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BusinessINSIGHT

TAX RATES PART OF COMPETITION FOR FOREIGN INVESTMENT

IN YEARS GONE BY, the Kingdom's relatively high corporate-income-tax rate may have impeded investment into Thailand and even sent it the way of competing countries with lower rates. To improve competitiveness, the government "temporarily" reduced the corporate rate to 23 per cent last year and to 20 per cent for the two accounting periods that begin between January 1, 2013, and December 31, 2014.

On the face of it, this is a positive move for inbound investors, as taxation affects total return on investment (ROI). The rationale, from the government's perspective, is to bring investment and jobs to Thailand and thus grow the economic pie by taxing it at a lower rate. However, as many players operate on a two-to-seven-year investment life cycle, the reduction in the headline rate being "temporary" leaves them on the cusp of an investment decision in Thailand, unclear on how their total return will be taxed.

As a positive, this reduction in the headline rate to 20 per cent brings Thailand's taxation competitiveness closer to that of other economies in the region such as Singapore (17 per cent), Hong Kong (16.5 per cent), Malaysia (25 per cent) and Vietnam (25 per cent). However, the headline rate does not always provide the full picture of an investor's total after-tax return.

As offshore investors receive their returns in the form of dividends, it is necessary to consider the total effective tax rate on such returns, including withholding taxes. Dividends paid offshore by Thai companies are subject to a 10-per-cent dividend withholding tax (DWT) in addition to the corporate income tax. So, for example, a Thai company generating Bt100 of taxable profit pays corporate tax of 20 per cent, leaving Bt80 to distribute as dividends. This Bt80 is subject to Bt8 of Thai DWT on distribution offshore. That is an effective tax rate to offshore shareholders of 28 per cent.

As Singapore, Hong Kong and Malaysia do not impose DWT, the effective tax rate on investment into Thailand of 28 per cent now looks far

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less competitive. Accordingly, the next challenge for Thailand is to reduce the DWT rate to lower its disadvantage. Unlike the reduction in the corporate-income-tax rate, a reduction in DWT may be achieved in a targeted manner through negotiation with major investment partners.

Countries often negotiate bilateral agreements for the double-taxation avoidance (DTA) to promote investment between those countries. They can agree reductions in the rate of DWT. However, before the end of December last year, no DTA to which Thailand had entered offered a rate of DWT below 10 per cent.

In December, a DTA was agreed between the Thailand Trade and Economic Office and the Taipei Economic and Cultural Office. Included in this DTA is a reduction in the DWT rate on dividends to 5 per cent, provided the recipient holds at least 25 per cent of the shares in the paying company.

As well as providing advantages to Taiwanese companies investing in Thailand, the reduction in the DWT rate within this agreement may have other implications.

Specifically, Thailand has signed double-taxation agreements with Mauritius and the United Arab Emirates that allow tax rates to be reduced if Thailand ever offers lower rates under a DTA with another party. If the agreement entered with the Taipei Economic and Cultural Office falls within these provisions, the 5-per-cent DWT should be available to investors from Mauritius and the UAE on the same terms as for investors from Taiwan.

However, we still await official confirmation on this matter.

Being entitled to the lower tax rate would be significant for Mauritius, which is frequently used as a location for investment into Thailand and which would have a competitive advantage over other holding-company locations such as Hong Kong, Singapore and the Netherlands.

A possible wider implication of the reduced DWT rate is that other major investment partners may seek to renegotiate their DTA to secure equivalent treatment. The DTA signed in December may, therefore, prove to be a catalyst for a more widespread reduction in the rate of DWT. Such a reduction should be seen as a having a positive effect on Thailand's prospects for foreign investment.

Further competitive improvements could be made by making the application of the reduced DWT on dividends paid from Thailand broader to all jurisdictions or by removing it completely and by providing clarity regarding the reduced corporate tax rate and whether such a reduction will be extended.

This would be welcomed by foreigners investing in Thailand and would improve the country's competitiveness as a destination for inbound investment in view of the introduction of the Asean Economic Community in 2015.

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