



TMI Eyes No. 29: Contract Drafting and Tax Implications (Part 1)

Every company enters into contracts—whether to generate profits, manage risks, or secure long-term growth. Yet, what often goes overlooked is that the way these agreements are drafted can have a significant impact on a company’s tax position. In this article, TMI highlights key considerations and practical talking points for business operators to point out that their agreements should not only be commercially sound but also structured to optimize tax efficiency.

Tax Related to Transactions and Contracts

1. First and foremost, business operators must clearly understand the needs and substance of the transaction. Once this is established, they should then identify the taxes that may apply under the Revenue Code when entering into agreements. These include:
 - (a) income tax (both personal and corporate),
 - (b) withholding tax,
 - (c) value-added tax (VAT),
 - (d) specific business tax (SBT), and
 - (e) stamp duty.

In addition, customs duty is a critical factor in certain transactions, especially where the agreement involves the cross-border movement of goods.

2. Next, operators should consider how to optimize their tax liabilities through careful contract structuring or restructuring. Examples of such considerations include:

2.1 Choosing the Type of Contract

Business operators should first understand the substance of the transaction and then determine the most suitable type of contract. The chosen structure can significantly affect the tax outcome. For example:

- **Asset Deal vs. Share Deal** – An acquisition of a business can typically be structured as either an asset deal or a share deal. The tax treatment differs: an asset deal may trigger VAT, SBT, and stamp duty, whereas a share deal generally results in capital gains taxation.
- **Service Agreement vs. Sale Agreement** – These two structures also carry different tax implications. A service agreement is usually subject to withholding tax, VAT, and

stamp duty, while a sale and purchase agreement is generally not subject to withholding tax or stamp duty.

In such cases, business operators should be aware of a common issue when a party manufactures products using raw materials, designs, or know-how provided by another party. While the manufacturer may view the transaction as a simple sale of goods, the Revenue Department often classifies it as a service agreement based on the underlying functions. This misclassification can lead to incorrect tax treatment.

TMI has also assisted in cases where foreign-owned manufacturers were challenged by the Department of Business Development under the Foreign Business Act B.E. 2542 (1999). The authorities argued that the manufacturers were effectively providing contract manufacturing services—a business activity restricted for foreign-owned companies unless they have BOI promotion, a foreign business certificate, or a foreign business license—rather than engaging in permissible manufacturing for sale.

2.2 *Separation of Agreements or Combined Agreements*

When multiple types of transactions are included in the same agreement, business operators should carefully consider whether to combine them into a single contract or separate them into distinct agreements.

- **Sale with Installation** – In some cases, combining transactions can reduce tax liabilities. For example, in agreements for the sale of goods that require installation (such as elevators, escalators, or air-conditioning systems), a single combined agreement for both sale and installation with one fee is generally treated as income from sales. This structure does not incur withholding tax and stamp duty. By contrast, if the service portion is separated into a standalone agreement, that fee would typically be subject to withholding tax and stamp duty.
- **Services vs. Lease of Immovable Property** – Services are generally subject to a 3% withholding tax and 7% VAT, while the lease of immovable property is subject to a 5% withholding tax and is not subject to VAT. Moreover, VAT incurred in connection with a leasing business is typically not creditable as input tax. If services and a lease are combined in one agreement with a single fee (or even with separate fees), the Revenue Department may treat the entire fee as a service fee—resulting in an overall lower withholding tax.

(to be continued next month)

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