

Lorenz & Partners

Legal Tax and Business Consultants

Relocating Headquarter Services to Thailand: Legal and Tax Implications

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About Lorenz & Partners

- International firm of business lawyers headquartered in Bangkok since 1995.
- The firm is specialised in legal, tax and business consultation for foreign companies investing in Southeast Asia.
- The firm maintains offices in Bangkok (*Thailand*), Hong Kong (*PR China*), Ho Chi Minh City (*Vietnam*) and Frankfurt am Main (*Germany*).

Agenda

- A. Introduction
- B. Board of Investment Promotion (IHQ/ITC)
- C. Comparison with other jurisdictions
- D. Legal implications in Thailand

A. Key Facts: AEC

- Thailand is member of the ASEAN Economic Community (**AEC**).
- The AEC's aim is the regional economic integration (*ten countries, one common market*):
 - A single market and production base
 - A highly competitive economic region
 - A region of equitable economic development; and
 - A region fully integrated into the global economy.
- Free movement of goods, services, investment, capital and labour.
- However, it remains to be seen how effective the measures will be implemented.

A. Thailand: Introduction

- Located geographically in the heart of the member states of ASEAN and AEC
- Excellent infrastructure
- Comparatively low wages and rents
- Investment promotions for Shared Services Hubs

A. Shared-Services Hub

- It is expected that AEC will enhance the trend of implementing shared service organizations.
- The Thai Board of Investment (**BOI**) offers investment promotion schemes for *International Headquarter (IHQ)* and *International Trading Centres (ITC)*
- Both schemes became effective on 2 May 2015 and were issued to strengthen Thailand's role in attracting foreign investors for establishing shared-services hubs.

A. Top 10 Criteria for Regional HQs

1. Proximity to clients/markets targeted for growth
2. Favourable legal and regulatory environment
3. Stable and favourable political environment
4. Favourable business environment
5. Favourable tax environment
6. Access to human capital
7. Lower cost of operations
8. Transparent and easy market access
9. Proximity to production facilities
10. Access to distribution channels

Source:
Asia-Pacific Headquarters Study,
European Chamber/Roland Berger

B. IHQ and ITC: Qualifying Criteria

Common Requirements for IHQ and ITC

- A company registered in Thailand
- At least THB 10 m paid up capital
- At least THB 15 m local operating expenses per fiscal year*

IHQ-Activities

- Providing administration or technical service, supporting service or financial management to its “associated enterprises”

ITC-Activities

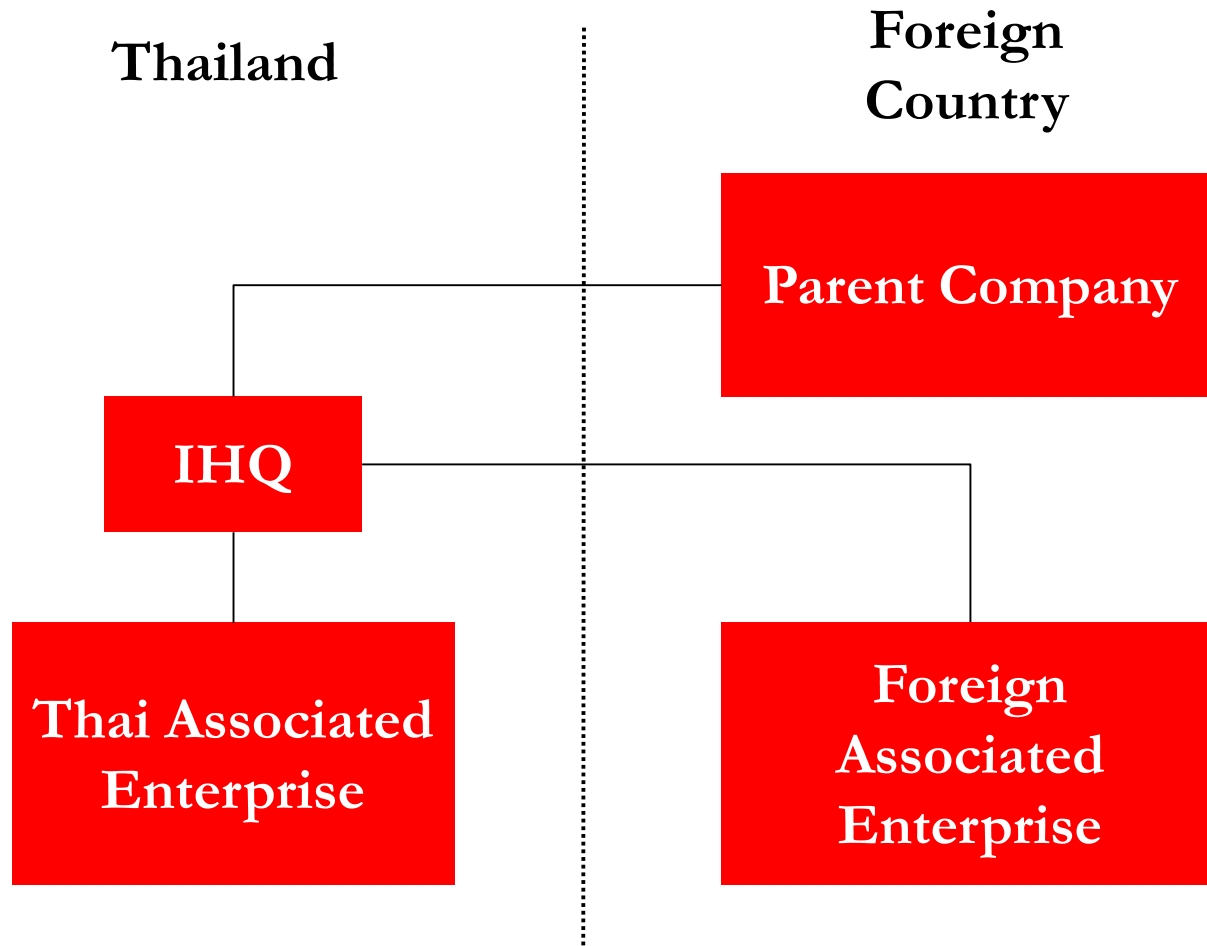
- Purchasing and selling goods, materials, and parts or providing services in international trades

* Excluding cost of sales

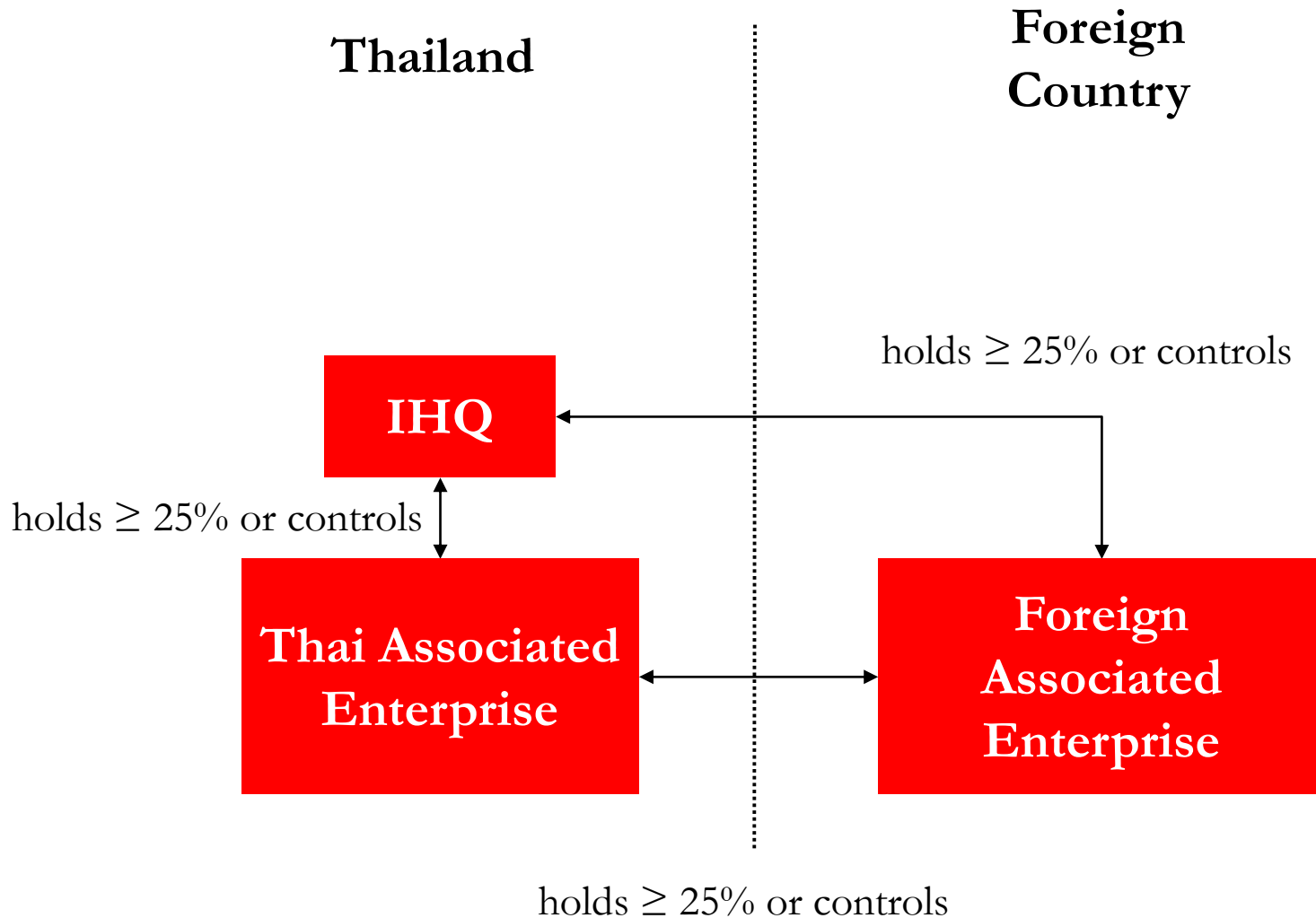
B. IHQ: Covered Activities

HQ Function	Trading Function	Treasury Center Function	Holding Company Function
HQ services and royalties to/from <ul style="list-style-type: none">- overseas and- Thai associated enterprises.	Trading of goods and trading-related services between overseas entities (“ <i>out-out</i> ” transaction).	Treasury support services to <ul style="list-style-type: none">- overseas and- Thai associated enterprises.	Dividends received from overseas associated enterprises.

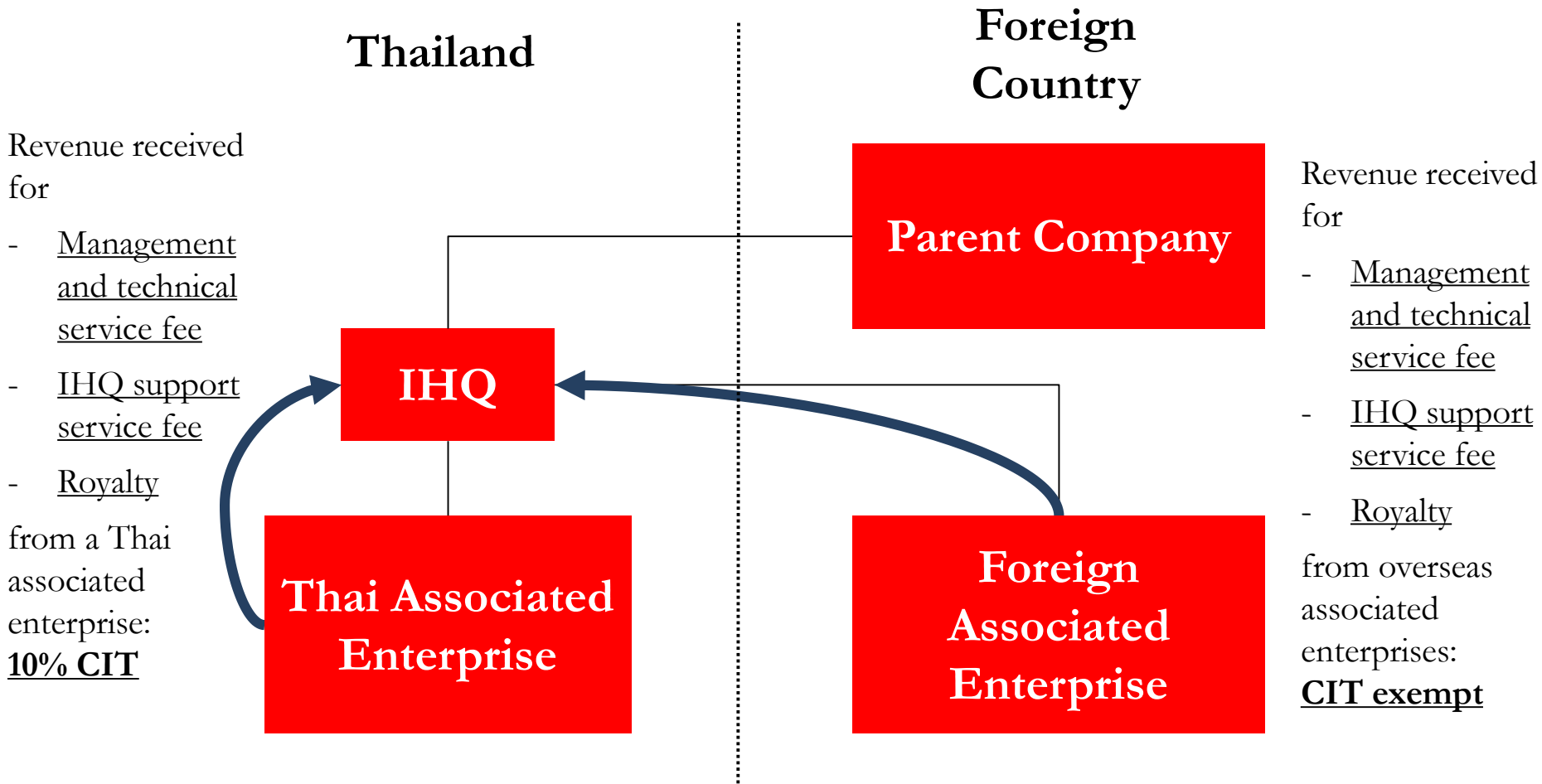
B. IHQ: Shareholding Structure



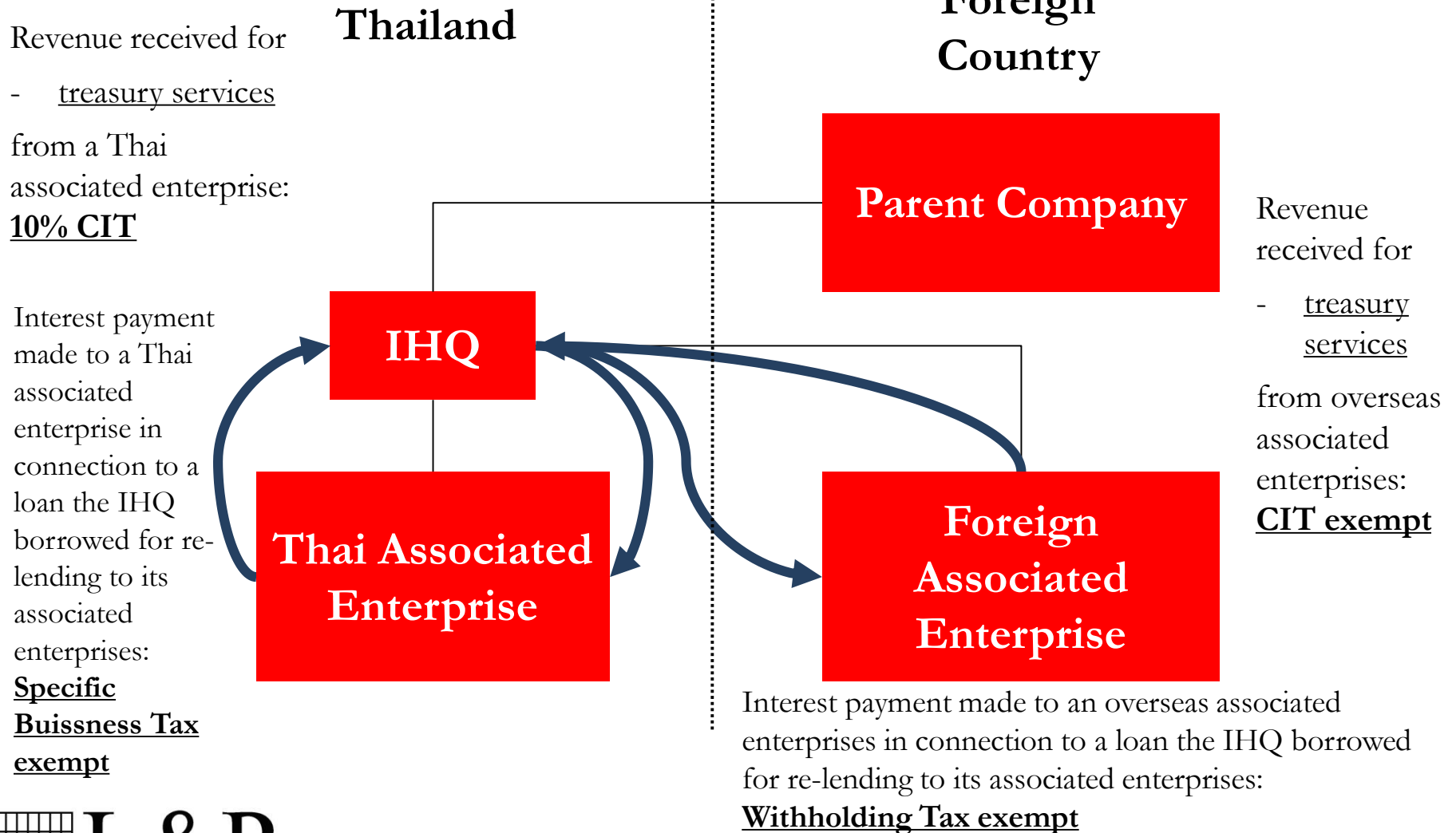
B. IHQ: Associated Enterprise



B. IHQ: Headquarter Function



B. IHQ: Treasury Centre Function



B. IHQ: Holding Company Function

Thailand

Dividends paid from the IHQ to its overseas shareholders from profits that are entitled to 0% CIT under the IHQ regime:

Withholding Tax exempt

Dividends received from a Thai associated enterprise:

Tax exemption according to general rules

Thai Associated Enterprise

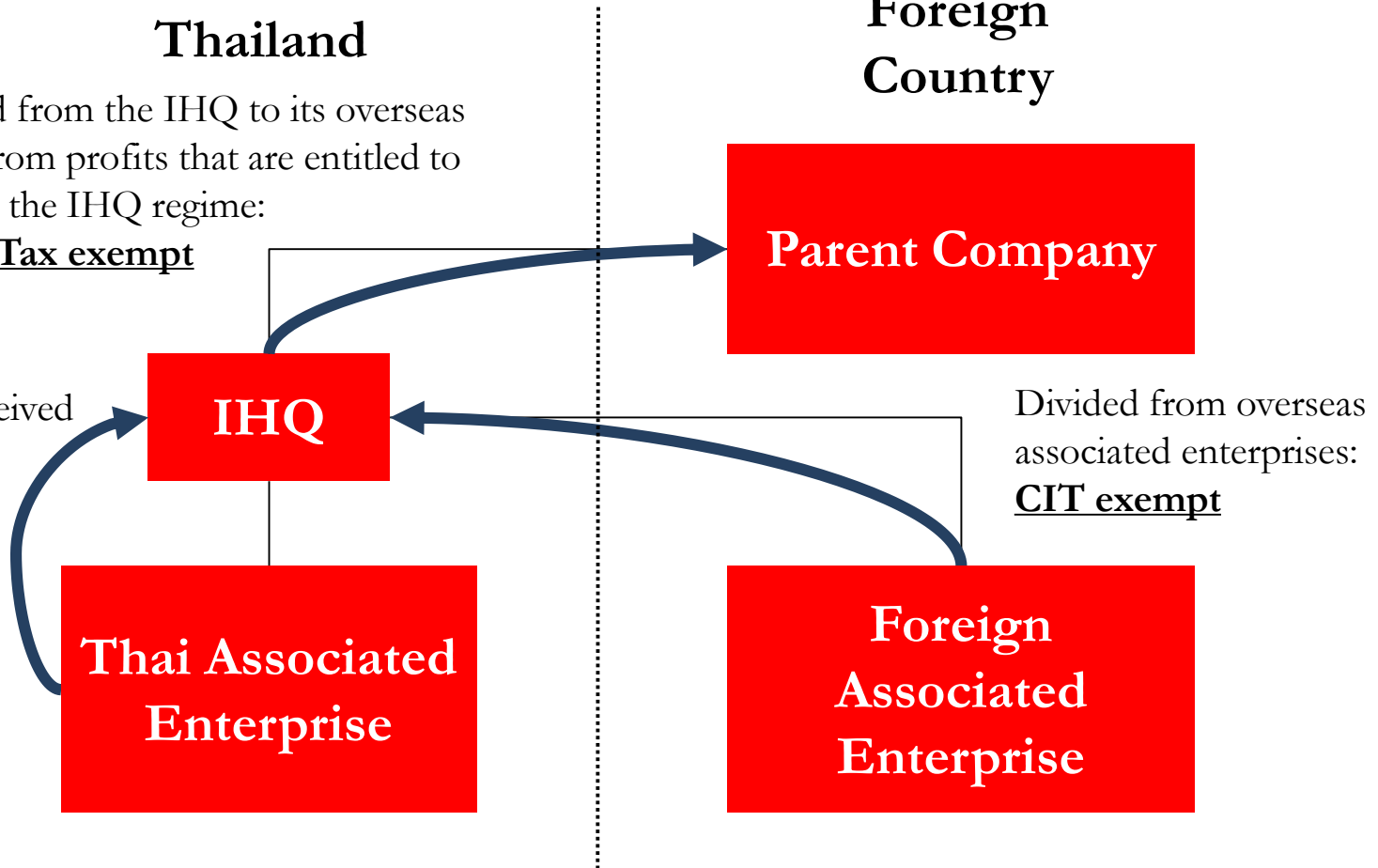
IHQ

Foreign Country

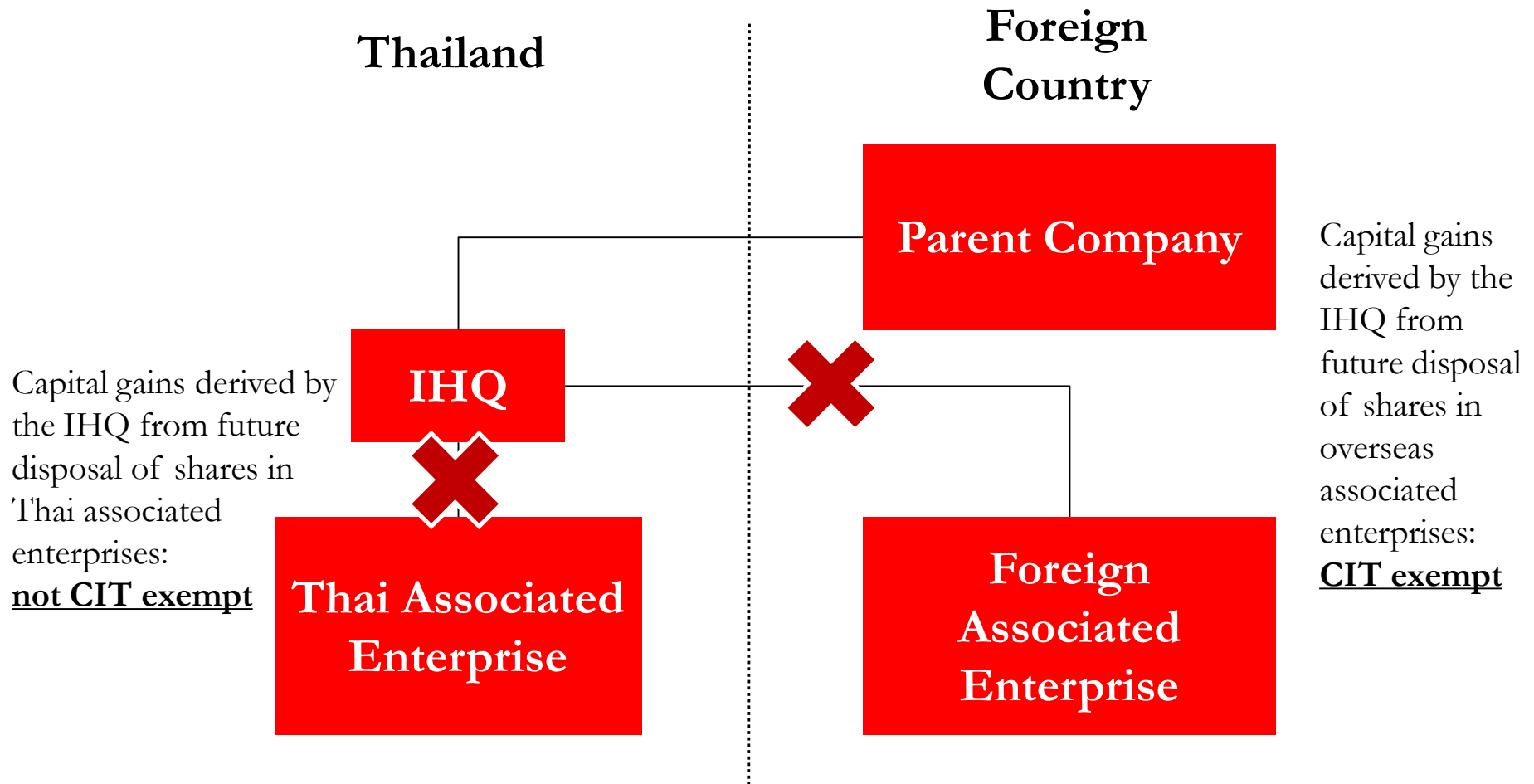
Parent Company

Dividends from overseas associated enterprises:
CIT exempt

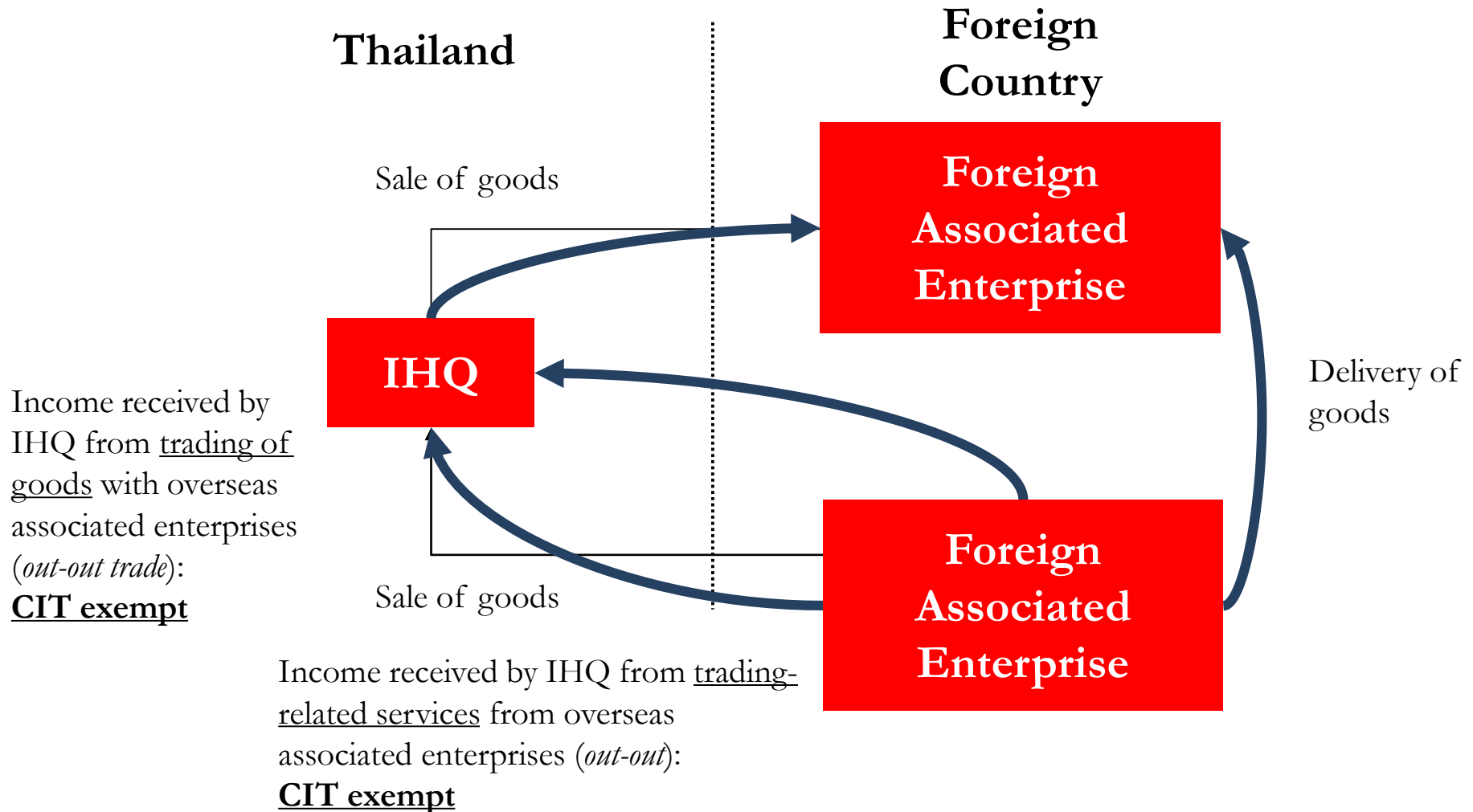
Foreign Associated Enterprise



B. IHQ: Holding Company Function II



B. IHQ: Trading Function



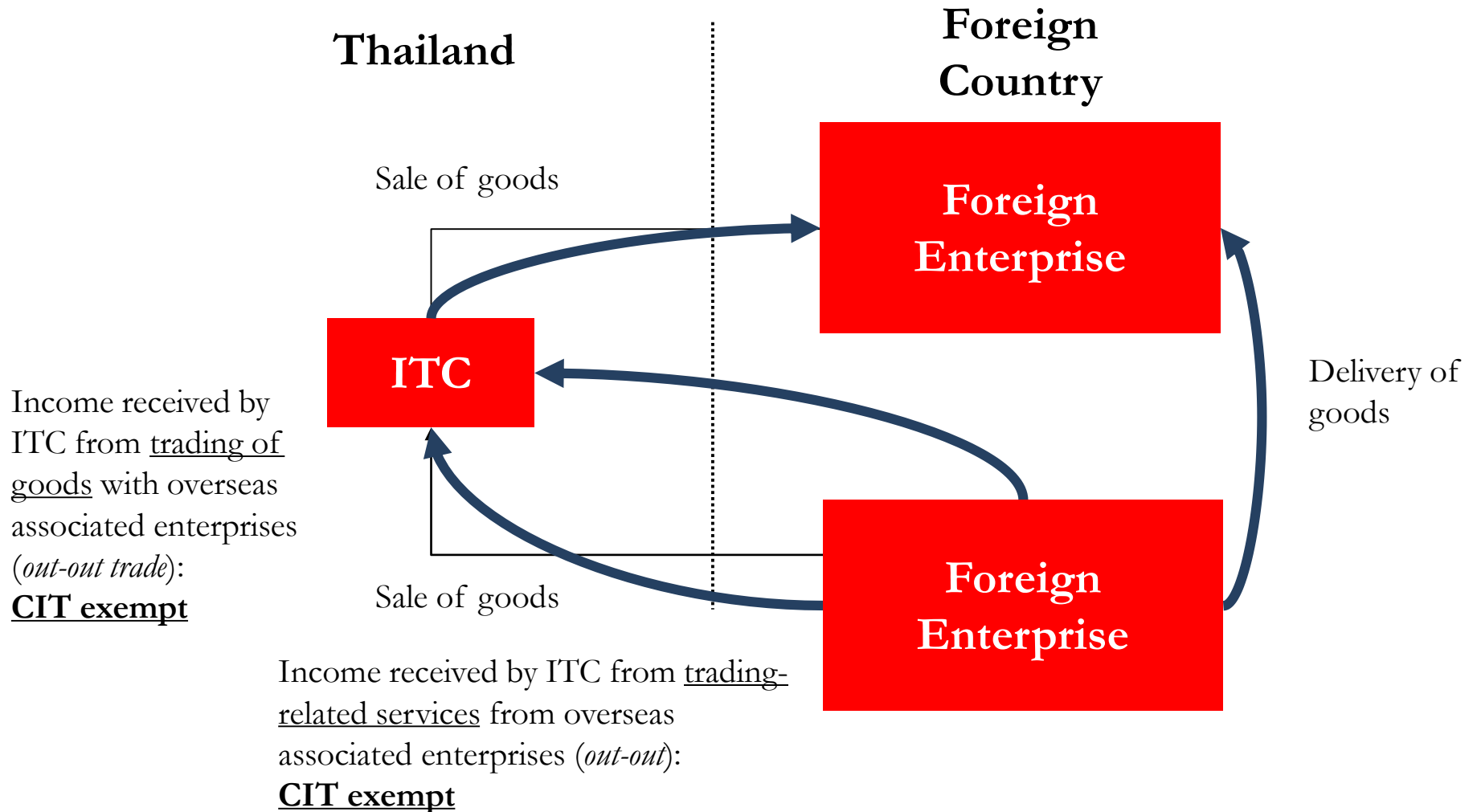
B. IHQ: Overview Tax Incentives

	“Out-Out”	“In-Out”	“In-In”
Headquarter		Income received from the provision of Management or technical services, supporting services to its associated enterprises incorporated under foreign law.	Income received from the provision of management or technical services, supporting services to its associated enterprises incorporated under Thai law.
Treasury		Income received from the provision of treasury centre services to its associated enterprises incorporated under foreign law.	Income received from the provision of treasury centre services to its associated enterprises incorporated under Thai law.
Holding		Royalties or dividends received from its associated enterprises incorporated under foreign law.	Royalties or dividends received from its associated enterprises incorporated under Thai law.
Trading	Income received from buying and selling goods abroad without importing such goods into Thailand, and income from international trade services provided to foreign companies and received in or from a foreign country.		
* Regular CIT Rate: 20%	CIT* Exempted		10% CIT (Half CIT Rate)

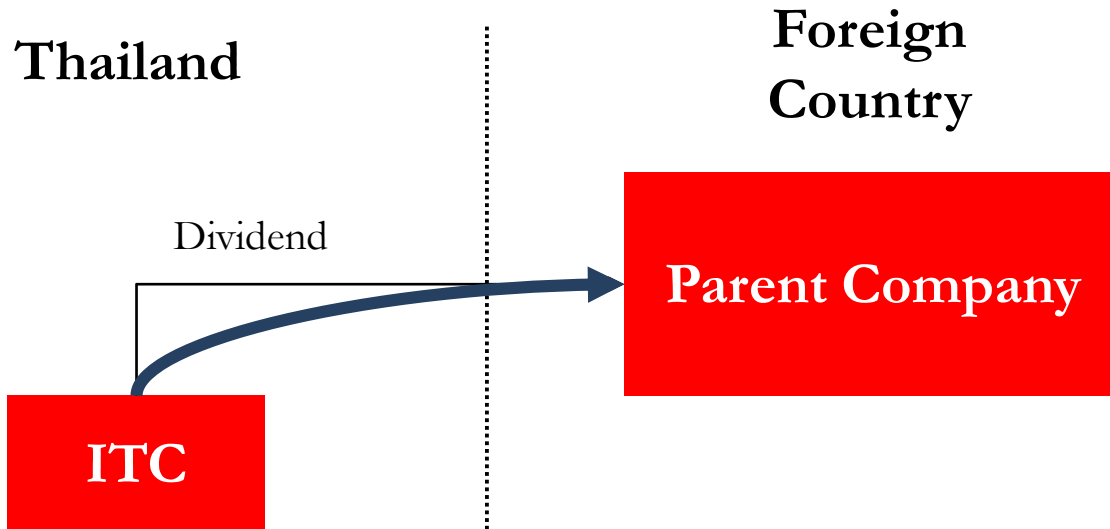
B. IHQ: Overview Tax Incentives II

Treasury	Interest on loans borrowed for re-lending to associated enterprises for financial management.	Interest received from loans provided to associated enterprises for financial management.
 Holding	Dividends paid from the net profits arising from the activities which are subject to the corporate income exemption described above.	
	WHT Exempted	SBT Exempted

B. ITC: Trading Function



B. ITC: Dividend Distribution



Dividend paid by ITC (*out of net profits or CIT exempt income*) to its corporate shareholders abroad who are not carrying out business in Thailand

Withholding Tax exempt (normally 10%)

B. ITC: Overview Tax Incentives

Trading	Income received from buying and selling goods abroad without importing such goods into Thailand, and income from international trade services provided to foreign companies and received in or from a foreign country.	Dividends paid from the net profit derived from qualified income to foreign corporate shareholders.
* Regular CIT Rate: 20%	CIT* Exempted	WHT Exempted

B. IHQ and ITC: PIT Incentives

IHQ	ITC
<p>15% flat personal income tax* for management level expatriates (<u>non-Thai nationals</u>) employed by the IHQ/ITC under the following conditions:</p> <ul style="list-style-type: none">• The employee must be present in Thailand for <u>at least 180 days</u> in a calendar year (Thai Tax Resident, Sec. 41(3) RC);• The employee must have obtained a <u>valid work permit</u> from the Ministry of Labour as a <u>skilled or expert worker</u>; and• The minimum <u>annual salary</u> of <u>THB 2.4</u> (approx. EUR 60k).	

* **Contract splitting** for regional roles outside of Thailand to further reduce the PIT rate is not possible, as the flat PIT already covers regional roles. Furthermore, **allowances and personal allowances cannot be applied**. As the current allowance rates for income from employment are at the low end, this point is rather negligible.

B. IHQ and ITC: PIT Incentives II

- A married MD with an annual salary of THB 4.5 m (*approx. EUR 112,500*) - whose wife does not work, but lives with him in Thailand - would be exposed to a PIT rate of approx. **24.56%**, amounting to an annual PIT of THB 1,105,350 (*approx. EUR 27,500*).
- Would he be employed by an IHQ/ITC company, he could make use of the flat tax rate of 15%, amounting to an annual PIT of THB 675,000 (*approx. EUR 17,000*).
- In the example it would, therefore, be possible to **save THB 430,350 (approx. EUR 10.500)** PIT per year.

B. IHQ and ITC: PIT Incentives III

- The flat PIT rate is also interesting for employers, when agreeing on packages for housing, schooling and other allowances, where the PIT is borne for the employee.
- Should, in our example, the MD move with his three children who all attend a private school in Bangkok (*approx. THB 600,000 per school year per child, in total THB 1,800,000 per year*), the IHQ/ITC company would have to pay approx. **THB 2,117,647** (= THB 1,800,000 / 0.85) for the schooling allowance instead of approx. **THB 2,796,230** (= THB 1,800,000 / 0.65) under the highest progression level.

B. IHQ/ITC: Non-Tax Incentives*

IHQ

- Exemption of import duty on machinery used in R&D and training activities
- Other non-tax Incentives:
 - Permission to bring expatriates into Thailand (4 years)
 - Permission to own land
 - Permission to remit foreign currency abroad
 - 100% foreign ownership

ITC

- Exemption of import duty on machinery
- Other non-tax Incentives:
 - Permission to bring expatriates into Thailand (4 years)
 - Permission to own land
 - Permission to remit foreign currency abroad
 - 100% foreign ownership

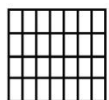
* Granted by the BOI.

B. IHQ and ITC: Covering Retailing

- **ITC** covers only **wholesaling** in Thailand. **Retailing** would need to be covered by a separate licence.
- **IHQ** covers only **wholesaling with affiliates** in Thailand. **Direct wholesaling** with third parties in Thailand can, if no ITC is applied, be covered through the „**Trade and Investment Support Office**“ promotion (*only for machines, tools and equipment*).
- **Retail** still needs to be covered for ITC and IHQ
 - by a Foreign Business Licence („**FBL**“) or
 - Reg. capital increase of THB 100 million.

C. Singapore, Malaysia and Thailand

	Singapore		Malaysia			Thailand	
Name	HQ Programme*		Principal Hub*			IHQ	ITC
Categories	Regional HQ	IHQ	Tier 1	Tier 2	Tier 3	-	
Paid-Up Capital	min. SGD 0.5 m [†] (approx. EUR 300k)		MYR 2.5 m (approx. EUR 550k)			THB 10 m (approx. EUR 250k)	
Operating Expenses	min. SGD 3 m [†] (approx. EUR 2 m)		MYR 10 m (approx. EUR 2.2 m)	MYR 5 m (approx. EUR 1.1 m)	MYR 3 m (approx. EUR 660k)	THB 15 m (approx. EUR 375k)	
No. of Affiliates	3 HQ services to 3 [†]		3 HQ services to 5	3 HQ services to 4	3 HQ services to 3	1 HQ service to 1	1 ITC service to 1
Tax Incentives	15%	0/5/10%	0%	5%	10%	0/10% + SBT/WHT exemption	
	Regular CIT Rate: 17%		Regular CIT Rate: 25%			Regular CIT Rate: 20%	
Duration	3+2 years	5-20 years	5+5 years			15 years	



C. Singapore, Malaysia and Thailand II

- Thailand's IHQ Scheme has the lowest and most transparent requirements and grants the longest fixed promotion period (15 years).
- Malaysia's Principal Hub scheme contains a *three tier promotion system*, which requires substantial paid-up capital and operating expenses. Even though, the underlying conditions are complex, they can be fulfilled.
- Singapore's Headquarters Programme comprises a *two tier promotion scheme* which requires high operating costs. The first tier (*Regional HQ*) only gives a tax advantage of approx. 2% CIT which is quite low compared to the administrative efforts. The second tier (*IHQ*) does not contain any clear requirements at all.

C. Hong Kong (SAR): An Alternative?

- Hong Kong's CIT rate is comparatively low (16.5%). It is only applicable on Hong Kong-sourced profits that are derived from a business carried on in Hong Kong.
- Offshore services (no services within Hong Kong) are taxed at 0%.
- PE problem in case of offshore status (where is the company managed?).
- Barely any *Double Tax Agreements* with Europe, no *Double Tax Agreements* with USA

D. Legal Implications in Thailand

When setting up a shared services hub in Thailand, the following general aspects of doing business in Thailand need to be considered:

- Lease-related issues
- Employment-related issues
- Transfer Pricing
- International taxation issues

D. Lease-related Issues

- IHQ entities will need to lease (or buy) office space for the purposes of their operation.
- Key provisions for foreign investors are:
 - Lease terms of more than three years need to be registered with the Land Department.
 - registration fee: 1% of the total lease fee
 - The term of a registered lease agreement cannot exceed 30 years.
 - Lessee has to withhold 5% withholding tax from every lease payment and submit it to the Revenue Department.

D. Employment-related Issues (I)

Prior to hiring new staff in Thailand, employer need to consider what happens to the staff in the previous headquarter location:

- Does the company have capacities for such staff in the original location?
- Can such staff be seconded to Thailand?
 - Does such staff require additional incentives/allowances?
 - What happens to previous social security contributions/entitlements?
 - Staff can benefit from 15% flat PIT in Thailand under IHQ/ITC.
- If not, what are the consequences of termination?
 - Entitlement to severance pay
 - Other possible claims

D. Employment-related Issues (II)

- The Thai Labour Protection Act B.E. 2541 (LPA) lays out a high standard with regards to employee protection and applies to both foreign and Thai employees.
- Employees are entitled to **severance pay** based on the duration of their employment period.
- An employer with 10 or more employees has to publish working rules at the workplace.

Duration of Employment	Severance Pay (days of the latest salary rate)
At least 120 days but less than 1 year	30
At least 1 year but less than 3 years	90
At least 3 years but less than 6 years	180
At least 6 years but less than 10 years	240
At least 10 years	300

D. Employment-related Issues (III)

- Severance pay can only be excluded under special conditions which are laid out in Sec. 118 (3) LPA (e.g. seasonal or special project work etc). With regards to headquarters services, these conditions are commonly not met.
- Special features must be observed for **fixed-term agreement** with regard to probation period, de-facto extensions and early termination rights (all three would render the agreement into an indefinite one).

D. Employment-related Issues (IV)

- Certain formalities need to be observed when **terminating an employee**:
 - To avoid severance pay and unfair termination damages, the employer should issue warning letters for employee misconduct.
 - Should the same misconduct reoccur within one year, the employment relationship may be terminated without the employee being entitled to severance pay.

D. Employment-related Issues (V)

- **Overtime** has to be compensated at 100%-300% of the hourly wage rate depending on when employees worked overtime
- Overtime pay can only be excluded in very limited cases, e.g. for staff with assigned HR responsibilities.
- Overtime generally requires the employee's consent.
- Overtime cannot be compensated with time-off.

D. Transfer Pricing (I)

- When rendering headquarters services to affiliated companies, transfer pricing regulations need to be complied with.
- Thailand is not a member of the OECD, but most of the regulations in force in Thailand are based on the OECD guidelines (Departmental Instruction No Paw 113/2545 - DI 113/2545).
- Tax authorities have the power to assess intercompany pricing and adjust transfer prices if they do not comply with the arm's length principle.
- In case the adjusted transfer price leads to a higher profit and as a result to a higher corporate income tax due, 1.5% interest per month from the due date will be levied on the unpaid amount. If VAT is affected, a penalty of up to 100% of the unpaid VAT will be levied.

D. Transfer Pricing (II)

- The following methods are approved to determine the ALP:
 - Comparable Uncontrolled Price Method
 - Resale Price Method
 - Cost Plus Method
- With regards to headquarters services, the Cost Plus Method is usually applied.
- To obtain certainty whether specific (sets of) transactions comply with the transfer pricing regulations, taxpayers can enter into an advance pricing agreement (APA) with the Revenue Department (time consuming!).

D. Transfer Pricing (III)

- New Transfer Pricing Bill aims to implement transfer pricing guidelines into the Revenue Code, including obligation to prepare extensive transfer pricing documentation. The draft Bill is currently being reviewed by the Cabinet and – if approved- is expected to become effective in 2018.
- Foreign investors should also be aware of the increased documentation requirements which will be implemented based on the OECD's Base Erosion and Profit Shifting (BEPS) measures.
- Apart from the correct transfer pricing itself, it should be noted that certain services (e.g. legal, accounting) may not be performed by majority foreign-owned companies, and should therefore not be invoiced as such.
- Details to be checked with countries serviced by the IHQ

D. International Taxation

- The repatriation of profits to the parent company may be affected by relocating the shared service hub to Thailand.
- Subject to the applicable Double Taxation Agreements, it may make sense to restructure the group holdings, e.g. by having the Thai headquarters hold the shares in its regional affiliates.
- Profits shifted to the Thai headquarters will be subject to the tax benefits under IHQ/ITC and dividends paid out of such profits are exempt from withholding tax.

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Q&A Session

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Thank you for your attention

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