information on key participants of the first and each subsequent level of possession of corporate rights of a legal entity (2002). Later on of the Law of Ukraine «On Banks and Banking» (2015) [15] was amended with the respective definition. In the context of the problems of determination of the beneficial owner and calculation of his share of corporate rights in the Letter of the SFS of Ukraine No. 2744/6 / 99-99-15-02-02-15 / PKI when providing clarification of the procedure for determination / calculation of the share of corporate rights possession the concept of "possession of corporate rights in a chain" is applied, but without providing its interpretation (2017) [16]. In the opinion of the authors of this article, this definition reveals the power structure, but does not provide characteristics, if possible, and the key purpose of managing this structure, for example, to pass a beneficiary test in a chain. In the national scientific and theoretical opinion and practice in the corporate rights chain, the beneficial owner is identified according to the information about the individual (surname, name and patronymic, affiliation, metrics).

The Dun & Bradstreet Inc. Manual «Subtleties of Ownership and Control: Understanding the Beneficiary Property Structure» from 2017 describes the beneficial ownership structure as a series of direct or indirect relationships that are combined in a loop. As a result, companies create loops in which they hold both funds of other companies from that loop and private equity funds. As a result, we have a complex structure in which, given the complexity of the information available, the identification of the final beneficiary becomes much more complex.

But in order to apply the international treaties on avoidance of double taxation there is a need to implement the procedure of complex assessment of beneficiary authorities in the chain, for the sake of which a complex of information on all participants of the beneficiary structure should be collected and processed. The very existence of a complex information flow on the beneficial ownership structure

and its management in order to determine the actual beneficial owner of the income is a key feature of the beneficial ownership chain from the corporate rights chain.

With that in mind, it should be noted that the ownership of corporate rights belongs not only to the beneficiary, but also to the chain agents. Therefore, in our opinion, for the purpose of identifying the beneficial owner, we should separate the concept of «chain of beneficial ownership», which until now has not been used at all and differs from the chain of corporate rights ownership in its evaluation and targeting of the beneficiary. We believe that targeting of the beneficiary is aimed at identifying the ultimate beneficiary in the ownership chain structure and allows minimizing tax risks in the area of avoidance of double taxation.

So, due to the lack of scientific and practical literature in the regulatory and wire field, we propose to define the concept of «beneficial ownership chain» as a linearly ordered set of participants in the structure of corporate rights ownership, information on the order of internal links between which allows you to determine the level of beneficial (direct and indirect) ownership and / or control of each member of this structure and to carry out targeting of the final beneficiaries.

The overall ownership structure of corporate rights and the share of beneficial ownership consists of documented documents on the relationship between legal entities and individuals, disclosing information on the established control relationship in the sphere of avoidance of double taxation and the existing ultimate beneficial owners (controllers) or brings their absence.

In order to effectively pass the beneficial owner test and bring the economic essence of relationships in the chain of corporate rights ownership, it is advisable for the taxpayer to protect himself by preparing documents that prove the reality of financial transactions:

- when concluding contracts for the use of intellectual property rights, indicate that it is not a commission, assignment or agency contract;
- to indicate in the Articles of Association that the company that receives dividends is the owner of corporate rights;
- not to specify in contracts with a non-resident company, there is an intermediary relationship;
- evidence of the fact that the company exists not only to "pump" money offshore, but also to add value to the market by covering other settlement agreements with the subsidiary company and the company you want to represent as a beneficiary;
- the agreements between the companies must be timed, i.e. it must not be allowed to take money and transfer it further along the chain in one day.

With the aim of applying international treaties on avoidance of double taxation, the taxpayer should keep in mind the independence of the choice of the list of documents to inform the tax authorities about the status of a non-resident as a beneficial owner, since the taxpayer is interested in the absence of additional tax payments at any accrual of income in favor of a non-resident.

4. Experimental

Based on the results of the beneficial ownership chain it was determined that the resident company «N» is not a beneficiary of non-resident company «A». However, for the purposes of corporate rights management in the chain of beneficial ownership it is necessary to determine at what stage the company-resident «N» loses the status of beneficiary. To this end, it is appropriate to cite a methodology for assessing beneficial ownership at each stage of its acquisition.

Fig. 1. shows an example of beneficial ownership chain formation, according to which we will define the index of beneficial ownership shares on a conditional example.

Given that a company creates value for shareholders when it makes a profit, it is the most effective indicator for any chain (beneficial ownership or value chain) Voynarenko M. et al. (2019) [17]. In other works the criteria of the maximum intensity of profit from transport problems in contrast to the known criteria of the minimum expenses or the minimum time for transportation on the basis of which the

algorithm of the decision of a transport problem is resulted are defined (2019) [18]. A continuation of research became to identify latent manifestations of the emergent characteristics of the economic system, a methodology for identifying the level of emancipation has been presented and indicators have been developed to enable the identification of these properties at an early stage in industrial operations (2020) [19].

The Beneficial Ownership Index (Ib) characterises the level of beneficial ownership (direct and indirect) in the beneficial ownership chain structure.

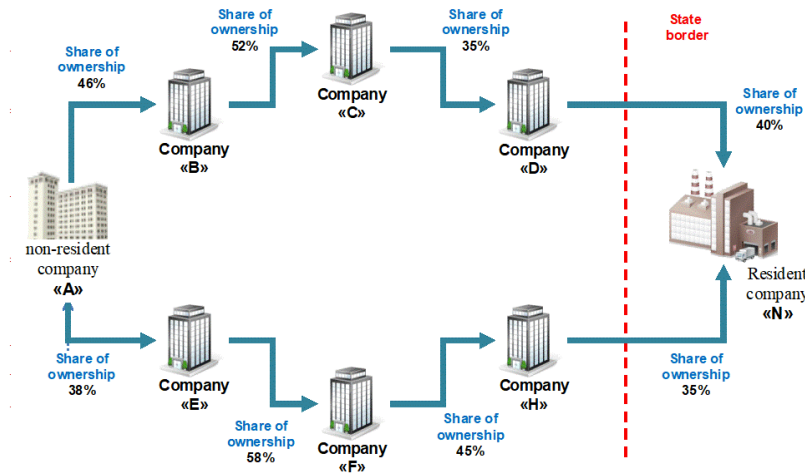


Fig.1. The beneficial ownership chain of the non-resident company «A» in the resident company «N».

The index is calculated as an algebraic sum of shares of corporate rights of a beneficiary of the entire number of links in the chain of corporate rights ownership, by the formula:

$$Ib = \left(\sum_{i=1}^n Cp_1 \cdot 100 \right) + \left(\sum_{i=1}^n Cp_2 \cdot 100 \right) + \dots + \left(\sum_{i=1}^n Cp_n \cdot 100 \right) \quad (1)$$

where Ib - beneficial owner index,%; Cp is the ratio of the share of rights.

$$Cp = \frac{\text{corporate_ownership}}{100} \quad (2)$$

For example, $Ib = (0,46 \cdot 0,52 \cdot 0,35 \cdot 0,4) \cdot 100\% + (0,38 \cdot 0,58 \cdot 0,45 \cdot 0,35) \cdot 100\% = 6,82\%(A \rightarrow N)$

According to the results of the matrix of subindexes of beneficial ownership for the purpose of targeting the final beneficiary it was determined that the beneficiary status of the resident company «N» in the non-resident company «A» lost at the III stage of corporate rights.

Other examples of companies and ownership shares:

$$2) Ib = (0,46 \cdot 0,36 \cdot 0,27 \cdot 0,3) \cdot 100\% + (0,65 \cdot 0,74 \cdot 0,35 \cdot 0,2) \cdot 100\% = 4,67\%(B \rightarrow M)$$

$$3) Ib = (0,75 \cdot 0,84 \cdot 0,65 \cdot 0,67) \cdot 100\% + (0,87 \cdot 0,74 \cdot 0,47 \cdot 0,65) \cdot 100\% = 47,09\%(C \rightarrow H)$$

$$4) Ib = (0,60 \cdot 0,72 \cdot 0,56 \cdot 0,54) \cdot 100\% + (0,86 \cdot 0,62 \cdot 0,34 \cdot 0,22) \cdot 100\% = 16,98\%(D \rightarrow K)$$

The results of the third equation showed that Company C is the beneficial owner of Company H, as corporate rights are lost and Company C owns Company H with more than 25% ownership

Table 1. Matrix subindexes of beneficial ownership non-resident company «A» in resident company «N»

Ownership chain			I stage of ownership	II stage of ownership	III stage of ownership	IV stage of ownership
		A	B	C	D	N
	A	The median share of ownership	46%	$0,46 \cdot 0,52 \cdot 100\% = 23,92\%$	$0,46 \cdot 0,52 \cdot 0,35 \cdot 100\% = 8,372\%$	$0,46 \cdot 0,52 \cdot 0,35 \cdot 0,4 \cdot 100\% = 3,348\%$
I stage of ownership	E	38%	84%			
II stage of ownership	F	$0,38 \cdot 0,58 \cdot 100\% = 22,04\%$		$23,92\% + 22,04\% = 45,96\%$		
III stage of ownership	I	$0,38 \cdot 0,58 \cdot 0,45 \cdot 100\% = 9,918\%$			$8,372\% + 9,918\% = 18,29\%$	
IV stage of ownership	N	$0,38 \cdot 0,58 \cdot 0,45 \cdot 0,35 \cdot 100\% = 3,4713\%$				$3,3488\% + 3,4713\% = 6,82\%$

5. Conclusions

The median ownership share allows for clear vertical control in the corporate rights management system at each stage of the beneficitation chain implementation.

Calculation Ib illustrates the expediency of erecting all links of corporate rights ownership in a single whole for qualitative and fast targeting of the beneficiary in order to minimize tax risks in the sphere of avoiding double taxation. This will contribute to the establishment of a favorable tax climate in the business environment, increase the transparency of business and the reliability of financial flows to regulators and, consequently, reduce the level of controlling pressure from them, generally increase the company's position in world ratings.

For the aims of economic and mathematical modeling, authors developed a methodology for assessing the beneficiary index in chain of beneficial ownership will be the basis for forecasting and adaptation of international business to the transformation tax changes.

Using the developed methodology, any member of the chain of ownership or other person is able not only to verify the final beneficiary, but also to calculate possible changes in the structure of the beneficial ownership and the related financial implications from for actions of various factors, such as changes in tax laws, changes in the ownership structure of corporate right or included / excluded / substitution of a member of the chain of ownership. This will increase the financial and tax security of a company or group of companies and help to protect the interests of stakeholders.

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