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Newsflash | October 2023

Accelerating growth: advantages and challenges of foreign direct investments in Thailand's automotive sector

I. Introduction

Thailand

Thailand is one of the ten members of the Association of South East Asian Nations ("**ASEAN**"), the second largest economy in the region in terms of GDP and the European Union's ("**EU**") fourth largest trading partner in ASEAN.

Strategically located at the heart of the ASEAN region, Thailand is renowned for its vibrant and diverse economy, of which the automotive sector is a cornerstone. The country's economic stability, coupled with a business-friendly environment and dynamic market sectors, makes it an attractive destination for foreign (direct) investments.

Automotive industry in Thailand

Thailand is currently the 12th largest automotive producer in the world and the largest in ASEAN. The automotive industry is a major contributor to Thailand's economy, accounting for approximately ten percent of Thailand's economic growth.

The country hosts some of the world's leading automakers, assemblers and component manufacturers, such as Toyota, Mitsubishi, Isuzu, Nissan, Honda, General Motors, Ford, Mercedes-Benz, BMW, Schaeffler, Bosch, and Continental, earning it the nickname "the Detroit of Asia".

Analysts predict a 3 - 4% growth in Thailand's automotive sector in 2023, largely driven by increased overseas demand and high export volumes, signalling an opportune time to invest in this sector.

II. Foreign direct investment

In order to conduct business in Thailand, foreign investors can choose between several types of legal structures, namely the establishment of a subsidiary in the form of a private limited company or the registration of an overseas company in the form of a branch, representative office or regional office. In general, foreign investors tend to establish a private limited company for their business activities in Thailand, which can carry on any legal business activity in accordance with the laws of Thailand and its registered business objectives.

Under Thai law, a limited company must have at least two shareholders. The Thai Civil and Commercial Code B.E. 2535 (1992) does not distinguish between shareholders from Thailand and shareholders from outside Thailand. However, under the Foreign Business Act B.E. 2542 (1999), some business activities are prohibited or restricted for foreign investors. Foreign ownership in a company is therefore generally limited to 49% of the total shares of a company. The remaining 51% of the shares must be held by Thai nationals or a majority Thai owned company.

However, there are ways to achieve majority or even 100% foreign ownership of a company in Thailand, for example by obtaining a Foreign Business License or by applying to the Board of Investment ("BOI"), a government agency that helps in promoting direct investment in Thailand, and obtaining a Foreign Business Certificate.

Given the above restrictions, some foreign investors resolve to setting up a joint venture structure with a Thai partner.

Board of Investment

The BOI offers several tax and non-tax incentives (see below) to encourage foreign direct investment, as well as the possibility to own 100% of the shares in a private limited company.

In addition, the BOI permits foreign investors to bring in skilled workers and experts, to own land, and to take out or remit money in foreign currency.

Eastern Economic Corridor

The Thai government's commitment to attracting eco-friendly and electric automobile production through initiatives like the

$45 billion Eastern Economic Corridor ("**EEC**") initiative make Thailand an attractive investment destination.

The EEC, encompassing the key industrial regions of Rayong, Chonburi, and Chachoengsao, is envisioned to transform these areas into a leading ASEAN economic zone focusing on technological and innovative industries. One of its aims is to extend the automotive value chain, with a particular focus on surface integration design and prototyping. The Thai government also plans to expand and improve the manufacturing process for electronic accessories and automotive parts.

Free Trade Agreements

Foreign investors in Thailand can benefit greatly from the country's Free Trade Agreements ("**FTA**") with Australia, China, India, New Zealand, and the ASEAN member states, i.e., Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, and Vietnam.

Negotiations for an EU-Thailand FTA were launched in March 2013 and suspended in 2014 following the military takeover in the country. Since then, Thailand and the EU have negotiated a Partnership and Cooperation Agreement ("PCA"), which provides a comprehensive framework for EU- Thailand relations and opportunities to develop cooperation. The PCA was signed in December 2022.

To further deepen engagements, Thailand and the EU have announced the resumption of negotiations for a comprehensive FTA in March 2023.

III. Advantages

Incentives for the automotive industry

For the automotive industry, the BOI currently offers support for 17 types of business activities, from the manufacturing of automobiles and engines, equipment, or parts, over manufacturing of battery electric vehicles ("**BEV**"), plug-in hybrid electric vehicles, hybrid electric vehicles, and BEV platforms to manufacture of fuel cells or parts.

The applicable tax incentives include exemption from corporate income tax for a period of eight years, exemption from import duties on machinery, exemption from import duties for raw or essential materials, exemption from import duties on materials for research and development ("R&D") purposes, exemption from import duties on raw or essential materials for production/export purposes, etc.

Companies setting up in one of the supercluster automotive zones in Pathum Thani, Ayutthaya, Nakhon Ratchasima, Prachin Buri, Chachoengsao, Chonburi, and Rayong can enjoy additional benefits, such as an additional corporate income tax reduction of 50% for five years.

In the EEC, investors can even enjoy exemption from corporate income tax for up to 15 years, exemption from import duties on machinery and raw materials imported for production for export and for R&D purposes, a R&D development investment fund, permission to own land, and a reduced personal income tax of 17% flat rate for expatriates.

Growing hub for BEVs

Thailand's automotive sector is currently transitioning to electric vehicles in line with global trends and market demands. The government has targeted 1.2 million electric vehicles and 690 charging stations in place by 2036 and showing commitment to keeping manufacturing within the country through no or low import tariffs and incentives for international investors.

As evidenced by the incentives offered by the BOI, the Thai government aims to attract foreign manufacturers to use Thailand as a base for the production of BEVs in the region. In 2016, the Thai government created a roadmap for the general popularisation of BEVs and approved a tax incentive scheme for BEV production in the country.

In 2018, the Japanese startup Fomm became the first car manufacturer to produce battery-powered electric vehicles in Thailand. In 2021, Great Wall Motor, a Chinese automobile manufacturer, opened a factory in Rayong. In the same year, Tesla entered the market to sell electric passenger cars. BYD, the world's largest electric vehicle manufacturer is in the process of building a factory in the EEC in Rayong, with an annual production capacity of 150,000 BEVs from 2024 onwards. Other companies signed contracts to produce electric vehicles in Thailand.

In 2023, the market for BEVs in Thailand picked up rapidly, with more than 44,000 new registrations in the first six months of the year.

Access to regional and global markets

Thailand's strategic location, modern ports and airports, and FTAs facilitate exporting and access to regional and global markets, with automakers paying no or very low taxes when exporting vehicles within the ASEAN region and beyond, such as China and India.

They offer investors the opportunity to extend their supply chain and gain competitive advantages in importing machinery and raw materials by eliminating or reducing import duties. Some FTAs further harmonize customs codes and product standards, which helps to speed up trade flows.

Infrastructure and logistics development

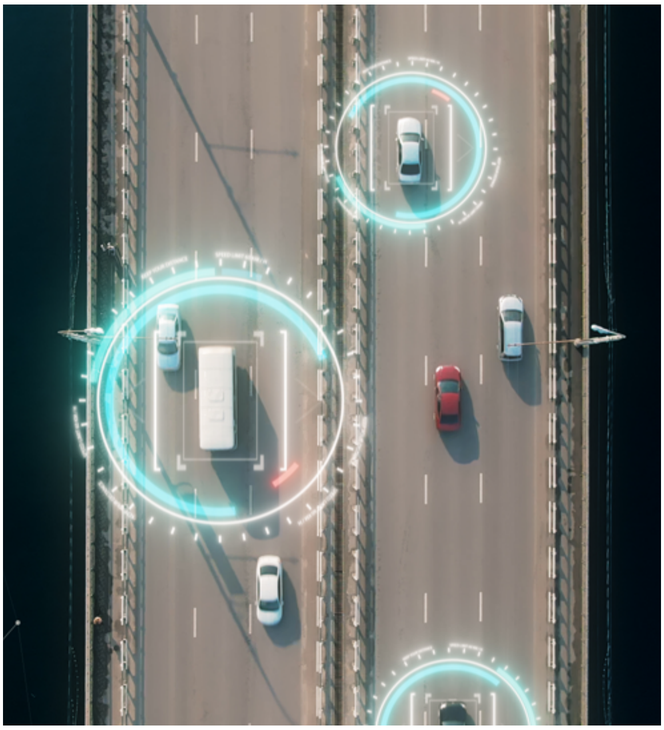
Domestic manufacturing and procurement of a wide range of car parts and the presence of approx. 1,500 Tier 1-3 suppliers eliminate the need for imports, making exporting a breeze and contributing to the seamless operation of automotive companies.

Technological advancement and innovations

The government of Thailand is actively fostering innovation through its "Thailand 4.0" policy, aiming to transition the country into a high-income nation by emphasizing investments in innovation and digitalization.

This policy marks the evolution from agriculture-centric (Thailand 1.0) to light and heavy industry-focused (Thailand 2.0 and 3.0) approaches, culminating in a modern, innovation-driven economy.

Within this framework, the modern automotive industry is identified as a priority sector, receiving special promotion and support. This focus on the automotive sector is particularly advantageous for investors as it ensures a conducive environment for investments, characterized by a commitment to technological advancements and adaptability to global market demands.



IV. Challenges

Restrictions for foreign investors

The Thai market imposes a wide range of regulations on foreign investors, governed by the Foreign Business Act B.E. 2542 (1999), which sets out the business activities that are restricted or prohibited to foreigners (i.e., companies with 50% or more foreign shareholding).

Exemptions from the Foreign Business Act B.E. 2542 (1999) are available under certain conditions, allowing foreign investors more flexibility and opportunities in conducting business in Thailand. These exemptions, coupled with the availability of numerous government subsidies and incentives, can make investing in Thailand attractive, despite the regulatory constraints.

A profound understanding of the investment laws and the available exemptions is imperative to navigate the market effectively and align one's company with the most advantageous access points.

Bureaucratic obstacles and regulatory complexity

Investors may encounter bureaucratic challenges and complex regulations compared to other jurisdictions, necessitating careful navigation and compliance to avoid legal repercussions, especially with the country's import tariffs and restrictions on foreign investments.

Cultural and linguistic barriers

Adapting to the local culture and language is crucial for effective communication and relationship-building with local stakeholders and navigating through the nation's unique business landscape.

V. Practical consideration

Successful direct investments

The successful establishment and significant investments by automakers like General Motors, Ford, Mercedes-Benz, and BMW illustrate the industry's potential and sustainable growth opportunities.

Outlook

The overall political situation in Thailand remains volatile. The results of the elections on 14 May 2023 seemed to signal a shift towards the previous opposition parties. However, the process and outcome of the subsequent coalition formation by the “established” parties have introduced uncertainties to the political landscape. The direction in which the country will move in the coming years remains to be seen.

The country is gradually recovering economically from the global pandemic, focusing on innovative industries like renewable energies, digital services, and high-tech industries, including the automotive sector. The country is working on key infrastructure projects, enhancing its railways, roads, ports, and airports, which are progressing steadily and positively impacting the nation’s development.

VI. Your Contacts in Thailand

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Release: October 2023

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