

Navigating the Transfer Pricing Challenges with Offshore Vessels



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Background

As offshore energy operations expand rapidly in the Middle East, specialised vessels are increasingly indispensable to the sector's success.

Typically, these assets are owned by overseas entities within the same group and are chartered on a bareboat basis to group vessel operators.

The operator then equips the vessel with **fuel**, **crew**, and the necessary **equipment** to provide services directly to third-party clients on a time charter basis.

Given that these vessels are often the most valuable asset involved in delivering the contract, the pricing of the intragroup bareboat charter demands careful consideration.



Transfer Pricing Outcomes for Bareboat Charter

A key aspect of determining appropriate remuneration for a bareboat charter is the functional and risk profiles of the vessel owner and vessel operator.

The level of responsibility the vessel owner and the vessel operator assumes directly impacts the type of return they may receive.

On one end, a vessel owner who is **actively managing** the asset and associated risk could command a much higher return, potentially a residual profit.

On the other, a vessel owner with **limited involvement** may receive a low-risk, fixed return, while the vessel operator earns the residual profit.

This variability underscores the importance of evaluating each arrangement based on specific facts and circumstances.



A one-size-fits-all approach is unlikely to yield defensible results, and insufficient consideration of these factors could expose companies to significant Transfer Pricing risks and ultimately a tax authority challenge.

Characterisation of Vessel Owner and Vessel Operator

Vessel Operator as Limited Risk Service Provider

In some cases, the vessel owner may take on substantial responsibilities, such as:

Making decisions around the **purchase, upgrades, or disposal** of the vessel.



They may also specify the **design** of the vessel to meet the needs of specific regions or clients and manage utilisation strategies over both the short and long term.



This involvement exposes the vessel owner to **higher levels of risk** and **necessitates active management**, including handling potential underutilization or shifts in market demand. Such an active role can justify higher remuneration, potentially entitling the owner to **residual profits**.

In contrast, the vessel operator in this scenario would typically undertake routine technical and engineering activities and not manage economically significant risks, leaving the operator with a routine return on its activities.



Characterisation of Vessel Owner and Vessel Operator

Vessel Owner as Limited Risk Asset Holder

On the other hand, if the owner's role is limited to providing the vessel as **a physical asset** without engaging in management or strategic decision-making, their role resembles that of a mere asset holder. In this case the vessel operator would typically undertake the value adding activities set out above, as well as, manage the economically significant risks.

Vessel owners in this position are often **shielded** from **utilisation risk** by entering into long-term bareboat charter agreements, further reducing their risk exposure.



In this case, the owner compensation may be limited to a risk-free return, reflective of their passive role, or in some instances the legal owner may not be considered the beneficial owner of the vessel at all due to the place of effective management rules.



In contrast, the vessel operator in such a case, would bear and manage the economically significant risks and therefore typically earn a residual profit.



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Benchmarking Challenges

Adding to the complexity is the challenge of finding reliable comparables.



Few companies provide similar assets on a bareboat charter basis to third-party customers, making market-based benchmarking nearly impossible.



Consequently, bareboat charter transactions are often limited to intragroup arrangements, creating a significant gap in available external comparables.

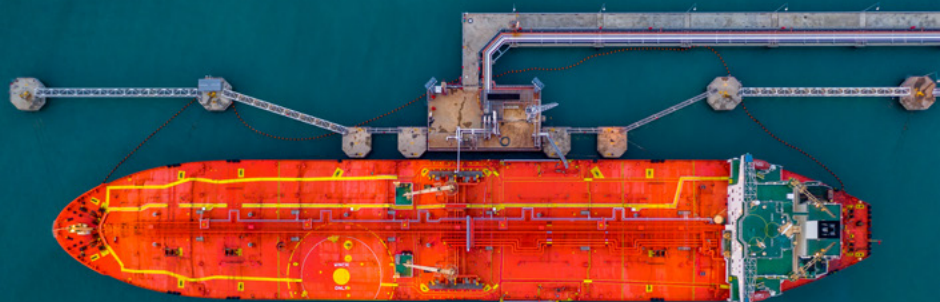
Furthermore, due to the level of capital expenditure required, typically companies owning and operating such assets are part of large multinational groups, therefore, influenced by transfer prices.



This lack of comparables forces companies to justify the arm's-length nature of the remuneration based on alternative data.

This can be achieved either through use of comparable uncontrolled prices ("CUPs"), discounted cashflow model, or industry-wide datapoints, e.g. return on asset or return on investment.

While the alternative approaches offer a helpful reference, they are not without comparability limitations, e.g. due to geography or vessel specifications, which can materially skew the results or require specific adjustments to improve comparability.



Key Takeaways

Document Functional Profiles and Risks

Clearly capture the activities and risk profiles of the vessel owner and vessel operator, as this will support the rationale for the Transfer Pricing model. Detailed discussion of economically significant risks in respect of the vessel is required to substantiate the analysis.

Assess and Support Remuneration Policy

Define and evaluate remuneration ranges based on the functional and risk profiles of the vessel owner and vessel operator.

Support the Transfer Pricing policy adopted with reliable datapoints, which are relevant to the functions undertaken and risks managed by each party.

For instance, it may be appropriate to support remuneration for a limited risk service provider with a benchmarking study or a discounted cashflow model for a limited risk asset holder.

Stay Proactive with Regional Tax Compliance

Align Transfer Pricing policies with Middle Eastern tax authority expectations.

Regularly update documentation to reflect evolving regional tax requirements.

Tax authorities in the Middle East region have raised several challenges and concerns regarding bareboat charter payments made to overseas affiliates.

Be prepared for a tax authority audit and consider proactive engagement through **Advanced Pricing Agreement** programmes available in **KSA**, the **UAE** and **Egypt**, where taxpayers may be able to obtain certainty in terms of the acceptability of their BBC Transfer Pricing policy by the local tax authorities and lock that position in for future years.





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