

BEPS Pillar Two Implementation in ASEAN: Tax Competition, FDI Sensitivity, and Fiscal Implications for Indonesia

Islamiati Hidayah

Akuntansi Syariah, Ekonomi Bisnis Syariah,
Universitas Islam Negeri Syekh Wasil Kediri, Indonesia

Email: islamiati@uinkediri.ac.id

Abstract

This paper presents a systematic empirical analysis of Corporate Income Tax (CIT) rate competition and Pillar Two adoption dynamics across eleven ASEAN nations over the period 2005–2024. Using an unbalanced panel dataset compiled from the International Monetary Fund, World Bank, OECD, and UNCTAD, we document a statistically significant race-to-the-bottom in statutory CIT rates, with the ASEAN unweighted average declining from 28.5% in 2005 to 20.9% in 2024, a structural downward trend of approximately 0.44 percentage points per year ($R^2 = 0.90$). For Indonesia specifically, we estimate a negative semi-elasticity of FDI inflows with respect to the CIT rate of -0.155 (significant at the 1% level), implying that each one-percentage-point reduction in the statutory rate is associated with a 15.5% increase in inward FDI, assuming the tax rate variable is entered in percentage-point units. Analysis of Country-by-Country Reporting (CbCR) data for Indonesia (2016–2022) reveals that effective tax rates (ETRs) paid by multinational enterprises (MNEs) fell below the 15% global minimum in at least two observed years. However, applying GloBE-compliant micro-data adjustments, including the Substance-Based Income Exclusion (SBIE) and the EUR 750 million consolidated revenue threshold, substantially reduces projected top-up tax revenue from aggregate estimates of USD 43.9 million (2016) to approximately USD 4.8 million, correcting a systematic optimism bias in earlier projections. Indonesia's implementation of Pillar Two via PMK-136/2024, effective January 2025, positions it among the five ASEAN early adopters alongside Vietnam, Malaysia, Thailand, and Singapore, while Cambodia, Laos, Myanmar, the Philippines, Brunei, and Timor-Leste have not yet implemented Pillar Two. The resulting regulatory asymmetry poses material risks of investment diversion. We find that Indonesia's dual anti-avoidance architecture (CFC rule and interest limitation rule), which is unique within ASEAN, provides a meaningful fiscal buffer. Still, its structurally thin tax-to-GDP ratio (10.4% average, 2005–2024) limits fiscal space to absorb FDI contraction. The paper provides a detailed regulatory breakdown of PMK-136/2024, the transfer pricing framework under PMK-172/2023, and the Coretax digitalisation initiative. It concludes with concrete policy recommendations for the Directorate General of Taxes (DGT) to manage the trade-off between Pillar Two compliance and regional investment competitiveness. Although the empirical dataset covers the period 2005–2024, several developments occurring in early 2025 are discussed as part of the implementation context and policy environment rather than as part of the econometric estimation sample.

Keywords: Pillar Two, BEPS, CIT rate competition, FDI semi-elasticity, GloBE

Introduction

The international corporate tax landscape underwent a structural shift between 2024 and 2025 as the global minimum tax framework under Pillar Two transitioned from a policy consensus to statutory enforcement across multiple jurisdictions simultaneously.¹ Within Southeast Asia, this convergence has been unprecedented: Vietnam enacted Pillar Two rules in January 2024, while Indonesia (via PMK-136/2024), Malaysia, Thailand, and Singapore followed from January 2025.² This simultaneous adoption by at least five of the eleven ASEAN members

¹ OECD, "Minimum Tax Implementation Handbook (Pillar Two)," in *OECD/G20 Base Erosion and Profit Shifting Project* (Paris: OECD Publishing, 2023).

² Anita Ama Sakumaa Yanney, "Cross-Border Financial Regulation and Its Influence on Multinational Business Operations, Tax Structures and Investment Flows," *World Journal of Advanced Research and Reviews*, Vol.

represents a historic fiscal policy convergence in one of the world's most dynamic emerging-market regions.³

Yet the policy landscape remains deeply asymmetric. Cambodia, Laos, Myanmar, the Philippines, Brunei, and Timor-Leste have not adopted Pillar Two as of 2025.⁴ More consequentially, the United States, through an Executive Order signed in January 2025, effectively suspended the applicability of Pillar Two within its jurisdiction, introducing structural asymmetry in global minimum tax enforcement.⁵ This divergence risks creating new profit-shifting channels and potentially redirecting foreign direct investment (FDI) away from compliant jurisdictions. For Indonesia, which enforces Pillar Two while competing for the same pool of FDI as its non-compliant neighbours, the stakes are particularly high.

This paper is motivated by a fundamental empirical gap in the existing literature. Despite a rich body of theoretical work on tax competition in ASEAN^{6,7} and growing descriptive analyses of Pillar Two's global impacts,^{8,9,10} no study has simultaneously and empirically quantified: (i) the race-to-the-bottom dynamics in ASEAN CIT rates over two decades; (ii) the elasticity of FDI inflows to CIT rate changes across ASEAN; (iii) the role of anti-avoidance institutions in moderating the CIT revenue-rate relationship; and (iv) the specific fiscal implications of Pillar Two for Indonesia using CbCR micro-data with GloBE-compliant adjustments. This paper addresses all four gaps.

Existing studies have generally examined Pillar Two, tax competition, FDI responsiveness, or anti-avoidance mechanisms as separate research streams. Most ASEAN-focused studies remain descriptive and do not jointly evaluate long-term CIT competition, investment sensitivity, institutional safeguards, and the implications for Pillar Two revenue within a unified empirical framework. Consequently, the interaction between regional tax competition and Indonesia's Pillar Two implementation remains insufficiently understood. This study addresses that gap by integrating these dimensions into a single empirical and policy-oriented analysis.

Our principal findings are: (1) CIT rates in ASEAN have declined at a statistically significant average of 0.44 percentage points per year, consistent with a structured race to the bottom; (2) FDI inflows to Indonesia exhibit a negative semi-elasticity of -0.155 with respect to the statutory CIT rate, assuming the rate is entered in percentage-point units; (3) aggregate CbCR estimates of Pillar Two top-up tax

26, No. 3 (2025), 597–620.

³ Angela Pennisi di Floristella, "United States and European Union Evolving Approaches in Southeast Asia: Moving Closer to Convergence or Divergence?," *Journal of Current Southeast Asian Affairs*, Vol. 38, No. 2 (2019), 172–93.

⁴ Rui Augusto Gomes, "Leveraging ASEAN Membership for Timor-Leste's Development: Issues and Recommendations," ERIA Discussion Paper Series (Timor-Leste, 2025).

⁵ Yongzhi Huang, "Fractured Sovereignty: OECD Pillar Rules and Canada's Constitutional and Compliance Challenges in Global Tax Reform," 2025.

⁶ John D. Wilson, "A Theory of Interregional Tax Competition," *Journal of Urban Economics*, Vol. 19, No. 3 (1986), 296–315.

⁷ George R. Zodrow and Peter Mieszkowski, "Pigou, Tiebout, Property Taxation, and the Underprovision of Local Public Goods," *Journal of Urban Economics*, Vol. 19, No. 3 (1986), 356–70.

⁸ OECD, *Tax Challenges Arising from Digitalisation of the Economy Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD Publishing, 2021).

⁹ Niels Johannesen, "The Global Minimum Tax," *Journal of Public Economics*, No. 212, (2022), 104709.

¹⁰ Michael Devereux and John Vella, "The Impact of the Global Minimum Tax on Tax Competition," in *International Tax at the Crossroads* (Edward Elgar Publishing, 2023), 141–65.

revenue are subject to severe optimism bias when SBIE carve-outs and the EUR 750 million threshold are not applied adjusted micro-data estimates are approximately 89% lower; and (4) the intra-ASEAN Pillar Two asymmetry creates material risk of investment diversion toward non-adopting jurisdictions in the short run.

Literature Review and Theoretical Framework

Tax Competition Theory

The canonical framework for understanding international CIT competition originates with Wilson, Zodrow, and Mieszkowski,¹¹ who independently demonstrate that when capital is mobile across jurisdictions, competition for investment leads governments to set tax rates below their social optima. Each jurisdiction faces an elastic supply of capital: a rate cut attracts inflows, while a rate increase triggers outflows, creating a Nash equilibrium with systematically depressed tax rates. The seminal empirical test by Devereux, Lockwood, and Redoano (2008) confirmed this prediction for OECD countries, finding significant strategic complementarity in statutory rates (coefficient approximately 0.65).¹²

In the ASEAN context, the race-to-the-bottom hypothesis has been largely assumed rather than formally tested. The region's CIT rate convergence over 2005–2024, documented in Section 4, provides the first systematic quantitative test. Critically, ASEAN jurisdictions are not homogeneous actors: Singapore's persistent low-rate strategy (17% statutory, EATR of 16.1%) reflects a first-mover advantage built on treaty networks and institutional quality, while Indonesia and Vietnam have pursued more gradual rate reductions from initially higher bases (28–30%). This heterogeneity implies that the equilibrium in ASEAN is not simply the global minimum, but is shaped by country-specific structural parameters.

Fiscal Externality and Spillover Effects

Fiscal Externality Theory by Gordon formalises the cross-border spillover of tax policy.¹³ A rate cut by Indonesia not only attracts FDI but also imposes a fiscal externality on neighbouring Vietnam, Thailand, and Malaysia by eroding their tax bases. This externality is not internalised in the non-cooperative equilibrium, justifying Pillar Two's approach of establishing a coordinated minimum rate. The critical empirical question is whether this minimum has been set at a level that actually constrains ASEAN behaviour. At 15%, the global floor lies below eight of the ten ASEAN countries with available data (mean ASEAN statutory rate in 2024: 20.9%). Only Singapore's EATR (16.1%) approaches the minimum after accounting for incentive regimes.

The primary impact of Pillar Two in the region is not on headline statutory rates, but on targeted tax incentives. Highly generous, uncoordinated tax holidays can easily lower an MNE's effective tax rate to between 5% and 10% in export-processing

¹¹ Zodrow and Mieszkowski, "Pigou, Tiebout, Property Taxation, and the Underprovision of Local Public Goods."

¹² Michael P. Devereux, Ben Lockwood, and Michela Redoano, "Do Countries Compete over Corporate Tax Rates?," *Journal of Public Economics*, Vol. 92, No. 5–6 (2008), 1210–35.

¹³ Roger Gordon, "Taxation of Investment and Savings in a World Economy: The Certainty Case" (Cambridge, MA, October 1985).

zones. Under Pillar Two, these incentives are neutralised, as other jurisdictions can collect the remaining top-up tax up to the 15% threshold. This policy shift redirects regional competition toward the quality of the non-tax investment environment.

Institutional Isomorphism and Anti-Avoidance Rule Adoption

DiMaggio and Powell's (2000) institutional isomorphism theory offers a compelling explanation for observed variation in ASEAN anti-avoidance rule adoption.¹⁴ Of the eleven ASEAN nations, only Indonesia has simultaneously implemented both a Controlled Foreign Corporation (CFC) rule and an interest limitation rule as of 2024. This reflects coercive isomorphism (pressure from the OECD/G20 Inclusive Framework) combined with normative isomorphism (DGT technical capacity development). Cambodia, Laos, Myanmar, and Timor-Leste, with limited institutional capacity, have not adopted comparable mechanisms, suggesting that mimetic isomorphism is insufficient to diffuse complex anti-avoidance rules in the absence of external pressure and domestic implementation capacity.

From a public finance perspective, anti-avoidance rules serve as a structural complement to CIT rate policies. Under uncoordinated tax regimes, anti-avoidance frameworks serve as a baseline protection that reduces profit shifting when rates are lowered, thereby mitigating revenue losses. Rather than being treated as administrative burdens, these rules must be analysed as key components of a country's revenue preservation strategy.

FDI Sensitivity to Taxation

The literature on the tax sensitivity of FDI consistently finds negative semi-elasticities in the range of -0.5 to -3.3 ,¹⁵ with meta-analyses reporting median values around -2.5 and European studies estimating sensitivities between -4.3 and -5.6 on Effective Average Tax Rates.¹⁶ However, these estimates are predominantly derived from OECD country data. They may not translate directly to ASEAN's institutional context, where non-tax factors, such as infrastructure quality, labour costs, the rule of law, and resource endowments, are often more binding constraints on investment decisions.

Empirical regional findings have demonstrated a positive correlation between corporate tax rates and FDI inflows¹⁷ in some Southeast Asian contexts, suggesting that robust tax revenues,¹⁸ when effectively collected, fund high-quality public goods, such as deep-water ports, highways, and legal systems that ultimately lower long-run operating costs and attract high-quality capital.¹⁹ This non-linear relationship

¹⁴ Paul J. DiMaggio and Walter W. Powell, "The Iron Cage Revisited Institutional Isomorphism and Collective Rationality in Organizational Fields," in *Economics Meets Sociology in Strategic Management*, ed. Joel A.C. Baum and Frank Dobbin (Emerald Group Publishing Limited, 2000), 143–66.

¹⁵ Ruud A. de Mooij and Sjeef Ederveen, "Taxation and Foreign Direct Investment: A Synthesis of Empirical Research," *International Tax and Public Finance*, Vol. 10, No. 6 (November 2003): 673–93.

¹⁶ Lars P. Feld and Jost H. Heckemeyer, "FDI and Taxation: A Meta-Study," *Journal of Economic Surveys*, Vol. 25, No. 2 (April 2011), 233–72.

¹⁷ Christian Bellak and Markus Leibrecht, "Do Low Corporate Income Tax Rates Attract FDI? – Evidence from Central- and East European Countries," *Applied Economics*, Vol. 41, No. 21 (2009), 2691–2703.

¹⁸ Nguyen Minh Ha, Pham Tan Minh, and Quan Minh Quoc Binh, "The Determinants of Tax Revenue: A Study of Southeast Asia," *Cogent Economics & Finance*, Vol. 10, No. 1 (2022).

¹⁹ Tajul Ariffin Masron, "Relative Institutional Quality and FDI Inflows in ASEAN Countries," *Journal of*

between taxation and FDI underscores the importance of country context when interpreting semi-elasticity coefficients.

Pillar Two: Revenue and Competitiveness Effects

The OECD's impact assessment projects global additional CIT revenues from Pillar Two in the range of USD 155–192 billion annually, concentrated in high-income jurisdictions.²⁰ For developing countries, the picture is more ambiguous. A critical methodological issue identified in the prior literature is the reliance on aggregate CbCR data to compute average ETRs. This approach ignores the foundational mechanics of the GloBE Rules, which mandate that ETRs be calculated individually for each constituent entity within a jurisdiction (jurisdictional blending), leading to an ecological fallacy.²¹ Aggregate models also fail to account for the Substance-Based Income Exclusion (SBIE) and the EUR 750 million consolidated revenue threshold, systematically overstating projected revenues.²² Micro-data simulations correcting for these factors indicate that the population of MNEs actually liable for top-up taxes in Indonesia is substantially smaller than aggregate projections suggest.²³

Research Methods

Data Sources and Coverage

This study constructs an unbalanced panel dataset covering eleven ASEAN member states, Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Timor-Leste, and Vietnam over the period 2005–2024 (220 country-year observations for the primary estimation sample). Data are integrated from: (i) OECD Tax Policy Analysis database and KPMG Corporate Tax Rates Survey for statutory CIT, EATR, and EMTR; (ii) UNCTAD World Investment Report for FDI inward and outward flows;²⁴ (iii) IMF Revenue Statistics Asia and Pacific edition for tax revenue metrics; (iv) IMF World Economic Outlook for macroeconomic aggregates; (v) World Bank Worldwide Governance Indicators;²⁵ (vi) OECD BEPS Implementation Database for anti-avoidance rule adoption status; and (vii) OECD GloBE Implementation Tracker (Q1 2025) for Pillar Two status.²⁶

The Indonesia CbCR dataset, covering MNE-level earnings, profits, tax accrued, and tax paid by jurisdiction category for 2016–2022, is sourced from the Directorate General of Taxes (DGT) of the Ministry of Finance. This longitudinal CbCR data enables direct estimation of effective tax rates and Pillar Two top-up tax potential at

Economic Studies, Vol. 44, No. 1 (2017), 115–37.

²⁰ OECD, "Minimum Tax Implementation Handbook (Pillar Two)."

²¹ OECD, "Country-Specific Information on Country-by-Country Reporting Implementation," OECD work on Country-by-Country reporting, accessed May 20, 2026, <https://www.oecd.org/en/topics/sub-issues/country-by-country-reporting-for-tax-purposes/country-specific-information-on-country-by-country-reporting-implementation.html#cbcrequirements>.

²² Devereux and Vella, "The Impact of the Global Minimum Tax on Tax Competition."

²³ Michael P. Devereux, Johanna Paraknewitz, and Martin Simmler, "Empirical Evidence on the Global Minimum Tax: What Is a Critical Mass and How Large Is the Substance-based Income Exclusion?," *Fiscal Studies*, Vol. 44, No. 1 (2023), 9–21.

²⁴ United Nations Conference on Trade and Development (UNCTAD), "World Investment Report 2024: Investment Facilitation and Digital Government" (New York, 2024).

²⁵ World Bank, "Worldwide Governance Indicators 2024" (Washington DC: World Bank, 2024).

²⁶ OECD, *Tax Challenges Arising from the Digitalisation of the Economy GloBE Information Return* (January 2025), OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, 2025), <https://doi.org/10.1787/a05ec99a-en>.

an aggregate level.²⁷ Full GloBE-compliant revenue estimation requires entity-level microdata with SBIE and threshold adjustments applied, as detailed in Section 6. Although the empirical dataset covers the period 2005–2024, several developments occurring in early 2025 are discussed as part of the implementation context and policy environment rather than as part of the econometric estimation sample.

Econometric Qualifications

The use of Driscoll-Kraay standard errors requires careful qualification in this context. The non-parametric Driscoll-Kraay covariance estimator is highly effective at simultaneously correcting for heteroskedasticity, serial correlation, and cross-sectional dependence. However, its consistency is asymptotically dependent on the time dimension ($T \rightarrow \infty$). With $T = 20$ and $N = 11$, the asymptotic assumptions are constrained, and Driscoll-Kraay standard errors may be downwardly biased, producing overly optimistic t-statistics. Driscoll-Kraay standard errors were selected because they are robust to heteroskedasticity, serial correlation, and cross-sectional dependence in panel data.

FDI Elasticity Estimation

We estimate the tax-FDI relationship using a log-linear panel specification:

$$\ln(FDI_{it}) = \alpha_i + \gamma_1 \cdot CIT_RATE_{it} + \gamma_2 \cdot GDP_GROWTH_{it} + \gamma_3 \cdot OPENNESS_{it} + \gamma_4 \cdot WGI_{it} + \mu_{it}$$

The coefficient γ_1 captures the semi-elasticity of FDI with respect to the CIT rate. If entered in percentage-point units (e.g., 22.0 for a 22% rate), $\gamma_1 = -0.155$ implies a 15.5% change in FDI per one percentage-point change in the CIT rate. All results in this paper use percentage-point scaling; the coefficient for Indonesia is $\gamma_1 = -0.155$ ($p < 0.01$). Using the Indonesia CbCR data (2016–2022), we compute effective tax rates as tax accrued divided by pre-tax profit. Two models are presented: (i) an unadjusted aggregate model using the standard Income Inclusion Rule formula, $Top-Up = \max(0, (15\% - ETR) \times \text{GloBE Income})$; and (ii) a GloBE-adjusted microdata model that additionally applies SBIE carve-outs and filters for the EUR 750 million consolidated revenue threshold. The comparison between these two models quantifies the magnitude of optimism bias in aggregate approaches.

Table 1. presents summary statistics for key variables over the 2005–2024 study period.

Table 1. Summary Statistics ASEAN Panel, 2005–2024

Variable	N	Mean	Std. Dev.	Min	Max	Unit
Statutory CIT Rate	200	23.6	3.8	17.0	35.0	%
FDI Inward Flow	199	13,039	32,121	–162	159,600	USD mn
GDP Growth	220	4.8	3.2	–8.1	13.0	%
Total Tax / GDP	177	12.8	6.3	0.9	42.1	%
Fiscal Balance / GDP	198	–1.5	3.4	–13.0	7.5	% GDP
WGI Governance Score	220	0.54	0.13	0.35	0.72	Index
EATR	84	19.5	3.1	16.1	22.8	%

Sources: IMF, UNCTAD, OECD, World Bank; authors' compilation.

²⁷ OECD, "Country-Specific Information on Country-by-Country Reporting Implementation."

Result and Discussion

1. CIT Competition Dynamics in ASEAN: Evidence of a Structured Race to the Bottom

Statutory Rate Trends, 2005–2024

The evidence on ASEAN CIT competition is striking. Every country with available data reduced its CIT rate over this period, with the ASEAN unweighted average falling from 28.5% in 2005 to 20.9% in 2024, a cumulative decline of 7.6 percentage points over twenty years. The linear panel trend regression yields a coefficient on the year variable of -0.441 percentage points per year, significant at the 1% level ($p < 0.001$, $R^2 = 0.90$). The cross-country standard deviation of statutory rates fell from 4.2 percentage points in 2005 to 2.6 percentage points in 2024 (a 38% reduction), providing sigma-convergence evidence consistent with strategic tax competition theory.

Table 2 documents the statutory CIT trajectory by country across selected years. Lao PDR undertook the largest single-period cut (35% in 2010 to 20% by 2021), likely driven by competition with Vietnam and Thailand for Mekong-corridor manufacturing investment. Cambodia maintained a stable 20% rate throughout a passive low-rate equilibrium. The Philippines' reduction from 32% to 25% (via the CREATE Act in 2021) represents one of the more dramatic recent reforms among non-Pillar Two adopters.

Table 2. Statutory CIT Rate Trajectory by Country (Selected Years)

Country	2005	2008	2010	2013	2016	2020	2024	Δ pp
Brunei Darussalam	30.0	27.5	23.5	20.0	18.5	18.5	18.5	-11.5
Cambodia	n/a	n/a	20.0	20.0	20.0	20.0	20.0	0.0
Indonesia	30.0	30.0	25.0	25.0	25.0	22.0	22.0	-8.0
Lao PDR	n/a	n/a	35.0	24.0	24.0	24.0	20.0	-15.0
Malaysia	28.0	26.0	25.0	25.0	24.0	24.0	24.0	-4.0
Myanmar	30.0	n/a	n/a	25.0	25.0	25.0	22.0	-8.0
Philippines	32.0	35.0	30.0	30.0	30.0	30.0	25.0	-7.0
Singapore	20.0	18.0	17.0	17.0	17.0	17.0	17.0	-3.0
Thailand	30.0	30.0	30.0	20.0	20.0	20.0	20.0	-10.0
Viet Nam	28.0	28.0	25.0	25.0	22.0	20.0	20.0	-8.0
ASEAN Avg.	28.5	27.8	25.6	23.1	22.6	22.1	20.9	-7.6

Sources: OECD Tax Policy Analysis, KPMG Corporate Tax Rates Survey; authors' compilation.

Heterogeneous Competitive Strategies

Three distinct competitive strategies are evident within ASEAN. Singapore represents the anchored low-rate strategy: having reached 17% by 2010, it has maintained this rate for 14 years, using non-rate instruments (IP regimes, financial incentive packages, treaty networks) to sustain competitiveness.²⁸ Its EATR of 16.1% marginally above the Pillar Two minimum reflects deliberate positioning just above the threshold. At the same time, its adoption of Pillar Two serves as a defensive measure to retain QDMTT revenues domestically.²⁹ In 2019, Singapore

²⁸ Alexander Degelsegger-Márquez, Rudie Trienes, and Svend Otto Remøe, *ASEAN Economic Community and Intellectual Property Rights: An Assessment of Framework Conditions for Innovation* (Wien: SEA-EU-NET, 2016).

²⁹ Pramod Kumar Siva, "The OECD Pillar Two Global Minimum Tax: Foundations, Justification, and Sovereignty Challenges," 2026.

held approximately USD 80 billion in profit-shifting inflows, the largest in ASEAN, confirming its function as a conduit jurisdiction.³⁰

The convergence bloc Indonesia, Vietnam, Thailand, Malaysia, and Myanmar pursued gradual rate reductions from the 25–30% range toward a 20–22% equilibrium. Vietnam's case is illustrative: its EMTR averaged 9.5%, far below its 20% statutory rate, driven by accelerated depreciation and investment incentives in industrial zones.³¹ This gap between statutory and effective rates is precisely what creates Pillar Two exposure for jurisdictions whose formal compliance (a statutory rate above 15%) masks substantial reductions in effective rates through incentive regimes.

2. FDI Sensitivity to CIT Rates in Indonesia and ASEAN

Indonesia-Specific FDI–Tax Relationship

For Indonesia, the 2005–2024 period provides three episodes of statutory CIT rate reduction from 30% to 28% (2009), to 25% (2010), and to 22% (2020) against a backdrop of rising FDI inflows, from USD 8.3 billion in 2005 to USD 24.2 billion in 2024. The Pearson correlation between Indonesia's statutory CIT rate and FDI inflows is -0.785 ($p < 0.001$), a strong negative association. The log-linear semi-elasticity estimate, with the CIT rate entered in percentage-point units, yields a coefficient of -0.155 ($p < 0.001$). Each one-percentage-point reduction in the CIT rate is associated with a 15.5% increase in FDI inflows.

Evaluated at the 2024 base of USD 24.2 billion, a one-percentage-point cut would be associated with approximately USD 3.75 billion in additional annual FDI inflows, assuming other factors held constant.³² This elasticity estimate falls at the lower end of the international meta-analytic range,³³ consistent with the expectation that non-tax factors, infrastructure gaps, bureaucratic procedures, resource endowments, and a 275-million-person domestic market are relatively more important determinants of FDI in Indonesia than in mature OECD economies.

This comparatively low sensitivity has a significant implication for Pillar Two policy: the investment cost of constraining Indonesia's ability to offer sub-15% incentives is materially lower than it would be in a tax-elastic economy.³⁴ The FDI semi-elasticity thus provides an important parameter for quantifying the FDI cost of compliance. A limitation of the present specification is the potential simultaneity between corporate tax rates and FDI inflows.³⁵ Governments may adjust tax policy in response to changing investment conditions, creating possible reverse causality. Accordingly, the estimated coefficient should be interpreted as an association rather than a strict causal effect.³⁶ Future research may employ instrumental variables or dynamic panel approaches to address this issue more rigorously.

³⁰ The ASEAN Secretariat, "ASEAN Investment Report 2024: ASEAN Economic Community 2025 and Foreign Direct Investment" (Jakarta: The ASEAN Secretariat, 2024).

³¹ The ASEAN Secretariat.

³² The ASEAN Secretariat.

³³ de Mooij and Ederveen, "Taxation and Foreign Direct Investment: A Synthesis of Empirical Research."

³⁴ OECD, "Minimum Tax Implementation Handbook (Pillar Two)."

³⁵ Edmund Ntom Udemba and Lucy Davou Philip, "Policy Insight from Renewable Energy, Foreign Direct Investment (FDI), and Urbanization towards Climate Goal: Insight from Indonesia," *Environmental Science and Pollution Research*, Vol. 29, No. 36 (2022), 54492–506.

³⁶ Gianni Carvelli, "Fiscal Adjustments and TFP Dynamics: Addressing Reverse Causality within a Heterogeneous Panel Framework with Global Shocks," *Journal of Economic Studies*, Vol. 51, No. 9 (2024), 112–36.

Panel-Level Dynamics and Correlation Structure

At the ASEAN panel level, the correlation between statutory CIT rate and log FDI inflows is -0.137 ($p = 0.081$), marginally significant at the 10% level. The weaker panel-level relationship relative to the Indonesia-specific estimate reflects compositional heterogeneity: Singapore's FDI is driven by financial-centre effects largely orthogonal to its CIT rate, whereas petroleum-sector dynamics dominate Timor-Leste's flows. Controlling for country and time fixed effects strengthens the negative coefficient. The full correlation matrix is presented in Table 3.

Table 3. Correlation Matrix Key Variables, ASEAN Panel 2005–2024

Variable	CIT Rate	FDI (log)	GDP Growth	Tax/GDP	Fiscal Bal./ GDP	WGI
CIT Rate	1.000	-0.428***	0.105	0.236**	-0.305***	-0.013
FDI Inward Flow (log)	-0.428***	1.000	-0.090	0.363***	0.466***	-0.196***
GDP Growth	0.105	-0.090	1.000	-0.178*	0.201**	0.093
Total Tax / GDP	0.236**	0.363***	-0.178*	1.000	0.071	-0.395***
Fiscal Balance / GDP	-0.305***	0.466***	0.201**	0.071	1.000	-0.178**
WGI	-0.013	-0.196***	0.093	-0.395***	-0.178**	1.000

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. Source: Authors' calculations.

The WGI results in Table 3 reveal substantively important patterns for understanding the institutional determinants of investment and fiscal capacity in ASEAN. The negative and statistically significant correlation between WGI Voice and Accountability scores and FDI inflows (-0.196^{***}) indicates that countries with stronger democratic governance do not systematically attract greater volumes of inward investment in this region. This finding is consistent with the structural composition of ASEAN's FDI, which is dominated by resource-seeking and efficiency-seeking capital investment types that respond primarily to natural resource endowments, labour cost differentials, and geographic market positioning rather than to the quality of political institutions. This result corroborates the earlier interpretation that Indonesia's low FDI semi-elasticity with respect to the CIT rate reflects the market-access- and resource-driven character of its inward investment stock.

The strong negative correlation between WGI and total tax revenue as a share of GDP (-0.395^{***}) points to a structural tension in the ASEAN fiscal landscape: jurisdictions with more accountable governance tend to exhibit lower fiscal extraction capacity, reflecting the region's diverse levels of development and state-capacity constraints. Equally, the negative correlation between WGI and fiscal balance (-0.178^{**}) suggests that more accountable governments tend to run larger fiscal deficits, potentially reflecting greater public expenditure demands and transfer pressures. Together, these patterns underscore the importance of institutional heterogeneity as a moderating factor in the tax-investment nexus and motivate the explicit inclusion of WGI as a control variable, γ_4 , in the FDI semi-elasticity specification reported in Table 2.

3. Indonesia's CbCR Analysis and Pillar Two Revenue Implications

MNE Effective Tax Rate Dynamics in Indonesia

The Country-by-Country Reporting data submitted by MNEs operating in Indonesia (2016–2022) reveals a nuanced picture of effective tax rates. Table 4 presents ETRs computed on both accrued and paid-tax bases.

Table 4. Indonesia CbCR MNE Effective Tax Rate Analysis (2016–2022)

Year	MNE Profit (USD mn)	Tax Accrued (USD mn)	Tax Paid (USD mn)	ETR (Accrued)	ETR (Paid)	Below 15%?
2016	626.5	50.1	57.6	8.0%	9.2%	Yes
2017	539.6	65.2	68.6	12.1%	12.7%	Yes
2018	439.5	53.6	64.7	12.2%	14.7%	Marginal
2019	170.5	44.7	23.5	26.2%	13.8%	No
2020	199.6	85.1	44.6	42.6%	22.3%	No
2021	288.5	71.6	76.8	24.8%	26.6%	No
2022	203.2	45.9	102.1	22.6%	50.2%	No

Source: Directorate General of Taxes, Ministry of Finance of Indonesia; authors' calculations.

MNE ETRs in Indonesia were clearly below the 15% Pillar Two threshold in 2016 and 2017 (accrued basis: 8.0% and 12.1% respectively), likely reflecting a combination of tax holiday utilisation, accelerated depreciation, and profit-shifting behaviours.³⁷ By 2019–2022, ETRs had risen substantially to 22–43% on an accrued basis, suggesting either a change in MNE mix, a shift in incentive utilisation, or strengthened DGT transfer pricing enforcement following the 2019 audit reforms. The 2018 observation is particularly important: the 2.5 percentage-point gap between the accrued ETR (12.2%) and paid ETR (14.7%) reflects timing differences between commercial and tax accounting, precisely the deferred tax adjustments that must be applied under Article 30(1) of PMK-136/2024 to avoid imposing artificial top-up tax liabilities.³⁸

The sharp increase in accrued ETRs after 2019 has important implications for Pillar Two exposure. As more MNEs operate with effective tax rates substantially above the 15% GloBE threshold, the population of firms potentially subject to top-up taxes becomes progressively smaller. Consequently, the 2016–2017 observations should be interpreted as an historical low-ETR benchmark rather than as representative of the post-2019 compliance environment.

The Ecological Fallacy and GloBE Revenue Projection Bias

A critical methodological limitation of aggregate CbCR-based revenue estimation is the ecological fallacy it produces when applied to GloBE mechanics. GloBE Rules mandate jurisdictional blending at the level of individual constituent entities, not at the MNE group aggregate level. To illustrate: if a multinational group operates two constituent entities in Indonesia, one paying a high ETR of 30% and another utilising a 0% tax holiday, the aggregate CbCR reports an average ETR of 15%. An aggregate model produces a top-up estimate of zero. Under PMK-136/2024's

³⁷ OECD, "Minimum Tax Implementation Handbook (Pillar Two)."

³⁸ The ASEAN Secretariat, "ASEAN Investment Report 2024: ASEAN Economic Community 2025 and Foreign Direct Investment."

jurisdictional blending rules, however, the 0% entity would be subject to a 15% top-up tax, generating substantial revenue that aggregate models entirely miss.

In the opposite direction, aggregate models systematically overestimate revenues by ignoring the SBIE and the EUR 750 million consolidated revenue threshold. Only MNE groups with consolidated annual revenues exceeding EUR 750 million (approximately IDR 12.7 trillion) in at least two of the four preceding tax years are subject to PMK-136/2024. SBIE rules further reduce the taxable GloBE income base by excluding a percentage of eligible tangible assets and qualified payroll costs, with transitional percentages declining from 10%/8% (payroll/assets) in 2023 to 5%/5% in 2033+.

When the EUR 750 million threshold and SBIE carve-outs are strictly applied, the population of MNEs liable for top-up taxes in Indonesia shrinks dramatically. Micro-data simulations indicate that only a small number of large-scale MNEs generate real top-up tax liabilities, with the average liability estimated at approximately IDR 8.6 billion per qualifying entity per year and total annual top-up revenue estimated at IDR 43 billion (approximately USD 2.6 million).

Table 5. Comparison of Top-Up Tax Projections Aggregate vs. GloBE-Adjusted Model (2016–2022)

Year	MNE Profit (USD mn)	Tax Accrued (USD mn)	Aggregate ETR	Top-Up: Unadjusted	Top-Up: SBIE- Adjusted	Revenue Difference	Bias Factor
2016	626.5	50.1	8.0%	USD 43.9 mn	USD 4.8 mn	–USD 39.1 mn	9.1×
2017	539.6	65.2	12.1%	USD 15.8 mn	USD 1.9 mn	–USD 13.9 mn	8.3×
2018	439.5	53.6	12.2%	USD 12.3 mn	USD 1.1 mn	–USD 11.2 mn	11.2×
2019	170.5	44.7	26.2%	USD 0.00 mn	USD 0.00 mn	USD 0.00 mn	n/a
2020	199.6	85.1	42.6%	USD 0.00 mn	USD 0.00 mn	USD 0.00 mn	n/a
2021	288.5	71.6	24.8%	USD 0.00 mn	USD 0.00 mn	USD 0.00 mn	n/a
2022	203.2	45.9	22.6%	USD 0.00 mn	USD 0.00 mn	USD 0.00 mn	n/a
TOTAL (2016–18)	—	—	—	USD 72.0 mn	USD 7.8 mn	–USD 64.2 mn	9.2× avg.

Sources: DGT, Ministry of Finance of Indonesia; PMK-136/2024; authors' calculations. SBIE-adjusted estimates incorporate PMK-136/2024 transitional exclusion percentages and the EUR 750 million threshold filter.

Table 5 demonstrates that aggregate models overestimate top-up tax revenues by factors of 8–11× in the years where ETRs fell below 15%. The primary fiscal benefit of Pillar Two for Indonesia is therefore not large incremental top-up revenues, but rather the discipline it imposes on incentive programs that currently erode the CIT base below the 15% floor.

4. Intra-ASEAN Pillar Two Asymmetry and Investment Diversion Risks

The Five–Six Divide

As of 2025, ASEAN is divided along the Pillar Two fault line. Early adopters in Vietnam (2024), Indonesia, Malaysia, Thailand, and Singapore (all 2025) collectively represent the five largest ASEAN economies and approximately 85% of ASEAN GDP. Non-adopters Cambodia, Laos, Myanmar, Philippines, Brunei, and Timor-Leste account for a disproportionately small share of GDP, but potentially a significant share of specific FDI flows in manufacturing and natural resources.³⁹

³⁹ The ASEAN Secretariat.

The Philippines is the most consequential non-adopter. With a statutory CIT rate of 25% and a large English-speaking workforce, it competes directly with Indonesia and Vietnam for export-oriented manufacturing and business process outsourcing. Its non-adoption of Pillar Two creates an asymmetric advantage in offering sub-15% incentives to qualifying MNEs without Pillar Two top-up exposure, a classic regulatory arbitrage scenario. MNEs that would face a QDMTT in Indonesia for sub-15% incentive utilisation have an incentive to relocate the incentivised activity to the Philippines.

Table 6. Pillar Two Implementation Status and Key Tax Parameters, ASEAN 2025

Country	Pillar Two Status	Stat. CIT (%)	EATR (%)	CIT/GDP (2022)	CFC Rule	Int. Limitation	Hybrid Mismatch	QDMTT Year
Viet Nam	Adopted (2024)	20.0	18.1	1.9%	No	No	No	2024
Indonesia	Adopted (2025)	22.0	22.7	1.8%	Yes	Yes	No	2025
Malaysia	Adopted (2025)	24.0	22.8	7.5%	No	Yes	No	2025
Thailand	Adopted (2025)	20.0	19.5	3.2%	No	No	No	2025
Singapore	Adopted (2025)	17.0	16.1	2.0%	No	No	No	2025
Philippines	Not adopted	25.0	n/a	4.2%	n/a	n/a	n/a	—
Cambodia	Not adopted	20.0	n/a	2.5%	No	No	No	—
Myanmar	Not adopted	22.0	n/a	n/a	No	No	No	—
Brunei Darussalam	Not adopted	18.5	n/a	n/a	No	No	No	—
Lao PDR	Not adopted	20.0	n/a	2.2%	No	No	No	—
Timor-Leste	Not adopted	n/a	n/a	n/a	No	No	No	—

Sources: OECD GloBE Tracker, KPMG, IMF, OECD BEPS Database; authors' compilation.

The US Executive Order and Its ASEAN Implications

The January 2025 US Executive Order, which directs federal agencies to identify and counter the extraterritorial application of foreign tax rules, specifically targets Pillar Two's UTPR, introducing an additional dimension to ASEAN's tax landscape. US-headquartered MNEs operating in ASEAN now face a regulatory environment in which their US parent may benefit from provisions that exempt it from UTPR exposure. At the same time, their ASEAN subsidiaries remain subject to QDMTT rules in Pillar Two-adopting jurisdictions. This creates a structural advantage for US MNEs relative to European MNEs in jurisdictions without QDMTT. Over time, US non-participation may incentivise the allocation of profits away from ASEAN Pillar Two jurisdictions towards US entities.

5. Regulatory Architecture of PMK-136/2024

Scope, Covered Taxes, and Exemptions

PMK-136/2024 comprises 16 Chapters and 74 Articles and applies to all domestic constituent entities and permanent establishments (PEs) that belong to an in-scope MNE group. The regulation specifically exempts government entities, international organisations, non-profit organisations, pension funds, and investment funds acting as ultimate parent entities. The EUR 750 million consolidated revenue threshold (approximately IDR 12.7 trillion) must be met in at least two of the four preceding tax years. To calculate the ETR of a constituent entity, PMK-136/2024 strictly defines which taxes qualify as Covered Taxes, as summarised in Table 7.

Table 7. Covered vs. Non-Covered Taxes under PMK-136/2024

Covered Taxes (Pajak Ditanggung)	Non-Covered Taxes (Pajak Non-Ditanggung)
Taxes on corporate income or profits	Indirect taxes, including VAT and PPnBM
Taxes on distributed profits or deemed distributions	Payroll taxes and social security contributions
Taxes levied instead of a generally applicable CIT	Property taxes and land/building taxes
Taxes on corporate retained earnings and equity	Digital services taxes (DST)
Allocated taxes from direct owners to a CFC based on profit share	Top-up taxes paid under IIR, UTPR, or QDMTT mechanisms

Sources: PMK-136/2024 and DGT guidelines.⁴⁰

Notably, Qualified Refundable Tax Credits (QRTCs) are treated as additions to GloBE income rather than reductions to covered taxes. Because a QRTC is treated as income rather than a tax reduction, it does not lower the ETR below the 15% threshold. This makes QRTCs a highly effective fiscal tool for supporting strategic sectors such as green energy, digital technology, and high-value-added manufacturing without triggering foreign top-up tax clawbacks.

Charging Mechanisms: DMTT, IIR, and UTPR

PMK-136/2024 implements three core charging mechanisms: (1) Domestic Minimum Top-Up Tax (DMTT) Indonesia's primary defensive mechanism, ensuring that if a domestic constituent entity's ETR falls below 15%, Indonesia imposes a domestic top-up tax locally, preventing other jurisdictions from claiming top-up taxes under their own IIR rules; (2) Income Inclusion Rule (IIR) requiring an Indonesian parent entity to pay top-up taxes on the low-taxed profits of its foreign subsidiaries if those subsidiaries are taxed below 15%; and (3) Under-Taxed Payment Rule (UTPR) a secondary backstop that distributes remaining top-up tax liability proportionally among the countries where an MNE group's constituent entities operate, calculated based on relative employee headcount and net book value of tangible assets.

Safe Harbour Provisions

Chapter XII of PMK-136/2024 establishes five types of Safe Harbours that deem top-up tax to be zero for qualifying jurisdictions: (1) Permanent Safe Harbour; (2) Transitional CbCR Safe Harbour, under which constituent entities pass one of three simplified tests the De-minimis Test (total revenue below EUR 10 million and pre-tax profit below EUR 1 million), the Routine Profit Test (pre-tax profit equal to or less than the computed SBIE amount), or the Simplified ETR Test (simplified ETR meets or exceeds 15% in 2024, 16% in 2025, or 17% in 2026, applicable up to fiscal years ending June 30, 2028); (3) Transitional CbCR Safe Harbour for Certain Entities and Groups; (4) Transitional UTPR Safe Harbour, reducing UTPR top-up tax to zero if the UPE's home jurisdiction has a statutory CIT rate of at least 20%, applicable for fiscal years beginning on or before December 31, 2025; and (5) Simplified Calculations Safe Harbour for Non-Material Constituent Entities.

The progressive ETR thresholds in the Transitional CbCR Simplified ETR Test deserve specific attention. By setting the thresholds at 15%, 16%, and 17% for 2024, 2025, and 2026, respectively, PMK-136/2024 effectively requires MNEs operating

⁴⁰ PPnBM (Pajak Penjualan atas Barang Mewah), translated as Luxury Goods Sales Tax (LGST), is an indirect tax imposed on designated luxury goods in Indonesia and is not classified as a Covered Tax under the GloBE Rules.

in transitional jurisdictions to demonstrate a gradual tightening of compliance, a deliberate design to phase in full GloBE discipline while minimising short-term compliance disruption. For Indonesia, with a statutory CIT rate of 22% and most large MNEs paying ETRs well above 15% post-2019 (per Table 4), the majority of in-scope entities are expected to qualify for safe harbour treatment in the early transitional years.

Table 8. Transitional SBIE Exclusion Percentages under PMK-136/2024

Fiscal Year	Eligible Payroll Cost (%)	Eligible Tangible Asset (%)	Policy Phase
2023	10.0%	8.0%	Transitional — Highest Benefit
2024	9.8%	7.8%	Transitional
2025	9.6%	7.6%	Linear Phase-Down Begins
2026	9.4%	7.4%	Transitional
2027	9.2%	7.2%	Transitional
2028	9.0%	7.0%	Transitional
2029	8.2%	6.6%	Convergence — Accelerated Step-Down
2030	7.4%	6.2%	Convergence
2031	6.6%	5.8%	Convergence
2032	5.8%	5.4%	Near Floor
2033+	5.0%	5.0%	Steady State — Permanent Floor

Source: Minister of Finance Regulation PMK-136/2024; compiled from regulatory texts.

The SBIE is particularly consequential for labour-intensive and capital-intensive MNE operations in Indonesia's manufacturing, mining, and infrastructure. For a qualifying entity with IDR 100 billion in eligible payroll and IDR 200 billion in tangible assets, the 2025 SBIE exclusion amounts to IDR 9.6 billion (payroll) plus IDR 15.2 billion (assets) = IDR 24.8 billion, directly reducing the taxable GloBE income base before top-up is applied. This makes the SBIE a powerful implicit incentive for real economic substance in Indonesia: the more workers employed and tangible assets deployed, the lower the top-up exposure.

6. Anti-Avoidance Architecture, Transfer Pricing, and the Coretax Modernisation *Indonesia's Institutional Advantage in Anti-Avoidance*

Indonesia stands out as the only ASEAN member with a comprehensive dual anti-avoidance architecture: a Controlled Foreign Corporation (CFC) rule and an interest limitation rule (thin capitalisation/earnings stripping provisions, further strengthened in 2019). By contrast, Vietnam, despite adopting Pillar Two earlier than Indonesia, lacks a CFC rule and hybrid mismatch legislation; Malaysia has an interest limitation rule, but no CFC rule; Singapore, Thailand, and Brunei have neither.

Anti-avoidance rules serve as a structural complement to CIT rate policy; they preserve the taxable base even when rates decline, reducing the revenue cost of rate competition. Indonesia's experience is consistent with this mechanism. Despite a CIT rate reduction from 25% to 22% in 2020, CIT revenue as a share of total tax revenue declined only modestly, partly supported by strengthened DGT transfer pricing enforcement. Indonesia's interest limitation rule is particularly relevant to the Pillar Two context, as the GloBE income computation adjusts for interest payments in ways that interact with domestic thin capitalisation rules, reducing compliance uncertainty.

Transfer Pricing Framework under PMK-172/2023

Promulgated on December 29, 2023, PMK-172/2023 consolidated previous transfer pricing regulations into a single framework. It introduced the ex-ante principle, requiring transfer pricing documentation to be based on facts and data available at the time of the transaction. The regulation enforces a strict three-tier documentation structure (Master File, Local File, and CbCR) with specific domestic thresholds: Master File/Local File is required for taxpayers with gross revenue exceeding IDR 50 billion, tangible goods transactions exceeding IDR 20 billion, or services/royalties/interest transactions exceeding IDR 5 billion, or any related-party transaction with a jurisdiction taxing below Indonesia's 22% rate. CbCR is required for taxpayers acting as domestic UPE of a group with consolidated gross revenue $\geq$ IDR 11 trillion, and must be filed electronically in XML format within 12 months after the fiscal year-end.

Compliance with the Arm's Length Principle remains mandatory for all related-party transactions regardless of documentation thresholds. Any upward transfer pricing adjustment by the DGT automatically triggers a secondary adjustment, treating the excess profit as a constructive dividend subject to a 20% domestic withholding tax (which is reducible under a tax treaty).

Digital Transformation via Coretax

The Core Tax Administration System (Coretax/PSIAP) went live on January 1, 2025, for corporate withholding and VAT invoicing, with integration of individual tax returns mandated for the 2025 fiscal year. Coretax fundamentally alters the tax compliance landscape by cross-referencing taxpayer data in real time with electronic invoices (e-Faktur), withholding tax certificates, and third-party financial records, eliminating delayed validation cycles.

Coretax interfaces directly with the Ministry of Law and Human Rights (AHU) database, providing tax officers with immediate visibility into Ultimate Beneficial Owner (UBO) structures and exposing complex investment chains and transfer pricing schemes. For in-scope MNEs, this transparency makes ETR calculations highly visible to both Indonesian authorities and foreign tax administrations, leaving limited room for aggressive tax planning.

By reducing administrative friction through a digitised, data-driven system, Coretax changes the nature of competition in Indonesia away from a race-to-the-bottom based on tax rate erosion toward a race-to-the-top in which administrative transparency, legal certainty, and efficiency serve as the primary attractors for high-quality global capital. This transformation is a more sustainable and durable driver of FDI than CIT rate competition alone.

Conclusion

This paper has provided a systematic empirical analysis of CIT competition dynamics and Pillar Two implications across ASEAN for the period 2005–2024, integrating original empirical findings with a regulatory analysis of PMK-136/2024, PMK-172/2023, and the Coretax digitalisation. The principal findings are unambiguous: ASEAN has experienced a statistically significant and structurally consistent race

to the bottom in corporate income tax rates, with the regional average declining by 0.44 percentage points per year, a cumulative reduction of 7.6 percentage points over two decades.

For Indonesia specifically, the CIT rate reduction from 30% (2005) to 22% (2020–2024) was associated with a meaningful expansion of FDI inflows, captured in a semi-elasticity of -0.155 . This elasticity at the lower end of the international range implies that Indonesia's FDI is driven primarily by resource-seeking and market-access motives that are relatively insensitive to changes in tax rates, thereby moderating the FDI cost of Pillar Two compliance.

On revenue estimation, the paper identifies a systematic optimism bias in aggregate CbCR-based top-up tax projections. When SBIE carve-outs and the EUR 750 million threshold are applied, adjusted micro-data estimates fall approximately 89% below aggregate projections, from USD 43.9 million to USD 4.8 million for 2016 alone, and by a factor of $9.2\times$ cumulatively across 2016–2018. The primary fiscal benefit of Pillar Two is not incremental top-up revenues, but the discipline it imposes on incentive programs.

Indonesia's dual anti-avoidance architecture, the regulatory depth of PMK-136/2024, the integrated transfer pricing framework under PMK-172/2023, and the Coretax digitalisation initiative collectively position Indonesia as the most institutionally advanced Pillar Two jurisdiction in ASEAN. The intra-ASEAN Pillar Two divide between five adopters and six non-adopters creates a structural asymmetry whose investment-diversion consequences will become empirically detectable within two to three years. Proactive implementation of the recommendations advanced in this paper, centered on QRTC deployment, GloBE computation capacity, incentive rationalisation, and regional coordination, provides a concrete roadmap for the DGT to navigate the post-Pillar Two environment without sacrificing fiscal integrity or investment competitiveness.

Future research should pursue three extensions. First, a dynamic stochastic general equilibrium (DSGE) model calibrated to Indonesia's economy would quantify the macroeconomic welfare implications of adopting Pillar Two. Second, difference-in-differences estimation comparing Pillar Two adopters and non-adopters within ASEAN will provide causal identification of adoption effects as post-2025 FDI data becomes available. Third, firm-level analysis using ORBIS or proprietary investment project data would enable the decomposition of the aggregate FDI response into extensive-margin (new entry) and intensive-margin (expansion) components.

Policy Recommendations

Based on the empirical findings and analytical framework presented in this paper, we advance the following concrete policy recommendations for the DGT and the Ministry of Finance of Indonesia.

1. *Phase Out Traditional CIT Holidays for In-Scope MNEs.*

Foreign clawbacks neutralise traditional tax holidays under the IIR. Broad-based income tax exemptions for in-scope MNEs no longer serve their purpose: offering a 0% tax holiday merely transfers sovereign revenue to foreign tax authorities. The

DGT should quantify the incentive-ETR interaction for major MNE investors and restructure incentive packages to deliver equivalent after-tax returns at ETRs above 15%. Dataset analysis indicates this intervention could prevent revenue transfers of approximately USD 4.8–44 million per year to foreign tax authorities (per Table 5 above).

2. *Deploy Qualified Refundable Tax Credits (QRTCs).*

The Indonesian government should expand the scope of QRTCs for strategic sectors, including green energy, digital technology, and high-value-added manufacturing. Because QRTCs are treated as additions to GloBE income rather than reductions to covered taxes, they do not lower the ETR below 15%, preserving their economic impact while avoiding Pillar Two friction. This is a technically superior incentive design with a significant long-run payoff.

3. *Implement Substance-Based Investment Incentives.*

Future incentives should focus on substance-based measures such as super-deductions for local R&D expenditure, investment allowances for tangible machinery, and payroll tax credits. These are compatible with GloBE rules as they do not directly reduce the ETR below 15%. For a qualifying entity with IDR 100 billion in eligible payroll and IDR 200 billion in tangible assets, the 2025 SBIE exclusion provides a direct base reduction of IDR 24.8 billion, a quantifiable incentive that rewards genuine substance deployment.

4. *Strengthen GloBE Income Computation Capacity.*

The DGT should establish a dedicated Pillar Two technical unit capable of auditing MNE-level GloBE income computations at the constituent entity level. The CbCR data demonstrates significant ETR volatility from 8.0% in 2016 to 42.6% in 2020, requiring specialized analytical expertise. Capacity investment within 12–18 months is critical to prevent the QDMTT from becoming a compliance fiction.

5. *Establish an ASEAN-Level Pillar Two Coordination Mechanism.*

Indonesia should advocate, through the ASEAN Economic Community framework, for a regional coordination mechanism that provides technical assistance to non-adopting members, particularly the Philippines, and develops a convergence timeline. Early adopters, collectively representing 85% of ASEAN GDP, have both the incentive and the institutional credibility to lead this effort. A level playing field strengthens the collective credibility of all adopters and reduces the risk of investment diversion.

6. *Monitor FDI Redirection through Enhanced MNE Reporting.*

The DGT should require annual CbCR submissions to be disaggregated by incentive-utilising entities, enabling real-time monitoring of whether Pillar Two implementation is associated with measurable FDI redirection toward non-adopting locations. Given a semi-elasticity of -0.155 , implying approximately USD 3.5 billion in FDI per 1 pp of constrained incentive generosity, early detection of a redirection greater than 5% within 2–3 years post-adoption would constitute a material policy signal warranting review.

7. Complete the Anti-Avoidance Architecture.

Indonesia should enact hybrid mismatch regulations aligned with BEPS Action 2 to prevent MNEs from exploiting the gap between Indonesia's CFC rules and the absence of hybrid mismatch provisions, which can generate deductible-not-includible payments that erode the Indonesian tax base independently of Pillar Two. Indonesia remains the only ASEAN Pillar Two adopter with a dual anti-avoidance architecture; closing the hybrid mismatch gap would make it the only ASEAN state with a comprehensive three-rule framework.

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