

Defining the Secrecy World

Rethinking the language of 'offshore'

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Purpose of this paper

The Mapping the Faultlines project is based on the assumption that the mechanisms that allow illicit financial flows to occur result from the synergistic relationship between the world's tax havens and offshore financial centres. At the time the project was proposed these were defined as follows:

1. Tax havens are the legislative, judicial, fiscal and regulatory spaces provided by jurisdictions that encourage the relocation of economic transactions to that domain;
2. An offshore finance centre (OFC) is the commercial response to the provision of those legislative, judicial, fiscal and regulatory spaces by those seeking to profit from the opportunities they provide.

The project also set out to identify the characteristics that identify a location as having tax haven status.

It soon became apparent that this would be difficult using prevailing language to describe the offshore sector since there was little agreement on what that language actually meant.

We therefore decided to reappraise the language of offshore and offer more accurate, and precisely defined terms for use in the Mapping the Faultlines project.

This paper has been developed through a process of discussion between expert practitioners, and its core arguments were tested at a number of academic conferences in 2008. To our immense satisfaction, some of the terms we propose, for example, 'secrecy jurisdiction' in place of 'tax haven', have been widely used at conferences and in the media in 2009. It is safe to conclude that in this respect the Mapping the Faultlines project has already had an impact on discourse about the offshore / secrecy¹ world.

This paper is in three parts. First it explores the way in which the offshore world works. Second, it suggests a new language to describe the 'offshore world'. Third it explores the policy implications that result from that revised language.

¹ When a phrase is written in this form the first term is that which has been used to date, the second that which this paper proposes replaces it.

Summary

This paper sets out to show four things.

The first is that the existing language of the so-called 'offshore world' is inappropriate for the purposes of rigorous analysis of the issues to which that term has been applied. The paper offers a new language for this purpose. In that terminology the term offshore is replaced by the term 'secrecy world'.

Second, it suggests that the assumption that the secrecy world is geographically located is not correct. It is instead a space that has no specific location. This space is created by tax haven legislation that which assumes that the entities registered in such places are 'elsewhere' for operational purposes, i.e. they do not trade within the domain of the tax haven, and no information is sought about where trade actually occurs.

Thirdly, this paper shows that the illicit financial flows that are the cause of concern with the secrecy world do not flow through locations as such, but do instead flow through the secrecy space that secrecy jurisdictions create (secrecy jurisdictions being the new term tax havens). As the paper shows, to locate these transactions in a place is not only impossible in many cases, it is also futile: they are not intended to be and cannot be located in that way. They float over and around the locations which are used to facilitate their existence as if in an unregulated ether. This suggests that any attempt to measure or regulate them solely on a national basis will always be problematic.

Finally, this paper suggests that the change in language that it promotes is consistent with existing understanding of the observed phenomena and adds new dimensions to the lexicon of offshore / the secrecy world. We hope that this new language will allow regulators to extend the scope of their work whilst also reducing the scope for sophistic and casuistic arguments put forward by those who exploit the secrecy world for personal gain.

Introduction – the language of offshore

The problem of defining what a tax haven is was noted in the first significant report on the subject: *"There is no single, clear, objective test which permits the identification of a country as a tax haven"*. (The Gordon report to the American Treasury, 1981)

In his book 'The Offshore Interface' Dr Mark Hampton commented: *"It is difficult to draw a clear analytical distinction between a tax haven and an OFC"* (1996, 15).

Twenty five years after Gordon, Jason Sharman reached similar conclusions: *"The term "tax haven" lacks a clear definition, and its application is often controversial and contested"* (2006, 21).

The UK's Financial Services Authority noted in 2008 that *"There is no internationally agreed definition of what constitutes an offshore financial centre (OFC), but there are common*

perceptions. Generally, there is a tendency to adopt the approach of "you know one when you see one"." (Treasury Committee, 2008a, 3)

Professional firms have the same difficulty: *"If one had to choose a single criterion, we might define an offshore centre as one that is part of a jurisdiction that has few or no Double Tax Agreements ('DTA') with other countries. ... However, this is an oversimplification."* (Deloitte in Treasury Committee, 2008a, 379)

So too do international regulators: *"It has proven difficult to define an OFC using a widely-accepted description. A range of criteria have been used, including (i) orientation of business primarily toward non-residents; (ii) favorable regulatory environment; (iii) low or zero tax rate; and (iv) offshore banking as an entrepôt business."* (IMF, 2008, 17)

Jurisdictions that have been labelled as tax havens are acutely sensitive to the importance of language: Chief Minister Lyndon Trott of Guernsey, referring to the IMF's decision to change its OFC regulation programme in July 2008 said *"On a scale of one to 10, this is a 10. The IMF is probably the most respected financial agency in the world. The key message is that the IMF has acknowledged that it is wrong to distinguish between jurisdictions because they are either onshore or offshore. The distinction should always be that some are well regulated and others are not so well regulated."* (Guernsey Evening Press, 2008)

Marketing consultants have the same acute antennae: *"The Isle of Man has been urged to rebrand itself as an 'independent financial centre' rather than an offshore centre, as tax havens look to clean up their act. William F. Baity, deputy director of US anti-money laundering agency FinCen, the Financial Crimes Enforcement Network, suggested the territory move away from the label 'offshore', which has negative connotations, to 'independent financial centre'. 'Perception is reality and you will struggle as long as people talk about offshore,' Bailey said."* (Accountancy Age, 2008)

It was, therefore unsurprising that when Rt. Hon John McFall MP asked a panel of expert accountants appearing before the UK Parliament's Treasury Select Committee in July 2008 to differentiate between a tax haven and an offshore financial centre he was told: *"A tax haven only distinguishes itself from an offshore financial centre if it encourages tax evasion. That would be a rough definition - which none of them would accept."* (Treasury Select Committee, 2008b)

This rapid review of the language of the offshore world makes three things clear. The first is that no one agrees what the language of the offshore world is or means. Second, despite this disagreement the use of that language is incredibly important to those who do operate offshore. Third, those engaged in the debate about the secrecy world consider that the language employed has serious implication for the future of financial regulation. This paper builds on all three perceptions.

Language as a contributor to regulatory failure

There are four main concerns about the secrecy world. The two that are most commonly addressed are money laundering of the proceeds of drugs trafficking and the financing of terrorism. These are the primary concerns of the IMF and the Financial Action Task Force, for example.

The third area of concern relates to financial stability, but until the recent credit crunch this attracted very little attention, with the Financial Stability Forum being seen as a relatively minor player in offshore regulation.

The fourth area of concern is tax evasion. This is the primary concern of the OECD, the European Union, and the UN Committee of Experts on International Cooperation on Tax Matters (henceforth referred to as the UN Tax Committee).

The language of the offshore world has been obfuscated by the differing agendas of the various regulatory agencies engaged in tackling drugs money-laundering, financial instability, tax evasion and tax avoidance. As Palan, Murphy and Chavagneux (2009) have shown, their use of language has been shaped by their priorities and their need to secure political support for achieving their objectives. So, for example, agencies focused on tackling money laundering avoid the term tax havens, preferring to encourage compliance by using the term offshore financial centres. Those who focus on tax issues do the reverse; they call the locations about which they have concern tax havens. This alienates the locations so labelled but appeals to the nation states that sponsor the work of those describing them as such. This is, however, ultimately counter-productive: the places so labelled have exploited the uncertainty and ambiguity in the resulting language for their own political advantage.

The outcome of this confusion over language is harmful at almost every level. The lack of clarity around the term 'offshore' is compounded and no one seems to know what a tax haven is as a consequence. If anything what is meant by the terms offshore financial centre (OFC) and international or independent financial centres (IFC) are even more uncertain.

This is important. Since the Gordon Report first drew attention to the problems that tax havens cause awareness of the issue has increased enormously, the offshore market has grown substantially but almost all attempts to regulate the activity have failed. If they had not the issue need not have been on the agenda at the G20 in 2009. This paper argues that the imprecision of the language used has been a significant contributor to that failure.

Secrecy jurisdictions

Any new language for use in analysing the 'secrecy world' (whatever that might be) has to be based upon an understanding of what actually happens there.

At the core of the 'secrecy world' are jurisdictions. They are not necessarily countries or states, although some are. For example, Malta and Cyprus are states in their own right. Some are dependencies of nation states, Guernsey and the Isle of Man, for example, whilst

others like Cayman and the British Virgin Islands are protectorates. Others are sub-national states, such as Delaware in the USA. The status of others is even more esoteric; the principalities of Lichtenstein and Monaco coming to mind. The difference in status does not matter; what characterises these places is their ability to create law that can have impact outside their own territories. This may require the tacit or implied consent of other parties; for example that of the federal state of which they are a part, or their protector state, or even of the political alliance of which they are a member (the EU in the case of Cyprus and Malta), but the issue remains the same; it is those jurisdictions that choose to create legislation or regulation with the intent that it be used and have impact beyond their own geographical domain that are of concern here. That is why any description of these locations has to include the word 'jurisdiction'.

Being a jurisdiction does not, however, categorise a location as being a part of the secrecy world. The majority of the world's jurisdictions play no part in this activity. There have, therefore, to be identifiable characteristics that differentiate those that are in the secrecy world from those that are not. This paper proposes two such characteristics.

Firstly, secrecy jurisdictions create regulation that they know is primarily of benefit and use to those not resident in their geographical domain.

Second, secrecy jurisdictions create a deliberate, and legally backed, veil of secrecy that ensures that those from outside that jurisdiction making use of its regulation cannot be identified to be doing so.

These characteristics in combination define a secrecy jurisdiction.

Importantly, tax is not mentioned in reaching this definition. There is no doubt that zero or low taxation is one of the attractions of secrecy jurisdictions. Without this attraction, lax regulation would lose much of its appeal to potential users, but in that sense low taxation is simply a marketing mechanism for secrecy jurisdictions. It is one of the numerous services they provide that are open to abuse by those resident elsewhere. To highlight the issue of tax, as implied by the term tax haven, is to distract attention from the core problem. That term may have popular appeal, but it has little practical application.

Another important point is that both of the identified characteristics must exist in tandem. Creating regulation for the benefit of people living elsewhere would be a fruitless exercise if the people using it cannot avoid their obligations in the place where they really reside. Secrecy is the guarantor of their ability to do that.

At a practical level no one would choose to use the regulation created by a secrecy jurisdiction, or take that risk that this might be discovered, if that regulation were more onerous than that in the place in which they normally reside. Almost inevitably this means that the regulation created by secrecy jurisdictions for the benefit of those resident elsewhere will be less onerous than that found in the economies from which they seek custom and that this regulation will, inevitably, as a result undermine the effectiveness of regulation in those places. A race to the regulatory bottom is inherent in the business model

of these places. This is again, however, not a defining characteristic of a secrecy jurisdiction but is instead the practical marketing necessity if it is to raise revenue from the regulation that it creates. The inevitable consequence is, however, pernicious. This explains why so many nations and regulatory agencies want to eliminate the abuse that secrecy jurisdictions promote.

Regulatory abuse

The range of regulations that might be created by secrecy jurisdictions for use by those not normally resident in their domain is wide. Such regulations might include:

1. Corporate laws, including those on incorporation, company residence, the types of share in issue, the use of nominees, the filing of accounts and other information on public record and the maintenance of records themselves;
2. Trust law, including those on the registration and taxation of trusts, the use of nominees, the right of settlors to declare trusts for their own benefit, the filing of information and accounts with regulatory authorities and the need to maintain records;
3. Taxation law of all sorts;
4. Banking laws, including the right to maintain bank secrecy for taxation, civil law and criminal law purposes;
5. Regulation with regard to competition law, labour issues, shipping, environmental matters, health and safety and other issue which might either through their absence, level of obligation or compliance obligations produce a lesser burden than those commonplace in other jurisdictions;
6. Information exchange agreements relating to civil, criminal and taxation law issues;
7. Legal cooperation regulation, including the willingness of the jurisdiction to enforce obligations arising in other jurisdictions through its legal system;
8. Human rights laws and related issues, such as obligations with regard to corruption;
9. Accounting and other information disclosure requirements of a non-statutory nature.

In combination these regulations cover a large range of business activity and it is this, when combined with secrecy that provides enormous scope for abuse.

It is stressed though that secrecy by itself is not a problem. In a world consisting of one state, the right to secrecy would not be an issue if the state chose not to know about the activity of its citizens. Secrecy is a problem when the regulation of one state is used to deny information to another state which considers it has the legal right to know it.

It should also be noted that the undertaking of transactions outside a location is not a problem: the cross-border trade is dependent upon such events occurring. It is hiding the fact that a transaction has taken place in one location by use of regulation and secrecy created in another location so that the full regulatory consequences of the transaction do not arise in the place where it was really located that gives rise to a problem. In that case the avoidance of obligation has occurred.

It is the combination of lax regulation and non-disclosure of its use that defines the problem created by secrecy jurisdictions. Yet this is precisely the problem that regulators have so far failed to address.

Offshore and secrecy jurisdictions

Defining a secrecy jurisdiction and the problems it creates is one thing. Linking secrecy jurisdictions to the concept of offshore necessitates a further step in understanding. That step requires appreciation of the fact that wherever 'offshore' is it is not in the secrecy jurisdiction.

The secrecy jurisdiction is a place. That means it is physically identifiable and it is, in consequence, constrained by geographic borders that limit its apparent domain. However, as the definition used here makes clear, secrecy jurisdictions seek to extend their sphere of influence beyond their own borders. Those places beyond its borders are where offshore is.

This has real implication within the secrecy jurisdiction. It is highly unlikely that there will be any secrecy at all within the secrecy jurisdiction. Most secrecy jurisdictions have very low tolerance for domestic non-compliance with their own regulation. After all, they have a society to run and tax to collect, and doing so in an efficient, organised and even transparent manner may well be vital to the political survival of those who run the secrecy jurisdiction. So, and for example, local companies will usually be required to report their income to domestic tax authorities, as will individuals and trusts, whilst safety and environmental laws will hopefully be in force and labour regulations may apply. This is, in fact a definition of what should be called 'onshore' because in an onshore environment the location in which the transaction takes place and the location in which it is regulated coincide. In addition there is (or at least there is expected to be) full transparency with regard to onshore transactions.

In that case we are faced with a dichotomy: the secrecy jurisdiction is apparently both onshore and offshore simultaneously. To understand what constitutes offshore therefore requires appreciation of the fact that the secrecy jurisdictions that facilitate offshore activity are not the places where one should look to find it. This is, of course, the logical consequence of the definition of a secrecy jurisdiction used in this paper. The regulation that it creates for the benefit of those not resident within it, and the veil of secrecy that it draws over their doing so, disguises the fact that except in minor part the activities so enabled do

not have anything to do with the secrecy jurisdiction itself. The impact of those transactions is not within the secrecy jurisdiction itself, because if they were they would be onshore, which for these purposes we might call 'here'; they are instead offshore, which for these purposes we might more usefully call 'elsewhere'.

'Here' and 'elsewhere'

Secrecy jurisdictions enable the creation of two distinct places, 'here' and 'elsewhere'. The former is a regulated, onshore, domestic space. The latter is the offshore space that is 'elsewhere'. Elsewhere is deemed by the secrecy jurisdiction to be somewhere distinctly different and outside its own domain.

This is exemplified by the way in which regulators in secrecy jurisdictions draw a distinct, although physically entirely unidentifiable and non-locatable, line between the two areas in which their regulation has impact. In the jargon of the offshore world that divide is a 'ring fence'. Onshore is one side of that fence, and can be located within the physical domain of the jurisdiction. Offshore is those places elsewhere where its regulation has impact, but as is noted below, this does not necessarily mean that the resulting transactions can be physically located anywhere.

Secrecy spaces

This gives rise to the next development in the language of this phenomenon. The term 'offshore' is problematic as the introductory quotes show. It gives rise to substantial confusion: indeed I have witnessed small island administrators from locations that are without doubt secrecy jurisdictions laugh at the idea that Switzerland might be 'offshore'. Liechtenstein, as one of only two double land locked states in the world certainly pushes these people's idea of offshore to the limit. In that case, and given the change in approach that the IMF is adopting, just as it seems timely to displace the term 'tax haven' with the term 'secrecy jurisdiction' so it seems appropriate to replace the term 'offshore' with the term 'secrecy space'.

Secrecy space is created by secrecy jurisdictions, either acting singly or in combination. It is not, however, in those jurisdictions, at least for legal purposes. As such in many, if not most cases, the secrecy jurisdiction will argue it has no duty to regulate the transaction undertaken using the mechanisms it supplies to the secrecy space, its logic being that these transactions are undertaken 'elsewhere'. This has most notably been seen in the recent report of the United States Government Accountability Office on the Cayman Islands (2008, 1) in which it was stated that:

Cayman officials said they fully cooperate with the United States. Maples [and Calder] partners said that ultimate responsibility for compliance with U.S. tax laws lies with U.S. taxpayers.

Maples and Calder is the largest firm of lawyers in Cayman. As the same report also noted:

While U.S. officials said the Cayman government has been responsive to information requests, U.S. authorities must provide specific information on an investigation before the Cayman government can respond.

The Cayman secrecy jurisdiction does, of course, make it as hard as possible for the US authorities to secure the specific information required before cooperation can take place. In addition, Maples and Calder makes it clear that their concern extends solely to the Cayman, or onshore, aspects of what are, by definition, offshore transactions undertaken by the more than 18,000 companies registered in their offices. Almost all of these companies operate within the secrecy space that Cayman has created for them because it considers them to be 'elsewhere' for regulatory purposes.

It is also worth noting that this concept of 'elsewhere' is not restricted to taxation. Indeed, commentators such as Ronen Palan think the 'offshore' world began in October 1957 when the Bank of England ruled that bank transactions undertaken in London in currencies other than sterling between parties not resident in the UK might be recorded by London banks as having occurred for accounting purposes within the UK but they were not otherwise to be considered subject to UK banking and foreign exchange regulation. They were deemed to have occurred 'elsewhere' for these purposes even though they took place in London. (Palan, 2003)

A similar phenomenon can be found in UK company law case. In 1928 it was decided in the case of *The Egyptian Delta Land and Investment Co. Ltd. v. Todd* in the UK House of Lords (ATO) that a company was resident where its central management and control was, which was deemed to be determined by the place where the directors met. This meant a company incorporated in the UK could be resident and regulated somewhere else. The decision was profoundly important: it endorsed the legal concept that an entity might be located in more than one place. Put simply, the company might be incorporated in the UK and be subject to its company law but if not resident there its taxation affairs were to be regulated 'somewhere' else.

Somewhere, not elsewhere

A further distinction is necessary at this point. Those who sought to prove that *The Egyptian Delta Land and Investment Co. Ltd.*, noted above, was 'elsewhere' so that it did not have to suffer UK tax could only do so because they could demonstrate that the company was not only not in the UK, but was actually somewhere else.

This concept of 'somewhere' is important. It provides a clear indicator for assessment of conduct. If a company created in a secrecy jurisdiction operates outside that jurisdiction's domain but is known, despite that, to be operating somewhere else that is identifiable with its activities in that place being fully disclosed to its regulators (tax and otherwise) then it is properly regulated. The regulatory environment might be weakened by being located across more than one domain but regulation is none the less intact. This can be shown diagrammatically:

	'Here'	'Somewhere'
Country providing the transaction structure	Jurisdiction A	Jurisdiction A
Country providing regulation of the transaction	Jurisdiction A	Jurisdiction B
Transaction type	Onshore	Regulated somewhere else

It is stressed: this diagram describes regulated transactions. What is happening here is entirely legal. Jurisdictions A and B might, for example, fully cooperate to ensure that the transaction is properly accounted for. But, as a matter of fact, for Jurisdiction A to consider that the transaction is 'somewhere' it must know the identity of Jurisdiction B and that that location in question has assumed responsibility for the transaction. If it does not then the claim that the transaction is regulated somewhere else is wrong.

Elsewhere

Now the concept of 'elsewhere' as created by the secrecy jurisdiction has to be added into this diagram.

	'Here'	'Somewhere'	'Elsewhere'
Country providing the transaction structure	Jurisdiction A	Jurisdiction A	Jurisdiction A
Country providing regulation of the transaction	Jurisdiction A	Jurisdiction B	Unknown
Transaction type	Onshore	Regulated somewhere else	In the secrecy space

The secrecy space has now been created and the transaction that takes place within that space is now categorized. This concept of 'elsewhere' is critical: without understanding it the ideas and motivations of those working in the secrecy space cannot be appreciated. The importance of 'elsewhere' is that it is unknown. That though does not mean it is nowhere, that is something else altogether.

Nowhere

To be 'nowhere' is the ultimate goal of those who use secrecy jurisdictions. If added to the diagram it looks like this:

	'Here'	'Somewhere'	'Elsewhere'	'Nowhere'
Country providing the transaction structure	Jurisdiction A	Jurisdiction A	Jurisdiction A	Jurisdiction A
Country providing regulation of the transaction	Jurisdiction A	Jurisdiction B	Unknown	Nowhere
Transaction type	Onshore	Regulated somewhere else	In the secrecy space	Unregulated
Space name	The regulated space		The secrecy space	

'Nowhere' in this case means that the jurisdiction which supplies the regulatory structure for the transaction cannot be identified because there is none responsible for doing so.

In the diagram it is Jurisdiction A that should have obligation to identify where the transaction undertaken by an entity created under its law is regulated. But secrecy jurisdictions do not usually make enquiry of the use made of entities created under their law when they operate outside their domain. Few have any mechanism to make such enquiry. There are reasons for this: first, they do not ask because they know that enquiry causes offence, which is bad for their business. Secondly they know that it is frequently the case that no jurisdiction can be identified in which the transaction is located for regulatory purposes² and they do not wish to be made aware of this. Third, if they find that there is no obligation to report then they will have proven the transaction is nowhere, as defined here. Whilst this may legally true they will know that this creates unacceptable regulatory gaps. For fear of this creating suggestion that they might have responsibility for the transaction they would rather not know where it is in that case.

Being nowhere does not happen by chance. It happens through the interaction of secrecy spaces provided by secrecy jurisdictions. An example might be where a person resident but

² Examples of this phenomenon are to be found in the report of the US Senate Permanent Subcommittee on Investigations Hearing: Tax Haven Abuses: The Enablers, The Tools & Secrecy, 2006.

not domiciled in the UK creates a trust in a secrecy jurisdiction such as the British Virgin Islands that in turn owns a company incorporated in Jersey that has a bank account in the Isle of Man and nominee directors in Cayman. The income of that company and trust are retained within the company. This sort of structure is costly, but that is a price of being 'nowhere'. This structure might achieve the aim of being unregulated almost everywhere.

This is possible because the individual creating this trust is allowed to do so without breaching UK law subject to meeting the non-domicile requirements of that country. If they can do so then they are not taxable in the UK on their income arising outside the UK even though they are resident in the UK. Nor do they have to make any declaration of that income or their association with the trust to the UK authorities, a right reconfirmed in 2008³. If they are not resident anywhere else then this means the regulation of this trust does, with regard to the settlor, happen nowhere, as defined above.

Trusts in most secrecy jurisdictions do not have to be registered with any authority. The trustees do not have to file tax returns if the settlor and beneficiaries are located outside that jurisdiction. There is no requirement to prove they are elsewhere. This is true of the BVI. The same is true of Jersey companies.

This then begs the question, if a bank account is in a different jurisdiction from the company that owns it who regulates it? Maybe the bank in the jurisdiction of location is responsible for money laundering, but there is certainly no tax oversight in that jurisdiction because the bank providing the account will know that at least notionally no tax liability will arise upon the company in its place of incorporation. It would seem that this is more than sufficient for most banks to stop any further enquiries on this issue. Having the directors in a location with no tax achieves the same result. Even if the rule established in the UK in 1928 noted above is followed and the company is taxable where its directors meet, there is no corporation tax in Cayman so in this case no regulation need apply.

As a result this combination creates a structure that is nowhere for tax purposes, and almost entirely so for all other purposes and yet apparently quite legitimately so.

Furthermore, none of those involved, be they the UK non-domiciled settlor of the trust, the trust or trustees, the company or its directors, would need to file a tax return in their official capacity anywhere by reason of this careful choice of structure. This is the ultimate aim of the offshore operator. This structure is nowhere. Achievement of this might not be possible in the physical world, but it is in this strange regulatory and secret space.

Transparency

³ For an explanation see <http://www.withersworldwide.com/news-publications/274/stop-press-budget-2008-residence-domicile-offshore-trusts.aspx> accessed 30-7-08

There is another dimension still to add to the diagram. Regulation is one issue, but what is required as a result of much regulation is transparency. Another line is needed to explain this. This is indicated as follows:

	'Here'	'Somewhere'	'Elsewhere'	'Nowhere'
Country providing the transaction structure	Jurisdiction A	Jurisdiction A	Jurisdiction A	Jurisdiction A
Country providing regulation of the transaction	Jurisdiction A	Jurisdiction B	Unknown	Nowhere
Transaction type	Onshore	Regulated somewhere else	In the secrecy space	Unregulated
Space name	The regulated space		The secrecy space	
Transparency status	Transparent	Visible	Opaque	Impervious

It is clear that there is a gradation in transparency as structures move from here, to somewhere and on through elsewhere to nowhere. It might cost more to be 'nowhere' but for the person seeking secrecy the result is an impervious structure that suits their purpose but thwarts regulators the world over.

The secrecy providers

There is then a further matter to be addressed. Structures of the sort described in the preceding paragraph do not come into place by chance. They are created by people seeking to exploit the secrecy spaces provided by the secrecy jurisdictions. The people pursuing this activity may be (and typically are) located in a secrecy jurisdiction.

These people are the secrecy providers. They are the lawyers, accountants, bankers, trust companies and others who provide the services needed to manage transactions in the secrecy space that secrecy jurisdictions enable.

These individuals and organisations, working together, might be called Offshore Financial Centres (OFC) except for the fact (as the opening quotations demonstrate) that the use and definition of that term has been problematic, and as such it has been discredited for most practical purposes. However, a need arises for a collective term for those organisations that commercially exploit the opportunities created by the legislation promulgated by the

secrecy jurisdictions. The term ‘secrecy provider’ is used here to describe those organisations.

Many of the organisations that are secrecy providers will also, of course, provide services within the regulated space. That does not negate the use of the term secrecy provider. Just as every secrecy jurisdiction will have a regulated space that is ‘onshore’ which does not prevent it also supplying structures deliberately designed for use in the secrecy space, so can a secrecy provider service both the regulated (onshore) and secrecy (offshore, unregulated) market places.

Consigning offshore to history

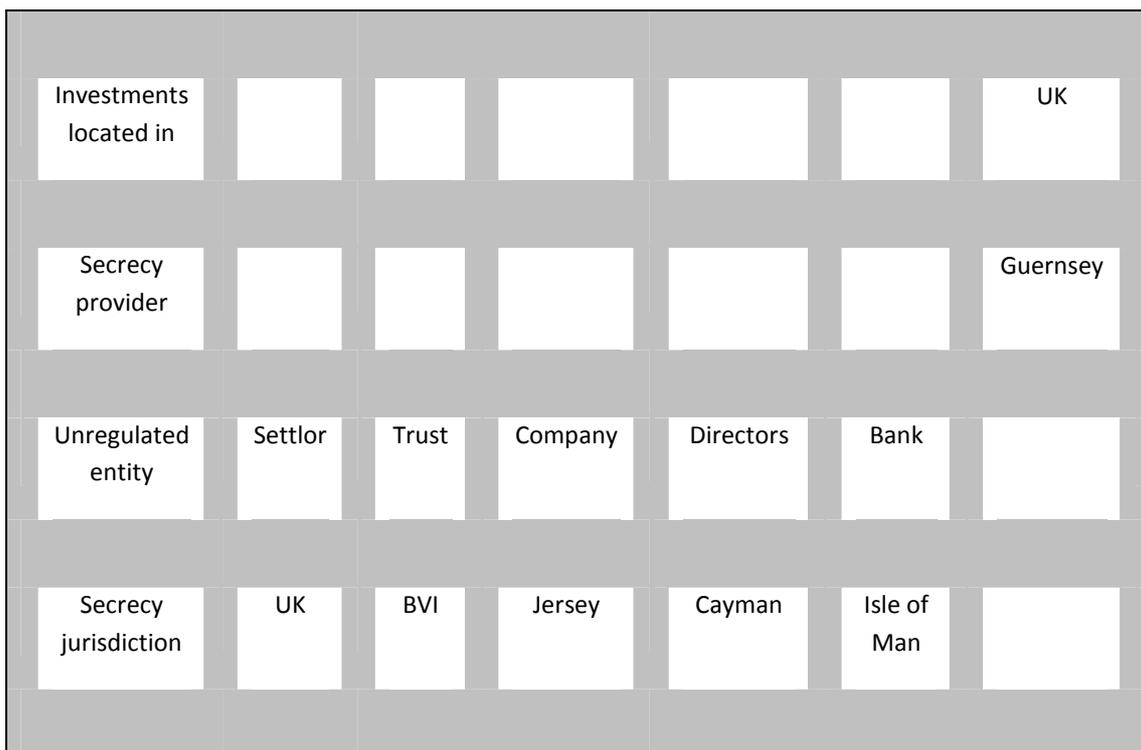
These last terms also suggest that the terms offshore and onshore should, like tax havens and OFCs be consigned to history. The onshore market is either regulated, whether that be locally (‘here’) or internationally (‘somewhere’). What has been considered the ‘offshore’ market is more accurately, and simply defined as the unregulated market, whether that be either secretly unregulated (‘elsewhere’) or knowingly unregulated (‘nowhere’), all of which terms have considerably greater value in use than those they replace.

If these terms, and the identities of the firms providing services to these markets, are built into the diagram we now have the following final form of the diagram developed in this section:

	‘Here’	‘Somewhere’	‘Elsewhere’	‘Nowhere’
Country providing the transaction structure	Jurisdiction A	Jurisdiction A	Jurisdiction A	Jurisdiction A
Country providing regulation of the transaction	Jurisdiction A	Jurisdiction B	Unknown	Nowhere
Transaction type	Locally Regulated	Internationally Regulated	Secretly Unregulated	Knowingly Unregulated
Space name	The regulated space		The secrecy space	
Market type	Regulated market		Unregulated market	
Transparency status	Transparent	Visible	Opaque	Impervious
Financial services providers	Local provider	International provider	Secrecy providers	

Applying this language to the secrecy world

It is stressed that when using these definitions there is no overlap between the terms secrecy jurisdiction, secrecy space and secrecy provider. They relate to different parts of the unregulated market. To see how this works a diagram of the intricate structure of trusts , companies and bank accounts described above is needed, with the additional assumption added that the funds are ultimately invested in the UK and the advice upon it has come from Guernsey:



What is stressed is that the important locations within this diagram are not the white spaces. That white space is the identifiable geographic location in which certain structures, people and commercial organisations can be located. It is even possible to locate the secrecy provider and the investment target for the whole structure within the white space, but the important part of the diagram is not the white space. The real issue about this structure is the grey area. That grey space is the secrecy space.

It is in the grey secrecy space that the entities located in specific geographical locations actually operate – because it is there that they are unregulated, whereas if they were actually in these locations they would be regulated by them.

Those entities may, of course, appear within the diagram to be located in the white space. This is the manner in which secrecy jurisdictions would wish them to be viewed. They do this because to the very limited extent that they do anything at all in each of these places they will be regulated. But the impact of and actual activity of the entities is deliberately

elsewhere, and this is the key concept that the grey space represents. The activity in that grey space is knowingly unregulated by the secrecy jurisdiction, a fact that current language enables them to ignore, and it is this vital distinction that this paper seeks to create, because it is in that grey space that the damage caused by secrecy jurisdictions occurs.

The secrecy space surrounds, but is not in any of the secrecy jurisdictions. The secrecy provider might work from within a secrecy jurisdiction but they too, by selling services into the secrecy space can also work (at least in part) outside the regulated place in which their activity resides, and it is common for secrecy jurisdictions to ensure that regulation exists to make sure that this can be achieved.

So it is in the grey secrecy space that the unregulated market exists, established by secrecy providers using unregulated entities registered in secrecy jurisdictions to move transactions from the regulated local or international sectors that are 'here' or 'somewhere' else that is identifiable into the secretly or knowingly unregulated spaces that are mythical locations 'elsewhere' or, maybe 'nowhere' at all.

It is this combination that some call the offshore world. But that is another misnomer. This is the secrecy world, the final term to be added to the list that already includes secrecy jurisdictions, secrecy spaces and secrecy providers.

Illicit financial flows

So what, one might ask? Why be concerned about this secrecy world? The answer is straightforward. It is in the secrecy world that illicit financial flows occur. The grey lines in the diagram are the conduits through which money passes for which people do not wish to be held to account. Those funds might be the proceeds of crime, payments associated with bribery and corruption, capital seeking flight from the territory in which it belongs and from which it has not secured legal departure, or they might be profits seeking to be located in a place other than that in which they really arose so that taxation liabilities might go unpaid in the place where they are rightfully due. These are the illicit fund flows of the world. Raymond Baker has estimated that these flows amount to between US\$1 trillion and US\$1.6 trillion a year, of which 60-65 per cent relate to commercial tax abuse (Baker, 2007).

The flow of these funds would be seriously impeded if the secrecy space did not exist. It is that fact that makes tackling the secrecy world an issue of such importance.

Facilitating opacity

Secrecy space is created by jurisdictions that promote legislation that facilitates transactions that they know will actually take place elsewhere, outside their regulatory domains, and about which they will make no enquiry. The ability to create regulation is not, however, the sole preserve of legislatures. Others have that opportunity and exercise it. In particular the accountancy profession has through the International Accounting Standards Board (IASB) acquired power to create regulation that has the force of law in approximately 100 countries

in the world, with more steadily coming within its sphere of influence. That regulation covers the form and content of accounting disclosure for many of the multinational companies of the world, including all in the European Union, and the United States now permits the use of this disclosure regime.

The organisations sponsoring the IASB have substantial overlap with many of the better known secrecy providers selling services into the secrecy space. The rules of international accounting include features that are extraordinarily beneficial to companies wishing to use the secrecy space to relocate the reported geographic location of earnings arising within multinational corporations. This is because all intra-group transactions are eliminated from view in the published consolidated accounts of multinational groups of companies. Many of the companies working in the secrecy space will be of this type. In addition those rules of disclosure do not require disclosure of the name or even the existence, let alone trading information of subsidiaries that parent companies do not consider significant to account users. And since intra-group trades are not considered of any interest for this purpose (because they are eliminated from view on consolidation) all entities used within the secrecy space for the purpose of profit reallocation will automatically fall out of view.

In combination this effective control of accountancy regulation by secrecy providers adds considerably to the opaqueness of the secrecy space.

Reconciling this view of the secrecy world with other opinion

This paper has suggested a new language for describing what has been previously been called the offshore world. There appear to be two criteria for determining the usefulness of this language. The first is that it fits with existing understanding of the nature of the phenomenon being observed. The second is that it has value in use.

Dealing with the first of these issues, it is evident from the quotations at the start of this paper that substantial differences of opinion arise concerning the meaning of many of the extant terms relating to offshore. So, and for example, the precise nature of a tax haven has been disputed, although mainly by the places to which the term has been applied. However, there is a general consensus that they are geographically identifiable locations that seek to attract business to their domain by offering light regulatory regimes, usually including low levels of taxation. This is a perception that easily fits with that of the secrecy jurisdiction as defined here.

The use of that secrecy jurisdiction as the provider of unregulated services within the secrecy space fits well with many of the definitions of offshore, and in particular that advanced by a Ronen Palan (2003) who identifies offshore as being the banking Euromarket, which exists entirely within the secrecy space and is very largely unregulated, sometimes deliberately knowingly so. The definition of an OFC use by Zoromé for the IMF (2007) also fits with that used here for a secrecy jurisdiction. He defines an OFC as:

a country or jurisdiction that provides financial services to non-residents on a scale that is incommensurate with the size and the financing of its domestic economy.

The overlap is obvious.

For some the term secrecy jurisdiction is already synonymous with that of tax haven. For example, Senator Carl Levin has used the terms interchangeably when promoting the Stop Tax Haven Abuse Act in the USA, and also describes the secrecy that these places sell as being their major product⁴.

The term secrecy jurisdiction has another powerful advantage for those, such as Sol Picciotto who have problem with the term tax haven, simply because this is too restrictive in that the regulation they produce for those not resident in their domain is of much wider range than that relating to taxation.

What then of the other terms? 'Secrecy world' is a direct replacement for 'offshore world' but removes the geographic ambiguity inherent within the latter. It has the advantage of describing the essential attribute that characterises the domain.

In the same way the term 'secrecy space' replaces 'offshore', which has proved problematic in use and has the advantage of more accurately describing the phenomena it defines which is not geographically located but which is precisely identifiable by its opacity.

Finally, the term secrecy provider describes firms which knowingly use the secrecy that their host jurisdictions provide to disguise the activities of their clients, and there is clear evidence that they do not seek to regulate the activity of those clients beyond the jurisdiction in which they are located. As such the description of those firms as secrecy providers within unregulated market appears accurate and removes the ambiguity within the term offshore financial centre which has caused considerable confusion, and some degree of inactivity with regard to regulation to date.

In this sense the terminology proposed by this paper is consistent with existing understanding and eases comprehension of that understanding by the lay user of these terms. That, however, is dependent upon their effectiveness in assisting the process of regulation which has motivated research in this area. There is insufficient space here to explore all the possibilities that this new language offers, so a couple must suffice.

The first example relates to confusion with regard to regulation. The following claim is typical of those made by those working within secrecy jurisdictions:

4 Statement of Senator Carl Levin on Introducing the Stop Tax Haven Act, Part I

<http://levin.senate.gov/newsroom/release.cfm?id=269514> accessed 30-7-08

*Jersey is well known ... as a Crown Dependency with a well regulated Finance Industry on which the local economy is dependent for its economic wellbeing.*⁵

At one level this is true. Jersey regulates as much as is currently required by international regulators but that regulatory requirement does not at present extend to the secrecy space which its laws create. So, activities happening within the domain of Jersey regulators may be well regulated, but for all practical purposes a company registered within its domain does not have to disclose any information that might be of use to an enquirer, nominees being allowed to perform all functions required to be disclosed on public record. A Jersey company that does not trade within the island does not have to submit either accounts or tax returns to any Jersey authority. Trusts created within its domain do not have to be registered with any authority and do not have to submit either accounts or tax returns to the Jersey authorities. Whilst the local banks do, according to the regulations of the Jersey Financial Services Commission have to report suspicion of tax evasion undertaken outside the island there were no such suspicious activity reports submitted to the Jersey police in 2006⁶ and when in 2007 the UK offered a tax amnesty to the customers of just five UK banks that maintained branches in that island tens of thousands of customers voluntarily declared sums upon which evasion had taken place but about which, apparently, no local bank had considered there to be any cause for concern (Times, 2007).

All this is clear evidence that the claim that Jersey makes to be well regulated is true, but only to the extent that regulation relates to activity undertaken within its geographic domain. When the whole basis of its financial services industry is to provide services to people outside its domain, many of whom rely on the secrecy it provides to hide that fact from their jurisdiction of residence, then this concept of regulation can be seen to be of decidedly limited extent and value.

The definitions proposed in this paper would allow this to be highlighted because the difference between the regulated and secrecy spaces is identified by the language used. No existing language does that and in consequence secrecy jurisdictions have, as Senator Walker does above, claimed to be well regulated whilst knowing that the vast majority of the transactions they facilitate remain entirely beyond the scope of their regulatory regime.

Secondly, there is the issue of the problem with the 'onshore / offshore' distinction. As another submission to the UK Treasury Select Committee hearing on OFCs notes:

Generally, the view is taken that the Treasury Committee's inquiry into offshore finance centres must not be seen as centering on the longstanding debate between

⁵ Paragraph 1 of a statement submitted by Senator Frank Walker, Chief Minister of Jersey in Treasury Committee 2008a, 393

⁶ See <http://www.taxresearch.org.uk/Blog/2007/03/02/jersey-officially-a-money-laundering-free-zone/> accessed 30-7-08 based on The Jersey Police Report, 2006

*onshore and offshore jurisdictions. Rather, it should be focused on the pertinent issue of the standard of regulation and supervision of financial centres, whether onshore or offshore, and a demonstrated willingness to cooperate on matters of exchange and sharing of information.*⁷

By eliminating the terms onshore and offshore from discussion and substituting in their place the terms the regulated space and secrecy space, which is exactly what the new language does, this dispute could be consigned to history, and yet at the same time the deficit in regulation that the secrecy jurisdictions create could be highlighted.

As these two examples show, this new language has value in use, not just in more accurately describing the observed phenomena, but also in providing those wishing to regulate those phenomena with a lexicon that empowers their action. The different standards of regulation that secrecy jurisdictions apply to their regulated space and the secrecy spaces they enable will allow regulators to add the secrecy space to their focus of attention. At present they do not have the language to do that. This new lexicon quite literally empowers them to go to areas they have never been before, and that is what society needs them to do.

The language makes three further things clear. The first is that regulation must extend to the secrecy space, which will require radical transformation of its current opacity. The second is that regulation cannot work if it does not apply to the work of the secrecy providers in and beyond the places in which they are located. The third is that regulatory reform is not just a local issue: reform of accounting and other international standards to expose the nature and use of the secrecy space is essential if it is to be exposed to view and properly regulated.

Conclusion

This paper makes four proposals. Firstly, the existing language of the so-called 'offshore world' is inappropriate for the purposes of rigorous analysis of the issues to which that term has been applied. It offers a new language for this purpose, renaming the 'offshore world' the 'secrecy world' in the process.

Second, the assumption that the secrecy world is geographically located is wrong. It is instead a space that has no specific location but is intended by the legislation that creates it to be either 'elsewhere', and so apart from the jurisdiction that permits the creation of the entities that trade within that space, or to be wholly or almost entirely unregulated with the knowing consent of all parties involved, and so effectively 'nowhere' for regulatory purposes.

Third, the illicit financial flows that are the cause of concern with the secrecy world do not flow through locations as such, but instead flow through the secrecy space that secrecy

⁷ Memorandum from the British Virgin Islands Financial Services Commission (FSC) in Treasury Committee, 2008a, 541

jurisdictions create. To locate them in a place is not only impossible in many cases, it is also futile: they are not intended to be and cannot be located in that way. They float over and around the locations which are used to facilitate their existence as if in an unregulated ether. This suggests that any attempt to measure or regulate them on a national basis will always be problematic, or just impossible, a task made all the more difficult because regulation within these spaces is also heavily influenced by the professional bodies and agencies of many of the persons providing services within the secrecy space; a fact that allows them to increase the opacity of that space.

Fourth, the change in language this paper promotes is consistent with existing understanding of the observed phenomena whilst adding new dimensions to the lexicon. These changes will allow regulators to extend the scope of their work whilst reducing the opportunity for sophistic avoidance of obligation by the secrecy jurisdictions and the secrecy providers who work within them to create the secrecy spaces that in combination make up the secrecy world.

Perhaps most important of all though has been the finding that this language has value in use. Since first introduced in early drafts of this paper circulated in 2008 the term secrecy jurisdictions has entered into normal usage amongst many non-governmental organisations engaged on issues relating to illicit flows of funds, in much of the press, especially but by no means exclusively in the UK, amongst legislators and politicians and in academic circles. This alone proves the worth of this exercise.

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