

OEM Service Providers' Common Problem - Sale of good should not be subject to withholding tax and stamp duty, or should it?

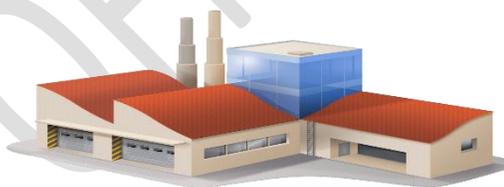
When you are a manufacturer, your business can be both production for sale under your own brand and *make to order for another operator*. The latter is typically known as an Original Equipment Manufacturers (OEM) or Toll Manufacturer.

The difference from the mere manufacturer, conducting the business as an OEM could be problematic in terms of distinguishing a transaction in hand whether it is a simple 'sale of goods' or a 'hire of work', especially when the manufacturing of the products is conditional upon the counter party's specifications and manners.

Legal-wise, sale of goods and the hire of work are governed by separate provisions of the Civil and Commercial Code of Thailand (CCC). Though the outcome of both transactions is finished product, legal concepts are completely different.

For the sale of goods, transferring of ***the product ownership*** is primary consideration. This notion is firmly linked to the consideration of whether the material of the product is more important than the work being done to manufacture such product, and who the material supplier is. In the 1987 case,¹ the court ruled that the productions of a refractory brick by Siam Cement Group (SCG), whether under the normal specification or under the customer's special requirements in terms of shape, size and heat resistance ratio, used the same materials for its production and the material was more important than the work

being done to such manufacture. Thus, it was considered that such transaction was sale of goods. Selling of an 'on-shelf' or 'in-stock' product could also be a factor in determining that the transferring of ownership of the product is essential due to the fact that production work is no longer required. Nonetheless, care should be taken in assuming such notion when the product could not be produced or prepared beforehand – for example, the ready mixed concrete product, which the court held in 1991 that the contract for supplying of the product was the sale of goods even though the product was made after being ordered by the customer.²



This Photo by Unknown Author is licensed under [CC BY-NC](#)

On the other hand, hire of work focuses on ***completion of the work being hired*** more than the transferring of ownership. In the 1991 case,³ the court considered the case where the hirer hired the OEM to produce soap and the hirer was the one who provided all the required materials and specifications – that being said, only the equipment and performance of work were contributed by the OEM. The court then held that the transaction was that of the hire of work.⁴ Production and sale of products with additional obligations in terms of installation, inspection and repairing could also be a factor. In the 1997 case,⁵ the court considered an agreement between the OEM and the hirer for the manufacturing and supply of marble floor and ruled that it was the hire of work contract.

¹ Supreme Court's decision No. 258/2530.

² Supreme Court's decision No. 2169-2170/2534.

³ Supreme Court's decision No. 2755/2534.

⁴ Considering this court's decision, it could be assumed that the production of products where the hirer provides all the material to the OEM is mostly the hire of work transaction.

⁵ Supreme Court's decision No. 126/2540.

The ground of the court's decision was on the facts that (i) the agreement required the OEM to produce and install the marble floor in a skillful manner; (ii) the hirer was entitled to inspect the installation before it pays for the product; and (iii) after the installation, the OEM was obliged to make repairment in case of any defects. These factors allowed the court to determine that it was not the product that was an essential part of the transaction, but the **completion of these works** by the OEM as specified by the hirer.

From the above considerations, it should be observable that the manufacturer in the sale transaction tends to have their own product brands and certain product specifications (though the customers can still decide on the appearance and certain quality of the product, provided that it does not affect the core essence of the production). The manufacturer in the sale transaction also tends to have stocks of product and distribution channels to various types of their own customers. Conversely, the OEM in the hire of work transaction would not possess their own product brand and would not have stocks of products in question. It is the 'equipment' and 'performance for the completion of work' that are required from the OEM.

Tax Consequences

Different transactions require different tax considerations. For decades, the Revenue Department has been challenging taxpayers for their mistreatment of relevant taxes in terms of sale of goods and the hire of work, particularly on the income tax (withholding tax, to be precise) and stamp duty.

⁶ Pursuant to Clauses 8 and 13 of the Departmental Regulation No. Taw Paw 4/2528 dated 26 September 1985.

⁷ Pursuant to Clause 2 (3) of the Notification of the Director-General of the Revenue Department Re Stamp Duty (No.37).



This Photo by Unknown Author is licensed under CC BY-ND

It is noticeable that the product manufacturer would prefer the sale transaction rather than the hire of work due to the fact that, in the former case, the product price will not be subject to withholding tax upon its payment to the manufacturer (i.e. resulting a better cash flow), and the manufacturer is not required to pay stamp duty for its contract execution (i.e. resulting less expense).

The hire of work, on the contrary, would require customers to deduct withholding tax the current rate of which is 3% from the contract price upon their payment to the OEM and remit the deducted amount to the Revenue Department within 7 days from the last day of the month in which the payment was made.⁶ The OEM is also required to pay stamp duty at the rate of 0.1% of the contract price pursuant to Item 4 of the Stamp Duty Schedule, and in case the contract price is at the amount of THB 1,000,000 or more, the OEM is required to pay for the stamp duty in cash instead of the stamp being affixed⁷ - in any cases, the stamp duty shall be paid within 15 days from the execution date of the relevant instrument.⁸

The value added tax (VAT) is not taken into consideration in this picture given the same treatment which is 7% VAT being imposed on sale of goods and provision of services.

⁸ Failure to pay for the stamp duty in a manner and period of time prescribed by the Revenue Code could subject the OEM to surcharge of up to 6 times the amount of the duty, and also criminal punishment, both fine and imprisonment.

Planning to reduce withholding tax and stamp duty?

As the contract value of the hire of work is typically comes from both ‘effort’ putting in and ‘labor’ to complete the work together with physical ‘material’ for the production, *many OEMs have decided to separate the sale of material agreement from the hire of work agreement, with an aim to reduce the contract value, thus lesser withholding tax deduction and stamp duty payable.*

Though it seems to be logical, the notion of the Revenue Department in most cases provides otherwise. *The authority sees that the supplying of product materials is firmly linked to the completion of the work; separation of these 2 contracts is only for the purpose of reducing the withholding tax and stamp duty responsibility, and thus the consideration should be taken back to the concept of whether the transferring of the product’s ownership or the completion of the work being hired is an essential part of the transaction.*⁹



This Photo by Unknown Author is

Accordingly, great care should be taken by the OEM when determining if the transaction in question is the sale of goods or the hire of work, as to ensure a proper taxes handling and to avoid argument and court case with the Revenue Department as well.

Additional Consideration on Foreign Business Law

It is the notion of the Department of Business Development (DBD), the Ministry of Commerce, that the manufacturing of the product as well as the sale of such products by a foreigner (both individual and corporate entity) are exempt from licensing requirement (Foreign Business License: FBL) under the Foreign Business Law. The exemption is explained by authority that the manufacturing business is considered as the promoted business which brings investments, capitals and technologies into the country, and has more advantage to the country when comparing against the competition towards Thai manufacturers.

Nonetheless, the OEM business is regarded by the DBD as the ‘**service business**’ under Annex 3 (21) of the Foreign Business Act that requires the foreigner to obtain the FBL before engaging in the business in Thailand. This is confirmed by many rulings of the DBD and still currently applies.

Thus, the foreign OEMs need to be aware of this FBL requirement when developing or shifting from producing their own product for sale to make to order.

⁹ For instance, the essential part of a construction contract is the completion of the work being hired by the customer – thus, the payment under a separated supply agreement for the material of the work is also subject to the

withholding tax at the current rate of 3% (Ruling of the Revenue Department No. Gor Kor 0811 (Gor Mor.13)/528 dated 5 January 2001 and No. Gor Kor 0811/1934 dated 13 March 2000).

ONE Law Article – Volume 9
June 2021

Keywords: Sale of Goods, Provision of Services, OEM, Hire-of-Work, Completion of Work, Manufacturing, Selling, Transfer of Ownership, Withholding Tax, VAT, Stamp Duty, Service Business, Promoted Business, Promoted Activity, BOI, FBL

ONE Law Office

In charge of this Article:

Yolapan Seetaraso

yolapan@onelaw.co.th

Apichon Sutthiphongkait

apichon@onelaw.co.th

Areeya Ananworaraks

areeya@onelaw.co.th

Chinapat Visuttiapat

chinapat@onelaw.co.th

ONE LAW OFFICE