



TMI Eyes No. 15: Contract Manufacturing and Foreign Business Law Alert

Recently, it has come to our attention that the Department of Business Development (DBD) has reported violations of the Foreign Business Act B.E. 2542 (1999) (FBA) against several business operators to the Economic Crime Suppression Division of the Royal Thai Police in cases related to contract manufacturing. We provide this information for readers to urgently review their compliance and take necessary measures.

Foreign Business Act (FBA)

Readers should be aware that any company with 50% or more foreign ownership is considered a "foreigner" or "alien" under the FBA. Such foreign entities are restricted from conducting certain businesses in Thailand unless they obtain a Foreign Business License (FBL) or Foreign Business Certificate (FBC). Foreigners without special privileges, such as BOI promotion, must apply for an FBL, while those with certain privileges can request an FBC.

Manufacturing for Sale vs. Contract Manufacturing

It is important to note that "manufacturing" is not listed among the restricted businesses under the Foreign Business Act (FBA). This generally allows foreign entities to engage in manufacturing without obtaining a Foreign Business License (FBL) or Foreign Business Certificate (FBC).

However, the Department of Business Development (DBD) adopts a more conservative and detailed approach to this distinction. The DBD differentiates between manufacturing for sale and contract manufacturing. Specifically:

Manufacturing for Sale: When operators manufacture their own goods for sale, such activities are classified as "manufacturing." As a result, these operators do not need to obtain an FBL or FBC.

Contract Manufacturing: When operators manufacture goods for others, these activities are deemed to be manufacturing services. Consequently, these operators must obtain an FBL or FBC before commencing business.

The DBD consistently rules that manufacturing products based on customers' designs or drawings constitutes contract manufacturing services. In other words, the DBD considers the "design" or "drawing" (intellectual properties) provided by customers as the key determinant in classifying manufacturing as either for sale or for services.

It is also notable that the DBD rarely considers factors such as the transfer of ownership or the intention to focus on the completed result of the works when determining the type of manufacturing. Other factors like ownership of manufacturing facilities, workforce, manufacturing techniques, raw materials, investments, manufacturing control, risks, and liabilities are not clearly mentioned by the DBD in its determinations.

This nuanced distinction by the DBD underscores the importance for businesses to carefully evaluate their manufacturing processes and the nature of their contracts to ensure compliance with the FBA.

Investigation

Recently, TMI has become aware of cases where the Department of Business Development (DBD) has made formal complaints against foreign companies to the Economic Crime and Suppression Division (ECSD) of the Royal Thai Police. These complaints are based on allegations that foreign companies have violated the Foreign Business Act (FBA) by engaging in contract manufacturing "services" without obtaining a Foreign Business License (FBL) or Foreign Business Certificate (FBC).

Please note that if these foreign companies are found guilty, they must cease their business activities immediately. Additionally, the companies and their directors may be subject to criminal sanctions.

TMI's Notes

We strongly urge readers to review their business transactions to determine if their activities may be classified as "services" under the FBA. Operators should strive to adjust their business transactions to be considered as "manufacturing" rather than "services." If this adjustment is not possible, they should explore other alternatives, such as modifying their business model or obtaining the necessary licenses.

It is important to note that even if operators have obtained Board of Investment (BOI) promotion or operate within an Industrial Estate Authority of Thailand (IEAT) area, they are still required to obtain an FBC from the DBD.

Therefore, it is crucial for all foreign companies to conduct a thorough review of their operations to identify any potential risks of violating the FBA. Proactively implementing appropriate measures will help minimize any possible exposure.

Daiki Koso, Partner and Monchai Varatthan, Partner, TMI Associates (Thailand) Co., Ltd.


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 bangkok@tmi.gr.jp

TOKYO | NAGOYA | KOBE | OSAKA | KYOTO | FUKUOKA |
SHANGHAI | BEIJING | YANGON | SINGAPORE | BANGKOK | HA NOI
HO CHI MINH CITY | PHNOM PENH | SILICON VALLEY | LONDON

 Sathorn Square Office Tower, 26th
Floor, unit 2608-2609, North
Sathorn Rd., Silom, Bangrak,
Bangkok 10500

 Facebook: TMI Associates – Thailand
Instagram: tmibkk
LinkedIn: TMI Associates (Thailand)