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WHT AND VAT COMPLIANCE Thailand Franchisees Beware!

Local advertising and promotion spending by Thailand franchisees has been ruled to be a royalty payment under their franchise agreements.

Foreign franchisors enter into franchise agreements with franchisees in Thailand in virtually the same way they enter into agreements with franchisees in other countries around the world, and it is normal for the foreign franchisors to incur withholding tax liability in the country of the franchisee when franchisees remit their fees to the foreign franchisor.

But in Thailand, this withholding tax liability has now been extended to the local advertising and promotion spending that is required of the franchisee under the terms and conditions of the franchise agreement.

The framework of a franchise agreement is that the franchisor provides the franchisee with access to and the right to use the system and intellectual property of the franchised business for a fee, commonly known as the franchise royalty fee. The franchise royalty fee can be paid up front, and usually, as a percentage of the franchisee's on-going sales revenues.

In addition to the payment of the franchise royalty fee, the terms and conditions of the franchise agreement requires the franchisee to spend an amount on local advertising and promotion activities (again, usually a certain percentage of the franchisee's on-going sales revenues). And before a franchisee can carry out the local advertising and sales promotion activities, the franchisee is required to obtain the approval of the franchisor in order to ensure that it complies with the franchisor's rules and conditions and that it will not harm the brand and the image of the franchised business.

Pursuant to the provisions of Section 70 of Thailand's tax code and Article 12 of Thailand's tax treaties, just about all amounts paid (other than payments for the purchase of physical goods) by a Thailand franchisee to a foreign franchisor are subject to withholding tax at source at the rate of 15%.

A Thailand franchisee is also required to make a 7% VAT remittance to the Thailand Revenue Department on behalf of the foreign franchisor according to the reverse-charge rule prescribed in Section 83/6 of the Thailand tax code.

For both the withholding tax and the VAT liabilities, the tax code clearly prescribes that the liabilities arise when the Thailand payer "pays" the foreign company, and most Thailand franchisees would be remitting the required 15% WHT and the 7% VAT on payment of their franchise royalty fees to the foreign franchisor.

But they would not generally be doing so for the local advertising and sales promotion spending paid to a Thailand-based advertising agency/service provider, because for such payments the tax code prescribes the payer having the duty to remit 2% or 3% WHT (as the case may be) and the advertising agency/service provider having the duty to remit the 7% VAT.

Surprisingly, the Thailand Revenue officers claimed, for one particular Thailand franchisee, that because the local advertising and sale promotion spending is a condition under the franchise agreement, the sums spent on local advertising and sales promotion were part of the consideration for the right to operate the business, and therefore, the local advertising and sales promotion spending was subject to 15% WHT under the royalty rule and 7% VAT under the reverse-charge rule, the same as for the franchise royalty fee.

The Thailand franchisee disagreed with the Revenue officers' argument and referred the matter to the Tax Court, which ruled in favor of the Thailand franchisee, saying that the advertising and promotion spending by the franchisee in Thailand cannot be considered as being paid to or received by the foreign company franchisor.

But the Revenue Department officers appealed the Tax Court's ruling to the Supreme Court, which has just very recently handed down its decision in favor of the Thailand Revenue Department.

Summary of Supreme Court Case No 4440 / 2552 (2009)

A Thailand franchisee entered into an agreement with a foreign company franchisor for the right to use the franchisor's system, trade name, trademarks etc for the purposes of operating the franchised business in Thailand.

According to the franchise agreement, the franchisee is required to incur advertising and sales promotion expenses in an amount not less than 3.5% of annual gross sales.

The franchisee is required, under the agreement, to hire a local advertising company in Thailand to carry out the advertising and sales promotion activities and to pay the amount of not less than 3.5% of annual gross sales to the local advertising company.

The Revenue Department officers formed the opinion that the payments to the local advertising company for the advertising and sales promotion activities in Thailand should be treated, for tax purposes, in the same way as the franchise royalty fee payment under the franchise agreement.

The Revenue Department assessed the franchisee 15% withholding tax and penalties on the advertising and sales promotion expenses on the basis that they are royalty payments under Section 70 of the Thai Rev-

-enue Code, plus 7% VAT and penalties thereon according to the reverse-charge rule under Section 83/6 of the Revenue Code.

The Supreme Court concurred with the assessment of the Revenue Department. It ruled that because the requirement for the Thailand franchisee to spend on advertising and sales promotion in Thailand is a condition under the agreement, the local advertising and sales promotion spending is therefore part of the consideration payable to the foreign franchisor for the right to operate the franchised business.

The Supreme Court reasoned as follows:

- Section 70 of the Revenue Code subjects the amount of assessable income to withholding tax, Section 39 of the Revenue Code defines the term assessable income to mean any property or any other benefit received, which is ascertainable in terms of money, and the amount of assessable income under Section 70 of the Revenue Code should be interpreted accordingly.
- The foreign franchisor prescribes the condition for the local advertising and promotion spending and controls the form and the content of the local advertising and promotion, which means that the Thailand franchisee is not undertaking the local advertising and promotion activities by and for its own business but also for the foreign franchisor's business.
- The local advertising and promotion spending of the Thailand franchisee is a benefit received by the foreign franchisor as defined in Section 39 of the Revenue Code and therefore the assessable income to the foreign franchisor under Section 70 of the Revenue Code.

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