

Call in for a Coffee – Tax Update

Hong Kong Permanent Establishments in Thailand

Our Call in for a coffee Edition No.29 (September 2005) introduced you to the new Hong Kong – Thailand Double Tax Agreement (DTA), which became effective on 1 January 2006 in Thailand.

As Hong Kong residents and Hong Kong Companies are not used to having to consider a DTA, it is therefore important for Hong Kong residents and companies to determine whether they have, or are deemed to have, a permanent establishment in Thailand under the rules in the new Hong Kong – Thailand DTA.

This is important because once a Hong Kong company has, or is deemed to have, a permanent establishment in Thailand, it will be subject to 30% corporate income tax in Thailand, as well as 10% profit remittance tax (i.e. a total of 37% tax in Thailand).

Assets tests

The first series of tests to be determined are whether a Hong Kong company has a permanent establishment by reason of it having 'assets' in Thailand. The 'assets' tests are:

- A place of management;
- A branch;
- An office;
- A factory;
- A workshop;
- A mine, an oil or gas well, a quarry or any other place of extraction of natural resources; and,
- A warehouse, in relation to a person providing storage facilities to others.

Activities tests

The second series of tests concern the 'activities' of a Hong Kong company in Thailand, and in this regard, the Hong Kong – Thailand DTA prescribes that the following shall be deemed to be a permanent establishment in Thailand:

- A building site, a construction, an assembly or an installation project, or supervisory activities in connection therewith, but only if such site, project or activities last more than 6 months; and,
- The furnishing of services, including consulting services, by an enterprise through employees or other personnel

engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting country for a period or periods aggregating more than 6 months within any 12 months period.

Agency tests

The third series of tests is the 'agency' test, and the Hong Kong – Thailand DTA prescribes that the following 'agency' activities of a person in Thailand could deem a Hong Kong permanent establishment in Thailand:

- Where a person in Thailand habitually exercises in Thailand an authority to conclude contracts in the name of the Hong Kong company;
- Where a person in Thailand habitually maintains in Thailand a stock of goods belonging to the Hong Kong company from which he regularly delivers on behalf of the Hong Kong company; or,
- Where a person in Thailand habitually secures orders in Thailand wholly or almost wholly for the Hong Kong company or for the Hong Kong company or other companies, which are controlled by it or have a controlling interest in it.

Commentary on the tests

The main purpose of the permanent establishment tests is to determine the right of a country to tax the profits of an enterprise of another country. Under the Hong Kong – Thailand DTA, Thailand cannot tax the profits of a Hong Kong company unless the Hong Kong company carries on its business through a permanent establishment in Thailand.

The assets tests determine a permanent establishment existence according to characteristics of a permanent establishment, being a fixed place of business at a company's disposal. These characteristics can be seen from the following examples:

- An employee of a Hong Kong company uses an office at a Thailand company (e.g. a newly acquired subsidiary) in order to ensure that the Thailand company complies with its obligations under contracts concluded with the Hong Kong company. In this case, the Hong Kong employee is carrying on activities related to the business of the Hong Kong company and the office that is at his disposal at the Thailand company constitutes a permanent establishment of the Hong Kong company.

- A Hong Kong salesman regularly visits a Thailand customer to take orders and meet with the Thailand purchasing officer in his office in Thailand. In this case, the Thailand customer's office is not at the disposal of the Hong Kong company for which the salesman works and therefore the office would not constitute a fixed place of business through which the business of the Hong Kong company is carried on. (However, in this case, one would also have to consider the agency tests.)

The 'activities' tests consist of two paragraphs, which provide expressly that a building site or construction or installation project or furnishing of services constitute a permanent establishment if such activities last for more than 6 months.

The term "building site, a construction, assembly or installation project" includes not only the construction of buildings, but also the construction of roads, bridges or canals, the renovation of building roads, bridges and canals, the laying of pipe lines and excavating and dredging. Additionally, an "installation project" is not restricted to an installation related to a construction project, but also includes installation of new equipment, such as a machine. Onsite planning and supervision of the erection of a building, construction, assembly or installation projects are also covered.

Activities of furnishing of services (including consulting services, professional advisory services and any other services of an independent nature) through employees or other personnel engaged by a Hong Kong enterprise, when such activities last for more than 6 months, also constitute a permanent establishment of the Hong Kong company.

The 'agency' tests deem a Hong Kong company having a permanent establishment in Thailand if there is, under certain conditions, a person in Thailand acting for the Hong Kong company, even though the Hong Kong company may not have a fixed place of business in Thailand. The agency tests give Thailand the right to tax in such cases.

The agency tests proceed on the basis that persons in Thailand having "authority to conclude contracts" can lead to a permanent establishment for a Hong Kong company maintaining the contracts. In such a case, the person in Thailand has authority to bind the Hong Kong company's participation in the business activity in Thailand.

The phrase "authority to conclude contracts" does not just confine the application of the test to an agent who enters into contracts literally in the name of the Hong Kong company. The test applies equally to an agent who concludes contracts, which

are binding on the Hong Kong company, even if those contracts are not actually in the name of the enterprise. For example, a Thailand agent is usually considered to possess authority to conclude contracts where he solicits and receives (but does not finalize) orders which are sent directly to a Hong Kong company, which approves the transactions.

The requirement that the agent "habitually" exercises an authority to conclude contracts reflects the principle that the presence and activity should be more than transitory to be regarded as a permanent establishment. But, it is not possible to lay down any frequency tests.

Where a Hong Kong enterprise carries on business dealings through a broker, general commission agent or any other agent of an independent status in Thailand, it cannot be taxed in Thailand in respect of those dealings if the agent is acting independently and in the ordinary course of his business.

Where a Thailand agent's commercial activities are subject to instructions or control by a Hong Kong company, such an agent cannot be regarded as independent of the Hong Kong company.

Another important factor will be whether the commercial risk of a transaction is borne by the agent (independent) or is borne by the Hong Kong company (permanent establishment).

Finally, a factor that is often considered by the Thailand Revenue officers for determining independent status is the number of principals represented by the agent. Independent status is more likely if the activities of the agent are performed for more than one enterprise.

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