

April 2011

DRKLAW TALKS No. 84: Overseas Contracts and Tax Implications

Many companies in Thailand are unaware of the tax implications of the contracts they enter into with overseas based companies, typically parent companies. Unawareness can lead to instances of non-compliance with the Thai Revenue Code, and eventually tax penalties and/or surcharges. This edition provides general guidelines for determining types of contracts in order to properly treat payments made there under for tax compliance purposes.

Types of Contracts and Nature of Payments: Determinant to Tax Implications

An affiliate Thai company paying a fee to an income recipient and that recipient being in a foreign country typically indicates the presence of a service agreement. Where a contract is deemed a service agreement under which “general services” are provided, the contract should be deemed a normal service contract (or technically a hire-of-work contract under Thai law). In this regard, the fee will be treated as a service fee under Section 40(2) of the Revenue Code and “business profits” under most double taxation agreements.

A contract designating a transfer of intellectual property and/or “know-how” from a foreign company to a Thai company is likely a “license” type agreement. As such, the fee would be treated as “royalties” under Section 40(3) of the Revenue Code and “royalties” under most double taxation agreements.

General Service Agreements and “Royalties” Agreements: Never Trust the Titles

Nevertheless, in practice, determining the type of contract implemented and nature of the fee paid are not so simple. Contract titles can be inaccurate or misleading. For the last two decades, the Author has encountered multitudes of contracts with titles not clearly reflecting their scope, e.g. service, management service, marketing, consulting, technical assistance, entrustment, know-know, licensing, royalties, etc. And, these days, the names of the agreements do not always imply or indicate their actual type or, for tax purposes, the nature of their fees. Close scrutiny of, among other things, particulars, contexts, conventional practices, and even consideration of the economic times in which the transaction will be undertaken, will always be required for correct classification of the income under the contracts for tax purposes.

Below are some observations about how a general service agreement and “royalties” agreement can be distinguished.

In a general service agreement, the services generally have the nature of opinions or purely technical assistance being rendered with respect to customary skills, e.g. engineering, accounting, marketing, legal services, etc. The service providers normally provide their knowledge to the recipient of the services. In this case, the consideration or remuneration for the service would generally be called a service fee (Section 40(2) of the Revenue Code and Business Profits under double taxation agreements.

On the other hand, provision or supply of know-how, secret information, or information concerning industrial experience would be considered a granting of the right to use intellectual property. To this extent, the fee will be considered royalties within the meaning of Section 40(3) of the Revenue Code and Royalties under double taxation agreements.

Once the type and nature of a contract are identified, the course of tax compliance with regard to payments, in this case “service fee” or “royalties” can be established.

Tax Implications of Service Agreements

Where a fee is classified as a “service fee” under Section 40(2) of the Revenue Code, the payer of the income will be required to:

- Deduct 15% withholding tax on the payment and remit the tax to the Revenue Department within 7 days of the month following the month in which the payment is made (using tax return PND 54). (The 15% withholding tax would, in most cases, be exempt if the fee is paid to the recipient being a resident of a country to which Thailand is a signatory under a double taxation agreement.)
- Remit 7% VAT, calculated based on the fee, to the Revenue Department within 7 days of the month following the month in which the payment is made (using VAT return PP 36).
- Pay stamp duty at the rate of 0.1% of the contract value on or before the execution date of the agreement.

Tax Implications of “Royalties” Agreements

Where a fee is classified as a “royalties” under Section 40(3) of the Revenue Code, the payer of the income will be required to:

- Deduct 15% withholding tax on the payment and remit the tax to the Revenue Department within 7 days of the month following the month in which the payment is made (using tax return PND 54). (The 15% withholding tax may be changed or reduced if the fee is paid to the recipient being a resident of a country to which Thailand is a signatory under a double taxation agreement.)
- Remit 7% VAT, calculated based on the fee, to the Revenue Department within 7 days of the month following the month in which the payment is made (using VAT return PP 36).

Author’s note

Thai companies correctly classifying the types of contracts that designate payments to overseas recipients, typically to parent companies, are very important. The correct classification by the paying Thai companies would facilitate their correctly complying with Thai tax laws. Failure to comply with the law would lead to tax penalties and surcharges. Thai companies making payments to foreign income recipients, typically parent companies, may follow the above basic rules to differentiate contracts in order to properly treat the resulting payments for tax purposes.

Further, readers should note that nowadays contracts are more complicated and the above implications are only general, not comprehensive. Readers should also be mindful about other issues, e.g. gross-up condition, tax deductibility, transfer pricing (appropriate fee levels), customs valuation (whether it is required to be added to the values of the imported goods for customs purposes), etc. as issues where non-compliance also carries penalties, surcharges, and scrutiny by Revenue Officials.

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