

Asia-Pacific Tax Bulletin, 2017 (Volume 23), No. 3

Thailand in International Tax Planning, Published online: 7 June 2017

by **Jack Sheehan**,
Partner, Head of the Regional Tax Practice
 and **Jonathan Blaine**,
Tax Director

In this article, the authors explain the provisions in Thailand's tax law that are designed to encourage foreign investment and economic development in the country. These include the participation exemption applicable to the taxation of foreign sourced dividends and capital gains under the holding company regime, and the international headquarters regime. The article addresses tax planning structures, which benefit from Thailand's domestic law and tax treaties. The authors also discuss the current state of transfer pricing, adoption of BEPS initiatives and anti-avoidance rules in Thailand's legislation.

1. Background

When all ten member states of the Association of Southeast Asian Nations (ASEAN), viz. Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Thailand, Singapore and Vietnam, signed the Declaration to establish the ASEAN Economic Community (AEC) in 2015, they committed themselves to deeper economic and social integration with their neighbours. So far, most goods, services and investments, some capital, and limited skilled labour have been allowed to move freely within the single AEC market. However, this formal integration has so far yielded mixed results. It is best viewed as a nascent stage, requiring greater development and input, rather than as an all-encompassing and singular integration event. For instance, while some 98% tariff barriers have been reduced or eliminated, other non-tariff barriers, such as those on skilled labour migration, remain stubbornly in place, hampering the development of a fully integrated common market.

Thailand's core legal system is fundamentally

modelled on the European civil law system. Nonetheless, like many other Asian legal systems, it has adopted or borrowed certain common law principles and doctrines. This is to ensure that the law keeps pace and evolves in tune with international developments, without having to undergo the arduous process of statutory modification. Therefore, while "precedent" is not a formal doctrine of the Thai courts, frequent use is made of previous court rulings to guide statutory interpretation and the decision-making process.

In Thailand, the tax law is primarily based on provisions of the Thai Revenue Code (TRC). The Thai Revenue Department (TRD), which is housed within the Ministry of Finance, is formally tasked with the responsibility of collecting tax revenue throughout the Kingdom. Taxes include, but are not limited to, the usual types of taxes found in most modern tax systems, viz. personal income tax, corporate income tax (CIT), value added tax, specific business tax and others, as provided by the TRC. Taxpayers must submit tax returns and pay taxes as prescribed by law. They are also subject to assessment by the TRD for any unpaid taxes, along with penalties and surcharges (i.e. interest) for failing to submit returns or paying tax by the statutory deadlines.



2. Holding Company Regime

2.1. Foreign dividends and the participation exemption

While Thailand has formally adopted a worldwide taxation scheme for all legal “persons” deemed resident in Thailand,^[1] it has a participation exemption for foreign sourced dividends received in Thailand, through the enactment of Royal Decree 442 (the Decree).^[2] In essence, when a Thai company receives dividends from outside Thailand, which fall outside the purview of the Decree, they will be subject to CIT.^[3] However, if the dividends are paid from a foreign company to a Thai owner and this income and shareholding falls within the scope of the Decree, it will not be subject to CIT.

The Decree provides that:

(1) if a Thai registered company holds at least 25% of the voting shares of a foreign (i.e. non-Thai registered) company for a six-month period before and after the date of the dividend distribution; and

(2) dividends are paid out of profits already subject to a headline tax rate of at least 15% in the foreign country where the company is deemed resident,

the dividends will not be taxable upon receipt by the Thai company.

This exemption provides parity between Thai companies that receive dividends from their foreign subsidiaries and Thai companies that derive dividends from their Thai subsidiaries.^[4]

Accordingly, it may be beneficial for a Thai group to use a Thai company as a locally based holding company for outbound expansion into other jurisdictions (assuming that the Thai parent company’s dividends qualify for the participation exemption). However, because these dividends qualify for exemption at the Thai level, any income taxes paid in the jurisdiction where the paying (subsidiary) company is resident would not qualify for tax credits (either direct or indirect) in Thailand. Therefore, any taxes incurred at the resident country level by the subsidiary (via CIT on the subsidiary’s earnings) or by the Thai entity (via a withholding tax (WHT) on dividends) are final taxes. However, these taxes may be reduced if

the subsidiaries are resident in countries with which Thailand has an applicable double taxation agreement (DTA).^[5]

2.2. Taxation of foreign capital gains

Any capital gains derived by a Thai company from the sale of shares in a company residing outside Thailand are deemed to be taxable income. The capital gains are accordingly subject to 20% CIT in Thailand. This amount of tax is comparatively high, and it is therefore common for shares in non-Thai companies to be held by an intermediary company, which resides in a country that does not tax capital gains (such as Singapore). Accordingly, if a Thai company held shares in a Singaporean company and the Singaporean company held shares in another non-Thai company, any sale of the shares below the Singapore holding company level would not be taxable in Thailand. This rule excludes distributions of dividends to the Thai company.

[1]. For Thai taxation purposes, the TRC, like many other national tax codes, provides that various types of entities have “personhood”. These entities include individuals, juridical partnerships and Thai corporations. The residence of these persons is determined via various rules, but suffice it to say that, for the purposes of the discussion here, most juridical entities are considered to be residents of Thailand if they are constituted pursuant to the Commercial and Civil Code of Thailand and are registered with the appropriate Thai authority responsible for recording such registration.

[2]. According to the TRC and under the relevant provisions of the Thai Constitution, the King may exercise his right to reduce taxes or to provide legal interpretations of existing laws by issuing a Royal Decree. Such a decree has the effect of law and acts to override existing provisions of the TRC or other legislation. Royal decrees are normally of limited duration, but can be renewed and extended and may also be given retroactive effect, if not signed by the time of the expiration of a previously issued decree.

[3]. At the time of writing this article, the CIT rate was 20%.

[4]. Under the TRC, dividends received by a Thai holding company from a Thai operating company are exempt from CIT at the holding company level, as long as the holding company holds at least 25% of the voting shares in the paying company for a period of three months prior to and after the dividend distribution. This shareholding requirement is also subject to the limitation that there is no cross-shareholding. Note that this holding period is slightly different from the six-month “prior to” requirement in the Decree.

[5]. While most Thai DTAs limit the WHT on dividends paid to a Thai resident country to 10%, there are a few countries (e.g. Taiwan and Mauritius) where the WHT rate is limited to 5%. Note that while the Taiwan-Thailand DTA (1999) explicitly provides the 5% limitation, the Mauritius 5% limitation is contained in clause (d) of the 1997 Protocol to the Mauritius-Thailand DTA (1997), which provides that the rates under that DTA are to be on a par with the lowest rate provided for in any other DTA entered into by Thailand. Therefore, as the Taiwan-Thailand DTA provides for a 5% limitation, the Mauritius-Thailand DTA imputes this 5% rate to dividends paid by a Mauritius resident company to a Thai resident company.

2.2.1. Capital gains on the sale of Thai shares by a non-Thai entity

No mechanism currently exists under Thai law to tax a capital gain derived by a foreign (non-Thai) entity that sells shares in a Thai company to another foreign company outside Thailand, provided that the transaction occurs entirely offshore.

Conversely, it is crucial to note that capital gains from the sale of Thai shares by a foreign holding company to a Thai purchaser will be subject to 15% WHT, even if the foreign entity has no taxable presence in Thailand. This WHT is imposed on the greater of the amount of the sale proceeds or the actual amount of the capital gain.

The WHT is collected by the Thai purchaser, and remitted to the TRD on the foreign seller's behalf. For the WHT to be levied only on the gain portion, the seller must provide the appropriate computation information to the purchaser, so that it can withhold and remit the correct amount to the TRD.

The WHT can be reduced, or even eliminated, by appropriate provisions of a relevant DTA. It is therefore quite common for a Thai entity's shares to be held by a company resident in a country that has a DTA with Thailand. This is especially the case where the DTA provides an exemption for capital gains from Thai tax if they are derived from the sale of shares by a resident of the other contracting state. An example is the Singapore-Thailand DTA (2015).



3. Taxation of Cross-Border Dividends, Interest, Royalties and Service Fees

3.1. Outbound dividends

The taxation of dividends paid by a company that is resident in Thailand to a foreign company shareholder with no taxable presence in Thailand is limited to a WHT rate of 25% under most DTAs. However, this income will actually be subject to WHT at 10% in Thailand under Thai domestic tax law. This 10% WHT is a final tax in Thailand, and foreign companies receiving Thai-sourced dividends are normally eligible to claim a foreign tax credit in their home jurisdiction for it. If a Thai company pays dividends to an individual, 10% WHT applies regardless of the individual's residence status.

3.2. Inbound dividends

When a dividend is remitted from a foreign company to a Thai company, the Thai company may be exempt from CIT if the participation conditions^[6] can be satisfied; otherwise, 20% CIT will apply. However, if a Thai tax resident individual receives dividends from a company residing in a foreign jurisdiction, those dividends are subject to personal income tax at progressive rates of 5-35%, provided that the dividends are received from abroad and are remitted into Thailand in the same calendar year that they were declared.

3.3. Outbound interest, royalties and service fees

Interest or royalty payments made to a foreign company with no business operations in Thailand are subject to 15% WHT when paid from Thailand. However, this rate may be reduced by an applicable DTA.

Thai income and withholding taxes will not apply to service fee payments made from Thailand to a foreign company with no business operations in Thailand if the foreign company is resident in a country that has a DTA with Thailand and the services are not provided in Thailand.

[6]. See section 2.1.

Thai tax implications differ if the interest, royalties or service fees are paid from Thailand to a foreign company deemed to be directly or indirectly operating a business in Thailand. In this situation, the foreign company must submit a corporate income tax return and pay 20% CIT on its net profits derived in Thailand.

4. Thailand's DTAs

Currently, Thailand has concluded 60 DTAs with other countries. Thailand's DTAs tend to have features of both the United Nations and OECD Model Conventions. As such, it is not uncommon to find that, even in its most recently concluded DTAs (e.g. the Singapore-Thailand DTA, which is effective from 1 January 2017), Thailand continues to include articles that do not appear in the OECD Model – such as those addressing independent personal services (Article 14) and a services permanent establishment (PE) (Article 5) – while at the same time omitting certain OECD provisions, such as the mutual assistance article (Article 27).

This mixed approach is equally applicable to other more “historical” provisions, such as the business profit force of attraction rule. Thailand has historically applied the force of attraction rule in its domestic law and still reserves its ability to do so, even under newer DTAs, e.g. the Russia-Thailand DTA (2010), but has not included it in others. The same can be said of certain PE articles, which specifically include within a PE the maintenance by a dependent agent of stock within Thailand for delivery to customers. This provision is again included in recent treaties, such as the Singapore-Thailand DTA (2017), the Taiwan-Thailand DTA (2013), and the Russia-Thailand DTA (2010), but is somewhat more limited in scope under some older treaties, such as the Thailand-United States DTA (1997), which grants an exception where delivery of the stock is occasional (Article 5(5)), but not where delivery is regular (Article 5(6)(c)).

For dividends, the approaches taken under different DTAs vary with some provisions being based on the UN Model's uniform dividend limitation approach, while others are based on the OECD Model's bifurcated approach. This distinction tends to make

little difference in practice, as the rates provided for under most DTAs either equal or exceed the current domestic withholding tax rate of 10%, with a few notable exceptions, e.g. the Taiwan-Thailand DTA, in which the rate is 5% when dividends are paid to beneficial owners holding at least a 25% participation, and the Mauritius-Thailand DTA, which incorporates the Taiwan-Thailand DTA 5% rate in accordance with the Protocol to the Mauritius-Thailand DTA.^[7]

One final example of the differing approaches contained in Thailand's DTAs is the treatment of capital gains on share dispositions as either taxable or exempt. Again, some DTAs provide an exemption from taxation of capital gains in the source country while others do not. This difference often plays a role in outbound investment planning, particularly in the way in which shareholdings in offshore (non-Thai) companies are structured.

5. International Headquarters

The Thai government has launched various incentive programmes to entice foreign companies to invest or to operate businesses in Thailand. One highly promoted programme is the international headquarters programme (IHQ), under which foreign direct investment into Thailand is encouraged by allowing multinational enterprises to establish an international or regional headquarters in Thailand, which can then avail of special tax and non-tax incentives.

5.1. Tax incentives

By qualifying as a Thai IHQ, an enterprise is granted the following income tax privileges by the TRD:

- (1) CIT exemption for income received from providing qualified IHQ services (e.g. management, technical, supporting, or financial management services) to its foreign associated enterprises;
- (2) CIT exemption for royalties received from foreign associated enterprises;
- (3) CIT exemption for dividends received from foreign associated enterprises;

[7]. Supra n. 5.

(4) CIT exemption for capital gains derived from the sale of shares of foreign associated enterprises, as long as less than 25% of the enterprise's assets comprise real estate assets in Thailand; and

(5) CIT exemption for the sale of goods outside Thailand, provided that the goods are not re-imported back into Thailand.

In addition, Thai IHQs enjoy a 50% reduction of the normal CIT rate (20%) applicable to income derived from providing qualified IHQ services to associated enterprises in Thailand and on royalties from associated enterprises in Thailand.

Dividends repatriated out of a Thai IHQ to its shareholders are exempt from WHT when paid out of income that enjoys a 100% income tax exemption under the IHQ programme. This includes, for example, dividends paid out of CIT-exempt dividends, royalties and IHQ service fees received from foreign associated enterprises.

Separately, an IHQ that provides financial management services to its associated enterprises is exempted from the specific business tax on gross receipts (a substitute for VAT on certain types of income). Additionally, to promote financial flows and investment liquidity amongst intra-group companies, the normal 15% WHT on interest payments from Thai entities to non-Thai foreign company lenders is eliminated, provided that the loan from the offshore lender to the Thai IHQ is used to fund its intra-group financial management service activities. Income received by the IHQ for these financial activities is also exempt from CIT.

In order to obtain these tax privileges, companies must submit the required applications, along with a detailed business plan, directly to the TRD. The TRD will grant the incentives once it is satisfied that the company:

- (1) fully intends to provide qualifying IHQ services to at least one foreign associated enterprise within the group;
- (2) will have registered and paid-up capital of at least THB 10 million^[8] on the last day of each accounting

period; and

- (3) will incur total operating expenses in Thailand of at least THB 15 million^[9] per annum.

Once IHQ approval is obtained, the tax incentives granted last for 15 years. Currently, there is no mechanism to extend or renew the incentives beyond this period.



5.2. Non-tax incentives

In addition to the tax privileges granted by the TRD to IHQs, a number of non-tax incentives are also provided by the Thai Board of Investment to facilitate the smooth and efficient operation of an IHQ. These include:

- (1) exemption from import duties on machinery used for research and development, and training activities;
- (2) exemption from import duties on raw materials and parts used in the production of goods for export;
- (3) authorization for the IHQ to hire skilled expatriates with relevant expertise needed to run the IHQ; and
- (4) land ownership rights for the IHQ in Thailand.

These incentives, when taken together, make an IHQ a powerful draw for investment into Thailand, while offering tangible benefits to multinational enterprises wishing to establish a presence within the AEC.

[8]. Approximately USD 290,000.

[9]. Approximately USD 435,000.

6. Transfer Pricing and Base Erosion and Profit Shifting

6.1. Transfer pricing

At present, no stand-alone transfer pricing legislation exists in Thai law, although a general arm's length pricing rule is featured under section 65(4) of the TRC. This provision stipulates that taxable Thai companies should not adopt prices for transactions that differ from market value, and empowers the TRD to adjust the value of a transaction if it is found to differ from the market price. The company may challenge the adjustment if it can provide reasonable justification as to why market value was not adhered to.

In Departmental Instruction No. Paw 113/2545, issued in May 2002, the TRD provided guidelines on the market value to be applied to transactions between related parties. The TRD defined "market price" to be the value of remuneration, a service fee or interest which would apply in transactions between independent parties, thus conforming to the OECD's standard definition of "arm's length price". The Departmental Instruction also provides that companies subject to Thai tax rules must submit specific documentation supporting transfer prices, but only upon request by a TRD officer. Historically, preparation and submission of transfer pricing documentation has never been required unless specifically requested by the TRD, usually in the context of a transfer pricing audit.

Recently, however, the Thai government has made efforts to update and formalize the transfer pricing regime, whereby the Thai Cabinet approved a draft Act, which formally amends the TRC. The Act introduces a new requirement compelling all Thai taxable companies with related-party transactions to submit transfer pricing documentation to the TRD within 150 days from the end of each accounting period (i.e. tax year-end). It also imposes sanctions on companies that fail to make the necessary submissions by the deadlines provided.

While this Act was reviewed and passed through the Cabinet, it is still under review by the Thai government

and has not yet been enacted by the National Legislative Assembly. Nonetheless, many companies with significant related-party transactions have already started complying with the transfer pricing provisions, in anticipation of the Act's eventual entry into force.

6.2. Base erosion and profit shifting

The OECD and G-20 member countries have made their view clear that all countries should endorse and implement the recommendations in the OECD's base erosion and profit shifting (BEPS) reports. This expectation also extends to developing countries, in order to prevent unfair competitive advantages due to tax policies that exploit inconsistent requirements imposed by different jurisdictions. Accordingly, as of 26 January 2017, the OECD announced that Thailand has formally joined the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes, as its 139th member.

While Thailand has formally joined the Global Forum and is poised to sign the OECD's Multilateral Instrument (MLI), it has yet to take any domestic measures aimed at formal implementation of the BEPS recommendations or automatic exchange of information (AEOI). In addition, the OECD BEPS project and the MLI contain numerous modifications to existing DTAs and require amendments to Thailand's domestic law to facilitate their implementation.

Nevertheless, given Thailand's espoused commitment to modernization of its financial regulatory framework, it is expected that it will eventually adopt many of the recommendations and fully participate in the AEOI process. This commitment has prompted Thailand's formal participation in the Foreign Account Tax Compliance Act (FATCA) programme, through the signing of the Intergovernmental Agreement for the implementation of FATCA and an upgrading of its anti-money laundering regime to meet Financial Action Task Force standards. Given Thailand's expressed desire to improve its appeal as a financial hub within the AEC and ongoing reforms under its new Constitutional framework, the country is expected to participate soon in these international reforms.

From a practical perspective, the signing of the MLI means that other reforms may eventually be in the offing, such as:

(1) the addition of limitations on benefits provisions, which currently do not exist in most Thai DTAs (the Thailand-United States DTA (1996) being the exception);

(2) the potential adoption of arbitration as a means of dispute settlement, given that Thailand is already a signatory to the International Arbitration Convention and has experience in this area; and

(3) provisions addressing hybrid entity treatment, which are not currently addressed in Thai DTAs and are not specifically provided for under Thai domestic law.

All of these reforms may bring about significant changes in Thai tax planning for both inbound and outbound investors.

7. Anti-Avoidance Rules

Thailand has yet to incorporate a formal general anti-avoidance rule into the TRC. It has also not adopted other formal tax anti-avoidance measures, which feature in many other tax jurisdictions, such as controlled foreign company and thin capitalization rules. This stands in contrast with other countries in the region, where there have been significant developments in the adoption of anti-avoidance measures. Unlike China, Indonesia, Singapore and Vietnam, which have adopted rules such as substance requirements for the granting of benefits under DTAs, look-through provisions for lower-tier share sales and other provisions intended to address abusive uses of DTAs and tax avoidance structures more generally, Thailand has yet to formally modify its tax rules to

address tax avoidance. That being said, under the country's Constitutional reform project (which is currently underway), there are specific provisions for modernization of the tax system, and certain proposals relating to anti-avoidance have been considered for adoption as part of this project. This process may therefore result in several new measures being adopted by way of either a significant updating of the TRC or the establishment of an entirely new code.

8. Conclusion

Through its holding company and IHQ regimes in particular, Thailand has put in place tax measures to encourage foreign investment and economic development in the country. The new IHQ regime, combined with Thailand's participation exemption and tax treaty network, means that Thailand is now a viable holding company option when structuring investments, particularly into ASEAN countries. The exemptions for foreign income and outbound dividends have the effect of making Thailand an alternative holding jurisdiction to the more commonly used territorial system of Singapore.

However, there is still much work to be done to expand the tax law, especially in the areas of transfer pricing, BEPS and general antiavoidance. As yet, it is unclear how these improvements will be achieved.

Uncertainty around the developing system of taxation in Thailand means careful attention needs to be paid to any investment structuring, with extra consideration given to incorporating flexibility into tax planning so as to accommodate expected changes in the legal environment.

Contacts:



Jack Sheehan

Partner; Regional Tax Practice
jack.sheehan@dfdl.com



Jonathan Blaine

Tax Director
Jonathan.Blaine@dfdl.com