TMI EYES
TMI Associates (Thailand) Co., Ltd.

TMI EYES No. 40: Classification of Business Activities — Sale of Goods vs. Hire of Work and Legal and Tax Implications

This report discusses the legal and tax implications of classifying a transaction as either a sale of goods manufactured for sale or a contract for hire of work, as the classification may result in different legal and tax compliance requirements.

Classification of Business Activities under the Foreign Business Act

The Foreign Business Act B.E. 2542 (1999) (the "FBA") regulates certain businesses conducted by foreigners, including businesses listed in List Three, which includes the provision of services. The FBA does not generally restrict foreigners from manufacturing and selling their own products, as manufacturing is not itself a business listed in List Three.

For FBA purposes, "foreigner" includes a company incorporated in Thailand with at least 50% of its capital held by foreign individuals or entities, as well as entities incorporated outside Thailand.

The key issue is therefore whether a company's business should be characterized as manufacturing goods for sale or providing manufacturing services / hire of work.

In modern business activities, this distinction can be complex and should be determined based on the substance of the transaction, including the parties' intention, the terms of the agreement, the nature and ownership of the materials and intellectual property, the characteristics of the goods and transaction, and the importance of the work and materials provided by each party.

For FBA purposes, the Department of Business Development ("DBD") generally considers that where a manufacturer purchases raw materials, manufactures products for its own account, and subsequently sells the products, the activity constitutes manufacturing and sale of its own products and is not a List Three restricted business. A foreign company may therefore conduct such business without an FBL, subject to other applicable laws.

In contrast, where a company manufactures products according to a customer's specifications, designs or requirements, or otherwise provides manufacturing services on a contractual basis, the DBD may regard the activity as the provision of services under List Three (21) of the FBA. The foreign company would then generally need to obtain an FBL or, where eligible for investment promotion, an FBC under Section 12 of the FBA.

Accordingly, foreign-owned companies should carefully assess the substance of their business activities and contractual arrangements. Misclassification may result in a violation of the FBA, which carries penalties of imprisonment for up to three years, a fine of THB 100,000 to THB 1 million, or both, as well as a possible order to cease the business.

Classification of Transactions and Tax Implications

The Revenue Department ("RD") applies similar substance-based criteria when classifying transactions. The distinction between a sale of goods and a hire-of-work contract can therefore have significant tax implications.

Under the Thai Revenue Code, a sale of goods is generally not subject to stamp duty, and the purchaser is generally not required to withhold tax on payment for the goods. In contrast, a hire-of-work agreement is generally subject to stamp duty at 0.1% of the contract value, and payments for hire of work are generally subject to withholding tax at the applicable rate.

Failure to properly pay stamp duty may result in additional liability, including a surcharge or penalty of up to six times the stamp duty payable, depending on the circumstances.

Accordingly, the classification should not be determined solely by the title or wording of the agreement. The RD will generally consider the substance of the transaction, including the ownership of raw materials and finished goods, allocation of manufacturing risks, the parties' intentions, whether the manufacturer produces goods for its own account or according to the customer's specifications, and the basis on which the price is determined.

TMI's Note

Businesses should not rely solely on the form or title of their agreements when determining the legal and tax treatment of their transactions. Given the potential implications under both the FBA and the Thai tax laws, companies should periodically **revisit and review their business models, contractual arrangements and actual transaction practices** to ensure that they remain consistent with the intended legal and tax treatment and do not inadvertently create adverse legal or tax consequences.

Where the nature of a transaction is unclear, businesses should seek appropriate legal and tax advice before entering into or continuing the arrangement.

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