

International Tax Potential in the Digital Economy: A Study on MNE Tax Avoidance and the Strengthening of Indonesia's Tax Regime.

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Abstract

International tax issues have become increasingly complex alongside the rising activities of multinational enterprises (MNEs), particularly within the digital economy. This study analyzes tax avoidance strategies employed by a simulated company, DIGIO FP Group, which exploits the "Double Irish" scheme, aggressive transfer pricing, and tax treaty abuse to shift profits to low-tax jurisdictions. Using a content analysis approach and fiscal adjustment simulation, the study finds that although DIGIO FP generates substantial revenue from users in Indonesia, its tax contribution remains minimal due to an operational structure that does not reflect actual economic substance. Additionally, practices such as treaty shopping and inconsistencies with the beneficial ownership principle indicate potential treaty abuse. The discovery of hidden funds through the AEOI system highlights the need to strengthen oversight of offshore assets. These findings underscore the importance of implementing the Global Minimum Tax regime (PMK 136/2024), enforcing the arm's length principle in transfer pricing, and reforming the definition of Permanent Establishment (PE). This research offers policy recommendations to enhance Indonesia's tax system in facing the challenges of globalization and digitalization of the economy.

Keywords: *Transfer Pricing, Double Irish, BEPS, Global Minimum Tax, Tax Treaty Abuse.*

INTRODUCTION

International tax issues in Indonesia have received increasing attention in recent years, in line with the rapid globalization of the economy and the growing role of multinational enterprises (MNEs) in various strategic sectors, particularly the digital sector. The cross-border activities conducted by MNEs pose complex challenges to the national tax system, as many of these companies have business structures spread across multiple jurisdictions with varying tax characteristics. One of the main emerging issues is the practice of Base Erosion and Profit Shifting (BEPS)—aggressive tax planning strategies used by MNEs to shift profits to low or no-tax countries, even though the economic activities generating these profits actually occur in other countries, including Indonesia (OECD, 2021).

A concrete example of BEPS is the “Double Irish with a Dutch Sandwich” scheme, which has been used by several prominent global tech companies. In this scheme, companies shift royalty payments and licensing fees between affiliated entities in different jurisdictions, significantly reducing their global tax burden. A study by Zulaikha and Fachrurrozie (2022) shows that such practices erode Indonesia's potential tax revenue, as profits that should be taxed domestically are legally shifted abroad through complex transfer pricing mechanisms that often do not reflect fair market value in intercompany transactions.

Furthermore, the rapid advancement of the digital economy has introduced new challenges to international taxation. Global digital companies such as streaming platforms, cloud service providers, cross-border e-commerce, and digital advertising firms often lack a permanent physical presence in Indonesia, making it difficult to classify them as tax subjects under conventional physical presence-based approaches. This creates a tax gap, as the economic value generated in Indonesia is not always matched by proportional tax contributions. Recognizing this, the Indonesian government has implemented an Income Tax on Electronic Transactions (PMSE) to tax foreign digital entities earning revenue from Indonesian consumers, regardless of their physical presence (Directorate General of Taxes, 2023).

In addition, the issue of Permanent Establishment (PE) has become a key focus in the context of globalization and digitalization. Prior to the revision through the Tax Regulation Harmonization Law (UU HPP) of 2021, the definition of PE was too narrow to encompass foreign entities with only a virtual presence. The UU HPP expanded the scope of the PE definition to accommodate significant economic presence without a physical form in the country. This ensures that such entities can still be subject to Corporate Income Tax (CIT) on profits derived from economic activities in Indonesia.

Treaty abuse and treaty shopping are also major sources of international tax leakage. In practice, MNEs often exploit Double Taxation Agreements (DTAs) by using intermediary entities that lack real economic activity (shell companies), solely to obtain more favorable tax treatment. This reduces the effectiveness of Article 26 Withholding Tax on foreign income that should otherwise be taxed at standard rates. To address this issue, Indonesia has ratified the Multilateral Instrument (MLI) as part of the OECD/G20 BEPS initiative to combat tax treaty abuse and reinforce the beneficial ownership principle.

Another challenge in international tax is the low compliance in reporting offshore assets and income. Many taxpayers hide their assets and income in non-transparent jurisdictions. In response, Indonesia has implemented the Automatic Exchange of

Information (AEOI) scheme and Country-by-Country Reporting (CbCR), enabling tax authorities to gain a more complete picture of MNEs' global profit distribution and economic activities.

To strengthen the integrity of the international tax system and respond to evolving global dynamics, the Indonesian government has also issued Regulation of the Minister of Finance (PMK) No. 136/PMK.03/2024 on the implementation of the Global Minimum Tax, which includes provisions for the Qualified Domestic Minimum Top-up Tax (QDMTT), Income Inclusion Rule (IIR), and Undertaxed Profit Rule (UTPR). These rules are part of the second pillar of the BEPS 2.0 framework, aiming to ensure that every profit made by MNEs is taxed at a minimum global rate, thereby eliminating overly attractive tax havens.

Despite these reforms, data indicate that MNEs' contributions to national tax revenues remain suboptimal, far below the economic value they generate. A case study of DIGIO FP Group, although fictional, is used in this research to realistically illustrate how tax avoidance through transfer pricing manipulation, cross-jurisdiction royalty schemes, and offshore fund concealment can significantly undermine effective tax oversight. Studies by Rachmadi et al. (2023) and Wahyuni & Prasetyo (2021) emphasize the critical role of the Directorate General of Taxes in enforcing tax justice through cross-jurisdictional supervision and international cooperation.

RESEARCH METHODS

This study adopts a descriptive qualitative approach using a case study method as the primary framework. This approach was chosen to explore in depth the phenomenon of tax avoidance by multinational enterprises (MNEs) through Base Erosion and Profit Shifting (BEPS) schemes, and to evaluate Indonesia's policy responses in addressing it.

The data used includes secondary data from regulations related to the UU HPP 2021, PMK No. 136/PMK.03/2024, Director General regulations, tax treaties, Directorate General of Taxes (DGT) reports, OECD publications, BEPS policy documents, academic journals, as well as news and investigative reports on digital taxation cases.

Data collection techniques involve a thorough document study of relevant international taxation regulations and policies, including national legislation such as the Tax Regulation Harmonization Law (UU HPP), Minister of Finance Regulations, and international tax rules like tax treaties and OECD documents related to BEPS. Additionally, this study analyzes official reports and publications, such as OECD BEPS Reports, CbCR Guidance, DGT Annual Reports, and publications from international organizations and academic journals discussing tax avoidance practices and cross-border tax policies. This technique aims to provide a comprehensive understanding of the legal and policy context and to identify the practical implications of their application in the Indonesian context.

The data analysis technique used is content analysis, a systematic method to explore, interpret, and derive meaning from various documents and texts related to regulations and international tax policies. This analysis aims to delve into how international tax law principles are implemented in Indonesia and to identify gaps that enable tax avoidance practices by MNEs. The study also employs comparative analysis, comparing globally used tax avoidance schemes—such as the Double Irish, treaty shopping, and the use of entities in low-tax jurisdictions—with the Indonesian tax

system, to assess the extent to which these schemes affect base erosion and profit shifting (BEPS).

As part of the qualitative approach, a simulated case study of DIGIO FP Group is used as a tool to represent real practices commonly found in global corporate structures. This case study illustrates the application of key international tax principles such as transfer pricing, treaty abuse, beneficial ownership requirements, and the global minimum tax mechanism under PMK 136/PMK.03/2024 (including QDMTT, IIR, and UTPR). Through this approach, the research not only highlights theoretical challenges in international tax enforcement but also presents policy simulations to estimate potential lost tax revenue and evaluate the effectiveness of regulatory interventions by the Indonesian tax authority.

Data validity is ensured through triangulation of official document sources, including policies, Ministerial Regulations (PMK), the General Taxation Provisions Law (KUP), the HPP Law, and academic literature.

RESULT AND DISCUSSION

To comprehensively analyze the case of international taxation, a qualitative analytical approach is used, employing content analysis and fiscal correction simulation on DIGIO FP Group, which serves as an MNE simulator.

1. Case Overview:

DIGIO FP GROUP is a multinational enterprise (MNE) based in Ireland, a low-tax jurisdiction, operating in the digital streaming and online advertising sectors. Although it earns USD 100 million in revenue from Indonesian users, its tax contribution to Indonesia is minimal. DIGIO FP Indonesia only acts as a marketing services provider, while USD 30 million in royalties and other service fees are shifted to affiliated entities in Ireland and the Cayman Islands, using the “Double Irish” scheme with Singapore as an intermediary. The recorded net profit before tax is USD 20 million, but the effective global tax rate is only 10%, well below Indonesia's corporate tax rate. DIGIO FP also exploits provisions in the Indonesia–Ireland tax treaty to avoid withholding tax under Article 26 Income Tax, and hid USD 5 million offshore, which was eventually detected through the Automatic Exchange of Information (AEOI) system.

This case illustrates the aggressive tax avoidance strategies employed by MNEs exploiting loopholes in international regulations. It also underscores the importance of strengthening global tax regimes such as the Global Minimum Tax (PMK 136/2024) and the need for Indonesia to enforce the beneficial ownership principle and monitor cross-border affiliated transactions.

To analyze the international taxation case involving DIGIO FP Group, a qualitative analysis approach is applied, incorporating content analysis and fiscal correction simulation. The analysis process is divided into analytical tools and identified issues.

2. Main Analytical Tools:

Regulatory Analysis: Review of Indonesian international tax provisions, including:

- a. Law on the Harmonization of Tax Regulations (UU HPP) 2021 (especially Permanent Establishment/PE definition),
- b. PMK No. 136/PMK.03/2024 on Global Minimum Tax (QDMTT, IIR, and UTPR),
- c. PMK No. 70/PMK.03/2017 on AEOI reporting,

- d. Indonesia-Ireland Tax Treaty, and
 - e. OECD Transfer Pricing Guidelines and the arm's length principle.
3. Fiscal Correction Simulation
- Used to estimate potential state revenue losses due to tax avoidance. This approach accounts for profit shifting, unreasonable royalty payments, hidden assets, and a global tax rate below the minimum threshold. Tax Avoidance Scheme Analysis: Identification of the "Double Irish" and treaty shopping schemes used to avoid tax obligations and assess whether they violate the beneficial ownership principle or merely exploit legal loopholes. PE (Permanent Establishment). Evaluation Assesses whether the local Indonesian entity meets the threshold for a PE, based on its marketing activity and substantial involvement in generating revenue within Indonesia's jurisdiction.
4. Key Findings and Issues:
- Profit Shifting via "Double Irish" Scheme
- DIGIO FP successfully shifted USD 30 million in royalties and revenue to Ireland and the Cayman Islands using dual-entity structures and a third-country intermediary (Singapore). Despite the revenue being sourced from Indonesian economic activities, the tax was paid in ultra-low-tax jurisdictions, resulting in an effective tax rate of only 10%.
- Miss classification of Indonesian Entity and PE Potential
- Although labeled as a marketing service provider, the Indonesian entity contributes significant value to the group. Under the UU HPP 2021, this role may qualify as a Permanent Establishment (PE), which would impose a tax liability on profits generated from such activities within Indonesia.
- Abuse of Tax Treaty and Violation of Beneficial Ownership
- DIGIO FP leverages the Indonesia-Ireland tax treaty to avoid withholding tax under Article 26, while the actual beneficiary of the royalties is in the Cayman Islands. This suggests treaty abuse and a breach of the beneficial ownership principle, as the Irish entity acts merely as a passive conduit with no substantial economic function.
- Non-Compliance with Offshore Fund Reporting
- The detection of USD 5 million in hidden offshore funds via AEOI indicates a failure to comply with global financial disclosure norms. According to PMK No. 70/2017, this can result in administrative penalties and fiscal sanctions.
- Need for Global Minimum Tax Implementation
- With an effective tax rate below 15%, DIGIO FP should be subject to the QDMTT (Qualified Domestic Minimum Top-Up Tax) under Indonesian jurisdiction. The failure to apply this indicates gaps in PMK 136/2024 implementation, which require technical and institutional strengthening.
- Weak Oversight on Transfer Pricing and Affiliated Transactions
- Cost shifting and aggressive transfer pricing are hard to enforce due to limited data and slow tax authority responses. The Directorate General of Taxes (DJP) needs to enhance cross-jurisdictional audits, international cooperation, and utilize CbCR (Country-by-Country Reporting) to systematically identify avoidance risks.

5. Additional In-Depth Analyses:

“Double Irish” Scheme and Its Impact on Indonesia’s Tax Revenue. This scheme involves two Irish entities, one controlled from a tax haven (Cayman Islands), and a third-party intermediary (Singapore). Despite earning USD 100 million from Indonesia, USD 30 million is shifted abroad as royalty and service fees, minimizing taxable profit in Indonesia. This leads to base erosion and cross-border profit shifting, undermining Indonesia’s corporate tax revenue.

PE Evaluation under UU HPP 2021. DIGIO FP Indonesia’s role in supporting the group’s digital operations qualifies as a significant economic presence, even without a physical presence. Using Functions, Assets, and Risks (FAR) analysis, this structure could be reclassified as a PE, warranting taxation on income sourced from Indonesia, rather than merely recognizing limited marketing margins.

Analysis of Treaty Abuse and Beneficial Ownership (Indonesia–Ireland). DIGIO FP’s use of the tax treaty to avoid Article 26 tax suggests treaty shopping, with Singaporean and Irish entities lacking economic substance. According to PMK No. 213/2018 Article 26, only the true beneficial owner with control and risk over the income qualifies for treaty benefits. The scheme thus violates OECD standards and the spirit of bilateral tax treaties.

Implications of Hidden Funds on PMK 70/2017 and AEOI Compliance

The undisclosed USD 5 million offshore triggers compliance issues under PMK No. 70/2017, potentially leading to fiscal corrections and international tax investigations. The case highlights the importance of global data integration and Indonesia’s proactive role in international tax cooperation.

Implementation of Global Minimum Tax (PMK 136/2024).

Indonesia's PMK 136/2024 introduces three key mechanisms:

- QDMTT: Domestic top-up tax when global ETR < 15%.
- Income Inclusion Rule (IIR): Parent jurisdictions can tax under-taxed affiliates.
- Undertaxed Profit Rule (UTPR): Allows taxation of under-taxed profits in source jurisdictions.

For DIGIO FP, with only a 10% ETR, Indonesia should impose a QDMTT to bring tax up to 15%. Additionally, UTPR can apply to Irish and Cayman entities if insufficient taxation occurs in those jurisdictions.

6. The Role of the Directorate General of Taxes (DJP) in Transfer Pricing Oversight

The DJP plays a key role in curbing MNE tax avoidance, utilizing risk-based audits, and evaluating transfer pricing documentation (master file, local file, CbCR). DJP can make transfer pricing adjustments, proving that inter-affiliate payments violate the arm’s length principle, and enforce Article 26 withholding tax where applicable. Collaboration through AEOI and Mutual Agreement Procedure (MAP) is crucial for ensuring international tax transparency and compliance. The following presents a simulation of fiscal adjustments and the potential income tax payable (PPh) as calculated by the Directorate General of Taxes (DJP).

Table 1. Fiscal Adjustments and Potential Income Tax Payable by the DGT (Simulation)					
Transaction Component	Amount (USD)	Tax Treatment	Fiscal Adjustment (USD)	Tax Rate	Potential Income Tax (USD)
Revenue from Indonesian users	100.000.000	Recognized abroad	100.000.000	22%	22.000.000
Royalty expense to Ireland	30.000.000	Deducted in Indonesia	Foreign income adjustment	–	–
Hidden funds (detected via AEOI)	5.000.000	Not Reported	Minimum must be 15% → subject to QDMTT	30% (AEOI penalty)	1.500.000
Effectiveness of DIGIO FP Global Minimum Tax	–	10% global	Minimum must be 15% → subject to QDMTT	5% (of 20 million)	1.000.000
Total Potential Additional Tax Revenue:					24.500.000

Based on Table 1 above, the analysis of potential fiscal adjustments and additional tax revenues can be explained as follows:

1. Revenue from Indonesian Users: USD 100 Million

The USD 100 million revenue earned from Indonesian users was not recognized as income in Indonesia, but rather reported in foreign jurisdictions with low tax rates. This is characteristic of the Double Irish scheme, where the local Indonesian entity pays service fees or royalties to an affiliated company in Ireland, which then channels the funds to tax havens such as the Cayman Islands. As a result, the company's profits are artificially shifted out of Indonesia. Therefore, fiscal correction is necessary.

Based on the substance over form principle, the Indonesian tax authority has the right to reallocate such income, as it economically originates from the Indonesian market. Referring to the corporate income tax rate (Article 29) of 22% applied to the shifted income of USD 100,000,000, there is a potential additional tax liability of:

$$\text{USD } 100,000,000 \times 22\% = \text{USD } 22,000,000$$

2. Royalty Payments to Ireland: USD 30 Million

The royalty payment of USD 30 million to the Irish entity is treated as an operating expense, reducing the taxable profit in Indonesia. This scheme often exploits the Indonesia-Ireland Tax Treaty to lower the withholding tax rate on royalties (e.g., from the domestic 20% to 10%). However, if the royalty amount is deemed non-arm's length (unreasonable) relative to the actual economic contribution of the Irish entity, the Indonesian Tax Authority can make a transfer pricing adjustment, rejecting the expense as not in line with the arm's length principle. This would increase taxable income in Indonesia and thus result in higher tax liability, even though the amount is not directly calculated in this simulation.

3. Hidden Funds (Detected via AEOI): USD 5 Million

The discovery of USD 5 million in undeclared offshore funds through the Automatic Exchange of Information (AEOI) system indicates previously unreported foreign income, which must be treated as taxable income. The tax rate applied to such

unreported income, as an administrative sanction, is 30%. Therefore, the potential additional tax liability from this hidden fund is: $\text{USD } 5,000,000 \times 30\% = \text{USD } 1,500,000$

4. DIGIO FP Global Tax Effectiveness: 10%

Globally, DIGIO FP Group pays an effective tax rate of only 10% on its profits, which is considered significantly low. This outcome stems from the use of tax avoidance schemes such as the "Double Irish with a Dutch Sandwich", where global profits are channeled through multiple jurisdictions with very low or even zero tax rates. In this case, the relevant regulation under the OECD/G20 Pillar Two framework mandates that all multinational enterprise (MNE) groups must be subject to a minimum global tax of 15%, including in Indonesia through the Qualified Domestic Minimum Top-up Tax (QDMTT) mechanism.

Therefore, since DIGIO FP pays only 10% in effective tax, a fiscal adjustment is required on the remaining 5%, which must be levied as an additional tax in Indonesia. Assuming the relevant profit base is USD 20 million, the potential additional income tax (PPh) is: $\text{USD } 20,000,000 \times 5\% = \text{USD } 1,000,000$

Through a fiscal correction approach—covering transfer pricing adjustments, taxation of hidden income detected via the AEOI system, and implementation of the global top-up tax under OECD standards—the Indonesian government can recover lost tax revenue resulting from DIGIO FP's aggressive tax avoidance strategies.

CONCLUSION

The case of DIGIO FP Group highlights the complexity and real challenges faced by the Indonesian tax authority in overseeing international taxation practices by multinational enterprises (MNEs). Tax avoidance schemes such as the "Double Irish" strategy, the exploitation of tax treaties, and the aggressive shifting of profits across jurisdictions have led to erosion of the national tax base, despite the fact that substantial economic activities take place within Indonesia. Research findings indicate that DIGIO FP's operational structure potentially meets the criteria for a Permanent Establishment (PE) under the Law on Harmonization of Tax Regulations (UU HPP) of 2021, which would render the company a taxable entity in Indonesia. However, the use of intermediary entities and the avoidance of Withholding Tax under Article 26 through treaty shopping demonstrate signs of treaty abuse, which fails to reflect the principle of beneficial ownership. The detection of undisclosed funds amounting to USD 5 million through the Automatic Exchange of Information (AEOI) system indicates that global transparency mechanisms have started to take effect, although further strengthening of supervision and enforcement of administrative sanctions is still needed in accordance with Regulation PMK 70/2017.

The implementation of the Global Minimum Tax policy (PMK 136/PMK.03/2024) through QDMTT (Qualified Domestic Minimum Top-up Tax), IIR (Income Inclusion Rule), and UTPR (Undertaxed Payments Rule) serves as a crucial instrument to prevent profit shifting to low-tax jurisdictions. Moreover, the active role of the Directorate General of Taxes (DJP) in transfer pricing audits, the use of Country-by-Country Reporting (CbCR), and bilateral cooperation are key to promoting compliance and fairness in the international tax system. Therefore, strengthening regulations, leveraging technology, and enhancing international cooperation must continue to be prioritized in

order to protect Indonesia's taxing rights and ensure that the tax contributions of multinational companies are aligned with the economic value generated within the country.

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