Whether Exclusive Distribution Fees Regarded as "Royalties" from Thai Tax Point of View?

When considering the applicable withholding tax rate on overseas payments, a Thai payer would need to consider types of outgoing payments and whether the recipients have a permanent establishment in Thailand. In addition, if the income recipient is a tax resident of other jurisdictions having Double Tax Agreements ("DTA") with Thailand, determining the type of payment should be carefully considered according to the relevant DTA.

One type of overseas payments that is often difficult to classify is "Exclusive Distribution Fee." Its nature and substance might involve the right to be the sole distributor in any territory country and the right to use the intellectual property.

What are "Exclusive Distribution Rights"?

"Exclusive Distribution Right" is what the supplier generally designs to give a single distributor the exclusive right to sell its products in an assigned territory or to a specific consumer base. The exclusive right always ties in with the promise that other distributors in the same region will not receive such privileges.

In return for granting the sole distributor right, the supplier receives the exclusive distribution fee. The fee is always questionable whether it is regarded as "royalty" or not.

What are "Royalties"?

The Thai Revenue Code ("TRC") does not provide a clear definition of the term "royalty." The TRC only specifies that a royalty represents a payment for the right to use property such as goodwill, copyright, or other rights. Also, the Thai Supreme Court tends to rule strictly on the narrow definition of "royalty," which covers only intellectual property such as copyright, trademark, and patent. For example, in the 1988 case [1], the court ruled that payment for a leasehold right did not constitute royalties under Section 40(3) of the TRC, which specify that royalties include consideration for goodwill, copyright, or any other rights. The court reasoned that "other rights" shall consist of rights that are similar in nature to goodwill or copyright.

Interpretation of royalties under Article 12 of the DTAs is much broader than that of the TRC and the Thai Supreme Court decisions. Royalties under the DTAs include consideration for the use of or for the right to use the following categories:

1) Intellectual property - e.g., patent, software, and design;
2) Equipment - e.g., commercial and scientific equipment; and
3) Experience and information - e.g., industrial information.

[1] Supreme Court's decision No. 1271/2531

Whether Exclusive Distribution Fees Regarded as Royalties?

Initially, the Thai Revenue Department ("TRD") interpreted royalties quite broadly by considering payments for any rights as royalties, including exclusive distribution fees.

However, the TRD later changed its position and ruled that exclusive distribution fees were not considered royalties since they were not paid in return for using or the right to use intellectual properties or industrial know-how. Thus, the payments in these transactions would be classified as business profits under Article 7 of the DTAs [2].

Precedent tax ruling number Gor Khor 0702/7937 dated 24 October 2014 also supports the latter interpretation above. The tax ruling is the case of a car dealer in Thailand who paid annual "Sole Distribution Rights Franchise Fee" to an overseas car manufacturer in exchange for being the sole dealer in Thailand. The TRD opined that such consideration was not for the use of or the right to use intellectual property under the definition of royalties. Thus, the fee was regarded as business profits that are not subject to withholding tax, as opposed to royalty fees. Unfortunately for this case, the TRD issued their opinion in the 4th year after entering into the exclusive distribution agreement. Nonetheless, the car dealer already deducted withholding tax on such an annual fee whereby the overpaid tax could be refunded only for the past three years.

Additionally, paragraph 10.1 of the Commentary on Article 12 of the 2021 OECD Model Convention also substantiates the above interpretation. The Commentary specifies that:

> *"Payments that are solely made in consideration for obtaining the **exclusive distribution rights** of a product or service in a given territory do **not** constitute **royalties** as they are not made in consideration for the use of, or the right to use, an element of property included in the definition [of royalties]."*

ONE Law's Comments

Besides the sole distribution right fee, the analysis above could also apply to other rights such as a right of way, passing right, insurance right, and negative right (i.e., a right to forbid others from acting against the right holder). These payments are not related to intellectual property or industrial information, and thus, they are non-royalty payments.

Also, the above sections cover only classifying the type of offshore payments for exclusive distribution rights whereby considering applicable withholding tax rate should also consider whether the income recipient resides in a treaty country and whether the income

[2] If the recipient does not have a permanent establishment in Thailand, such income is not subject to corporate income tax in Thailand. Thus, the Thai payer is not required to withhold withholding tax on such overseas payments.

recipient has a permanent establishment in Thailand.

Moreover, the Thai payers should make sure whether overseas payments are subject to withholding tax and the applicable tax rates to prevent problems from surcharge from underpaid tax or difficulties from making a tax refund request.

In addition to withholding tax, an overseas service payment is also subject to 7% VAT, regardless of whether such expense is a royalty payment or not.

Keyword: Sole & Exclusive right, Exclusive Distributors, Exclusive Distribution Fee, Royalty, Intellectual Property, Withholding tax, Business Profits, Tax Refund, The Thai Revenue Department, The Revenue Code, Thai Supreme Court, Double Tax Agreement.

ONE Law: In-charge of this article

Yanisa Deevee
yanisa@onelaw.co.th

Em-on Prasongchin
em-on@onelaw.co.th

Chinapat Visuttipat
chinapat@onelaw.co.th

For any further information, please contact:
Email: info@onelaw.co.th
Phone: +66(0)8-0554-8111