

# Supreme court sets precedent on royalties



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Taxpayers and the Revenue Department have been locked in endless disputes over the nature of fees paid to offshore service providers. Should such fees be classified as “royalties” or “service fees” under an agreement for avoidance of double taxation, more commonly known as a tax treaty?

If any fee is regarded as a “royalty”, it continues to be subject to 15% withholding tax without regard to the application of a tax treaty (a reduced tax rate of 5%, 8% or 10% may be available under some treaties). Yet, if the service fee is regarded as “business profit”, it will be eligible for withholding tax exemption in Thailand, provided the foreign company has no “permanent establishment” in the country.

As the interpretation of this matter could give rise to 15% withholding tax, the term “royalty” needs to be considered carefully. Basically, it includes “consideration for information concerning industrial, commercial and scientific information”, but most assessment officers broaden the interpretation. Their view is that if, in the relevant service agreement, the foreign company represented that “it has expertise or experience and it is qualified to provide certain technical services” to the Thai company, they would treat it as “information concerning industrial, commercial or scientific experience” and the fee would be considered a “royalty” for withholding tax purposes.

Taxpayers are likely to argue that such an interpretation is erroneous and contrary to the OECD commentary that guides interpretations. In reality, there is no good reason for a taxpayer to enter into a contract with a foreign contractor who lacks experience or expertise or who is not qualified to perform work.

In an extreme case, if a foreign company enters into a licensing agreement to grant the right to use intellectual property to a Thai company and, at the same time, enters into an offshore service agreement to provide the same party with certain services not related to the use of such intellectual property (i.e., management and administration), tax authorities will not hesitate to consider the fees under both agreements as royalties and impose 15% tax. This raises an issue as to the legal basis and tax policy that would require a foreign company acting as a licensor and, at the same time, providing general services, to pay such withholding tax.

This very unusual perception has been haunting Thai taxpayers for a long time. To avoid unnecessary disputes with the taxman, the use of two separate foreign companies and two separate agreements is normally advisable, which in turn creates unnecessary contractual complications. In any case, the Revenue Department usually assumes that anyone taking this approach is trying to avoid tax and will attack the arrangement.

It is also unfortunate that in some cases, judicial review tends to sympathize with the government and the primacy of tax collection, instead of adopting a neutral interpretation of the royalty definition and tax treaty principles. This has occurred even when tax authorities have failed to exercise due effort to prove such tax avoidance attempts and the genuine nature of such general services.

In a notable case that was finally resolved last month, a reputable Thai company entered into an intellectual property agreement, e.g., use of trademark, and an offshore service agreement with a Dutch company, which did not come to perform services in Thailand. The payments were divided into two portions: a fixed amount and a variable fee, based upon the gross revenue.

As the Thai company was obligated to pay the fixed fee even though it did not obtain any service in that relevant month, the fixed fee was regarded as a royalty for withholding tax purposes while the tax authorities agreed to apply the business profit treatment to the variable fee.

The Thai company strongly argued that the assessment was not correct as it was impossible, for the same services, that one payment was regarded as a business profit while the other was regarded as royalty.

Surprisingly, the Taxation Court ruled in favor of the Revenue Department based on the personal view of the assessment officer and ignored evidence and proofs presented by the Thai company on the general nature of services. The case was under consideration by the Supreme Court for more than seven years. The Supreme Court reversed the tax court’s decision last month and, significantly, set out one good precedent under the tax treaty principle. That is:

“... [A] royalty, being consideration for information concerning industrial, commercial or scientific experience, must be for proprietary information or expertise of the grantor. That said, the grantor who is the owner must have proprietary right over the information so granted. It is widely accepted that a royalty is not service fee, but consideration for the right to use or for the transfer of intellectual property; for example, licensing of copyright or a patent or trademark or service mark.

“Unlike a royalty, a professional service fee is consideration for an application of knowledge, expertise, or experience to create work or production for an employer. For example, an engineer applies his knowledge or expertise and experience to design a factory for his employer. Therefore, if it can be proven that all services are not related to any transfer of technology or expertise or experience, it is regarded as ‘business profit’ eligible for withholding tax

exemption in Thailand pursuant to the double taxation agreement entered into between Thailand and the Netherlands...”

Interestingly, the Supreme Court also stated that “it was personal view of the assessment officer and such interpretation (remark: different tax treatments for the fixed fees and the variable fees) for tax collection under the same agreement is groundless under the law or under the tax treaty”.

We are thankful for the Supreme Court’s judgment in setting out perhaps the clearest interpretation on the “royalty” definition ever,

and for respecting the principle of the tax treaties that Thailand has entered into with around 55 countries so far.

From now on, the tax authorities should carefully study the tax treaty guidelines and the Supreme Court’s judgment and start to accept more accurate interpretations in the same way that a prudent nation is supposed to.

Source: <http://www.bangkokpost.com/business/news/344550/supreme-court-sets-precedent-on-royalties>

### Publications from WIPO

#### WIPO Handbook on Industrial Property Information and Documentation

This online *Handbook on Industrial Property Information and Documentation* is the authoritative source of the World Intellectual Property Organization (WIPO) Standards, Recommendations and Guidelines in the field of industrial property information and documentation. It also provides information on various matters concerning patent, trademark and industrial design documentation. The Handbook is a valuable aid to industrial property offices in establishing or modernizing their information and publication systems. It helps industrial property offices and other users to keep pace with, and put into implementation, developments in information technologies that apply to the exchange, dissemination and sharing of industrial property information, as well as for the retrieval of the technological information contained in patent documents and, to a certain extent, the legal information contained in industrial property documents in general. The Handbook is an important tool for both the novice and the more experienced industrial property information user. The various Standards, Recommendations and Guidelines reproduced in this Handbook have been drafted with the help of groups of experts from many countries in meetings organized by WIPO and are the result of international cooperation in the field of industrial property. The contribution of these experts to the development of industrial property information is gratefully acknowledged.

#### Guide to Technology Databases

The Guide is a detailed technical paper which is aimed at industrial property office examiners and users in general to assist them in identifying the correct database and using the possible functionalities and tools offered by specific databases. Therefore, the current Guide examines a selection of commercial and non-commercial database services considered representative of the broader population of existing services in order to illustrate types and combinations of features available through these services.

#### Inventing the Future — An Introduction to Patents for Small and Medium-sized Enterprises

This Guide focuses on patents, a key tool to enhance a company’s ability to draw maximum benefit from new and innovative ideas and technological capabilities. The management of knowledge resources, especially new ideas and concepts, is essential to the ability of any enterprise, to change, adapt, and seize new opportunities as it competes in a fast-changing business environment. In the knowledge economy of today, the patent strategy of an innovative enterprise should be a key factor in its business strategy. This guide explains in a simple and practical way the business benefits of the patent system for all types of enterprises. The guide also provides practical information intended to help readers to understand the basics and to be able to ask the right questions while consulting an expert on patent matters.

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# The intricacies of Thai patent licenses



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Not as widely discussed as its Trademark counterpart, the intricacies of Patent Licensing Agreements (Patent Licenses) in Thailand has not often been brought to light: where in fact the many 'dos and don'ts' that are more volatile could easily snare an unwary proprietor.

Fundamentally, Patent Licenses have to be in writing and submitted with the Department of Intellectual Property (DIP), a Provincial Commercial Office or Government Office as prescribed by the Director-General of the DIP (Director-General). This recordal is necessary.

Section 41 of the Thai Patent Act provides that the Patent License must comply with the requirements and procedures prescribed by the Ministerial Regulations. This read with Section 152 of the Civil and Commercial Code renders Patent Licenses that are in contravention of these fundamental rules, void.

Slightly distinct from Trademark Licensing Agreements, it has to be borne in mind that delicate care and much emphasis has been placed in regulating the *exclusivity* of Patent rights, especially as regards to monopolization and *mala fide* distribution of those rights. In tandem, wider, encompassing powers have been given to the DIP and its Director-General.

This is incorporated *vide* stipulations such as Sections 39, 41 and 55 of the Thai Patent Act whereby the Director-General has the discretion whether to refuse or accept recordal of the License, or even request the Board of Patents to cancel the Patent itself where the Patent License is not in accordance with Section 41.

This wide provision, together with the Director-General's discretion in granting compulsory licenses to replace Patent Licenses such as that provided in Section 45 and 46: in effect imposes a requirement of 'reasonableness' for a Patent License to be registrable.

Especially care thus has to be taken with the drafting of Patent Licenses. There are many Patentee/Licensor-preferential clauses that could completely negate the Patent License in its entirety if it were incorporated. In these respects, for instance, the Ministerial Regulation No. 25 (1999) was introduced in view of preventing contractual oppression by the party with more bargaining power.

This Regulation sets out a number of terms restricted from Patent Licenses, examples of such are Clause 3(1) which prohibits/regulates clauses restricting the *acquisition of materials* to be used in production by the licensee from the patentee or a distributor designated by the licensor, Clause 3(7) which prohibits clauses restricting licensees from *exporting products* for sale or

distribution overseas or requiring permission from the licensor to carry out the same and Clause 3(10) which prohibits clauses which allow the licensor to *regulate the selling price or market* of the manufactured products.

Put simply, 'tying arrangements' and terms tending overtly to the licensor are generally prohibited from Patent License Agreements. Moreover, Section 39(1) of the Patent Act strictly disallows the imposition of any condition, restriction or any royalty term which is unjustifiably anti-competitive.

Further, other Statutory Provisions like the Thai Unfair Contract Terms Act 1997, Trade Competition Act 1999, Civil & Commercial Code and Revenue Code 1938 all have considerable determination of Thai Patent Licenses. These 'other' provisions have to be treated with caution as they are potentially novel from other jurisdictions for instance the great discretion given to the Courts in determining what is 'unfair' in the Unfair Contract Terms Act and the Trade Competition Act which provide a notably broad and restrictive anti-competitive threshold that the terms of Patent Licenses have to be adherent.

In respect of litigation, although it may seem certain that the licensor's right to sue in infringement proceedings would naturally vest in the licensee: this aspect of Patent Licensing still remains a lacuna. The Central Intellectual Property and International Trade Court (CIPITC) had in the case of Phuket Cement Sale Co., Ltd v Noppawong Construction Co., Ltd and Co. opined that the licensor had no *locus standi* to bring the action because the Patent License only expressly authorized use of the Patent rights while omitting to grant clear authority to the licensee to take legal action on the licensor's behalf.

It is clear that to achieve the intended derivation of rights, a properly calculated, well drawn Patent License covering all bases is essential while relentlessly guarding against the 'don't's'.

What more now in light of Thailand's increasing worry of unfair monopolization of Patent IPRs, ensuing in wide compulsory license powers to be bestowed upon the DIP: it is a fair estimation that the Thai Patent Office and relevant authorities will be *particularly wary* of Patent Licenses in general and be *extra vigilant* in ensuring that the threshold for compliance is high.

Patentees that have vision of licensing in Thailand have to be aware of the various intricacies of Thai Patent Licensing and ensure that much thought has been invested in the License Agreement itself.

Source: <http://www.bangkoklegal.wordpress.com>