LEGAL ARTICLE

In July 2011 as the Democratic Administration prepared to leave the office, foreign business law became an issue again in the telecommunication industry. As a matter of fact, during the same period, the Facts Investigation Working Penal of the Department of Business Development announced the conclusion of its investigation on foreign business law malpractice. In light with these events, perhaps it is a good time to revisit foreign business law.

FOREIGN BUSINESS LAW

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Like many other countries,

Thailand protects local owned businesses from foreign competition through a legal mechanism. The Foreign Business Act, B.E. 2542 (1999) (the "FBA") prohibits a foreign owned company from engaging in certain restricted businesses. The restricted businesses under the FBA are classified into three categories:

- Businesses under Schedule 1 (Strictly closed to foreign competition);
- Businesses under Schedule 2 (Open for applying a license); and
- Businesses under Schedule 3 (Open for applying a license).

The businesses under Schedule 1 are completely closed to foreign competition, thus a foreign owned company is strictly prohibited from operating the businesses under Schedule 1. This means the FBA does not allow a foreign owned company to file a foreign business license application for any Schedule 1 business.

The businesses under Schedule 2 and Schedule 3 are not completely closed to foreign competition as the FBA makes it possible for a foreign owned company to apply for a foreign business license to engage in any business under Schedule 2 and Schedule 3. And if the license is granted, the foreign owned company may operate the restricted business under the license.

For manufacture business, it is largely open to foreign owned companies (not in any Schedule), while the services business is listed as a restricted business under Schedule 3.

OPTIONS FOR FOREIGN COMPANIES

So when a great opportunity

comes, as a foreign investor who is keen on commencing a business in Thailand, what option do you have? Here's the rundown of options that you'd better carefully review.

1. Obtaining Foreign Business License

For the businesses under Schedule 2 and Schedule 3, a foreign owned company may apply for a license. While a result of an application may seem uncertain, in the reality the Foreign Business Board, a decision maker under the FBA, has a track record of granting licenses to certain businesses (of course with certain terms and conditions) and rejecting license applications for other businesses.

Getting a license is probably the best option provided that a foreign company can manage to get a license. The only negative aspect of getting a license

here is the cap on the debt to equity ratio, which limits the use of thin capitalization.

The Department of Business Development has issued the approval criteria guidelines for several businesses. Basically if a foreign company manages to comply with the conditions of the relevant guideline, obtaining a license is not too difficult. Currently, the department has the guidelines for the below businesses:

- a representative office;
- a regional office;
- a service or other business with the state sector or the state enterprise;
- a service rendered to an affiliated company;
- installation, repair and maintenance services;
- real estate lease;
- financial leasing;
- hire purchase;
- factoring;
- manufacture hire of work;
- a service or other business with the private sector; and
- wholesale.

2. Board of Investment Promotion

The second option is getting the investment promotion from the Board of Investment (BOI). Upon receipt of the investment promotion, a foreign owned company is exempt from the FBA's restriction unless the Board of Investment specifies otherwise. Getting a BOI promotion is a good option too, however, not every restricted business is eligible for the BOI promotion.

3. Use of Free Trade Agreement or Treaty of Amity

A foreign company from Australia, Japan or the United States of America is eligible for the exemption to the FBA's restriction to extent that the relevant Free Trade Agreement or Treaty of Amity provides.

The United States Treaty of Amity is the most generous one as the Treaty allows US owned companies to operate practically any restricted business in Thailand with the exception of just six businesses.

The Thai-Australia Free Trade Agreement ("TAFTA") allows Australian shareholders to own up to 100% or 60%, depending on the types of businesses, in a Thai company that engages in the businesses specified by the TAFTA. The eligible businesses are land and marine mining, construction, hotel and luxurious resort business, full service restaurant, general consultancy services for regional operating headquarters, branch or affiliated companies, convention hall, international good exhibition center, distribution and installation services for goods manufactured by Australian owned juristic persons in Thailand, tertiary education institute with expertise in life sciences, bio-technology and nano technology, theme park and zoo, marine park and tourism pier.

The Japanese-Thai Economic Partnership Agreement ("JTEPA") allows Japanese shareholders to hold up to 100%, 75%, 60%, 51%, or 50% in a Thai company that engages in retail/wholesale of goods manufactured by itself or its affiliated company in Thailand under the same brand or automobile goods under the same brand, advertisement, hotel, sale of food and beverage (restaurant), general management consultancy services, logistic consultancy services, maintenance and repair services. The JTEPA also imposes the cap on the debt equity ratio for Japanese owned companies operate under the JTEPA.

4. Operating as Thai Owned Company

A foreign investor may partner up with Thais and operate a business as a Thai owned company. This option is often adopted by many foreign investors. It is noteworthy that this option must be used with care.

First, prior to choosing this option, a foreign investor should figure out first the likelihood of getting a foreign business license from the Department of Business Development based on the previous track record of the Foreign Business Board. If there is some chance of getting a license, it is better to try to get a license. Once the business operates as a Thai owned company, converting to a license holder may not be quite straight forward. Conversion from a Thai owned company to a licensor holder may require the suspension of business operation.

Second, other options (BOI and FTA/Treaty) should be properly explored for businesses that are qualified for other options.

Third, if Thai shareholders are legitimate business partners, this option is fine and perfectly lawful. Nevertheless in the case where Thai shareholders are not legitimate business partners, then this arrangement could potentially lead to a legal trouble down the road.

WATCH OUT FOR NOMINEE

The use of a Thai nominee shareholder to circumvent the FBA's restriction is illegal. As recent as August 2011, the Department of Business Development still continues to implement the nominee shareholder investigation project, but this time in the main provinces, including Chonburi, Phuket, Rayong, Trad and Chaing Mai. Again, the focus will be given to land trading and real estate business, agriculture business, companies with the foreign shareholding ranging from 40% but less than 50%, or with foreign authorized directors.

Based on the conclusion of the investigation of the Facts Investigation Working Penal of the Department of Business Development, the Penal took into its consideration the following facts in determining whether holding companies are nominees for the foreigner or not.

1. A loan was extended from an unspecified source.

2. Directors and authorized directors of different holding companies come from the same group of people. Under holding companies' Articles of Association, a foreign shareholder has more votes for each share than Thai shareholders have for each share and the dividend entitlement of the foreign shareholder is higher than the dividend entitlement of Thai shareholders. This indicates that the foreign shareholder has more power to manage holding companies than do Thai shareholders.

3. Holding companies have no actual business premises and have never used the registered offices for operating other businesses.

4. Holding companies have the same registration particulars and are under the management of the same group of people.

Since 2006 the use of multi-tier holding companies structure is no longer considered safe and this investigation is just another reminder that this structure is vulnerable to a possible legal challenge.

This legal article was written by Narit Direkwattanachai, a corporate & tax attorney at NARIT & Associates with expertise in foreign business law. He holds a bachelor of laws (1st class honors) from Chulalongkorn University, a master of law from the University of Cambridge, UK and an MBA in finance from the Georgia Institute of Technology, USA. He can be reached at narit@naritlaw.com