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International Tax Law and Cross-Border Taxation: A Narrative Literature Review on Tax Sovereignty, BEPS, and Global Tax Reform

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ABSTRACT
The rapid advancement of economic globalization and digitalization has brought significant changes to the dynamics of the international taxation system. This study aims to comprehensively examine international tax law and cross-border taxation based on prior literature using a Analysis Literature Review approach. This methodology involves summarizing and analyzing findings from various previous studies related to transfer pricing practices, Base Erosion and Profit Shifting (BEPS), and digital economy taxation. The results of the comparative analysis indicate that conventional taxation principles, such as the Arm's Length Principle (ALP) and source-based taxation, are increasingly inadequate in protecting the fiscal interests of developing countries against BEPS practices, transfer pricing manipulation, and digital business expansion. This article contributes theoretically to the concept of tax sovereignty and inter-nation equity by highlighting the structural gaps in current policies. Furthermore, this study recommends the strengthening of General Anti-Avoidance Rules (GAAR), the consideration of formulary apportionment, and the optimization of Automatic Exchange of Information (AEoI) as priorities for equitable international tax reform.

Keywords: BEPS, International Tax Law, Tax Treaty, Transfer Pricing, Literature Review.
JEL Code: F38, H25, H71

I. Introduction

The expansion of economic globalization over the past few decades has produced a substantial transformation in the structure and dynamics of the world's taxation system (Avi-Yonah, 2021). The process of international economic integration, marked by increasing cross-border trade flows, the entry of Foreign Direct Investment, and the mobility of production factors including capital, labor, and technology, has created increasingly multidimensional and complex cross-border economic relations. This dynamic directly demands the presence of a taxation framework capable of adequately accommodating and responding to inter-jurisdictional interactions, which in its development came to be known academically as the International Taxation System (Khifni and Tehupeiory, 2024). Conceptually, International Tax is understood not merely as a technical mechanism for collecting tax on cross-border transactions, but also as a supreme legal system that functions to regulate and distribute taxing rights among sovereign states. In practice, each state holds its own fiscal sovereignty in granting the authority to impose tax based on the jurisdictional principle it adopts. However, differences in the taxation systems applied across countries frequently give rise to jurisdictional conflicts that culminate in the phenomenon of international double taxation. International tax therefore exists as a normative instrument that serves to balance and align the interests of the country where income

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originates (the source country) with the country where the taxpayer is domiciled or resident (the residence country).

In its development, the concept of international tax has also come to encompass various regulatory instruments designed to counter tax avoidance practices carried out by multinational corporate entities. Multinational corporations have wide latitude in designing their operational structures to reduce their global tax liabilities, among other things through inter-affiliate pricing mechanisms (transfer pricing), the opportunistic exploitation of tax treaties (treaty shopping), and the shifting of profits to jurisdictions with very low or nil tax regimes (tax haven jurisdictions) (Loso Judijanto and Al-Amin, 2024). Although collective efforts such as the Base Erosion and Profit Shifting (BEPS) initiative spearheaded by the OECD have been successfully implemented in response to this issue, the acceleration of digital economic development has instead introduced new and more complex challenges (Setiawan and Rahayu, 2023). This is because digital-based business models allow companies to obtain large profits from a particular jurisdiction without maintaining any significant physical presence in the form of a Permanent Establishment (PE).

The rapidly unfolding phenomenon of digital transformation, coupled with increasingly aggressive tax avoidance practices, has generated an asymmetry in the distribution of taxing rights among nations, one that specifically places developing countries at a disadvantage. Prior studies have identified various fundamental weaknesses in this global taxation system, albeit from differing points of view. Most research has focused on the exploitation of legal loopholes through transfer pricing schemes, while other bodies of literature have instead highlighted the problem of double taxation treaty abuse (treaty shopping) and the limitations of conventional tax instruments in taxing entities without a Permanent Establishment (PE). Nevertheless, the synthesis of this literature indicates that, to date, no comprehensive research framework yet exists that integrates the three crucial issues, specifically transfer pricing, tax treaties, and the digital economy, into a single, comprehensive evaluative model of tax sovereignty fairness.

Based on this mapping, the main research problem in this study is the inability of the conventional taxation system to maintain the source country's tax base amid the disruption of contemporary business models. In this context, a fairly fundamental research gap was identified, in that prior studies have tended to examine the dimensions of international tax only partially. Furthermore, studies that specifically and comprehensively analyze the issue of global tax justice from the perspective of developing countries' interests remain scarce, thereby opening room for this study to make a meaningful contribution. This research therefore aims to comprehensively examine and compare the findings of prior research in an integrated manner through a Narrative Literature Review approach, in order to address the challenges of international tax law and cross-border taxation. Accordingly, in answering the research gap and research objectives above, this study formulates three research questions, as follows:

a. How effective is the application of conventional instruments, such as the Arm's Length Principle (ALP) and Tax Treaties, in countering transfer pricing manipulation practices and cross-border BEPS exploitation?
b. What structural gaps and threats does the digital economic transformation pose to fiscal sovereignty, particularly with respect to the tax revenue of developing countries?
c. What governance recommendations and institutional reforms of international tax can make the distribution of taxing rights more equitable (inter-nation equity) for all jurisdictions?

II. Literature Review and Hypothesis Development

2.1. Tax Justice Theory and the Doctrine of Inter-Nation Equity

The principle of fairness in a taxation system does not apply solely within the domestic context to ensure an equitable distribution of the tax burden among citizens, but also carries a dimension that extends more broadly beyond national jurisdictional boundaries. Within the architecture of the international taxation system, taxing authority is managed through the distribution of taxing rights between two principal

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jurisdictions: (1) the source country, namely the country where capital is invested and where economic activity or value creation actually takes place (OECD, 2022; Picciotto, 2018), and (2) the residence country, namely the country where the taxpayer or investor is legally domiciled.

The conceptual foundation of this idea was laid by Peggy B. Musgrave (1969) through the doctrine of inter-nation equity, or fairness among nations. This doctrine asserts that the division of taxing rights between the "source country", that is, the country where capital is invested and economic activity takes place, and the "residence country", in other words, the country where the taxpayer or investor is domiciled, must be carried out fairly and proportionally, and mandates that developing countries should not have their resources exploited without receiving commensurate compensation in state revenue. However, the synthesis of various contemporary studies reveals a fairly sharp gap between inter-nation equity theory and empirical reality on the ground. Findings put forward by Pratama (2024) and Permata (2025) confirm that, in practice, developed countries tend to dominate the process of formulating global tax policy, causing taxing rights to systematically shift from source countries toward residence countries. This shift has become increasingly relevant and crucial to reassert as a normative foundation, particularly in responding to the challenge of taxing digital-economy-based companies that are able to earn profits on a massive scale from a source jurisdiction without needing to establish a physical presence in the form of a Permanent Establishment (PE) (Avi-Yonah, 2021; Brooks, 2018; Christians and Magalhaes, 2020; Pratama, 2024).

2.2. Tax Sovereignty Theory and Multilateral Cooperation

Historically, Tax Sovereignty Theory is rooted in the Westphalian principle, which asserts that every sovereign state holds full and exclusive authority to establish its own taxation system, set rates, and independently define its taxable subjects without outside intervention. However, amid the tide of globalization, this conception of absolute sovereignty has transformed into cooperative tax sovereignty. Through this cooperative paradigm, states voluntarily delegate part of their authority through multilateral legal frameworks in order to withstand two principal threats: (1) tax havens, specifically tax-shelter jurisdictions that offer very low or nil tax rates to attract global funds, and (2) treaty shopping, specifically the opportunistic practice in which corporations establish shell companies (conduit companies) to hijack tax treaty relief facilities to which they are not actually entitled.

In practical terms, the application of this cooperative sovereignty concept has been concretely realized through the Inclusive Framework initiated by the OECD/G20. One of its most significant forms of implementation is the Global Minimum Tax (GMT) policy as set out under Pillar 2, which requires countries to comply with a global corporate tax rate floor of at least 15% through the Income Inclusion Rule (IIR) and Undertaxed Profits Rule (UTPR) mechanisms (Devereux et al., 2021). A synthesis of the empirical literature shows that compliance with this OECD consensus gives rise to a sovereignty dilemma. Findings from Wijaya and Santoso (2024) and Novarina and Rohayati (2023) present real examples showing that developing countries, including Indonesia, are in fact disadvantaged because they lose the fiscal sovereignty to use tax discount instruments (such as tax holidays) to attract Foreign Direct Investment. This demonstrates the link between theory and practice, in which global tax governance structurally continues to marginalize the diplomatic bargaining position of developing countries.

2.3. Taxation Principles and the Arm's Length Principle (ALP) Mechanism

The international taxation system is fundamentally grounded in the tension between two principal guiding standards: the source principle (taxation is carried out in the country where the income is generated) and the residence principle (taxation is based on the taxpayer's country of residence). To govern cross-border transactions between companies belonging to the same multinational group, the international community has agreed on the use of the Arm's Length Principle (ALP), or the Principle of Fairness and Business Custom (OECD, 2022). The ALP is built upon the legal fiction of the separate entity approach, which assumes that each subsidiary within an affiliated group transacts fairly as though they were two independent business entities

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operating in an open market (Russo, 2022). The primary purpose of the ALP is to prevent transfer pricing manipulation, that is, the engineering of prices in transactions between affiliated companies, which corporations frequently use to shift profits toward tax haven jurisdictions (Beer et al., 2020). It is precisely this aggressive practice of deliberately exploiting legal loopholes to shift profits and erode the source country's tax base that is technically defined as Base Erosion and Profit Shifting (BEPS).

The technical implementation of ALP rules relies heavily on comparability analysis, which involves comparing affiliated-transaction data with independent market-transaction data to determine an "arm's length price" (Verlinden and Smits, 2019). Based on a synthesis of studies by Khifni and Tehupeiory (2024) and Setiawan and Rahayu (2023), the implementation of this conventional method encounters structural failure in developing countries. As a concrete example in Indonesia, tax authorities have frequently lost various international tax court disputes related to transfer pricing. This failure largely stems from the limited availability of domestic comparable analytical databases, particularly when tax authorities are confronted with the need to value transactions involving intangible assets such as digital algorithms, technology patents, and trademarks that are highly exclusive and difficult to compare. This empirical condition demonstrates that this legacy tax-sovereignty protection mechanism (ALP) is no longer relevant for containing the expansion of modern business models that continue to grow in source countries.

III. Research Method

3.1. Research Design

This study employs a Narrative Literature Review method with a qualitative approach. The choice of this qualitative design is based on the characteristics of the object of study, specifically international tax policy, which is heavily laden with aspects of legal products, global institutional architecture, and normative values related to sovereignty fairness. As a result, an in-depth exploration of this object of study is difficult to achieve by relying solely on quantitative measures. The data used are qualitative secondary data, encompassing regulatory texts, reports from international institutions, and empirical findings sourced from prior journal articles. The methodological innovation of the approach used in this study lies in the character of the review, which is not limited to summarizing existing literature, but instead seeks to integrate three pillar issues that have tended to be studied in a fragmented manner, particularly transfer pricing practices, Base Erosion and Profit Shifting (BEPS) regulation, and the digital economy, into a single systematic evaluative framework concerning cross-border tax fairness.

3.2. Instruments and Sample

The literature search strategy was carried out systematically through highly reputable academic databases, namely Google Scholar, Scopus, and the official publication database of the Organisation for Economic Co-operation and Development (OECD). This search was conducted using a combination of keywords via Boolean operators, namely: "International Tax Law" OR "Tax Sovereignty" AND "Transfer Pricing" AND "BEPS" OR "Digital Economy Taxation". The publication timeframe was limited to the years 2007 through 2026, with the aim of capturing both the historical development and the contemporary regulatory dynamics of this field of study. Therefore, to ensure the transparency of the sampling process and the validity of the data, the article screening process was carried out through a rigorous filtering stage based on the criteria summarized in Table 1 below:

Table 1. Literature Inclusion and Exclusion Criteria

Parameter	Inclusion Criteria	Exclusion Criteria
Document Type	Peer-reviewed journal articles, official	Opinion articles, popular magazines,

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	reports from international institutions (OECD/UN).	unreviewed working papers, blogs.
Substantive Focus	Discusses international tax, global governance, transfer pricing, BEPS, or cross-border digital tax.	Discusses only purely domestic tax administration with no cross-border jurisdictional relevance.
Language and Time Period	Written in Indonesian or English, published between 2007–2026.	Languages other than Indonesian/English, published before 2007.

The literature screening process was carried out by first evaluating titles and abstracts to eliminate irrelevant articles. Following this, the remaining literature was read in full (full-text reading) until ultimately 10 (ten) principal pieces of literature, deemed the most authoritative and relevant, were selected as the final analytical sample.

3.3. Data Analysis

The data analysis workflow in this study was carried out through three systematic stages: (1) Identification, namely the process of unpacking and dissecting the theoretical concepts contained within each piece of literature reviewed. (2) Extraction, namely the process of drawing out key findings related to the failures or successes of currently applicable tax instruments. (3) Synthesis, namely the process of comparing and consolidating these findings into a new narrative conclusion. As the primary measurement tool within this workflow, this study employs a comparison matrix instrument. This matrix serves a crucial function in mapping the extraction results into a structured visualization, with the aim of highlighting three fundamental aspects, namely: (1) views already agreed upon by experts (consensus), (2) shifts or evolution in theoretical thinking alongside changes in the global business landscape, and (3) differences in argumentation and research gaps that remain subjects of debate among academics to this day (Paul and Criado, 2020). Through the combination of this matrix instrument with thematic-comparative analysis, the regularities and blind spots present in contemporary international tax policy can be unpacked with greater precision and systematic rigor (Okoli and Schabram, 2016).

IV. Result and Discussion

This section presents the synthesized results of the ten prior pieces of literature rigorously selected using the Literature Review Analysis method. These ten works focus on four main themes: international tax law, transfer pricing, double taxation avoidance (tax treaties), and the challenges of taxation in the digital economy era. This method was chosen because it offers structured, transparent, and measurable steps for selecting the literature most relevant to the research objectives. Each piece of literature reviewed was then examined using thematic-comparative analysis to identify three key elements: (1) commonalities in findings indicating agreement among researchers; (2) differences in perspectives and theories employed; and (3) research gaps indicating areas that remain under-discussed (Templier & Paré, 2018; Xiao & Watson, 2019). This process involves not merely summarizing the content of the literature, but also critically and deeply analyzing the field of international taxation. For ease of understanding, all of the literature findings are summarized in matrix form in Table 2. This table maps the focus, methodology, and key findings of each piece of literature analyzed. This visual presentation is designed to give readers a comprehensive overview, while also demonstrating that this research was conducted transparently in accordance with literature review methodology standards. The ten works in the table also serve as the primary reference sources for this study.

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Table 2. Literature Extraction and Mapping

No.	Researcher & Year	Research Title	Methodology	Results & Key Findings
1.	(Loso Judijanto & Al-Amin, 2024)	Tax Treaty and Tax Haven in International Tax Avoidance	Normative Juridical Analysis & Qualitative	Developing countries are frequently exploited through tax treaty and tax haven loopholes. Recommendations include a fairer renegotiation of DTAAs (Double Taxation Avoidance Agreements)
2.	(Khifni & Tehupeiory, 2024)	Transfer Pricing and BEPS in International Tax	Descriptive Qualitative	Transfer pricing practices are very difficult to monitor without robust data exchange instruments. The BEPS Action Plan has proven to be an effective mitigation solution when implemented comprehensively
3.	(Novarina & Rohayati, 2023)	The Application of International Tax in Indonesia	Case Study & Literature Review	Indonesia's taxation system still faces overlapping regulatory constraints in responding to cross-border transactions, requiring the strengthening of tax intelligence functions.
4.	(Permata, 2025)	The Application of Double Taxation Avoidance in the Global System	Comparative Qualitative	Double Tax Avoidance does not always benefit the source country of income. There is a disparity in the distribution of taxing rights
5.	(Samudera & Purwati, 2025)	Tax, Transparency, and Cross-Border Economic Crime	Fiscal Policy Analysis	Bank secrecy and a lack of transparency catalyze tax crimes. Exchange of Information (EOI) is the key to preventing global tax evasion
6.	(Setiawan & Rahayu, 2023)	Analysis of BEPS Action Plan Adoption on Multinational Compliance	Quantitative & Panel Data Analysis	BEPS implementation in developing countries increases the level of formal compliance, but intangible-asset-based profit shifting still occurs.
7.	(Darussalam & Septriadi, 2022)	Fiscal Sovereignty and the Dynamics of Double Taxation Avoidance Agreements	Normative Legal	Tax treaties (DTAAs) serve a dual function: preventing double taxation, but without anti-abuse rules, they will be exploited for treaty shopping.
8.	(Pratama, 2024)	Tax Fairness in Cross-Border Digital Economic Transformation	Systematic Literature Review	The concept of a physical Permanent Establishment (PE) has become obsolete. It proposes that the concept of Significant Economic Presence be promptly ratified multilaterally.
9.	(Wijaya & Santoso, 2024)	Developing Countries' Readiness to Face OECD Pillar 1 and Pillar 2	Empirical Fiscal Study	The implementation of the global minimum tax (Pillar 2) has the potential to kill local tax incentives. Developing countries must adjust their FDI-attraction strategies without violating the consensus

No.	Researcher & Year	Research Title	Methodology	Results & Key Findings
10.	(Avi-Yonah, 2021)	The Architecture of International Tax Law: Hegemony vs. Fairness	Theoretical Analysis	The global tax system more heavily accommodates the taxing rights of residence countries. A reformulation of tax governance that favors source countries is needed

4.1. The Dynamics of Transfer Pricing and the Structural Failure of the Arm's Length Principle

Based on the analysis of the literature reviewed, transfer pricing emerges as the common thread linking all findings in this study. Khifni & Tehupeiory (2024) explicitly argue that transfer pricing practices are difficult to monitor in the absence of robust instruments for cross-jurisdictional data exchange. This monitoring difficulty extends beyond mere procedural completeness or administrative technicalities. More fundamentally, it reveals a structural weakness inherent in the Arm's Length Principle (ALP) itself, which, paradoxically, has served as the primary guideline for global transfer pricing regulation for decades. The root of this fundamental weakness lies in ALP's underlying assumption, which no longer aligns with contemporary business realities (a loss of empirical relevance). The principle presumes that every intra-group transaction within a multinational enterprise can always be matched against an equivalent transaction between independent parties in the open market, through comparability analysis. Empirically, real-world failures of ALP are frequently observed in the practices of multinational technology firms that shift operating profits out of market jurisdictions (such as Indonesia) through royalty payments for copyrights or software licenses to affiliated entities in tax haven jurisdictions. This phenomenon directly validates the shortcomings of Musgrave's Inter-Nation Equity theory in practice, whereby ALP's inability to trace the value of intangible assets systematically undermines the taxing rights of source countries. This finding is consistent with the synthesis offered by Khifni & Tehupeiory (2024) and Setiawan & Rahayu (2023) who assert that although the adoption of the BEPS Action Plan has improved formal (procedural) compliance in developing countries, profit shifting based on intangible assets continues on a massive and largely unchecked scale. These findings reveal a genuine gap: firms no longer manipulate the prices of physical goods, which are relatively easy to trace, but instead exploit valuation loopholes in technology patents, algorithms, and user databases, assets for which comparable market benchmarks are virtually impossible to establish.

This finding is further corroborated by Gultom and Wardhani (2025), who show that transfer pricing practices among multinational enterprises are no longer confined to internal pricing mechanisms but have evolved into instruments of profit shifting that exploit differences in tax rates, the complexity of affiliated transactions, and weak cross-jurisdictional oversight. Strengthening transfer pricing regulation and documentation is therefore an essential prerequisite for maintaining international tax compliance. From an institutional standpoint, this systemic weakness is further underscored by Novarina & Rohayati (2023), who argue that Indonesia's tax system remains hampered by overlapping regulations in addressing cross-border transfer pricing practices. This regulatory constraint is compounded by the continued weakness of tax intelligence functions in detecting potential tax avoidance at an early stage. Indonesia's situation essentially reflects a structural challenge shared by most developing countries. Global standards such as ALP require tax authorities to possess highly sophisticated analytical capabilities and comprehensive data access. Given their limited administrative resources, developing countries become easy targets for exploitation through these regulatory gaps. Consequently, tax authorities in developing countries, as source countries of income, frequently reach an impasse when attempting to correct corporate tax assessments, and face substantial risk of losing when such disputes are brought before international tax tribunals.

This issue becomes even more complex when considered alongside the shift toward the digital economy, as highlighted by Pratama (2024) That study emphasizes that the "physical presence" requirement (such as the establishment of a branch office or factory), which has long determined Permanent Establishment (PE) status and, by extension, served as the basis for taxation and the application of ALP standards, has lost its

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relevance. In the current digital era, global technology giants can generate substantial profits from a given country without maintaining any physical premises or representation there. As a result, the entire ALP evaluation framework, which has traditionally relied heavily on physical presence (such as functional analysis, tangible assets, and on-the-ground risk), has become blunt and unworkable. This new reality ultimately gives rise to what may be termed a double structural failure. First, a conceptual failure occurs, in which ALP theory proves inadequate for valuing intangible assets. Second, a jurisdictional failure occurs, in which conventional tax systems lose their footing, unable to reach digital business models that operate across national borders without physical form.

Viewed through the lens of distributive justice in economic equity, the failure of the ALP system does not affect all parties equally. Permata (2025) contends that empirical evidence points to a persistent systemic gap that disadvantages the country in which profit is actually generated (the source country). This imbalance in the allocation of taxing rights demonstrates that current transfer pricing rules systematically favor the parent company's home country (the country of residence), the majority of which are developed nations. Developed countries derive this advantage at the expense of developing countries' taxing rights, even though it is in developing countries that economic value is actually created and circulated. This inequity is strongly supported by the theoretical critique of Avi-Yonah (2021), who sharply observes that the current design of international tax law falls far short of the ideal of global justice, and instead reflects the dominance (hegemony) of developed OECD member states. He accordingly calls for a comprehensive overhaul of international tax governance so that its rules become more favorable to the interests of source countries.

Based on these findings, it can be concluded that a fundamental overhaul of the global transfer pricing system is an urgent necessity. Addressing this systemic weakness requires two key reform measures: first, the adoption of the formulary apportionment method to allocate taxing rights among countries more equitably, based on tangible economic indicators such as sales volume, employment levels, and asset value; and second, stricter enforcement of tax documentation requirements (such as the Master File and Local File under BEPS Action 13), accompanied by capacity-building for tax officials in developing countries (Khifni & Tehupeiory, 2024; Setiawan & Rahayu, 2023). Should these reform measures be neglected, existing regulatory loopholes will continue to be exploited by multinational enterprises, systematically eroding the fiscal sovereignty and tax revenues of developing countries without meaningful recourse. Beyond reforming international tax regulations, the effectiveness of transfer pricing oversight also depends on robust public financial governance. Transparent and accountable fiscal governance, supported by an adaptive system of government financial management, will strengthen tax authorities' capacity to identify cross-border tax avoidance practices and reinforce the implementation of international tax policy. Tax reform, therefore, depends not only on changes to legal instruments but also on strengthening the quality of public sector financial management as a foundation for a sustainable tax system (Idrus, 2024).

4.2. Exploitation of Tax Treaties and the Asymmetry of Power Between Developing Countries

A critical review of the literature (Darussalam & Septriadi, 2022; Loso Judijanto & Al-Amin, 2024; Permata, 2025) reveals a significant irony in the implementation of Double Taxation Avoidance Agreements (DTAAs). In principle, these agreements were designed with a legitimate objective: to provide legal certainty so that a given income is not taxed twice in different countries. In practice, however, the DTAA system harbors a concealed bias, whereby its rules systematically favor developed countries as the home countries (countries of residence) of multinational enterprises. Drawing on Avi-Yonah (2021), this bias is not merely a technical flaw in the rules but a genuine reflection of the power asymmetry between nations that has been deeply embedded since the earliest formation of the global tax system. According to Loso Judijanto & Al-Amin (2024), developing countries are highly vulnerable to the loopholes embedded in DTAAs. This vulnerability stems from the dominance of the OECD Model, which frequently suppresses withholding tax rates in source countries on the grounds of attracting investment. In practice, multinational enterprises exploit this leniency through treaty shopping, establishing conduit companies in various jurisdictions solely to hijack DTAA tax relief facilities, despite having no genuine economic activity in those jurisdictions. This condition consistently

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produces inequity, as the taxing rights of developing countries (as source countries) continue to erode while developed countries (as residence countries) increasingly benefit. As critiqued by Avi-Yonah (2021), this imbalance is not a mere technical anomaly but a tangible reflection of the entrenched dominance of developed-country power within the historical formation of the global tax system.

Therefore, in order to unravel this exploitation, which often hides behind banking secrecy, Samudera & Purwati (2025) assert that DTAA reform must be carried out in tandem with strengthening transparency through the Exchange of Information (EOI) mechanism. As a concrete strategic step, Loso Judijanto & Al-Amin (2024) urge developing countries to simultaneously revise their tax treaties using the Multilateral Instrument (MLI). Through this instrument, developing countries can efficiently inject anti-abuse clauses, particularly the application of the Principal Purpose Test (PPT), which grants tax authorities the power to void DTAA facilities where proven manipulative, as well as tightening beneficial ownership requirements, which mandate proof of genuine economic benefit ownership. Although global instruments such as the MLI offer a promising solution, Novarina & Rohayati (2023) caution that their effectiveness depends heavily on domestic readiness. The case of Indonesia shows that the implementation of anti-abuse clauses is still frequently hampered by overlapping domestic regulations and weak tax intelligence capabilities. It can therefore be concluded that equitable DTAA renegotiation, global data transparency, and the strengthening of local tax institutional capacity are not merely separate policy options. All three form a single, absolute, and urgent package of reform that must be implemented promptly so that developing countries can put a stop to corporate exploitation and reclaim their fiscal sovereignty on the international stage.

4.3. The Transformation of the Digital Economy and the Distortion of Inter-Nation Equity

Studies by (Pratama, 2024; Wijaya & Santoso, 2024) reveal an important fact: the rapid growth of the digital economy has become the greatest threat to inter-nation equity, the equitable allocation of taxing rights among nations, a foundational principle of Musgrave's theory. This threat is fundamentally structural and undermines the system as a whole, such that it cannot be resolved through minor administrative amendments alone. Pratama (2024) further critically emphasizes how technology giants can extract substantial profits from users in a given country by exploiting digital service data and platforms, without establishing any physical office or representation (Permanent Establishment/PE) in that country. This situation clearly undermines the fundamental principles of international taxation, whereby the market country in which economic value is actually created loses its right to tax, simply because outdated legal rules still rigidly require physical presence as a precondition for taxation.

At present, conventional tax systems have proven unable to address digital business models, as technology giants can exploit millions of data points and user activities in developing countries without providing those countries a fair share of taxing rights (Setiawan & Rahayu, 2023). This condition significantly disadvantages developing countries and violates Musgrave's principle of inter-nation equity, which holds that taxation should occur where economic value is actually created. To address this structural inequity, the OECD formulated a global solution through Pillar One, regarded as a crucial political compromise (Wijaya & Santoso, 2024). Under this policy, the outdated legal requirement of maintaining a physical office (Permanent Establishment) is replaced by the concept of Significant Economic Presence (SEP), proposed for global implementation to enable countries to tax digital entities (Pratama, 2024). Ultimately, the adoption of Pillar One and the SEP concept constitutes formal recognition of market countries' rights to the profits of digital giants, as well as a corrective step aligned with demands for a fairer global tax system long dominated by the interests of developed countries (Avi-Yonah, 2021).

On the other hand, the implementation of the 15% Global Minimum Tax (GMT) under OECD Pillar Two imposes its own costs on developing countries, as it eliminates their capacity to offer tax incentives (such as tax holidays) to attract foreign investment (Wijaya & Santoso, 2024). Ironically, if a developing country sets a tax rate below 15% to attract investors, the resulting tax differential is instead collected by the developed country in which the parent company resides, further exacerbating the inequitable distribution of global tax revenue (Permata, 2025). From the perspective of Tax Sovereignty Theory, the implementation of Pillars One

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and Two effectively compels developing countries into a scheme of cooperative tax sovereignty, in which they must relinquish part of their domestic fiscal authority. However, a comparative synthesis (Avi-Yonah, 2021; Wijaya & Santoso, 2024) shows that this global compromise is inherently asymmetric: the governance of Pillar Two is heavily dominated by the interests of developed countries, while developing countries bear the burden of administrative and technical complexity and lose incentive-based competitiveness, without receiving genuinely fair and inclusive compensation in the allocation of taxing rights (Avi-Yonah, 2021; Pratama, 2024; Wijaya & Santoso, 2024).

4.4. Global Transparency (AEOI) as a Double-Edged Sword

The shift from an era of banking secrecy toward the Automatic Exchange of Information (AEOI) system represents the most significant revolution in the history of international taxation. This system has gradually dismantled corporate concealment in tax haven jurisdictions and succeeded in exposing trillions in previously hidden funds (Samudera & Purwati, 2025). This transparency is critical for tracing the fraudulent practices of multinational enterprises that frequently establish shell companies solely to exploit tax relief (Loso Judijanto & Al-Amin, 2024). Where the reform of global tax rules through the Multilateral Instrument (MLI) functions to close legal loopholes (Darussalam & Septriadi, 2022), AEOI functions to close informational loopholes. Furthermore, when combined with Country-by-Country Reporting (CbCR), AEOI helps bridge the information asymmetry between tax authorities and corporations, making the oversight of transfer pricing manipulation considerably more transparent and effective (Khifni & Tehupeiory, 2024; Setiawan & Rahayu, 2023).

Although it brings a welcome breath of fresh air, this transparency revolution gives rise to a great irony in the form of a capacity gap in developing countries such as Indonesia (Novarina & Rohayati, 2023). Tax authorities are now indeed flooded with millions of pieces of cross-border financial data, yet they lack an adequate technology system and skilled Big Data analysts to process this mass of information into evidence of legal violations. As a result, the valuable data from AEoI risks ending up as nothing more than a pile of digital archives without generating any state revenue (Samudera & Purwati, 2025). This system and human-resource gap creates a vicious circle, since the same weakness will also hinder developing countries in implementing the Global Minimum Tax policy (Pillar 2), which depends heavily on tax officials' ability to accurately access and analyze corporate financial data (Wijaya & Santoso, 2024). Therefore, to overcome this capacity gap, developing countries must undertake substantial investment in modernizing their tax administration systems. Such modernization is an absolute prerequisite, encompassing the development of advanced information technology infrastructure, enhanced expertise among tax officials, and the strengthening of domestic legal provisions to ensure AEOI data can be validly used as evidence in court. In addition, genuine inter-agency cooperation among tax authorities, financial intelligence units, and law enforcement bodies must be substantially strengthened (Novarina & Rohayati, 2023; Wijaya & Santoso, 2024). Without such institutional reform from within, this sophisticated global transparency system will remain little more than an empty promise, leaving developing countries perpetually deprived of their rightful tax revenue potential.

V. Conclusion

Based on the literature review, the current international tax system remains largely outdated because it continues to rely on twentieth-century principles that are increasingly incompatible with digital business models, intangible assets, and cross-border economic activities. The traditional requirement of physical presence and the application of the Arm’s Length Principle have proven insufficient to determine where value is created and where profits should be taxed (Khifni & Tehupeiory, 2024; Pratama, 2024). These weaknesses disproportionately affect developing countries, which frequently lose substantial tax revenues through profit shifting, treaty abuse, and the artificial allocation of profits to low-tax jurisdictions, despite serving as important markets and sources of economic value (Loso Judijanto & Al-Amin, 2024; Permata, 2025). Although

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the OECD Two-Pillar Solution represents an important reform, its implications remain contested. Pillar One expands taxing rights over digital enterprises without requiring a physical presence, but its technical complexity may constrain implementation in countries with limited administrative capacity. Pillar Two establishes a 15% global minimum tax, yet it may restrict the ability of developing countries to use fiscal incentives to attract foreign investment without guaranteeing an equitable redistribution of taxing rights (Avi-Yonah, 2021; Wijaya & Santoso, 2024). Similarly, the Automatic Exchange of Information has weakened international banking secrecy, but the resulting volume of financial data cannot be effectively transformed into tax revenue without adequate technology, institutional coordination, and skilled personnel (Novarina & Rohayati, 2023; Samudera & Purwati, 2025).

Accordingly, developing countries must adopt coordinated strategies to protect their tax sovereignty and strengthen their participation in international tax governance. First, they should promote formulary apportionment as an alternative to the Arm's Length Principle by allocating multinational corporate profits according to observable economic indicators, including sales, employment, and asset values. Second, while awaiting the full implementation of Pillar One, countries may consider unilateral digital taxation based on Significant Economic Presence to ensure that technology corporations contributing substantially to domestic markets remain within the national tax base. Third, because the global minimum tax reduces the effectiveness of tax holidays and low-rate competition, investment policy should shift toward non-fiscal incentives, including regulatory certainty, integrated digital licensing, reliable infrastructure, research and development support, and the availability of a highly skilled workforce. Fourth, tax administrations should modernize their intelligence systems through Artificial Intelligence, Big Data analytics, integrated Core Tax Administration Systems, and stronger inter-agency coordination to identify transaction anomalies, treaty shopping, and profit-shifting practices in real time (Khifni & Tehupeiory, 2024; Pratama, 2024; Setiawan & Rahayu, 2023; Wijaya & Santoso, 2024). At the macroeconomic level, these findings imply that developing countries, particularly Indonesia, must redesign their fiscal architecture by reducing their dependence on aggressive tax competition and creating a sustainable investment ecosystem based on institutional quality and productive non-fiscal support.

This study is limited by its qualitative literature-review approach, which does not provide direct empirical estimates of revenue losses or evaluate the operational effectiveness of specific tax reforms. Future research should therefore employ quantitative and mixed-method designs to estimate Indonesia's potential tax losses arising from digital corporations operating without a Permanent Establishment and to assess the distributional consequences of Pillar One and Pillar Two for developing economies. Further studies should also examine the technological, institutional, and human-resource readiness of Core Tax Administration Systems to integrate Artificial Intelligence and Big Data analytics, particularly for detecting treaty-shopping arrangements, hidden beneficial ownership, and abnormal cross-border transactions in real time. Comparative research across developing countries would additionally provide valuable evidence regarding the effectiveness of unilateral digital taxes, formulary apportionment, non-fiscal investment incentives, and international information-exchange mechanisms. Such research is essential to support the formulation of a more inclusive international tax architecture that balances global cooperation with the fiscal sovereignty, administrative capacity, and development needs of emerging economies.

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