

Charting the path for the future of capital management

Presentation by PwC Thailand - Financial services team
14 November 2023



Agenda

1. Introduction to capital management
2. Financing structure
3. Alternative for liquidity management
4. Managing bad debts
5. Key takeaways
6. Q&A

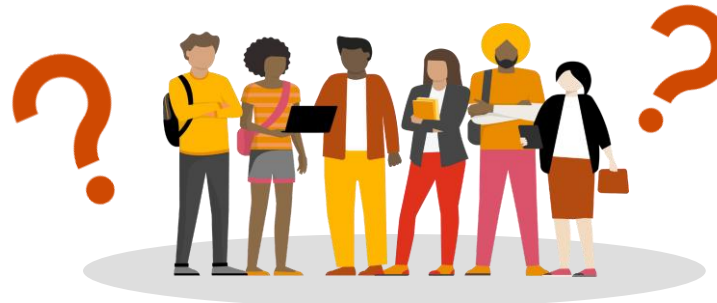
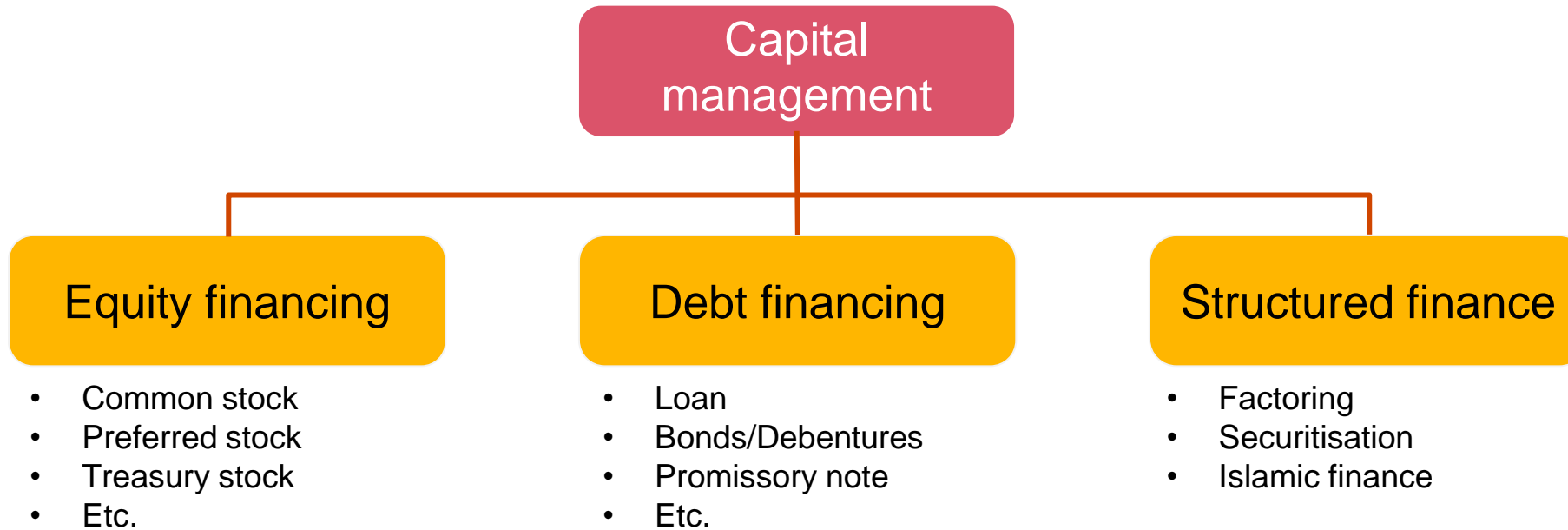


1

Capital management



Capital management





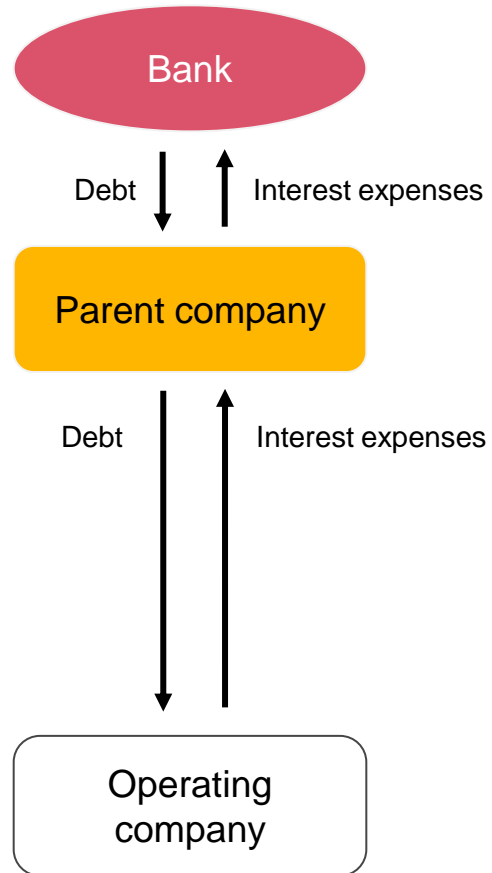
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Financing structure

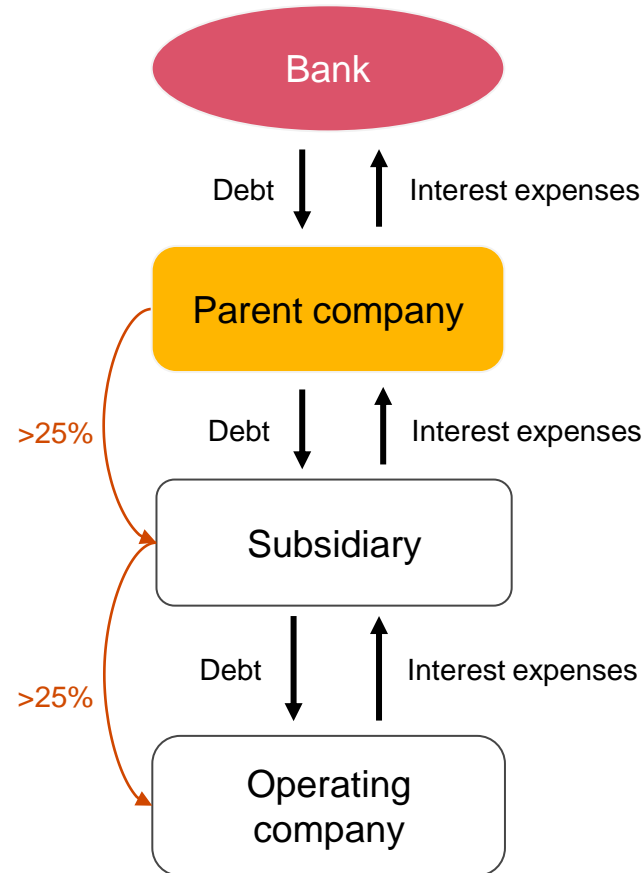


Common debt financing structures

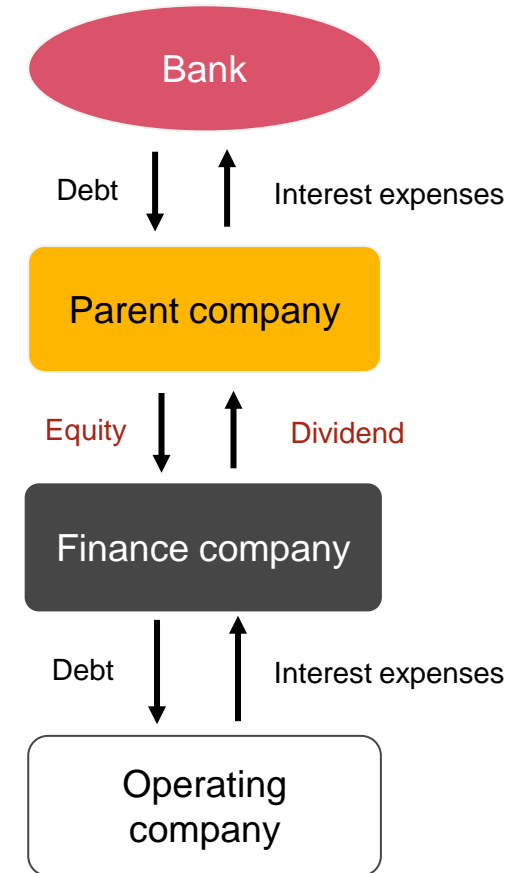
Structure#1 – direct lending



Structure#2 – re-lending

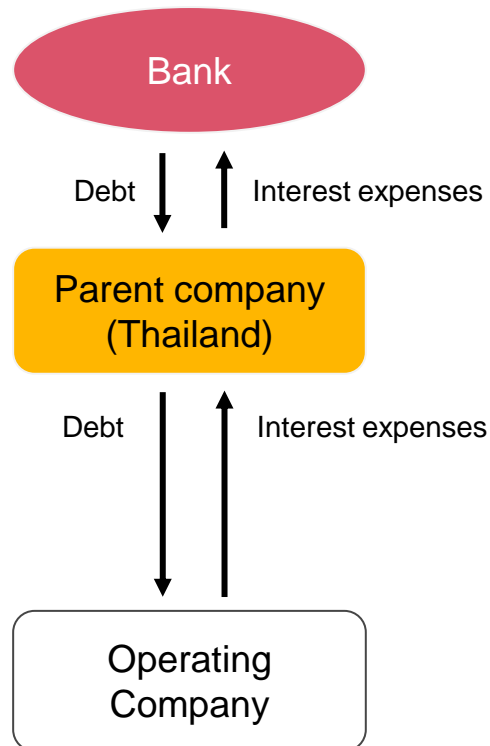


Structure#3 – double dip



Financing structures - Structure#1 direct lending

Structure#1 – direct lending



Outline

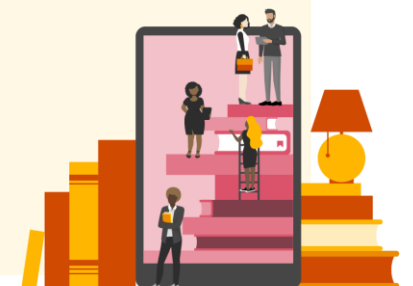
- Thai Parent uses third party borrowing to finance Operating Company (OpCo).

Key tax considerations:

- Interest rate should be set at arm's length
- SBT at 3.3% (when conditions for SBT exemption is not met)
- Ability and timing for utilising withholding tax (Domestic vs Overseas tax)

Question:

- How should the interest rate for an inter-company loan be priced from a transfer pricing perspective?



Interest rate pricing for a loan

Thai Revenue Department's view

(Tax ruling No. 0702/560 dated 21 January 2015)

Based on the Revenue Department's ruling, interest charged must not be lower than the market interest rate where the loan amount is derived from:

1

Lender's
own funds

The interest rate must not be less than that of a fixed deposit with a commercial bank.

2

A loan
from
another
(external)
source

The interest rate charged should be at the lending rate under the same conditions or not lower than the loan interest rate paid to the other source.

3

Cannot
clearly
identify the
source of
the funds*

*has a loan from another source

The RD assumes that the loan to the other company was from an outside funding source so the interest rate charged must not lower than the loan interest rate paid to the other source.

Interest rate pricing for a loan

Key considerations from OECD



Interest rate pricing (OECD's perspective)

Whether a purported loan should be regarded as 'loan'



The lender's perspectives

Whether to give a loan, how much, and on what terms:

- Factors concerning the borrower (e.g. creditworthiness of borrower, purpose of loan, source of repayment)
- Failure of the purported debtor to repay on the due date or to seek a postponement
- Other options realistically available



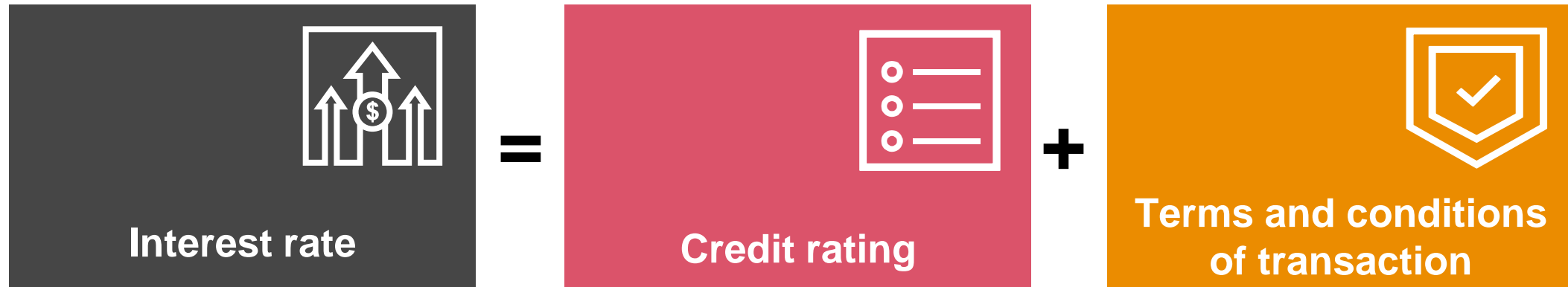
The borrower's perspectives

Optimise cost of capital:

- Business strategies
- Risk of not being able to make interest and principal payments on time or raise more capital
- Existence of financial covenants, guarantee and security
- Ability to obtain loans from unrelated lending institutions and other options realistically available

Interest rate pricing (OECD's perspective)

Interest rate building blocks



- Creditworthiness of borrower

- Nature and amount of loan
- Tenor and maturity
- Schedule of repayment
- Guarantee
- Level of seniority
- Currency
- Timing of issuance
- Etc.

A landmark case for arm's length pricing

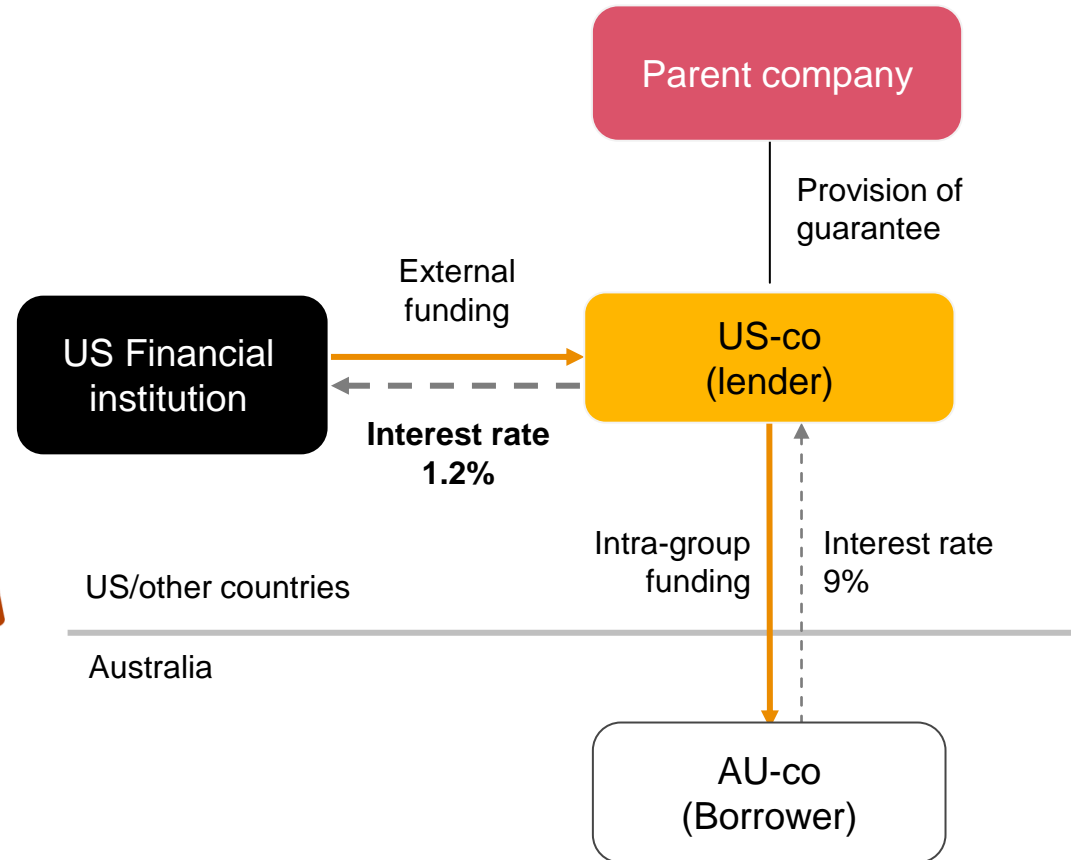
OECD country court case: Australia (2017)

Background

- US subsidiary borrowed externally in USD at a rate of 1.2% (with a guarantee from Parent company).
- US-co on-lent funds to AU-co at an effective rate of 9% (based on the standalone credit rating of AU-co).

Taxpayer's position

- The effective rate of 9% is arm's length as the intra-group loan benchmark reflects rates offered to companies with similar creditworthiness to AU-co.



A landmark case for arm's length pricing

OECD country court case: Australia (2017)

Tax authority's position

The arrangement is not arm's length as:

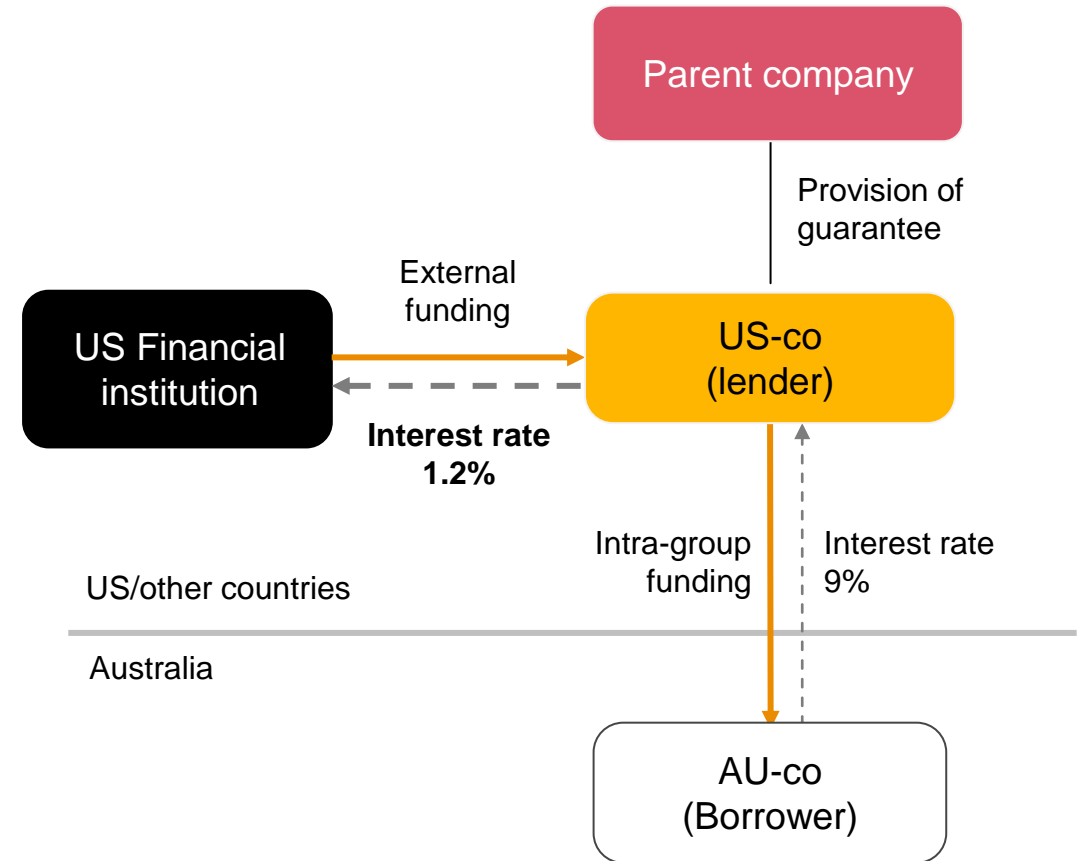
- AU-co would likely be able to significantly reduce the rate of 9% if it provided the customary security and covenants
- if AU-co had borrowed from a third-party lender, it would have undertaken all reasonable measures to reduce the rate.

In not doing so, the subsidiary had inflated its cost of borrowing.



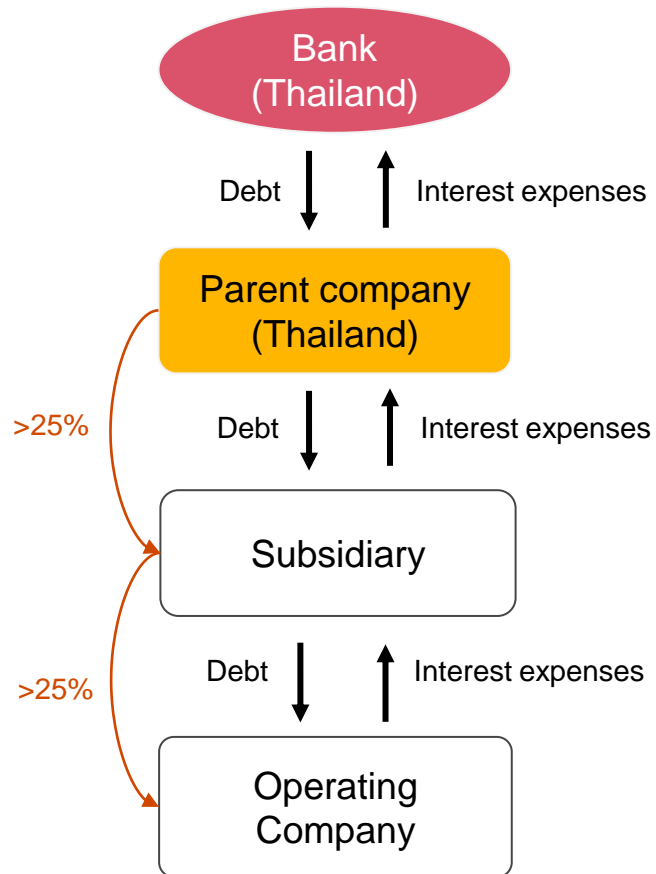
Court ruling: the Australian tax court ruled in favour of the tax authority –

an assessment was made to disallow the difference between the 9% effective rate and the rate offered by third-party lenders had Parent company provided a guarantee to AU-co.



Financing structures – Structure#2 re-lending

Structure#2 – re-lending

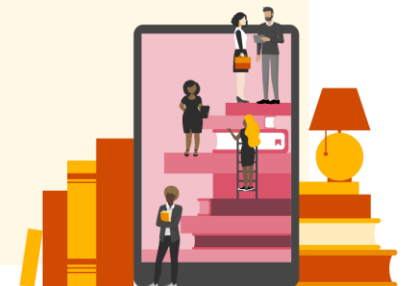


Outline

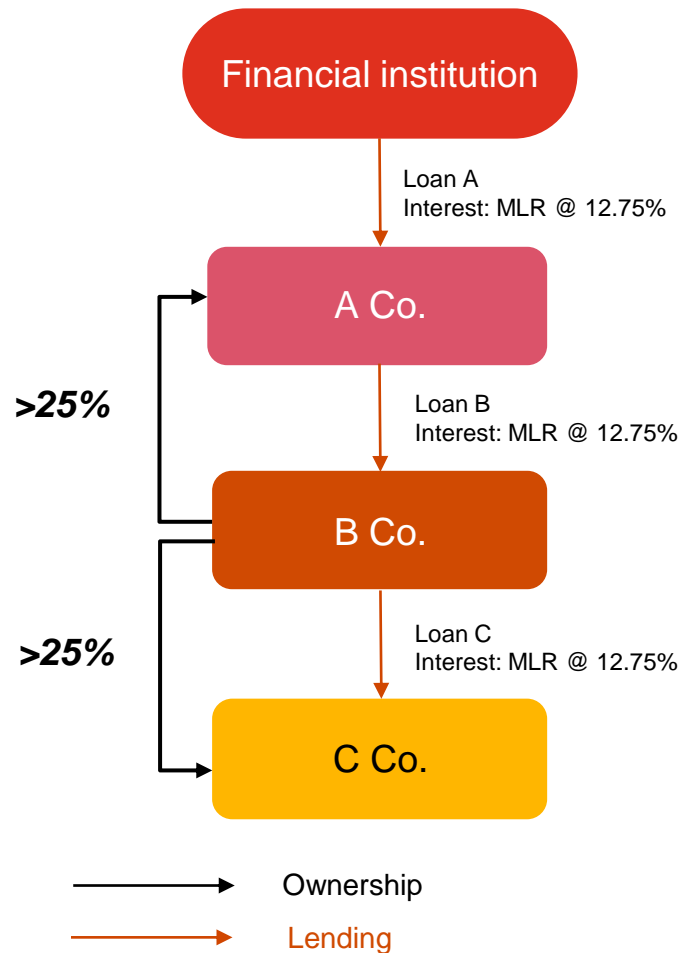
- Thai Parent uses third party borrowing to lend to Subsidiary
- Subsidiary then relends to OpCo
- Thai Parent holds shares (more than 25%) in Subsidiary
- Subsidiary holds shares (more than 25%) in OpCo.

Questions:

- Because Thai Parent does not directly hold shares in OpCo, could the insertion of Subsidiary help relieve SBT cost?
- Any tax risk associated to this structure?



Thai Supreme Court case – Sham transaction (No. 12127/2558)



Fact

Shareholding structure

- B Co. held more than 25% of shares in A Co. and C Co. for more than six months prior to the date of the loan.

Loan structure

- A Co.'s loan amount was derived from a loan from external source.
- A Co. firstly gave the loan to B Co. who then gave the loan to C Co.
- The principal amount from each lender to each borrower in this flow is the same.
- The interest rate charged from each lender to each borrower is the same.

Revenue Department's position

The RD viewed that the loan was structured with an objective to have SBT exempted and so the loan from B Co. to C Co. was considered as a sham transaction and should be voided. A Co. should then be subject to SBT.

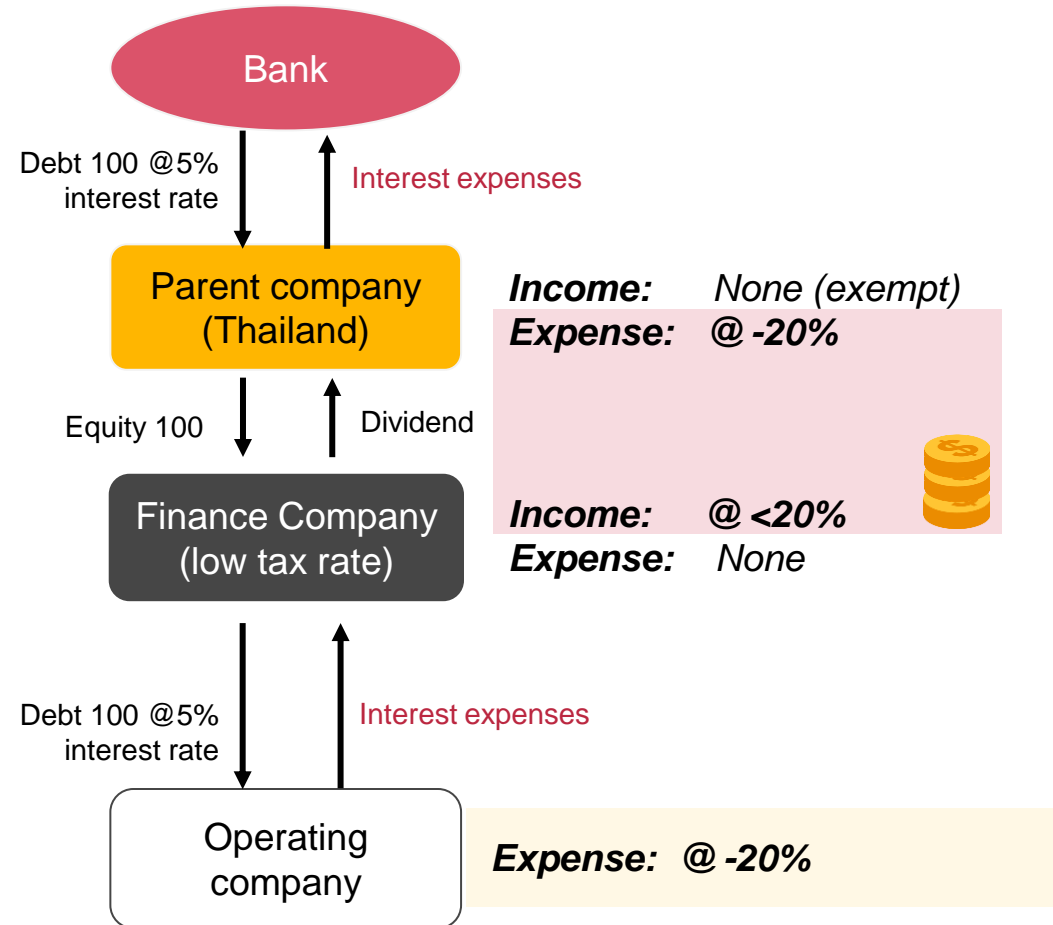
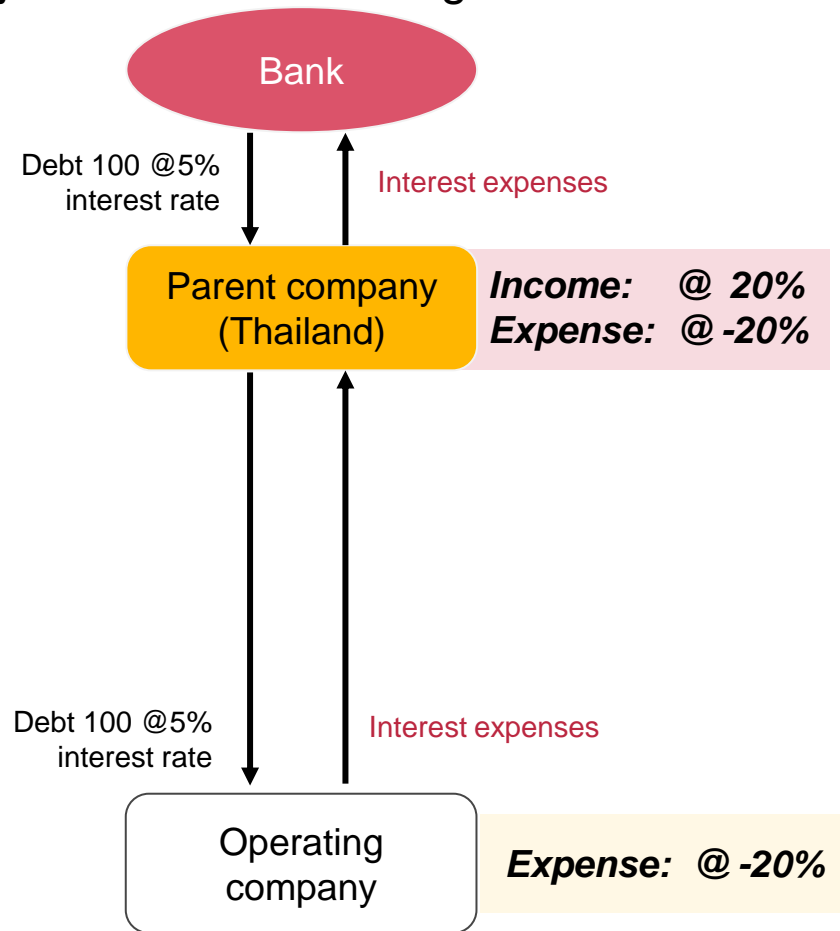
Court's view

The court is not convinced on the business substance and viewed that the loan from A Co. to B Co. was intentionally created to avoid SBT (sham transaction).

Questions:

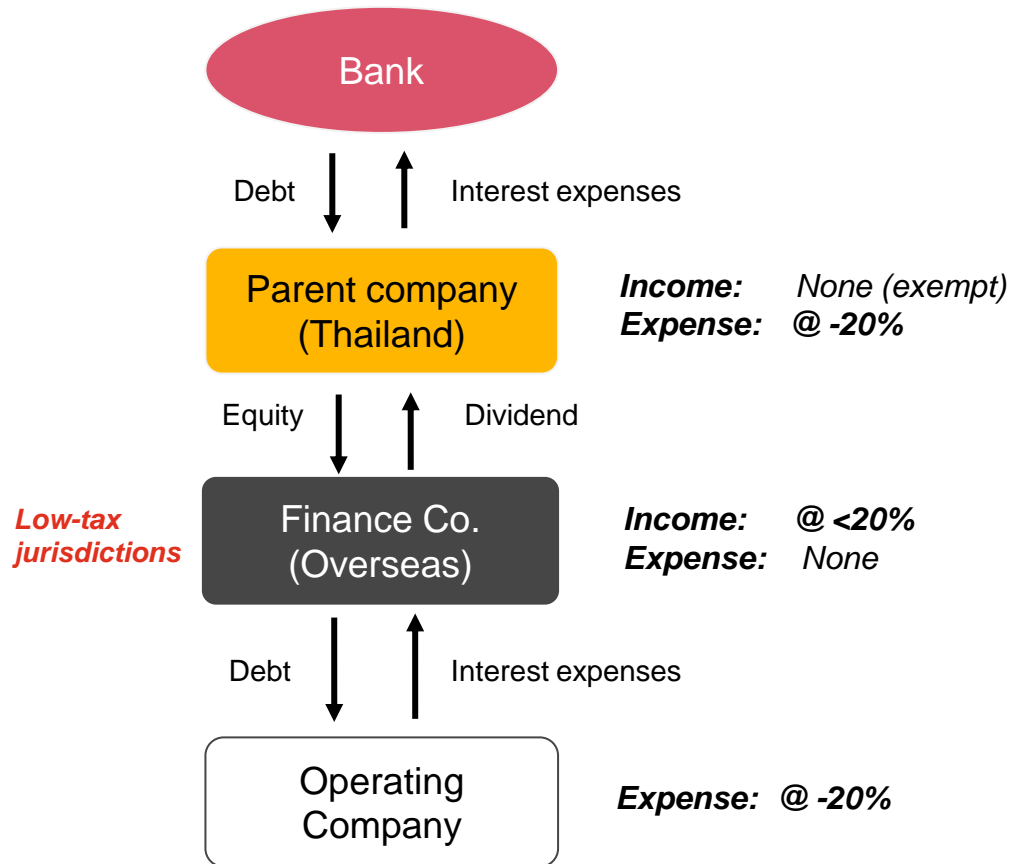
- If B Co. was compensated with some margin, would this help prevent the risk of a sham transaction? Is there any tax risk to C Co. on the additional margin being added?

Financing structures – Structure#3 double dip



Financing structures – Structure#3 double dip

Structure#3 – double dip



Outline

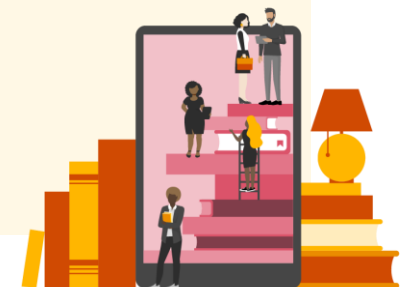
- Thai Parent uses third party borrowing to capitalise into Finance Co.
- Finance Co. is located in a low-tax jurisdiction
- Finance Co. lends money to OpCo

Benefits

Group ETR could be improved

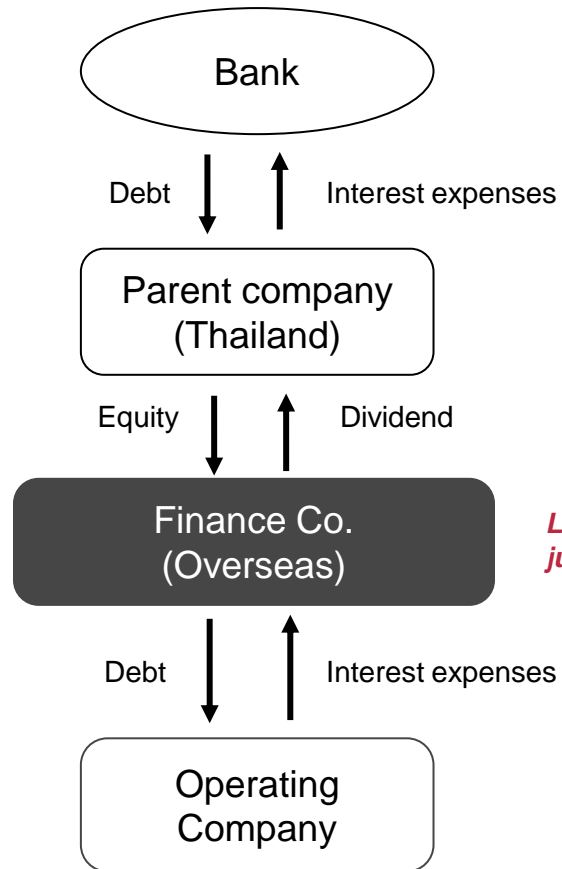
Key tax consideration:

- Conditions to get tax-exemption
- Deductibility of expenses
- Tax in Finance Co's country
- Any potential WHT leakage
- Business substance of Finance Co and anti-treaty shopping provisions under MLI



Financing structures – Structure#3 double dip

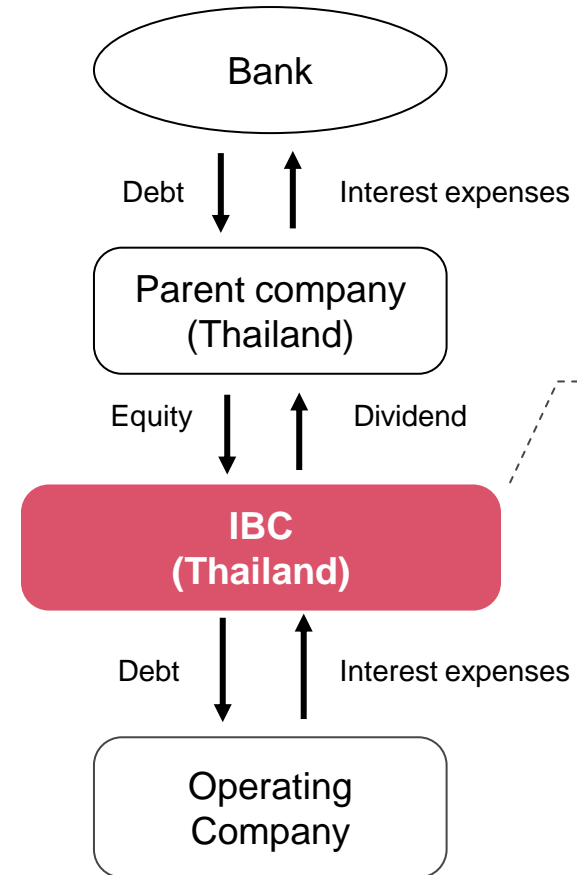
Structure#3 – double dip



Low-tax jurisdictions



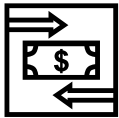
Structure#3 – double dip



Must obtain Treasury Centre License from BOT

Treasury Centre functions (under BOT)

Examples



Cross border payment management

Flexibility to act as an agent for ROBO/POBO and re-invoicing.



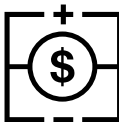
Obligations settlement

Wider scope of cashless settlement including multi-netting obligations of group companies.



FX trading and risk management

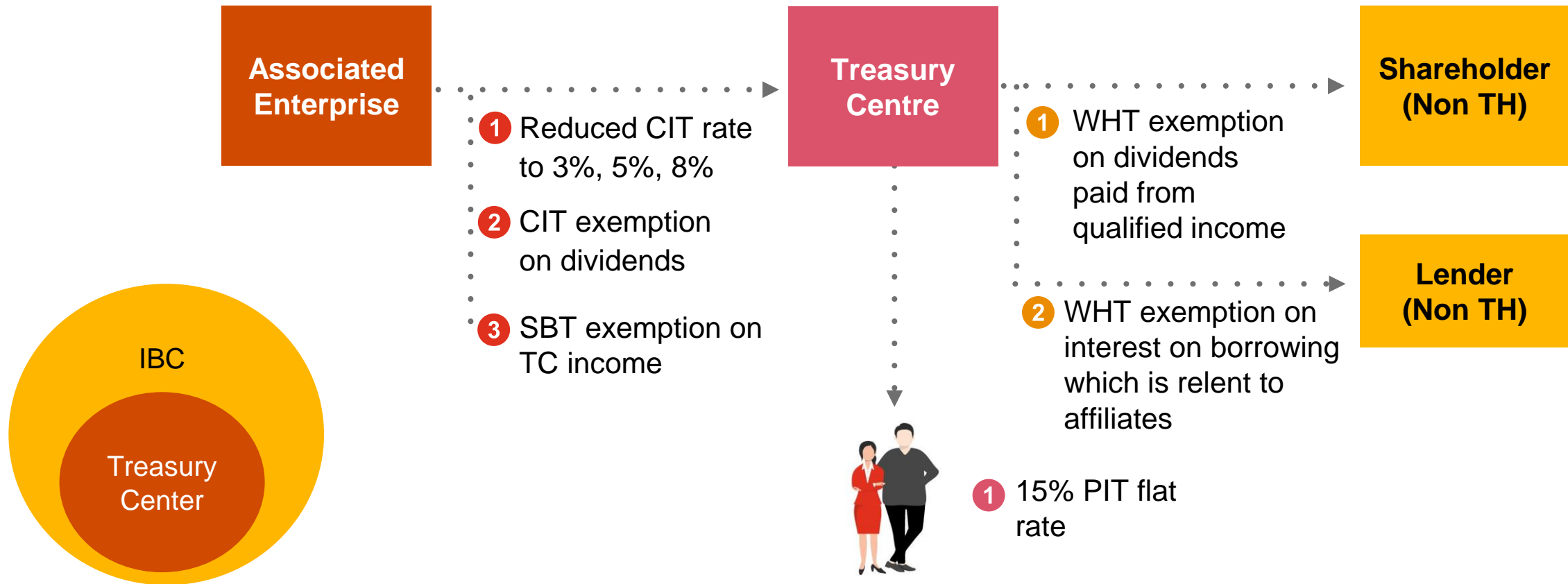
Allowed to buy and sell FX with group companies and can manage FX risk of the group companies through a derivative transaction.



Liquidity management

Allowed to grant FX loan to a Thai group company.

Treasury Centre under IBC – Tax benefits



“Are you ready
to become a
Treasury Centre?”

Treasury Centre – Readiness

1 Readiness of corporate profile

- Non-FS Thai company
- Being part of the group companies for which it provides treasury functions.
- Group companies must be non-FS and engage in cross border trade, services or holding.
- Minimum number of group companies must be met.

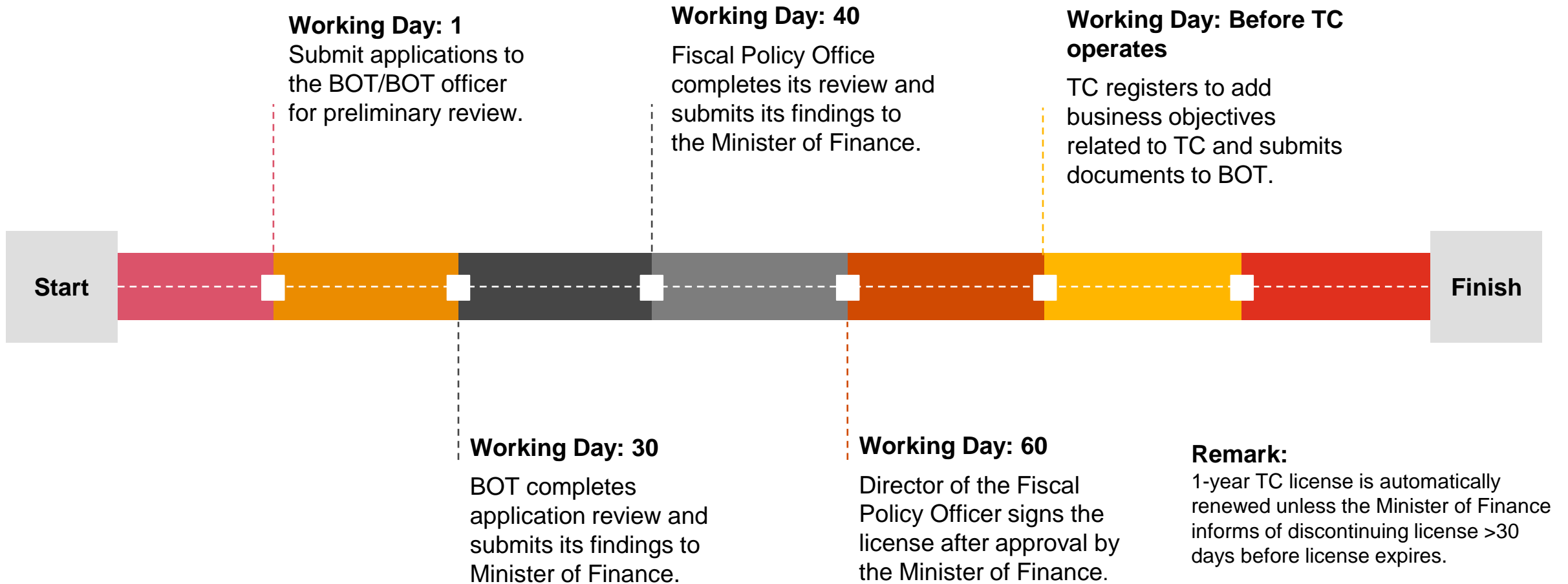
2 Readiness of applications

- Applications and documentation
- Determining the desired scope of work
- Dealing with the BOT and satisfying the burden of proof

3 Readiness of operation

- Monthly reporting to the BOT
- Documents declaration to commercial bank
- Maintenance of documentations
- Separate accounting record and transactions of TC business
- Tax compliance

Treasury Centre – Timeline



A decorative graphic on the left side of the slide. It features a large, stylized number '3' in black, centered within a yellow circle. This yellow circle is surrounded by a thick orange ring. Below the orange ring is a light gray ring, and at the bottom is a dark gray shape. The overall design is modern and abstract.

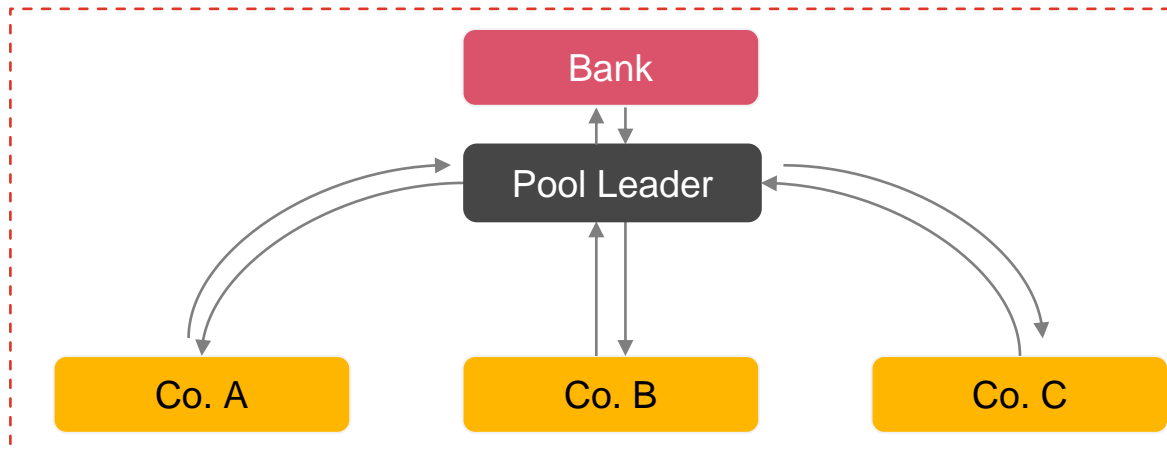
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Alternative for liquidity management

A decorative graphic on the right side of the slide, consisting of a vertical grid of small, light gray dots arranged in a regular pattern.

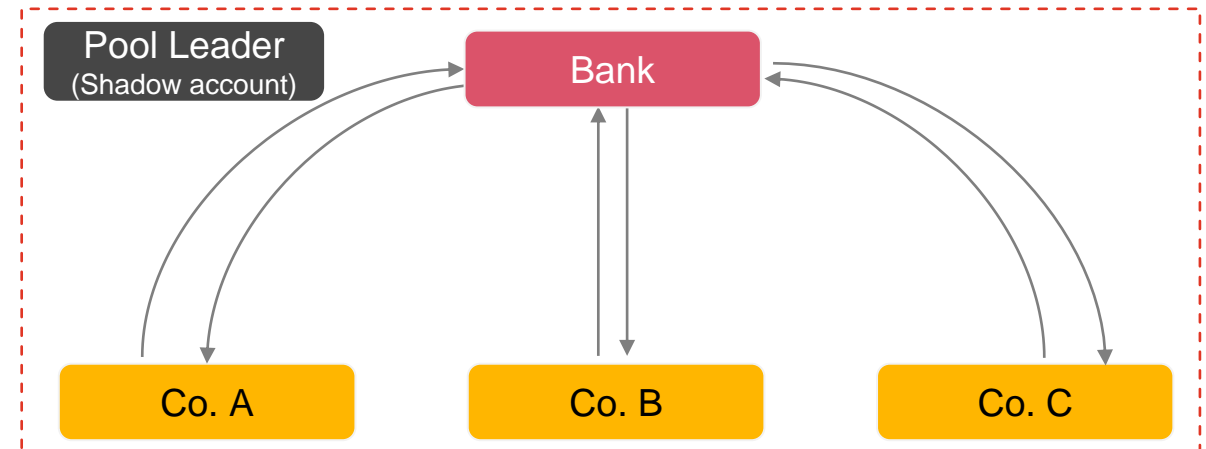
Type of cash pooling

Physical cash pooling



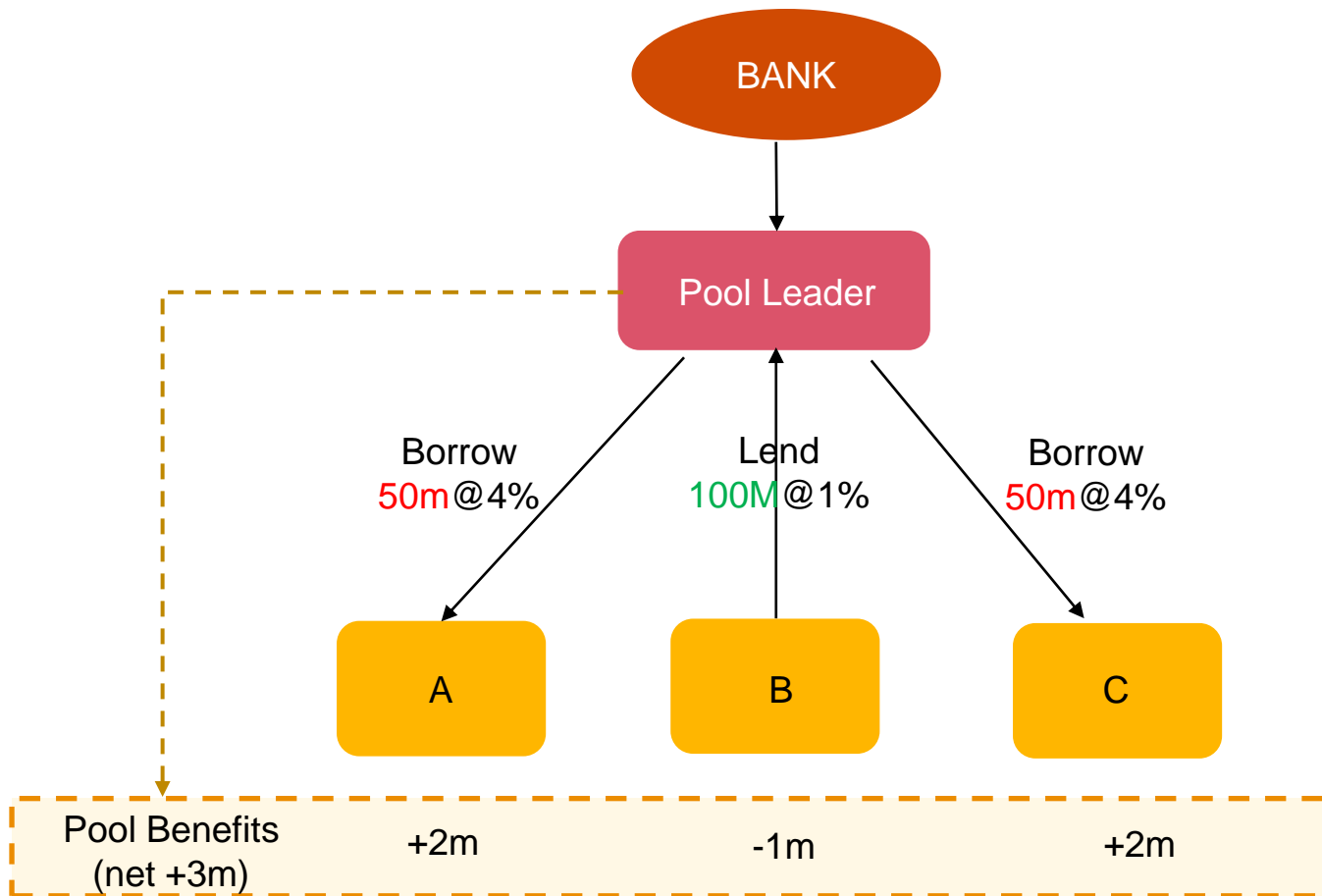
- Deposits/withdrawals of participants are physically and legally moved from the Pool Leader periodically.
- Physical cash pooling is usually a single currency pool.

Notional cash pooling



- Not physically moved to and from a central account.
- Each member maintains a position with the bank and receives/pays interest based on its net credit/debt position.
- Typically administered by the external bank.
- It can be a single or multiple currency pool.

Allocation of cash pool benefits



Background

- Withdrawal rate = 4%
- Deposit rate = 1%

Pool leader's perspective

- A borrowing (50m@4%) = +2m
- B lending (100m@1%) = -1m
- C borrowing (50m@4%) = +2m

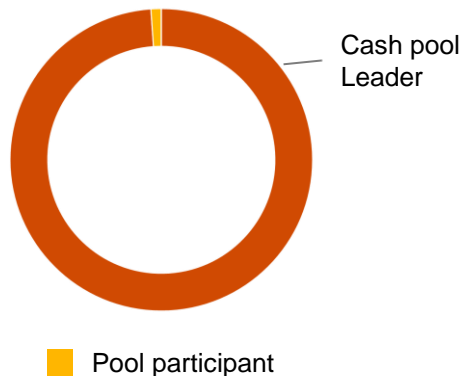


How to allocate the interest spread of 3m?

Selection of an appropriate transfer pricing method

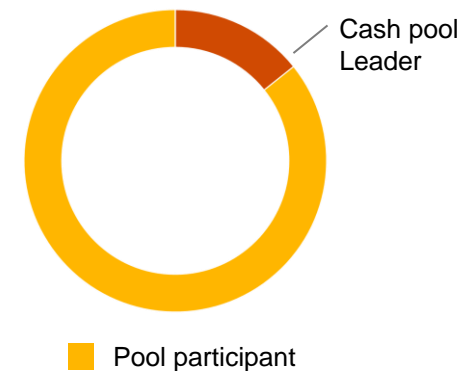
Entrepreneur

- Header as an **in-house bank**
- Assume **credit risk**
- Header remuneration is draw/deposit spread and returns on invested excess capital
- Remuneration of the cash pool participants based on **market interest rates**



Service provider

- **Routine functions** of header
- No significant risks of header
- Routine remuneration based on **administrative function performed**
- **Residual profits** allocated between pool participants





4

Managing bad debts



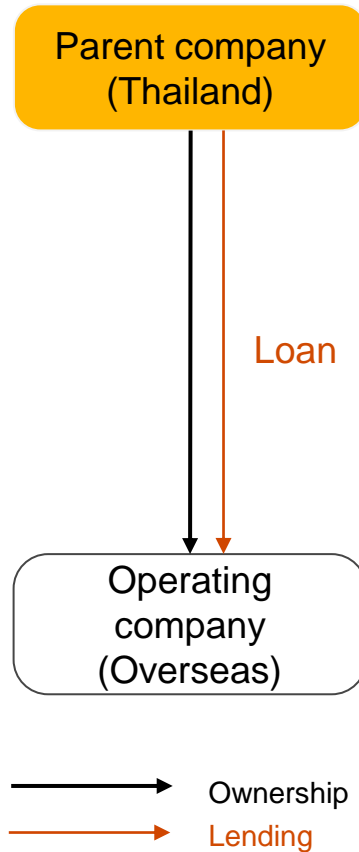
Managing bad debts



1 Write-off bad debts

2 Debts sale

Write-off bad debts

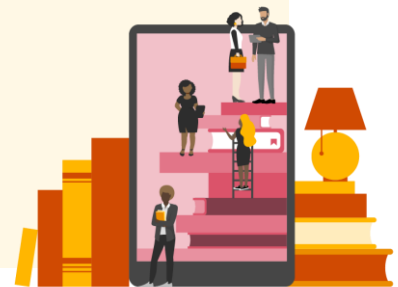


Outline

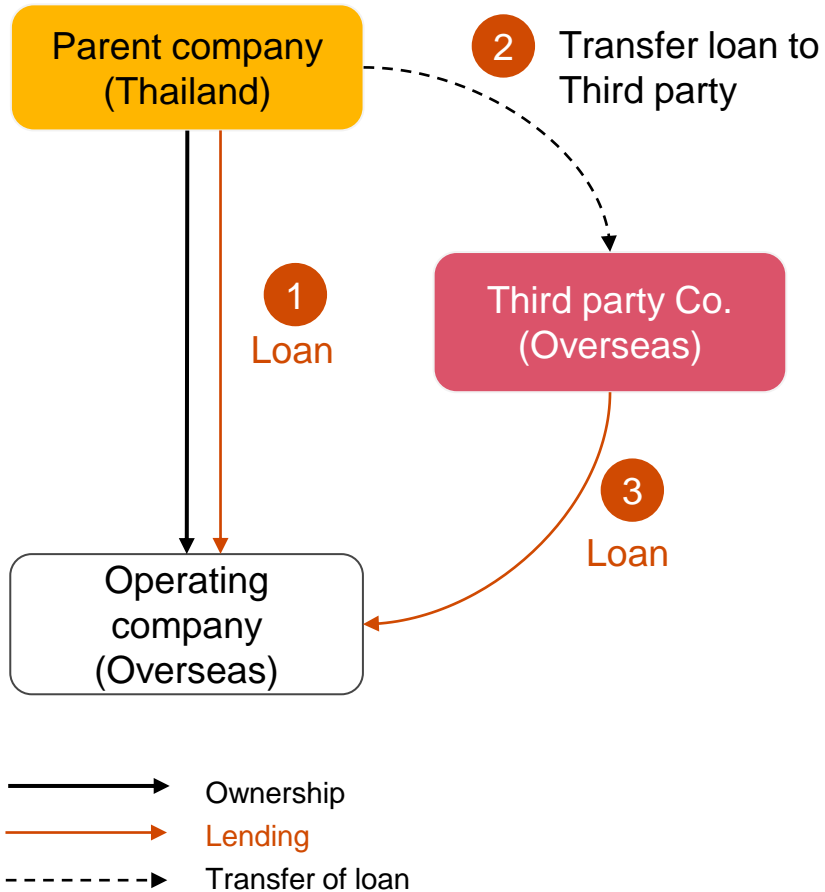
- Thai Parent lends to Foreign subsidiary.
- Foreign subsidiary suffers losses from operation and defaults.
- To manage its cash tax position, Thai Parent would like to write off the loan.

Tax issues

- Is bad debt write off for foreign debtor loan tax-deductible?
 - Tax ruling No. 0706/11057 dated 15 December 2004
 - The current tax law (MR.186 revised by MR.374)



Debts sale



Outline

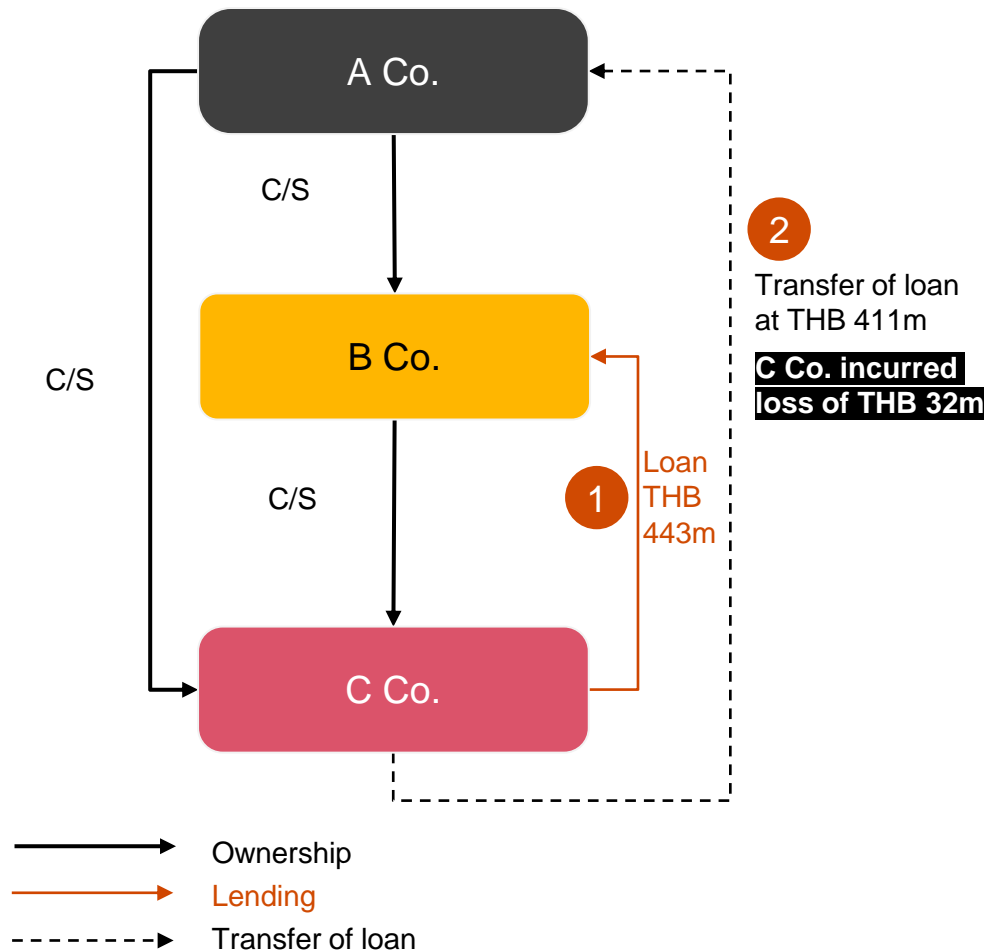
- Thai Parent lends to Foreign subsidiary.
- Foreign subsidiary suffers losses from operation and defaults.
- To manage its cash position, Thai Parent sells loan to Foreign Third party and incurs a loss on debt sale.
- Foreign Third party becomes the lender.

Tax issues

- Would the loss on debt sale be regarded as deductible expense? Must it comply with the tax bad debt write off rules (MR.186) ?
 - Tax ruling No. 0706/1314 dated 16 February 2006
- If Thai Parent sold its loan to its another related party company instead, would the loss on debt sale still be eligible for tax deduction?
- Would this lead to Principle Purpose Test (PPT) concern?



Supreme Court case – Debts sale (No. 7146-7147/2559)



Key transactions:

- A Co., B Co. and C Co. are related party companies for tax purpose.
- C Co. provided a loan to B Co.
- C Co. transferred a claim on the loan to A Co.
- For compensation of the transfer, A Co. paid THB 7m to C Co. and paid the other debt of C Co. for THB 404m.
- C Co. incurred a loss of THB 32m from the transfer. **Is this tax deductible?**

Supreme Court's position:

- Allow loss from debt sale as tax-deduction, if the transfer price is at arm's length basis (e.g. debtor's creditability)
- Documents to support the transfer price are a must.
- The court was not convinced that C Co's transfer price was at the market price. So, loss from the transfer is non-deductible.



5

Key takeaways



Key takeaways



Interest rate pricing should be considered from both lender's and borrower's perspective (OECD approach).



Using TC / IBC could help improve ETR, but approval from BOT and RD is required.



Prioritising transaction substance is now an integral part of a refined tax strategy.

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Thank you

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