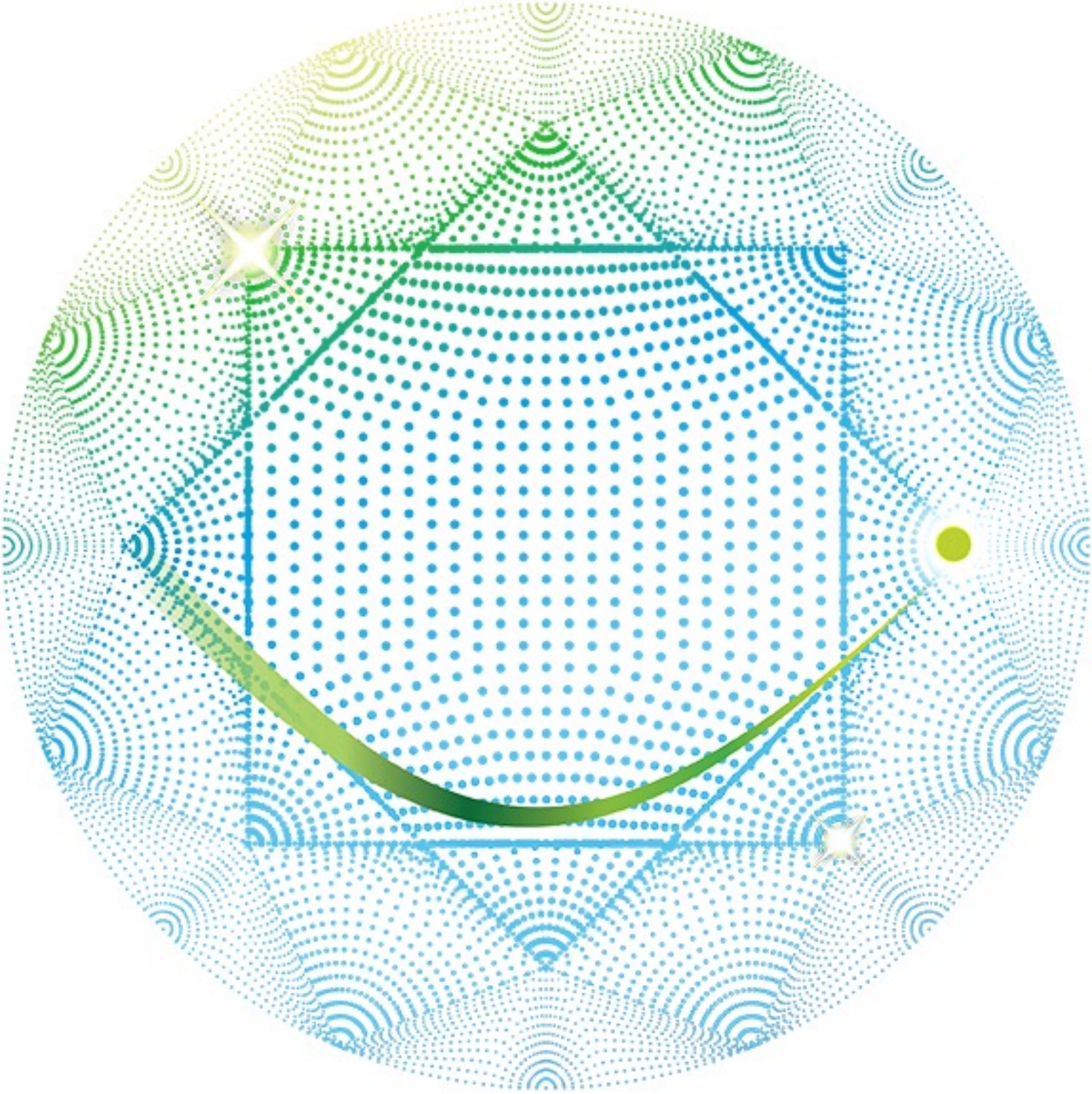

Transfer pricing implications for the maritime shipping industry – a gcc perspective

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Table of content

The maritime shipping industry

The maritime shipping industry is crucial for global logistics, handling 80-90% of worldwide merchandise trade. It primarily operates in the Business-to-Business (B2B) space, transporting goods, raw materials, and commodities across international ports and terminals. As a key component of global trade, it ensures the smooth flow of essential resources.

This article focuses on the Gulf Cooperation Council (GCC) region, highlighting the transfer pricing challenges faced by industry players and the emerging trends shaping this dynamic sector.

Overview of global maritime shipping

The global maritime shipping industry, valued at around $300 billion in 2022, plays a vital role in global trade. Despite a decline of 0.4% in trade volumes in 2022, the industry is projected to grow over 2% annually until 2028, underscoring its resilience.

The industry is categorized by cargo types such as containerized goods, dry bulk (coal, iron ore), liquid bulk (oil, gas), and specialized items (vehicles, machinery). Key players like Maersk, Mediterranean Shipping Company ("MSC"), and Compagnie Générale Maritime ("CMA CGM") dominate with extensive networks and services, shaping the competitive landscape.

Overview of Middle East maritime shipping

In 2023, the Middle East maritime shipping market reached $20 billion, driven by key players like DP World and the Saudi Ports Authority. The region's strategic location is fueling its projected growth to $37.19 billion by 2028, with a 13.14% Compound Annual Growth Rate (CAGR).

Key players include:

1 Ports and Authorities: DP World (UAE), Suez Canal Authority (Egypt), Saudi Ports Authority (KSA), Asyad Group (Oman), King Abdullah Port (KSA).

2 Shipping Companies: Bahri (KSA), United Arab Shipping Company (UASC) (UAE), Milaha (Qatar), Oman Shipping Co.,(Oman) and others.

Figure 1 below showcases the impressive growth trajectory of the Middle East maritime shipping market growing from $11.12 billion in 2018 to $20.06 billion in 2023, with a 12.52% CAGR. This growth, projected to continue at 13.14% CAGR until 2028, is driven by tech advancements, port investments, and the region's strategic role in global trade.

Maritime shipping, as a key component of logistics, directly influences supply chains and regional logistics operations. Technological advancements, infrastructure investments, and the region's global trade role are critical for stakeholders optimizing supply chains. In the next section, we explore the correlation between maritime shipping and logistics.

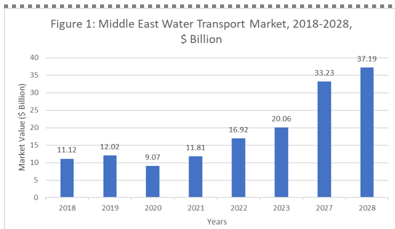
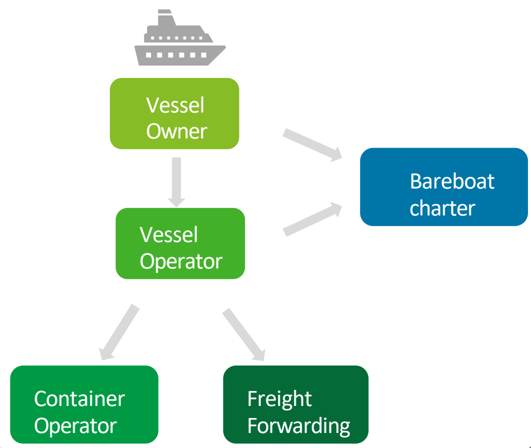


Figure 1: Middle East Water Transport Market, 2018-2028, $ Billion

Maritime and logistics correlation

Maritime and logistics are deeply interconnected, with several key service providers in the maritime shipping industry:

1. **Vessel Owner:** Owns the ship and may either transport goods or lease the vessel on a voyage or time charter basis.
2. **Vessel Operator/Feeder Service Providers:** Acquires vessels through charter from the vessel owner.
3. **Container Operator:** Manages the movement of cargo containers between vessels and transport vehicles.
4. **Freight Forwarder:** Coordinates shipping from pickup to delivery, including customs, insurance, warehousing, and packaging. They may issue Bills of Lading or Air Waybills.
5. **Bareboat Charter:** A lease agreement where the charterer assumes most of the owner's customary liabilities.



Tax and transfer pricing integration in maritime shipping

The maritime shipping industry operates within a complex supply chain consisting of various stakeholders, governed by International Commercial Terms (incoterms) and contractual agreements that outline responsibilities, costs, and risks between sellers and buyers in international trade.

Key incoterms

1. **Free Alongside Ship (FAS):** Seller delivers goods alongside the ship at the port; the buyer assumes all risks and costs from that point.
2. **Free on Board (FOB):** Seller covers costs until goods are loaded onto the vessel; after loading, the buyer takes over costs and risks.
3. **Cost and Freight (CFR):** Seller pays for transport to the destination port, but the buyer assumes risks from that point.
4. **Cost, Insurance and Freight (CIF):** Same as CFR, but the seller also pays for insurance. The buyer handles customs and final delivery.

Key aspects of the supply chain model

1. **Complex Value Chain:** The involvement of multiple stakeholders, such as ship owners, charterers, and freight consumers, each playing distinct roles.
2. **Inter-relationships and Contracts:** Charter-party agreements (spot, time, and bareboat charters) govern operations, risk allocation, and financial transactions.
3. **Operational Efficiency:** Management companies act as intermediaries to ensure regulatory compliance and optimize vessel usage, enhancing supply chain efficiency.
4. **Tax Compliance:** Non-resident shipping companies must comply with tax laws in various jurisdictions, making compliance crucial for seamless supply chain operations.

Impact of supply chain changes on transfer pricing

1. **Recalibration of Supply Chain Models:** Multinational shipping companies need to reassess the functional and risk profiles of related entities and adjust intercompany pricing structures as supply chains evolve.
2. **Risk Allocation:** Entities such as limited risk distributors, previously insulated from significant risks, may now undertake greater risks. Transfer pricing should appropriately compensate these entities.
3. **Regionalization of Logistics Hubs:** As logistics hubs and management personnel become regionalized, it is necessary to review which group entities make key business decisions. These entities should be remunerated based on their contribution to the value chain.

Transfer pricing analysis is essential to reflect the allocation of risk ensuring that transactions between related parties adhere to the arm's length principle, promoting fair taxation and preventing profit shifting.

Taxation and subsidies in shipping

In the maritime shipping industry, various taxation regimes and subsidies play crucial roles in defining the financial and operational landscape for Multinational Enterprises (MNEs).

1. **Tonnage Taxation** An example is the tonnage tax scheme, exempting shipping companies from corporate income tax and taxing them based on the net tonnage of their fleets rather than actual profits. This system simplifies compliance and offers reassurance of certainty in tax matters. Many European Countries have tonnage tax schemes prevalent from many years, supporting growth and stability in the shipping sector.
2. **Flag of Convenience** Flags of Convenience (FOCs) allow shipping companies to register their vessels in countries with lenient regulations and favorable tax environments, such as Panama, Liberia, and the Marshall Islands. These jurisdictions often have more relaxed enforcement of labor and safety standards, reducing overall operational costs further for the MNEs.

In summary, understanding the nuances of tax subsidies is crucial for MNEs in the maritime shipping industry to manage their tax obligations effectively while remaining competitive globally.

Transfer pricing issues in maritime shipping

Shipping companies often operate through Associated Enterprises (AEs) acting as shipping agents, handling activities such as booking, documentation, and container management. Various remuneration models and transfer pricing issues arise in this sector, including agency commission, net revenue split, rate card model, cost plus model, and bareboat charter arrangements.

Agency commission

The first remuneration model discussed is agency commission. Shipping agents, acting as AEs, handle local cargo activities such as booking, documentation, and container management. The agency commissions are usually charged based on a percentage of the freight income received by the principal shipping line. Transfer pricing implications arise due to fluctuating commission rates and the lack of publicly available data for comparison. Taxpayers often use the Transactional Net Margin Method (TNMM) to assess compliance. However, if the agent's profits differ significantly from industry peers, transfer pricing adjustments may be required. Robust transfer pricing documentation and comparability analysis are essential to substantiate the arm's length nature of commission arrangements.

Net revenue split

The second remuneration model discussed is the net revenue split. Under this method, revenue from customers is split between origin and destination companies after deducting third-party costs. The revenue split is typically on a 50:50 basis, but variations may occur based on varying contributions to business generation. Transfer pricing implications arise from demonstrating the arm's length nature of the revenue split between AEs. Important factors to consider include consistency of terms and conditions, revenue split information, and material geographic differences. The internal Comparable Uncontrolled Price (CUP) method is often applied to assess the arm's length nature of controlled transactions. Additional support through the TNMM using the Operating Profit to Value-Added Expenses (OP/VAE) ratio as the profit level indicator can ensure accurate profitability assessment within the industry.

Rate card model

The third remuneration model discussed is the rate card model. This model involves different rates between group companies in different countries to facilitate coordination functions. Defending this model using the CUP method becomes challenging due to varying rates across countries. Hence, the TNMM is often employed to assess the arm's length nature of these intercompany transactions. By focusing on the VAEs incurred by the freight forwarder rather than pass-through costs, such as local shipping and customs charges, a clearer measure of the freight forwarder's performance can be obtained.

Cost plus model

The fourth remuneration model discussed is the cost-plus model. In this model, one member of the multinational group acts as the principal entity, compensating other group members on a cost-plus basis. The principal entity enters into contracts with customers and subcontracts parts of the transactions to its subsidiaries across various countries. Transfer pricing implications arise from ensuring that entrepreneurial risks and rewards are borne by the principal entity. Although this model is not widely prevalent, careful consideration should be given to allocating profits appropriately and implementing clear cost allocation methodologies.

Bareboat charter

The fifth remuneration model discussed is the bareboat charter. This model involves the operator of a Mobile Operating Drilling Unit (MODU) utilizing assets from related parties to provide offshore drilling services. Transfer pricing implications arise from ensuring the legal form of the bareboat charter services aligns with the substance, and comparable independent third-party providers of technical services are used for benchmarking. The TNMM, specifically the Return on Sales (ROS) as the Profit Level Indicator (PLI), is often employed to evaluate related party transactions against selected comparables.

The maritime shipping industry faces various transfer pricing issues due to remuneration models and complexities in determining arm's length pricing. Robust transfer pricing documentation, comparability analysis, and the use of appropriate methods such as TNMM and CUP are essential to substantiate the arm's length nature of transactions. By carefully considering the specific circumstances, market conditions, and value-added activities performed by the entities, shipping companies can navigate these transfer pricing challenges effectively.

Emerging trends in maritime shipping

Offshore shipping services hubs

Offshore shipping service hubs have gained importance in the maritime industry, leading tax authorities to issue compliance guidelines for assessing associated risks. A modified cost-plus approach is preferred for evaluating hub-related risks, focusing on operating costs linked to providing or organizing shipping services for related parties. For hubs combining marketing and shipping functions, separate risk assessments are recommended.

Carbon pricing for shipping industry

Carbon pricing presents challenges for the adoption of zero-emission ships due to cost disparities, and transfer pricing policies must align carbon pricing costs and revenues with the arm's length principle. Multinational Enterprises (MNEs) in maritime shipping need to document how carbon pricing impacts their transfer pricing arrangements to ensure compliance.

Conclusion

In conclusion, the maritime shipping industry in the GCC region is a significant and growing market, underpinned by technological advancements and strategic geographical importance. The future outlook remains positive, with expected continued growth and further integration of advanced technologies to enhance efficiency and safety in maritime operations.

With emerging trends in the maritime shipping industry, especially surrounding offshore shipping service hubs and carbon pricing for shipping, actors in the industry must maintain awareness of these shifts, adjusting accordingly while keeping abreast of compliance requirements.

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