



## The Arm's Length Principle vs the Global Tariff Approach: Determining Which is Better for Realising the SDGs

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### ABSTRAK

*The increasing complexity of global taxation has ignited the debate between the Arm's Length Principle (ALP) and the Global Tariff Approach (GTA), particularly regarding their alignment with the Sustainable Development Goals (SDGs). This paper presents a comparative legal and empirical analysis of both principles (together with the emerging Global Minimum Tax (GMT)) to assess their effectiveness, fairness, and institutional feasibility across jurisdictions. Using case studies from the United States, the European Union, India, and Indonesia, the findings reveal that while ALP remains dominant due to its treaty embeddedness and legal clarity, it creates significant administrative burdens and inequities for developing countries with limited data and capacity. Conversely, GTA and GMT offer greater systemic fairness and predictability, promoting revenue sufficiency and fiscal sustainability in line with SDG 10 (reducing inequality), SDG 16 (strong institutions), and SDG 17 (global partnerships). The study concludes that a hybrid model, combining ALP's legal precision with GTA/GMT's structural fairness, supported by inclusive multilateral governance, represents the most viable pathway toward a more equitable and sustainable international tax architecture. Policy recommendations include enhancing developing countries' administrative capacity, expanding access to global comparables data, and supporting UN-led efforts toward a more balanced global tax convention.*

Peningkatan kompleksitas perpajakan global telah memicu perdebatan antara Prinsip Kewajaran (ALP) dan Pendekatan Tarif Global (GTA), terutama jika dikaitkan dengan Tujuan Pembangunan Berkelanjutan (SDGs). Artikel ini menyajikan analisis hukum dan empiris komparatif terhadap kedua prinsip tersebut (bersama dengan Pajak Minimum Global yang sedang berkembang (GMT)) untuk mengevaluasi efektivitas, keadilan, dan kelayakan institusionalnya di berbagai yurisdiksi. Menggunakan studi kasus dari Amerika Serikat, Uni Eropa, India, dan Indonesia, temuan menunjukkan bahwa meskipun ALP tetap dominan karena tertanam dalam perjanjian dan kejelasan hukum, prinsip ini menimbulkan beban administratif yang signifikan dan ketidakadilan bagi negara berkembang dengan data dan kapasitas yang terbatas. Sebaliknya, GTA dan GMT menawarkan keadilan sistemik dan kepastian yang lebih besar, mendukung kecukupan pendapatan dan keberlanjutan fiskal sesuai dengan SDG 10 (mengurangi ketidaksetaraan), SDG 16 (institusi yang kuat), dan SDG 17 (kemitraan global). Studi ini menyimpulkan bahwa model hibrida, yang menggabungkan ketepatan hukum ALP dengan keadilan struktural GTA/GMT (didukung oleh tata kelola multilateral yang inklusif) mewakili jalan paling layak menuju konsep pajak internasional yang lebih adil dan berkelanjutan. Rekomendasi kebijakan meliputi peningkatan kapasitas administratif negara-negara berkembang, perluasan akses ke data perbandingan global, dan dukungan terhadap upaya PBB menuju konvensi pajak global yang lebih seimbang.

## 1. INTRODUCTION

### 1.1. Background

In the era of economic globalization, cross-border trade and investment have become the backbone of many countries' economic growth. However, harmonization of international tax policies, particularly with regard to transfer pricing and cross jurisdictional tax treatment, remains a major challenge. The two main principles that have been used in international taxation arrangements are the Arm's Length Principle (ALP) and the Global Tariff Approach.

The Arm's Length Principle, recommended by the

Organization for Economic Cooperation and Development (OECD), requires transactions between affiliated entities across countries to be conducted as if they were independent parties. This principle is widely used to prevent profit shifting to low-tax jurisdictions. However, its application is often complicated and triggers disputes between countries, especially in determining objective fair value (OECD, 2022).

In contrast, the global rate approach or formulary apportionment approach emphasizes the apportionment of multinationals' profits based on predetermined formulae, such as the proportion of sales, assets and labour in each country. This approach is considered simpler, but has not been widely adopted globally due to the lack of international consensus and the potential violation of the principle of state fiscal sovereignty (Avi-Yonah &

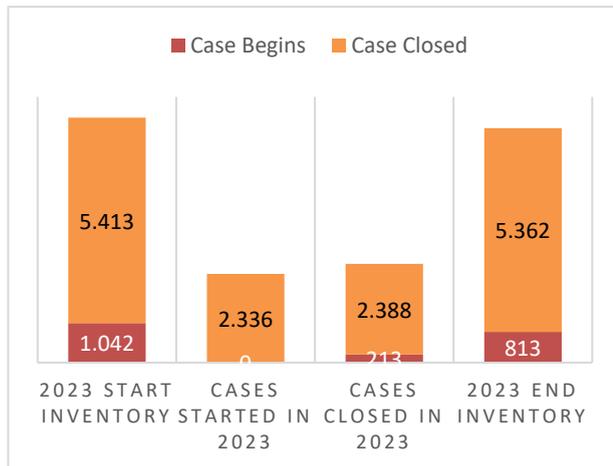
Moreover, in the context of sustainable economic development, the two approaches have different implications for fiscal justice, income redistribution, and foreign investment attraction. Therefore, it is important to comparatively review the application of the two principles based on international law and best practices in various jurisdictions to formulate a more effective and equitable approach.

Therefore, the purpose of this study is to comparatively assess the conceptual, legal, and practical dimensions of the Arm's Length Principle (ALP), the Global Tariff Approach (GTA), and the Global Minimum Tax (GMT) in achieving fiscal equity and supporting the Sustainable Development Goals (SDGs), particularly SDG 10 (Reduced Inequalities), SDG 16 (Strong Institutions), and SDG 17 (Global Partnership). This study also aims to evaluate their suitability for developing countries, including Indonesia, in balancing global tax harmonization with fiscal sovereignty.

### 1.2. Problem Formulation

1. How do the Arm's Length Principle (ALP), formulary apportionment (Global Tariff Approach/GTA), and the Global Minimum Tax (GMT) differ in their conceptual design, legal implementation, and practical outcomes across jurisdictions?
2. What are the implications of adopting ALP versus GMT for developing countries (particularly in Indonesia) in terms of revenue sufficiency, equity, administrative feasibility, and dispute risk, and how do these align with selected SDG targets (10, 16, 17)?

Table 1. Total MAP Caseload



Source: OECD 2023 Mutual Agreement Procedure Statistics

Clausing, 2007) .

Dispute resolution related to the application of the arm's length principle also takes a long time. Latest data from OECD (2023) shows that the minimum time to resolve tax disputes through the Mutual Agreement Procedure (MAP) for Transfer Pricing cases takes 32 months with more than 2000 cases. This shows the high complexity and disagreement between countries in applying the arm's length principle.

## 2. THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

### 2.1. Arm's Length Principle (ALP)

#### 2.1.1. Definition and History of ALP in International Tax Regimes

The *Arm's Length Principle* (ALP) is a key principle in the international tax system used to regulate transactions between affiliated companies across jurisdictions. The essence of this principle is that prices in transactions between related parties should be set as if the transactions were between independent parties under fair market conditions (OECD, 2022).

The concept was first systematically introduced in the OECD and UN *Model Tax Convention* in the mid-20th century, in response to the increasing practice of tax avoidance by multinational companies through transfer pricing manipulation. Since then, ALP has become a standardized principle widely adopted by tax authorities around the world, including in the

bilateral context through double taxation avoidance agreements (Dourado, 2013).

### 2.1.2. ALP in OECD Guidelines and its Implementation

The OECD strengthened the position of ALP through the latest *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* in 2022. These guidelines provide a methodological framework for determining fair prices for various types of transactions, including the use of Comparable Uncontrolled Price (CUP), Resale Price, Cost Plus, Transactional Net Margin, and Profit Split methods (OECD, 2022).

In general, the application of ALP requires the availability of comparable and verifiable data. OECD member countries and some partner countries, including Indonesia, require transfer pricing documentation and Country-by-Country Reporting (CbCR). In Indonesia, the transfer pricing documentation obligation is regulated through Minister of Finance Regulation (PMK) No. 172/PMK.03/2023, which emphasizes the importance of compliance with the arm's length principle in related party transactions, as a form of protection against tax base erosion (Direktorat Jenderal Pajak, 2023).

### 2.1.3. Challenges of ALP Implementation in Developing Countries

Although ALP aims to realize fiscal justice, its application creates significant challenges in developing countries. These include limited access to comparable data, weak tax information systems, and limited administrative capacity (Beer et al., 2020). Tambunan (2020) notes that in Indonesia, the absence of reliable price information and the heavy burden of documentation hinder mid-sized businesses. Furthermore, disputes are often protracted: OECD (2023) reports show that Mutual Agreement Procedure (MAP) cases take over 30 months on average, straining the capacity of developing country administrations.

### 2.1.4. Criticisms of ALP: Capacity Asymmetry and Fiscal Justice

ALP has been criticized for being ill-suited to today's global economy of digital services, intangibles, and integrated supply chains. It tends to favour developed countries with stronger information and audit resources (Fuest & Riedel, 2012). Cobham and Janský (2017) show that ALP perpetuates inequities between residence and source countries, undermining fiscal sovereignty. In Indonesia, Syahrani (2021) observes that ALP often legitimizes profit shifting through manipulative benchmarking, weakening global tax fairness.

## 2.2. Formulary Apportionment (Global Tariff Approach, GTA)

### 2.2.1. Concept of GTA and Formulary Apportionment

Formulary apportionment (sometimes called the Global Tariff Approach, GTA) offers a systemic alternative to ALP. Rather than pricing individual transactions, GTA consolidates a multinational's global profits and allocates them by formula to jurisdictions based on objective indicators such as sales, employees, or assets (Zucman, 2014). This approach reduces the scope for transfer pricing manipulation and better reflects substantive economic activity (Picciotto, 2022a). Although not widely adopted, GTA remains a central reform proposal because it offers simplicity, fairness, and redistribution potential for source countries.

### 2.2.2. Advantages and Limitations

For developing countries, GTA offers clearer taxing rights and less dependence on comparable (Cobham & Janský, 2017). However, feasibility is constrained by sovereignty concerns, treaty incompatibility, and the lack of international consensus (Brooks & Hearson, 2023).

## 2.3. Global Minimum Tax (GMT / Pillar Two)

### 2.3.1. Concept of GMT

The Global Minimum Tax (GMT), introduced under the OECD/G20 Inclusive Framework's Pillar Two, is not an apportionment regime. Unlike GTA, GMT does not distribute profits by formula. Instead, it operates as a coordinated top-up tax system to ensure that multinationals face a minimum 15% effective tax rate on profits, regardless of where they are booked (OECD, 2021).

### 2.3.2. Mechanisms

GMT equalizes effective tax rates through three instruments:

- Income Inclusion Rule (IIR) – parent jurisdiction collects top-up tax when subsidiaries are taxed below 15%.
- Qualified Domestic Minimum Top-up Tax (QDMTT) – source jurisdiction has priority to collect the top-up.
- Undertaxed Profits Rule (UTPR) – backstop ensuring that low-taxed income is captured if IIR and QDMTT do not apply.

Indonesia adopted GMT via Minister of Finance Regulation No. 136/2024, regulating the global minimum tax and top-up obligations (DJP, 2024).

### 2.3.3. Clarification of GMT's Role

Although GMT shares policy goals with GTA (curbing profit shifting and base erosion), it is conceptually distinct. GMT does not allocate profits by formula; it ensures tax rate floors across jurisdictions. Its contribution lies in rate equalization, not apportionment. Thus, GMT complements but does not replace ALP or GTA (Garcia-Bernardo et al., 2017; UNCTAD, 2022).

### 2.3.4. Opportunities and Challenges

For developing countries, GMT protects against aggressive tax planning and stabilizes revenues (Cobham & Janský, 2017; Siregar, 2023). However, its implementation requires consensus, domestic legal alignment, and administrative capacity (UN, 2023a; PCT, 2024a).

## 2.4 Indicative Revenue Effects from Official Assessments

The OECD's global figure highlights GMT's systemic importance compared with the uncertain and uneven revenues typically generated under ALP enforcement. For the EU, the expected €64 billion annually demonstrates the capacity of coordinated regional action to mobilize substantial fiscal resources. India's projections reveal that even incremental adoption through QDMTT can secure sizeable revenues, especially valuable for a country experiencing rapid digitalization and multinational activity. Indonesia's estimates, while more modest in absolute terms, underline the significance of GMT for smaller and emerging economies: even 0.2% of GDP represents a stable and predictable fiscal contribution. Taken together, these official projections demonstrate that GMT is not just a legal framework but a practical tool for materially enhancing tax revenues across jurisdictions of varying size and capacity.

## 2.5. Comparative Clarification

- ALP: Transaction-level comparable, data-intensive, dominant in treaties, but biased towards developed states.
- GTA: True formula-based allocation, simpler and more equitable in theory, but politically difficult to implement.
- GMT: Coordinated top-up system that equalizes effective tax rates via IIR/QDMTT/UTPR, not a formula. Offers pragmatic revenue protection but adds new compliance layers.

This separation reduces conceptual ambiguity and strengthens legal accuracy in evaluating international tax reform regimes.

## 2.3. Relationship between the International Tax System and the Sustainable Development Goals (SDGs)

### 2.3.1. Tax as a Supporting Instrument for SDGs

A fair, transparent, and efficient tax system is an important prerequisite in achieving the *Sustainable Development Goals (SDGs)*, particularly in terms of financing development, reducing inequality, and strengthening institutions. Taxes are not only a fiscal tool to finance the state budget, but also a wealth redistribution mechanism and a policy instrument that can strengthen social stability and long-term economic competitiveness (UNDP, 2024).

UNDP in its *Tax for SDGs* programme states that equitable tax reforms are instrumental in supporting global agendas, including poverty eradication (SDG 1), improving the quality of education and health (SDGs 3 and 4), and reducing inequality (SDG 10). In developing countries, where dependence on external financing is high, optimizing tax revenue through international tax policy reform is even more crucial (PCT, 2024).

### 2.3.2. Linkages of ALP and GTA with SDGs 10, 16, and 17

The three SDGs that are most closely related to the international tax system are:

- **SDG 10 (Reduced Inequalities)**: ALP and GTA have direct consequences for the global distribution of taxation rights. ALP, which relies on market price benchmarking, tends to favour developed countries with high administrative capacity. In contrast, GTAs-particularly in the form of the Global Minimum Tax (GMT) provide opportunities for developing countries to gain a share of taxes that have been lost due to *profit shifting* (UNCTAD, 2022).
- **SDG 16 (Peace, Justice and Strong Institutions)**: The principles of fiscal justice and transparency in the tax system support the establishment of strong and accountable institutions. The implementation of ALP, when accompanied by transparent transfer pricing documentation as stipulated in MoF Regulation No. 172/PMK.03/2023, can strengthen the integrity of the national tax system (DJP, 2023).
- **SDG 17 (Partnerships for the Goals)**: Multilateral cooperation such as the *Inclusive*

*Framework on BEPS and the Platform for Collaboration on Tax* (IMF-OECD-UNWB) is the foundation of global tax coordination. Indonesia's adoption of the GMT through MoF Regulation No. 136 Year 2024 demonstrates national commitment to international consensus in promoting cross-jurisdictional fiscal justice (DJP, 2024).

### 2.3.3. Empirical Evaluation: Fiscal Equity and Global Inequality Distribution

A study by Cobham and Janský (2017) shows that developing countries lose up to USD 200 billion per year due to international tax avoidance practices, mostly by multinational corporations through transfer pricing manipulation. Inequality in access to information, audit resources, and weaknesses in administrative capacity are the main factors of the fiscal imbalance.

Zucman (2014) in his research shows that around 40% of multinational companies' profits are channeled to low- or no-tax jurisdictions. In this context, ALP—which relies on transaction price benchmarking—has proven ineffective in addressing aggressive profit shifting.

In contrast, the GTA approach, especially in the form of GMT, provides a more objective redistribution scheme that does not rely on individual price manipulation. The implementation of GMT in Indonesia is expected to broaden the tax base equally and promote the reduction of disparities between tax jurisdictions (Siregar, 2023).

### 2.3.4. Global Tax Reform in Support of SDGs

Global tax reform is not only a technical fiscal issue, but also part of an inclusive development strategy. Developing countries have long called for changes to the international tax governance structure that are more democratic and participatory. Efforts such as the establishment of the *Global Tax Convention* under the auspices of the United Nations (UN) are part of the movement towards a more equitable system (UN, 2023).

Reforms such as the GMT, improved ALP documentation, and strengthened cross-border tax cooperation must be accompanied by capacity support for developing countries, both in the form of technical assistance, global data access, and protection of *source-based taxation* rights.

Indonesia, through the adoption of MoF Regulation 136 Year 2024 and MoF Regulation 172 Year 2023, has taken an important step in integrating the national tax system into a more inclusive and sustainable development-oriented global framework.

## 2.4. Principles of International Law in the Global Tax Regime

### 2.4.1. Principles of Non-Discrimination and Global Fiscal Justice

In international law, the principle of non-discrimination is the main foundation governing relations between countries, including in the context of cross-jurisdictional taxation. This principle is reflected in Article 24 of the OECD Model Tax Convention, which affirms that states may not impose discriminatory tax treatment on foreign nationals or companies compared to domestic ones under comparable conditions (OECD, 2022).

In the context of international taxation, the principle of non-discrimination is closely related to global fiscal justice, which is the principle that all countries, both developed and developing, should obtain a fair right to the tax base of economic activities occurring in their territory. This principle encourages a tax system that not only prevents tax evasion, but also distributes taxation rights proportionally to real economic contributions (Christians, 2010).

Indonesia, within the ALP framework as stipulated in MoF Regulation No.

172/PMK.03/2023, has endeavoured to ensure fairness by testing the reasonableness of transfer prices on related party transactions. Meanwhile, the implementation of the Global Minimum Tax (GMT) through MoF Regulation No. 136 Year 2024 reflects Indonesia's commitment to adopt a global framework that better ensures the fairness of tax allocation on corporate profits across countries (DJP, 2024).

### 2.4.2. Fiscal Sovereignty vs International Tax Harmonization

One of the most fundamental tensions in the international tax regime is between national fiscal sovereignty and international tax harmonization efforts. Fiscal sovereignty gives a country the exclusive right to set its own tax policy, including determining rates, incentives, and the tax base. However, economic globalization has created pressure to harmonize such policies within a multilateral cooperation framework to avoid erosive practices such as *base erosion and profit shifting* (BEPS) (Fuest & Riedel, 2012).

The Arm's Length Principle (ALP) approach, which is predominantly adopted by OECD countries, is often criticized for narrowing developing countries' room for flexibility in designing their tax policies. In contrast, schemes

such as the Global Minimum Tax in Pillar Two of the OECD/G20 balance the need for harmonization while still allowing countries to maintain national rates, provided that the global minimum tax is met (OECD, 2021).

For Indonesia, the enactment of MoF Regulation 136 Year 2024 is an important step in navigating this dilemma. On the one hand, Indonesia aligns its policy with international consensus; on the other hand, the MoF Regulation still provides room for selective implementation based on specific jurisdictions and taxpayer groups (DJP, 2024). This approach reflects the importance of resetting the balance between global participation and preservation of domestic fiscal sovereignty.

### 2.4.3. Criticism of the Dominance of Developed Countries in Global Governance

Much of the criticism of the current international tax system is directed at the dominance of developed countries, especially in forums such as the OECD, which are perceived to set global standards without balanced representation from developing countries (Hearson, 2021). Developing countries are often just "policy followers" and do not have an equal bargaining position in the formulation of global rules.

In response, a number of developing countries together with the UN are pushing for the establishment of a Global Tax Convention that is more inclusive, transparent, and strengthens the role of the Global South (a term for developing and least developed countries) in the world's fiscal governance (UN, 2023). This proposal arises from concerns that the OECD's approach to ALP and GMT tends to be technocratic and biased towards jurisdictions that have sophisticated tax infrastructure.

In this context, Indonesia and other developing countries are encouraged to strengthen diplomatic positions in multilateral forums and build regional coalitions capable of voicing domestic fiscal needs in the redesign of the global tax system. Measures such as the implementation of MoF Regulation 172/2023 and MoF Regulation 136/2024 are not merely technical, but also political—that is, as a form of resistance to structural inequality in the international tax system.

## 2.5. Good Public Policy Theory in the Context of SDGs

### 2.5.1. The Concept of Effective and Adaptive Public Policy

Effective and adaptive public policy is an important prerequisite in realizing sustainable development. In the context of taxation, policies

must be able to balance between the country's fiscal objectives and the changing dynamics of the global economy. An effective policy is one that is able to achieve fiscal objectives with efficiency, while an

adaptive policy has the flexibility to adjust to changes in the external environment, including digital transformation, global financial architecture, as well as commitment to the Sustainable Development Goals (SDGs) (Howlett & Ramesh, 2003).

In Indonesia, tax policy has shown an adaptive response through the enactment of PMK No. 172/PMK.03/2023, which strengthens transfer pricing documentation to prevent tax evasion, and PMK No. 136/2024, which implements the *Global Minimum Tax* (GMT) provisions as part of OECD/G20 Pillar Two. Both reflect a policy direction that not only aims to increase tax revenue, but also supports global fiscal justice.

### 2.5.2. Principles of Good Governance in Tax Policy

*Good governance* in tax policy includes the principles of transparency, accountability, participation, effectiveness, and rule of law (Grindle, 2007). Within the SDGs framework, good governance is a key requirement for realizing SDG 16 (strong institutions) and SDG 17 (global partnership).

Transparency in tax policy refers to the availability of publicly accessible information, such as *Country-by-Country* reporting (CbCR) and automatic information exchange. Meanwhile, accountability demands that tax policy should be subject to public scrutiny and able to explain the basis for fiscal decision-making. Both have been adopted in the ALP policy through MoF Regulation 172/2023 which requires reliable transfer pricing documentation and is open to audit.

The GMT policy in MoF Regulation 136/2024 also promotes the principle of multilateral participation through Indonesia's commitment to the *Inclusive Framework on BEPS*, which involves more than 140 jurisdictions in designing fair and transparent tax systems globally (OECD, 2021).

### 2.5.3. Evidence-Based Policy and Adaptive Policy-Making

Tax policies that support SDGs should be formulated based on evidence (evidence-based policy), not just political pressure or development rhetoric. Evidence-based policy allows the government to identify revenue gaps, potential

tax evasion, and the socio-economic impact of fiscal incentives (Nutley et al., 2007).

In the context of ALP and GTA, evidence-based policy encourages empirical evaluation of the effectiveness of each approach on fiscal redistribution and global inequality reduction. For example, research by Cobham and Janský (2017) shows that the GMT approach is more successful in securing developing countries' taxation rights than ALP, which is fraught with technical burdens and information asymmetries.

In addition, *adaptive policy-making* becomes important when fiscal policy must be adjusted to rapid global dynamics, including shifts in global supply chains and the digital economy. Indonesia has demonstrated this approach by integrating the GMT scheme into the national tax system even though the system is not yet fully mature globally.

#### 2.5.4. Criteria for Pro-SDGs Tax Policy

To be in line with the SDGs agenda, tax policies should fulfil the following criteria:

##### 2.5.4.1. Fiscal Effectiveness

The policy must be able to increase state revenue in a sustainable manner and close the fiscal gap due to tax evasion. The implementation of GMT through PMK 136/2024 is an example of a policy that strengthens the country's tax base without having to unilaterally increase domestic tariffs (Nutley et al., 2007).

##### 2.5.4.2. Social Justice

Tax policy must distribute the tax burden fairly based on the ability to contribute. ALP, which focuses on price comparison, often favours developed countries. In contrast, GTA provides greater fairness to developing countries as it distributes taxation rights based on real economic activity (UNCTAD, 2022).

##### 2.5.4.3. Transparency and Accountability

The transfer pricing documentation stipulated in MoF Regulation 172/2023, including CbCR disclosure provisions and automatic exchange of information, is an example of a policy that upholds fiscal transparency and accountability.

##### 2.5.4.4. Multilateral Participation

Pro-SDGs policies should be integrated in an inclusive international tax architecture. Active engagement in the OECD/G20 and support for the proposed *Global Tax Convention* at the UN reflect Indonesia's policy direction towards more participatory and equitable tax governance globally (UN, 2023).

#### 2.5.4.5 Negotiation Dynamics and Structural Inequality

A recurring theme in international tax governance is the structural imbalance between developed and developing countries. While principles such as the Arm's Length Principle (ALP), formulary apportionment, and the Global Minimum Tax (GMT) are framed as global standards, the processes that produce them often reflect asymmetries in negotiating power.

Hearson (2021) documents that the OECD-led Base Erosion and Profit Shifting (BEPS) negotiations were dominated by G7 countries, particularly in agenda-setting and technical drafting. Developing countries such as India and Indonesia were active participants but had to negotiate from a defensive position, pushing repeatedly for stronger recognition of source-based taxation to protect their fiscal interests. These dynamics illustrate that "structural inequality" is not merely a normative claim but is observable in the procedural history of multilateral negotiations.

Such asymmetries have tangible implications. For instance, the EU's swift adoption of Pillar Two through a binding Directive contrasts with the phased adoption strategies of India and Indonesia, where capacity constraints and domestic legal adjustments shape sequencing. Without mechanisms to address these inequalities, developing countries risk being norm-takers rather than norm-shapers in global tax reform.

#### 2.6. Developed Country Case Studies

##### 2.6.1. United States of America

The United States (US) is one of the pioneers and main supporters in the application of the *Arm's Length Principle* (ALP) in the international tax system. As a country with well-established administrative capacity and legal system, the US offers a concrete example of how ALP is implemented in practice, and demonstrates the dynamics between domestic regulation, national interest, and commitment to international cooperation.

##### 2.6.1.1. Implementation of ALP through IRC 482

The application of ALP in the United States is legally contained in Internal Revenue Code (IRC) Section 482, which authorizes the Internal Revenue Service (IRS) to reallocate income and expenses between affiliated entities if they are deemed not to reflect the principle of *arm's*

*length* transactions (Gravelle, 2019). This regulation is used as a legal basis to prevent *profit shifting* practices by multinational companies that can significantly reduce the federal tax base.

IRC 482 has a very technical and detailed approach in determining the reasonableness of transfer prices. The IRS also publishes Treasury Regulations under IRC 482, which provide in-depth guidance on pricing methods, including traditional methods (CUP, resale price, cost-plus) and profit-based methods (comparable profits method and profit split method).

The implementation of ALP in the US places great emphasis on documentation compliance, intensive audits, and a strict sanction system, making it one of the most active jurisdictions in transfer pricing enforcement (Ault, 2013).

#### **2.6.1.2. APA Mechanisms and Transfer Pricing Audits**

One important feature of the US tax system in the context of transfer pricing is the Advance Pricing Agreement (APA). The APA programme allows companies to obtain advance fiscal certainty regarding transfer pricing methods for cross-border transactions. The IRS actively promotes APAs as a means to reduce disputes and increase voluntary compliance (IRS, 2022).

There are three types of APAs available in the US: unilateral, bilateral and multilateral. Data from the IRS shows that the majority of approved APAs are bilateral, demonstrating the US commitment to cross-border tax cooperation through negotiated channels between tax authorities.

Nevertheless, transfer pricing audits remain a key element of oversight. The IRS actively conducts audits of large multinational companies, particularly those operating in the technology and pharmaceutical sectors, which often have large exposures to *base erosion and profit shifting* (BEPS) risks. These audits are supported by in-house experts and robust data intelligence systems (Gravelle, 2019).

#### **2.6.1.3. Challenges and Discrepancies with the Spirit of Global Cooperation**

Despite the US being a pioneer in ALP implementation and contributing greatly to the development of the OECD guidelines, the country is often criticized for its fiscal unilateralism approach, which is considered to be against the spirit of global cooperation. For example, the US refused to implement the Digital Services Tax (DST) adopted by some

European countries, opting instead for domestic systems such as the Global Intangible Low Taxed Income (GILTI) as a response to the taxation challenges of the digital economy (Clausing, 2020).

Policies such as GILTI and Foreign-Derived Intangible Income (FDII) reflect the US' unilateralist approach to maintaining its domestic tax base. This approach has been criticized for creating distortions and fragmentation in the international tax system, while undermining multilateral consensus-based global initiatives such as the OECD/G20 Pillar Two (Picciotto, 2022).

Furthermore, the US is among the countries that have not formally adopted the Global Minimum Tax (GMT) in the form agreed in Pillar Two, even though the GILTI system already has a similar function. This lack of synchronization creates global uncertainty and reinforces inequality in the distribution of tax rights between countries (Brooks & Hearson, 2023).

#### **2.6.2. European Union**

The European Union (EU) is the most supranationally integrated economic region in the world, and therefore has a great interest in creating a coordinated and effective tax system among its member states. In dealing with the challenges of tax avoidance and profit shifting by multinational corporations, the EU has taken a more collective and harmonized approach than other jurisdictions. One of the main focuses is how the *Arm's Length* Principle (ALP) is uniformly applied across the bloc through regional policies and legal frameworks.

##### **2.6.2.1. Harmonization of ALP through BEFIT**

One of the EU's key initiatives in corporate taxation harmonization is the Business in Europe proposal: Framework for Income Taxation (BEFIT). BEFIT aims to replace the traditional ALP system with a more coordinated and formula-based approach (*formulary apportionment*), where consolidated profits of corporate groups will be allocated to member states based on objective indicators such as labour, fixed assets and sales (European Commission, 2021).

Through BEFIT, the EU explicitly recognizes the limitations of ALP in addressing tax avoidance involving cross-border structures and transactions between affiliated companies within the bloc. This formula-based approach is an evolution of ALP, where the principles of fiscal fairness and administrative simplicity are key considerations.

Harmonization through BEFIT is also intended to reduce the compliance burden for companies and increase legal certainty between member states, as well as strengthen the EU's bargaining position in global taxation forums such as the OECD (Clausing, 2020).

### 2.6.2.2. Collective Efforts to Avoid Intra-EU Tax Avoidance

One of the fundamental weaknesses in the previous EU tax system was the use of different national tax rates and systems by multinational companies to conduct *tax base erosion* within the EU itself. To address this, the EU launched the Anti-Tax Avoidance Directives (ATAD I and II), which contain general anti-avoidance provisions, interest restrictions, exit taxation, and *controlled foreign company* (CFC) rules (European Commission, 2016).

In addition, the automatic information exchange scheme through the Directive on Administrative Cooperation (DAC6) requires companies and tax consultants to report potentially aggressive taxation schemes. This is reinforced by *state aid investigations* by the European Commission against a number of member states such as Ireland, the Netherlands, and Luxembourg related to the granting of *tax rulings* that are considered to violate the principle of fair competition in the EU single market (Pogge & Mehta, 2016).

This collective approach shows that the EU is not just a single market, but also strives to be a coordinated fiscal area, with a focus on transparency and avoidance of tax base dilution among member states.

### 2.6.2.3. Regional and International Tax Law Coherence

Coherence between EU regional tax law and the international framework is both a challenge and a key objective of European fiscal integration. While member states still have sovereignty over corporate tax rates, the EU seeks to harmonize general principles of taxation with international standards such as the ALP and OECD agreements on Base Erosion and Profit Shifting (BEPS) and the Global Minimum Tax (GMT).

The European Commission is actively supporting the implementation of OECD Pillar Two and integrating GMT elements into EU law through the proposed EU Minimum Tax Directive, which is aligned with the global GMT structure. This demonstrates that while the tax system in the EU is national, there is supranational coordination to ensure alignment with international norms (European Council, 2022).

However, some challenges still arise, particularly regarding differences in compliance levels and administrative capacity between member states. In addition, the need to reach consensus among the 27 member states often slows down the adoption of common fiscal policies, including BEFIT and the strengthening of collective ALP instruments.

## 2.7. Developing Country Case Studies

### 2.7.1. India

India is one of the developing countries that has actively developed a comprehensive transfer pricing policy and was among the first Global South jurisdictions to operationalize ALP comprehensively (Finance Act 2001), later supplemented by safe harbors and APAs. As a country with a large population and a rapidly growing digital market, India faces major challenges in preventing tax base erosion and profit shifting by multinational companies, particularly in the IT, manufacturing and digital services sectors.

#### 2.7.1.1. Implementation of ALP and the Role of Strict Documentation

India began to formally implement the transfer pricing framework through the Finance Act 2001, which adopted the ALP principles into the Income Tax Act, 1961. Transfer pricing regulations are detailed in Rule 10A to 10E of the *Income Tax Rules*, and require taxpayers to undertake rigorous documentation of related party transactions. These provisions include proving price reasonableness based on five methods in line with the OECD Guidelines (OECD, 2022).

India's documentation regime requires three levels of documentation: *Local File*, *Master File*, and *Country-by-Country Reporting (CbCR)*—with a global turnover threshold of ₹500 crore for CbCR obligations. This documentation is used as the basis for ALP assessment by tax authorities and has become a key tool in detecting price manipulation practices by affiliated companies (Bhatia & Sinha, 2021).

One of the characteristics of the Indian transfer pricing system is a very aggressive approach to audits and litigation. Many Indian transfer pricing cases lead to lengthy legal disputes, which illustrates the high intensity of scrutiny but also the limitations of the settlement mechanism.

Table 2. India: Transfer Pricing Instruments

Policy Instrument	Key Features	Thresholds / Scope	Outcomes / Trends
Documentation (ALP)	Three-tiered: Local File, Master File, CbCR (Finance Act 2001; Rules 10A–10E)	CbCR for groups with turnover > ₹500 crore	High compliance cost; aggressive audits; frequent litigation (Bhatia & Sinha, 2021).

<b>Safe Harbor</b>	Fixed profit margins for IT/KPO services (CBDT Notification 46/2013)	Profit margin 17–24% depending on service type	Reduced disputes for compliant taxpayers (Rao & Shukla, 2020).
<b>Advance Pricing Agreements (APA)</b>	Introduced 2012; unilateral, bilateral, multilateral APAs	Open to MNEs with cross-border related party transactions	>400 APAs signed by 2022, mostly bilateral (CBDT, 2022); significantly reduced disputes, model for Global South (Rao & Shukla, 2020).

availability of relevant and credible comparable for certain sectors. Many transfer pricing disputes stem from differences in the selection of comparable between taxpayers and tax authorities, especially in the case of unique services or intangible transactions (Chowdhury, 2019).

The limitations of domestic databases and reliance on international commercial databases such as Prowess also lead to high costs and uncertainty. This is a structural issue for a developing country like India that does not yet have an extensive ecosystem of independent transaction data like OECD countries (Rao & Shukla, 2020).

In addition, although India's tax courts are relatively active and independent, the high transfer pricing caseload causes delays in case resolution. Litigation can last for years before reaching a final judgement at the tribunal or Supreme Court level.

### 2.7.1.2. Safe Harbor Mechanism and APA in India

In response to the high volume of transfer pricing disputes, India introduced two important policies to provide legal certainty: safe harbor rules and Advance Pricing Agreements (APAs).

Safe harbor was first introduced in 2013 through CBDT Notification No. 46/2013, which stipulates a fixed profit margin for certain sectors such as IT services and KPO (Knowledge Process Outsourcing) services. This policy provides administrative ease for taxpayers and reduces the likelihood of transfer pricing audits if they opt for the authority-defined margins (Rao, N., & Shukla, 2020).

Meanwhile, the APA programme started in 2012 and developed into one of the most successful instruments in India's transfer pricing policy. There are three types of APAs adopted: unilateral, bilateral, and multilateral. Data from the Central Board of Direct Taxes (CBDT) shows that by 2022, more than 400 APAs have been signed, with the majority being bilateral APAs with partner countries such as the US, Japan and the UK (CBDT, 2022).

India's APA programme has reduced the number of disputes and provided certainty to foreign investors. The success of the programme serves as a model for other developing countries seeking to improve tax compliance without burdening complex audit systems.

### 2.7.1.3. Dispute Issues and Comparative Data Infrastructure

Although India has a strict documentation regime and dispute prevention mechanism, challenges remain, especially in terms of the

### 2.7.2. Indonesia

As one of the developing countries with an open economy and a continuously strengthening tax system, Indonesia has shown commitment in adopting international tax principles such as the *Arm's Length Principle* (ALP) and the *Global Minimum Tax* (GMT). However, the application of these principles must still consider the domestic context, tax administration capacity, and national fiscal interest.

#### 2.7.2.1. Implementation of ALP through the Law on Harmonization of Tax Regulations and MoF Regulation 172/2023

Indonesia formally adopted the ALP principle through the provisions in Law No. 7 of 2021 on Harmonization of Tax Regulations (HPP Law). This regulation strengthens the legal position of transfer pricing as an instrument to prevent *base erosion and profit shifting* (BEPS) by business entities with special relationships.

In more detail, the government issued Minister of Finance Regulation (PMK) Number 172/PMK.03/2023 on the determination of reasonableness and business practices in transactions affected by special relationships. This PMK emphasizes that all taxpayers conducting related party transactions are required to create transfer pricing documentation, consisting of *master files*, *local files*, and country-by-country reports (*CbCR*), in accordance with OECD standards (DJP, 2023).

This transfer pricing documentation is the tax authority's main tool in assessing price conformity between affiliates, as well as

suppressing *transfer mispricing* practices. In this context, ALP is an important mechanism to protect the domestic tax base while ensuring that profits are taxed at the location of substantial economic activity.

However, challenges still arise, especially regarding the availability of domestic comparable data, the high compliance burden for businesses, and the need for competent human resources in the tax administration environment (Syahrani, 2021).

Table 3. Indonesia: Transfer Pricing & GMT Framework

Policy Instrument	Key Features	Thresholds / Scope	Outcomes / Trends
<b>ALP Documentation</b>	MoF Regulation 172/PMK.03/2023; aligned with OECD standards	Master File, Local File, CbCR mandatory for taxpayers with related party transactions	Strengthened enforcement under HPP Law (Law No. 7/2021); challenge: limited comparable, HR capacity (Syahrani, 2021).
<b>APA Mechanism</b>	Regulated by PMK 22/PMK.03/2020	Available for unilateral/bilateral arrangements	Uptake modest; potential to reduce disputes (Rao & Shukla, 2020).
<b>GMT Adoption</b>	MoF Regulation 136/2024 (Pillar Two compliant)	15% minimum tax on groups with consolidated income > €750 million	Includes IIR + QDMTT; projected IDR 15–25 trillion annually (~0.2% GDP) (MoF, 2024).

### 2.7.2.2. Adoption of Global Minimum Tax through PMK 136/2024

As part of its commitment to the OECD/G20 Inclusive Framework on BEPS, Indonesia adopted the Global Minimum Tax (GMT) through Minister of Finance Regulation Number 136 of 2024. This regulation sets a global minimum tax rate of 15% for

parent entities with consolidated income above €750 million, in line with OECD Pillar Two (DJP, 2024).

MoF Regulation 136/2024 includes *Income Inclusion Rule (IIR)* and *Qualified Domestic Minimum Top-up Tax (QDMTT)* mechanisms that allow Indonesia to tax profits previously diverted to jurisdictions with lower tax rates. This move not only broadens the national tax base but also strengthens Indonesia's fiscal position in the global tax system.

The adoption of GMT provides a strategic opportunity for developing countries such as Indonesia to obtain a fair share of the profits of multinational companies that have been hidden in offshore structures. In addition, the implementation of QDMTT prevents tax evasion without waiting for the home jurisdiction to implement GMT, thus strengthening national fiscal sovereignty (Siregar, 2023).

### 2.7.2.3. Balance between Global Integration and Fiscal Sovereignty

Indonesia's integration in the global tax system through the implementation of ALP and GMT shows the direction of fiscal policy that is responsive to international dynamics. However, this integration must still be managed carefully to maintain national fiscal sovereignty. Indonesia needs to ensure that the global standards adopted do not conflict with domestic needs, especially in terms of economic development, protection of SMEs, and equalization of tax revenue between sectors.

The biggest challenge is to adjust global standards with the still-developing national taxation infrastructure. For example, information systems and international data exchange still need to be improved to keep up with the complexity of transfer pricing documentation and GMT reporting.

In this context, the Indonesian government needs to adopt an adaptive and evidence-based policy approach. A combination of domestic law enforcement and active participation in multilateral forums is key to balancing global integration and fiscal autonomy (Brooks & Hearson, 2023).

## 2.8. Case Study Comparison and Evaluation

An evaluation of case studies in developed countries such as the United States and the European Union, as well as developing countries such as India and Indonesia, shows significant variations in the application of the *Arm's Length Principle (ALP)* and the *Global Tariff Approach*

(GTA) as international tax policy frameworks. These differences reflect the diversity of economic structures, institutional capacities, and bargaining positions in global forums that contribute to the level of fiscal effectiveness and fairness.

### **2.8.1. Critical Success Factors for ALP and GTA: Administrative Capacity, Data, and Bargaining Position**

ALP implementation requires high administrative capacity, including competent tax human resources, robust information systems, and access to comparables. Countries such as the United States and India have active transfer pricing audit systems and relatively better databases, making ALP implementation technically feasible (Bhatia & Sinha, 2021). In contrast, countries such as Indonesia and parts of the Global South face serious challenges in providing the necessary comparative data and econometric analyses (Tambunan, 2020).

In contrast, the GTA or formulary apportionment approach-which underlies the concept of the Global Minimum Tax (GMT)-is less dependent on individual transaction data. This approach is more suitable for countries with limited administrative capacity, as its global profit allocation mechanism is based on objective indicators such as sales, assets and labour (Picciotto, 2022).

International bargaining power also affects the success of implementation. Countries such as the US and EU are in a dominant position in formulating global standards. Meanwhile, India and Indonesia struggle to balance domestic interests and multilateral commitments through negotiations in the OECD/G20 forum (Hearson, 2021).

### **2.8.2. Effects on State Revenue and Fiscal Equity**

The effectiveness of ALP and GTAs in increasing state revenues largely depends on the structure of the economy and the intensity of cross-border affiliate activities. In India, aggressive application of ALP and intensive transfer pricing audits have significantly contributed to increased tax revenue from the digital and services sectors (Rao & Shukla, 2020). However, this strategy often leads to lengthy disputes that absorb administrative resources.

In contrast, Indonesia adopted a more pragmatic policy through transfer pricing documentation under PMK 172/2023 and the adoption of GMT in PMK 136/2024, which aims to broaden the tax base without burdening the supervisory system.

In the context of fiscal justice, the GTA approach is considered more progressive as it distributes taxation rights based on real economic

presence, rather than legal structure or location of ownership. Studies by Cobham and Janský (2017) and Zucman (2014) suggest that GTA, through GMT, is able to reduce *profit shifting* and balance tax allocation between source and domicile countries.

### **2.8.3. Alignment with SDGs and Fiscal Sustainability**

Tax policies that contribute to the SDGs must balance fiscal effectiveness, social equity, and long-term sustainability. Complex and technical ALP tends to be non-inclusive for developing countries, potentially undermining the achievement of SDG 10 (reduced inequality) and SDG 16 (strong institutions) (UNDP, 2024).

Meanwhile, the GTA approach through the GMT is considered more pro-SDGs because it creates fiscal justice between countries and supports SDG 17 (global partnership). Indonesia, through the adoption of MoF Regulation 136/2024, demonstrates an integrative effort to strengthen fiscal sustainability and secure taxation rights from global profits of multinational companies (Siregar, 2023).

However, the sustainability of these reforms is highly dependent on long-term international commitments, domestic enforcement capacity, and the availability of fair dispute resolution mechanisms for countries with limited bargaining power (PCT, 2024).

### **2.8.4 Conflict Resolution Mechanisms in the Implementation of the ALP and GTA**

#### **2.8.4.1. Sources of Conflict in ALP and GTA**

The implementation of international taxation system, whether based on *Arm's Length Principle* (ALP) or *Global Tariff Approach* (GTA), often causes conflicts between jurisdictions. This conflict is not only technical, but also structural and political. In the context of international tax cooperation, the source of conflict reflects the tension between the principles of fiscal justice, national sovereignty, and the dominance of developed countries in setting global standards.

#### **2.8.4.2. Different Interpretations of the Fairness Principle in ALP**

One of the main sources of conflict in the application of ALP is the different interpretation of the concept of "arm's length" in related party transactions. Although the OECD Guidelines (2022) provide a framework of ALP methods such as *Comparable Uncontrolled Price (CUP)* and *Transactional Net Margin Method (TNMM)*, their application often results in different fair values

between jurisdictions. This triggers double taxation or double non-taxation if not addressed bilaterally through the *Mutual Agreement Procedure* (MAP) (OECD, 2023).

This distinction is also affected by the method of selecting comparables, transaction structure, and business assumptions. For example, what is considered "comparable" by tax authorities in India may not necessarily be accepted by authorities in Japan or Indonesia (Rao & Shukla, 2020).

#### **2.8.4.3. Lack of Adequate Comparable Data**

ALP relies heavily on the availability of comparable data. Developing countries often suffer from a lack of relevant independent transaction data, either due to underdeveloped markets or lack of access to commercial databases (Syahrani, 2021). In many cases, it is these data discrepancies that lead to disputes between tax authorities and taxpayers, or between two jurisdictions in international tax cases. For example, Indonesia faces major challenges in obtaining comparable data for transactions of unique services and intangible goods. This makes the tax administration rely heavily on subjective interpretation, which in turn increases legal uncertainty (Tambunan, 2020).

#### **2.8.4.4. Jurisdictional Disputes and Double Taxation**

Jurisdictional conflicts in the determination of taxing rights is one of the most obvious impacts of the uncoordinated application of ALP. Multinational companies may be drawn by two different jurisdictions that both claim taxation rights on the same profits. If not resolved through MAPs or arbitration mechanisms, this can give rise to international double taxation which is contrary to the principles of efficiency and fairness (UN, 2023).

In contrast, under a GTA or *formulary apportionment* system, jurisdictional conflicts can be minimised as profit allocation is done systematically and independent of the transfer pricing structure. However, the implementation of GTA is still limited and there is no multilateral consensus for its recognition as a legitimate system in bilateral tax treaties (Picciotto, 2022).

#### **2.8.4.5. Misalignment of International Standards and Domestic Policies**

Another source of conflict is the disharmony between global standards such as the OECD Transfer Pricing Guidelines and domestic policies of developing countries that often still favour rule-based or flat-rate approaches. Countries like India, for example, have safe harbor and presumptive profit policies that in some cases contradict the OECD substance approach (Chowdhury, 2019).

Something similar happens in Indonesia, where national policies based on PMK 172/2023 and domestic fiscal audit approaches are sometimes not fully compatible with internationally agreed ALP documentation principles. As a result, taxpayers are faced with a double compliance burden and uncertainty in the cross-jurisdictional audit process (DJP, 2023).

#### **2.8.4.6. Unequal Bargaining Position of Developing Countries in Multilateral Forums**

Conflicts in international tax governance also stem from structural inequalities in global policy-making forums, where developing countries have a weak bargaining position. The dominance of OECD and G7 countries in drafting international standards such as ALP and GMT often does not consider the needs and limitations of Global South jurisdictions (Brooks & Hearson, 2023).

As a consequence, developing countries tend to become "policy followers" who have to adapt their domestic systems to international standards without equal participation. This creates internal conflicts in national policy formulation, as well as resistance to the implementation of global principles that are deemed incompatible with local realities.

### **2.9. Conflict Resolution in ALP**

Conflicts arising from differences in the application of the *Arm's Length Principle* (ALP) in transactions between affiliated entities across jurisdictions are one of the biggest challenges in the international tax system. To address it, various mechanisms have been developed in bilateral and multilateral frameworks to prevent and resolve disputes fairly and efficiently. These mechanisms include Mutual Agreement Procedure (MAP), Advance Pricing Agreement (APA), safe harbor rules, as well as Automatic Exchange of Information (AEOI) and Country-by-Country Reporting (CbCR) systems.

#### **2.9.1. Mutual Agreement Procedure (MAP)**

MAP is a bilateral dispute resolution mechanism as stipulated in Article 25 of the OECD Model Tax Convention, which allows tax authorities from two countries to discuss and resolve tax disputes without having to go through litigation. The MAP process includes several stages: submission of a request by the taxpayer, initial evaluation by the competent authority, bilateral negotiations, and (if agreed) implementation of the agreement into each country's tax system (OECD, 2022).

Despite having a strong legal foundation, the implementation of MAP faces various obstacles, especially in terms of completion duration. Data from OECD (2023) shows that the average completion time of MAP globally is more than 30 months. In developing countries, this process is often constrained by limited human resources, access to information, and different interpretations of transfer pricing documents.

### 2.9.2. Advance Pricing Agreement (APA)

APA is an *ex-ante* mechanism that allows taxpayers and tax authorities to agree on a transfer pricing method before the transaction is carried out. This scheme provides legal certainty to taxpayers and reduces the risk of future disputes. APAs can be unilateral (between taxpayers and one tax authority), bilateral (between taxpayers and two tax authorities within the framework of a tax treaty), or multilateral (involving more than two jurisdictions) (Rao & Shukla, 2020).

In developed countries such as the United States and Japan, APAs have become a key pillar in transfer pricing dispute resolution. India has also demonstrated the success of its APA programme, with more than 400 agreements concluded since 2012, mostly bilateral in nature (CBDT, 2022). Indonesia itself has regulated the APA mechanism through PMK 22/PMK.03/2020, although the volume of requests is still limited compared to partner countries.

APA provides strategic benefits, especially in preventing potential cross-jurisdictional conflicts and strengthening fiscal certainty for foreign investors in developing countries.

### 2.9.3. Safe Harbor Rules

Safe harbor is a provision that sets a certain profit margin or standard method for certain types of transactions or industries, so that if used by taxpayers, the tax authority will not make transfer pricing corrections. This mechanism reduces the administrative burden for both taxpayers and tax authorities, and avoids recurring technical disputes (OECD, 2013).

India is one of the most active countries in implementing safe harbor, particularly in the IT services and *knowledge process outsourcing (KPO)* sectors. India's safe harbor sets a fixed profit margin, such as 17-24% for certain service providers (Bhatia & Sinha, 2021). Indonesia has also evaluated the application of safe harbor for MSMEs and certain sectors, although it has not been widely implemented to date.

However, the main challenge of safe harbor is the risk of *over-simplification* and potential inconsistency with the ALP principles in the OECD

Guidelines, so its use should be accompanied by periodic evaluation.

### 2.9.4. Automatic Exchange of Information (AEOI) and CbCR

AEOI and *Country-by-Country Reporting (CbCR)* are part of global fiscal transparency that is crucial in preventing cross-jurisdictional conflicts. AEOI, which is governed by the OECD's *Common Reporting Standard (CRS)*, allows tax authorities to automatically exchange financial data, including information on beneficial owners, account balances, and passive income across countries (OECD, 2017).

The CbCR, on the other hand, requires parent entities of multinational companies to report their profit distribution, economic activities, and the amount of tax paid in each country where they operate. This obligation has been regulated in Indonesia through PMK 213/PMK.03/2016, later strengthened in PMK 172/PMK.03/2023, as part of transfer pricing documentation (DJP, 2023).

The implementation of AEOI and CbCR has improved early detection of profit shifting practices, and strengthened the position of tax authorities in resolving transfer pricing conflicts in an objective and coordinated manner (UNCTAD, 2022).

### 2.10. Conflict Resolution in GTA/Global Minimum Tax

Different from the *Arm's Length Principle (ALP)* approach, which often leads to jurisdictional conflicts due to different interpretations of market prices, the *Global Tariff Approach (GTA)* - embodied in the form of the Global Minimum Tax (GMT) - seeks to simplify and stabilize the international tax system through formula-based profit allocation and multilateral consensus. Nevertheless, a conflict resolution mechanism is still needed, especially considering the diversity of domestic tax systems and the unbalanced position of countries in the global forum.

#### 2.10.1 Income Inclusion Rule (IIR)

The Income Inclusion Rule (IIR) is one of the main pillars of the Global Anti-Base Erosion Rules (GloBE) framework introduced by the OECD/G20 in the Base Erosion and Profit Shifting (BEPS) Pillar 2 project. The main objective of the IIR is to ensure that income earned by subsidiaries of multinational enterprises located in countries with low effective tax rates remains subject to additional taxation by the country where the parent entity is located (OECD, 2021).

Through the implementation of the IIR, the jurisdiction where the ultimate parent entity is located has the right to levy additional taxes on the difference between the effective tax rate paid by the subsidiary and the agreed global minimum rate of 15% (OECD, 2021). Thus, the IIR serves as an instrument to encourage multinational companies not to shift profits to low-tax jurisdictions, as they will still be subject to top-up tax in the parent company's home country. Technically, the IIR is applied by calculating the effective tax rate (ETR) of an entity operating in a specific jurisdiction. If the rate is below the global minimum rate, an additional tax is calculated and added at the parent entity level. This rule alters cross-border tax incentives and promotes greater transparency and compliance in tax avoidance (Hanlon & Heitzman, 2022).

### **2.10.2 Qualified Domestic Minimum Top-up Tax (QDMTT)**

The Qualified Domestic Minimum Top-up Tax (QDMTT) is a domestic mechanism that allows a country to first collect additional taxes on the income of entities within its jurisdiction, before that right is taken over by another country through the IIR (OECD, 2022). QDMTT grants the jurisdiction where the entity operates the right to ensure that income taxed at a lower rate is subject to additional tax until it reaches the global minimum rate of 15%, without having to surrender that taxing right to the country where the parent company is located.

By implementing QDMTT, the source country retains a portion of the global tax base, thereby reducing the potential erosion of the national tax base. The OECD states that QDMTT must be substantially consistent with the calculation and recognition mechanisms in the GloBE Rules to be internationally recognized (OECD, 2022). Therefore, a credible and standard-compliant design of QDMTT is crucial to prevent the home country from losing its taxing rights over domestic entities with low ETR.

In practice, the implementation of QDMTT can provide incentives for countries to maintain or even increase taxation on multinational companies in their jurisdictions, thereby supporting the principles of fairness and equality in the international tax system (Devereux et al., 2022).

### **2.10.3. Global Agreement Framework through Inclusive Framework OECD/G20**

The GMT is an outcome of the OECD/G20 Inclusive Framework on BEPS, which covers more than 140 jurisdictions. The Framework offers a global consensus model through two pillars: Pillar One, which reallocates the taxation rights of large multinationals to the markets in which they operate, and Pillar Two, which sets a global minimum tax rate

of 15% for companies with global income of more than €750 million (OECD, 2021).

One of the advantages of this framework is the integrated dispute prevention and review mechanisms. The OECD designed the *Subject to Tax Rule* (STTR), *Income Inclusion Rule* (IIR), and *Undertaxed Profit Rule* (UTPR) systems to regulate the order of taxation and prevent *double taxation* and *double non-taxation*. Through multilateralism coordination, this framework allows alignment between jurisdictions without complex bilateral negotiations (OECD, 2023).

Indonesia officially adopted the GMT through PMK 136/2024, and became an active part of the Inclusive Framework forum. This step reflects Indonesia's readiness to harmonize domestic systems with international standards to avoid jurisdictional conflicts and enhance legal certainty (DJP, 2024).

### **2.10.4. UN Global Tax Convention (Draft)**

Although the OECD has led international tax reform efforts, a number of developing countries consider that the forum is not representative enough. As an alternative, the UN through the Economic and Social Council (ECOSOC) proposed a draft Global Tax Convention, which aims to establish a new framework that is more inclusive and balanced (UN, 2023).

The Convention is proposed as a fairer alternative dispute resolution forum based on the principle of inclusiveness, where developing countries have a greater voice in drafting rules and resolving tax conflicts. The UN Convention is also expected to be a counterweight to the dominance of the OECD and G7 countries in global tax governance (Brooks & Hearson, 2023).

Although still in the formulation stage, the support for the UN Convention shows the urgent need to create a global conflict resolution system that is not only legal-formalistic, but also responsive to structural inequality between countries.

### **2.10.5. Determination of Apportionment Formula and Consistency of Implementation**

One of the main mechanisms in the GTA is the apportionment of taxation rights based on an objective formula, which considers indicators such as location of sales, number of workers, and value of fixed assets. This formula is intended to replace individual transfer pricing, which is often manipulative (Avi-Yonah & Clausing, 2007).

The advantages of this approach are consistency and simplicity of application, as companies no longer need to compile transaction

documentation per affiliated entity. This can directly reduce interpretative conflicts, as well as prevent transfer pricing manipulation practices through *intermediate ownership* schemes or the use of *low-tax jurisdictions* (Picciotto, 2022).

However, the main challenge of this formula allocation system is the need for harmonization of indicator definitions across different jurisdictions. For example, how "value of fixed assets" or "labour" is measured and reported may affect the allocation outcome. Therefore, multilateral oversight mechanisms and information exchange remain necessary to maintain the integrity of the system (OECD, 2022).

A number of developing countries, including Indonesia, could strategically benefit from this approach as tax allocations would better reflect real economic activity, rather than the location of legal entities. This is important in the context of achieving global fiscal justice and sustainable financing of the SDGs (UNCTAD, 2022).

### **2.11. Strengthening the Capacity of Developing Countries to Reduce Conflicts**

Developing countries face structural challenges in implementing international taxation principles such as the *Arm's Length Principle* (ALP) and the *Global Minimum Tax* (GMT). Low institutional capacity, limited data access, and weak bargaining position in global forums are the main causes of cross-jurisdictional tax conflicts. Therefore, systemic capacity building is a key strategy to minimize asymmetry and ensure global fiscal justice.

### **2.12. Institutional Reform and Human Resource Training of Tax Authorities**

The first step in reducing conflict is to strengthen the tax authority's institutions, both in terms of organizational structure, information technology, and the quality of human resources (HR). Institutional reforms should focus on the integration of tax data, the establishment of special units for transfer pricing and international taxation, and the improvement of cross-border economic analysis capabilities (IMF, 2022).

Human resource training is a crucial element in accurately understanding and implementing the ALP method and GMT pillars. Countries such as India and South Africa have shown that continued investment in technical training for tax officials can reduce the number of disputes and improve the effectiveness of transfer pricing audits (Rao & Shukla, 2020).

Indonesia has also developed *transfer pricing training* programmes in cooperation with international institutions such as the OECD and the World Bank Group (WBG), as part of institutional

strengthening after the implementation of MoF Regulation 172/2023 and MoF Regulation 136/2024.

### **2.13. Access to Global Databases and Benchmarking**

Lack of comparables is at the root of many transfer pricing conflicts. Developing countries often do not have access to global databases such as Amadeus, Orbis, or TP Catalyst that are used in ALP benchmarking. As a result, taxpayers and tax authorities in developing countries face great difficulties in making price reasonableness assessments (Syahrani, 2021).

Efforts to provide collectively accessible public databases, whether through the OECD or the UN, should be encouraged as part of fair access to information. Initiatives such as the UN Transfer Pricing Profiles and the CbCR (Country-by-Country Reporting) database need to be expanded in scope and technically facilitated to benefit developing countries (OECD, 2022).

Benchmarking of industrial policies and profit margins can also reduce interpretation conflicts, especially if Global South countries can make local adaptations of margins used in developed countries with similar economic bases.

### **2.14. Strengthening Negotiating Positions in International Forums**

Developing countries are often mere *policy takers* in international forums such as the OECD/G20 Inclusive Framework, without sufficient ability to influence decisions. Therefore, it is important for developing countries to improve their fiscal diplomacy capacity through the training of international tax negotiators, cross-country technical support, and the formulation of solid common positions (Brooks & Hearson, 2023).

Indonesia, for example, can maximize its membership in the G20 and OECD Inclusive Framework forums by strengthening its technical delegation, strengthening policy arguments, and voicing the needs of developing countries in discussions on the allocation of taxing rights and multilateral dispute settlement.

Furthermore, the strengthening of negotiating capacity also includes strategies for the legitimate use of *treaty override* instruments, if needed to protect national tax bases from international frameworks that are overly favourable to the country of capital domicile.

### 2.15. South-South Collaboration in Global Tax Governance Advocacy

In response to the inequality of global tax governance that has been dominated by the Global North countries, developing countries have begun to encourage the Global South-South Cooperation. This collaboration aims to strengthen the bargaining position of developing countries in formulating a more equitable, inclusive and sustainable international tax architecture (UNCTAD, 2022).

Forums such as the South Centre and the African Tax Administration Forum (ATAF) have become important platforms for developing countries to share data, policy strategies, and experiences of ALP and GMT implementation. These advocacy efforts have become even more important in the discussions on the UN Global Tax Convention, which is currently being drafted as an alternative to the hegemony of the OECD (UN, 2023).

South-South collaboration also opens opportunities for the development of regional comparables database, joint audit mechanism, and transfer pricing training hub tailored to the economic characteristics of the Global South.

### 2.16 Brief Literature Review on ALP and GTA

Prior studies on the Arm's Length Principle (ALP) have highlighted its dominant role in global transfer pricing governance, yet also its limitations in developing countries (Fuest & Riedel, 2012; Cobham & Janský, 2017). Empirical analyses show that while ALP promotes neutrality and comparability, it often results in unequal fiscal outcomes due to data asymmetry and high compliance costs (Beer et al., 2020). Conversely, the Global Tariff Approach (GTA), or formulary apportionment, has been widely discussed as an alternative model offering simplicity and fairness (Zucman, 2014; Picciotto, 2022). However, its adoption remains limited due to concerns about sovereignty and the absence of global consensus (Brooks & Hearson, 2023). This study contributes to the literature by systematically comparing these approaches with the Global Minimum Tax (GMT), an emerging global instrument bridging both fairness and feasibility dimensions.

## 3. RESEARCH METHODOLOGY

### 3.1 . Approach and Type of Research

This study adopts a normative-comparative legal approach combined with qualitative analysis. The normative dimension examines principles and norms in international tax law, while the comparative

dimension assesses variation in implementation across jurisdictions.

### 3.2. Data Sources

#### 3.2.1 Primary Legal Materials:

- OECD Transfer Pricing Guidelines (2022 edition)
- UN Model Convention
- National regulations from case study jurisdictions (e.g., EU Council Directive 2022/2523, US Internal Revenue Code (GILTI), India Finance Act 2001 & 2024, Indonesia Laws No. 7/2021 & MoF Regulations 172/2023, 136/2024)

#### 3.2.2. Secondary sources:

- Books and peer-reviewed journal articles on ALP, GTA/formulary apportionment, and GMT
- Reports from international organizations (OECD, UN, IMF, World Bank, Tax Justice Network)
- Policy papers and technical notes from national tax administrations in the US, EU, India, and Indonesia

#### 3.2.3. Empirical anchors

- OECD MAP statistics (2023)
- official impact assessments (OECD 2020; European Commission 2022; India 2023; Indonesia MoF 2024)

#### 3.2.4. Document Corpus and Inclusion Criteria

The comparative analysis uses a corpus consisting of:

- Key international documents from 2015–2024 (to capture post-BEPS and Pillar Two developments).
- National regulations, case law, and administrative guidance in the four selected jurisdictions.
- Inclusion criteria for case study jurisdictions: (a) representation of both developed and developing economies; (b) active participation in OECD/G20 Inclusive Framework; (c) publicly accessible regulatory and policy data; and (d) relevance to debates on fiscal justice.

### 3.3 Time Window

The analysis covers 2010–2025, capturing the evolution of ALP enforcement (post-BEPS era), the negotiation of Pillar Two (2019–2021), and the first wave of GMT implementation (2024–2025).

#### 3.3.1. Matching with SDGs:

- Comparative results were mapped against SDG 10 (reduced inequalities), SDG 16 (strong institutions), and SDG 17 (global partnerships).
- Indicators aligned with UN and OECD monitoring frameworks (e.g., tax-to-GDP ratio, MAP case statistics).

### 3.3.2. Conclusion Building

Findings integrated into legal arguments regarding fiscal justice, suitability for developing countries, and compatibility with global sustainable development.

### 3.3.3 Data Collection Technique

Data were collected via desk research including:

- Academic literature searches from databases (JSTOR, Scopus, Google Scholar).
- Policy reports from official websites of OECD, UN, IMF, World Bank, and national ministries of finance/tax authorities.
- Legal documents including treaties, tax regulations, explanatory memoranda, and public policy guidelines.

### 3.3.4 Data Validity

Triangulation was achieved by cross-verifying:

- Legal provisions with official gazettes and government websites.
- Empirical data (revenue, disputes) with OECD, EU, and national reports.
- Academic claims with peer-reviewed literature.

Conceptual validity was reinforced by aligning the evaluation matrix with SDG 10 (inequality reduction), SDG 16 (institutional strength), and SDG 17 (global partnerships)

## 3.4 Analysis Technique

This research applies a replicable coding scheme to ensure auditable comparison:

1. Problem Identification  
Coding categories: weaknesses in ALP (e.g., data asymmetry, disputes), weaknesses in GTA (e.g., sovereignty, coordination), and limits of GMT (e.g., administrative readiness).
2. Comparative Study
  - Jurisdictions analyzed: United States, European Union, India, and Indonesia.
  - Coding dimensions: (a) conformity with international law principles (non-discrimination, fiscal sovereignty); (b) revenue sufficiency; (c) administrative

feasibility; (d) equity effects; (e) dispute risk.

- Period covered: 2015–2024, to capture both pre- and post-Pillar Two policy evolution.

### 3.4.1 Case Selection Logic

Four jurisdictions were purposively selected:

- **United States:** As a leading economy with a partial overlap regime (GILTI) but no formal GMT adoption.
- **European Union:** As the earliest and most comprehensive adopter of both IIR and QDMTT under a binding Directive.
- **India:** As a developing country pioneer with extensive ALP instruments (safe harbor, APA) and staged GMT adoption.
- **Indonesia:** As a Southeast Asian developing country that recently legislated ALP reforms (PMK 172/2023) and GMT adoption (PMK 136/2024).

This mix enables comparison across developed and developing contexts, different legal traditions, and contrasting adoption timelines.

## 3.5 Coding and Assessment Scheme

A four-pillar evaluation matrix was applied to each jurisdiction's adoption of ALP and GMT:

- Revenue sufficiency (measured by official impact assessments and GDP share)
- Equity across jurisdictions (degree to which system benefits source vs. residence countries, based on academic assessments)
- Administrative feasibility/compliance cost (documentation burdens, HR capacity, system readiness)
- Dispute risk/duration (MAP statistics, litigation caseloads, APA uptake).

Each pillar was scored on a three-point scale (High/Medium/Low) with explicit assumptions documented in the appendix for transparency.

### 3.5.1 Elaboration of Scoring Mechanism

The scoring mechanism applied in the evaluation matrix (Appendix 1) was developed using a three-point ordinal scale (High = 3, Medium = 2, Low = 1). Each dimension—revenue sufficiency, equity, administrative feasibility, and

dispute risk—was scored based on empirical indicators from official sources and peer-reviewed assessments. For instance, revenue sufficiency scores relied on OECD and national MoF projections (e.g., PMK 136/2024 impact analysis), while administrative feasibility scores were derived from documentation and HR capacity assessments in each jurisdiction. The final composite evaluation reflects the average of individual pillar scores, with qualitative triangulation to ensure validity. This transparent scoring system enables structured comparison across ALP, GTA, and GMT regimes.

## 4. RESULTS AND DISCUSSIONS

### 4.1. Theoretical and Practical Comparison of ALP vs GTA

A comparison between the Arm's Length Principle (ALP) and the Global Tariff Approach (GTA), particularly in the form of the Global Minimum Tax (GMT), shows that each has strengths and weaknesses depending on the country's capacity to implement it. ALP, on the basis of individual comparables, demands granular data and complex analyses. In contrast, the GTA tends to be simpler and provides a basis for profit allocation based on real activities such as labour, assets and sales (Avi-Yonah & Clausing, 2007; OECD, 2021).

Developed countries such as the United States can implement ALP aggressively with the support of strong data and legal infrastructure (Gravelle, 2019). On the other hand, India shows that even developing countries can utilize ALP effectively if supported by mechanisms such as APA and safe harbor (Bhatia & Sinha, 2021). However, ALP often leads to disputes and high administrative burdens in countries with limited capacity like Indonesia, making GTA a more rational choice (Syahrani, 2021; Siregar, 2023).

### 4.2 Comparative Evaluation Matrix ALP, GTA and GMT

Indonesia's dual adoption of ALP (under MoF Regulation 172/2023) and GMT (under MoF Regulation 136/2024) exemplifies a hybrid approach where traditional and reformist models coexist. This study's findings suggest that ALP remains important for ensuring fair valuation of intra-group transactions, while GMT—rooted in the Global Tariff Approach—enhances revenue stability and reduces dispute risks. For Indonesia, the optimal path may involve leveraging both systems strategically: ALP for micro-level compliance assurance and GMT for macro-level fiscal sustainability. Policymakers could thus prioritize capacity building for ALP enforcement while concurrently expanding GMT coverage to capture global digital and intangible profits.

The comparative matrix illustrates (Appendix 1) significant differences in how ALP, GTA, and GMT perform across legal, fiscal, and institutional dimensions.

- **ALP** scores the highest on legal principle (5) and political feasibility (5) due to its entrenched role in bilateral treaties and global practice. However, it performs poorly on equity (2), administrative feasibility (2), and dispute risk (2), reflecting the heavy reliance on comparables, asymmetry of capacity between developed and developing countries, and frequent transfer pricing disputes. Revenue sufficiency is only moderate (3), as outcomes depend heavily on domestic enforcement capacity.
- **GTA** presents a strong theoretical case for fairness and redistribution, with a maximum score (5) on equity across jurisdictions. It also performs strongly on revenue sufficiency (4) and dispute risk (4) since formula-based allocation can secure stable tax bases and reduce litigation. However, its political feasibility (2) and legal principle score (2) remain weak because it requires deep treaty reforms and faces resistance from states unwilling to cede fiscal sovereignty. Administrative feasibility is moderate (3), reflecting its technical simplicity but political complexity.
- **GMT** stands out for its revenue sufficiency (5) and balanced performance across most dimensions. It secures a minimum 15% effective tax rate globally and reduces dispute risk (4) through top-up mechanisms. Its equity score (4) indicates improvements over ALP but still retains residence-country bias compared to GTA's stronger redistribution. Administrative feasibility (4) is relatively high, as the Inclusive Framework provides standardized rules, though capacity remains a challenge for some developing countries. Political feasibility is also strong (4), supported by the OECD/G20 adoption, even if uneven across jurisdictions.

Overall, the analysis shows that ALP remains dominant but weak on equity and efficiency, GTA offers the fairest distribution but is politically unviable, and GMT provides a pragmatic compromise with strong revenue outcomes and moderate feasibility. In terms of SDG alignment, ALP mainly supports SDG 16 (institutions), GTA most directly promotes SDG 10 (inequality reduction), while GMT aligns broadly with SDG 10,

16, and 17, making it the most balanced reform in practice.

#### **4.3. Country Case Evaluation: ALP vs GMT**

The comparative scoring (Appendix 2) highlights important contrasts in the performance of ALP and GMT across jurisdictions:

- United States: ALP remains effective in raising revenue due to strong IRS enforcement and information access. However, its bias toward residence-based taxation limits equity outcomes (score 2). GMT adds incremental equity and dispute reduction, but overlaps with GILTI provisions mean limited revenue gains.
- European Union: The EU context reveals the weakness of ALP in fragmented Member State enforcement, leading to uneven revenue capture and intra-EU leakage. GMT performs better because of the Directive-based harmonization, improving both revenue sufficiency and equity while lowering disputes.
- India: ALP generates revenues through aggressive audits and APA mechanisms but suffers from heavy litigation, raising dispute risk. GMT is relatively more pro-source and secures additional revenue, although implementation requires significant institutional adaptation.
- Indonesia: ALP scores lowest here, reflecting weak comparables, burdensome compliance, and persistent disputes. GMT substantially improves revenue sufficiency and equity, making it the more SDG-aligned approach for a developing economy.

Conclusion: The analysis shows that GMT consistently outperforms ALP on equity, dispute reduction, and sustainable revenue mobilization, particularly in developing economies (India, Indonesia). ALP remains administratively feasible in high-capacity systems (US, EU), but it does not align as strongly with SDG 10 (Reduced Inequalities) or SDG 17 (Partnerships). By contrast, GMT strikes a more balanced alignment with SDG 10, 16, and 17, and thus represents a more sustainable reform pathway.

#### **4.2. Effectiveness in Realizing the SDGs**

An assessment of the contribution of ALP and GTA to the SDGs, particularly SDG 10 (reducing inequality), SDG 16 (strong institutions), and SDG 17 (global partnership), shows that GTA is systemically more progressive. The implementation of GMT as a GTA instrument guarantees a global minimum tax, reduces profit shifting incentives, and broadens the tax base in source countries, which have been disadvantaged (Cobham & Janský, 2017; UNCTAD, 2022).

While ALP is more suitable for jurisdictions with strong tax enforcement systems, this approach widens the gap when adopted without customization by developing countries. In contrast, the GMT through MoF Regulation 136/2024 demonstrates Indonesia's efforts to strengthen fiscal justice and participation in global governance (Directorate General of Taxes, 2024).

#### **4.3. Dimensions of International Law and Fiscal Justice**

From an international law perspective, there is a tension between fiscal sovereignty and global harmonization. ALP often imposes OECD standards on jurisdictions with different local needs. This creates a conflict between compliance with global norms and domestic fiscal needs. The GTA, with its more multilateral character, opens up room for reform towards a fairer and more inclusive international tax system (UN, 2023).

However, the implementation of GTAs still faces legal challenges, including incompatibility with bilateral tax treaties and potential overlap of taxing authorities. Therefore, policy convergence between ALP and GTA remains a central issue in global tax governance.

#### **4.4. Capacity of Developing Countries and Dispute Settlement Mechanism**

Conflicts arising from the application of ALP—such as fair value interpretation, lack of comparable data, and double taxation jurisdictions—have highlighted the need for systemic reforms. Developing countries rely heavily on instruments such as the Mutual Agreement Procedure (MAP), Advance Pricing Agreement (APA), and safe harbor to reduce conflicts and increase legal certainty (OECD, 2023; Rao & Shukla, 2020).

The adoption of GMT opens up space for the design of more efficient multilateral dispute resolution mechanisms, but requires global consensus and recognition. Therefore, strengthening tax administration capacity, fiscal diplomacy, and cross-border intelligence data are key to the success of fairness-based reform of the international tax system (UN, 2023; PCT, 2024).

#### **4.5. Reform Direction and Policy Implications**

Indonesia's experience in adopting ALP through MoF Regulation 172/2023 and GMT through MoF Regulation 136/2024 reflects a progressive yet cautious fiscal reform direction. The biggest challenge is to create a balance between global integration and domestic fiscal

sovereignty. Therefore, the strategy going forward should include:

- Strengthening the institutional and human resource capacity of tax authorities (Tambunan, 2020)
- Development of domestic comparable databases and access to global databases
- Policy coordination between fiscal and monetary institutions
- Active participation in multilateral forums and support for the UN Global Tax Convention

This discussion confirms that international tax system reform is not just a technical issue, but a global political-economic agenda that concerns the fiscal rights of developing countries in a more equitable and sustainable global economic order.

#### **4.6 The Dual Application of ALP and GTA/GMT — Opportunities and Challenges**

The comparative analysis demonstrates that the coexistence of the Arm's Length Principle (ALP) and the Global Tariff Approach (GTA) (operationalized through the Global Minimum Tax (GMT)) represents an emerging paradigm in international tax governance. The dual application of these frameworks offers both strategic opportunities and institutional challenges, particularly for developing economies such as Indonesia that aim to balance fiscal sovereignty with global harmonization.

##### **4.6.1. Strategic Rationale for Dual Application**

The dual framework enables countries to capture complementary strengths from both regimes. The ALP, as a transaction-based model grounded in market comparables, supports micro-level precision in detecting profit-shifting practices and ensures legal continuity under existing bilateral tax treaties (Sureth-Sloane et al., 2023). Conversely, the GTA/GMT provides a macro-level stabilization mechanism that secures a minimum effective tax rate across jurisdictions, thereby enhancing revenue sufficiency and reducing opportunities for base erosion (Englisch, 2023).

In Indonesia's context, ALP enforcement under PMK 172/2023 strengthens institutional integrity and documentation discipline, while GMT implementation under PMK 136/2024 safeguards national taxing rights and promotes predictable fiscal inflows. This combination embodies an adaptive and evidence-based fiscal policy aligned with the SDGs, particularly SDG 10 (Reduced Inequalities), SDG 16 (Strong Institutions), and SDG 17 (Global Partnership).

##### **4.6.2. Legal and Normative Tensions**

Despite its potential, the dual application introduces normative inconsistencies due to the divergent conceptual foundations of ALP and

GTA/GMT. ALP relies on transactional comparability, whereas GMT applies consolidated profit allocation or rate equalization (Sureth-Sloane et al., 2023).

This divergence may create overlapping obligations for multinational enterprises (MNEs), which must comply with detailed ALP documentation requirements while also computing top-up taxes under GMT. The lack of explicit coordination mechanisms between these frameworks may lead to double compliance burdens and conflicting tax positions.

Furthermore, ALP's legal basis is embedded in most bilateral tax treaties, while GMT currently operates through domestic legislation and multilateral soft law (Avi-Yonah, 2005). Without treaty-level harmonization, jurisdictional conflicts may arise concerning the recognition of taxing rights and the avoidance of double taxation.

##### **4.6.3. Administrative and Capacity Constraints**

The success of this dual regime hinges on administrative capability. Implementing ALP demands expertise in transfer-pricing methods and access to reliable comparables, while GMT requires advanced capacity in calculating global effective tax rates (ETRs) and managing digital reporting (Englisch, 2023).

For developing countries, maintaining dual expertise may stretch human and financial resources, leading to fragmented oversight. Indonesia's experience illustrates this tension: while the Directorate General of Taxes has invested in transfer-pricing capacity, additional training is required to integrate GMT's top-up tax calculations and cross-border information exchange into the national audit architecture (Belianto & Rahayu, 2024).

##### **4.6.4. Data Integration and Systemic Compatibility**

ALP and GMT differ not only conceptually but also technologically. The former depends on micro-level transactional data, whereas the latter requires macro-level consolidated accounting data across jurisdictions (Englisch, 2023). Incompatibility between these datasets may hinder consistency in audit outcomes and fiscal analysis.

To overcome this, Indonesia must harmonize data flows between the ALP documentation system (PMK 172/2023) and the GMT reporting infrastructure (PMK 136/2024) through a unified, digitized tax information platform. Without such integration, compliance and verification processes risk duplication and inefficiency.

#### 4.6.5. Dispute Risk and Legal Certainty

Dual application could generate cross-framework disputes, where a taxpayer deemed compliant under GMT could still face adjustments under ALP audits. This overlap increases legal uncertainty and may undermine investor confidence.

Traditional dispute-resolution mechanisms (such as the Mutual Agreement Procedure (MAP) and Advance Pricing Agreement (APA)) will require procedural adaptation to address top-up tax elements and coordinate cross-jurisdictional relief.

Developing countries must therefore advocate for the inclusion of GMT clauses in bilateral tax treaties to prevent double taxation and clarify jurisdictional competence (Parada, 2024).

#### 4.6.6. Policy Coherence and Fiscal Sovereignty

From a political economy perspective, the dual system reveals a delicate balance between international harmonization and national policy autonomy. While adherence to OECD/G20 and UN frameworks enhances credibility, strict compliance may constrain the ability of developing countries to design locally responsive fiscal incentives (Englisch, 2023).

For Indonesia, the key challenge is to ensure that global integration through GMT does not undermine domestic objectives such as SME development, investment promotion, or sectoral competitiveness. Maintaining this equilibrium is essential for safeguarding fiscal sovereignty within an increasingly interconnected global tax regime.

Ultimately, integrating ALP and GMT within a coherent and inclusive fiscal architecture represents a pragmatic evolution of international tax governance, one that bridges precision with fairness, and sovereignty with solidarity.

#### 4.7 Strategic Takeaways and Forward-looking Reflections

The dual adoption of the Arm's Length Principle (ALP) and Global Minimum Tax (GMT) in Indonesia demonstrates a transitional phase between traditional transfer pricing regulation and a more coordinated international tax framework. This hybrid approach allows the country to safeguard domestic taxing rights while remaining aligned with global standards under the OECD/G20 Inclusive Framework. However, coexistence of both systems may create technical overlaps in determining taxable income and timing differences in the recognition of top-up taxes. These challenges underline the importance of designing clear coordination rules between ALP-based documentation and GMT top-up assessments (Avi-Yonah, 2005).

Strategically, countries like Indonesia can derive several key benefits from this dual structure.

First, ALP ensures compliance continuity and investor familiarity through established treaty mechanisms, while GMT strengthens revenue resilience by guaranteeing a floor rate. Second, the combination enhances bargaining leverage in international negotiations, signaling readiness to adopt global norms without compromising fiscal sovereignty. Third, it provides a learning platform for gradual convergence toward more formulaic or hybrid apportionment systems in the future, as global consensus deepens.

Nonetheless, policymakers must remain alert to foreseeable issues:

- Regulatory fragmentation, where domestic transfer pricing audits and GMT top-up assessments overlap or conflict.
- Administrative burden, particularly for small tax administrations managing dual documentation regimes.
- Legal uncertainty, if bilateral treaties remain ALP-based while GMT operates multilaterally.

These risks can be mitigated through integrated administrative guidance, clear sequencing between ALP and GMT computations, and enhanced data-sharing capacity among jurisdictions (Adebayo et al., 2024).

#### 4.8. Positioning in the Taxation Literature

This paper contributes to the international taxation literature by clarifying conceptual distinctions among the three dominant approaches to taxing multinational enterprises: the Arm's Length Principle (ALP), formulary apportionment (here referred to as the Global Tariff Approach/GTA), and the Global Minimum Tax (GMT) under OECD/G20 Pillar Two. Prior studies often treat these approaches in isolation or portray GMT as a hybrid of ALP and formulary apportionment. By sharpening the conceptual boundaries, this study avoids the conflation found in earlier work and underscores that GMT functions as a coordinated top-up mechanism rather than a formula-based allocation regime (OECD, 2020; Picciotto, 2022a).

The discussion also speaks to the literature on North–South asymmetries in global tax governance. While critics highlight the dominance of developed countries in setting OECD standards (Fuest & Riedel, 2012; Hearson, 2021), this paper shows (through the case studies of India and Indonesia) that developing countries are not merely passive recipients but have begun to strategically use instruments such as QDMTT to defend domestic taxing rights. This finding contributes to ongoing debates on the fiscal

sovereignty of emerging economies within global tax reforms (Cobham & Janský, 2017; Brooks & Hearson, 2023).

A further contribution lies in connecting doctrinal analysis to empirical anchors. Whereas much of the legal scholarship remains at the level of treaty interpretation and principle evaluation, this study integrates OECD MAP statistics, jurisdictional adoption data, and official revenue projections. This strengthens the bridge between doctrinal legal analysis and empirical fiscal outcomes, echoing recent calls for more evidence-based legal research in tax law (Dourado, 2013; UNCTAD, 2022).

Finally, by assessing the implications of ALP, GTA, and GMT against the backdrop of administrative capacity and fiscal justice, this paper positions itself within the normative literature advocating for sustainable and equitable tax systems. The comparative evidence suggests that while ALP remains central to dispute resolution, the GMT provides measurable revenue stability for developing countries. The paper thus aligns with reformist scholarship that views international tax law not only as a technical allocation system but also as a governance mechanism with distributive consequences (Picciotto, 2022a; Siregar, 2023).

## 5. Conclusions

This study sought to address two research questions: (1) How do the Arm's Length Principle (ALP), Global Tariff Approach (GTA), and Global Minimum Tax (GMT) differ in design, implementation, and outcomes? and (2) What are their implications for developing countries such as Indonesia in achieving SDG-linked fiscal objectives?

The analysis finds that ALP, though well-entrenched, often favours developed jurisdictions due to data and capacity asymmetry, whereas GTA and GMT present more equitable alternatives. The Global Minimum Tax, as a pragmatic evolution of GTA, provides developing countries with a fairer share of global tax rights while preserving fiscal sovereignty. For Indonesia, maintaining a dual regime (ALP for transfer pricing control and GMT for base protection) offers the most balanced approach to achieving fiscal justice, stability, and SDG alignment.

When viewed through the lens of sustainable development, both ALP and GTA/GMT can be complementary. ALP contributes to institutional strengthening (SDG 16), while GTA/GMT enhances fiscal equality and multilateral partnership (SDG 10 and SDG 17). Therefore, rather than choosing between them, Indonesia and similar developing economies should focus on integrating both

principles within a coherent global tax policy framework.

## 6. Recommendations

### 1. National Level:

- a. Develop integrated ALP–GMT compliance frameworks to avoid double calculation and ensure consistency in determining effective tax rates.
- b. Expand domestic databases and strengthen local comparable to reduce dependency on OECD data sources.
- c. Introduce training programs for tax officials on GMT computation, digital reporting, and dispute prevention.

### 2. Regional and Multilateral Level:

- a. Advocate within ASEAN and UN forums for coordinated GMT adoption guidelines tailored to developing economies.
- b. Support the UN Global Tax Convention as a balancing forum to OECD dominance, promoting inclusivity and equity in global tax rule-making.
- c. Foster South–South collaboration for joint audits, shared databases, and transfer pricing capacity-building hubs.

### 3. Strategic Takeaway:

Indonesia and similar jurisdictions can leverage the ALP–GMT dual regime not merely for compliance, but as a strategic fiscal diplomacy tool, one that ensures participation in global reform while protecting domestic tax sovereignty. This adaptive strategy positions developing countries as rule-shapers rather than rule-takers in the evolving architecture of international taxation.

## 7. Research Limitations

This study has several limitations. First, the analysis is still conceptual and based on literature studies, so it does not yet illustrate empirical data on actual tax revenue from the implementation of the two approaches. Second, limited access to multinational tax databases and MAP statistics limits the depth of comparative analysis of tax disputes. Third, the evolving domestic legal framework (e.g. technical implementation of GMT in Indonesia) could not be fully evaluated at the time of writing.

## 8. Academic and Policy Implications

Academically, this study contributes to expanding cross-disciplinary understanding between international taxation, law, and sustainable development. On the policy side, the results of this study emphasize the need for global tax governance reform that is not only technically effective, but also structurally fair and politically participatory.

The application of international tax principles cannot be separated from the geopolitical context, institutional capacity, and national development design. Therefore, the search for best practices should not only be technocratic, but should also consider global justice, fiscal sustainability, and the sovereign aspirations of developing countries.

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APPENDIES

Appendix 1. Comparative Evaluation Matrix

Coding Dimension	ALP (Arm's Length Principle)	GTA (Formulary Apportionment)	GMT (Global Minimum Tax)	Related SDGs
Legal Principle	5 – entrenched in treaties, widely used	2 – theoretical, not implemented globally	4 – embedded in OECD/G20 Pillar Two rules	SDG 16
Revenue Sufficiency	3 – moderate, capacity dependent	4 – potentially high via consolidated profits	5 – ensures 15% minimum ETR	SDG 17
Equity Across Jurisdictions	2 – favours residence countries	5 – strong pro-source redistribution	4 – curbs base erosion but retains residence bias	SDG 10
Administrative Feasibility	2 – comparables heavy, costly	3 – simpler than ALP but requires treaty reform	4 – standardized top-up rules manageable	SDG 16
Dispute Risk	2 – frequent MAP/APAs, lengthy	4 – reduced through formulaic allocation	4 – mitigated via top-up rate equalization	SDG 16
Political Feasibility	5 – dominant and entrenched	2 – low due to sovereignty/treaty barriers	4 – medium-high with Inclusive Framework adoption	SDG 17

Appendix 2. Country Case Evaluation: ALP vs GMT

Country / Dimension	ALP Score	GMT Score	Assumptions & Sources	SDG Link
<b>United States</b>				
Revenue Sufficiency	4	3	Strong IRS enforcement under IRC §482; GMT overlaps with GILTI, less incremental (OECD, 2022; Gravelle, 2019).	SDG 17
Equity Across Jurisdictions	2	3	ALP favours residence (US MNEs benefit); GMT redistributes partially but retains residence bias (Cobham & Janský, 2017).	SDG 10
Administrative Feasibility	4	4	US has strong institutional capacity to implement both ALP and GMT (OECD, 2022).	SDG 16
Dispute Risk	3	4	ALP yields high MAP caseload; GMT reduces transfer pricing disputes (OECD, 2023).	SDG 16
<b>European Union</b>				
Revenue Sufficiency	3	4	ALP uneven across Member States; GMT harmonized under EU Directive (Brooks & Hearson, 2023).	SDG 17
Equity Across Jurisdictions	2	4	ALP leads to intra-EU leakage; GMT redistributes revenues more equitably (Zucman, 2014).	SDG 10

<b>Administrative Feasibility</b>	3	4	ALP inconsistent; GMT benefits from supranational coordination (OECD, 2021).	SDG 16
<b>Dispute Risk</b>	3	4	ALP yields high MAP cases; GMT reduces intra-EU disputes (OECD, 2023).	SDG 16
<b>India</b>				
<b>Revenue Sufficiency</b>	3	4	ALP generates revenue but with high litigation; GMT secures top-ups (Rao & Shukla, 2020).	SDG 17
<b>Equity Across Jurisdictions</b>	2	4	ALP under-allocates to source; GMT more pro-source (Cobham & Janský, 2017).	SDG 10
<b>Administrative Feasibility</b>	3	3	India has capacity, but ALP compliance is costly; GMT requires adaptation (Bhatia & Sinha, 2021).	SDG 16
<b>Dispute Risk</b>	2	3	ALP produces high litigation; GMT mitigates but does not eliminate disputes (OECD, 2023).	SDG 16
<b>Indonesia</b>				
<b>Revenue Sufficiency</b>	2	4	ALP weak due to lack of comparables; GMT secures top-ups (PMK 136/2024; UNCTAD, 2022).	SDG 17
<b>Equity Across Jurisdictions</b>	2	4	ALP under-allocates; GMT pro-source, benefiting developing economies (Cobham & Janský, 2017; Siregar, 2023).	SDG 10
<b>Administrative Feasibility</b>	2	3	ALP burdensome with weak comparables; GMT manageable with international support (OECD, 2021).	SDG 16
<b>Dispute Risk</b>	2	3	ALP disputes lengthy and costly; GMT reduces disputes modestly (OECD, 2023).	SDG 16

**\*Scoring scale:**

1 = very weak, 2 = weak, 3 = moderate, 4 = strong, 5 = very strong.

**Appendix 3. Jurisdictional Adoption of GMT (2024–2025)**

<b>Jurisdiction</b>	<b>GMT adoption status</b>	<b>Instrument</b>	<b>Effective year</b>
<b>United States</b>	No formal adoption; GILTI overlaps with Pillar Two but not fully compliant	Internal Revenue Code (GILTI provisions)	n/a
<b>European Union</b>	Adopted IIR + QDMTT	Council Directive (EU) 2022/2523	Jan 2024
<b>India</b>	Adopted QDMTT; IIR legislation expected	Finance Act 2024 (domestic top-up)	2025
<b>Indonesia</b>	Adopted QDMTT; IIR pending	PMK No. 136/2024	2025