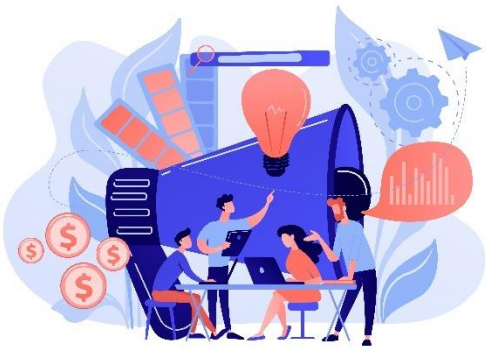
WHY 'MARKETING SERVICE FEE' IS DEEMED AS 'ROYALTY'?



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Payment of the ***marketing service fee*** by a Thai subsidiary to its parent company outside Thailand could be problematic. Especially after the Philips case back in 1997. Thai Revenue Department ("TRD") at the time ruled the fee paid from Philips subsidiary in Thailand to its related party in the Netherlands as '***Royalty***' instead of '***Marketing service fee***'. The Supreme Court then confirmed TRD's notion later in 2012 resulting in the tax assessment on Philips subsidiary in Thailand nearly THB 30 million[1].

What happened? **Why** was this **'Marketing service fee' deemed as 'Royalty'**? You can find our conclusion, analysis, and comments for more clarification below.

TAX CASE OF PHILIPS IN THAILAND

Philips Electronics (Thailand) Limited ("Philips-TH"), a Thai subsidiary under Philips group, **was assessed withholding tax** of the marketing-service-fee payment from 1997 to 2001 by TRD, amounting to the approximate liability of THB 29.1 million (surcharge included). The withholding tax was imposed on the fee (around THB 25 million per annum) paid to Philips Export B.V. of Eindhoven in the Netherlands ("Philips-NT") under the Marketing Service Agreement (the "MSA") which requires Philips-NT to gather and analyze market's environment and consumer's behavior for Philips-TH's planning of new product launch.

Generally, **the payment of marketing service fee** paid by a Thai company to overseas would be treated as a fee for **'Hire of work'** under Section 40(8) of the Thai Revenue Code (the "TRC"), and so **would not be subject to withholding tax** under Section 70 of the TRC, and the double tax agreement between Thailand and the Netherlands (the "DTA").

However, the Supreme **Court ruled in favor of TRD** that the payment was **'License fee'** or **'Royalty fee'** instead. Based on this, Philips-TH was liable for withholding tax deduction on such sum under Section 40(3) and Section 70 of the TRC, and the DTA.

Why Philips-TH lost this tax case?

Considering the decision of the Supreme Court, we could **point out significant weak points** of Philips-TH, as follows:

- **Transferring of experience and know-how could be noticed.**

  Despite Philips-TH's defense that marketing report was **provided based on mere facts** and **marketing principles** and **no kind of experience or know-how** was **transferred** to them, one of the key arguments by the Supreme Court was that **'the substance of marketing**

[1] Supreme Court's decision No. 15773/2555 (*Philips Electronics (Thailand) Limited v Revenue Department*)

services' rendered under the MSA could be considered as licensing of ***'trade secret'*** by Philips-NT. This *is due to the fact* the MSA provided that the Philips-NT has been engaging in this business for nearly a century and fully committed to share the experiences, provide marketing and selling products services. Thus, it seemed reasonable to the Court to believe **that transferring of experience and know-how** by Philips-NT to Philips-TH was **unavoidable**.

Agreement's terms and conditions give rise to the protection of Philips-NT's confidential information.

The Court's notion was also supported by the content of the MSA indicating, under the **confidentiality condition**, that Philips-TH is the only entity that can utilize advice received from Philips-NT, and Philips-TH shall *not sell or transfer this advice to unauthorized third parties*. Therefore, the Court considered that Philips-NT acted as **the right holder of the trade secret**.

Fee arrangement is not on the basis of work done.

The Court also pointed out that the fee arrangement (i.e., 0.5% of Net sales per annum), *which was consistently paid regardless of any work delivered*, ***did not reflect*** the services Philips-TH received from Philips-NT, and are of the nature of the licensing agreement instead.

Lack of supporting documents of marketing services.

Philips-TH was **unable to provide evidence** or **supporting documents** of the services so rendered by Philips-NT (i.e., marketing report).

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The above is what we believe were the decisive factors that led to **Philips-TH's huge payment of tax liabilities** after two tiers of court's procedures. Similarity can be found in another tax case of ***Electrolux (Thailand)***[2], held later in 2014, where the Court was of the opinion that marketing services which included the provision of the parent company's **information and picture** (for advertising brochure and catalog) contained **specific knowledge**, **technique, and experiences of the parent** for its **commercial products**. As a result, the fee paid to the offshore related party was **deemed as 'Royalty'** as well.

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In conclusion, ***to avoid the same tax mistake***, a Thai service receiver shall ensure that: -

(i) **provision of marketing service** under the service agreement results in reasonable deliverable; -
(ii) the **fee** quoted under the service agreement should be related to or reflect the work delivered; -
(iii) **sufficient supporting documents** for fee payment's purposes shall be required under the service agreement and to be provided upon actual payment (i.e., marketing report); and

[2] Supreme Court's decision No. 5808/2557 (*Electrolux (Thailand) Col., Ltd. v Revenue Department*)

(iv) if possible, the service agreement shall limit **transferring of know-how** and **commercial experience** of the service provider.

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On a separate note …

Oddly, the common fact of both Philips and Electrolux cases is that **both plaintiffs** cannot illustrate to the satisfaction of the Court the **proof of marketing service rendered** to them, and it seems that the fee would be paid every year ***regardless*** of what being delivered, if any.

This can give rise to our observation that both TRD and the Supreme Court may use these two cases as an opportunity to tackle **aggressive inter-company tax planning** where the offshore parent **shifts profit** from its subsidiary in Thailand through another offshore related party by way of **'Marketing service fee'** which is generally not subject to tax in Thailand, and no marketing service is actually performed. Labeling such transaction as **'the licensing of rights'** and the fee paid under the transaction as the **'royalty'** would enable Thailand to withhold tax on the fee upon its payment *(THB 25 million per year in case of Philips and THB 11 million per year in case of Electrolux)*.

Although it cannot be clearly concluded as it is not stated in the Court's judgment, we are of the opinion that achieving the ***Court's requirements*** discussed above (i.e., reasonable marketing fee, tangible evidence prepared, etc.) could help the Thai service receiver in **minimizing tax risks** arising from **'unclear tax treatment'** of marketing service fee payment**.**

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