



# Creating incentives

Embracing foreign investment, the Thai government has over the years relaxed various restrictive laws. But, as Cynthia M Pornavalai, a partner at *Tilleke & Gibbins* explains, there is still a lot to bear in mind when considering M&A activity there.

## Introduction

Recognising the importance of foreign investment for its economic growth, Thailand has through the years relaxed restrictive investment laws and regulations, thus favourably positioning itself as a prime market for cross-border M&A activity. Continuing the trend toward investment liberalisation, the Bank of Thailand and the Ministry of Finance will implement the second phase of the Financial Sector Master Plan over the course of 2010-2014, which will grant waivers on income tax, specific business tax, and stamp duty for earnings on merger and acquisition activities. However, these waivers, coupled with the driving force of increased competition, have also pressured local enterprises to consider merging with each other in order to strengthen and prevent takeovers by foreign firms. Nevertheless, Thailand remains a highly viable option for foreign investment, and M&A activity is expected to play a prominent role in the Thai marketplace.

## Legal pathway for M&A in Thailand

Under Thai law, there are three types of M&A transactions that occur: full merger or amalgamation, share acquisition, and asset acquisition. Under the *Civil and Commercial Code (CCC)*, mergers of limited companies are referred to as amalgamations. The CCC sets forth registration and notice requirements for amalgamations. The amalgamation of companies forms a new company that is

entitled to the rights and subject to the liabilities of the amalgamated companies.

For cross-border M&A of public companies, the *Securities and Exchange Act* governs the acquisition of securities for business takeovers. Share acquisition is by far the most popular method of M&A, due to lower tax burdens. There is no registration fee for the transfer of a company's shares. However, stamp duties are required to be affixed to the share transfer instruments at the rate of Baht 1 for every Baht 1,000 or a fraction of the paid-up value of the shares or of the nominal value of the instrument, whichever is greater.

In asset acquisition, the acquirer purchases the assets of the target company. There are no registration duties for the transfer of a company's movable assets. However, value added tax (VAT) is imposed on the sale of movable assets at seven percent of the selling price. The transfer of immovable assets (land and building) is subject to a registration fee of two percent of the price as appraised by the Land Department, plus 0.5 percent stamp duty. Said transfer of immovable assets is further subject to specific business tax (SBT) at the rate of 3.3 percent of the selling price or the price as appraised by the Land Department, whichever is greater. If SBT is already paid for the transfer, such transfer will be exempted from stamp duty.

Foreign investors should be mindful of limitations on foreign ownership when considering cross-border M&A

ventures in Thailand. The *Foreign Business Act* reserves certain types of business activities for Thai nationals only, so foreign investment in those businesses is limited to less than 50 percent of share capital unless specially permitted or otherwise exempted. The Board of Investment of Thailand grants incentives to qualifying investment projects in Thailand that are available to both Thai and foreign investors, and may sometimes exempt foreign investors from certain restrictions under the *Foreign Business Act*. Other incentives include tax breaks, customs duty exemptions or reductions, land ownership for foreign companies, and visa and work permit privileges for foreigners.

### Competition law

The *Trade Competition Act* (TCA) governs anti-monopoly and competition law in Thailand. The TCA seeks to maintain a fair and open market, and thus prohibits businesses from exerting influence through unfair trade practices that have been deemed anti-competitive. As such, the TCA forbids business mergers and acquisitions which may result in a monopoly or unfair competition, unless the Trade Competition Commission's permission is first obtained.

### Employment law

The *Labour Protection Act*, the *Thai Civil and Commercial Code*, the *Labour Relations Act*, the *Social Security Act*, the *Compensation Fund Act*, the *Alien Employment Act*, and the *Royal Decree Naming Professions Prohibited to Aliens* govern employment law in Thailand. Except for the *Alien Employment Act* and the *Royal Decree*, Thai labour laws apply to all employees working in Thailand, regardless of

nationality. Therefore, employers are required to provide, at the minimum, benefits and welfare to employees.

Foreign investors should pay close attention to regulations that apply to general termination. Employees in Thailand are protected against redundancies or termination of employment without cause and are entitled to compulsory severance pay. If employment is found to have been terminated without cause, the court may order reinstatement of employment even if compulsory severance pay has been already paid to the employees. Employers can potentially avoid litigation by consulting with employees and reaching a settlement and release agreement.

For termination with cause, employers may terminate employment effective immediately, without making a severance payment. However, if the employer terminates employment without cause, the employer must serve a notice of termination at least one pay period in advance, or as stipulated in the employment agreement, whichever is longer, but more than three months' notice is not necessary. If the terminated employee considers the termination unfair, he may pursue the case in labour courts and seek compensation for unfair dismissal.

Foreign persons must obtain work permits from the Ministry of Labour and maintain valid non-immigrant visas in order to work or physically operate a business in Thailand. A foreign person intending to work in Thailand must first obtain a non-immigrant business (B) visa from a Royal Thai Embassy or Consulate abroad before entering Thailand. After entering Thailand on a B visa, the foreign person may obtain a work permit from the Ministry of Labour. The work permit application must be sponsored by an entity that is registered in Thailand. The Alien Employment Act regulates and limits how many foreigners each employer may sponsor. The number of foreigners



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each employer may sponsor depends on a variety of factors, including the amount of the employer's paid-up capital, whether the employer is foreign or domestic, the amount of tax the employer paid during the preceding year, and whether the foreign employee has specialized knowledge or skills.

### Main taxes on resident businesses

Generally, corporate income tax must be paid at the rate of 30 percent of the net profit earned during a tax year. Reduced progressive rates are granted to small and medium-sized enterprises. Value added tax (VAT) is payable at the rate of seven percent (or 0 percent for export of goods and services) on certain categories of business transactions, including sale of goods, provision of services, export sales, and import of goods. Specific business tax (SBT) and municipal taxes may apply to other business activities instead of VAT, such as banking or securities activities. Foreign investors should note that Thailand also has a wide network of double tax treaties, including treaties with European countries, Asian countries, and the United States.

### Potential pitfalls for the foreign investor

Perhaps the most challenging aspect of M&A in Thailand concerns legal due diligence. Although due diligence plays a vital role in M&A, there are no specific statutory requirements in Thailand for legal due diligence reviews during the course of an M&A deal. Such reviews are essential in order to prevent or mitigate future liability. The review process can unearth determining factors, such as a target's noncompliance or any violation of laws, regulations, restrictions on foreign ownership, or restrictions on share transfers, which may eventually make or break a deal. A legal team can also confirm the legitimacy of issued shares; whether there are any encumbrances on major assets; whether the target is legally authorised to conduct business with the proper or requisite licenses; potential breach of terms and obligations of material commercial contracts or employment agreements; and most importantly, whether or not there is any pending litigation by or against the target or if there are any bankruptcy or reorganisation filings.

There are, however, limitations to the performance of legal due diligence review in Thailand. First, Thailand does not have a centralised recording system of pending

nationwide court suits to arrange for litigation searches. Independent litigation searches have to be conducted at each major court in Bangkok—the Central Bankruptcy Court and the Business Reorganization Office, Civil Court, South Bangkok Civil Court, Intellectual Property and International Trade Court, Central Labour Court, Criminal Court, and Central Tax Court. If the target is located outside Bangkok, litigation searches at that provincial court must be arranged.

Another limitation is that Thailand also lacks a centralised asset registry. Real property searches have to be arranged at the appropriate Land Office where the target's real property is situated. Copies of land title deeds may serve to facilitate the conduct of these property searches. Lastly, any encumbrances on shares can only be verified by vetting the Register of Shareholders, which is maintained solely by the target and is not in publicly available records.

Political uncertainty also plays a key role in undermining investor confidence in Thailand. Although Thailand would benefit markedly from political stability, private sector growth momentum has remained resilient throughout recent periods of political turmoil. Despite political differences on domestic issues within the country, there is a general consensus on pro-investor policies that will continue to support economic development and expansion.

### Conclusion: what does the future hold?

With exports of goods accounting for approximately 60 percent of the gross domestic product, international trade continues to be a significant factor in Thailand's economic stability and growth. The government actively creates and promotes incentives to draw in foreign investment. Although the *Foreign Business Act* has not been revised since its enactment, Thailand has made efforts to open up further to international trade. With respect to negotiating free-trade agreements, Thailand is a signatory to the ASEAN Free Trade Area which came into force on January 1, 2010, resulting in greater market access within Southeast Asia. Thailand has also entered into free-trade agreements with Australia, China, India, Japan, and New Zealand. All of these factors make Thailand a highly attractive location for cross-border M&A prospects.

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