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Thailand - Philippines revised double taxation agreement enters into force

On 5 March 2018, a revised double taxation agreement ("Revised DTA") between Thailand and the Philippines entered into force (available here). It replaces the existing 1983 treaty and will become effective on 1 January 2019.

Below we summarise the key provisions of the Revised DTA.

Detailed summary of the main changes

Expanded definition of resident and the new tie-breaker test – Article 4

The Revised DTA expands the definition of a person deemed to be a resident of Thailand or the Philippines by adding that such person will be a resident if its place of effective management is situated in Thailand or the Philippines respectively.

In addition, the tie-breaker test has been updated to move away from the sole focus on the place of incorporation. Pursuant to the Revised DTA, if an incorporated entity is a resident of both Thailand and the Philippines, the residency status will be determined by reference to the place of incorporation, the place of effective management or, if the place of effective management cannot be determined, by way of Mutual Agreement Procedure.

Permanent Establishment ("PE") definition – Article 5

The Revised DTA expands the existence of a fixed place of business PE by including (i) any other place of extraction **or exploration** of natural resources; (ii) a farm or plantation and (iii) a building site, a construction, installation or assembly projects **or supervisory activities in connection with such projects** where such site, project or activities continue for a period of more than 3 months (previously 6 months for building site and construction projects).

The services PE provision was also amended in order to cover the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, only if it lasts for a period or periods aggregating more than 6 months within any 12-month period (previously more than 183 days).

Paragraph 3 of Article 5 establishes now an exception in respect of a fixed place of business which is engaged in activities having a preparatory or auxiliary character. Therefore, the fact that one fixed place of business combines any of the activities mentioned in subparagraphs a) to e) does not mean of itself that a PE exists, as long as the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

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In addition, Article 9 (Insurance) was deleted and moved to Article 5 now establishing that an insurance enterprise will be deemed to have a PE in the other contracting State if it collects premiums in the territory of that State or insures risks situated therein through an employee or through a representative who is not an agent of an independent status.

Expanded Business Profits Article – Article 7
Business profits are taxable in the other Contracting State to the extent that they are attributable to:

a) the PE; or
b) sales in the other State of goods or merchandise of the same or similar kind as those sold through the PE; or
c) other business activities carried on in the other State of the same or similar kind as those carried out through the PE.

Shipping and air transport – Article 8
The Revised DTA facilitates that the tax charged on income or profits derived in a Contracting State by an enterprise of the other Contracting State from the operation of ships or aircrafts in international traffic should not exceed 1.5% of the gross revenues derived from sources in that State.

Dividends, Interest and Royalties – Articles 10, 11 and 12
The Revised DTA introduces a general 15% withholding tax applied on dividends and adds a new 10% preferential tax rate on dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends.

It is important to note the introduction of a "beneficial ownership" requirement with respect to dividends in the Revised DTA, as it highlights the shift to a commercial substance-focused approach in a local tax authority's application of the DTA relief.

Under the Revised DTA, 10% preferential tax rate on interest paid to any financial institution (including an insurance company) is maintained and a general 15% withholding tax applies in respect to any other interest payments if the recipient is the beneficial owner.

The Revised DTA provides a 15% withholding tax on royalties if the recipient is also the beneficial owner.

Given the current withholding tax rates under the Thai domestic law, this should not have any practical impact on the tax implications of paying dividends, interest or royalties from Thailand to a shareholder/entity located in the Philippines. However, we believe that companies may find it valuable to assess whether these changes will impact their current tax treatment of payments of such nature from the Philippines to shareholders/ entities located in Thailand.

Personal services provisions – Article 14 and 15
The previous Personal Services article is now divided into Independent Personal Services (Article 14) and Dependent Personal Services (Article 15), each with its own criteria for determining when income/remuneration derived by a resident of a Contracting State for personal services rendered in the other Contracting State may be taxable in that other state.

Exchange of information – Article 26
This Article has been updated to reflect changes to the same Article in the OECD Model Tax Convention. It adds that if information is received by a Contracting State in accordance with the Revised DTA, it may be disclosed to courts and administrative bodies involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes covered by the Revised DTA. The tax authorities may use the information only for such purposes and this information may be disclosed in public court proceedings or in judicial decisions.

Other changes
Another provision of the DTA which has been substantially revised includes Article 19 (Governmental Function).

The Mutual Agreement Procedure article (Article 25) states that any case in which a resident's taxation is not in accordance with the provisions of the convention, the resident must present the case within three years of first notification of such an action (previously two years). It also limits the ability of a Contracting State to increase the tax base of a resident of either Contracting States by including items of income which have also been charged to tax in the other Contracting State to three years from the end of the taxable period in which the income concerned has accrued (except in case of fraud, willful default or neglect).

KPMG observations

The enforcement of the Thailand – Philippines Revised DTA has been highly desired since its signature back in 2013. As discussed above, major portions of the 1983 tax treaty were revised in order to make the treaty more relevant to the current tax laws and environment and in order to be in line with the OECD Model Tax Convention.

Overall, it should provide investors, mobile employees and employers with greater tax certainty on the Philippines and Thailand tax treatment of certain income. Thai investors intending to invest or currently holding investments in the Philippines may now need to carefully evaluate the potential impact of the Revised DTA on tax implications of investing in the Philippines. The same can be said for current or future Filipino investors looking to enter into the Thai market.

How can we help

As a committed advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

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