

Call in for a Coffee - Tax Update

Thailand companies now have the long awaited law allowing for tax exemption on dividends they receive from offshore companies. Or do they?

We refer to the Royal Decree issued under the Revenue Code No.442, effective as from 24 November 2005, and we believe that it is important to bring the following matters to the attention of clients and the Thailand business sector generally.

We have been watching the developments concerning the granting of taxation exemption on dividends received from offshore companies very closely, and this article seeks to explore with you some of the technical tax matters that have taken place over recent times in Thailand.

On 17 August 2004 (around 18 months ago) a Thailand Government "policy" announcement was made stating that the following would be implemented in order to increase the country's competitiveness:

"In order to increase the competitiveness of Thai businesses in foreign countries through tax privileges close to or equivalent to those available for local investment, it is considered appropriate to introduce tax measures to allow limited companies that are established under Thai law and which invest in juristic companies or partnerships established under a foreign law, to be exempt from tax on dividends received, subject to the following conditions:

1. The company, which is the recipient of the dividends must hold not less than 25% of the voting shares in the company paying the dividends for a period of not less than 6 months before the date the dividends are received;
2. The said dividends must be derived from taxable net profits in the foreign country at the normal tax rate of not lower than 15% of the net profits; and,
3. In the event that a special law in a particular foreign country stipulates a tax reduction or exemption for the net profits under 2, the company which receives the dividends is still eligible for tax exemption under this measure."

It should be noted that the above "policy" announcement is in line with international taxation conventions.

The following Tax Ruling, however, seems to have ruled against the above Thai Government policy announcement. This is understandable, but what is far more interesting is that the Revenue Department seems to apply a different interpretation for the allowance of the tax exemption.

On 21 March 2005 (around 9 months ago), the Thailand Revenue Department issued Taxation Ruling No Gor Kor 0706/2319, denying tax exemption on dividends received from a Singapore company.

The facts of the case involved a Thai company holding 100% of the voting rights shares in a Singapore resident company and receiving dividends from that Singapore resident company. Under Singapore's domestic law, dividends are not subject to withholding tax at source and the Thai company understood that the dividends paid by the Singapore company would be entitled to Thai tax exemption under the provision of Article 23(2) of Thailand-Singapore DTA.

Article 23(2) of that DTA provides that where a Singapore resident company pays a dividend to a Thailand resident company, which holds not less than 25% of the voting shares in the Singapore company, the dividend received shall be exempt from Thai tax.

The Revenue Department explained that tax relief under Article 23(2) of the DTA would only be granted where income is taxed again in the resident country after it has been taxed in the source country. In this case, the Revenue Department said, since the dividends are not subject to withholding tax in Singapore, there should be no relief of taxation in Thailand because no double taxation has been incurred by the Thai Company. The Revenue Department thus concluded that Article 23(2) of the DTA was not operative and the Thailand company was required to include the dividend as income for corporate income tax purposes in Thailand.

Singapore does not impose withholding tax on dividends because it chooses not to subject Singapore corporate income to double taxation in Singapore. What should be decisive in granting the dividend tax exemption under the Thailand-Singapore DTA is that the Singapore company should be "subject to tax" (which is similar to what the policy announcement prescribes), and not whether the distributed profits (dividends) have actually "been taxed".

In our opinion, the words in the DTA are clear: the income should be "subject to tax" as distinguished from income "being taxed". Singapore as the source state, is entitled to tax dividends, but Singapore chooses only to tax the profits from which the dividends are derived (and not the dividends themselves). Our view is that it should have been considered that the dividends received from the Singapore resident company should be exempt from Thai tax under the DTA.

An international tax opinion on this issue can be found in the German Federal Tax Court Case No IR 127/95 dated 27 August 1997 regarding the application of the German - Canada DTA Article 23(3). In that case, the Court ruled that "exemption from German tax could not be denied although the income concerned was not "taxed". The German Federal Court agreed with the taxpayer that the income of the permanent establishment has been "subject to tax" in Canada, because one has to look to the income of the permanent establishment as a whole".

If the opinion expressed in the above Ruling is indicative of the Revenue Department's practice in this matter, then dividends that are paid by offshore companies to Thai recipient companies may never be eligible for tax exemption. That is, irrespective of any DTA prescription, and irrespective of any Thailand Government policy announcement or law.

This now brings us back to our newly issued Royal Decree No 442, which provides as follows:

For Thai resident private and public companies receiving dividends from the holding of shares in foreign companies, such dividends are excluded for the purposes of computing Thai corporate income tax when the following conditions are met:

1. The Thai company must hold at least 25% of the voting rights shares in the foreign company paying the dividends;
2. The Thai company must carry on holding those shares in the foreign company paying the dividends for at least 6 months before the date of receipt of the dividends;
3. The dividends must be paid from the net profits of the foreign company paying the dividends, which has been subject to domestic corporate income tax at a rate not lower than 15%; and,
4. In the case where there is a special law in the foreign country of the company paying the dividends that provides for reduction or exemption of corporate tax on net profit, the Thai company is still entitled to exemption under this provision.

Remember what the Revenue Department said in Tax Ruling No Gor Kor 0706/2319? It said that taxation relief would only be granted where income is taxed again in the resident country after it has been taxed in the source country. In the case of dividends, the Revenue Dept said, since the dividends paid are not subject to withholding tax in Singapore, there should be no relief of taxation in Thailand because no double taxation has been incurred by the Thai Company.

Is there a difference of opinion between the Thai Government policy and the Revenue Dept interpretation in respect of this matter?

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