

Capital gain . . . but more tax than your company bargained for

What people commonly suspect in the Thai real estate market is that if a company sells immovable property such as land it is subject to a specific “capital gains tax” or that the sale of that land is taxed at the corporate income tax (“CIT”) rate of 30%. However, such is not necessarily the case.

First, even though it is true that a “gain” realized on the sale of immovable property must be recognized by the selling company in the accounting period when the sale took place, companies in Thailand pay tax only on the *net* profit. Section 65 Revenue Code (“RC”) defines “net profit” as the result of income from business or arising out of business in one accounting year, less certain expenses. In other words: the “net profit” of the whole accounting year is the basis of taxation and not a single taxable event, such as the sale of immovable property.

Also, the amount of tax payable further depends on the classification of the selling entity. The corporate income tax rate in Thailand is generally 30%. However, this rate is reduced for so called “small and medium sized enterprises” (“SME”). SMEs are taxed on a progressive scale. The tax rate for an SME is 15% for the first one million Thai baht in profit and 25% for the profit between one and three million Thai baht. The profit exceeding three million Thai baht is then taxed at 30%. Please note that there are several special conditions when computing net profit or loss such as, exemptions, bad debts or depreciation.

Now it is likely that the most substantial transaction cost on the sale of land by a company will be the resulting CIT. In order to avoid this (and other) costs, some sellers have occasionally resorted to “under-declaring” the sale price of land when they transfer it. Obviously, such behaviour is illegal. For one, the seller of such land clearly evades corporate income and specific business taxes.

However, also the buyer of such undervalued land will be committing unlawful tax evasion. When a corporate entity sells an immovable property, a “withholding tax” at the rate 1% of the sale price is required to be “deducted” from the sale price and paid to the authorities on transfer. The *legal* duty to withhold and pay this tax is the buyer’s. And a surcharge on the late or inadequate payment of the withholding tax at a rate of 1.5% per month of the late paid amount is applicable.

Furthermore, such undervaluation is also highly ill-advise from the commercial standpoint of the corporate buyer. Since the land will be booked into the accounts of the buying entity at the undervalued amount any subsequent sale of such land will result in a higher taxable event than it would have without the undervaluation on the initial purchase of such land. For example, hypothetically (very generalized and simplified):

In 2005 the Company A actually buys the land for two million Thai baht but the purchase is declared to be for only one million Thai baht. In 2010, Company A sells the land for three million Thai baht. The actual realized profit in such case is one million Thai baht, and the CIT “should be” approximately three hundred thousand Thai baht. However, because Company A declared that they originally bought the land for one million Thai baht, the actual CIT Company A will have to pay is approximately six hundred thousand Thai baht.

Therefore, a corporate purchaser of an undervalued plot of land should be very much aware that by undervaluing such purchaser takes over the corporate income tax *liability* of the corporate seller (in addition to the purchaser’s own legal and tax liability); and that is certainly far more (or perhaps “less”) than bargained for!

DUENSING KIPPEN is an international law firm specializing in business transaction and dispute resolution matters, with offices in Bangkok and Phuket, Thailand and affiliated offices in 45 other countries. Visit them at: duensingkippen.com