WHAT ARE TAX TREATMENTS FOR 'CAPEX' AND 'OPEX' RELATED TO COMMERCIAL CONSTRUCTION?

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The construction of business premises, e.g. office buildings, factories, warehouses, retail shops etc., for business purposes (under this article shall be referred to as **'Commercial Construction'**) would involve many transactions. For instance, the commercial construction project shall involve purchasing fixed assets[1] (i.e., land, office building, and factories), the loan for project funding, commission arrangement, lease of land and building etc. The more transactions involved, the more tax considerations to be taken into account. One of the most significant issues relating to the commercial construction is how to treat expenditure relating to the commercial construction under a tax perspective. This article will focus on the tax treatment of each expenditure relating to the commercial construction.

The expenditure relating to the commercial constructions can be separated into two types which are **'Capital Expenditure** (or **"CAPEX"**)**'** and **'Operating Expenditure** (or **"OPEX"**)**'**. Since corporate income tax ("CIT") is calculated based on the Thai Revenue Code ("TRC"), tax treatments for CAPEX and OPEX related commercial constructions could be <u>different</u> from the accounting treatment.

Understand general concepts, tax treatments, and common tax mistakes for CAPEX and OPEX for commercial construction would help taxpayers manage their tax risks and efficiently arrange their tax planning for companies' benefits.

WHAT IS CAPEX AND OPEX OF COMMERCIAL CONSTRUCTION FOR TAX PERSPECTIVES?

From tax perspective, CAPEX is the expenditure the companies paid for maintaining, altering or improving fixed assets to **extend fixed asset's useful life for <u>over a year</u>**, for example, expenses paid for maintenance to extend fixed assets' useful life, land and building improvements, etc. Furthermore, CAPEX also includes the expenses **paid for the fixed assets acquirement** (i.e. interest on a loan for land purchase).

On the other hand, OPEX is the expenditure **paid for business operation**, **<u>not to</u> extend** the fixed asset's useful life where the company will **benefit from that expense for <u>less than a year</u>**, for instance, expenses paid to restore the building, commission or finder fee paid to realtor or broker for finding land and building seller; land and building registration fee is paid to the Department of Lands.

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[1] Fixed asset is an asset which the useful life is more than a year.

COMMERCIAL CONSTRUCTION EXPENDITURES, CATEGORIZATION, AND THEIR TAX TREATMENTS

Many taxpayers still confuse as to whether expenses relating to commercial construction should be categorized as CAPEX or OPEX because there is no clear line to justify the purpose of some expenses whether there are for acquiring fixed assets maintaining, altering or improving fixed assets to extend fixed asset's useful life for over a year or not, e.g. repair and maintenance expenses, commission fee for acquiring the building, land lease registration fee which line under the company's accountability in the commercial construction scenario. This may result in tax malpractice and liabilities to taxpayers.

The categorization of CAPEX and OPEX, therefore, is a key to correct tax treatments. The below table demonstrates sample of expenses that the taxpayers always have a difficulty categorizing them as to they are CAPEX or OPEX.

CAPEX group		The reason for categorization
Land	**Building**	
Interest expenses on loan for land purchase	Interest expenses on loan for building construction, only the interest paid before the buildings are complete and ready to use	The interest expenses arise from the loan taken to **the fixed asset acquirements** (i.e. land and building).
Land improvement cost	Building improvement cost	These costs paid for improve land and building, and the company could **utilize the land and building improvements over a year**.
Upfront fee	Flooring installation cost	The land upfront fee is paid **for land acquirement** and the floor installation cost paid **to extend the building's ability to use over a year.**
Land transfer fee	Building demolition cost (to remove old building and replace new building)	The land transfer fee and the building demolition cost are paid for **the fixed asset acquirements** (i.e. land and building).

OPEX group	The reason for categorization
Land and Building	
Interest expenses on loan (after the buildings are complete and ready to use)	The interest expenses arising from the loan taken after the buildings are complete and ready to use are considered expenses relating to the business operation, not expenses paid for the acquirement of the buildings.
Land commission/referral fee	The commission fee relating to the acquirement of the lands or buildings, referral fee, land registration fee, or cost for repainting building are considered expenses relating to the business operation, not expenses paid for the acquirement of the lands or buildings, or expenses paid for extending the building's ability to use over a year.
Land registration fee	
Cost for Repainting building	

After the commercial construction expenditures are categorized according to tax concepts as above tables, the next step is to understand tax treatments for CAPEX and OPEX and their examples.

Tax Treatments of CAPEX and OPEX

CAPEX and OPEX tax treatments would be performed when the CAPEX and OPEX transactions per tax treatments are different from the accounting treatments. Hence, understanding these differences between accounting and tax could help the company identify which CAPEX and OPEX transactions could be adjusted for tax purposes.

1) CAPEX

From tax perspectives, CAPEX is a ***disallowed expense*** and shall be **added back** for tax purposes, but it **could be deducted over the fixed asset's useful life** as ***the depreciation*** according to Thai tax laws[2].

To deduct CAPEX as the deprecation, the company would focus on ***the useful lives of fixed assets*** between the accounting and tax treatments specified according to the company's policy and Thai tax law[3].

However, if the useful lives per **accounting are less than tax purposes** (i.e. 5 years for accounting purposes and 10 years for tax purposes) which causes the accounting depreciation being deducted over the depreciation allowed under Thai tax regulations, the tax adjustments for CAPEX must be applied. However, if there is no difference in useful lives between accounting and tax treatments, or if the useful lives per accounting are higher than tax purposes, the tax adjustments for CAPEX may not be required.

Example: *The company paid Baht 10 million for building improvement during the company's fiscal year 2021. The useful life of the building improvement per accounting is 5 years but per tax is 10 years.*

- ***Tax treatments:*** *Since this building improvement cost could be treated as CAPEX for CIT calculation, the company could not deduct the amount of Baht 10 million of building improvement cost for its CIT calculation of the fiscal year 2021. Nonetheless, the company could deduct such building improvement depreciation for Baht 1 million annually (Baht 10 million/ 10 years) from 2021 to 2030 for tax treatments instead.*

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2) OPEX

OPEX is a ***fully deductible tax expense*** for the purpose of corporate income tax calculation, provided that supporting documents evidencing that such expense relates to the business operation and is paid or deemed to be paid within the accounting period under the accrual basis. In addition, the accounting treatment for OPEX is quite similar to the tax treatment.

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[2] Section 65 ter (5) of the TRC

[3] Section 65 bis (2) of the TRC and Royal Decree No. 145

Example: *The company paid Baht 0.5 million for the land commission fee to a realtor during the company's fiscal year 2021.*

- ***Tax treatments:*** *The company could deduct the amount of Baht 0.5 million for land commission fee for the purpose of corporate income tax calculation for the fiscal year 2021 if this expense is paid for commercial purposes and relating to business operation.*

TAX BENEFITS FOR THE EXPENDITURE OF COMMERCIAL CONSTRUCTION

Commercial construction requires huge source of funds and expenses which shall the project owners' cash flow. However, a well-planned tax planning on the expenditure relating to the commercial construction adopted by the project owner may result in tax efficiency. Good understanding on the nature and the treatment of CAPEX and OPEX from tax perspectives shall help the taxpayers achieve that purpose.

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The followings are samples of tax planning on the expenditure relating to the commercial construction and tax benefits available for the taxpayers under the Thai tax law.

- **Tax planning for commercial construction**
  - Tax planning for interest expenses on loan: As the interest on the loan paid during the construction of the buildings should be capitalized as CAPEX which need to be depreciated over the 10 years under the allowable depreciation rate of the buildings, the project owner may negotiate the term of loan agreement by requesting the grace period where the minimal amount of interest will be paid during the construction period to minimize CAPEX which cannot recognize as taxable expenses within the period of payment and may affect the project owner's cash flow.

    For example, the commercial construction would take at least 3 years to complete. The project owner is seeking a loan from commercial banks. The first bank offers the loan with the loan period of 10 years and the interest expenses which would be paid equally every month, says Baht 1 million per month (Loan 1). The second bank offers the loan with the loan period of 10 years and grace period where the project owner would pay minimum amount of the interest in the first three years during the construction, says Baht 200,000 per month, and the interest due will increase to Baht 1.8 million after the grace period (Loan 2).

- Loan 1: In the first three years during the construction, the interest paid (Baht 12 million per year) would be capitalized as CAPEX. The project owner will pay Baht 12 million interest per year but can recognize only Baht 0.12 million per year as depreciation of the building. This will affect the project owner's cash flow during the construction period. After the construction period, as the interest paid will not increase, the project owner will have less interest expense to be recognize as operating expenses for tax purposes comparing to Loan 2. This might result in higher corporate income tax payable comparing to Loan 2.

- Loan 2: In the first three years during the construction, only the minimal amount of the interest paid (i.e. Baht 0.24 million per year) would be capitalized as CAPEX. There would be more efficiency in term of cash flow management during the construction period. Moreover, after the construction period, as the interest paid will increase, the project owner will have more interest expense to be recognize as operating expenses for tax purposes comparing to Loan 1. This might result in lower corporate income tax payable comparing to Loan 1.

- Tax planning for input value added tax ("VAT") utilization

In case the company is a VAT registrant entered into the Land Lease Agreement in the form of Built-Transfer-Operate[4] ("BTO"), the input VAT arising from the construction using in VAT business could be treated as non-creditable input VAT which cannot be offset against output VAT for VAT calculation if the building owner transfers the completed building to the landlord **before three years** since the date of completion[5].

Therefore, it is advisable that building owner negotiates with the landlord to transfer the building **three years after the completion of building construction** instead ("B+3TO"). This will enable building owner **utilize input VAT for construction** to offset against the output VAT for the purpose of VAT calculation under the Thai tax law.

- **Tax incentive related to commercial construction**

The Thai government from time to time grants tax incentive regarding the expenditure spent for purchasing machinery in order to boost up inbound investment. The commercial construction might require industrial machinery where the project owner may utilize such tax incentives which usually provides special deduction of the expense paid for those purposes.

[4] Land Lease Agreement (BTO) means the lessee is accountable for the building construction and has to transfer the building to landlord after construction completed as a part of rental fee (cash-inkind).
[5] Notification of the director-general of the revenue department on VAT No. 42

For example, the Royal Decree issued under the Revenue Code re: tax exemption (No. 710) B.E. 2563 grants 100 percent additional deduction for expenses paid for investment in machinery if the expenses are from 1 January 2019 to 31 December 2020.

KEY TAKE AWAY

The project owner of the commercial construction needs to have good understanding of the type of each expense relating to the commercial construction and the differences of treatment between CAPEX and OPEX. Duly consideration on the categorization of each expenditure relating to the commercial construction must be done in order to enable the project owner to manage its cash flow and tax efficiency.

There are tax planning and tax incentive for the commercial construction available for the project owner (e.g. tax planning on interest expenses on loan, the period of the building transfer under the Land Lease Agreement, the special deduction for taxable expenses) which could help the project owner manage or improve the business operation, i.e. cash flow management, operating performance, term of commercial contract negotiation, etc.

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