L&P

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Taxation of Technical Consulting Services in Thailand

Thai Tank Terminal Co., Ltd. vs. Thai Revenue Department (Supreme Court Decision No. 13993/2555 (2012))

March 2016

I. Introduction

This newsletter shall explain the tax treatment of technical consulting services provided from abroad to a Thai entity. The following summary of the complaint of **Thai Tank Terminal Co., Ltd**. (the **"Plaintiff"**) against the **Revenue Department** (the "**Defendant**") regarding notice for the submission of corporate income tax provides a useful illustration of how the laws concerning taxation of technical services are currently being interpreted by the Thai Supreme Court.[1]

II. Background

On 30 May 2001, the Defendant issued three notices for the corporate income tax submission to the Plaintiff:

1. Notice for the submission of the corporate income tax for the year 1995, issued on 30 May 2001;

2. Notice for the submission of the corporate income tax for the year 1994, issued on 30 May 2001;

3. Notice for the submission of the corporate income tax for the year 1996, issued on 28 September 2001.

All of the notices above referred to Section 70 of the Revenue Code:

> *"A company or juristic partnership incorporated under foreign laws and not carrying on business in Thailand but receiving assessable income under Section 40 (2)(3)(4)(5) or (6) which is paid from or in Thailand, shall be liable to pay tax."*

The Plaintiff, a foreign-invested entity registered under Thai law, entered into two separate service agreements with Pack Tank International BV, a company established under the laws of the Netherlands (**"PTI"**), for the provision of services from PTI to the Plaintiff: an Intellectual Property License Agreement and an Offshore Services Agreement. When calculating payment under the respective agreements, the Plaintiff deducted 15% withholding tax from payments under the Intellectual Property License Agreement, as the Plaintiff deemed such payments to be royalties in accordance with the applicable Double Taxation Agreement ("**DTA**"). However, no withholding tax was deducted from payments arising in connection with the Offshore Services Agreement.

The Offshore Services Agreement provided that throughout the six-year duration of the contract, payment was to be divided into two parts: a variable fee and a monthly fee, with the monthly fee paid by the Plaintiff at a flat rate regardless of the service received from PTI.

[1] Supreme Court Decision No. 13993/2555 (2012).

Under the Offshore Services Agreement, PTI offered services and assistance in several areas, including budgeting and budget control, employee training, procurement training, human resources, safety measures and security control, chemicals management and storage, fire control, database management, and other general services. The Offshore Services Agreement did not include any confidentiality clause.

All services in connection with the Offshore Services Agreement were performed outside of Thailand. PTI did not carry on any business directly in Thailand.

The Plaintiff held the opinion that the payments in connection with the Offshore Services Agreement were not subject to (withholding) tax in accordance with the applicable DTA and thus submitted the complaint against the tax notices of the Defendant.

III. Basis of the Plaintiff's Claim

The Plaintiff's claim was based on the following key arguments:

Firstly, the Thai Revenue Code provides that assessable income under Section 40(3) includes

> *"Fee of goodwill, copyright or any other rights, annuity or annual payment of income derived from a will, any other juristic act, or court decision."*

The term *"other rights"* in the context of this provision is meant to include royalties.

The taxation of royalties is described in Article 12 of the DTA between Thailand and the Netherlands. Based on this Article, for fees for services related to the transfer of information and knowledge to be categorised as a royalty, the fee charged must directly relate to the use or the transfer of intellectual property. In contrast, a service fee is charged primarily for provision of a service, even if intellectual property may (secondarily) be involved.

IV. Decision of the Court of First Instance and Court of Appeal

The court of first instance and the court of appeal ruled that the payments under the Offshore Services Agreement were subject to withholding tax.

The Court of Appeal ruled that the counselling given by PTI was to be considered as *"the use of, or the right to use, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience"* under Article 12 of the DTA.

Even though the Offshore Services Agreement did not specify that the Plaintiff had to keep the information confidential, nor that the Plaintiff should return the outcome of the services to PTI once the Offshore Services Agreement was terminated, the essence of Article 12 does not lie in confidentiality of the information, as long as intellectual property rights are involved.

When the Court of Appeal considered the nature of services that PTI rendered for the Plaintiff under the Offshore Services Agreement, the Court found that most parts of the services consisted of industrial, commercial and scientific counselling. Merely a small part of the services concerned general counselling. The Court then went on to conclude that the payment was made for royalty fee, rather than for general counselling services. The flat rate fee under the Off-

shore Services Agreement for the duration of 6 years included, consequently, a royalty fee in disguise and was therefore subject to 15% withholding tax.

V. Decision of the Supreme Court

The Supreme Court did not confirm the rulings of the court of first instance and court of appeal.

Following examination of the facts of the case and the testimonies of various witnesses and experts in the context of Thai taxation laws and the DTA, the Supreme Court made the following key determinations:

1. The services received by the Plaintiff were not a final product, i.e. they did not constitute knowledge or information that the Plaintiff could use or apply directly in its business. Rather the services received involved the transfer of general and broad principles that needed to be adapted by the recipient to meet the needs of the recipient's particular business.

2. A royalty is a fee paid by the recipient for a transfer of intellectual property or a permission to use intellectual property. This aspect varies from a fee given to a service provider for his or her knowledge, skills, or experience to generate work or finished products.

3. Another criterion used to determine whether a service was a royalty or general service is the amount of the contracted fee related thereto. The amount of the contracted fee must be comparable and reasonable with respect to the services provided. In this case, the fees for services paid by the Plaintiff were significantly higher than the market price for general service in this business segment, which, if taken on its own, could indicate that the services provided were in fact a royalty.

4. The Offshore Services Agreement did not contain any obligations or requirements for confidentiality in relation to the services. Services attracting royalties relate to the transfer of information which is of high industrial, commercial and scientific value and that as such requires an agreement of confidentiality between the parties.

On the basis of the above findings, the Court concluded that the services provided by PTI to the Plaintiff were of general business nature, not a transfer of industrial, commercial or scientific information. The monthly flat fee payment made by the Plaintiff to PTI for such services was, consequently, a "service fee" and not a royalty.

VI. Conclusion

This decision indicates that the Thai Supreme Court is aligning itself more and more with international interpretations of royalties in international taxation.

Having said this, the decision does in fact not substantially change the previous position of the Supreme Court on the definition of royalties, nor does this decision provide any additional clarification as to at what level services (for example engineering services) will be classified as royalties. The Supreme Court's emphasis on the existence of a confidentiality clause opens doors to argue that payments for such technical services are in fact considered royalties if a confidentiality clause is implemented into the contract.

It therefore should be suggested either avoiding or at least carefully wording such confidentiality clauses in contracts

on technical services in order to not provide arguments to the Revenue Department to qualify payments under such contracts as royalties.

Other than that, unfortunately, this decision does not give any additional guidance as to how to avoid future disputes with the Revenue Department.

We hope that the information provided in this newsletter was helpful for you.
If you have any further questions please do not hesitate to contact us.

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