ARTICLE

Action 2 and the Multilateral Instrument: Is the Reservation Power Putting Coordination at Stake?*

Luís Eduardo Schoueri** & Guilherme Galdino***

In order to address tax arbitrage on hybrids arrangements, Action 2 of the Action Plan on Base Erosion Profit Shifting requires coordination on the modification of both levels domestic provisions and tax treaties. In this sense, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting includes three provisions (Articles 3, 4 and 5) related to the hybrid mismatch arrangements. However, as these provisions may be subject to reservations, the coordination requirement may not be verified, undermining its effectiveness. Through an empirical analysis, this article shows that the signatories present a low commitment to these provisions. After explaining the coordination requirement in light of Action 2 recommendations and the need to modify tax treaties, the authors describe Articles 3, 4 and 5, and test such coordination. As the signatories of the Multilateral Instrument often reserve the right to apply one or more of these provisions, the reservation power is putting coordination at stake.

1 Introduction

Praised as an independent legal instrument which would modify the operation of several bilateral treaties in a binding way,[1] the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ('Multilateral Instrument', hereafter 'MLI')[2] of the Organization for Economic Cooperation and Development (OECD) has foreseen a number of reservations,[3] which use, by several signatories, ends by revealing a lack of consensus as to measures to address BEPS situations. This article focuses on Action 2 of the Action Plan on Base Erosion Profit Shifting ('BEPS Project'), taking into account the three provisions (Articles 3, 4 and 5) included on the MLI that are related to the hybrid mismatch arrangements.

Grounded on an alleged 'single tax principle',[4] which states that income shall be taxed once, not more, not less, Action 2 suggests a number of unilateral measures (primary and defensive linking rules) which should align the tax treatment of a hybrid instrument/entity in both jurisdictions. Since these measures could potentially not be allowed by provisions contained in bilateral treaties, the latter should be amended in order to prevent them to be ineffective. All in one, Articles 3, 4 and 5 of MLI should turn said measures compliant with the bilateral treaties.

As the signatories of the MLI may reserve the right to apply such provisions, and Action 2 requires coordination to address hybrids mismatches, the number of tax treaties affected is relevant. The scope of this article is to analyse the effectiveness of the MLI provisions on hybrids taking into account both the coordination requirement of Action 2 and the reservations power on the MLI. For this purpose, section 2 explains the coordination requirement in light of Action 2 recommendations and the need to modify tax treaties. Besides including the description of the

Notes

* The authors acknowledge the excellent research made by the graduate student Henrique Tochilovsky.

** Professor of Tax Law at the University of São Paulo. Vice President of the Brazilian Tax Law Institute. Email: schoueri@lacazmartins.com.br.

*** LLB at the University of São Paulo. Lawyer in São Paulo. Email: guilherme.galdino@lacazmartins.com.br.

1 *See* A. Bosman, *General Aspects of the Multilateral Instrument*, 45 Intertax 642, 643 (2017).

2 OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (Paris: OECD Publishing 2016), http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf (accessed 10 Oct. 2017), hereafter MLI.

3 *See* R. Garcia Antón, *Untangling the Role of Reservations in the OECD Multilateral Instrument: The OECD Legal Hybrids*, 71 Bull. Int'l Tax'n 544, 548–551 (2017); and L. E. Schoueri & R. A. Galendi Jr., *Interpretative and Policy Challenges Following the OECD Multilateral Instrument (2016) from a Brazilian Perspective*, 71 Bull. Int'l. Tax'n 340, 343 (2017).

4 For authors praising the single tax principle, *see* R. S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 Tax L. Rev. 507, 517 (1997); and Y. Brauner, *What the BEPS?*, 16 Fla. Tax Rev. 55, 80 (2014). For authors rejecting or questioning the single tax principle, *see* H. D. Rosenbloom, *The David R. Tillinghast Lecture International Tax Arbitrage and the 'International Tax System'*, 53 Tax L. Rev. 137, 137–166 (2000); F. De Lillo, *In Search of Single Taxation: The Twilight of an Idol?*, Thesis (Advanced Master's International Tax Law, University of Amsterdam: IBFD 2017); and D. Shaviro, *The Two Faces of the Single Tax Principle*, 41 Brook. J. Int'l L. 1293, 1293–1301 (2016).

MLI provisions on hybrids, section 3 tests such coordination. Not only shows this section that an important part of the MLI signing parties adopted reservations to said articles, but also criticizes the lack of discussion regarding the allocation of the taxing rights.

2 BEPS ACTION 2 AND THE COORDINATION REQUIREMENT

In order to address aggressive tax planning on hybrid mismatch arrangements,[5] BEPS Action 2 includes recommendations (1) for domestic provisions and (2) for modifications on the OECD Model Tax Convention (OECD-MC) to prevent the 'unduly' entitlement of the benefits of treaties by the use of hybrid instruments and entities.[6] The use of hybrids is a case of tax arbitrage, which can be defined as the taking of advantage of mismatches between tax systems to achieve low or no taxation.[7] Considering these mismatches, Action 2 also provides (3) guidelines, where it is the case, to ensure coordination whenever more than one State intends to address a hybrid arrangement.[8]

According to Avi-Yonah, as 'tax arbitrage directly negates the single tax principle', which would allegedly be one of the pillars of the 'International Tax Regime', it should be addressed by both international and domestic measures.[9] Although such principle presents embryonic basis on the work of the League of Nations,[10] it was sustained and it became well known by the mentioned author, who associated it to the existence of 'a coherent international tax regime'.[11] Therefore, the combat to tax arbitrage would be necessary because it would be against the coherence of such regime.

The BEPS Project departs from the idea that the so-called 'International Tax Regime' would be generally recognized. However, the statement that '[t]ax policy is at the core of countries' sovereignty, and each country has the right to design its tax system in the way it considers most appropriate' is accompanied by another contradictory idea, according to which there would be the 'need' for the creation of 'new set of standards designed to establish international coherence in corporate income taxation'.[12] In such system, since all gaps, loopholes, frictions and mismatches arising from the interactions between national tax law must be addressed by new rules,[13] coordination would thus be required.

Interesting enough, the need of measures to be adopted by States can be seen as a recognition that no 'International Tax Regime' exists (or at least, not one including the claimed 'single tax principle'): if there were such a system, then loopholes could be fulfilled by the interpreter based on such principle. The need for concrete measures indicates that on its absence, States are not supposed to follow the principle or, perhaps, given tax policy reasons, they even do not intend to adopt such measures.

Even those who advocate the existence of an 'International Tax Regime' seem to acknowledge that its present scope is very restricted. Accordingly, as stated by Y. Brauner, '[t]he legal framework and the lack of coordination among countries further permitted' the Multinational Enterprises (MNEs) 'to also avoid some of the regulatory power imposed by countries, including their taxpaying obligations'.[14] In other words, as recognized by the BEPS Project, the current international tax rules were not able to stop such tax planning. That is why Action 2 requires coordination in order to address tax arbitrage.

Based on the coordination requirement, Action 2 indicates that the 'competition-based paradigm'[15] has its days numbered. On the one hand, coordination is required as both jurisdictions may apply domestic provisions addressing hybrid arrangements, which may lead to a lack of legal certainty and double taxation. On the other hand,

Notes

5 OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 – 2015 Final Report* 15, OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD Publishing 2015), http://dx.doi.org/10.1787/9789264241138-en (accessed 10 Oct. 2017), hereafter *Action 2 – 2015 Final Report*. For the concept of 'aggressive tax planning', *see* A. Dourado, *Aggressive Tax Planning in EU Law and in the Light of BEPS: The EC Recommendation on Aggressive Tax Planning and BEPS Actions 2 and 6*, 43 Intertax 42, 48–50 (2015). For the meaning of 'hybrid mismatch arrangements', *see* N. Boidman & M. Kandev, *BEPS on Hybrids: A Canadian Perspective*, 74 Tax Notes Int'l 1233, 1234–1235 (2014).

6 *Action 2 – 2015 Final Report*, at 16.

7 *See* R. S. Avi-Yonah, *Tax Competition, Tax Arbitrage and the International Tax Regime*, 61 Bull. Int'l Tax'n 130, 137 (2007). *See also* B. Kuzniacki et al., *Preventing Tax Arbitrage via Hybrid Mismatches: BEPS Action 2 and Developing Countries*, WU International Taxation Research Paper Series No. 2017-03, 2–3 (2017), https://ssrn.com/abstract=2941617.

8 *Action 2 – 2015 Final Report*, at 16.

9 R. S. Avi-Yonah, *International Tax as International Law: An Analysis of the International Tax Regime* 1 and 186 (Cambridge tax law series 2007).

10 *See* League of Nations (1927), *Double Taxation and Tax Evasion*, report presented by the Committee of Technical Experts on Double Taxation and Tax Evasion, Doc. G.216. M.85 II, 23, http://biblio-archive.unog.ch/Dateien/CouncilMSD/C-216-M-85-1927-II_EN.pdf (accessed 14 Nov. 2017).

11 Avi-Yonah, *supra* n. 4, at 1.

12 OCDE (2013), *Action Plan on Base Erosion and Profit Shifting* 15 (Paris: OECD Publishing), http://dx.doi.org/10.1787/9789264202719-en (accessed 9 Oct. 2017), hereafter *Action Plan*.

13 *See Action Plan*, at 15.

14 Brauner, *supra* n. 4, at 55, 64.

15 *Ibid.*, at 55, 58.

coordination is required as tax treaties may prevent the application of such rules or even be used to generate 'unduly benefits'.[16] In short, the response to tax arbitrage is to achieve 'consensus' in both levels of rules, domestic law and treaties, on a 'coordinated' way among a considered number of states.[17]

In order to achieve such coordination, Action 2 establishes several measures, calling on consensus between States on: (1) the manner in which rules shall be applied; (2) how to implement provisions, specially taking into account temporal aspects; (3) how provisions should address transitional arrangements; and (4) ensuring that rules are operating as predicted. At the same time, not only shall countries (5) agree on the procedures related to exchanging information on the domestic tax treatment of arrangements, assisting the application of the rules by tax administrations, but also (6) to seek the availability of such information to taxpayers. Moreover, States shall (7) make further comments regarding the interaction between the recommendations in Action 2 and other actions of the BEPS Project.[18]

The coordination requirement of Action 2 is more related to hybrids mismatches arrangements neutralization at all costs than to the application of principled rules. Assuming that allocation of taxing rights is not at stake,[19] Action 2 sets aside the discussion about which jurisdiction 'has "lost" tax revenue under the arrangement'.[20] At the end of the day, what matter is the non-generation of no or low taxation. The application of a defensive rule makes this clear: if one jurisdiction does not neutralize the effects of the hybrid arrangement, the other jurisdiction's policy of whether address those effects is not affected.[21] The reasons why a jurisdiction does not tax certain income or allows the deductibility of such expense are not under debate. If the tax outcome is generated, the primary rule shall be applied; otherwise the piece of cake will be given to the other jurisdiction.

The intention to address hybrid arrangements involves not only a 'multilateral' level, but also requires changes on tax treaties.[22] For instance, transparent entities may be used to obtain benefits where both Contracting States do not consider, under their own domestic law, their income as income of one of its residents. Also, hybrid entities may implicate dual-residence situations, being potentially entitled to tax treaty benefits which are considered unduly as it generates the so-called BEPS. Additionally, some defensive rules may require the need to swift exemption method to credit method. As the Source State may not tax items of income that, under the tax treaty involved, would have the right to impose it, the credit method would present an advantage comparing to the exemption method since it will ensure that relief would only be provided according to the amount paid in that State. In this sense, the MLI has its role: to introduce such modifications in several treaties at the same time. Nevertheless, whenever signatories of the MLI adopt reservations to the articles related to hybrids, one may conclude the coordination requirement may be undermined as Action 2 may not be followed.

3 BEPS Action 2 and the Multilateral Instrument: Is Coordination a Reality?

Published on 24 November 2016 and open for signature since 31 December 2016, the MLI has already been signed by seventy-one States.[23] Although the OECD Secretary General has described the MLI as 'a turning point in tax treaty history'[24] because its scope is to 'overcome the hurdle of cumbersome bilateral negotiations and produce important efficiency gains',[25] it may face both interpretative and effectiveness challenges. Substantive provisions, compatibility clauses and the role of the Explanatory Statement accompanying the MLI ('Explanatory

Notes

16 *Action 2 – 2015 Final Report*, at 12 and 94.

17 R. De Boer & O. Marres, *BEPS Action 2: Neutralizing the Effects on Hybrid Mismatch Arrangements*, 43 Intertax 14, 15 (2015).

18 *Action 2 – 2015 Final Report*, at 94.

19 *Action Plan*, at 11.

20 *Action 2 – 2015 Final Report*, at 95.

21 *Action 2 – 2015 Final Report*, at 11 and 18.

22 *Action 2 – 2015 Final Report*, at 102.

23 Andorra, Argentina, Armenia, Australia, Austria, Belgium, Bulgaria, Burkina Faso, Cameroon, Canada, Chile, China, Colombia, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Egypt, Fiji, Finland, France, Gabon, Georgia, Germany, Greece, Guernsey, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Isle of Man, Israel, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mauritius, Mexico, Monaco, Netherlands, New Zealand, Nigeria, Norway, Pakistan, Poland, Portugal, Romania, Russia, San Marino, Senegal, Serbia, Seychelles, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom and Uruguay. *See* OECD, *Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (2017), status as of 25 Oct. 2017, http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf (accessed 26 Oct. 2017).

24 OECD (2017), *Ground-Breaking Multilateral BEPS Convention Signed at OECD Will Close Loopholes in Thousands of Tax Treaties Worldwide, Remarks by Angel Gurría* (Paris: OECD Secretary-General), https://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf (accessed 16 Oct. 2017).

25 OECD (2015), *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 – 2015 Final Report* 18, OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD Publishing), http://dx.doi.org/10.1787/9789264241688-en (accessed 13 Oct. 2017), hereafter *Action 15 – 2015 Final Report.*

Statement')[26] are examples of interpretative challenges. The number of signatories and the tax treaties listed by them are examples of effectiveness challenges. For instance, from 2,381 tax treaties listed by all 71 signatories, 1,116 tax treaties are Covered Tax Agreements (CTAs)[27] under the terms of Article 2 of the MLI. Considering the maintenance of this pattern, more than half of the conventions listed will not be modified by the MLI.

Taking the interpretative and effectiveness perspectives at the same time, one may illustrate with the mechanism of reservations under the MLI. As stated by Article 28(1), provisions that do not constitute 'minimum standards' of the MLI may be subject to reservation[28]: States are free, without any justification, to opt out of such provisions, i. e., making them inapplicable to one or more tax treaties listed.[29] On the one hand, the power to reserve such provisions turns the MLI into 'a flexible instrument', which means that more countries with different legal and culture backgrounds may sign such convention.[30] On the other hand, the MLI becomes more complex[31] and its effectiveness may be undermined. Given that one State may adopt a certain provision and the other may reserve the right to include it, cases of 'asymmetry' may arise. Accordingly, asymmetry may derive from the fact that the application of some provisions is not necessarily related to the choice made by the other part.[32] The power to reserve the provisions of the MLI may also deflate the scope of the MLI. If States opt out of the application of many provisions, the CTAs listed by them are not affected:[33] 'past choices' remain applicable. Depending on the number of reservations, the flexibility intended to offer 'different levels of commitment to the signatory states'[34] may, at the end of the day, turn some of the MLI provisions ineffective. This may be the case of the provisions on hybrids. As such provisions are not considered as minimum standards[35] – which is firm indication that there is no obligation, derived from the International Law, for States to follow the single tax principle – only a low level of commitment may be achieved, which may impact the coordination required to address tax arbitrage.

3.1 *The Inclusion of Part II of Action 2 on the Multilateral Instrument*

Part II of the MLI entitled 'Hybrid Mismatches' includes three provisions: Article 3 (Transparent Entities); Article 4 (Dual Resident Entities); and Article 5 (Application of Methods for Elimination of Double Taxation). As these provisions are subject to reservation, the effectiveness of the MLI on hybrids will depend on the lists of reservations provided by the signatories States. Before the discussion on whether the coordination is being undermined, one may describe those provisions related to hybrids.

3.3.1 *Article 3: Transparent Entities*

Article 3 of the MLI is composed by six paragraphs. Article 3(1) is the substantive provision as it intends to address income obtained through transparent entities.[36] Despite some terminological differences,[37] Article 3(1) establishes the proposed Article 1(2) that shall be included on the OECD-MC.[38] Following the *ratio* of the 1999 OECD report on partnerships,[39] this provision looks to ensure that 'the benefits of tax treaties are granted' solely if the income derived by the resident of a Contracting State is subject to tax, and not only liable

Notes

26 OECD (2016), *Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (Paris: OECD Publishing), https://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf (accessed 12 Oct. 2017), hereafter *Explanatory Statement*.

27 For the purposes of this article, one does not consider new tax treaties, listed as CTAs, that have not been entered into force when the signatory also listed as CTA an older tax treaty with that other Contracting State. I.e. the reason why the total of tax treaties adopted in this article is different from the total present on the MLI Database. According to this base, 2,381 tax treaties have already been listed, but only 1,136 (and not 1,116) are considered CTAs. OECD, *MLI Database – Matrix of Options and Reservations* (2017), status as of 25 Oct. 2017, http://www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm, (accessed 30 Oct. 2017).

28 *See* para. 14 of the *Explanatory Statement*.

29 *See* C. Silberztein, B. Granel & J-B. Tristram, *OECD Multilateral Convention to Prevent BEPS: Implementation Guide and Initial Thoughts*, 24 Int'l Transfer Pricing J. 323, 325 (2017).

30 P. Valente, *BEPS Action 15: Release of Multilateral Instrument*, 45 Intertax 219, 221 (2017).

31 *See* J. Malherbe, *The Issues of Dispute Resolution and Introduction of a Multilateral Treaty*, 43 Intertax 91, 94 (2015).

32 Schoueri & Galendi Jr., *supra* n. 3, at 340, 340–343.

33 *See* para. 14 of the *Explanatory Statement*.

34 *See* Antón, *supra* n. 3, at 544, 544.

35 *See* paras 3, 46 and 54 of the *Explanatory Statement*, and provisions (a), (b) and (c) of the Art. 28(1) of the MLI.

36 *See* para. 39 of the *Explanatory Statement*.

37 *See* para. 40 of the *Explanatory Statement*.

38 *See* OECD, *Draft 2017 Update to the OECD Model Tax Convention* 10 (11 July 2017), http://www.oecd.org/ctp/treaties/draft-contents-2017-update-oecd-model-tax-convention.pdf (accessed 31 Oct. 2017).

39 *See* OECD, *The Application of the OECD Model Tax Convention to Partnerships* (Paris: OECD Publishing 1999), http://dx.doi.org/10.1787/9789264173316-en (accessed 15 Nov. 2017).

to tax or not treated 'as the income of one of its residents'.[40] Such approach may be problematic when the Residence State would not, in any case, have taxed such income. For instance, the Residence State may not recognize a particular item of income that is taxed by the source state (e.g. capital gains, deemed dividends), irrespective of who derives such income. Given that the existence of the entity is not modified by the treatment of the income in the Residence State, i.e., that the Residence State exempts the income as such, irrespective of its beneficiary, one may conclude that the Source should not question the treaty entitlement.[41]

As in the context of transparent entities the income may be attributed to different residents, its partners or the entity itself, Article 3(2) establishes rules regarding to the elimination of double non-taxation. This paragraph sets forth that, when the same income or capital is subject to tax by both States as income or capital of one of its residents, neither of them is obliged to grant any tax relief for the tax levied, by the other State, based exclusively on the residence of the taxpayer.[42]

Article 3(3) establishes that a sentence shall be included at the end of Article 3(1) in the CTA if one or more States opt out Article 11(3)(a), which establishes a saving clause that protect the right of a State to tax its own residents.[43] The purpose of such sentence is to ensure that Article 3(1) is not interpreted to impinge a State's right to tax its residents.[44]

Given that some current tax treaties already contain provisions addressing fiscally transparent entities, which may vary substantially,[45] Article 3(4) introduces a 'compatibility clause'.[46] This provision establishes that Article 3(1) shall apply 'in place of or in the absence of' such provisions. In other words, Article 3(1) replaces these provisions to the extent that it does not affect 'integrity rules', such as a provision considering a beneficiary of a business trust to have a permanent establishment and attributing to it part of the business profits of the trust to which the beneficiary is beneficially entitled. As it may be noted, these integrity rules assume that the income is treated as income of a resident of a State 'entitled to benefits under the relevant' CTA.[47]

While Article 3(5) permits partial or entire reservation on Article 3 of the MLI,[48] Article 3(6) establishes the obligation to notify whether the State made the reservation and which type of it, clarifying, for example, if a CTA presents a provision of the same category. This obligation is relevant in order to ensure which provision is applicable to each CTA.

3.1.2 *Article 4: Dual Resident Entities*

Article 4 of the MLI has four paragraphs. Article 4(1) seeks to modify provisions that correspond to Article 4 (3) of the OECD-MC. As a result of Action 6[49] combined with Action 2,[50] a case-by-case approach will be adopted in Article 4(3) of the OECD-MC.[51] Given that dual resident often implicate tax avoidance arrangements,[52] one intends to replace the criterion of place of effective management. The purpose is to condition the applicability of the treaty on the outcome of the Mutual Agreement Procedure (MAP). Not only may the mentioned criterion be used, but also the place of incorporation or of constitution and 'any other relevant factors' may be taken into consideration. Article 4(1) also introduces a consequence if there is no agreement on the residence of the taxpayer: such person is not entitled to treaty benefits 'except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting Jurisdictions'.

The approach established by this provision seeks to address no taxation, but at the end of the day will allow a potential increase of double taxation. Accordingly, the current treaties usually provide a criterion (place of effective management) as a tie-breaker rule and, if it is the case, it may set forth the need for MAP when both States

Notes

40 *Action 2 – 2015 Final Report*, at 139.

41 A. Nikolakakis et al., *Some Reflections on the Proposed Revisions to the OECD Model and Commentaries, and on the Multilateral Instrument, with Respect to Fiscally Transparent Entities – Part 1*, 71 Bull. Int'l Tax'n 475, 491–492 (2017); and A. Nikolakakis et al., *Some Reflections on the Proposed Revisions to the OECD Model and Commentaries, and on the Multilateral Instrument, with Respect to Fiscally Transparent Entities – Part 2*, 71 Bull. Int'l Tax'n 553, 561 (2017).

42 OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report* 89, OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD Publishing 2015), http://dx.doi.org/10.1787/9789264241695-en (accessed 11 Oct. 2017), hereafter *Action 6 – 2015 Final Report.*

43 Para. 149 of the *Explanatory Statement.*

44 Para. 154 of the *Explanatory Statement.*

45 Para. 43 of the *Explanatory Statement.*

46 Para. 44 of the *Explanatory Statement.*

47 Para. 45 of the *Explanatory Statement.*

48 *See* paras 46 and 47 of the *Explanatory Statement.*

49 *Action 6 – 2015 Final Report*, at 72–75.

50 *Action 2 – 2015 Final Report*, at 137–138.

51 *See* OECD, *supra* n. 38, at 11.

52 *Action 6 – 2015 Final Report*, at 72.

consider such taxpayer resident following such criterion.[53] In these treaties, many dual-resident situations are solved and MAP is an exceptional remedy. Since treaties' mechanism depend on defining one of the Contracting States as the State of Residence, one may conclude that whenever the tie-breaker rule works, treaties' mechanism for avoiding double taxation may succeed. On the other hand, if tie-breaker rules do not work, then the very functioning of a treaty will depend on whether the Contracting States will be able to find a solution under a MAP. In such scenario, the direct introduction of a MAP imposes a step back. Double taxation cases that would be addressed may not be solved anymore. As more than one criterion shall be taken into account, the probability of a State deeming a taxpayer as its resident increases. Nevertheless, given that Contracting States 'shall endeavour to determine' the residence by MAP, no agreement may be achieved or the prediction made taking into account non-formal[54] criteria may not be verified due to the power of negotiation of the Contracting States. If no agreement is achieved, the taxpayer is punished by the non-entitlement to the benefits of the treaty.

Of course, this would not be a problem if arbitration had been a minimum standard under the MLI.[55] However, since arbitration is not mandatory under MLI, the very success of Article 4 of MLI may imply that more cases of double taxation will occur. In other words, in order to reduce cases of double non-taxation, Article 4 increases the risk of double taxation. It is not clear, however, why States should prefer to avoid double non-taxation than double taxation. All in all, the very first objective of tax treaties still is (or should be) to avoid double taxation in order to enhance international transactions. Even the modification on the preamble of the tax treaties by Article 6 of the MLI does not put at the same level that purpose and the prevention of tax avoidance. On the contrary, the purpose of the tax treaties is to eliminate double taxation 'without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance'.[56] Therefore, besides being controversial even in light of the new preamble, increasing the risk of double taxation, thus creating barriers to international transactions, seems to be a very high price in order to avoid double non-taxation.

Moreover, legal certainty may also be endangered by the fact that a person other than an individual may not predict the legal consequences of where it was incorporated or carries on its business. As the MAP does not involve the participation of the taxpayer and it may lack transparency regarding the decisive criterion adopted to solve the dual-residence issue, no prediction is possible. This does not mean that tax avoidance is addressed by such provision, but it may affect the very establishment or continuity of the business. The 'indication of the factors' used to solve these cases is only a suggestion, present in proposed Commentaries, that some States may follow.[57] The provision that was created to address only some blurred situations of dual residents ends up turning all cases uncertain.

As Article 4(1) of the MLI introduces a new tie-breaker rule, actually leaving the decision to the power of negotiation of the Contracting States, related provisions of the CTA involved shall not apply. Two tie-breaker rules applying to the same situation cannot be accepted. That is why Article 4(2) is considered a 'compatibility clause'.[58] This paragraph ensures that Article 4(1) of the MLI is applied in place of the tie-breaker rule established by such CTA. This replacement does not occur in case those provisions address 'the residence of companies participating in dual-listed company arrangements'.[59]

Following the same structure of Article 3 of the MLI, the last two paragraphs of Article 4, Article 4(3) and Article 4(4) also, respectively, permit partial or full reservation on Article 4 of the MLI, and establish the obligation to notify whether the State made the reservation and which type of it.

3.1.3 *Article 5: Application of Methods for Elimination of Double Taxation*

Given that high attention is required on the interaction between possible modifications to domestic law and tax treaties,[60] Action 2 establishes some recommendations regarding methods for elimination of double taxation. As a result, Article 5 of the MLI presents three alternatives of provisions in order to 'address problems arising from the inclusion of the exemption method in treaties

Notes

[53] *See* OECD, *Model Tax Convention on Income and on Capital 2014 (Full Version)* (Paris: OECD Publishing 2015), para. 24.1 on Art. 4(3) of the OECD-MC, C(4)-9, http://dx.doi.org/10.1787/9789264239081-en (accessed 31 Oct. 2017).

[54] *See Action 6 – 2015 Final Report*, at 73.

[55] *See* Part VI of the MLI.

[56] *See Action 6 – 2015 Final Report*, at 91–93.

[57] *Action 6 – 2015 Final Report*, at 74.

[58] Para. 51 of the *Explanatory Statement*.

[59] *See* para. 53 of the *Explanatory Statement*.

[60] *Action Plan*, at 16.

with respect to items of income that are not taxed in the State of source'.[61]

Article 5(1) is the introductory provision, which establishes the options that a Party may choose: Option A (paragraphs 2 and 3); Option B (paragraphs 4 and 5); Option C (paragraphs 6 and 7); or none of them. As the alternative chosen by a State shall be applied only to 'its own resident', Article 5(1) permits non-uniform application of those provisions. The Explanatory Statement clarifies that such 'asymmetrical application' is common with respect to methods for elimination of double taxation.[62] Despite the fact that the adoption of 'one-size-fits-all' provision to all CTAs listed may be a problem due to the different balances in each treaty, such Options could cause some problems. Not only could it override a tax sparing or a matching credit provision, but also jeopardize the exemption method. Regarding tax sparing clauses, the equilibrium of the tax treaty would be modified if the total credit given had been substituted to the real one.[63]

Option A intends to modify those CTAs that do not present Article 23(A)(4) of the OECD-MC.[64] Although this alternative is not considered a minimum standard, Action 2 establishes that the inclusion of Article 23 A(4) is a 'minimum' measure for the States that intend to follow the recommendations of such report.[65] Therefore, the purpose of Article 5(2) of the MLI is quite similar to the one of Article 23(A)(4) of the OECD-MC: the non-application of the exemption method in case that the other Contracting State applies the CTA, exempting or limiting the rate of such income or capital from tax. Instead of applying the exemption method, Article 5(2) provides for the credit method, allowing deduction from the tax on income or capital until, if it is the case, the tax paid to the other Contracting State. As a 'compatibility clause',[66] Article 5(3) emphasizes that the application of Article 5(2) shall only apply to CTAs that do not have a provision like Article 23(A)(4) of the OECD-MC.

Despite being limited to dividends payment, Option B would be considered by Action 2 '[a] more complete solution'[67] in comparison to Option A. According to Article 5(4), the exemption method[68] shall not be applied in case the other Contracting State consider that, under its domestic law, a deduction is risen by the income. The credit method shall be applied, allowing a deduction from the tax on the income of that resident in an amount equivalent to the income tax paid in that other Contracting State. Similarly to Article 5(3), Article 5(5) is a 'compatibility clause'[69] that clarifies the application of Article 5(4) of the MLI.

Option C would be considered by Action 2 'a more general solution to the problems of non-taxation resulting from potential abuses of the exemption method'.[70] According to Article 5(7), the scope of this alternative is to substitute the exemption method in the CTAs by the credit method. The provision introduced by Article 5(6) has the wording 'as updated by the BEPS Project',[71] which includes the following sentence on Article 23(B) '(*except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State)* (emphasis original)'.[72] This approach, however, may have consequences not previously predicted. One of them is the displacement of the obligations of both states to grant relief related to third-state income, given that both states would be taxing it only due to its residence, which may result in double taxation.[73]

Furthermore, the inclusion of such sentence has the same consequences as Article 3(2) of the MLI, since it also 'clarifies' the non-obligation to grant relief for the tax paid if the income is attributed to different taxpayers by each State.[74] Although it seems that Article 3(2) is restricted to cases related to fiscally transparent entities, there is no indication in its wording in this sense.[75] Therefore, reservations to apply only one of these provisions may present problems of interpretation.

Notes

[61] Para. 60 of the *Explanatory Statement*.

[62] Para. 60 of the *Explanatory Statement*.

[63] Schoueri & Galendi Jr., *supra* n. 3, at 340, 346. *See also* Antón, *supra* n. 3, at 544, 548–551; and R. T. Santos, *Os Instrumentos Híbridos à luz dos Acordos de Bitributação: Implicações Fiscais para Além do Projeto BEPS* 356–357 (Lumen Juris 2017).

[64] *See* para. 61 of the *Explanatory Statement* and *Action 2 – 2015 Final Report*, at 146–147.

[65] *Action 2 – 2015 Final Report*, at 147.

[66] Para. 64 of the *Explanatory Statement*.

[67] *Action 2 – 2015 Final Report*, at 147.

[68] *See* para. 66 of the *Explanatory Statement*.

[69] Para. 67 of the *Explanatory Statement*.

[70] *Action 2 – 2015 Final Report*, at 147.

[71] Para. 68 of the *Explanatory Statement*. *See also Action 6 – 2015 Final Report*, at 88.

[72] *See* OECD, *supra* n. 38, at 16.

[73] Nikolakakis et al. (Part 1), *supra* n. 41, at 553, 554.

[74] *Action 6 – 2015 Final Report*, at 89.

[75] Nikolakakis et al. (Part 1), *supra* n. 41, at 553, 554.

Despite the possibility of asymmetrical application of Options A, B and C, Article 5(8) permits full reservation of Article 5. The concern of some States may be limited to the application of Option C. In this sense, Article 5(9) permits that States 'reserve the right' to apply Option A or B, but impose the non-application of Option C by the other Contracting State. Regarding such provision, one shall agree that 'this type of reservation operates as a veto power granted by a contracting state that impedes the other contracting state from applying Option C'.[76] In order to ensure the application of the correct provisions to each CTA, Article 5 (10) establishes the obligation to notify the alternative chosen.

3.2 *Will Coordination Be Achieved?*

Notwithstanding one may argue that the first obstacle of the coordination is the proper difference between the tax treaties listed by the signatories of the MLI and the CTAs, each State may provide bilateral negotiations addressing hybrids, following the measures of Action 2. In spite of the flexibility of the MLI, minimum standards are present in this convention and, therefore, some States may not intend to include them in some tax treaties. However, whether a State lists a tax treaty, but reserves the right to apply Articles 3, 4 or 5 of the MLI, one should not expect the existence of future bilateral negotiations in order to include similar provisions. On the contrary, such reservations should be seen as a sign that States tend not to follow the Action 2 approach to hybrids. Taking into consideration the reservations adopted by the seventy-one signatories and the tax treaties listed, one may see the (in)effectiveness of the MLI provisions related to hybrids (section 3.2.1). Moreover, if only a few States adopt such approach, the coordination required by Action 2 may be undermined also considering that many States may not adopt domestic provisions given the lack of debate regarding allocation of taxing rights (section 3.2.2).

3.2.1 *The Reservations Power on Hybrid Provisions*

Taking into consideration the data of the MLI Matching Database provided by the OECD,[77] it is possible to verify whether such provisions related to Action 2 present on the MLI are being subject to reservation.[78]

Forty-six[79] out of seventy-one signatories reserved the right for the entirety of Article 3 not to apply to its CTAs. This means that 938 out of 1,116 CTAs are not modified by the MLI. From the remaining twenty-five States, only four[80] reserve the right for the non-application of Article 3(2), which implies that 66 out of 178 CTAs will be partially modified by Article 3(2). At the end of the day, only 112 CTAs[81] will be modified as envisaged by Article 3 of the MLI.

Regarding Article 4, forty-three[82] out of seventy-one signatories reserved the right for the entirety of this article not to apply to its CTAs. In terms of tax treaties, such article will not modify 934 out of 1,116 CTAs. From the remaining twenty-eight signatories, four[83] (e.g. Australia) include Article 4(1), but replacing the consequence if there is no agreement on the residence of the taxpayer. Thus, following the reservation stated by Article 4(3)(e) of the MLI, these States intend to establish that it is not possible to grant any relief unless the residence criterion is decided by the competent authorities.[84] However, as Ireland made, under the terms of the Article 4(3)(f), reservation on the entirety of Article 4 not to apply to its CTAs with States which have made the reservation provided by Article 4(3)(e), its treaty with Australia will not be modified by Article 4 of the MLI. Therefore, only 181 CTAs[85] will be affected by Article 4 of the MLI.

With respect to Article 5 of the MLI, thirty[86] signatories expressly reserved the right for the entirety of such article not to apply to all its CTAs. This means that 782

Notes

76 *See* Antón, *supra* n. 3, at 544, 548–551; and Schoueri & Galendi Jr., *supra* n. 3, at 340, 343.

77 OECD, *supra* n. 27.

78 For an overview of the reservations made by the signatories, *see* Bosman, *supra* n. 1, at 642, 651–654.

79 Austria, Bulgaria, Burkina Faso, Cameroon, Canada, China, Colombia, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Egypt, Finland, France, Gabon, Georgia, Germany, Greece, Guernsey, Hong Kong, Hungary, Iceland, India, Indonesia, Isle of Man, Italy, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Lithuania, Malta, Mauritius, Monaco, Pakistan, Portugal, San Marino, Senegal, Serbia, Seychelles, Singapore, Slovenia, Sweden and Switzerland.

80 Ireland, Japan, Luxembourg and United Kingdom.

81 As the scope of Art. 3(1) of the MLI remains verified when States reserve the right under Arts 3(5)(b) and 3(5)(d), it is considered in such number the CTAs that are not modified given the existence of a provision similar to Art. 3(4). *See* e.g. some treaties listed by Australia, Chile, Ireland, Netherlands, Norway and Spain.

82 Andorra, Austria, Belgium, Bulgaria, Burkina Faso, Cameroon, Canada, Chile, Croatia, Cyprus, Czech Republic, Denmark, Finland, France, Gabon, Georgia, Germany, Greece, Guernsey, Hong Kong, Hungary, Iceland, Isle of Man, Italy, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mauritius, Monaco, Pakistan, Portugal, San Marino, Seychelles, Singapore, Spain, Sweden, Switzerland and Turkey.

83 Australia, Costa Rica, Fiji, Indonesia and Japan.

84 *See* para. 56 of the *Explanatory Statement*.

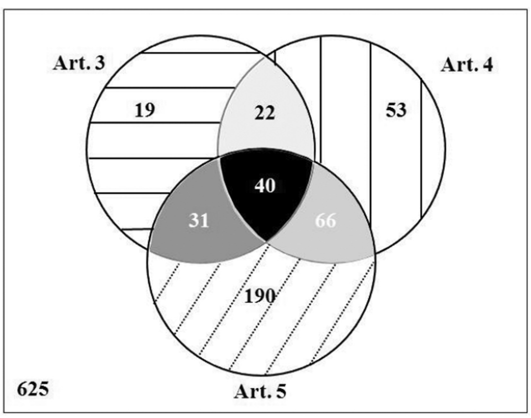
85 As the scope of Art. 4(1) of the MLI remains verified when States reserve the right under Arts 4(3)(b), (c) and (d), it is considered in such number the CTAs that are not modified given the existence of a provision similar to Art. 4(1). *See* e.g. some treaties listed by Indonesia, Ireland and Mexico.

86 Bulgaria, Canada, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, France, Greece, Guernsey, Hong Kong, Hungary, Iceland, India, Indonesia, Isle of Man, Jersey, Korea, Latvia, Malta, Mauritius, Pakistan, Russia, San Marino, Serbia, Seychelles, Singapore, South Africa, Sweden, Turkey.

out of 1,116 CTAs will be not modified by Article 5 of the MLI. From the other States, only sixteen signatories chose one Option provided by such provision. While five[87] of them chose Option A, eleven[88] signatories chose Option C and no State adopted Option B. Despite not adopting any alternative, Italy assumed that this 'does not prevent the other jurisdiction from changing its methods'; Italy chose to apply none of the Options to its own residents. Moreover, under Article 5(9) of the MLI, Liechtenstein, Luxembourg[89] and Switzerland objected the adoption of Option C by the other Contracting State: 7 CTAs[90] which would be affected by Article 5 of the MLI are addressed by such 'veto-power'. Therefore, only 327 out of 1,116 CTAs will be modified by Article 5 of the MLI. As twenty-four[91] signatories do not inform any reservation, but also have not chosen an option yet, the policy regarding such article may vary.

Considering the numbers of Articles 3, 4 and 5 altogether, i.e., matching the CTAs that are affected by one or more of these provisions, one can illustrate with the following Figure 1:

Figure 1: CTAs (Not) Affected by MLI Provisions on Hybrids[92]



From 1,116 CTAs, 491 will be modified by one or more articles related to hybrids. The remaining 625 CTAs will not contain any MLI provision on this issue. 262 out of 491 CTAs will be affected by only one article: 19 CTAs by Article 3; 53 CTAs by Article 4; and 190 CTAs by Article 5. From the remaining 229 CTAs, solely 40 will be modified by all three articles. 189 out of 229 CTAs will be changed by only two articles as the following: 22 CTAs by Articles 3 and 4; 31 CTAs by Articles 3 and 5; and 66 CTAs by Articles 4 and 5.

Taking into account the numbers of CTAs affected by each MLI article on hybrids, one can see a low commitment of the signatories to these provisions. The effectiveness of the MLI related to Action 2 is not verified in the majority of the CTAs. Actually, considering that the complete effectiveness of the MLI would be the inclusion of all three articles, it is almost ineffective as only 40 out of 1,116 CTAs are affected by such provisions. Of course this does not necessarily imply the rejection of the so-called 'single tax principle', but at least indicates that there is no consensus on its meaning and enforceability.[93]

Furthermore, these reservations adopted by the signatories denote that the coordinated approach envisaged by Action 2 may not be achieved: the 'chance of success' related to a 'collaborative process'[94] is being undermined. Once the MLI (and, obviously, Action 2) is supposed to deal with treaty issues in a 'swift and coordinated manner',[95] the prerogative of having its applications declined by signatories substantially harms such approach. As many States do not follow (entirely) the MLI provisions related to hybrids, one may not suppose that domestic provisions recommended by that Action will be enacted by them, specially, considering the lack of debate regarding the allocation of taxing rights. Accordingly, many of such provisions would not be applicable under current tax treaties; if treaties remain unaltered, then primary and defensive rules may not be effective.

3.2.2 *Allocation of Taxing Rights: A Necessary Debate*

Following the idea that the measures of the BEPS Project 'are not directly aimed at changing the existing international standards on the allocation of taxing rights on

Notes

87 Austria, Liechtenstein, Luxembourg, Netherlands and Switzerland.

88 Argentina, Cameroon, Gabon, Norway, Poland, Portugal, Romania, Senegal, Slovakia, Spain and Uruguay.

89 Only for the treaties with Austria, Belgium, Bulgaria, Czech Republic, Estonia, France, Germany, Hungary, Iceland, Liechtenstein, Monaco, Morocco, Netherlands, Panama, Poland, Romania, Saint Martin, Seychelles, Slovak Republic, South Arab and Switzerland.

90 Treaties between: Liechtenstein and Uruguay; Luxembourg and Poland; Luxembourg and Romania; Luxembourg and Slovakia; Switzerland and Argentina; Switzerland and Poland; and Switzerland and Portugal. The treaties between Switzerland and Chile, and Switzerland and Lithuania may be affected by such reservation if Chile or Lithuania adopts Option C.

91 *See* Andorra, Armenia, Australia, Belgium, Burkina Faso, Chile, China, Colombia, Egypt, Fiji, Finland, Georgia, Germany, Ireland, Israel, Japan, Kuwait, Lithuania, Mexico, Monaco, New Zealand, Nigeria, Slovenia and United Kingdom.

92 This figure was elaborated by the authors taking into account the data of the MLI Matching Database provided by the OECD. OECD, *supra* n. 27.

93 *See* De Lillo, *supra* n. 4.

94 Brauner, *supra* n. 4, at 55, 84.

95 *Action 15 – 2015 Final Report*, at 18.

cross-border income',[96] Action 2 sets aside this discussion. Actually, the debate is blurred by the difficulty to determine which State has in fact 'lost tax revenue' as the rules of each State involved have been followed. However, Action 2 alleges 'a reduction of the overall tax paid by all parties involved as a whole, which harms competition, economic efficiency, transparency and fairness'.[97] In a few words, Action 2 requires States to address tax arbitrage on hybrids without taking into account which one 'has "lost" tax revenue under the arrangement'.[98]

If Action 2 seeks to split a pie over which there is no certain criterion for division, it is symptomatic the lack of discussion regarding the allocation of the taxing rights.[99] This may be one of the reasons why the reservation power is being highly used by MLI signatories.

States may be exercising their reservation power given that MLI provisions may affect disproportionately the CTAs. Different from bilateral negotiations, the balance of the tax treaties was not addressed on the MLI.[100] No provision was included or excluded in light to ensure the equilibrium envisaged by the parties. If the scope of the MLI is to modify past choices, it ultimately changes the concessions made in the past.

Even though one may argue that the reservation power ensures the States will, the MLI provisions end up affecting the balance of the CTAs because the choices made by the other State may not be counterbalanced. Considering symmetrical and asymmetrical reservations, no State can totally anticipate what will be the provisions applicable to its CTAs. At the end of the day, it will also depend on the reservations made by the other Contracting State. One could argue that if both States opt out of a provision, the balance of the treaty is not modified. However, one State may make no reservation on a part of the MLI, but the other State opts out of only one provision of such part; despite the first State may apparently have agreed that its CTAs would be partially affected by those provisions, it would not be possible to foresee how each CTA would be affected. Given the random character of the outcome of the reservations on a certain CTA, the provisions of the MLI may modify provisions of such tax treaty that may be of concern to a Contracting State, while preventing any other act of the other Contracting State to correct another issue of the bilateral tax treaty that might be of concern to it and that is addressed by the MLI.[101] Only in some occasions it is possible to anticipate a possible measure of the other State, as in the 'veto-power' present in Article 5 (9). However, this implies the very inapplicability of a MLI provision: it becomes ineffective. Thus, despite protecting the balance of the tax treaty, coordination continues to be harmed.

Moreover, considering that some States have not signed the MLI and, even many of those that signed it do not adopt the provisions related to hybrid mismatches, the dependence on domestic provisions may also be frustrated. Besides the fact that it would be 'difficult to resolve if only domestic provisions were involved',[102] some States may not be subject to lost revenue or the capacity to attract investment[103] when, according to the recommendations of Action 2, they must consider the tax rules of the other State. Taking also into account the number of reservations adopted, there is a risk of a *bandwagon effect*: the more States indicate that they will not follow the Action 2 approach, the more other States take an individualistic approach towards it. Also, States that would be, at first sight, willing to adopt these measures, may change their belief considering such scenario. Primary and defensive rules may be adopted not following the recommendations of the Action 2. On the one hand, Source States may apply as many primary rules as possible (raising taxation) or consider that tax treaties, when is the case, prevent the application of defensive rules by Residence States (enabling the attraction of investment). On the other hand, Residence States may disregard both some primary rules applied by Source States and the jurisdiction limitation present in tax treaties; imposing as many defensive rules as possible.

Given the considerations related to reservation power as well as to the debate of allocation of taxing rights, one may conclude that the coordination, which is required to address hybrids mismatches, may not become a reality because it is being undermined.

4 Conclusion

The scope of this article was to analyse the effectiveness of the MLI provisions on hybrids, in light of the reservation power and also taking into account the coordination

Notes

96 *Action Plan*, at 11.

97 *Action Plan*, at 15.

98 *Action 2 – 2015 Final Report*, at 95. For the impossibility to assume the existence of a 'loss', *see* De Boer & Marres, *supra* n. 17, at 38; and Kuzniacki et al., *supra* n. 7, at 43.

99 For considerations related to need to debate the allocation of taxing rights, *see* L. E. Schoueri & R. A. Galendi Jr., *Justification and Implementation of the International Allocation of Taxing Rights: Can We Take on Take One Thing at a Time?*, in *Tax Sovereignty in the BEPS Era* vol. 60, 47, Series on International Taxation, (S. A. Rocha & A. Christians eds, Amsterdam: Wolters Kluwer 2017).

100 *See* D. Kleist, *A Multilateral Instrument for Implementing Changes to Double Tax Treaties: Problems and Prospects*, 44 Intertax 823, 825 (2016).

101 C. Silberztein & J-B. Tristram, *OECD: Multilateral Instrument to Implement BEPS*, 23 Int'l Transfer Pricing J. 347, 352–353 (2016).

102 Malherbe, *supra* n. 31, at 91.

103 *See* e.g. Brazil and Colombia. Kuzniacki et al., *supra* n. 7, at 46.

requirement. In this sense, considering that Action 2 seeks to address tax arbitrage, the lack of discussion regarding the allocation of the taxing rights is symptomatic.

As the very idea of coordination can be questioned in abstract level,[104] the outcome obtained on the reservations analysis is not surprising. The article shows that, taking into account the number of CTAs affected by each MLI article on hybrids, the signatories present a low commitment to these provisions. The reservations power is being highly used by them, turning the MLI provisions on Action 2 almost ineffective. From 1,116 CTAs, only: 112 CTAs will be modified as envisaged by Article 3 of the MLI; 181 CTAs will be affected by Article 4 of the MLI; and 327 will be modified by Article 5 of the MLI. Moreover, 625 out of 1,116 CTAs will not contain any MLI provision on hybrids. From the remaining 491 CTAs, 262 will be affected by only one article: 19 CTAs by Article 3; 53 CTAs by Article 4; and 190 CTAs by Article 5. Others 189 CTAs will be changed by only two articles as the following: 22 CTAs by Articles 3 and 4; 31 CTAs by Articles 3 and 5; and 66 CTAs by Articles 4 and 5. Solely 40 CTAs will be modified by all three articles. This is a clear sign that States tend not to follow the Action 2 approach to hybrids.

Several reasons may explain this result. The fact that Article 4 may increase the risk of double taxation, or that Article 5 would affect the equilibrium between Contracting States, could possibly be included among them. On a more general perspective, the authors believe that the so-called 'single tax principle', as such, has not reached the consensus ideally described by the OECD. Countries are keen to avoid double taxation, but no satisfactory explanation has been given so far why they should tax situations beyond their own policies. A deeper study on the impact of double non-taxation on international commerce, on the one hand, and on the legitimacy to tax such income, is still missing. It is not correct to state that it is irrelevant who is taxing, provided that some taxation occurs. The legitimacy of taxation is a need in International Tax.

However, one must take into account that this is not a definitive status[105] of the MLI provisions regarding Action 2. The MLI, as a whole, is being examined by the current and potential signatories. Almost all States presented a provisional list of tax treaties and of expected reservations.[106] States may be cautious to include so many provisions and may, given external pressure, withdraw their reservations. Also, only Austria and the Isle of Man have effectively ratified the MLI.[107] So far though, the reservation power is putting coordination at stake.

Notes

[104] *See* Boidman & Kandev, *supra* n. 5, at 1233, 1244; and De Boer & Marres, *supra* n. 17, at 38 and 41.

[105] For the opinion that '[t]he success of the MLI shall not be measured today', *see* Silberztein, Granel & Tristram, *supra* n. 29, at 323, 329.

[106] *See* Art. 28(7) of the MLI.

[107] *See* OECD, *supra* n. 23.