

INTERPRETATION OF DOUBLE TAXATION CONVENTIONS IN THE CONTEXT OF COUNTERACTING FINANCIAL CRIMES

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ABSTRACT

Considering the long history of the double taxation treaties, there is no doubt that their mechanisms of administrative cooperation are of paramount importance in the process of counteracting tax evasion as well as other financial crimes, e.g. money laundering of terrorism financing. At the same time, modern trends of globalization, digitalization and virtualization creates the new reality in which the criminals might find creative ways of committing financial crimes that demand the necessary reaction from the international community.

The Multilateral Convention to implement Tax Treaty Related Measures to Prevent BEPS (MLI) is the unique example of multilateral tax cooperation that has to impede the growth of illegal activities in the area of taxation and to update the network of double taxation conventions. Nevertheless, the comparison of the mechanisms of interpretation of the conventional norms under the MLI and the multilateral environmental treaties demonstrates that the MLI does not provide the necessary basis for the maintaining permanent dialogue among its participants. Thus, it might have the restrictive impact of the efficiency of its application as well as the cooperation in the area of counteracting the financial crimes.

Keywords: Tax Crimes, Financial Crimes, Interpretation, Double Taxation Conventions, Multilateral Cooperation.

INTRODUCTION

Cross-border economic relations would be considerably threatened if two or more states subjected the same income to taxation because the situation might be followed with the negative consequences of double taxation. Many states conclude international tax conventions in order to eliminate double taxation. These conventions are also known as double taxation conventions (DTCs) (Lang, 2013). The number of DTCs is constantly growing that might be confirmed by the fact that more than 4500 bilateral DTCs were concluded between 1942 and 2015 (Ash & Marian, 2019). They have created a basis for the international tax regime that is based on the benefits principle and the single tax principle. The first principle states that active (business) income should be taxed primarily by the residence country. The second one states that cross-border income should be taxed once, i.e. not more nor less than once, at the rate determined by the benefits principle, i.e. the source country rate for active income and the residence country rate for passive income (Avi-Yonah, 2015).

It should be added that the terms of the DTCs share the same approaches and definitions in most of its provisions due to the reference to the OECD Model Tax Convention (OECD MTC)

and its Commentaries in the process of negotiation. As a result, the OECD MTC and its Commentaries has been developed into an “*international tax language*” that is a common denominator in the process of interpretation and application of the provisions of the DTCs even if they are concluded between the contracting parties that are not the members of the OECD (Vogel, 1997).

Nevertheless, the international tax regime based on the DTCs is under modernization now. Its rules and standards are not adequate to allocate taxing rights and income among countries, prevent tax base-eroding transactions carried by multinationals, and fight harmful tax competition especially in the context of the digitalization of the economy (Victor, 2019). As the reaction from the international community, the G-20 decided to give the OECD the mandate to lead the Base Erosion and Profit Shifting Project (BEPS) in 2013. Its results have created the situation in which the participating states should modernize their approaches to normative regulation of international tax relations at international as well as domestic levels.

These changes in the international tax cooperation might have an important impact on the mechanism of counteracting financial crimes because of the strong and complex connection among DTCs, illicit financial flows and a range of criminal practices that are covered by the broad term “*illiciti*”. These three elements are in the basis of the offshore world (Picciotto, 2018)

The competitiveness of the national tax system is the most important driver of tax reforms, bringing it in line with the best practices but this dynamic shifts tax sovereignty from an absolute to a relative dimension, where the substance of decision-making is often not determined by the legislative body, which just retains the form of tax sovereignty (Pistone, 2016). At the same time, combatting such crimes as tax evasion, money laundering and terrorist financing necessitates a “*whole of government approach*” where different financial crime authorities can pool their knowledge and skills to collectively prevent, detect, and enforce these crimes (Organization for Economic Co-operation and Development, 2019). The international tax cooperation based on the DTCs is not the exception from the abovementioned rule and should be analyzed in the context of the counteracting financial crimes especially taking into account the MLI as the unique example of multilateral tax treaty.

Thus, there is a need to characterize the legal instruments of interpretation of the provisions of the MLI as the unique example of multilateral tax treaty in the comparison with the similar mechanisms such as multilateral environmental treaties based on the role of tax cooperation for the success of counteracting not only tax evasion but also the financial crimes like money laundering or financing terrorism.

METHODOLOGY

The methodological basis of the study is determined by the general and special methods of scientific knowledge. The systematic approach is a common research method that is allowed for identifying issues of the interrelation between international tax cooperation and counteracting financial crimes. The logical semantic method is used for the purposes of the analysis of the terms and conditions of the MLI and the OECD MTC in accordance with the tasks of the research (for example, the concept of interpretation). The formal method is applied for formulation of suggestions on the improvement of the normative basis of international tax cooperation from the point of view of counteracting financial crimes. A comparative legal

method is used to compare the approaches implemented in the provisions of the MLI, the recommendations of the OECD MTC and its Commentaries and the multilateral environmental treaties. Normative basis of the research is represented by the model acts the guidelines of the OECD and the multilateral international treaties.

RESULTS AND DISCUSSION

At the beginning, it is necessary to define the features of international cooperation in the combating of crimes at the modern stage of its development. First, the international cooperation in the combating crimes is focused on the crimes that cover more than one state in the aspects connected with their planning, committing or direct (indirect) consequences. Second, the international cooperation in criminal matters is one of the main dimensions of the activity that the law enforcement authorities are mandated. Third, counteracting criminality determines the application of specific cooperation forms at the international level that are limited by the prescriptions of domestic as well as international law. Lastly, legal regulation of international cooperation has a polysystemic nature in case of the fight against criminality (Alaberdeev & Luhashyn, 2012).

The definition of specific features of international cooperation in the combating crimes becomes even more complicated in case of different types of crimes. At the same time, this approach demands the uniform position to understanding the crimes that are included in their concrete type. Unfortunately, it is difficult to find the common definition of financial crimes because different concepts might be applied depending on the jurisdiction and on the context. In general, one might divide the views on financial crimes into the three groups. The first one proposes to include into the definition of financial crime any type of illegal activity that results in a pecuniary loss, e.g. armed robbery or vandalism. The narrower approach makes an accent on the necessity to limit the definition of financial crimes by non-violent crimes that result in a pecuniary loss. The other one proposes to include into the definition of financial crimes only non-violent crimes resulting in pecuniary loss crimes but with the necessary involvement of a financial institution in one of the three main roles:

1. Perpetrator.
2. Victim.
3. Knowing or unknowing instrumentality of crime (International Monetary Fund, 2001).

The experts of the OECD point out that:

“The term “financial crimes” covers a broad range of offences, including tax evasion, tax fraud, money laundering, corruption, insider trading, bankruptcy fraud and terrorist financing (Organization for Economic Co-operation and Development, 2012).”

As it follows, they have left the attempts to define the term “*financial crimes*” and propose only the non-exclusive list of crimes that should be covered by it and do not generate discussion on their nature as financial crimes. It is worth mentioning that the Interpol shares the same approach with the OECD because financial crime is interpreted as the one that ranges from basic theft or fraud committed by ill-intentioned individuals to large-scale operations

masterminded by organized criminals with a foot on every continent, e.g. theft, fraud, deception, blackmail, corruption or money-laundering (Interpol, 2019).

Despite the discussion around the definition of the term “*financial crime*”, it is hardly possible to exclude the tax crimes (e.g. tax evasion or tax fraud) from its coverage taking into account negative financial consequences of tax crimes, their nature and interrelation with other financial crimes such as money-laundering or terrorism financing. By their very nature, tax crimes are closely linked to other financial crimes and it is well recognized that tax authorities have a central role to play in identifying and reporting money laundering and terrorist financing (Organization for Economic Co-operation and Development, 2019). Thus, the international tax cooperation impacts on the development of the international interaction among many jurisdictions on counteracting financial crimes because the improvement of tax control means the limitation of opportunities to commit financial crimes especially tax crimes but also money laundering or terrorism financing.

Among the instruments of the international tax cooperation based on the DTCs, exchange of tax information might be labelled as the most important in the context of counteracting financial crimes. The role of exchange of tax information is based on the theory of asymmetric information focuses on the type of uncertainty where individuals have different types of information, the typical situation being that they have private information about their own characteristics that is not directly available to other people, like those responsible for the design of public policy including the fiscal policy (Sandmo, 1999). Thus, this instrument of international tax cooperation might help tax authorities to increase the effectiveness of tax control by using more accurate data obtained from the competent authorities under the DTCs. It is desirable to give administrative assistance for the purpose of ascertaining facts in relation to which the rules of the DTCs are to be applied. Moreover, in view of the increasing internationalization of economic relations, the contracting states have a growing interest in the reciprocal supply of information on the basis of which domestic taxation laws have to be administered, even if there is no question of the application of any particular article of the DTC (Organization for Economic Co-operation and Development, 2017). There is no surprise that the mutual exchange of tax information allows tax authorities to get more data about the taxpayers that might reveal the details of illegal activities including the financial crimes.

At the same time, the interrelation between international tax cooperation and the international interaction on counteracting financial crimes is not the autonomous from the general tendencies of the development of the last one. The proper understanding of these tendencies allows us to describe how jurisdictions from all the regions are strengthening their relations in the area of counteracting financial crimes despite the differences in their political, economic and social systems:

1. Inclusion of more and more issues into the area of legal mechanism of cooperation on counteracting financial crimes because of the appearance of new types of crimes and new ways of their committing that have the negative transboundary consequence (e.g. identity theft fraud or cryptocurrency theft).
2. The shift from bilateral to regional or even global level of international cooperation on counteracting financial crimes.
3. Conventional cooperation is complemented by the wide application of instruments of soft law in case of counteracting financial crimes that might be illustrated by the example of the FATF Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation.

4. The existence of tension between developing and developed countries concerning the improvement of legal mechanism on counteracting financial crimes at the international level.

As it seems, these factors have made more complex interrelation between international tax cooperation and the international interaction on counteracting financial crimes. Additionally, it should be noted that the international tax cooperation based on the DTCs is also changing in accordance with the challenges of digitalization and globalization. One of the obvious results of this transformation process is the signing of the MLI that is focused on the amendments of the provisions of DTCs of all participating jurisdictions. It is stated in the preamble that its signing is determined by the need for an effective mechanism to implement agreed changes in a synchronized and efficient manner across the network of existing DTCs without the need to bilaterally renegotiate each such convention. The MLI represents a completely new approach to implementing tax convention changes (Kleist, 2018).

The MLI has been divided in seven parts-two general ones (introduction and final provisions) as well as five detailed ones (hybrid entities and instruments, including anti-double-taxation methods, abuse of double taxation agreements, preventing the avoidance of permanent establishment status, making dispute resolution mechanisms more effective, arbitrary) (Franczak, 2018). Nevertheless, the mechanism of application of the MLI has its own features because of the existence of the minimum standards to ensure that a DTC is not used as a vehicle to facilitate non-taxation.

This minimum standard has a few components (Alschner, 2019):

1. The insertion of new preamble language into DTCs that clarifies the parties' common intention that the treaty should not create opportunities for taxation avoidance or evasion.
2. The introduction of a Principal Purpose Test that seeks to prevent treaty abuse by enabling states to deny tax benefits derived through strategic treaty shopping where one of the principal purposes of corporate restructuring was to gain access to that DTC benefit.
3. The introduction of procedural modifications aimed at improving the dispute settlement mechanism that strengthens and streamlines the mutual agreement procedures under DTCs.

The other provisions of the MLI are not included in the minimum standard. Thus, if a provision does not reflect a minimum standard, the MLI generally allows for an opting out of that provision entirely or, in some cases, out of part of that provision. Opting out is accomplished by making a reservation. Each article specifically sets out the permitted reservations. When a party uses a reservation to opt out of a provision of the MLI or to opt out of a part of a provision, that provision or part of a provision will not apply between the reserving party and the other parties to the MLI, unless explicitly provided otherwise in the relevant provisions (Kleist, 2018).

Despite the division between the provisions of the minimum standard and the provisions of the non-minimum standard under the MLI, there is no doubt that the issue of interpretation of its norms is of paramount importance. It is well-known that the need for interpretation arises when the need to clarify the meaning of a term arises that becomes even more difficult in case of the absence of common positions between the parties. That is why it is necessary for contracting states to establish or agree on the means that will be used to interpret a treaty mainly to resolve interpretation issues that may arise (Dutta, 2008). Nevertheless, treaty interpretation is among the most controversial subjects of international law. While scholars generally agree that treaty

interpretation should ascertain the intentions of the parties, they rely on different hermeneutic principles to accomplish this task (Ris, 1991).

Interpretation as process of finding or determining the meaning of an international treaty is based on the semiotic triangle that comprises three entities in its corners and comes from the modern linguistics (Djeffal, 2016):

1. The sign as a part of the text of a treaty that is to be understood as meaning something.
2. The meaning as a linkage between conventional terms and the objects in the real world.
3. The referent as the object in the real world to which the sign might be applicable through the meaning.

The interpreters might be challenged within the process of reconstruction of the meaning of the conventional terms with a lot of issues such as the application of static or dynamic approach. This situation underlines the necessity of clear set of rules for interpretation of the conventional provisions.

In accordance with Art: 32(2) of the MLI, any question arising as to the interpretation or implementation of the treaty provisions may be addressed by a Conference of the Parties on the basis of Art: 31(3) of the MLI. A Conference of the Parties may be requested by communicating a request from any of the participating jurisdictions to the depositary of the MLI that has the obligation to inform the other parties about the request. If it is supported by one-third of the participating jurisdictions within six calendar months of the communication by the depositary of the request, the Conference of the Parties must be convened.

The proposed mechanism of the interpretation does not look adequate in case of the provisions of the MLI considering the permanent process of the changes in the area of taxation.

At first, one might admit that the international tax competition continues to exist. As a result, different jurisdictions are still competing for the investments and might use the instruments that might seem questionable in the light of the demands of the MLI. Of course, if these measures are not in accordance with the BEPS minimum standards, they will be under consideration of the partners in the process of the peer-review. At the same time, there is no the same level clarity in case of the provisions of the MLI that are not covered by the BEPS minimum standards. It has to be added that the list of the provisions that are not covered by the minimum standard of the MLI is much longer in comparison with the list of provisions included in the same minimum standard.

Lastly, the provisions of the MLI are focused on the making changes and amendments to the DTCs that are based on the OECD MTC in most cases. It is worth mentioning that the OECD MTC has been updated 10 times since the publication of the first ambulatory version in 1992 (in 1994, 1995, 1997, 2000, 2002, 2005, 2008, 2010, 2014 and 2017). The last update included a large number of changes resulting from the OECD BEPS project and, in particular, from the final reports on Actions 2, 6, 7 and 14 produced as part of that project (Organization for Economic Co-operation and Development, 2017). As it seems, the changes are determined by the rapid evolution of tax relations that demands the adequate reaction from the jurisdictions in their attempts to provide the necessary financing via taxes. Thus, it is hardly possible that the MLI does not demand the same level of regularity in updating its own provisions including the review of the processes of their interpretation and application.

In comparison with the MLI, it seems possible to characterize the mechanism of interpretation that are based on the provisions of the multilateral environmental treaties because

they are also aimed at regulation of dynamic subject area and have the comparable number of the participants. The example of such treaties might be the Montreal Protocol on Substances that Deplete the Ozone Layer (the Montreal Protocol) (a protocol to the Vienna Convention for the Protection of the Ozone Layer) that was signed in 1987. The common feature is that both international treaties concerning the interpretation of their provisions are based on the decisions adopted by the participants during the Meetings of the Parties in accordance with Art: 11 of the Montreal Protocol or the Conference of the Parties under Art: 32(2) of the MLI. Nevertheless, there is an also sufficient difference between their mechanisms of interpretation.

First, the Montreal Protocol includes clear demand about the regularity of the Meeting of the Parties in contrast with the MLI. It seems that the existence of the similar provisions might help to maintain the permanent dialogue between the participants aimed at the realization of the common purposes in the context of the MLI.

Second, the Montreal Protocol states that the decisions adopted by the Meetings of the Parties should be obligatory if they concern the most crucial issues such as the adjustments to the ozone depleting potentials or to the global warming potentials in accordance with Art: 2(9) (d). There are no provisions on the obligatory nature of the decisions on interpretation that might be adopted by the Conference of the Parties under Art: 32(2) of the MLI.

Finally, the provisions of the Montreal Protocol define the functions of the Meetings of the Parties and include the provisions concerning the set of rules that should be clarified at the first Meeting of the Parties. The MLI again ignore these issues.

Based on the difference between the mechanisms of interpretation in the MLI and the Montreal Protocol, it might be assumed that the provisions of the MLI concerning the mechanism of interpretation are too vague and do not allow to maintain permanent dialogue among the participants. As a result, it is hardly possible to expect the high level of efficiency from the measures of the MLI in the absence of the permanent interaction among the participants in the area of interpretation of its provisions that are not included in the BEPS minimum standard covered by the provisions of the MLI. Consequently, counteracting financial crimes seems to be less efficient because the MLI should update the network of the DTCs in the attempt to close the opportunities for the improper application of their provisions.

CONCLUSION

The criminals committing the financial crimes have a high level of adaptability and knowledge in the specific areas. Additionally, the rapid development of modern technologies allows them to find new ways of violations in the area of financial regulation including the area of taxation. Taking into account intrinsic link between counteracting tax crimes and the other financial crimes, it is necessary to provide the highest level of efficiency of application the provisions of international as well as domestic legal norms. At the same time, it is hardly possible in the absence of flexible mechanism of interpretation of international treaties on which the cooperation among the public authorities is based including the MLI with its focus on the DTCs. There should be created the framework for the permanent dialogue among the participants that allows reacting where it is needed on the changes in the trends of committing financial crimes.

The comparison between the Montreal Protocol and the MLI demonstrates the difference in their approaches to interpretation of the provisions of respective international treaties. The MLI does not include any demands on the regularity of cooperation among the participants, its specific procedures or the legal status of documents that might be adopted on the issues of interpretation. Thus, one might assume that the potential of cooperation on the interpretation of the provisions of the MLI is not fully reflected in its approach that might have the negative impact in the process of application of the MLI. Consequently, it might be resulted in the restrictive effect on the counteracting not only tax crimes but also the other financial crimes.

ACKNOWLEDGMENT

I would like to thank the Middle East University for its exceptional support.

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