

**BIZ INSIGHT**

# The tax pitfalls of marketing expenses for operators

**SPECIAL TO THE NATION**

IN DOING BUSINESS, companies will incur operating costs that vary according to the nature of the undertaking.

For manufacturers, the key operating costs, apart from raw materials and overheads, might include such expenses as manufacturing know-how and technical assistance. For distributors, the key operating costs will normally include inventory, marketing and selling, and administrative expenses.

From the business point of view, all of these costs would be regarded as expenses necessarily incurred. Efficient cost management should then lead to profitability, while inefficient cost management could lead to losses.

However, it's never that simple when taxes are involved. Costs incurred by businesses are not always regarded as being incurred exclusively for the purpose of acquiring profit, or even for the purpose of the business. Excessive costs and unqualified costs can lead to

tax adjustments. That's not all. In addition to corporate income tax, there are value added tax and withholding-tax issues that could cause headaches for business operators.

When considering marketing expenses, as an example, business operators should not overlook the withholding-tax issues, especially when cross-border payments are involved.

Under Thai tax law, marketing expenses will generally be subject to 15-per-cent withholding tax when paid to an overseas service provider unless the payment is regarded as being in the nature of 'business profit' under a tax treaty that Thailand has concluded with the other country, in which case it will be exempt from withholding tax.

This seems to be a straightforward tax matter, right! So, how could an issue like marketing expenses create a lot of tax trouble for a business operator?

There was an interesting Supreme

Court judgment (No 5807/2557) last year regarding marketing fees paid to an overseas company by a distributor of branded electrical appliances in Thailand that I would like to share with you.

The distributor hired the foreign company to provide marketing services covering the design and preparation of leaflets, brochures, catalogues and other marketing papers based on the qualifications and specifications of the appliances, and also included advice on sales promotion campaigns.

The distributor agreed to pay a service fee to the foreign company as a percentage of its annual sales and treated the payment as business profit under the relevant double-taxation treaty.

The payments were later disputed by a Revenue officer, who took the view that the fee should be regarded as a

'royalty' and therefore subject to 15-per-cent withholding tax.

The distributor disagreed and claimed that it had only received print ads and not secret information, know-how or the right to use any copyright, patents or trademark. Furthermore,

there is no law specifying that a payment calculated as a percentage of sales will be regarded as a royalty.

The case eventually reached the Supreme Court, where the judges ruled that the marketing fee paid by the distributor was in the nature of a royalty and therefore was subject to Thai withholding tax.

Based on the judgment, the factors used by the Supreme Court included the skills and investment of the service provider, the relationship between the parties, and the supporting documents.

The judge also commented that the

print ads contained literary work (for example, articles and photographs) which required a high investment and skilled staff to deliver the services. The service provider also had to use technical expertise regarding the products that may be secret information.

The service provider and the taxpayer are group companies under the same control and at the same time the taxpayer lacked strong and sufficient evidence to support its testimony on the services received, according to the court.

Taking all of these factors into account, the Supreme Court agreed with the Revenue Department that the fees were royalties in nature.

In general, however, whether marketing fees may or may not be regarded as royalties will depend on the activities, efforts and deliverables performed by service providers, as well as the limitation of use imposed on the recipients of the services.

If you are going to enter into a similar business arrangement, the most important thing is to start in the right way from the beginning, where the form and substance must be in line with each other.

You should ensure at least that the scope of services is clearly defined, the payment structure is in line with the nature of the services, and any other terms of business are also in line with service objectives.

All deliverables and supporting documents should be kept properly, and the relevant tax implications should be determined and evaluated.

This is in order to have strong grounds and support if ever the arrangement is questioned later by the authorities.

If you start it right at the outset, from both the technical and documentation aspects, your tax risk should be well-managed and your exposure to tax, penalties and surcharges mitigated.

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