



Newsletter No. 213 (EN)

**Relocating Headquarters Services
to Thailand**

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I. Introduction

Southeast Asia (SEA) remains one of the most attractive investment regions within Asia. The Asian Development Bank estimates GDP growth rates of 4.8% in 2017 and 5% in 2018. As investments expand throughout SEA, investors face the challenge of where to centralise their back-office services (e.g. accounting, HR, legal, procurement, etc.). While Singapore – often referred to as the “Gate to Southeast Asia” – is regularly utilized by foreign investors as the starting point for investments in the region, an increasing number of investors (intend to) relocate their regional headquarters within SEA to Thailand.

Thailand, located geographically in the heart of the member states of the Association of Southeast Asian Nations (ASEAN) and the ASEAN Economic Community (AEC), offers an excellent infrastructure, and comparatively low wages and rents. Apart from that, the Thai Board of Investment (BOI) and the Thai Revenue Department (TRD) grant investment and tax incentives for the establishment of headquarters in Thailand.

This brief shall give an overview of the key legal and tax implications of relocating headquarters services to Thailand:

II. IHQ Investment Promotion

In May 2015, the BOI has issued its International Headquarters (IHQ) promotion scheme, formerly known as Regional Operating Headquarters (ROH). While the ROH-scheme's criteria were rather impractical and discouraged investors from applying, the IHQ promotion aims at competing with

other investment locations such as Singapore and Malaysia.

1. IHQ Promotion Criteria and Non-Tax Incentives

The IHQ promotion's criteria are straightforward:

- The IHQ company needs to be registered under Thai law with a minimum paid-up capital of THB 10 mil. (approx. EUR 250k);
- Minimum annual expenses of THB 15 mil. (approx. EUR 375k) are necessary in Thailand; and
- Headquarters services need to be granted to at least one affiliated company abroad.

Based on the IHQ promotion, (foreign) investors can

- Fully foreign-own such IHQ-entity;
- Obtain visa and work permits for expat staff through the BOI's One Stop Service Center (and, thereby, being released from the strict immigration and work permit rules, e.g. 4 Thai staff per expatriate ratio, minimum capital requirements per expat: THB 3 mil. (approx. EUR 75k) per expatriate); and
- Purchase land for business purposes.

2. Tax Incentives granted by the Thai Revenue Department

The TRD grants the following tax incentives for a period of up to 15 consecutive accounting periods by separate application:

- Corporate Income Tax (CIT) exemption on:
 - Income from offshore affiliated companies: Income from managerial, technical, supporting, financial and management services, royalties, dividends and capital gains
 - Income from offshore trading and related services: Income from out-out trading including trans-shipment or transit under Thai Customs Law and income from providing international trading-related services to foreign companies;
 - Dividends paid out of profits exempted from CIT
 - Interests on loans made for on-lending to affiliated companies
- CIT reduction (from 20% to 10%) on income from Thai affiliated companies: Income from managerial, technical, supporting, financial and management services and royalties
- Special Business Tax: Exemption on gross receipts from lending to associated enterprises
- Flat Personal Income Tax rate for expatriates: 15% (instead of progressive rates – 0-35%)

III. Lease-related Issues

IHQ entities will be required to lease (or buy) office space for the purposes of their operation. Lease agreements are governed by Sec. 537 et seq. of the Thai Civil and Commercial Code (CCC). Key provisions for foreign investors are:

- Lease terms of more than three years need to be registered with the Land Department (Sec. 538 CCC).
- The term of a registered lease agreement cannot exceed 30 years (Sec. 540 CCC).

A registration fee of 1% of the total lease becomes due in case the lease agreement needs to be registered (lease term more than three years). In practice, lease agreements are, therefore, concluded for three-year periods with renewal options. Foreign investors need to keep in mind, however, that e.g. three years consecutive back-to-back agreements are generally not enforceable (Supreme Court Decision, 6451/1995).

From a tax point of view, foreign investors need to comply with their obligation to withhold 5% tax from the lease fee and remit it to the Thai Revenue Department (Departmental Regulation No. Taw Paw 259/2559). In order to lower the withholding tax burden, the lessor will often require the lessee to enter into two separate contracts (a lease agreement and a service agreement), thereby reducing the lessor's withholding tax burden.

IV. Employment-related Issues

When relocating expats and staffing the IHQ entity with local employees, investors should keep in mind that the Thai Labour Protection Act B.E. 2541 (LPA) lays out a high standard with regards to employee protection. Just to name the most relevant:

1. Severance Pay and Unfair Termination Claims

Employees are entitled to severance pay based on the duration of their employment period (unless the employment relation has not been terminated with cause according to Sec. 119, 118 LPA):

| Duration of Employment | Severance Pay |
|--|-----------------------------------|
| At least 120 days but less than 1 year | 30 days of the latest salary rate |
| At least 1 year but less than 3 years | 90 days of the latest salary rate |

| | |
|---|------------------------------------|
| At least 3 years but less than 6 years | 180 days of the latest salary rate |
| At least 6 years but less than 10 years | 240 days of the latest salary rate |
| At least 10 years | 300 days of the latest salary rate |

In case an employment is terminated without cause, employees may also claim damages for unfair dismissal (Sec. 49 Labour Court and Labour Procedure Law Act B.E. 2522). According to the Supreme Court's jurisprudence, Labour courts will assess the cause of termination and whether the employee was reasonably terminated or whether the employer had a sufficient and justifiable reason to terminate the employment contract.

2. Fixed-term Agreements

A common misunderstanding is that employers can circumvent severance pay claims by simply entering into fixed-term employment agreements (FTEAs). 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. Regardless of that, FTEAs are attractive to limit the duration of an employment without having to follow a formal termination process. This limits the employer's exposure with regards to claims for unfair termination (see above). However, when making use of FTEAs, employers need to closely monitor the employment period in order to prevent de facto extensions, whereby the employee stays on the payroll after the end of the fixed term. In this case, the FTEA converts into an ordinary employment relationship, making it necessary to comply with the termination process.

3. Termination

Severance pay and unfair termination claims can be avoided by terminating employment

agreements in accordance with Sec. 119 (1) LPA. In practice, the most relevant termination reason is the termination due to a warning letter (Sec. 119 (1) No. 4 LPA). To make use of this provision, employers need to issue warning letters, stating the exact breach of the employee's obligation. Should the breach of the obligation reoccur within one year, the employment relationship may be terminated without the employee being entitled to severance pay.

4. Overtime

Foreign investors should pay attention to the proper compensation of overtime. According to Sec. 61-63 LPA, overtime is compensated at 100%-300% of the hourly wage rate depending on when employees worked overtime. Employers often try to exclude these binding provisions by including overtime lump sum clauses in their model employment agreements. Generally speaking, these clauses are void, as the overtime provisions of the LPA can only be excluded with regards to staff assigned HR responsibilities and special tasks conclusively defined in Sec. 65 LPA.

5. Company Working Rules

Employers employing more than ten employees must publish company working rules (Sec. 108 LPA) that have to include the following:

- Working days, working hours and rest periods;
- Weekly and public holidays;
- Rules governing overtime and holiday work;
- Date and place of payment of wages and overtime pay;
- Discipline and disciplinary measures;
- Grievance mechanism; and
- Termination and severance pay.

V. Transfer Pricing

When rendering headquarters services to affiliated companies, Thailand's transfer pricing regulations need to be complied with. Even though Thailand is not a member of the OECD, most of the regulations in force in Thailand are based on the OECD guidelines (Departmental Instruction No Paw 113/2545 - DI 113/2545). According to Sec. 65 bis (4) Thai Revenue Code (RC), tax authorities have the power to assess intercompany pricing. In case the authorities find that the pricing mechanism does not comply with the arm's length principle (ALP), the transfer price may be adjusted accordingly.

1. Transfer Pricing Methods

According to Cl. 3 (1)-(3) DI 113/2545, 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.

2. Transfer Price Documentation

Even though there are no statutory filing requirements in force, according to Cl. 4 DI 113/2545, transfer price documentation (TPD) containing the following content shall be kept at the taxpayer's office:

- Ownership structure and relationship between the affiliated entities;
- Budgets, business plans, details of related-party transactions and financial projections;
- Pricing policies, product profitability and relevant market information; and
- Documentation supporting selection of a particular pricing method.

Where taxpayers can prove based on their TPD that the selected transfer pricing method results in a fair market price, tax officials are obliged to accept such method.

3. Advance Pricing Agreement

Taxpayers may enter into an advance pricing agreement (APA) with the TRD. In order to do so, taxpayers must submit a letter requesting an APA together with relevant documents to the Director-General of the TRD in order to set the criteria, methods and conditions with which the taxpayer must comply (Cl. 5 DI 113/2545).

4. Transfer Pricing Bill (2015)

On 7 May 2015, the Cabinet approved the Transfer Pricing Bill which is still under revision by the National Legislative Assembly. According to the Bill, the following changes shall come into force:

- Transfer price documentation may have to be prepared at the time of entering into a intercompany transaction;
- Transfer price documentation may have to be submitted together with the yearly financial statements; and
- Failure to comply with the documentation requirements may be subject to penalties of up to THB 400k (approx. EUR 10k).

Up to date, the Bill has not been passed.

German invested companies should be aware of the increased documentation requirements which will be implemented based on the Base erosion and profit shifting (BEPS) measures.

VI. Conclusion

Apart from the decision to set-up a (regional) headquarters in Thailand which is ultimately a commercial decision based on the specific business needs, knowing the key legal and tax provisions is mandatory. As can be seen from

the above, relocating headquarters services to Thailand triggers a broad range of legal and tax consequences. A proactive approach with regards to proper planning (*e.g. applying for a BOI investment promotion and TRD tax incentives*)

as well as proper documentation (*e.g. with regards to HR and transfer pricing*) are essential to mitigate potential risks.

*We hope that the information provided in this newsletter was helpful for you.
If you have any further questions please do not hesitate to contact us.*

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