

Advantage

Tax and business law intelligence for international companies



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TAX RISK MANAGEMENT

Beware of the Hidden Tax Risks in Your Business Strategies for the Recession

By all accounts, 2009 is going to be a recession year for business in Thailand. You should not expect the Thai Government to make it any easier for you, you should not expect the taxman to be any kinder to you as far as your compliance obligations are concerned, and in relation to the recession strategies that you could be implementing in 2009, you should be aware of the hidden tax risks that are inherent in some of those strategies.

Selling at Below Market Prices

A business strategy of selling at lower prices is often adopted in recession years. Whilst such a strategy is primarily intended to improve a company's cash flow and in some cases, is vital for a company's survival in a recession, selling at below market prices can result in a (surprising) tax liability.

Before you implement any strategy of selling at below market prices, you need to carefully consider and formulate a position with respect to Section 65 bis (4) of the Revenue Code, which prescribes as follows:

"In the case where, without justifiable ground, property is transferred, service is rendered or money is lent without any compensation, service charge or interest, or with compensation, service charge or interest at an amount lower than the market value, the assessment officer has the power to assess the compensation, service charge or interest at the market value on the date of the property transfer, rendering of service or lending of money."

In layman's terms, this provision requires a Thailand company, for the purposes of computing income tax, to always account for sales of goods and services at the market value on the date of the sale of goods or rendering of services.

Only when there is "justifiable ground" for selling at a lower price shall a Thai company be allowed to apply the lower prices for the purposes of computing tax liability. If your company does not have a "justifiable ground", the Revenue officers can adjust your sales prices and re-assess your company's corporate tax liability.

You may think that the global economic downturn is a sufficient "justifiable ground" for selling below market prices. But merely saying that is not enough. As all tax liabilities in Thailand are determined on the self-assessment system, your company has the onus of proof, under the self-assessment system, to prove to the Revenue officers that "justifiable ground" does exist for your particular company and your particular circumstances, and invariably such proof is required in documentary form.

Remember, it's going to be a few years before the Revenue officers investigate your strategy, and proof in documentary form is therefore vital if you are to successfully argue against any Revenue challenge a few years after the event.

There is no definition of "justifiable ground" in the law, and apart from a guideline giving justifiable ground to companies selling goods and services to the Thailand Government for their special projects, there are no other guidelines for "justifiable ground" under the law.

The guidelines for this matter are really only obtained from researching and examining past tax rulings of the Revenue Department and past judgments of the tax courts. We have done this for you, and below are some rulings and judgments, which should help you to determine whether your own company's strategy for selling at lower prices could be caught by Section 65 bis (4) of the Revenue Code.

Selling motorcycle spare parts below the market price to an affiliated company was held not to be justifiable for the purposes of Section 65 bis (4).

Selling liquor products to retailers below the market price because of potential gains to be made by other means was held not to be justifiable for the purposes of Section 65 bis (4).

Selling audio equipment and appliances to a certain customer below the market price because another customer had previously ordered them and cancelled the order was held not to be justifiable for corporate income tax purposes under Section 65 bis (4).

Selling chemical products below cost price because the chemical products are sold according to the world market price was held to be a justifiable ground for the purposes of Section 65 bis (4).

Selling cars below the cost price because demand for cars had plummeted but the car dealer was obliged to meet a certain sales volume that it had contractually promised to a foreign car manufacturer, requiring the car dealer to sell at prices below cost to stabilize the cash flow of the business in order to survive was held to be justifiable for the purposes of Section 65 bis (4).

The “guideline” that can be extracted from these few cases is that selling property below market price is a permitted justifiable ground for the purpose of Section 65 bis (4) of the Revenue Code only when there are specific independent external forces on the particular company that dictate the selling of property at lower prices. In the case of the chemical products retailer, it was the world price dictating the retailer’s below cost retail prices, and in the case of the car dealer, it was the contractual commitments to an independent party and the resulting cash flow effect that dictated the car retailer’s need to sell at prices below cost.

In both cases, the chemical products dealer and the car retailer provided documentary evidence for their selling below market price, the documentary evidence provided was external rather than internal, and there was clear evidence before the court that selling below market price was not just a ploy to create tax losses.

Offsetting Debts

Thai tax law imposes withholding tax on payments of services from or in Thailand to foreign companies and it also imposes VAT on the payment, for which the payer in Thailand is liable, according to the reverse-charge rule. The tax point (i.e. the time when the tax liability is triggered) for such withholding tax and VAT is the date the payment is made to the foreign company.

If you implement a business strategy of offsetting an accounts payable debt owed to a foreign company against an accounts receivable debt owed from the foreign company, you should be aware that the offset is considered to be the same as physically making a payment. This means that on the date of the offset, the tax point is triggered, and you remain obliged to the Revenue Department for the withholding tax and the VAT liabilities.

Accepting “Haircuts” on Debts

A business recession strategy of accepting haircuts on debts that are owed to a foreign company can also result in a (surprising) tax liability for your company.

If a foreign company grants a haircut on a debt for a service rendered or some other similar kind of debt (such as a royalty) in order to ease your company’s financial burden, then because the haircut reduces the payment or cancels the payment altogether, you may think that both the withholding tax and the VAT obligations are relieved.

But this is not so for VAT. The Thai tax law imposes VAT on services rendered by a foreign company and used in Thailand irrespective of payment being made.

Therefore, in the case of a haircut being accepted on a debt, although there may be a reduced payment or no payment at all, the VAT liability still arises because the service has been rendered and used.

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