TMI EYES

TMI Associates (Thailand) Co., Ltd.

TMI EYES No. 10: Service Fees VS Royalties

Recently, TMI has received a rare favorable judgment from the Central Tax Court on a case about the classification of royalty income versus service fee. TMI believes that it would be beneficial for all readers to share this case so that readers can be aware of their transactions to avoid a lengthy and frustrating dispute.

The Case

In this case, the taxpayer ("Plaintiff") was assessed by a Revenue Office in the Bangkok area on the ground that the payments made by the taxpayer were not service fees, but royalties. The details of the transaction were that the taxpayer employed a famous design company in the US to design a building. The design started from scratch and under the specifications and directions of the taxpayer. The taxpayer separately employed a construction company to construct the building based on the design. It is agreed between the taxpayer and the US design company that the ownership of the design will belong to the taxpayers. Yet, there was one key term that the taxpayer must not allow a third party to use the design.

The taxpayer treated the design fee as a service fee and did not withhold any tax on the payment when making the payments to the design company in the US.

To this end, the Revenue officer just ignores all the terms and how the designer worked for the taxpayer. The officer simply adhered to the only one term that the taxpayer cannot allow the third party to use the design and used such terms to conclude that the design fee was considered "royalty" which the taxpayer must, but failed to, deduct royalty at the rate of 15% of the design. And, such that the Revenue Department assessed the withholding tax, penalty, and surcharge in a very large amount.

The taxpayer appealed, but the Board of the Appealed rejected the appeal.

The taxpayer then brought the case to the Central Tax Court against the Revenue Department. The Court ruled in favor of the taxpayer on the ground that the payment should be categorized as a service fee, not a royalty because it is the payment for the design of the plan, not for the right to use an intellectual property work. The Court viewed that the limitation that the taxpayer cannot allow a third party to use the design, due to the design company wanting to protect its reputation, would not be sufficient to conclude that the payments were royalties.

Royalties VS Service Fee

TMI would like to point out that the dispute between taxpayers and the Revenue Department on how to determine a type of fee and its tax implications has long been an issue.

It is most important for all taxpayers and readers to know what type of income they are paying to an overseas recipient, as each type of income is subject to different tax implications, e.g. no withholding tax on general services under double taxation avoidance agreements, and 15% withholding tax on most royalties.

TMI would like to point out that generally, a service fee paid to foreign companies as remuneration for general service without the service provider granting the right to use any intellectual properties or secret industrial or commercial information is treated as a general service fee or business profit under Article 7 of applicable DTA. The key character is that the service provider exercises its effort and knowledge to execute the work and the result of the work belongs to the employer.

Whereas, the payment, paid as a remuneration for the use or the right to use the information concerning industrial, commercial, and scientific experiences, is considered a royalty. The royalty also includes payments in exchange for the right to use all intellectual properties, e.g., trademark, patent, copyright, and know-how (secret information). It is noted that in the case of royalty, the provider will not transfer the ownership of the right of the intellectual property to the employer.

Other related issues

The readers should also note that where a payment is categorized as royalty, the taxpayers who import goods into Thailand must also be aware that such royalty may also be subject to customs duty. (Please refer to the previous publications early this year.)

TMI's Observation and Recommendation.

Nowadays, there are more and more international transactions, and most importantly, they are increasingly delicate and complicated. Not to mention typical technical assistance agreements, etc., but the agreement involved digitalized transactions. It is therefore complex to distinguish the type of payments, and thus the tax implications.

It is very important for all readers, especially, those who are paying income to overseas service providers, to reconfirm the types of income so that the readers can minimize all potential tax risks. Particularly, the readers/taxpayers who pay income in complicated transactions, and those who also import goods. Thus, taxpayers should constantly review their transactions to prevent any unwanted losses of revenue or profits for incorrect tax treatments.

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