THAILAND

MARKET ENTRY STRATEGIES IN THAILAND

Italian Companies Entering the Thai Market

As the business world continues to globalize, more than ever international and multinational enterprises are seeking to expand into other markets. In recent years, with increased labour costs and regulations, certain countries that used to be favoured, such as China, are becoming less optimal. Now, Southeast Asia, specifically Thailand, is becoming a very attractive choice. Thailand has a modern market, affordable and skilled labour force and is a perfect gateway to the Asia Pacific.

When seeking expansion, Italian companies must tackle two major challenges. First of all, determine the strategy to enter the new market. There are many options, from forming a new foreign business to an acquisition of an existing business. Next, due to CFC Rules amended by the Decree n. 142/2018 (implementing Council Directives (EU) 2016/1164 and 2017/952, the AntiTax Avoidance Directives, or ATAD) and increased scrutiny on Italian international tax reporting, businesses have concerns about potential Italian compliance questions.

When entering the Thai market, foreign investors have several options. Sometimes, when greenfield investments may present unnecessarily high risks and costs, M&A transactions

offer an alternative, and oftentimes financially viable, foreign direct investment solution. The following is a high-level overview of the investment options.

Figure 1. *Common Market Entry Strategies*

What are Mergers and Acquisitions?

Generally, mergers and acquisitions (M&A) refer to the transactions in which a company combines or consolidates in some form with another entity. The definition of M&A is intentionally broad, as M&A can include obtaining a company's assets as well as its equity. While the two terms 'mergers' and 'acquisitions' are often used interchangeably, they differ in legal meaning and practice.

M&A is useful in that it can help an entity leverage competitive advantage through growth, downsizing or changing the nature of its business operations.

Mergers

A merger is a process by which two companies combine to form a new legal entity under the same corporate name. For example, Company A will purchase Company B and continue operations under Company A's name. In a merger transaction, the acquired company's assets are bought by the purchasing company, meaning that after the transaction is concluded only the purchasing company survives. Generally, the size of the purchasing company is relatively larger than the purchased company. The purchasing company (also known as the absorbing company) will acquire all the assets and liabilities of the absorbed company.

In terms of shares and ownership, the shareholders of the absorbing company keep their ownership, whereas the shareholders of the absorbed company are given shares of the absorbing company.

A merger is a corporate strategy often used to increase the financial and operational strengths of both companies.

Amalgamations

An amalgamation is a type of merger process. However, it should be distinguished from a merger, as not all mergers are amalgamations. An amalgamation occurs when two companies combine to form a larger single company, with neither of the previous companies remaining in independent operation. Effectively, a new company is created and neither of the existing companies survives. For example, Company A and Company B combine to operate as Company C. Effectively, an amalgamation involves three companies; the two existing companies and the new entity that is created. The assets and liabilities of both existing companies are transferred into the balance sheet of the newly formed company. Amalgamation often occurs between similar-sized companies that operate in the same industry, thus resulting in reduced operational costs. Amalgamation is useful in that it can be used to access new markets, technologies, and geographies, among other aspects.

Acquisitions

An acquisition refers to the purchase of a corporate asset or target company. After the acquisition, the buying company obtains more than 50% ownership in the target company. In a simple acquisition, the purchasing company merely obtains a majority stake of the target company, which does not change its name or organisational structure. For example, Company A acquires Company B and continues to operate as the existing entity of the two separate companies. The result is that both companies survive and continue to operate.

Types of Mergers and Acquisitions

Conducting a merger or acquisition is a dynamic and complex process which poses many challenges for the businesses involved. The process may differ depending on the type of M&A transaction being undertaken. There are three main types of M&A transactions depending on the relationship between the merging companies.

Horizontal

Generally, a horizontal merger is one between two companies in the same industry sector. The companies are in direct competition and share the same markets. An example is when one book publishing company purchases another book publishing company. This can be beneficial in that it can help increase market share, expand market opportunities, and save costs.

Vertical

A vertical merger is between a customer and company or supplier and company. For example, an ice cream making company merges with a company that supplies ice-cream cones. A vertical M&A can assist in reducing the overhead cost of operations.

Conglomerate

A conglomerate M&A refers to the process where the two companies are unrelated. The objective here is often the diversification of goods and services.

Risks of Mergers and Acquisitions

M&A transactions usually offer growth opportunities; however, there are some substantial risks that entities must be aware of before engaging in an M&A deal.

Lack of Due Diligence

Proper due diligence is critical for preparing a successful M&A transaction. Prior to entering the transaction, the buying or acquiring company should ensure to learn as much as possible about the target or acquired company. Essential information to be analysed includes the company's financials, contracts, customers, insurance, any outstanding litigation, and any other information that will ensure a holistic understanding of the company.

Weak due diligence can expose a company to increased risks, such as poor valuation, litigation, and tax issues.

Overpayment

Overpaying for a company is a common error committed by purchasing companies and can have extremely detrimental implications including destroying shareholder value. There is often considerable tension surrounding an M&A transaction and there may be pressure not only from the seller but also internally and from intermediaries involved in the transaction. Overpayment is one of the major and regular mistakes in M&A agreements, with the root of the problem often coming down to a highly pressurized environment and poor valuation practices.

The overall strategy and goals surrounding the deal should be identified and a comprehensive valuation report is prepared, focusing on key financials and tax returns over a substantial period, as well as organisational structure and shareholder agreements. This can help mitigate the risk that a company overpays in a transaction, even in the circumstance they are pressured to close the deal quickly.

Miscalculating or Overestimating Synergies

Consolidating two separate workforces and company cultures is a process that takes time and can accrue extra costs if expectations of integration are overestimated from the outset. Often, problems arise where a company is unrealistic about realising synergies, or the way in which two companies can function and operate more valuably together than they did individually.

Being conservative and focused on synergy estimates is one of the most important aspects of realising effective synergies. Attempting to generate synergies in every aspect of the business from the outset will likely lead to no synergies being realised at all.

Miscalculating synergies can also contribute to overpayment where the synergies are calculated in the overall purchase price, and yet, the purchasing company does not receive the benefit of these synergies for a very long period.

An early focus on capturing the easiest synergies that will yield the highest return is perhaps the most advantageous way to approach synergies. Ensuring that stakeholders and team members are aligned around the overarching goal of the transaction can help guarantee that the correct synergies are captured to achieve this objective.

Integration Shortfalls

In the majority of M&A transactions, post-merger integration is the most complex and challenging part for businesses. Post-transaction, both companies undergo major organisational changes to how they previously operated. This can oftentimes be a slow, tedious process and is likely to fail without careful and considered planning prior to the initial stages of the transaction itself. Companies should ensure to prepare a detailed integration plan from the outset of the entire M&A process.

A comprehensive integration plan is integral to a successful post-transaction transition and should include addressing any potential challenges that may arise due to the merging of the two different company cultures. Integration planning should begin very early, and businesses need to take into account the values, norms, and assumptions of each individual company. This is not always an easy process as the culture of a company can be difficult to identify. However, processes such as on-site visits, analysis of management styles, workflows, and one-on-one conversations with employees can assist in ensuring that the companies are a cultural fit and provide a smooth integration process.

M&A Transactions in Thailand

Currently, the Civil and Commercial Code (“**CCC**”) only recognizes the concept of “amalgamation” of companies, which refers to a transaction consummated by two or more companies to form a new company (A + B = C). Upon registration, the new company comes into existence, and the amalgamating companies are dissolved. The newly formed and registered company shall, by virtue of law, be entitled to all the property, obligations, rights, duties, and responsibilities of the dissolved companies. Nonetheless, the transfer of a business license to the new entity remains uncertain in practice.
Recently, Thailand’s cabinet approved the draft amendment to the CCC (the “Proposed Amendment”) on 26 June 2020 and subsequently sent the same to the House of Representatives for parliamentary approval. The Proposed Amendment is to offer an alternative to a “merger” of companies, which refers to a transaction consummated by two companies (A + B), which are merged into a single company (either A or B). Where companies are merged, one of the merged companies (either A or B) will survive to succeed all the property, obligations, rights, duties, and responsibilities of the dissolved companies.

Upon rechecking with the official at the Office of the Council of State, the House of Representatives has already resolved to accept the principle of the Proposed Amendment in Agenda 1 and is currently under consideration of the Commission of the House of Representatives before being officially promulgated in the Government Gazette.

With the Proposed Amendment, amalgamation is no longer the only method for the combination of companies. Companies would have the alternative to undertake either a merger or an amalgamation, providing further that shareholders of each company cast a vote of not less than three-fourths of the total number of votes of shareholders who attend the meeting and have the right to vote.

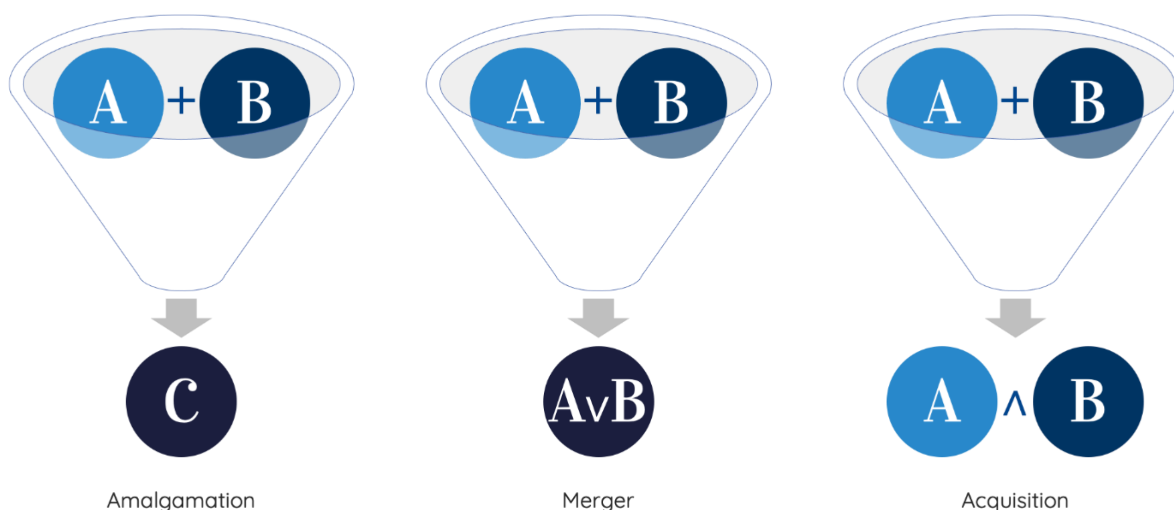

Figure 2. *Amalgamations, Mergers and Acquisitions.*

Italian Tax Considerations

When Italian businesses seek to expand overseas, tax issues are almost certain to arise and tax regulations are the major difficulties encountered by Italian companies when working in other countries. Hence, individuals and entities seeking to do business overseas must understand and prepare for overseas tax planning and compliance.

A Double Tax Agreement (DTA) is in effect between Italy and Thailand, which prevents individuals or companies in both countries being taxed twice on the same income. Here, the tax residence of a company is central in determining its tax liability. Usually, a business has a taxable base in Thailand if it has a registered office, an administrative seat, and the principal object of the company in Thailand. However, according to Italian CFC (controlled foreign company) rules, profits realized by a non-resident entity are deemed to be the profits of a resident person in case where the non-resident entity: (1) is controlled by the resident person; and (2) satisfies some specific requirements of being subject to an effective tax rate lower than 50% of the effective tax rate, which would apply if it were resident in Italy and more than 1/3 of its revenue is derived from passive income.

A corporate tax inversion (*esterovestizione*) is a form of tax avoidance involving a fictitious location of a company for taxation in a country other than Italy. This fictitious location is, in other words, the country where the company resides. Article 73, paragraph 5-bis of the TUIR—the so-called anti-tax haven provision—provides for relative presumptions of tax residence in Italy for foreign holding companies controlled or administered by Italian residents.

However, even if these provisions are triggered, with proper planning the effects can be mitigated or even avoided completely. In the worst-case scenario, earnings are immediately taxed in Italy, creating a virtual tax-neutral situation that still allows expansion into Thailand at no tax cost.

Additionally, Italian tax law may not only allow but even make it easier for companies to expand internationally. While applicable laws and regulations may prevent Italian companies from enjoying tax deferrals, they allow profit shifting to Thailand easing tax burden in Italy. Also, the ‘participation exemption’ allows tax-free repatriation of profits to an Italian parent corporation.

Overall, for most businesses there are no tax impediments to investing or expanding into Thailand, and, in some cases, there may even be benefits. Even if there are tax consequences, it is likely to create a tax-neutral position rather than a cost or double tax. Furthermore, the reporting requirements are not to be feared if you are working with qualified professionals. Therefore, Italian tax and reporting should not be viewed as a barrier to Thai investment or expansion — so long as appropriate measures and plans are in place.

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Italian Trade Commission

Agenzia ICE di Bangkok

14/th floor, Bubhajit Building
20 north Sathorn rd
10500, Bangkok

Per ulteriori informazioni contattare:

+ 00662/6338491

+ 00662/6338355

+ 00662/6338494

bangkok@ice.it

Responsabile: GIUSEPPE LAMACCHIA

IPR/FAIR TRADE DESK BANGKOK

Desk Assistenza e Tutela della Proprietà Intellettuale e Ostacoli al Commercio
Referente: Avv. Luca Bernardinetti

Layout grafico e impaginazione

ICE - Agenzia per la promozione all'estero e l'internazionalizzazione delle imprese italiane

Ufficio Coordinamento Promozione del Made in Italy
Nucleo Grafica@ice.it | Vincenzo Lioi & Irene C. Luca