Flexibility in International Institutional Design

The Case of the OECD MLI

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Work-in-Progress, please do not circulate. All comments are extremely appreciated.

Abstract

This paper examines the effectiveness of flexibility provisions in promoting cooperation in the design of international institutions. I consider the case of the OECD Multilateral Instrument (MLI), which has achieved broad participation in signing and ratification. Its flexibility measures, however, have resulted in narrow applicability and shallow modifications to existing tax treaties. The study shows that the use of reservations by jurisdictions to opt-out of demanding articles and exclude tax treaties from being modified has limited the actual coverage of the MLI. Furthermore, the findings suggest that the choice of reservations and treaty exclusions depends on the calculated self-interest of jurisdictions, considering both the potential costs and benefits of their involvement in the MLI. Importantly, the study argues that the effectiveness of flexibility measures in promoting cooperation depends on the scope of the existing international regime. Specifically, when a multilateral convention is tasked to reform an existing regime that is mainly built upon bilateral agreements, the effectiveness of flexibility measures can be limited by an uneven distribution of potential benefits and the tendency of states to avoid costly commitments. This paper contributes to the literature on institutional design and compliance and highlights the need for careful consideration of the inclusion of flexibility provisions in the design of similar multilateral conventions in the future.

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1 Introduction

Global issues necessitate international cooperation, often facilitated through multilateral institutions that aspire to a broad, ideally universal, array of participants. However, the existence of preference heterogeneity among states, combined with the necessity of unanimous commitment to establish such a multilateral institution, might result in a broad yet shallow agreement determined by the least common denominator (Downs et al. 1998). To avoid the so-called broader-deeper trade-off, multilateral institutions often incorporate various forms of flexibility measures to allow nonuniform obligations across states (Gilligan 2004). In many issue areas, flexibility is considered as an efficient design feature that promotes deeper cooperation among states that they would otherwise not commit to in the absence of those flexible arrangements (Rosendorff and Milner 2001; Bernauer et al. 2013; Kucik and Reinhardt 2008; Koremenos 2005).

In this paper, I argue that there is a crucial scope condition for the argument that international institutions equipped with flexibility provisions are cooperation-enhancing. Specifically, when a multilateral convention is tasked to reform an existing international regime that is mainly built upon bilateral agreements, flexibility measures can result in a narrow and shallow institution. The reason is two-fold. Firstly, while it takes the mutual agreement between parties of the original bilateral agreement for the multilateral convention to be applicable, either party can unilaterally impede cooperation, either in part or in its entirety. Secondly, due to the uneven distribution of potential benefits of the new institution, states would tend to use flexibility measures to avoid costly commitments. Therefore, the mismatch between countries' positions further limits the actual applicability of the new, multilateral institution.

I examine the argument with the case of the OECD *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (MLI).[1] As a crucial component of the Base Erosion and Profit Shifting (BEPS) project, the OECD MLI seeks to address international tax avoidance and tax treaty shopping by reforming the existing inter-

1. Throughout the paper, I use "OECD MLI", "MLI", "Multilateral Convention" interchangeably to refer to this institution.

national tax regime that is built upon thousands of bilateral tax treaties (BTTs). Given the sheer number of BTTs, the OECD concluded that it would be too cumbersome if the changes were carried out through bilateral renegotiation (OECD 2014). Instead, the proposed MLI can "streamline the implementation of the tax treaty-related BEPS measures" and modify existing tax treaties in a synchronized way (OECD 2015). Officially launched in June 2017 and entered into force a year later, the MLI has garnered 100 signatories worldwide (as of this writing), among which 79 jurisdictions have ratified the agreement by the end of 2022.[2]

Although the OECD MLI resembles other multilateral agreements in the way that it provides states with various flexibility provisions, I argue that these measures, instead of avoiding the broader-deeper trade-off, actually turn the MLI into a shallow and narrow institution. To empirically test this argument, I collect data on the position that MLI signatories have taken across all substantive articles. I document that the actual applicability of the MLI, in terms of the tax treaties covered, is much narrower than the number of its participants. Even for tax treaties that would be affected, the level of modification is considerably shallow due to the use of reservations to opt out of provisions. Moreover, using various measures that capture the potential cost and benefit if the MLI is applied, I find that jurisdictions tend to exploit the flexibility of the MLI for self-interest. Firstly, states with lower corporate tax rates opt out of more optional articles and only commit to the least demanding options to meet the minimum standard. Secondly, states are more inclined to include a certain tax treaty for MLI coverage if the treaty represents a greater challenge of tax treaty-shopping. In addition, by examining the case of dividend transactions, I find that only countries that choose to apply an article that seeks to address dividend-related treaty abuse would actually utilize the MLI by including tax treaties that expose them to treaty-shopping risks.

This paper contributes to the literature on institutional design by analyzing a unique case in international cooperation: the OECD MLI. The analysis furthers our comprehension of the role of flexibility in the design of international institutions. In line with existing studies on the usage of reservations in human rights treaties (Hill Jr 2016; McKibben and

2. Signatories of the OECD MLI includes jurisdictions that are not sovereign states, such as the Crown Dependencies of the United Kingdom (Jersey and Guernsey) and Special Administration Region of China (Hong Kong). Throughout the paper, I use terms like "states", "countries", and "jurisdictions" interchangeably to refer to these units.

Western 2020), the findings indicate that states often opt out of more demanding articles upon ratifying the multilateral agreement. Nonetheless, the MLI differs from human rights treaties in that it intends to modify bilaterally-negotiated agreements. While reservations are made unilaterally by each state, the effects of these reservations apply symmetrically to both parties of BTTs.

Examining the unique case of the OECD MLI, this paper also furthers our understanding of the interplay between bilateralism/regionalism and multilateralism in international cooperation. While the impact of preferential trade agreements (PTAs) on the multilateral trading system has been widely debated in the literature, with PTAs being seen as either building blocks or stumbling blocks for the WTO (Baldwin and Seghezza 2008; Horn et al. 2010; Bagwell et al. 2016; Bhagwati 2008; Limão 2006), the unique case of the OECD MLI offers a valuable perspective on the effect of multilateralism on existing bilateral arrangements. By exploring the consequences of flexibility measures embedded in the MLI, this study enhances our understanding of the potential complementarity or tension between bilateralism and multilateralism in the realm of international tax cooperation.

Moreover, the findings of this study have important implications for future international tax reform. Despite the fact that countries face constraints on their fiscal autonomy due to tax treaty-shopping (Arel-Bundock 2017), the MLI is unlikely to entirely eradicate this practice and "kill treaty shopping", as some OECD officials had hoped it would.[3] This highlights the need to acknowledge the distributional nature of the modern international tax regime (Rixen 2008) and to consider it carefully in the design of new multilateral conventions. By gaining a deeper understanding of the factors that motivate countries to utilize flexibility provisions in multilateral tax agreements, policymakers can better design international tax governance frameworks that promote greater equity and reduce opportunities for tax avoidance.

The remaining sections of this paper are structured as follows: Section 2 provides a review of the existing literature on the role of flexibility in the design of international insti-

3. Following the signing ceremony of the MLI in June 2017, OECD tax policy director Pascal Saint-Amans commented that the MLI is "going to kill treaty shopping". See https://www.reuters.com/article/us-oecd-tax-idUSKBN18Y2SL

tutions. In Section 3, I introduce the case of the OECD MLI and develop the argument for how the flexibility provisions have influenced its effectiveness. Section 4 presents descriptive evidence that illustrates the narrow and shallow nature of the MLI resulting from the flexibility provisions. Then, in Section 5, I provide empirical evidence on the determinants of participation, the use of reservations, and the inclusion of tax treaties for MLI coverage. Lastly, Section 6 concludes with a discussion of the implications of the findings.

2 Flexibility and the Broader-Deeper Trade-Off

One of the fundamental questions in the field of international relations concerns the optimal design of international institutions to facilitate cooperation among states. Flexibility, as a critical dimension of institutional design, plays an essential role in promoting cooperation through international institutions (Koremenos et al. 2001; Voeten 2019). The ability of institutions to accommodate diverse preferences, needs, and circumstances of states can foster trust and facilitate agreement among them. This highlights the importance of understanding how flexibility is incorporated into international institutions and how it impacts their effectiveness in achieving their objectives.

2.1 Ex-post Flexibility Measures

Early works on flexibility primarily focus on what can be categorized as "ex-post" flexibility. This refers to the ability of states to modify their obligations *after* the establishment of the institution, particularly in cases of unforeseen circumstances or crises. According to Koremenos et al. (2001), flexibility pertains to "how institutional rules and procedures accommodate new circumstances" (773).

Prominent examples of ex-post flexibility include "escape clauses" in trade agreements (Rosendorff and Milner 2001) and "derogation" provisions in human rights treaties (Hafner-Burton et al. 2011). Ex-post flexibility measures are considered as efficient and can make initial agreements easier to reach, especially in cases where the uncertainty over future situations is high (Rosendorff and Milner 2001). By allowing states to temporarily suspend their obligations without violating the agreement, this kind of flexibility measures enhances the likelihood of cooperation and enables states to make deeper commitments (Kucik and Reinhardt 2008).

Other types of ex-post flexibility in the design of international institutions involve treaty duration and renegotiation provisions, or transformative flexibility as defined by Koremenos et al. (2001). Similar logic suggests that finite duration and renegotiation provisions are more likely to be included when future circumstances are highly uncertain (Koremenos 2005).

2.2 Ex-ante Flexibility Measures

In multilateral institutions, the existence of preference heterogeneity and the necessity of unanimous agreement might result in shallow commitments in the sense of the least common denominator, often known as the broader-deeper trade-off (Downs et al. 1998). However, there is a remedy, which is to allow the members to establish varying levels of commitment through the institution design (Gilligan 2004; Bernauer et al. 2013).

This remedy requires a different type of flexibility that manifests *before* the establishment of the institution. This accordingly can be termed as "ex-ante" flexibility. The most common type of ex-ante flexibility is the use of reservations to opt out of certain provisions (Koremenos 2016). By employing reservations, members of the same multilateral institution are not confined to the same set of commitments and provisions. Instead, they are able to reconcile the multilateral obligation with their own circumstances and preferences, thus broadening participation to states that would otherwise be unwilling to join (Simmons 2009).

"Ex-ante flexibility" is often found in issue areas that aspire to universal participation, such as human rights treaties and environment agreements (Hafner-Burton 2013; Neumayer 2007; Marcoux 2009). Recent studies often find that states make calculated decisions while deciding on the use of reservations, especially in human rights treaties where governments whose preference is not in line with the treaty obligations would also sign and ratify these agreements (Vreeland 2008). In choosing the provisions to opt out through the reservation, members of human rights treaties not only consider the state-level characteristics (Simmons

2009, 98–103; Neumayer 2007), but also weigh the individual obligations (Zvobgo et al. 2020) and opt out the provisions that they find most challenging to conform to (McKibben and Western 2020).

Therefore, the existing literature highlights the importance of flexibility measures in inducing otherwise impossible cooperation among states. Especially for multilateral conventions aiming at a broad participation base, the inclusion of ex-ante flexibility measures, such as reservations, is essential to accommodate varying preferences while circumventing the broader-deeper trade-off.

However, as argued in the next section, the OECD MLI provides a unique and valuable case where flexibility proves to be counterproductive. Instead of ensuring a broad participation with relatively deep commitments, flexibility turns the MLI into a narrow and shallow convention.

3 The OECD MLI: Narrow and Shallow?

In the aftermath of the global financial crisis, the OECD and G20 launched the BEPS project in 2013 to address the issue of international tax avoidance and tax evasion, which results in significant tax revenue loss. The project developed a 15-point action plan, including Action 15, which recognized that the international tax regime heavily relies on thousands of tax treaties signed between countries.[4] To achieve the BEPS goals, many measures of the plan require amendments to existing tax treaties, hence highlighting the need for a multilateral instrument to provide an innovative approach to international tax matters.

To address this challenge, the OECD Committee on Fiscal Affairs (CFA) developed a mandate in February 2015 to set up an ad hoc Group for the development and negotiation of a multilateral instrument to "provide an innovative approach to international tax matters" (OECD 2015, 9). The group held its first meeting in November 2015 and completed negotiations within only a year. In November 2016, the MLI was adopted by the ad hoc Group, which had grown to involve more than 100 jurisdictions.

Maximizing the number of participating jurisdictions has been a top priority for the

4. See https://www.oecd.org/tax/beps/beps-actions/

OECD, who believes that the existing international tax rules can only be genuinely modified and harmonized through broad participation, thus achieving a level playing field (OECD 2015, 19). As a result, ever since the designing stage, the OECD has wanted the ad hoc Group to design a multilateral instrument that can "provide flexibility in the level of commitment". Acknowledging the heterogeneity both among different countries as well as different bilateral treaties, the MLI is designed to be "flexible enough to accommodate the positions of different countries and jurisdictions" (OECD 2017, para. 14).

At first glance, the MLI might seem to be yet another success story where flexibility contributes to broad participation. Its first high-level signing ceremony, held on June 7, 2017 in Paris, has attracted the participation of 76 governments to sign on the multilateral convention. Ever since then, the number of participants keep growing. On October 6, 2022, when Mongolia submitted its signature, the OECD cheerfully reported that it has now 100 signatories – "an important milestone."[5]

However, there are crucial distinctions between the MLI and other multilateral agreements. Despite the success of attracting a large number of signatories, the nature of the MLI implies that the breadth of its applicability cannot be evaluated simply with the number of participating jurisdictions. Instead, what is crucial is the number and content of bilateral treaties that will actually be covered and modified by the MLI. The MLI's unique nature indicates that the flexibility measures actually compromise its effectiveness, making it lack both breadth and depth. In the following sections, the paper explains in detail how the MLI's flexibility compromises its effectiveness in modifying and harmonizing international tax rules.

3.1 Flexibility Measures in the MLI

The MLI contains thirty-nine articles, arranged into seven different parts. Articles from Part II through Part VI contain the "substantive" provisions that correspond to different proposed modifications of tax treaties based on the BEPS action plan. Table 1 below shows

5. See https://www.oecd.org/tax/beps/mongolia-signs-landmark-agreement-to-strengthen-its-tax-treaties-and-south-africa-de htm.

the correspondence between the OECD MLI and BEPS actions.[6]

Table 1: OECD MLI: Parts, Articles, and Corresponding BEPS Actions

Part	Article	BEPS Action
I: Scope and Interpretation of Terms	Article 1 - 2	
II: Hybrid Mismatches	Article 3 - 5	Action 2
III: Treaty Abuse	Article 6 - 11	Action 6
IV: Avoidance of Permanent Establishment Status	Article 12 - 15	Action 7
V: Improving Dispute Resolution	Article 16 - 17	Action 14
VI: Arbitration	Article 18 - 26	Action 14
VII: Final Provisions	Article 27 - 39	

Notes: Columns 1 and 2 display the different parts and articles comprising the OECD MLI. Column 3 indicates the relevant BEPS action for each substantive part of the MLI. For further information, please refer to https://www.oecd.org/tax/beps/beps-actions/.

The flexibility measures in the OECD MLI are twofold. The first dimension is that signatories can choose to reserve the right either for the entirety or part of a certain article not to apply to its tax treaties, depending on whether the articles reflect the "minimum standards" of BEPS actions. Among the substantive provisions, only the following four articles are mandatory because they consist of BEPS minimum standards[7]:

1. Article 6: Purpose of a Covered Tax Agreement
2. Article 7: Prevention of Treaty Abuse
3. Article 16: Mutual Agreement Procedure
4. Article 17: Corresponding Adjustments

For these mandatory articles, while jurisdictions cannot completely opt out of the provisions, the OECD still provides them with multiple alternatives to choose from. Although the OECD insists that it does not "give preference to a particular way" that states choose

6. The Multilateral Instrument itself is the Action 15 of the BEPS Project. See https://www.oecd.org/tax/beps/beps-actions/action15/

7. Article 6 and 7 correspond to BEPS action 6 – Prevention of tax treaty abuse, and Article 16 and 17 corresponds to BEPS action 14 – Mutual Agreement Procedure.

to meet the minimum standard (OECD 2017, para. 14), there are clear differences in the level of stringency and subsequent compliance and adjustment costs. The difference is most evident in Article 7 on measures to prevent treaty abuse, which is the most lengthy and probably the most important article in the entire MLI. For this article, states can choose to either apply the Principle Purpose Test (PPT), or the PPT in combination with the Limitation of Benefits (LOB) provision.[8] While the identification of the "principal purpose" of a particular arrangement or transaction is objective and subject to interpretation (Avi-Yonah and Xu 2018), the LOB test includes detailed requirements for "qualified persons".

Articles other than the mandatory ones are generally considered as optional. For these provisions, states are "generally given the flexibility to opt out of that provision entirely" (OECD 2017, para. 14). To do so, jurisdictions simply need to state that they "reserve the right for the entirety of Article X not to apply", when submitting the list of reservations and notifications to the OECD.

The second dimension of flexibility measures in the OECD MLI is that states get to specify the bilateral treaties that they wish to be covered, and subsequently modified, by the multilateral convention. Since the MLI aims to modify the entire BTT network in a synchronized way, it intends to be applied to "the maximum possible number of existing agreements" (OECD 2017, para. 9). Nevertheless, states are still provided with the flexibility to exclude certain tax treaties from the multilateral convention. To do so, they just need to make sure the treaty is not in the list of agreements to be covered in their notification submitted to the OECD, no justification needed.

3.2 Matching of Reservations and Treaty Coverage

Therefore, members of the OECD MLI are guaranteed twofold flexibility measures upon signing and ratifying the multilateral convention: 1) choice of alternatives in mandatory provisions, together with their opt-out freedom of optional articles; and 2) the freedom to specify existing tax treaties to be covered. While flexibility might benefit both the breadth and depth of multilateral agreements in other cases, it actually makes the MLI both narrower

8. See OECD (2016, Art. 6)

and shallower.

The reason for the MLI's narrowness and shallowness can be attributed to its nature as a multilateral convention intended to modify bilateral treaties. Flexibility measures, such as the ability to opt out of certain provisions, are significantly magnified in this context. These measures impact every stage of determining the applicability of MLI provisions, including whether a treaty will be modified and which article will be modified.

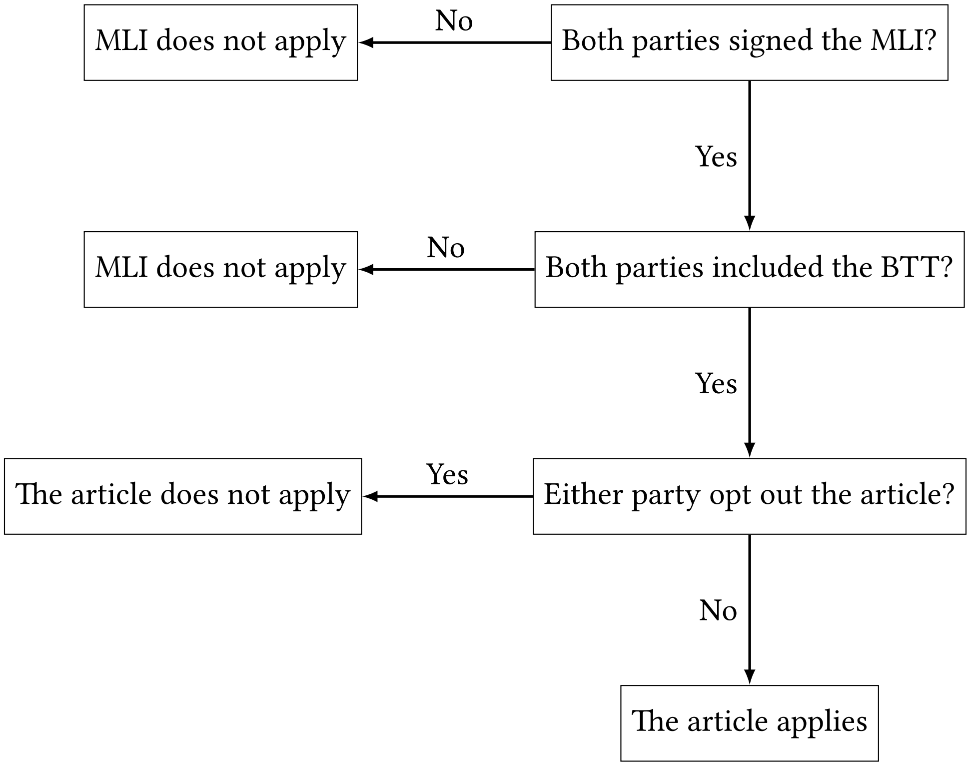
In the first stage, the MLI only applies to "Covered Tax Agreements" (CTAs). That is, a bilateral tax treaty that both parties have included in the list of treaties to be covered in their notifications submitted to the OECD. As a result, as long as one country decides not to include the treaty, regardless of the other jurisdiction's position, the treaty would not be impacted by the MLI.

If both parties have included their bilateral treaty to be covered by the MLI, thus entering the second stage, the application of the MLI provisions would depend on the reservations made by the signatories. Here, the same logic applies. As long as at least one party chooses to opt out of a certain provision, that article would not apply to the CTA.[9]

Figure 1 below shows the condition for a certain MLI provision to be applied to a bilateral tax treaty.

9. Similarly, if one party reserves the right for part of the article not to be applied, even though the other party makes no reservations, only the part of the article that neither party has reserved would be applied.

Figure 1: MLI Article Applicability Flowchart



Notes: This figure shows the conditions for a generic article in the OECD MLI to be applicable to a specific bilateral tax treaty. Applicability may vary depending on factors such as whether the article is mandatory for meeting the BEPS minimum standard, whether either party has opted out of the provision, and the existence of similar clauses in the treaty.

Therefore, the flexibility measures in the MLI is magnified by the "matching" process and make it much harder for the provisions to be applicable. Compared with other cases, when states elect reservations upon ratifying human rights treaties, they do so to only change their own obligation in those agreements. However, in the case of the MLI, while reservations are made unilaterally by each state, the effect of these reservations applies symmetrically to both parties of the bilateral treaty that falls under the MLI.[10] In other words, any party has the veto power over the application of a certain MLI provision to any of its bilateral tax treaties.

Even worse, the much-emphasized flexibility measures in the MLI are not as flexible as they are portrayed: states are generally not allowed to make reservations on a certain provision *only* to part of the treaties they have notified – something that is possible if the

10. See https://www.oecd.org/tax/treaties/step-by-step-tool-on-the-application-of-the-MLI.pdf

treaties are modified through bilateral negotiation. In order to do so, they need to either exclude the treaty to be covered by the MLI, opt out of the provision in relation to all the treaties it has notified, or both.

In summary, the flexibility measures that OECD counted on to ensure broad participation of the MLI would lead to a multilateral convention that lacks both breadth and depth. In contrast to the existing literature highlighting the cooperation-promoting feature of flexibility measures, the case of the MLI provides an important scope condition for such arguments. When the new multilateral institution is tasked to reform an existing international regime mainly built upon bilateral agreements, a focus on providing flexibility in the design of the multilateral institution might actually be cooperation-inhibiting.

In the following sections, I first present descriptive evidence that, despite having a large number of signatories, the MLI has limited breadth and depth. Then, I provide empirical evidence in support of the argument that states deliberately utilize the MLI's flexibility measures to implement only the least costly changes, leading to its shallowness and narrowness.

4 Descriptive Evidence

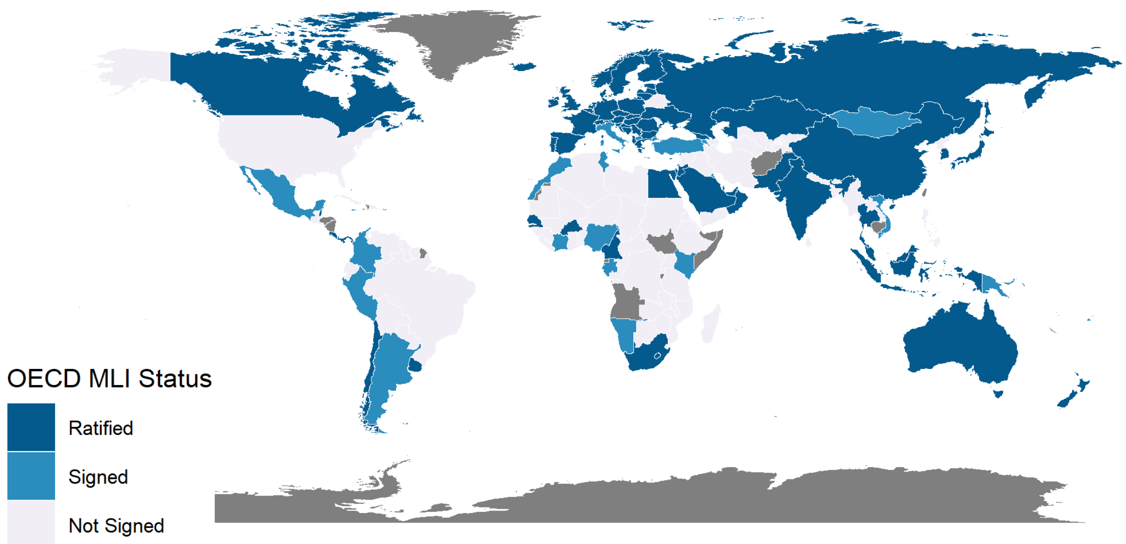
How do the various flexibility measures included in the MLI affect its breadth and depth? In this section, I first provide some descriptive evidence showing that, despite the ostensibly broad participation, the actual applicability of the MLI is seriously limited due to the high degree of flexibility its signatories enjoy.

4.1 Signatories of the MLI

Figure 2 below shows the geographical distribution of all the MLI signatories (at this writing).[11] By the end of 2022, a total of 100 jurisdictions have signed the multilateral convention, among which 79 have deposited the ratification instrument to the OECD.

11. Data from the OECD, see https://oe.cd/mli

Figure 2: Participants of the OECD MLI



Note: This figure displays the signing and ratification status of the OECD MLI by jurisdictions as of the end of 2022. Of the 100 signatories, 79 have deposited the ratification instrument. Jurisdictions shown in gray either have no active bilateral tax treaties as of 2015 or are overseas territories of other sovereign states.

Most major economies have signed the MLI, including countries that been identified by scholars as investment hubs including Ireland, Luxembourg, the Netherlands, and Mauritius. These countries have been benefiting from tax treaty shopping schemes and might have been expected to resist the proposed modification of bilateral tax treaties ('t Riet and Lejour 2018; Beer and Loeprick 2018).

The most notable absentee from the MLI is the United States, which was a member of the ad hoc Group but so far has not yet signed the multilateral convention. Henry Louie, then deputy international tax counsel at the U.S. Treasury, stated that the reason was "the bulk of the multilateral instrument is consistent with U.S. tax treaty policy that the Treasury Department has followed for decades."[12] Brazil, on the other hand, is the only other G20 member that has not joined the MLI. According to the Brazilian Tax Administration, the main reason for its absence is the anticipated difficulty and lengthiness of obtaining approval from its National Congress (Tomazela 2017).

Besides the U.S. and Brazil, other non-signatories of the MLI are mainly geographically

12. Kevin A. Bell. 2017. "Treasury Official Explains Why U.S. Didn't Sign OECD Super-Treaty. https://www.bna.com/treasury-official-explains-n73014453413/. Cited in Oguttu (2018).

concentrated, including jurisdictions in Africa, South America, and the Middle East and Central Asia regions, where the tax treaty network is not as expansive as in Europe or East Asia.

In sum, when it comes to participating jurisdictions, it does not seem to be the case that countries choose to stay away from signing the MLI in order to keep their existing tax treaties untouched. In Section 5.1, I provide further evidence showing that the determinants of countries' decision to participate in the OECD MLI are practical, rather than tax treaty-shopping concerns.

4.2 The Use of Reservations

Despite the seemingly broad participation of jurisdictions, the true breadth of the MLI, as argued in the previous section, is determined by the reservations that its signatories choose to apply, and the tax treaties that are covered. To evaluate this, I gathered data on the use of reservations for each substantive article of the MLI, based on the Instrument of Ratification provided by each state to the OECD.

As shown below in Figure 3, a significant proportion of jurisdictions choose to limit the true applicability of the MLI through reservations. For mandatory articles, jurisdictions often opt for the least demanding option to meet the BEPS minimum standard. For example, as in the mandatory Article 6, while Article 6 (3) only seeks to include the following sentence in the preamble language to existing tax treaties, 29 jurisdictions (37%) decided to opt out of it as it was not required for the minimum standard:

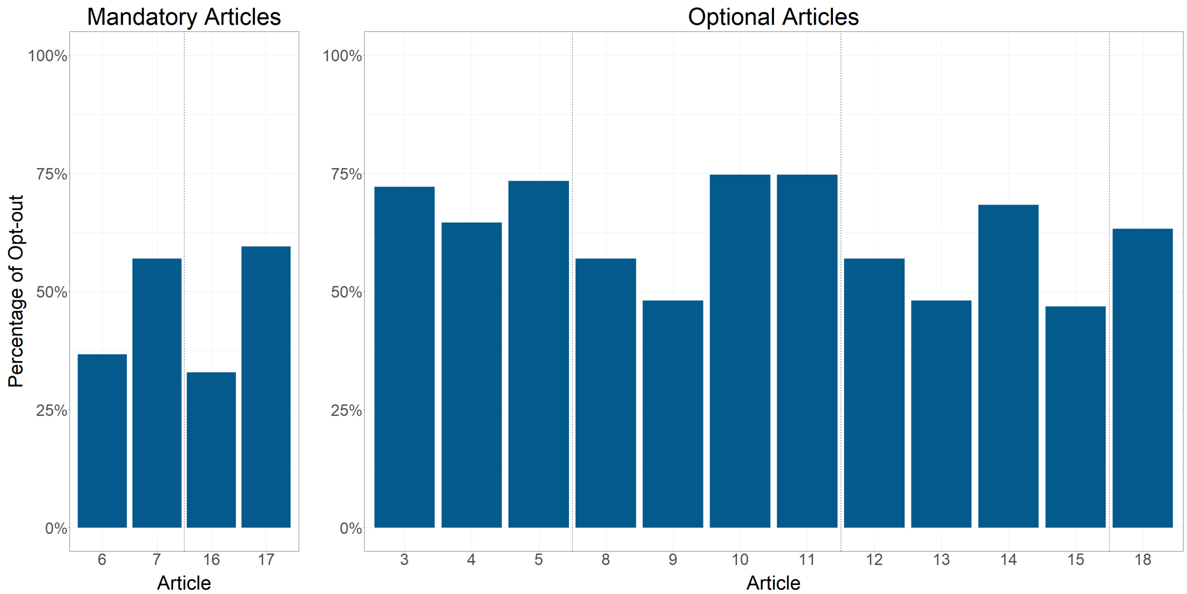
> "Desiring to further develop their economic relationship and to enhance their co-operation in tax matters,".[13]

Regarding more demanding provisions such as Article 7, more than half of the signatories chose to only apply the default PPT measure, while giving up on the more detailed LOB clause.

The take-up of optional articles in the MLI is even lower. On average, these clauses are completely opted-out by the signatories through reservations in more than 60% of the cases.

13. OECD (2016). Art. 6 (3).

Figure 3: Proportion of Article Opt-Outs, Jurisdiction-Level

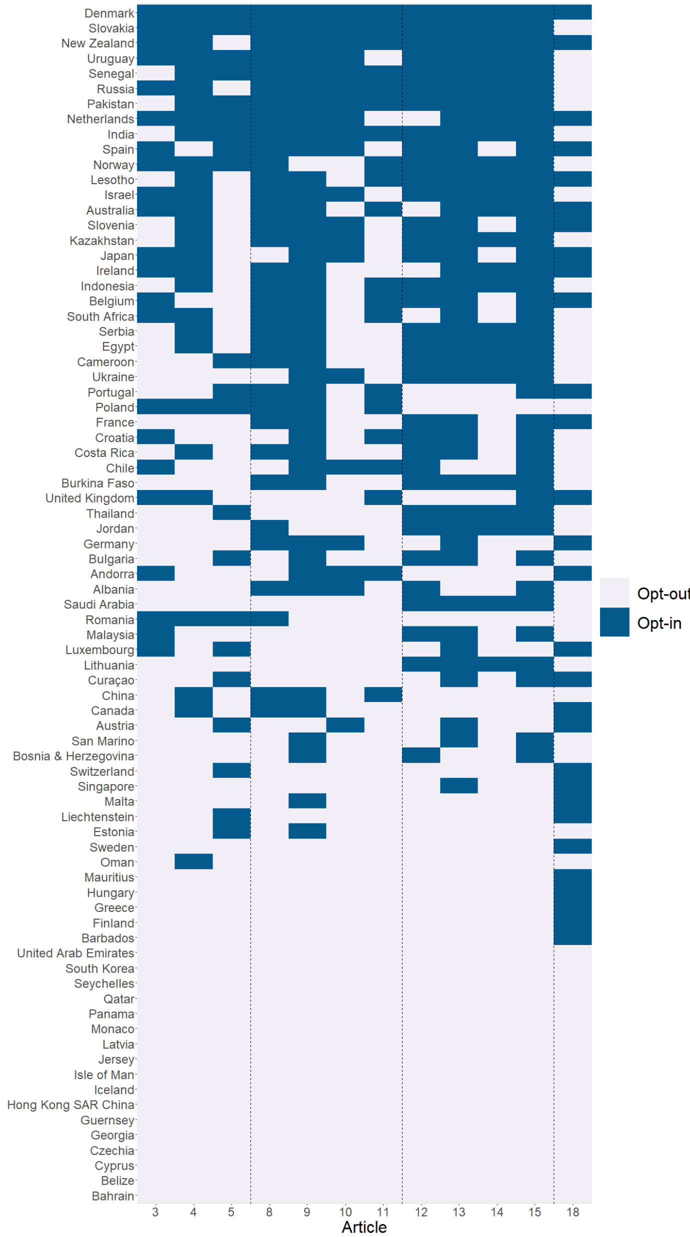


Note: The left panel displays the percentage of jurisdictions that opted for the least demanding option for each of the four mandatory articles. The right panel shows the percentage of jurisdictions that chose to opt-out of the entire article for each of the optional articles. See Table A.1 in Appendix A for a complete list of the coding scheme. Jurisdictions can opt out of Part IV, which includes Articles 18 to 26 on Arbitration, by reserving Article 18. The data is based on a sample of 79 jurisdictions that deposited the ratification instrument by the end of 2022.

There is also a huge variation across countries in terms of the use of reservations, as illustrated in Figure 4 below. On the one hand, some countries rarely use reservations to opt-out of optional articles, including Denmark, Slovakia, and New Zealand. On the other hand, jurisdictions that are known for conducing treaty shopping schemes, such as Cyprus, Barbados, and the Channel Islands (Jersey and Guernsey), have opted out of all the optional articles.

This variation raises the question of whether countries with more favorable tax codes, which are more likely to play a role in tax treaty shopping and be hit by MLI modifications, are more likely to use reservations. To address this question, I examine the factors that affect countries' use of reservations upon ratifying the MLI in Section 5.2.

Figure 4: Opt-Outs of MLI Articles



Note: This figure visually represents the opt-out behavior of jurisdictions for specific optional articles in the OECD MLI, ordered by the total number of reservations. Columns represent individual articles while rows represent jurisdictions. See Table A.1 in Appendix A for a complete list of the coding scheme. Jurisdictions can opt out of Part IV, which includes Articles 18 to 26 on Arbitration, by reserving Article 18. The data is based on a sample of 79 jurisdictions that deposited the ratification instrument by the end of 2022.

4.3 Tax Treaty Coverage

In addition to opting out of the articles, the inclusion of tax treaties to be covered by the MLI directly determines the coverage of the multilateral instrument. In the end, the MLI could only modify "Covered Tax Agreements" – tax treaties that both parties have notified the OECD to be covered by the multilateral convention.

The left panel of Figure 5 shows the matching status of all notified tax treaties.[14] While more than 1300 tax treaties are matched thus the MLI is applicable, over 300 tax treaties will not be covered because at least one jurisdiction has excluded it from their list in the notification. In addition, there are also more than 1200 tax treaties in the waiting status because the other party has not yet signed or ratified the MLI.

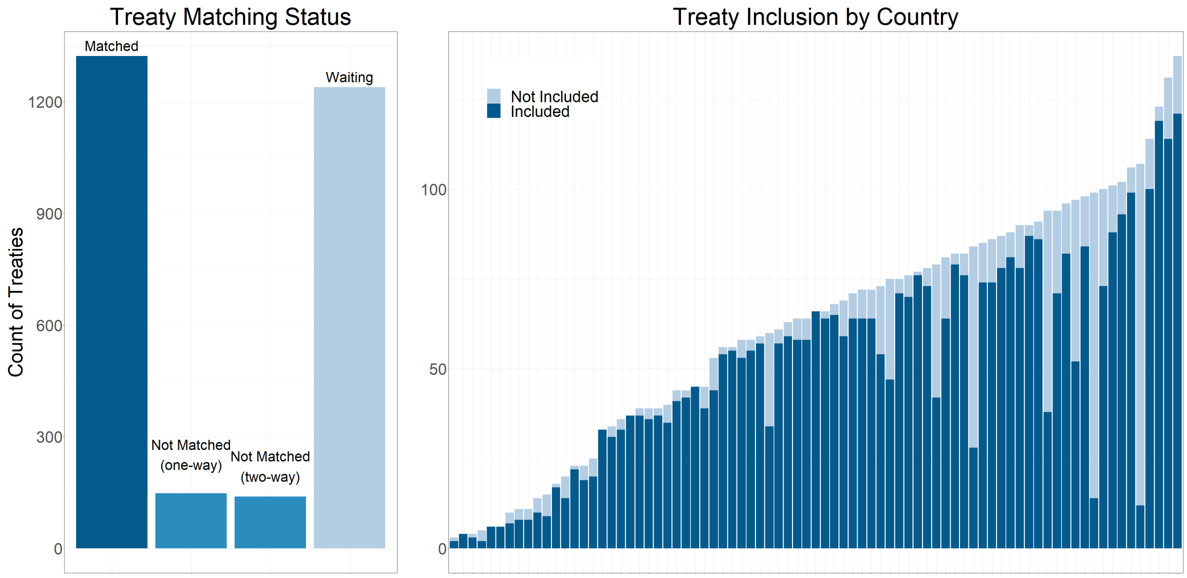
More importantly, jurisdictions have excluded a significant number of tax treaties from MLI coverage. However, the complete portfolio of tax treaties for each jurisdiction is not publicly available, making it challenging to understand this pattern. The right panel of Figure 5 shows the MLI coverage across jurisdictions using data from Qian (2023), who has compiled the universe of tax treaties since the 1900s.[15] Combined, the 79 jurisdictions that have ratified the MLI have excluded over 800 tax treaties from MLI coverage. For example, while Switzerland have concluded more than 100 tax treaties, one of the most in the world, it only included 12 of them in the ratification instrument. Similarly, Germany merely notified 14 tax treaties out of its portfolio of almost 100.

In Section 5.3, I investigate how MLI ratifiers determine which of their existing tax treaties are included for MLI coverage. To answer this question, I examine the potential gain and loss on a dyad-level within each country, if the corresponding tax treaty is modified by the MLI.

14. Data collected from "Notification – Agreements Covered by the Convention" as listed in each jurisdiction's Instrument of Ratification.

15. For this part of the calculation, only the tax treaties that jurisdictions have signed before the deposition of the ratification and have not been terminated upon ratification are included.

Figure 5: Number of Treaties by Matching Status



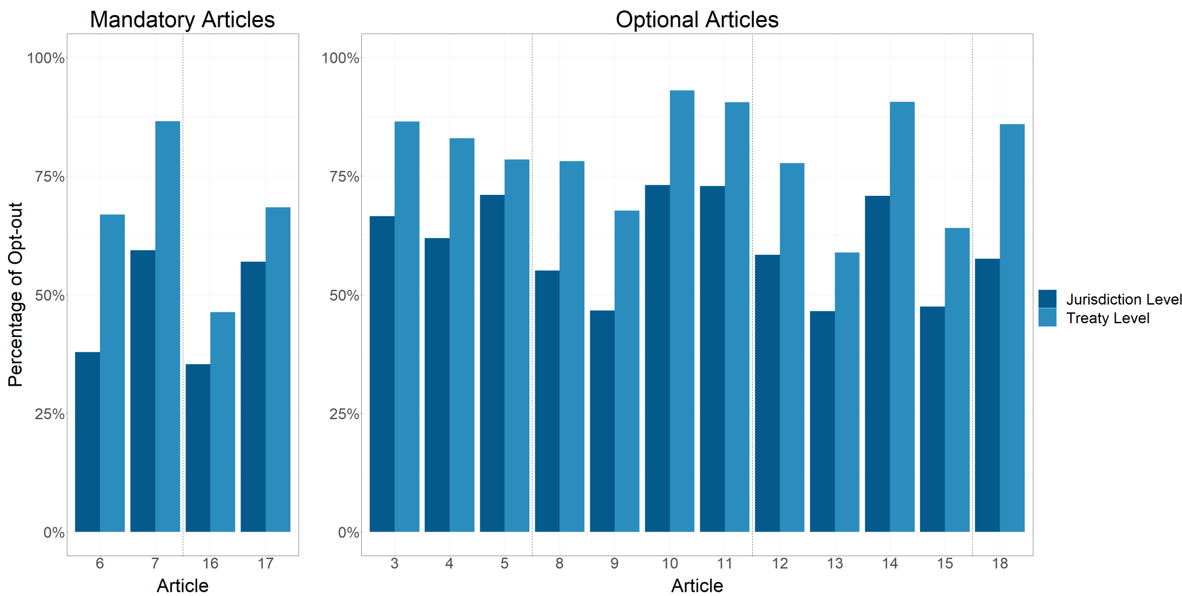
Note: The figure displays the bilateral tax treaty matching status and MLI coverage across jurisdictions. The left panel shows whether treaties are matched (both parties have notified the treaty), not matched (one party has not notified the treaty, either one-way or two-way), or waiting (the other party has not yet signed the MLI or deposited the ratification instrument). The right panel displays the number of treaties included (or not included) for MLI coverage by each jurisdiction. Data is based on Qian (2023).The data is based on a sample of 79 jurisdictions that deposited the ratification instrument by the end of 2022.

4.4 Reservation Mismatch

As argued in the previous section, any jurisdiction can block the application of a certain MLI provision unilaterally, even if the treaty of concern is notified by both parties. Consequently, the reservations used by the MLI signatories will be magnified when reflected in the actual applicability of MLI provisions to specific tax treaties.

Figure 6 confirms that reservations made by jurisdictions significantly limit the true applicability of the MLI. Using data on the applicability of each substantive article for every tax treaty that is covered by the MLI, Figure 6 shows that the actual proportion of treaty opt-outs is consistently higher than the proportion calculated based only on the jurisdiction-level position. The light blue bars in the figure show the proportion of tax treaties that would undergo modification with the least demanding option for mandatory articles or remain unmodified for optional provisions. In comparison, the dark blue bars display the same proportion of tax treaties, but weighted by the total number of tax treaties notified and taking into account the reservations made by each jurisdiction.[16] This pattern is consistent across all articles.

Figure 6: Comparison of the Proportion of Article Opt-Outs



Note: This figure presents the percentage difference in all matched treaties that will a) undergo modification with the least demanding option for each of the four mandatory articles (left panel); b) remain unmodified for each of the optional articles (right panel). The dark blue bars indicate the percentage calculated at the jurisdiction level, weighted by the number of tax treaties that the jurisdiction chooses to include in the MLI. The light blue bars indicate the percentage calculated based on all notified treaties. See Table A.1 in Appendix A for a complete list of the coding scheme. Jurisdictions can opt out of Part IV, which includes Articles 18 to 26 on Arbitration, by reserving Article 18. The data is based on a sample of 79 jurisdictions that deposited the ratification instrument by the end of 2022.

5 Empirical Analyses

So far, I have illustrated that the use of flexibility measures by MLI signatories, in the form of opting out of articles and excluding treaties, is prevalent. This situation constrains the actual applicability of the MLI to a great extent.

16. That is, Total opt-out$_j$ = $\sum_i(\text{Treaty}_i * \text{Opt-out}_{ij})$, where Treaty$_i$ refers to the total number of tax treaties notified by country i, and Opt-out$_{ij}$ indicates whether the jurisdiction chose to opt-out of article j.

In this section, I explore the motivation behind jurisdictions' participation in the MLI and utilization of its flexibility provisions. To do so, I focus on the differences in tax treaty-shopping concerns across both countries and their existing tax treaty partners.

Specifically, I provide empirical evidence for the following arguments:

1. The decision of countries to participate in the OECD MLI is primarily driven by practical concerns rather than tax treaty-shopping concerns.

2. Instead, the use of reservation and inclusion of tax treaties are determined by tax treaty-shopping factors.

5.1 Which Countries Signed the MLI?

5.1.1 Sample

To investigate the determinants of signing the OECD MLI, I focus on a sample of 183 jurisdictions that have signed at least one "eligible" BTT, and therefore are potentially affected by the MLI. Given that the OECD MLI was drafted in 2016, an "eligible" BTT refers to a comprehensive BTT that was signed before 2016 and was not terminated as of 2016. Note that the sample excludes overseas territories or dependencies, such as the overseas collectivity of France, British Overseas Territories, and the constituent countries of the Kingdom of the Netherlands.

5.1.2 Data

The outcome variable is `MLI signature`, which is an indicator variable equal to 1 if the jurisdiction has signed the MLI and 0 otherwise. As of the end of 2022, 100 out of the 183 jurisdictions had signed the MLI.

Three variables are included to capture the importance of tax treaty-shopping for jurisdictions. Firstly, I include `CTR`, measured with the top corporate income tax rate (logged) for the year of 2016.[17] Secondly, I measure the exposure of tax treaty-shopping using the share of "`Inward Phantom FDI`" – investments into empty corporate shells with no link

17. Data from the Tax Foundation, see https://taxfoundation.org/global-tax/corporate-income-taxes/

to the local real economy, of all inward FDI, averaged over 2009-2016, using the estimates developed by Damgaard et al. (2019).[18] Lastly, I include `Tax Haven`, indicating whether the jurisdiction has appeared on major lists of tax havens, using data from Gravelle (2009).

A set of variables, capturing different aspects of possible motivations for jurisdictions to join the MLI, are included. Firstly, as the MLI seeks to amend the existing BTTs in a synchronized way, jurisdictions with more BTTs would be more affected by joining the MLI. Therefore, I include the variable `BTT`, measured as the logged total number of eligible BTT (as defined above) for each jurisdiction. Secondly, I include measures of levels of economic development and the scale of inward FDI, as the MLI might be more appealing to developing and capital-importing countries because it enhances source-based taxation (Avi-Yonah and Xu 2018). Specifically, `High Income` is an indicator variable equal to 1 if the jurisdiction is classified as high-income by the World Bank in the year of 2016.[19] `Inward FDI (%GDP)` is the average ratio of inward net FDI inflow to GDP, averaged over 2000 to 2016.[20] Given the non-normal distribution and the existence of negative values, the values are transformed using the inverse hyperbolic function. Thirdly, democracies are more likely to participate in international cooperation (Mansfield et al. 2002), so I control for the regime type with data from the V-dem Project, using the `Electoral Democracy` measure.[21] As countries that depend more on tax revenue might be more eager to limit tax treaty-shopping through the MLI, I include `Tax Revenue`, measured as the ratio of tax revenue to GDP, also averaged over 2000-2016.[22]

5.1.3 Results

Table 2 presents results from logistical regression. Due to the small sample size, covariates are added incrementally, depending on the number of missing values.

Throughout the six columns, the coefficient of the number of tax treaties is positive and

18. The data starts from the year of 2009.

19. Data from https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups.

20. Data from the World Bank. https://data.worldbank.org/

21. Data from https://www.v-dem.net/. The choice of V-Dem is due to its better coverage. The results are qualitatively the same is using other measures, such as the Polity2 index.

22. Data from UNU-WIDER Government Revenue Dataset. Version 2022. https://doi.org/10.35188/UNU-WIDER/GRD-2022.

statistically significant, indicating that jurisdictions with a larger number of tax treaties are more likely to sign the MLI, possibly with the hope to modify tax treaties in a synchronized way, instead of through numerous bilateral negotiations. In addition, the level of development, regime type, and the importance of tax revenue are also positively correlated with the likelihood of signing the MLI. In comparison, the estimated coefficients of treaty-shopping-related factors, such as corporate tax rate, phantom FDI, and tax haven list status, are not distinguishable from zero at common confidence intervals.

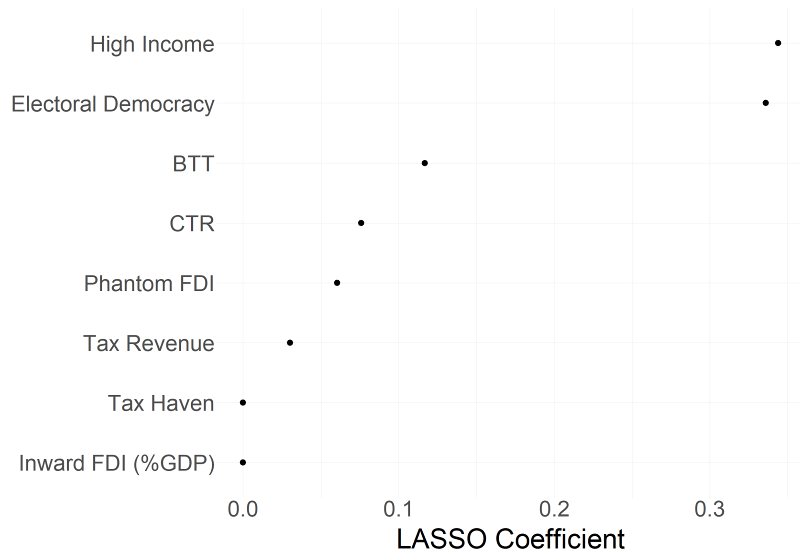
Due to the small sample size and a relatively large number of covariates, I further examine the results using LASSO regression with cross-validation for variable selection. Figure 7 displays the coefficients of the same variables used in Table 2 using LASSO regression. In line with the results in Table 2, the most important determinants of MLI signature are the income group level, regime type, and the number of existing BTTs.

Table 2: Determinants of MLI Signature

	MLI Signature				
	(1)	(2)	(3)	(4)	(5)
BTT	1.033***	1.177***	1.167***	1.203***	1.219***
	(0.179)	(0.236)	(0.245)	(0.285)	(0.288)
High Income	1.753***	1.799**	1.801**	3.265**	3.060**
	(0.494)	(0.880)	(0.881)	(1.560)	(1.517)
CTR	0.009	0.092	0.086	0.437	0.554
	(0.302)	(0.494)	(0.497)	(0.557)	(0.565)
Inward FDI (% GDP)		0.197	0.195	0.056	−0.121
		(0.293)	(0.294)	(0.325)	(0.342)
Electoral Democracy		3.406***	3.383***	3.155**	2.646*
		(1.109)	(1.119)	(1.410)	(1.440)
Phantom FDI			0.002	0.004	0.008
			(0.017)	(0.019)	(0.020)
Tax Revenue				0.071*	0.083*
				(0.041)	(0.043)
Tax Haven					1.910
					(1.178)
Observations	180	160	159	147	147

Notes: Results from logistic regression. The dependent variable equal to 1 if the jurisdiction has signed the OECD MLI by the end of 2022. $*** \ p < 0.01$, $** \ p < 0.05$, $* \ p < 0.1$.

Figure 7: Determinants of MLI Signature: LASSO Results



Note: This figure shows the coefficients from LASSO regression. The dependent variable equal to 1 if the jurisdiction has signed the OECD MLI by the end of 2022. Non-binary variables are standardized. λ is determined using cross-validation.

5.2 Which Countries Opted-Out of More Articles?

As the MLI seeks to address treaty-related tax avoidance and profit-shifting schemes, countries like Ireland and Mauritius, who have traditionally benefited from such arrangements, are likely to lose their comparative advantage. Nevertheless, these countries have signed and ratified the MLI anyway.

However, through the use of reservations to opt out of most articles, participation in the MLI might actually bring only negligible changes to the tax treaties of these jurisdictions. As shown in the previous section, jurisdictions known for facilitating tax treaty shopping have reserved the applicability of most articles.

To further examine the usage of reservations, Table 3 tests the determinants of the number of opt-outs for the 79 jurisdictions that have deposited the ratification instrument to the OECD.[23]

Here, the dependent variable is the total number of provisions that each jurisdiction has

23. Reservations made upon signing the MLI are provisional and can be modified, but those made upon ratification are regarded as definitive. After the deposition of the ratification instrument, states can only withdraw the reservations, or replace them with more limited ones. See OECD (2016). Art. 28 (9).

either completely opted out (optional articles), or opted only for the least demanding option (mandatory articles).[24] The covariates included in the analysis are the same as in Table 2.

Across columns in Table 3, the only coefficient that is precisely estimated is the one for CTR, which is negative and significant at conventional confidence levels. This indicates that countries with lower corporate income tax rates tend to opt out of more articles upon ratifying the MLI.

The results of the LASSO regression, which uses the same specification as Column (5) of Table 3, are presented in Figure 8. These results are consistent with those in Table 3. The LASSO model selects only three variables as important predictors of the number of MLI article opt-outs: corporate income tax rate, the ratio of phantom FDI, and the amount of inward FDI as a percentage of GDP. Among these variables, corporate income tax rate has the largest impact, as its coefficient is the largest in absolute value.

24. Least demanding option means that states opted out all the sub-articles, excepted the required one. Specifically, this means: Article 6 – Opt out of paragraph 3; Article 7 – Opt out of paragraph 4 and the LOB clause; Article 16 – Opt out of the first sentence of paragraph 1; Article 17 – Opt out of the entire article and endeavor to resolve through bilateral negotiations.

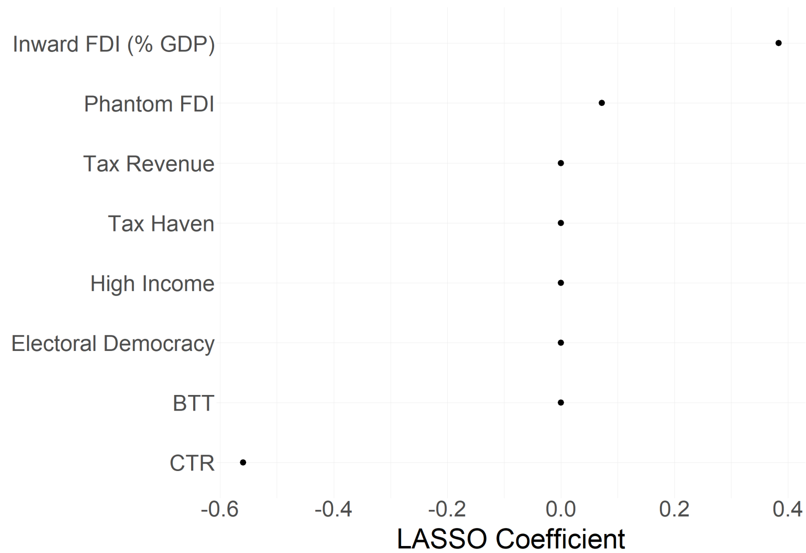
Table 3: Determinants of MLI Reservations

	Number of Opt-outs				
	(1)	(2)	(3)	(4)	(5)
BTT	−0.029	0.010	−0.016	−0.012	0.005
	(0.041)	(0.059)	(0.062)	(0.062)	(0.064)
High Income	0.136	0.140	0.148	0.080	0.069
	(0.083)	(0.101)	(0.101)	(0.108)	(0.108)
CTR	−0.132***	−0.140**	−0.158**	−0.162**	−0.159**
	(0.040)	(0.067)	(0.069)	(0.075)	(0.075)
Inward FDI (% GDP)		0.069*	0.063	0.068	0.030
		(0.042)	(0.042)	(0.043)	(0.056)
Electoral Democracy		−0.142	−0.150	0.137	0.128
		(0.183)	(0.183)	(0.234)	(0.234)
Phantom FDI			0.004	0.004	0.004
			(0.003)	(0.003)	(0.003)
Tax Revenue				−0.002	−0.0005
				(0.007)	(0.008)
Tax Haven					0.142
					(0.131)
Observations	79	70	70	64	64

Notes: Results from ordinary least squares regression. The dependent variable is the total number of articles that the jurisdiction has completely opted-out (optional articles) or opted for the least demanding provision (mandatory articles). See Table A.1 in Appendix A for a complete list of the coding scheme. Jurisdictions can opt out of Part IV, which includes Articles 18 to 26 on Arbitration, by reserving Article 18. The data is based on a sample of 79 jurisdictions that deposited the ratification instrument by the end of 2022.

$*** \ p < 0.01$, $** \ p < 0.05$, $* \ p < 0.1$.

Figure 8: Determinants of MLI Reservations: LASSO Results



Note: This figure shows the coefficients from LASSO regression. The dependent variable is the total number of articles that the jurisdiction has completely opted-out (optional articles) or opted for the least demanding provision (mandatory articles). Non-binary variables are standardized. λ is determined using cross-validation.

5.3 Which Treaties Did Countries Include?

In addition to the choice of article reservations, MLI signatories also strategically choose which treaties to be included for MLI coverage.

On this point, the most evident example is the India-Mauritius tax treaty. Mauritius has been known as one of the top conduit countries for investment into India, owing to the tax advantages investors can get from the bilateral tax treaty between the two countries. According to the Indian government, Mauritius is the largest source of FDI for India from 2000 to 2022, with FDI inflow from Mauritius totaling over 161 billion US dollars, which accounts for more than 26% of India's total FDI inflow.[25] However, upon ratifying the MLI, despite including 44 tax treaties for MLI coverage, Mauritius intentionally excluded its tax treaty with India from the list, a move that cannot be considered as coincidence. Even though India has notified its tax treaty with Mauritius, the treaty would not be modified by the MLI since it is not considered as a "covered tax agreement." Tax consultants view the exclusion of the India-Mauritius tax treaty as a "smart move" that has put Mauritius in

25. See https://hcimauritius.gov.in/pages?id=9avme&subid=yb8md&nextid=RdG7d

an advantageous position, because transactions between the two countries would not be subject to MLI provisions, such as the required PPT test.[26]

To test whether the India-Mauritius case represents the general pattern among MLI signatories when deciding whether to include a certain tax treaty, I use measures on not only the amount of FDI flows between the two parties of a tax treaty, but also the share of "phantom FDI" of overall FDI flow.[27] As tax treaty shopping typically involves structuring international transactions through a third, conduit country to take advantage of treaty benefits (Weyzig 2013; Arel-Bundock 2017), a large share of "phantom FDI" could serve as the proxy for the intensity of treaty shopping between two jurisdictions.

Other practical factors might also affect the likelihood for a certain tax treaty to be included for MLI coverage. One such factor is the "age" of the tax treaty. Older treaties might be more vulnerable to treaty shopping, as the original function of BTTs is primarily to prevent double taxation (Rixen 2008). Also, treaties might not be included if they were signed right before the ratification. To account for this factor, I include `BTT Year`, measured as the difference between the year of MLI ratification and the year of treaty signature.

Another factor that might affect tax treaty notification is whether the treaties were `legacy` treaties. That is, if the BTT was signed by the jurisdiction's predecessor, or signed during the colonial era, the applicability of these treaties might be complicated. For example, after the collapse of the Soviet Union, former Soviet states, as well as the tax treaty partners with the former Soviet Union, took different and sometimes inconsistent positions regarding whether to continue applying these former-Soviet tax treaties. To address this concern, I use data from Qian (2023) to account for whether the treaty is considered a "legacy" treaty.

The sample of the analysis consists of all the "eligible" tax treaties for the 79 jurisdictions that have ratified the MLI. "Eligible" tax treaties refer to those signed before the year of MLI ratification and are still in force. The analysis is conducted at ratifying (host) state-treaty level.[28]

26. See https://www.nishithdesai.com/Content/document/pdf/Articles/170816_A_Not-notifying-the-India-Mauritius-treaty-is-a-smart-move_Bizweek_11-08-17.pdf

27. Data from Damgaard et al. (2019). Inward FDI is measured in million US dollars, and Inward Phantom FDI (%) is measured as the ratio of phantom FDI to total FDI inflow, both variables are transformed using the inverse hyperbolic function.

28. In rare cases, the MLI signatory includes more than one tax treaty with the same partner jurisdiction.

The results, reported in Table 4 below, provide supportive evidence. While the coefficient of `Inward FDI` cannot be distinguished from zero, the estimated coefficient for the share of phantom FDI is consistently positive and statistically significant in column (1) to column (3). This suggests that jurisdictions are more likely to notify tax treaties for MLI coverage if they face greater treaty shopping challenges in the form of inward FDI from shell companies from the tax treaty partner. The relationship is robust to the inclusion of the (host) country fixed effect, (treaty) partner country fixed effect, or both host and partner country fixed effects.

In addition, column (4) of Table 4 explores the conditional effect of treaty-shopping challenges on the corporate tax rate of the MLI signatory (`Host CTR`). The estimated coefficient of the interaction term is positive and statistically significant, suggesting that the positive correlation between treaty-shopping challenges and the treaty notification is larger for high-tax jurisdictions. This finding implies that higher corporate tax rates may lead to a greater incentive for jurisdictions to participate in the MLI and to notify tax treaties for MLI coverage when faced with treaty shopping challenges.

For example, Belgium has notified both the 1987 tax treaty (signed with the former Soviet Union) and the 2008 tax treaty (not yet in force) with respect to Moldova.

Table 4: Treaty-Shopping and Tax Treaty Notification

	Tax Treaty Notified			
	(1)	(2)	(3)	(4)
Inward FDI	-0.009	0.002	0.017	0.012
	(0.014)	(0.016)	(0.023)	(0.016)
Inward Phantom FDI (%)	1.602***	0.681***	1.298**	-2.059***
	(0.568)	(0.216)	(0.520)	(0.591)
BTT Year	0.802***	0.470***	0.756***	0.505***
	(0.091)	(0.084)	(0.120)	(0.085)
Legacy	-1.129***	-0.674***	-1.215***	-0.744***
	(0.278)	(0.257)	(0.398)	(0.256)
Host CTR				-0.044***
				(0.008)
Host CTR * Inward Phantom FDI (%)				0.119***
				(0.026)
Host FE	✓		✓	
Partner FE		✓	✓	✓
Observations	3507	3527	3328	3527

Notes: Results from conditional logistic regression. Robust standard errors clustered at host jurisdiction level reported in parentheses. The dependent variable equal to 1 if the tax treaty was notified by the host jurisdiction in its ratification instrument deposited to the OECD. The data is based on a sample of 79 jurisdictions that deposited the ratification instrument by the end of 2022.
$*** \ p < 0.01$, $** \ p < 0.05$, $* \ p < 0.1$.

5.4 Interaction between Reservations and Treaty Inclusion

The results presented in Table 3 and Table 4 suggest that the choices of article opt-outs and treaty notification are associated with tax considerations: jurisdictions with lower corporate tax rates tend to use reservations to block the application of more articles, and states are more likely to include tax treaties for MLI coverage if they face greater treaty-shopping challenges from the partner country.

How does the use of reservation interact with the choice of excluding tax treaty from MLI coverage? To examine this question, I explore a specific case of tax treaty shopping in terms of dividend transfer transactions.

Article 8 of the MLI requires jurisdictions to include in their tax treaties a specific anti-abuse clause addressing tax treaty shopping in the case of dividend transfer schemes. Specifically, given that many tax treaties either exempt or limit the withholding taxes on dividends paid to a foreign parent company where the payer holds more than a certain amount of the capital share or voting rights, this article adds a "minimum holding period" when determining if a certain dividend transfer can be entitled to such treaty benefits. If applied, the foreign parent company should hold the required share or votes for a minimum of more than 365 days prior to the transaction, or otherwise, the treaty benefits would be denied.[29] Therefore, the application of MLI Article 8 could prevent treaty shopping when companies temporarily increase their shareholding for the sole reason to exploit treaty benefits.

The key, then, is to identify the tax treaties that are most vulnerable to such treaty-shopping schemes when it comes to dividend transactions. To account for this, I use data from Qian (2023), who develops measures of tax treaty-shopping risks for dividends, interest, and royalty payments for over 170 jurisdictions since the 1980s using original datasets on countries' statutory withholding tax rates and tax treaty rates.

Specifically, for the purpose of this section, `Treaty Shopping Risk` is an indicator variable equal to 1 if the tax treaty of concern can be used to transfer dividends from the host country to a third country, through the treaty partner, in order to minimize the dividend withholding tax. For example, in the case that companies often route dividends from India to the United States through Mauritius,[30] the variable `Treaty Shopping Risk` would equal to 1 for India concerning the India-Mauritius tax treaty.

Results in Table 5 show that, in the case of dividends tax treaty-shopping, the choice of tax treaty notification for MLI coverage is connected with the jurisdiction's choice of article reservation. Column (1) shows that jurisdictions that opted-in to apply Article 8 are more likely to include the tax treaty that could be exploited to structure dividend tax treaty-shopping. In comparison, the estimated coefficient of `Treaty Shopping Risk` is indistinguishable from zero in Column (2), where the sample is the jurisdictions that chose to opt out of Article 8. In line with the results in the first two columns, the estimated coefficient for the interaction of `Opt-in Article 8` and `Treaty Shopping Risk` is positive and statistically significant, indicating that the positive relationship between treaty-shopping risk and treaty notification is mainly driven by jurisdictions that opt-for Article 8

29. See OECD (2016), Art. 8 (1).

30. For discussion of tax treaty shopping to minimize withholding taxes, see Arel-Bundock (2017), Thrall (2021), and Qian (2023).

application.

Table 5: Article 8 Reservation, Treaty-Shopping, and Tax Treaty Notification

	Tax Treaty Notified		
	Opt-in Article 8	Opt-out Article 8	All Sample
	(1)	(2)	(3)
Inward FDI	-0.028	0.057*	0.016
	(0.028)	(0.029)	(0.019)
Inward Phantom FDI (%)	1.937***	-0.088	0.685***
	(0.605)	(0.301)	(0.244)
BTT Year	-0.845***	-0.904***	-0.856***
	(0.250)	(0.234)	(0.155)
Legacy	-0.017	-1.066**	-0.463
	(0.389)	(0.517)	(0.289)
Treaty Shopping Risk	1.026**	-0.441	-0.302
	(0.460)	(0.442)	(0.129)
Opt-in Article 8			0.210
			(0.406)
Opt-in Article 8 * Treaty Shopping Risk			1.053*
			(0.561)
Partner FE	✓	✓	✓
Observations	1348	1072	2926

Notes: Results from conditional logistic regression. Robust standard errors clustered at host jurisdiction level reported in parentheses. The dependent variable equal to 1 if the tax treaty was notified by the host jurisdiction in its ratification instrument deposited to the OECD. Column (1) includes only the jurisdictions that have opted-in Article 8 of the MLI. Column (2) includes only the jurisdictions that have opted-out of the entirety of Article 8 of the MLI. The data is based on a sample of 79 jurisdictions that deposited the ratification instrument by the end of 2022.
$*** \ p < 0.01$, $** \ p < 0.05$, $* \ p < 0.1$.

6 Conclusion

This paper contributes to our understanding of the role of flexibility in promoting international cooperation through the case of the OECD Multilateral Instrument. By examining the MLI, a unique multilateral convention designed to modify bilateral tax treaties, we can gain valuable insights into the design of international institutions. This study highlights the importance of practical concerns, such as the number of tax treaties and economic development, in driving MLI participation, as well as the impact of domestic corporate tax regime on the use of article opt-outs and treaty notifications to address tax treaty-shopping concerns. Furthermore, the study emphasizes the strategic considerations involved in selecting which tax treaties to include for MLI coverage, with the India-Mauritius tax treaty serving as a notable example. Finally, the paper also identifies the importance of identifying vulnerabilities to treaty-shopping schemes in designing effective international institutions.

The findings of this paper raise important questions about the effectiveness and efficiency of flexibility measures in promoting cooperation in international institutions. While flexibility provisions might encourage broad participation and avoid the broader-deeper trade-off in other issue areas, the results presented in this paper show that flexibility measures have made the MLI not only narrow in applicability but also shallow in the level of actual modifications to existing tax treaties. Despite their willingness to sign and ratify the multilateral convention, jurisdictions may use reservations to opt out of articles and exclude tax treaties from being modified in an intentional, collective, and calculated manner. Only a fraction of the existing tax treaties would actually be covered and modified, and more than half of the articles would not be applicable in the modification process. Furthermore, this paper shows that reservation and treaty exclusion are mostly used in cases where the concern of tax treaty-shopping is larger. In other words, the MLI would not be applicable to cases where actual changes are most needed.

These findings contribute to the literature on institutional design and compliance. While scholars argue that allowing states to set their commitments at different levels, often through reservations, can mitigate the broader-deeper trade-off and promote cooperation (Gilligan 2004; Kucik and Reinhardt 2008), this paper has shown that a flexible multilateral convention might not be effective to bring about real changes when the existing rules are mainly built upon bilaterally-negotiated agreements.

Overall, the findings of this study have significant implications for the design and effectiveness of international institutions, especially in the area of taxation. However, its implications are not limited to taxation but extend to other areas where multilateral cooperation is necessary. For instance, similar to international taxation, the regime for the protection of foreign investment is also built upon thousands of bilateral agreements, and some have argued that the MLI could provide a model for the future reform of the investment regime (Alschner 2019). Furthermore, this paper's findings also have implications for ongoing international negotiations. As of this writing, the OECD is currently working on the development of the Multilateral Convention (MLC) in its two-pillar solution to address the tax challenges arising from the digitalization of the economy.[31] The findings of this paper suggests that policymakers and international organizations need to carefully weigh the costs and benefits of the flexibility provisions when designing similar multilateral conventions in the future.

31. See https://www.oecd.org/tax/beps/international-tax-reform-multilateral-convention-to-implement-pillar-one-on-track-for htm

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Appendices

A Data Description

A.1 Coding Rules

Table A.1 below shows the type (optional or mandatory) of each substantive article of the OECD MLI, as well as the coding scheme to decide whether jurisdictions have completely opted out of optional articles or opted for the least demanding option for mandatory articles. The coding scheme is used for the analysis presented in Figure 5, Figure 4, Figure 6, Table 3, and Table 5.

Table A.1: Coding Scheme of MLI Article Opt-outs

Index	Article	Type	Criteria of Opt-out
3	Transparent Entities	Optional	Opt-out entirely under Art. 3(5)(a)
4	Dual Resident Entities	Optional	Opt-out entirely under Art. 4(3)(a)
5	Application of Methods for Elimination of Double Taxation	Optional	Opt-out entirely under Art. 5(8)
6	Purpose of a Covered Tax Agreement	Mandatory	Opt-out of Art. 6(3) under Art. 6(6)
7	Prevention of Treaty Abuse	Mandatory	Opt-out of Art. 7(4) and the LOB provision
8	Dividend Transfer Transactions	Optional	Opt-out entirely under Art. 8(3)(a)
9	Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property	Optional	Opt-out entirely under Art. 9(6)(a)
10	Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions	Optional	Opt-out entirely under Art. 10(5)(a)
11	Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents	Optional	Opt-out entirely under Art. 11(3)(a)
12	Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies	Optional	Opt-out entirely under Art. 12(4)
13	Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions	Optional	Opt-out entirely under Art. 13(6)(a)
14	Splitting-up of Contracts	Optional	Opt-out entirely under Art. 14(3)(a)
15	Definition of a Person Closely Related to an Enterprise	Optional	Opt-out entirely under Art. 15(2)
16	Mutual Agreement Procedure	Mandatory	Opt-out the first sentence of Art. 16(1) under Art. 16(5)(a)
17	Corresponding Adjustments	Mandatory	Opt-out under Art. 17(3) to resolve through bilateral negotiations
18	Choice to Apply Part VI	Optional	Choose not to apply Part VI

A.2 List of MLI Signatories

Table A.2 shows the list of the 79 jurisdictions that have signed the ratified the OECD MLI by the end of 2022. These jurisdictions are include in the analyses throughout the paper, using data from the Instrument of Ratification deposited to the OECD.

In addition, 21 jurisdictions have signed but not yet ratified the MLI. These jurisdictions listed in Table A.3 below, are only included for analysis for Figure 2 and Table 2.

Table A.2: List of Jurisdictions Signed and Ratified the MLI

Jurisdiction	MLI Signature	Instrument of Ratification	Entry into Force
Albania	2019-05-28	2020-09-22	2021-01-01
Andorra	2017-06-07	2021-09-29	2022-01-01
Australia	2017-06-07	2018-09-26	2019-01-01
Austria	2017-06-07	2017-09-22	2018-07-01
Bahrain	2020-11-27	2022-02-23	2022-06-01
Barbados	2018-01-24	2020-12-21	2021-04-01
Belgium	2017-06-07	2019-06-26	2019-10-01
Belize	2019-01-11	2022-04-07	2022-08-01
Bosnia and Herzegovina	2019-10-30	2020-09-16	2021-01-01
Bulgaria	2017-06-07	2022-09-16	2023-01-01
Burkina Faso	2017-06-07	2020-10-30	2021-02-01
Cameroon	2017-07-11	2022-04-21	2022-08-01
Canada	2017-06-07	2019-08-29	2019-12-01
Chile	2017-06-07	2020-11-26	2021-03-01
China	2017-06-07	2022-05-25	2022-09-01
Costa Rica	2017-06-07	2020-09-22	2021-01-01
Croatia	2017-06-07	2021-02-18	2021-06-01
Curaçao	2017-12-20	2019-03-29	2019-07-01
Cyprus	2017-06-07	2020-01-23	2020-05-01
Czech Republic	2017-06-07	2020-05-13	2020-09-01
Denmark	2017-06-07	2019-09-30	2020-01-01
Egypt	2017-06-07	2020-09-30	2021-01-01
Estonia	2018-06-29	2021-01-15	2021-05-01
Finland	2017-06-07	2019-02-25	2019-06-01
France	2017-06-07	2018-09-26	2019-01-01
Georgia	2017-06-07	2019-03-29	2019-07-01
Germany	2017-06-07	2020-12-18	2021-04-01

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Jurisdiction	MLI Signature	Instrument of Ratification	Entry into Force
Greece	2017-06-07	2021-03-30	2021-07-01
Guernsey	2017-06-07	2019-02-12	2019-06-01
Hong Kong (China)	2017-06-07	2022-05-25	2022-09-01
Hungary	2017-06-07	2021-03-25	2021-07-01
Iceland	2017-06-07	2019-09-26	2020-01-01
India	2017-06-07	2019-06-25	2019-10-01
Indonesia	2017-06-07	2020-04-28	2020-08-01
Ireland	2017-06-07	2019-01-29	2019-05-01
Isle of Man	2017-06-07	2017-10-25	2018-07-01
Israel	2017-06-07	2018-09-13	2019-01-01
Japan	2017-06-07	2018-09-26	2019-01-01
Jersey	2017-06-07	2017-12-15	2018-07-01
Jordan	2019-12-19	2020-09-29	2021-01-01
Kazakhstan	2018-06-25	2020-06-24	2020-10-01
Korea	2017-06-07	2020-05-13	2020-09-01
Latvia	2017-06-07	2019-10-29	2020-02-01
Lesotho	2022-02-09	2022-07-28	2022-11-01
Liechtenstein	2017-06-07	2019-12-19	2020-04-01
Lithuania	2017-06-07	2018-09-11	2019-01-01
Luxembourg	2017-06-07	2019-04-09	2019-08-01
Malaysia	2018-01-24	2021-02-18	2021-06-01
Malta	2017-06-07	2018-12-18	2019-04-01
Mauritius	2017-07-05	2019-10-18	2020-02-01
Monaco	2017-06-07	2019-01-10	2019-05-01
Netherlands	2017-06-07	2019-03-29	2019-07-01
New Zealand	2017-06-07	2018-06-27	2018-10-01
Norway	2017-06-07	2019-07-17	2019-11-01

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Jurisdiction	MLI Signature	Instrument of Ratification	Entry into Force
Oman	2019-11-26	2020-07-07	2020-11-01
Pakistan	2017-06-07	2020-12-18	2021-04-01
Panama	2018-01-24	2020-11-05	2021-03-01
Poland	2017-06-07	2018-01-23	2018-07-01
Portugal	2017-06-07	2020-02-28	2020-06-01
Qatar	2018-12-04	2019-12-23	2020-04-01
Romania	2017-06-07	2022-02-28	2022-06-01
Russian Federation	2017-06-07	2019-06-18	2019-10-01
San Marino	2017-06-07	2020-03-11	2020-07-01
Saudi Arabia	2018-09-18	2020-01-23	2020-05-01
Senegal	2017-06-07	2022-05-10	2022-09-01
Serbia	2017-06-07	2018-06-05	2018-10-01
Seychelles	2017-06-07	2021-12-14	2022-04-01
Singapore	2017-06-07	2018-12-21	2019-04-01
Slovak Republic	2017-06-07	2018-09-20	2019-01-01
Slovenia	2017-06-07	2018-03-22	2018-07-01
South Africa	2017-06-07	2022-09-30	2023-01-01
Spain	2017-06-07	2021-09-28	2022-01-01
Sweden	2017-06-07	2018-06-22	2018-10-01
Switzerland	2017-06-07	2019-08-29	2019-12-01
Thailand	2022-02-09	2022-03-31	2022-07-01
Ukraine	2018-07-23	2019-08-08	2019-12-01
United Arab Emirates	2018-06-27	2019-05-29	2019-09-01
United Kingdom	2017-06-07	2018-06-29	2018-10-01
Uruguay	2017-06-07	2020-02-06	2020-06-01

Table A.3: List of Jurisdictions Signed but Not Ratified the MLI

Jurisdiction	**MLI Signature**
Argentina	2017-06-07
Armenia	2017-06-07
Colombia	2017-06-07
Côte d'Ivoire	2018-01-24
Fiji	2017-06-07
Gabon	2017-06-07
Italy	2017-06-07
Jamaica	2018-01-24
Kenya	2019-11-26
Kuwait	2017-06-07
Mexico	2017-06-07
Mongolia	2022-10-06
Morocco	2019-06-25
Namibia	2021-09-30
Nigeria	2017-08-17
North Macedonia	2020-01-29
Papua New Guinea	2019-01-23
Peru	2018-06-27
Tunisia	2018-01-24
Türkiye	2017-06-07
Viet Nam	2022-02-09