

The Passive Association Factor in Determining Transfer Pricing for Intra-Group Service Transactions: A Case Study of the Tax Court Decision on the Appeal Filed by PT SCI

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Abstract

Keywords:

Arm's Length Principle, Intra-Group Services, Passive Association, Tax Dispute, Transfer Pricing

This study explores the role of the passive association factor in determining transfer pricing for intra-group service transactions, focusing on the Tax Court's decision in the PT SCI case. The research aims to clarify how passive association is treated under Indonesian regulations and its implications for the application of the arm's length principle. Employing a qualitative descriptive case study approach, data were collected through in-depth interviews with tax authorities, practitioners, and academics, as well as document analysis of relevant regulations and court decisions. The population includes stakeholders in transfer pricing regulation and enforcement, with purposive sampling used to select key informants. Data were analyzed using coding, memoing, and thematic analysis to identify patterns and draw conclusions. The results show that passive association is often not eligible for remuneration, yet the lack of clear regulatory guidance leads to inconsistent interpretations and legal uncertainty. The study concludes that clearer criteria and practical guidelines are needed to distinguish passive from active association, ensuring fairer transfer pricing practices and dispute resolution in Indonesia.

INTRODUCTION

In the aftermath of the global pandemic, Indonesia has demonstrated significant economic recovery, ranking among the world's top economies by GDP and achieving record investment realization in 2022 (BPS, 2023; Katadata, 2023). This surge in investment, particularly foreign direct investment, has led to a notable increase in cross-border transactions, intensifying the complexity of tax regulation and enforcement in Indonesia (Arsyad, 2016; OECD, 2022). The prevalence of multinational enterprises operating in Indonesia has heightened the risk of tax avoidance through transfer pricing schemes, especially in intra-group service transactions, which often challenge the boundaries of the arm's length principle (Darussalam et al., 2022; Solilova & Nerudova, 2018).

The regulatory landscape for cross-border transactions in Indonesia remains fragmented, as tax policies are shaped by the prerogatives of individual jurisdictions, resulting in inconsistencies and legal uncertainties (OECD, 2022; United Nations, 2021). One prominent issue is the exploitation of regulatory gaps by multinational enterprises through Base Erosion and Profit Shifting (BEPS), with transfer mispricing serving as a primary mechanism for shifting profits to low-tax jurisdictions (Das, 2020; Llanes & Mukanov, 2012). The recent tax dispute involving PT SCI exemplifies these challenges, as the adjustment of guarantee fee expenses by tax authorities was justified on the grounds of insufficient economic substance, despite the taxpayer's assertion of compliance with the arm's length principle (Amalia & Waluyo, 2021; OECD, 2022).

The divergence in perspectives between taxpayers and tax authorities underscores the ambiguity in applying the arm's length principle, particularly regarding the concept of passive association in intra-group service transactions (Deloitte, 2015; OECD, 2022). While Indonesian regulations stipulate that passive association should not warrant remuneration, they lack detailed guidance on distinguishing between passive and active associations, leading to inconsistent interpretations and enforcement (United Nations, 2021; Darussalam et al., 2022). This regulatory gap not only complicates compliance for taxpayers but also poses challenges for tax authorities and courts in adjudicating disputes fairly and consistently (Solilova & Nerudova, 2018; United Nations, 2021).

This study aims to analyze the treatment of passive association in testing the arm's length nature of intra-group service transactions under Indonesian regulations, with a specific focus on the Tax Court's decision regarding PT SCI's guarantee fee adjustment. The urgency of this research lies in addressing the persistent legal uncertainty and providing clarity on the criteria for distinguishing passive from active association, which is critical for ensuring fair tax compliance and dispute resolution (OECD, 2022; United Nations, 2021). The novelty of this study is its comprehensive integration of recent international guidelines and empirical evidence from a high-profile Indonesian tax dispute, offering practical recommendations for both policymakers and practitioners to enhance the consistency and fairness of transfer pricing enforcement (Amalia & Waluyo, 2021; Das, 2020).

METHODS

Research Type and Method

This study adopts a qualitative research approach with a descriptive case study design, focusing on the analysis of the passive association factor in intra-group service transactions, particularly in the context of the PT SCI tax dispute (Darussalam et al., 2022; Amalia & Waluyo, 2021). The qualitative method is chosen to enable an in-depth exploration of regulatory interpretations, judicial reasoning, and practical implications, aligning with the recommendations of Creswell (2021) and Sugiyono (2022) for studies that seek to understand complex social phenomena in their real-world context. Data were collected through field studies, including in-depth interviews with tax authority representatives, practitioners, and academics, as well as comprehensive literature reviews of relevant regulations, court decisions, and scholarly works (Neumann, 2014; Sudaryono, 2022).

Instruments and Data Analysis Techniques

The primary research instruments comprised semi-structured interview guides and a document analysis protocol, both designed to capture nuanced perspectives on the application of the arm's length principle and the passive association factor (OECD, 2022; United Nations, 2021). Data analysis was conducted using coding and memoing techniques, as outlined by Miles and Huberman (1994), to systematically categorize and interpret findings. The process involved four key stages: data collection, data reduction, data display, and conclusion drawing, ensuring analytical rigor and traceability (Sugiyono, 2022; Emzir, 2021). Thematic analysis was employed to identify patterns and relationships within the data, with triangulation used to enhance the validity of the findings (Creswell, 2021; Darussalam et al., 2022).

Population and Sample

The population of this research includes all stakeholders involved in the regulation, implementation, and adjudication of transfer pricing in Indonesia, such as tax authorities, practitioners, and academics (Darussalam et al., 2022; Amalia & Waluyo, 2021). The sample was selected purposively to ensure the inclusion of informants with direct experience and expertise relevant to the PT SCI case and the broader context of intra-group service transactions (Sugiyono, 2022; Sudaryono, 2022). This purposive sampling approach is consistent with qualitative research standards, allowing for the selection of information-rich cases that can provide deep insights into the research questions (Creswell, 2021; Emzir, 2021).

Research Procedures

The research was conducted in several systematic stages. First, a comprehensive literature review was performed to establish the theoretical and regulatory framework (OECD, 2022; United Nations, 2021). Next, field studies were carried out through interviews and document analysis, focusing on the PT SCI case and related regulatory documents. Data were then coded and analyzed thematically, with findings validated through triangulation and peer debriefing (Miles & Huberman, 1994; Sugiyono, 2022). The final stage involved synthesizing the results to formulate conclusions and recommendations, ensuring that the research process adhered to established qualitative research protocols (Creswell, 2021; Emzir, 2021).

RESULTS AND DISCUSSION

The Treatment of Passive Association in Testing the Arm's Length Nature of Related-Party Transactions

Provisions regarding the application of the Arm's Length Principle (ALP) in affiliated transactions are stipulated in several regulations, including PER-43/2010 in conjunction with PER-32/2011. Article 14 of these regulations states that the ALP must serve as the basis of analysis for service transactions conducted between affiliated entities. A service transaction is deemed to comply with the ALP if (a) the provision or receipt of services has genuinely occurred, as evidenced by the existence of economic or commercial benefits that add value to the transaction, and (b) the value of the intra-group service transaction is equivalent to that which would have been agreed upon between independent parties under comparable conditions. The subsequent paragraph provides that intra-group service transactions may be considered non-compliant with the ALP if they arise merely due to the ownership of a parent company in one or more entities within the same corporate group.

Furthermore, the implementation of the Arm's Length Principle (ALP) may refer to audit guidelines for transactions influenced by special relationships, as set out in SE-50/PJ/2013. This circular reiterates the importance of ensuring the benefit of a service as well as the appropriateness of the service fee as part of the analytical steps for assessing the fairness of intra-group service transactions. SE-50/PJ/2013 explicitly mentions the element of "passive association," classifying it as one of the factors that renders an intra-group service transaction ineligible for remuneration. A similar position is reflected in PMK-22/PMK.03/2020 concerning the "Preliminary Stages" of assessing the fairness of specific transactions, in this case, intra-group services. However, neither regulation provides a detailed practical nor philosophical explanation of the elements that may characterize a service transaction as falling within the scope of passive association. This omission

inevitably creates a legal gap and uncertainty. To enrich the analysis and identify the elements of passive association more thoroughly, reference is made to international frameworks that form the foundation of ALP regulations in Indonesia, namely the OECD Transfer Pricing Guidelines.

Referring to the OECD Transfer Pricing Guidelines, paragraph 7.5 identifies two key issues in analyzing the arm's length nature of intra-group service transactions. These issues are: the existence of the intra-group service itself and the reasonableness of the compensation for such service. With respect to existence namely, whether the service has in fact been rendered this may be tested through the application of the benefit test. In line with this, Amalia and Waluyo (2021) emphasized that assessing the fairness of intra-group service transactions requires not only identifying appropriate comparables but also determining and substantiating the economic benefits derived from the services. Such economic benefits may include increased sales, improved profitability relative to comparable companies, the ability to maintain market share, and greater efficiency and effectiveness in ongoing production processes (Llanes & Mukanov, 2012).

The OECD Transfer Pricing Guidelines also provide clarification regarding the benefit test. From the perspective of the arm's length principle, the question of whether an intra-group service has genuinely been rendered to one or more members of a corporate group must be assessed based on evidence of economic or commercial benefits received by the service recipient, which either enhance or preserve its business position (OECD, 2022). From a philosophical standpoint, it may further be asked whether an independent party, under comparable circumstances, would be willing to pay for or bear the cost of the tested intra-group service, or whether such a party would instead choose to provide the service internally (in-house). If, in such a scenario, an independent entity would neither be willing to pay for the service nor perform it internally, then it can be concluded that, under economically reasonable conditions, the service should not warrant compensation. This philosophical analysis offers a logical foundation for testing; however, in practice it is challenging to regulate. Therefore, the OECD Transfer Pricing Guidelines provide several examples of transactions that should not ordinarily be remunerated, albeit limited to specific types of transactions.

One of the critical aspects to be considered in intra-group service transactions is the existence of incidental benefits. Such incidental or implicit benefits should not warrant remuneration. Incidental benefits can be defined as circumstances in which an intra-group service is directly rendered to certain group members, while other entities within the group indirectly derive advantages from the service. These incidental beneficiaries are not entitled to compensation, as in an arm's length scenario, an independent party would not be willing to pay for a service from which it only derives indirect benefits, since such benefits would accrue even without payment. This reasoning ultimately reaffirms the underlying philosophy of the arm's length principle: namely, what an independent party would reasonably do under comparable conditions.

A concept closely related to incidental benefits is passive association, which likewise should not be remunerated. According to the OECD Transfer Pricing Guidelines, paragraph 7.13, passive association is defined as an incidental benefit received by a group member solely by virtue of its membership in a corporate group, rather than as a result of any specific activity (OECD, 2022). The most fundamental example of passive association is when a subsidiary obtains a higher credit rating because a bank recognizes its affiliation with the corporate group, as compared to the situation in which the subsidiary would be assessed independently without being considered part of the group.

The UN Transfer Pricing Manual likewise provides guidance that intra-group service transactions classified as passive association should not warrant remuneration. In addition, the UN TP Manual clarifies which types of services may be defined as “active” services, namely deliberated concerted actions involving the performance of functions, the use of assets, or the assumption of risks by one affiliated entity for the benefit of one or more other related entities. From the perspective of the arm’s length principle, such services are deemed to merit appropriate compensation.

The underlying rationale of this statement is that, under normal conditions, entities generally make decisions entirely from an economic perspective, namely to maximize benefits while minimizing costs (Rahmatullah, Inanna, & Mustari, 2018). The UN Transfer Pricing Manual similarly asserts that an optimal multinational enterprise is one capable of exploiting resources to generate goods or services with the greatest possible economic value (United Nations, 2021). In line with this reasoning, the author contends that such criteria can serve as a countermeasure against tax avoidance practices involving Base Erosion and Profit Shifting (BEPS), which seek to increase costs and reduce profits in a particular tax jurisdiction an approach fundamentally inconsistent with sound economic principles.

From the interviews conducted with several parties concerning the subject of passive association, the author obtained a number of references that may serve as the analytical basis for identifying the characteristics that are economically justified to warrant remuneration. The fundamental guiding question used as a point of reference is: what criteria would lead an independent entity, from an economic standpoint, to be willing to provide remuneration for services performed by another independent entity

The first finding identified by the author is “Value Creation.” Darussalam et al. (2022) explain that value refers to the significance, utility, or benefit of an object as determined by the party seeking to utilize it. Ordinarily, a company will focus on value creation as part of its business activities, either through the development of products or the provision of services, with the ultimate objective of generating profit.

In the context of transfer pricing, value creation is employed to clarify the criteria by which profit shifting may be deemed inappropriate, namely by assessing whether value is actually generated within a given jurisdiction (Das, 2020). This concept serves to direct attention to the substance of an activity or transaction. From the perspective of an independent entity, payment would only be made for services that are perceived to deliver value commensurate with the costs incurred. This once again reflects the economic principles and decision-making rationale of such an entity. The value generated through the provision of services constitutes a commodity that may legitimately be remunerated by the party benefiting from those services.

In the case of intra-group service transactions, the value sought lies in the benefit derived from the service. As stated in the OECD Transfer Pricing Guidelines, such benefit is that which is capable of enhancing or maintaining an entity’s business position in the market. The interpretation of this provision is that, in assessing the eligibility of a service for remuneration, the relevant consideration is whether the service provides a positive impact on the business operations of the recipient entity. These positive effects may take various forms, including increased sales, cost efficiencies, or improved profitability.

Specifically with respect to financial guarantees, Chapter 10, Section D of the OECD Transfer Pricing Guidelines elaborates on the potential benefits arising from the provision of such guarantees. The benefits that materialize when an entity receives a guarantee service include: (1)

more favorable loan terms, and (2) increased access to higher borrowing limits. When a guarantee is provided by a party with a strong credit rating to another entity, financial institutions are likely to perceive the loan application as carrying lower risk compared to the scenario in which no guarantee is present.

In addition to value creation, the second element identified by the author as a basis for analyzing the characteristics that are economically justifiable for remuneration is the presence of functions, assets, and risks (FAR). The 2021 UN Transfer Pricing Manual similarly emphasizes that an “active” condition can be substantiated by the existence of deliberated concerted action—activities carried out with deliberate consideration. This concept encompasses the performance of functions, the use of assets, or the assumption of risks by one affiliated entity for the benefit of one or more related entities (United Nations, 2021). This reasoning is consistent with the logical premise that an independent entity would demand payment for functions it performs, assets it employs, or risks it assumes. Conversely, the counterparty would also be willing to provide remuneration once it is established that functions have been performed, assets have been utilized, or risks have been transferred.

Specifically in the case of financial guarantees, the guarantor assumes the risk of covering the debt should the guaranteed party fail to fulfill its repayment obligations. Any type of risk undertaken constitutes a characteristic that justifies the imposition of a guarantee fee. This aligns with the economic concept that remuneration should be commensurate with the level of risk assumed: the higher the risk, the greater the return that should be obtained, and vice versa.

In addition, it is essential to note that the existence of functions, assets, and risks associated with the provision of intra-group services must be properly documented and supported by reliable data. From a practical standpoint, the evidentiary aspect is of paramount importance, particularly when testing the arm’s length nature of transfer pricing arrangements. From these two analytical bases, the characteristics of intra-group services that merit remuneration can be identified. An intra-group service may be classified as a form of active association (as opposed to passive association) when the transaction has a clear objective of value creation and when the service involves the performance of functions, the use of assets, and the assumption of risks that justify compensation to the service provider.

The Alignment of the Tax Court’s Ruling on the Adjustment of PT SCI’s Guarantee Fee with the Arm’s Length Principle

During the court proceedings, the author observed that PT SCI and the Directorate General of Taxes (DGT) engaged in arguments primarily on the issue of existence, disputing the evidence and the economic benefits of the guarantee fee paid by PT SCI to its parent company. Throughout the hearings, there was no discussion of passive association, which should have been a significant point of consideration in analyzing the fairness of an intra-group service transaction. Unfortunately, the proceedings remained entirely focused on the debate over economic benefits, without providing clarity as to which party prevailed on this issue.

With respect to the benefits of an intra-group service transaction, both the DGT and PT SCI should have referred to evidence grounded in the arm’s length principle. The author observed that the analysis of the economic benefits of the guarantee fee transaction was carried out sporadically by both parties and lacked structure, resulting in neither side presenting a dominant argument. On the one hand, PT SCI asserted that all supporting documentation had been submitted during the proceedings, yet without a holistic presentation of arguments from an academic perspective. On

the other hand, the DGT repeatedly argued that the supporting data provided by PT SCI was insufficient, without clarifying what was lacking or what additional evidence would have been required for the DGT to accept PT SCI's claims.

Referring to the previous analysis, in order to determine whether a service falls under the category of passive association or not, it is necessary to conduct an examination of the following elements: value creation and an analysis of the existence of functions, assets, and risks associated with the performance of the service, in this case with respect to the provision of a guarantee.

With respect to value creation, several aspects may serve as the basis for assessment, namely the background of the loan, the borrower's risk profile, and the analysis of conditions before and after the guarantee was provided. In the context of PT SCI's case, the loan submitted to the bank was intended for working capital purposes. This objective is, in principle, a reasonable justification for an entity to apply for a loan. Nevertheless, during the trial proceedings, PT SCI did not present a clear calculation concerning the exact amount of the required loan, thereby weakening the argument regarding the rationality of such loan application. Furthermore, in terms of the borrower's risk profile, PT SCI is a manufacturing company with relatively simple functions, limited to slitting and shearing activities. This condition results in the company possessing relatively few assets. Consequently, PT SCI's ability to obtain financing from financial institutions without the provision of a guarantee from its parent company was highly unlikely. This factor can be regarded as an economic justification for the parent company's guarantee, thereby reinforcing the relevance of applying a value creation analysis in assessing the arm's length nature of the guarantee fee paid by PT SCI.

However, this statement was not substantiated by evidence demonstrating the condition prior to the provision of the guarantee. Correspondence from the bank indicating that PT SCI required an external guarantee could have served as supporting documentation to strengthen such a claim. Finally, with respect to the analysis of the borrower's condition before and after the provision of the guarantee, PT SCI did not present a sufficiently detailed argument. Nevertheless, from a logical standpoint, such an assertion may still be accepted, since the existence of a guarantee should reasonably be expected to enhance the borrower's creditworthiness and provide the opportunity either to obtain a higher loan amount or to secure a lower interest rate compared to the circumstances prior to receiving an external guarantee.

With respect to the analysis of the existence of functions, assets, and risks associated with the provision of services, it is necessary first to consider the ordinary characteristics of guarantee services. Guarantee services inherently involve risks that justify the entitlement to remuneration. When a risk is demonstrably transferred from the guaranteed party to the guarantor, the guarantor thereby obtains a clear and legitimate basis for charging service fees to the guaranteed party. In the case of PT SCI's tax dispute, the risk of loan default was explicitly and demonstrably assumed by its parent company.

This claim is further substantiated by the existence of a loan agreement between PT SCI and the bank, as well as a guarantee letter between PT SCI and its parent company. According to the explanation provided by PT SCI's tax consultant, both documents contain clauses that explicitly stipulate the transfer of risk from the subsidiary to its parent company. Therefore, under the functional, asset, and risk analysis, PT SCI's parent company holds a strong justification for being entitled to remuneration in the form of a guarantee fee.

In the event that PT SCI were able to present sufficient supporting evidence for its arguments, the guarantee fee paid by PT SCI to its parent company should, in substance, be regarded as a

reasonable and normal transaction for a corporation. The remuneration provided by PT SCI to its parent company should not have been subject to adjustment by the DGT, as it was already consistent with domestic regulations in Indonesia as well as with international guidelines. Unfortunately, during the court proceedings, the supporting evidence relating to these arguments was not sufficiently convincing for either the respondent or the panel of judges, and therefore the adjustment was upheld in the Tax Court's Appeal Decision.

Regardless of the arguments presented by PT SCI or the DGT, the panel of judges advanced its own reasoning in deciding the tax dispute involving PT SCI. The argument put forward by the judges was that "in essence, the provision of the guarantee was for the benefit of the affiliated party itself as the shareholder of the Appellant, and therefore the Appellant should not also be burdened with a guarantee fee." In the author's view, however, this reasoning contradicts the fundamental concept applied in assessing the arm's length principle, namely the concept of the separate legal entity.

The concept of the separate legal entity mandates that each affiliated entity must be assessed independently, such that the group relationship should not be taken into account when testing the arm's length nature of the remuneration. This is also affirmed by the UN TP Manual 2021, paragraph 9.8.6, which explicitly states that when applying the arm's length principle, the first step is to treat affiliated entities engaged in financial transactions as if they were independent entities dealing with each other at arm's length (United Nations, 2021).

Therefore, the author contends that the reasoning advanced by the panel of judges in deciding the tax dispute involving PT SCI is inconsistent with the arm's length principle. This inconsistency arises both from the approach adopted by the judges in adjudicating the dispute and from their inability to establish what evidentiary requirements should have been demonstrated during the proceedings, which in turn rendered the arguments of the disputing parties sporadic and lacking in structure.

CONCLUSION

The main findings of this research demonstrate that the credibility of the National Nutrition Agency's Instagram account exerts a significant positive influence on public awareness regarding the Free Nutritious Meal Program. This relationship is primarily mediated by perceived usefulness, which strengthens the impact of account credibility on public awareness, highlighting the importance of content that audiences find beneficial. Digital literacy also plays a role as a borderline mediator, indicating that the ability of audiences to access and evaluate digital information is a crucial factor in the effectiveness of government health communication. The structural model tested using Generalized Structured Component Analysis (GESCA) shows a good fit and explains more than 50% of the variance in public awareness, thereby reinforcing the validity of these findings in the context of digital government communication.

However, this study is limited by its use of purposive sampling focused on Generation Z and millennial Instagram users in Indonesia, which may restrict the generalizability of the results to broader populations or other social media platforms. Additionally, the measurement of digital literacy remains general and does not delve into specific aspects related to health content. Future research should expand the sample to include diverse demographics and digital platforms, as well as develop more specialized instruments for measuring digital literacy in the context of health communication. The practical implications of this study emphasize the need for government social media accounts to maintain high credibility, produce relevant and useful content, and promote

digital literacy among the public to enhance the effectiveness of digital health communication and increase public awareness and participation in strategic programs such as free nutritious meals.

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