EFFECTIVE TAX PLANNING FOR COMMERCIAL CONTRACTS

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Presentation Outline

- Strategic tax planning for commercial contracts
- Transfer pricing
- Strategies to minimize tax exposure and liabilities
- Tax covenant and warranties

Tax planning strategies

Overview- an uncertain environment

- Tax laws are not prescriptive – open to interpretation
- Some specific issues are dealt with by Public Guidelines rather than law
- Private rulings given by the Revenue Department have been published - and subsequently overturned

Overview

- Tax laws have not kept pace with global and local developments
- “Market” approach to tax treatment – consistent treatment by market players may influence the ultimate interpretation of the tax laws
- Form v substance to determine tax treatment

Key tax considerations for commercial contracts

Taxes under the Revenue Code

- Corporate income tax
- Specific Business Tax
- VAT
- Withholding taxes
- Stamp duty

And taxes under other laws!

Tax risk management

- Understanding tax positions in your business
- Understanding relevant tax liabilities when entering into contracts
- Proposing tax issues to your tax risks management team: CEO, CFO, tax director, accounting director
- Seek tax advice!
- Discuss tax issues with other party
- Consider requesting a tax ruling from Revenue Department

Transfer pricing

Importance of Transfer Pricing

- Transfer pricing (TP) is the single most important issue for corporate tax departments of cross-border businesses
- 86% of multinational parents rank TP as the most important international tax issue
- 93% of subsidiaries also rank TP!

How to manage TP risk

- Documentation is critical to successful TP policy
- Key means of demonstrating compliance with arm's length principle
- Sets tone for how taxpayer will be perceived
- Should be treated as a protective tool requiring careful analysis

List of 10 documents

1. Documentation indicating the structure and relationship between businesses in the same group, including structure and nature of business of each entity.
2. Budgets, business plans and financial projections.
3. Documentation indicating the company's business strategies and the reasons for adopting such strategies.
4. Documentation indicating sales and operating results and the nature of its transactions with the group companies.
5. Documentation indicating the reasons for entering into international transactions with group companies.

List of 10 documents

6. Pricing policies, product profitability, relevant market information and profit sharing of each business. **Consideration should be given to functions performed, assets utilized and risks assumed of the associated businesses.**

7. Support for why a particular pricing methodology is selected.

8. Where several pricing methods are considered, documentation indicating the methods apart from the method in (7) and the reasons for rejection of these methods. These documents should be created at the same time the decision is made to select the method in (7).

9. Evidence of the negotiation positions taken by the company in relation to its international transactions with associated enterprises and the basis for those negotiating positions.

10. Other documents in determining market price (if any).

The role and value of economic analysis

- TP is based on the arm's length principle
- The key concept underlying this principle is comparability
- TP is a "benchmarking exercise". The pricing of dealing between related parties must <u>always</u> be benchmarked in some way against this fictional arm's length price.

Some tax planning strategies

Tax consequences: Leasing real estate

Tax Liabilities	Rental of imm. property	Rental of furnishings	Services
Withholding tax	5%	5%	3%
VAT	Exempt	7%	7%
Stamp duty	0.1%	No	0.1%

Tax consequences: Hire of work, Sale of goods

Tax Liabilities	Hire of work	Sale of goods
Withholding tax	3%,5%	No
VAT	7%	7%
Stamp duty	0.1%	N/A

Tax planning for offshore entity

Permanent establishment ("PE"):

- ✓ having "activity-type" PE in Thailand :specified in DTA: construction, installation, assembly or supervision (Activity test) and
- ✓ Period 3, 6 months or 183 days in any calendar year or accounting period (Time-test)
- Connected project.

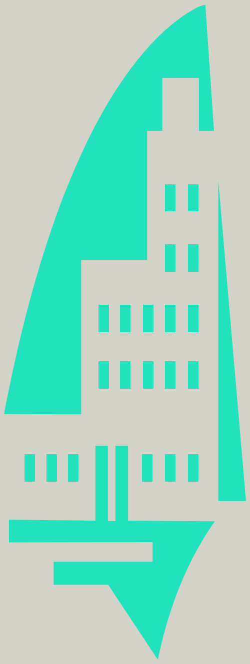
Tax planning for offshore contractor

- **For instance**: A Co offshore has a construction project for a Thai customer consisting of materials, equipments and labor, value of project: **Baht 100,000,000.**
- **Tax planning**

- Offshore supply contract: materials and equipment cost Baht 80,000,000 Engaged by A Co.
- Onshore supply contract: onshore materials and equipment, installation and construction cost Baht 10,000,000 and labor Baht 10,000,000 engaged by new Thai Co.
- Offshore supply contract executed outside Thailand and the ownership of offshore materials and equipments transferred outside of Thailand.

Tax consequences

Tax	Offshore 80 M	Onshore 20 M
CIT 30%	No	On net profit
WHT 3%	No	600,000
VAT7%	No	1,400,000
Stamp duty 0.1%	No	20,000



Summary of Court decisions on the split of the hire of work and sale of goods contracts

- Split of sale price and the fee of hire of work in one contract is acceptable under certain conditions:

- The Court considered the context of the Agreement.

- The contractor shall not have agent employee or go-between in Thailand upon the execution of the contract.

Summary of Court decisions on the split of the hire of work and sale of goods contracts

- The price of materials and equipment are separately agreed from the price of the hire of work in the contract.
- The transfer of ownership takes place outside of Thailand.
- The terms of payment for offshore materials and equipment is not tied to the completion of hire of work.

Joint venture or Consortium

Joint venture	Consortium
Joint capital	No word contained as JV in the written agreement
Joint works	No joint capital
Joint profit and loss	Clearly separate works for each party
	No joint receipt of revenues
	No sharing of profit

(Private ruling No.Gor Kor 0802/12307 dated 25 July 2539)

Tax consequences:
Joint venture VS Consortium

Joint venture	Consortium
Register as tax entity	Not register
All income :30% in joint venture entity	Income received by each party shall be included in computation of CIT in its own account.
Register for VAT	Not register for VAT
Tax invoice, receipt issued or received – in the name of JV	Tax invoice, receipt issued or received – in the name of each party

Tax covenants and warranties

Some examples

- Quoting prices net of taxes – be clear what taxes you mean.
- Clauses that pass the liability for taxes from one party to another.
- Transactions with foreign parties – who will be liable for the withholding taxes and VAT – should we apply double tax agreements?

Example – sale of real estate

- **"The Buyer shall be responsible for all conveyance or government fees and any other taxes fees or dues in any way relevant to the sale in relation to the registration of the transfer of ownership."**
- The seller is shifting the liability for all transfer taxes and fees to the buyer – under the law they should be on his account except the 2% registration transfer fee, which is shared equally.

Warranties

Company acquisitions

- Often a “boilerplate provision” - the seller give warranties regarding tax liabilities.
- Weigh up the value of the words – are you prepared to enforce the contract and litigate?
- Due diligence tax reviews will clarify tax issues that exist.

Questions from the floor

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Presenter profile

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BDO profile

BDO Richfield Advisory Limited specialises in providing tax and legal services to international clients operating in Thailand and the Asia Pacific region.

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