Transfer pricing issues related to projects involving the use in Australian waters of non-resident owned mobile offshore drilling units – ATO compliance approach

Relying on this Guideline

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this Guideline in good faith, the Commissioner will administer the law in accordance with this approach.

Table of Contents **Paragraph**

What this Guideline is about 1
Date of effect 19
Who to contact 21
The risk framework for offshore drilling and associated activities 23
Arrangements to which this Guideline applies 23
The ATO's role and compliance approach 26
Risk assessment framework 30
Do you need to self-assess your risk rating? 34
How to self-assess your compliance risk 41
Profitability risk indicators 43
Contract revenue risk indicator 46
How to decrease your risk rating 48
Transitioning existing arrangements to the green zone 53
Reporting your risk rating 61
Outcomes of your risk rating 62
What you can expect if you are in the green zone 63
Limited compliance activity 64
Advance pricing arrangement program if within the green zone 67
Outside the green zone 68
What to expect if you are outside the green zone 68
Review and audit proceedings 71
What you can expect from the ATO's compliance activities 71

What this Guideline is about

1. This Guideline sets out the ATO's compliance approach to transfer pricing issues for projects involving the use in Australian waters of non-resident owned mobile offshore drilling units (MODUs) such as drill-ships, drilling rigs (including but not limited to submersibles, semi-submersible and jack-up rigs), pipe-laying vessels and heavy-lift vessels.

2. While typically these assets are the subject of lease-in lease-out arrangements whereby the asset is sourced from the non-resident owner via a chain of related party bareboat leases, the scope of this Guideline may also include related party bareboat leasing direct from the non-resident (legal or in-substance) owner. This Guideline addresses transfer pricing issues related to the use of these assets in Australian waters by the Operator, be it one or more of:

- an Australian tax resident, or
- a non-resident entity with a permanent establishment in Australia.[1]

3. References in this Guideline to 'the Operator' are intended to include the entity or entities who ensure the performance of the drilling (or similar) contract in satisfaction of the project specifications, coordinating both the MODU and highly skilled personnel (who operate the MODU). If you are an Operator performing these functions, this framework is intended to assist you assessing your compliance risk and understanding the ATO's compliance approach for these activities.

4. Unless otherwise specified, references in this Guideline to the Australian operations, arrangements, contract or project, and to Australian revenue, earnings, profits, losses and costs, are intended to refer to the entirety of the offshore drilling and associated activities of the Operator in Australia, and to amounts resulting from those activities. Accordingly, when considering for example, the profitability of the Australian operations, this may require the aggregation of the financial results of more than one entity to correctly apply the relevant risk indicator in this Guideline.

5. Some of the concepts presented in this Guideline may be applicable to activities other than offshore drilling but you should engage with us if you require further specific guidance in relation to activities other than offshore drilling and activities associated with offshore drilling.

6. This Guideline does not apply to:

- oil and gas production platforms, which are not engaged in any drilling activities and are permanently anchored to the ocean floor
- cable-laying vessels which lay telecommunications and electric power transmission systems, operating in a different industrial context, under quite different technical and regulatory conditions, risks and economic circumstances
- port works, such as hard-stand construction, dredging, rock-dumping, reclamation and associated activities, which involve quite different technical and regulatory conditions, risks and economic circumstances, or
- tax risks other than tax transfer pricing risk.

[1] Permanent establishment in Australia – be it actual or deemed (including, for example, a substantial equipment permanent establishment where the leasing of a vessel in Australian waters may result in an enterprise resident of the other country having a substantial equipment permanent establishment in Australia in accordance with the relevant permanent establishment article in the Double Taxation Agreement (examples include article 5(4)(b) of the United States Convention, article 5.3(b) of the United Kingdom Convention or article 5(4)(c) of the German Agreement).

7. Nor does the Guideline apply if the substance of the arrangements differs from their legal form.

8. You can use the framework set out in this Guideline to:

- assess the compliance risk of the transfer pricing outcomes of your offshore drilling and associated activities in accordance with the ATO's risk framework
- understand the compliance approach that we will likely adopt having regard to the risk profile of your offshore drilling and associated activities
- work with us to mitigate the transfer pricing risk in relation to your offshore drilling and associated activities and be confident you have reduced your risk exposure, and
- understand the type of analysis and evidence we use when assessing the transfer pricing outcomes of your offshore drilling and associated activities.

9. This Guideline provides a self-assessment risk framework that allows you to assess your transfer pricing outcomes using the ATO's risk framework. You will not need the ATO's input or sign off on your risk rating. However, you may be asked to tell us if you have self-assessed your rating and if so, what your risk rating is. At the same time it is acknowledged that you may require confirmation from the ATO regarding the applicability of the risk framework to your circumstances and activities.

10. The application of the risk framework allows us to differentiate risk, and prioritise our compliance resources.

11. It also allows us to tailor our engagement with you, having regard to the risk rating of your offshore drilling and associated activities. If your activities are assessed as being in the low risk zone you can expect that we will not generally apply compliance resources to test and assess the transfer pricing outcomes of those activities. If your activities fall outside the low risk zone, you can expect that we will monitor, test and/or verify the transfer pricing outcomes of your activities. The higher the risk rating of your offshore drilling and associated activities, the more likely they will be reviewed as a matter of priority.

12. This Guideline does not limit the operation of the law.[2] The information provided in this Guideline does not replace, alter or affect the ATO's interpretation of the law in any way. Nor does it relieve you of your legal obligation to comply with all relevant tax laws, one of which when pricing your arrangements is to use the transfer pricing methodology (or combination of methodologies) that is most appropriate and reliable for your circumstances.[3] Nor does this Guideline create any safe harbour or administrative concession.

13. It does not necessarily follow that having a low (that is, green) risk rating under this Guideline means that your transfer pricing outcomes are correct or that you have a reasonably arguable position. Equally, having a high (that is, red) risk rating under this Guideline does not necessarily mean that your offshore drilling and associated activities fail to comply with Australia's transfer pricing rules. Rather compliance with Australia's transfer pricing rules is a function of your particular facts and circumstances informed by arm's length conditions.

14. While there is no presumption that because your offshore drilling and associated activities are outside the low risk zone that your transfer pricing outcomes are incorrect,

[2] For example, this Guideline does not limit the operation of Subdivision 284-E of Schedule 1 to the *Taxation Administration Act 1953* (TAA) which sets out special rules about unarguable positions for cross-border transfer pricing.

[3] Subsection 815-125(2) of the *Income Tax Assessment Act 1997* (ITAA 1997).

being outside the low risk zone does mean that we consider that you are at risk of obtaining a transfer pricing benefit and therefore we may conduct further compliance activity to test the outcomes of your activities. In these circumstances it would be advisable to have transfer pricing documentation and supporting evidence for the position you have taken commensurate to the risk profile of your activities. As a general proposition, the higher your risk rating the more detailed and comprehensive we would expect your transfer pricing documentation and supporting evidence to be.

15. You should not rely on the profit markers used in this Guideline to determine arm's length conditions. This Guideline does not replace an appropriate comparability analysis, selection of the most appropriate method or proper application of the transfer pricing obligations under the law.

16. The risk framework used in this Guideline is for risk assessment purposes only, and there is no requirement that you use any particular transfer pricing method in order to comply with Australia's transfer pricing rules. Those rules require that the arm's length conditions are identified using the transfer pricing method (or combination of methods) that is the most appropriate and reliable in the particular circumstances, having regard to all relevant factors.

17. If your offshore drilling and associated activities are subject to further review, you can expect that we will test the actual pricing outcomes of your arrangement and will apply the most appropriate and reliable transfer pricing method for your particular circumstances. The ATO is not limited by this risk framework when testing the actual conditions and pricing of your offshore drilling activities for compliance with Australia's transfer pricing rules.

18. We prefer to take a 'prevention before correction' compliance approach and we are committed to working with you to help you mitigate your transfer pricing risks. Therefore, if you are unsure about your transfer pricing treatment or you would like certainty in relation to your arrangements, you should contact us for assistance.

Date of effect

19. This Guideline applies both before and after its issue.

20. The use and application of this Guideline will be reviewed for the first two years after finalisation. Any revisions to improve its efficacy will be made at the end of the review period or on an 'as necessary' basis. We will undertake consultation in relation to proposed material changes.

Who to contact

21. If you wish to discuss your offshore drilling and associated activities with us you may contact us at international@ato.gov.au.

22. Alternatively, if you have a dedicated ATO relationship manager you may approach them directly for assistance with your case.

The risk framework for offshore drilling and associated activities

Arrangements to which this Guideline applies

23. Arrangements for the supply of offshore drilling and associated services typically include the following features:

- A contract is negotiated and executed between the Operator of a MODU and an unrelated third-party client to perform offshore drilling (or similar) services and associated services in Australian waters. The Operator may

include one or more Australian tax residents and/or a non-resident entity with or without an existing presence in Australia.[4]

- The parties to the arrangement have agreed to the Australian legal system having jurisdiction in the event of a contractual and/or commercial dispute.
- The MODU, is made available to the Operator by a party related (directly or indirectly) to the Operator typically under one or a chain of bareboat charter arrangements. In many cases, the MODU may be supplied into Australia by a related party stand-alone leasing entity resident of a country with which Australia has a tax treaty.
- The MODU is operated by highly skilled personnel either employed by or under the control of the Operator. Those personnel (in particular core crew) not in the employ of the Operator are typically provided by a party related or connected in some way to the Operator.
- Other services (for example, technical and procurement services) required to complete the contract may also be provided by a party related in some way to the Operator.

24. The nature of the Operator's taxable presence in Australia may differ between arrangements. For example, the taxable presence may be a separate legal entity, resident in Australia or a tax resident of another jurisdiction operating at or through a permanent establishment in Australia or multiple entities.[5] The nature of the Operator's taxable presence in Australia should not impact the ATO's approach to risk assessment for the purposes of this Guideline as it is concerned with the Australian operations comprising the entirety of the offshore drilling and associated activities performed in Australia. In this context, activities associated with the offshore drilling could include input to attract and engage customers, secure contracts, contract management, engineering, procurement, health, safety and regulations, maintenance and vessel repairs, crewing services or office support.

25. This Guideline is premised on the basis that the legal form of your arrangements accords with their substance, and that entities acting independently would have entered into those arrangements in comparable circumstances. The comments and guidance provided by Taxation Ruling TR 2014/6 *Income tax: transfer pricing – the application of section 815-130 of the Income Tax Assessment Act 1997* will assist you in this regard. In particular, you should pay close attention to whether any of the exceptions[6] to the subsection 815-130(1) basic rule apply to your circumstances and consider adjusting your arrangement as appropriate (refer to paragraphs 44 to 61 of TR 2014/6). If the substance of your arrangements differs from their legal form, or if independent entities would not have entered into your arrangements in comparable circumstances, then this Guideline will not apply to you. Furthermore this Guideline does not apply if other tax risks beyond transfer pricing are identified as arising under the arrangements (for example, including but not limited to any potential application of the diverted profits tax).

The ATO's role and compliance approach

26. Australia's income tax law places an onus on taxpayers to self-assess their compliance with the tax transfer pricing rules on the basis that their related party arrangements represent a set of 'arm's length conditions' so that no transfer pricing benefit results.

[4] Refer to paragraph 2 of this Guideline.
[5] Refer to paragraph 2 of this Guideline.
[6] Refer to subsections 815-130(2) to (5) of the ITAA 1997.

27. In examining whether the outcomes of such arrangements comply with the transfer pricing rules, we may use a different transfer pricing method or different comparability data to that which you have used. Testing the results implied by a taxpayer's transfer pricing method through the use of a different transfer pricing method, and/or through the examination of different comparable arrangements or entities, is standard administrative practice when conducting transfer pricing risk analyses. We concentrate our efforts on international related party dealings that pose the highest risk of not complying with the transfer pricing rules.

28. Part of this approach involves assisting you to assess your risk exposure to compliance action and to work with you to mitigate any potential risk of you not complying with Australia's transfer pricing rules. This Guideline identifies indicators that are considered by us as low risk of not complying with the transfer pricing rules.

29. Importantly, this Guideline does not constitute a safe harbour and the information provided in this Guideline does not replace, alter or affect in any way the ATO's interpretation of the relevant law as discussed in various taxation rulings. It does not relieve you of your obligation to self-assess your compliance with all relevant taxation laws, but is designed to give you confidence that, if you apply this Guideline appropriately and align your arrangements with the low risk category, then we will generally not allocate compliance resources to test the transfer pricing outcomes of your arrangements.

Risk assessment framework

30. Our compliance approach will vary depending on the risk rating of your offshore drilling and associated activities. The following principles and profit markers will assist you to understand how we assess risk of such related party arrangements thereby enabling you to self-assess your compliance risk. The risk framework is made up of four risk zones. As noted in paragraph 14 of this Guideline, falling outside the low risk zone has no bearing on whether your arrangements are transfer pricing compliant under the law. Rather it is used by the ATO as a risk indicator which when triggered means we will generally conduct some form of compliance activity to further test the taxation outcomes of your offshore drilling and associated activities. The higher the risk rating, the more likely they will be reviewed by us as a matter of priority.

31. We may ask you to tell us in writing whether you have reviewed the compliance risk of your offshore drilling and associated activities and which risk zone you believe your arrangements fall within. You may be required to inform us which risk zone you believe you fall within via the Reportable tax position schedule.

32. If we conduct a review, we may take account of other factors beyond those contained in this Guideline. This is because we will need to evaluate, among other things, the evidence that supports the commerciality of your arrangements.

33. Our risk framework for offshore drilling and associated activities is made up of four risk zones:

Risk zone	Risk level
White zone	self-assessment of risk rating is not necessary
Green zone	low risk
Amber zone	moderate risk
Red zone	high risk

Do you need to self-assess your risk rating?

34. This Guideline's risk assessment framework will apply to your offshore drilling and associated activities (note that you may be obliged to fill in the Reportable tax position schedule or the ATO may request that you apply the risk assessment framework).

35. However in certain circumstances the risk assessment framework will not apply, for example, where we have already reviewed your relevant activities and the transfer pricing outcomes have been agreed, are considered low risk or have otherwise been resolved. More specifically, it will not be necessary to apply the risk assessment framework to your offshore drilling and associated activities if your circumstances satisfy both (a) and (b):

(a) if

(i) you have an advance pricing arrangement (APA) covering these activities in the relevant year

(ii) there is a settlement agreement between you and the ATO covering these activities that applies to the relevant year, or

(iii) we have conducted a review of your relevant activities in the last two years and provided you with a 'low risk' rating (or a 'high assurance' rating in relation to justified trust)

AND

(b) there has been no material change in your transfer pricing approach and/or the functions, assets and risks of your offshore drilling and associated activities since the period reflected in the agreement or review.

36. When determining if you have received a low risk rating from us (as per paragraph 35(a)(iii) of this Guideline), you should only consider risk ratings provided after this Guideline has been issued. A risk rating may be provided by us through traditional review or audit activities or alternatively via 'sign off' letters provided under programs such as an annual compliance agreement, pre-lodgment compliance review or justified trust. For risk ratings provided by the ATO after this Guideline has been issued, you will only satisfy the criteria if the letter explicitly provides a low risk rating (or high assurance in the justified trust context) for the transfer pricing outcomes of your offshore drilling and associated activities.

37. If you satisfy the criteria in paragraph 35 of this Guideline, then you do not need to apply the self-assessment framework in this Guideline and you will be taken to be in the white zone.

38. If you are in the white zone, the ATO's compliance activity will depend on your particular circumstances. For instance, if you have an APA you will be subject to an annual compliance review process. Ordinarily you will be advised by us what future activities may be conducted at the conclusion of your matter. If you are unsure, you should discuss your particular circumstances with us.

39. Even if you are in the white zone, you are still required to assess your compliance with the transfer pricing rules contained in Division 815 of the ITAA 1997.

40. If you do not meet the criteria for being in the white zone, you should consider the following sections on how to self-assess the compliance risk rating of your offshore drilling and associated activities.

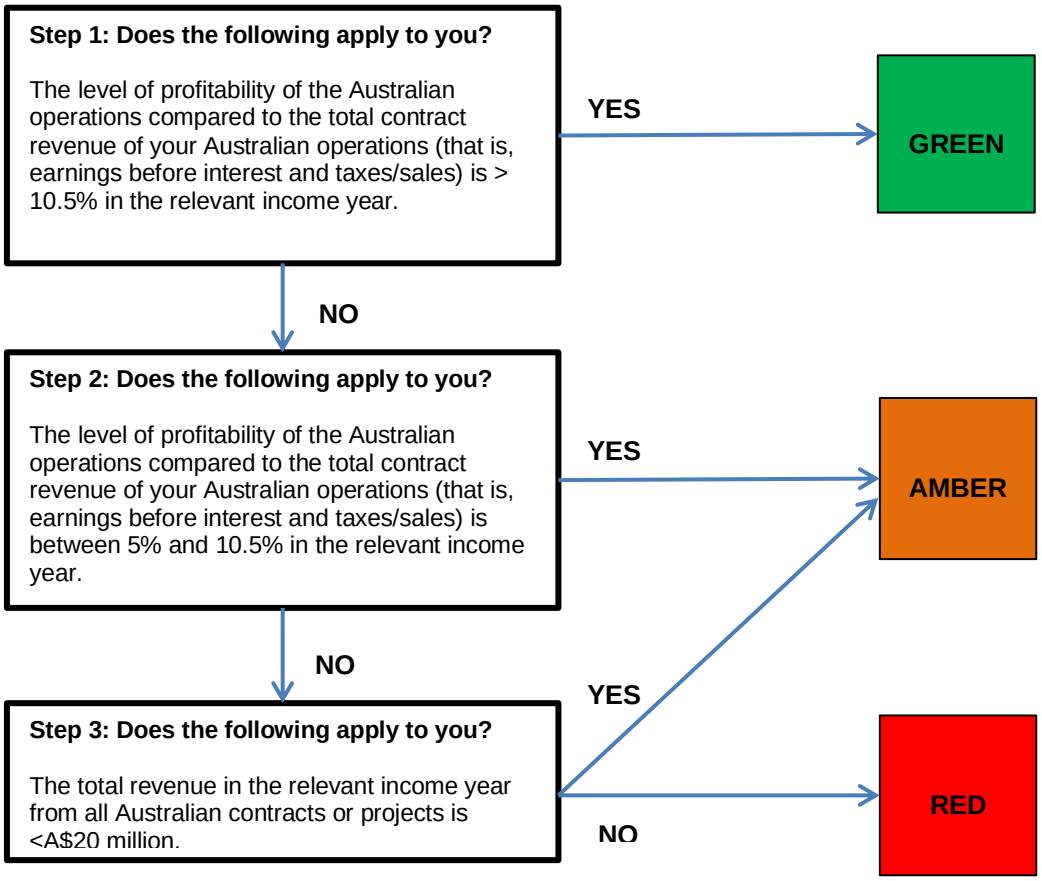
How to self-assess your compliance risk

41. In assessing compliance risk in relation to your transfer pricing approach for the relevant year, we will consider the following indicators:

(a) level of profitability of the Australian operations, and

(b) the materiality of your contract or project revenue.

42. The following flow chart provides a high-level summary of our risk classification process:



Profitability risk indicators

43. For the purposes of self-assessing your risk rating using this Guideline, you should compare the level of operating earnings derived from Australian operations to the total Australian contract revenue in the review period. In other words, you should convert the resulting Australian operating earnings derived to an equivalent operating margin (that is, EBIT[7] / sales[8]).

44. After deriving the operating margin outcome for the Australian operations for the relevant year, you should compare that level of profitability to the indicators provided in this Guideline. If the operating margin outcome for the Australian operations is:

- **10.5%** or greater you will be classified as being in the green zone – low risk
- **between 5% to 10.5%** you will be classified as being in the amber zone – moderate risk, or
- **5% or less** you will be classified as in either the amber (moderate risk) or red (high risk) zones, depending on the contract risk indicator discussed in paragraphs 46 and 47 of this Guideline.

[7] Earnings before interest and tax.
[8] Third party contract revenue.

45. The profit markers in this Guideline are provided to give you transparency in relation to the ATO's compliance approach. You should not use the profit markers as a safe harbour to adjust your arrangements so that you sit lower within a particular zone merely because it does not change your overall risk zone. We will monitor outcomes for offshore drilling and associated activities over time to ensure there is no unexplained change in your level of risk. Where we identify a change in your level of risk we may seek to understand the facts of your arrangement further.

Contract revenue risk indicator

46. If the profitability margin of the Australian operations is 5% or less, you will need to have regard to the amount of your contract revenue in Australia in the relevant year.

47. If you have less than A$20 million total contract or project revenue in the relevant year in respect of your Australian arrangements for the supply of offshore drilling and associated services then for the purposes of the risk rating in this Guideline you will be classified as being in the amber zone. This level of revenue does not warrant a classification in the red zone for the relevant year.

How to decrease your risk rating

48. If you are outside the green zone and would like to decrease your risk rating, you are able to do so by engaging cooperatively and constructively with us to gain greater confidence in relation to the transfer pricing outcomes of your offshore drilling arrangements. You will be able to move to the white zone if your case is resolved in a way that meets the criteria for the white zone (refer to paragraph 35 of this Guideline).

49. You may engage with us in a number of ways, including (but not limited to):

- applying for an APA, or
- if you have a client engagement team, working with this team to achieve a low risk rating.

50. An APA is 'an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (for example, method, comparables and appropriate adjustment thereto, critical assumptions as to future events) for the determination of the transfer pricing of those transactions over a fixed period of time'.[9] The Commissioner's practice and procedures in relation to APAs, including criteria to enter the APA program is set out in Law Administration Practice Statement PS LA 2015/4 *Advance Pricing Arrangements*. The APA program will take a 'whole of client' and 'whole of code' approach in deciding whether to proceed with an APA, meaning that all risks (not just offshore drilling risks) will be considered as part of the APA process.

51. Your risk rating will not preclude you and the Commissioner from entering into an APA. The level of analysis and supporting documentation you provide should reflect the complexity and materiality of tax at risk of your arrangement. In practice, we would expect that the higher your risk rating, the more in depth and comprehensive your analysis would be. If you provide insufficient evidence, such that the Commissioner considers there is a low likelihood of reaching agreement without expending considerable additional effort to properly understand the functions, assets and risks of the offshore drilling and associated activities and other relevant circumstances you will not be able to proceed in the APA program.

[9] OECD, 2010,*OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010*, OECD Publishing, Paris, paragraph 4.123.

52. You may also engage with your ATO client engagement team, who will work with you to provide you with confidence in relation to your compliance risk. At the conclusion of this review, the team will provide you with an ATO-assessed risk rating. The level of information required through this process will be tailored according to your specific circumstances and the risk profile of your arrangements. However, practically speaking, again, the higher your risk rating the more evidence you will be expected to provide to help us understand and test the transfer pricing outcomes of your offshore drilling and associated activities.

Transitioning existing arrangements to the green zone

53. We recognise that the publication of this Guideline may cause taxpayers to review their arrangements for offshore drilling and associated activities with the effect that some taxpayers may adjust the pricing of their arrangements going forward to come within the green zone.

54. If you have an existing arrangement and you intend to adjust your pricing to move within the green zone going forward, we are willing to work with you to resolve the 'back years' in a cooperative and practical manner.

55. In recognition that this is the first time that the ATO has publicly released guidance in relation to offshore drilling and associated activities, and to encourage willing and cooperative compliance going forward, for the period of 12 months from the date of publication of this Guideline, we will consider remitting shortfall penalties[10] to nil and shortfall interest charge[11] to the base rate if certain pre-conditions are met. The conditions are that you make a voluntary disclosure in relation to all income years where your arrangements are in place and adjust your historic and prospective pricing to reflect an appropriate transfer pricing outcome based on the law. If you do so, we will view this as a strong factor in favour of exercising the Commissioner's discretion to remit.[12]

56. You can inform us of your intentions to transition your arrangements at any time before you are notified of the commencement of an audit.

57. This undertaking is conditional on:

- the substance of your arrangements for offshore drilling and associated activities being consistent with their legal form, and not otherwise coming within the exceptions in subsections 815-130(2) to (5) of the ITAA 1997 referred to in paragraph 25 of this Guideline, and
- you making a full and true disclosure of the arm's length conditions based on the commercial or financial relations in connection with which the actual conditions of your arrangement operate.

58. If you are not proposing to adjust your back years to come within the green zone, you should contact us to discuss your arrangement as we will need to consider the

[10] Division 284 in Schedule 1 to the TAA.
[11] Division 280 in Schedule 1 to the TAA.
[12] The Commissioner's guidelines on remission of shortfall penalties are set out in Law Administration Practice Statement PS LA 2011/30 *Remission of administrative penalties relating to schemes imposed by subsection 284-145(1) of Schedule 1 to the Taxation Administration Act 1953*, Law Administration Practice Statement PS LA 2012/4 *Administration of the false or misleading statements penalty – where there is no shortfall amount*, Law Administration Practice Statement PS LA 2012/5 *Administration of the false or misleading statement penalty – where there is a shortfall amount*, Law Administration Practice Statement PS LA 2014/4 *Administration of the penalty imposed under subsection 284-75(3) of Schedule 1 to the Taxation Administration Act 1953* and PS LA 2016/2 *Administration of scheme penalties arising from the application of Subdivision 815-A for income years which started on or after 1 July 2004 and before 1 July 2012 (transition period)*. The Commissioner's guidelines on remission of shortfall interest charge are set out in Law Administration Practice Statement PS LA 2006/8 *Remission of shortfall interest charge and general interest charge for shortfall periods*.

particular facts and circumstances of your case. We accept that adjustments made to pricing to come within the green zone going forward do not create a presumption that the pricing of the arrangement for the back years is non-arm's length. However, you bear the onus to support your position with appropriate evidence. Approaching us voluntarily may also reduce your penalty and interest exposure should we determine that you obtained a transfer pricing benefit.

59. If you choose to take no action regarding your back years, you will be subject to the usual compliance approach for those years (that is, the approach outlined in this Guideline for arrangements outside of the green zone).

60. If your voluntary disclosure results in double taxation you may seek relief via the mutual agreement process. If this is relevant to you, you should discuss your circumstances with us.

Reporting your risk rating

61. We may ask you to tell us whether you have assessed the risk rating of your offshore drilling and associated activities, and inform us of your risk rating zone. Self-assessing your risk rating is voluntary, but if you opt out or are unable to self-assess we will ask you to advise us accordingly. You may also be asked to tell us your risk rating via the Reportable tax position schedule or we may write to you directly to ask you.

Outcomes of your risk rating

62. The remainder of this Guideline will help you to understand how the ATO's engagement with you will be tailored having regard to your risk rating.

What you can expect if you are in the green zone

63. If you are in the green zone, we will treat your arrangement as being at lower risk of not complying with Australia's transfer pricing rules. This means that we will generally not apply compliance resources to the arrangement (other than to confirm certain facts and to check that your arrangements fall within scope of this Guideline), minimising your compliance costs and providing practical certainty for your arrangement.

Limited compliance activity

64. If your arrangements for the supply of offshore drilling and associated services are in the green zone, we will generally not apply compliance resources to examine the transfer pricing outcomes of those arrangements. However, this does not constitute a safe harbour. It is important to note that being in the green zone does not relieve you of your obligation to comply with the transfer pricing rules. Your self-assessment responsibilities require you to consider whether or not you get a transfer pricing benefit from your arrangements for the supply of offshore drilling and associated services.

65. We will generally only apply resources to arrangements in the green zone to:

- verify your eligibility (that is, factually confirm the application of the risk indicators)
- confirm that you have performed all calculations in accordance with the ATO's guidance, and
- confirm the substance of your arrangements.

66. As noted in paragraph 45 of this Guideline, where we detect there to be an unexplained drift within a risk zone, we would apply resources to better understand the

factors at play and their impact on your arrangements that have contributed to that drift. The level of profitability associated with the low risk classification is not a proxy for an arm's length outcome and does not entitle you to increase or decrease your level of profitability to bring it into alignment with the low risk classification.

Advance pricing arrangement program if within the green zone

67. Being in the green zone does not preclude you and the ATO from entering into an APA. We do note, however, that if you are in this zone you may be less likely to request an APA in relation to your arrangements.

Outside the green zone

What to expect if you are outside the green zone

68. Our approach for arrangements outside the green zone will differ depending on whether your arrangement is within the amber or red zones.

69. The risk zone will determine:

- the priority and manner in which we will deal with your matter including the potential to access the APA program or assisted dispute resolution to resolve potential disputes
- the level of analysis and supporting evidence that we may seek from you, and
- the form a review might take.

With higher level risk matters (red zone) there is an increased likelihood for matters to proceed directly to audit (including the use of formal powers for information gathering) and potential litigation.

70. Where you are outside the green zone we encourage you to engage with us and discuss your position with your dedicated ATO relationship manager (where applicable) or otherwise contact us at international@ato.gov.au. When considering your position we will take into account the following:

- the quality of your transfer pricing documentation and supporting evidence
- market conditions, and
- your individual facts and circumstances.

Review and audit proceedings

What you can expect from the ATO's compliance activities

71. We will prioritise the ATO's compliance resources to deal with taxpayers involved in offshore drilling and associated activities that are assessed as having the highest risk of obtaining a transfer pricing benefit. We use a variety of products to review and assess the risk associated with your relevant activities. Compliance approaches may include monitoring, risk reviews and audits.

72. Generally, we will conduct a risk review to test and further assess the level of risk associated with your offshore drilling and associated activities before a decision is made to proceed to audit or not. Reviews and audits have separate processes and considerations to the risk framework set out in this Guideline (which provides the initial risk assessment). When we review your relevant activities it is not limited by the approaches, indicators or methods set out in this Guideline.

73. During a risk review we will assess the transfer pricing risk associated with your offshore drilling and associated activities in accordance with Australia's transfer pricing rules and whether they represent a significant risk. The most common types of reviews are comprehensive reviews where we review all of your business activities, and specific reviews where we review a single issue (such as the transfer pricing outcomes of your relevant activities). The type of review will depend on your particular circumstances.

74. Regardless of the type of review, when reviewing your offshore drilling and associated activities we will look to get an understanding of your:

- business arrangement in the context of your industry
- contribution to the creation of value and profit, and
- transfer pricing treatment.

75. As part of this exercise we examine all relevant information, starting with primary information in the form of any executed legal agreements and supporting information such as analysis set out in your transfer pricing documentation.

76. Regardless of the transfer pricing method you have applied to your arrangements, in testing the outcomes in a review or audit context we will most likely request documentary evidence including:

- contracts between you and your client, including any amendments or related agreements that detail any variations or material changes to those contracts
- bidding and tendering documents, including invitation to tender, scope of work, cost analysis and similar working papers. We may also ask for information on how your services are marketed to your potential clients, your marketing strategy/plan, how you develop and maintain customer relationships and the involvement of your operational staff in technical marketing
- invoices, payment and/or bank records to the extent necessary to account for all of the revenue associated with the contract, as amended and varied
- financial statements for all entities involved in the execution of the program of works to the extent necessary to account for all of the costs associated with the contract, as amended and varied, including those costs borne by related parties offshore
- organisational charts and summary information on employees involved in the execution of the contract, including but not limited to the names of key operating personnel, job titles, description of their roles and reporting lines within the company. We may also ask for information on qualifications, remuneration and years of service to assess the contribution being made by your assembled workforce
- project reports, timelines, plans, budgets (including cash flow projections) and management accounts
- for each vessel or rig involved in your contract or project work, the
    - name of the vessel or rig (including the asset's International Maritime Organisation number)
    - description of the vessel (that is, the asset's type, class, generation)
    - year of construction
    - original construction cost (including any data and information on upgrades to the asset during its life)

- dates of entry to and exit from Australian waters (including the length of time involved at the work site or project location)
- the name of the ship's captain or master

- the owner's fixed asset schedule (including the assumptions upon which it is based) and information on the identity of the asset's insurer and/or a copy of the insurance policy
- if the vessel or rig owner has commissioned a valuation of the asset
  - the value as determined
  - methodology upon which that valuation is based
  - purpose of the valuation (for instance, for insurance purposes)
- if you have borrowed funds from a third party to fund the construction of a new vessel or rig, or the acquisition of an existing vessel or rig, details of the lender and the key features of the loan (for instance, amount funded, currency, interest rate, term, security). If a cost-benefit analysis or similar feasibility study was provided to the financier in support of the loan, we ask for that document and/or the data and information upon which it is based.

Commissioner of Taxation
19 February 2020

References

ATOlaw topics	International issues ~~ Transfer pricing ~~ in documentation International issues ~~ Transfer pricing ~~ profit shifting International issues ~~ Transfer pricing ~~ valuation methodology
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