

## Royalties: How Thailand applies royalty tax on payments

In 1988, it was the very first time the Supreme Court of Thailand defined the term '**royalties**' under Thai tax law. The Supreme Court's interpretation, however, was found different from the 'royalties' specifically defined under tax treaties between Thailand and other countries. Since then, Tax Courts including the Supreme Court have continued to uphold such interpretation as precedent given that there has been no specific definition of royalties for income tax purposes under domestic law.

Under the Thai Revenue Code ("TRC"), royalty is one of eight types of taxable income. Royalties include the payment for:

*"value of goodwill, value of copyright or other rights, annuity, or income in the same nature deriving from will, other juristic acts or court decision."*

The Supreme Court further ruled to explain that the word '*other rights*', as stipulated in Section 40 (3) of the TRC, shall be the rights of the same nature of goodwill and copyright. Therefore, '*leasehold right*' is not regarded as 'other rights' in light of royalties (refer the Supreme Court Case No. 1271/2531).

As a tax firm, we agree with the Supreme Court Case No. 1271/2531 those royalties shall merely refer to payments for the use of or other right similar to the use of intellectual properties.

The Thai Revenue Department ("TRD") has also been adopting this concept in its practices. When it comes to a tax audit, we find that the TRD will usually look into substance of transaction together with relationship between contracting parties in addition to obligations under relevant contracts in order to identify royalties. Key clauses in commercial contract, e.g., confidentiality, non-disclosure and technical expertise of the service provider, could technically give rise to royalties.

We can learn from example of the TRD's private tax rulings whether payments shall be regarded as royalties or not.

### Shrink-Wrapped Software

The TRD ruled in 2004 that the payment for standard computer program (non-customized) and sale in shrink-wrapped packaging including manual and a CD was regarded as 'royalty'.

According to this ruling, the ownership of program was not transferred to the distributor while end-customer had the right to use the program under the end-user license with no right to reproduce. Given that it is provision of software services, the TRD viewed that the payment for such local sale of shrink-wrapped software in Thailand was regarded as 'royalty', and not sale of goods. Such payment, therefore, shall be subject to withholding tax at the current rate of 3%.

In the US, the court viewed that a "shrink-wrap license" transaction is a sale of goods rather than a license transaction. The court held that a single payment for a perpetual transfer of possession is, in reality, a sale of personal property and therefore transfers the ownership in that copy of the software. (*Softman Products Company, LLC v. Adobe Systems Inc., Case No. CV 00-04161 DDP (Cal. Central District Court)*)

However, some country such as Singapore considered the payment for shrink-wrapped software was 'royalty' but granted income tax exemption or several European countries, who were the Committee of Experts on International Cooperation in Tax Matters, agreed that sale of shrink-wrapped computer software would be considered as 'royalty'. This is referred to the Update of the UN Model Double Taxation Convention between Developed and Developing Countries – Inclusion of software payments in the definition of royalties (as of 7 October 2020).



### Embedded Software

In the TRD ruled the payment for embedded software was 'royalty' in contrast with the Supreme Court of NEC Case (refer the Supreme Court Case No. 2050/2559).

According to this Court Case, the embedded software was part of system operating the storage hardware. The buyer necessarily expected not only the software alone but also the whole package including the physical hardware. In addition, there was no separation of software and hardware prices according to the purchase order and invoice with respect to this transaction. Accordingly, the Supreme Court viewed that this transaction was a sale and purchase contract i.e., a non-royalty transaction.

With this Court Case, it is understood that the trigger points were thanks to the separation of price and documentation. Thus, this is a potential tax planning for the offshore software seller.

### Debt Forgiveness on Trademark License Fee

The TRD ruled in 2006 that debt in relation to royalties payable for trademark licensing forgiven by an offshore party to a Thai corporate debtor was not subject to withholding tax under Thai tax law on the basis that it was not considered as royalty.

Nonetheless, the amount of debt forgiveness shall be considered as taxable income of the Thai debtor for corporate income tax purposes. The Thai debtor was also required to self-assess VAT on the debt forgiveness of the unpaid service fee.

This ruling is a good sample for different treatments between withholding tax and VAT implications. Tax point for withholding tax and self-assessed VAT is the payment of service fee from Thailand to the offshore party. It is arguable though that VAT should not be self-assessed due to no actual payment.

<sup>1</sup> Section 587 provides that a "hire of work" contract is defined as a contract whereby a person, called contractor, agrees to accomplish a definite work for another person,

### Ancillary Services (Software-Related Services)

The payments for software-related services e.g., commissioning, installation, test-run, training, localization, customization, technical assistance, program and technology updating, hot-line and help-desk services, software rectification, maintenance service arise from software service are generally considered as royalties.

The TRD views that any payments related to confidential information, secret formula, know-how, intellectual property, market channel and customer database and proprietary rights shall be deemed as royalties as well.



It is arguable the above tax position of the TRD may not be in line with the view of the Supreme Court if the transaction is rearranged and the taxpayer pursues its case into the court level.

In relation to VAT, the TRD established the practice that software related service is 'provision of service' and, therefore, subject to VAT at the rate of 7%.

However, some elements of royalty transaction are in the nature of hire of work contract under the Thai Civile and Commercial Code<sup>1</sup> (e.g., installation, staff training, maintenance) while some transactions are not (e.g., licensing).

In Thailand, hire of work contract is also subject to stamp duty at the rate of 0.1% of the contractual value but a pure licensing contract is not subject to stamp duty because a licensing contract, as a contract for the use of copyright in literary works under the Copyright Act B.E. 2537; is not regarded as the hire of work contract. Therefore, separation of related-royalty services contracts should be considered for tax efficiency rather than mixed the

called employer, who agrees to pay him a remuneration of the result of the work.

scope of work/service in the same contract of the royalty transaction.

### Precedent Court Cases of Royalties Interpretation

Scrutiny on cross-border transactions by the TRD particularly related to withholding tax on royalties has recently increased. It is worthwhile to understand the major tax cases related to royalties ruled and the development of the interpretation by the court in order to mitigate future tax risks.

The TRD interpretation and Supreme Court decisions in relation to royalty income have significant impacts on 'franchise market'. As a result of the Pizza Hut Thailand's case, the franchising parties should review its franchise contract in order to restructure the franchising transaction and amend terms and condition of franchise agreements in order to avoid further tax investigation on royalties arise from cross-border transactions.

Amending the existing franchise agreements now cannot make a change to the royalties paid in the past. The risk of a tax investigation remains unchanged. In addition to the franchise transactions, the TRD focused on the 'marketing services fee' paid to offshore suppliers and imposed tax on it by way of deeming royalty as same as the Supreme Court decision. For example, the cases of Philips and Electrolux's.

The Supreme Court ruled in the major tax cases relating to royalties as follows:

Year	Supreme Court Decisions
1976	Issuance of company shares in exchange for right to use patented innovation in manufacturing of tyres was deemed royalties.  (Case No.809/2519)

Year	Supreme Court Decisions
1988	Design of plan and layout as well as construction of plastic factory including installation of equipment without provision of services involved technology would NOT be regarded the activities that would generate royalties.  (Case No.3923/2531)
1989	The TRD viewed that total consulting fee that consisted of royalties and non-royalties (such as advising on financial, accounting, marketing consulting) cannot be distinguished. The payment of the whole amount was to be treated as royalties.  The Supreme Court viewed differently that the whole consulting fees would NOT be deemed as royalties. Taxpayers shall be able to separate payments and treat royalties differently from non-royalties.  (Case No.410/2532)
1992	Provision of right to use information and technology in petroleum exploration with the restriction not to disclose such technology would be considered to generate royalty income.  (Case No.4099/2535)
1994	Remuneration for the right to produce coffee using a specific formula and know-how with advice on the processing of production and condition to retain the confidential information and return all relevant documents after expiration of agreement would be regarded as royalties.  (Case No.665/2537: Nestle Thailand's case)
1995	Remuneration payment for technical assistance agreement considered royalty. This is supported by the following factors; 1. The engineering and technical assistance agreement was relating to the trademark license agreement with a condition to

Year	Supreme Court Decisions
	<p>maintain high quality of dairy cream and advising on process of production.</p> <p>2. The advice of technical assistance must be kept confidential and all advising documents returned to the service provider after termination of contract.</p> <p><i>(Case No.2642/2538: Carnation case)</i></p>
2004	<p>The remuneration payment under the marketing service agreement would NOT be considered royalties. This is supported by the following factors;</p> <p>1. The purpose of this agreement was to provide advice, assist with the general administration and negotiate commercial contracts, select distributors, promote, procure, advertise the sale of products in Thailand.</p> <p>2. Marketing materials under consultation became the ownership of the service recipient.</p> <p>3. There was no provision of sole distributorship to use the brand or trademark for the sale of products.</p> <p>4. There was no provision of special information and experience which is not restricted to disclose to the public.</p> <p><i>(Case No. 4812/2547: Louise T. Leo Novens' case)</i></p>
2006	<p>Remuneration payment for the marketing and commercial channel including database of customers (name, address, price, terms of business) would be regarded as royalties as the information related to commercial experience.</p> <p><i>(Case No. 1056/2549: Hana Semi-conductor's case)</i></p>
2009	<p>Under the Franchise Agreement, the Thai franchisee was required to follow to the control and sole discretion of foreign franchisor in relation to promotion and advertising. Franchisee had no independence to do the advertising in terms of form and content. Franchisee was</p>

Year	Supreme Court Decisions
	<p>responsible for the budget of the promotion and advertising in Thailand but did not directly pay it to the franchisor.</p> <p>It was considered that while the budget was not the fee payable directly by the franchisor, but it did benefit the franchisor economically not having to pay this budget to promote its franchise in Thailand. In addition, the promoting budget was required to be paid at certain rate of gross sale in exchange of provision of franchise.</p> <p>Therefore, it was deemed that the franchisor derived this taxable income as a part of franchising fee and was regarded as royalties.</p> <p><i>(Case No. 4440/2552: Pizza Hut case)</i></p>
2012	<p>The TRD viewed that the marketing fee paid by Thai subsidiary company to its Dutch parent company was regarded as 'royalties' and not eligible for tax exemption under the double tax treaty between Thailand and the Netherlands.</p> <p>The Marketing Service Agreement specified the followings term and conditions, so the TRD viewed the fee paid as 'royalties':</p> <p>(1) required confidentiality conditions</p> <p>(2) trade secret was used to provide the service</p> <p>(3) the service provider was an expert with an almost 100-year experience.</p> <p><i>(Case No.15773/2555: Philips Electric's case)</i></p>
2012	<p>Cost allocation from the US parent company to the Thai subsidiary is payment for SAP Accounting Software subscription and was subject to withholding tax as such cost allocation was in connection with the license fee which was regarded as royalties and subject to withholding tax by virtue of double tax treaty.</p> <p><i>(Case No.14588/2555: Esso Thailand's case)</i></p>
2012	<p>Remuneration payment for the management services provided by the Dutch parent company to its Thai subsidiary</p>

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	<p>with royalty payment for the license of parent company. Management fee is deemed as royalty payment in view of the TRD.</p> <p>However, the Supreme Court viewed that such management fee was NOT regarded as royalties since the management service was paid to reflect the real transaction of management activities provided by the parent company.</p> <p><i>(Case No.13993/2555: Thai Tank Terminal's case)</i></p>
2014	<p>Marketing fee paid by Thai subsidiary to its Swedish parent company for marketing collateral e.g., brochure and catalogue of products for sales in Thailand while the marketing materials include brand, trademark and logo (Electrolux) owned by the Swedish parent company. The payment of marketing fee was paid as per the invoice provided without any marketing service agreement.</p> <p>The TRD viewed that the marketing fee is regarded as 'royalty' on the basis that payment is a consideration for the right to use trademark, brand and logo in the brochure and catalogue. In this case the Supreme Court agreed with the TRD and viewed that this marketing fee was regarded as royalty.</p> <p><i>(Case No.5808/2557: Electrolux's case)</i></p>
2016	<p>Separation of products price (software and hardware) under shipping documents for customs clearance in relation to PBX communication system of CBU (complete built unit) products was subject to 'royalty tax' only the software service part.</p> <p>However, the Supreme Court viewed that embedded software was a part of product to operate the hardware it came with. As the buyer meant to buy the physical hardware, the transaction should be regarded as sale and purchase. Therefore,</p>

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	<p>remuneration payment under the part of software price was NOT deemed as royalty.</p> <p><i>(Case No. 2050/2559: NEC's case)</i></p>
2016	<p>The payment for software improvement service fee including training and consulting regarding the software was considered payment for the service where knowledge and expertise in computer technology which is a modified technology from experience in commerce, science or industry was transferred. Thus, royalty tax applied.</p> <p><i>(Case No. 8334/2559)</i></p>

#### ONE Law's Comment

We can see that the Supreme Court interprets the term 'royalty' by relying on '**substance over form**' concept with the following key factors:

1. Provision of specific information arise from the experience (commercial, industrial, scientific experience)
2. Provision of the right to use the intellectual property or trade secret
3. Confidentiality conditions

In practice, there are many TRD's tax rulings on cross-border royalties but unfortunately many cases have not been brought to the high court to conclude the final interpretation the legal status of royalties or not. Accordingly, care should be taken for cross-border transactions to ensure that you properly comply with the relevant tax laws and practices in Thailand including definition of royalty from double tax treaties between Thailand and other 61 countries up to 2018.

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