

Tax Alert

6 July 2016

Free Zone (FZ) Updates - Local Content and Essential Production Process Criteria on Goods Produced in FZ for Domestic Market

The purpose of this Tax Alert is to facilitate understanding of the proposals and should not be used exclusively for tax planning without prior consultation with experts.

In our last Tax Alert, issued in January 2016, we reported the release of the Finance Notification No. 13 ("FN13") dated 17 December 2015, which stipulates two key requirements that must be fulfilled by a FZ operator to qualify for duty-free treatment on the release of goods produced in the FZ to the domestic market:

- i) **Local content test** : The total value of raw materials originating in Thailand and ASEAN , labor costs, and other production costs actually incurred in Thailand in order to produce the goods, including profit, is not less than 40% of the ex-factory price of the goods; and
- ii) **Process test** : The goods produced meet the Essential Production Process ("EPP") criteria as outlined by the Office of Industrial Economics, Ministry of Industry ("OIE").

FN13 comes into effect on 20 June 2016 with a 2-year grandfathering relief provision for existing FZ operators who have been granted duty reduction/exemption on goods under the old 2012 Finance Notification or those awaiting Customs' decision on their duty reduction/exemption applications when FN13 comes into force.

In the lead up to FN13 entering into force, several key notifications have been released to facilitate the enforcement of FN13. The content of two key notifications issued in June is summarized below.

1. Customs Notification No.73 / 2559 (“CN 73”) dated 17 June 2016

- ▶ CN 73 stipulates the key customs rules for the implementation of FN13 and outlines the local content calculation base, key definitions, customs formalities and documentation requirements for FZ operators.
- ▶ For locally procured raw materials which are produced in Thailand, CN 73 requires FZ operators to obtain certification that these raw materials have undergone a substantial operation process (“SOP”) and more than a minimal operation process. Six independent institutes have been tasked by the Customs Department with the responsibility of defining the SOP criteria and have approval to certify that these criteria have been fulfilled.
 - i. Thai Automotive Institute
 - ii. Electrical and Electronics Institute
 - iii. Thailand Textile Institute
 - iv. Iron and Steel Institute of Thailand
 - v. Plastic Institute of Thailand
 - vi. National Food Institute

For example, the Thailand Automotive Institute (TAI) has issued Notification No.21/2559, dated 20 June 2016, stipulating the applicable SOP criteria for vehicle parts and materials, as outlined below :-

Types of parts	Substantial operation process (SOP) criteria		
Single parts & components	In order for single parts and components to be granted certification, they must have undergone a fundamental change in form, shape or nature, resulting in a new product that differs from the materials used in its production. In addition, the transformation must be carried out using a machine and/ or tooling in a factory.		
	Process	Machine	Tooling
	Casting	Furnaces	Mold
	Forging	Forging machine	Die
	Stamping	Stamping machine	Die
	Injection	Plastic/rubber injection machine	Mold
	Blow molding	Plastic blow molding machine	Mold
	Compression	Hot compression machine	Mold
	Forming	Hot compression machine	Mold
	Extrusion	Extruder machine	Extrusion die
For certification requests for parts/ components using a production process not specified above, TAI will consider how substantial the transformation of the raw materials/ materials/ parts is, and the transformation should not be a minimal operation processes.			

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1. Customs Notification No.73 / 2559 (“CN 73”) dated 17 June 2016 (Con’t)

Types of parts	Substantial operation process (SOP) criteria
Assembled parts	<p>In order for assembled parts/components to be granted certification, the producer must comply with certain guidelines and conditions, as follows:</p> <ul style="list-style-type: none"> i. The process for assembly of parts must be a substantial production process, involving the use of e.g. machine technology and other tooling. It should not be a minimal operation process. ii. Additional information may be submitted for consideration, such as testing that enhances the capability or function of the parts/ components in terms of engineering, promoting innovation, or introducing new technologies. iii. When all raw materials/ materials/ parts are all imported for assembly in Thailand, a decision on whether to grant certification will take into account whether the assembly process qualifies as a substantial production process or is a minimal operation process <p>Applications for certification of assembled parts are considered on a case by case basis, as each manufacturer will have different production technology and the technology of the raw materials/ materials/ parts will also differ.</p>

▶ CN73 also expands the definition of “minimal operation process” to include:

- i) *“Assembly of parts of goods to a complete article, or simple disassembly of the goods to parts, or simple assembly or forming parts to a complete article”.*
- ii) *“Simple testing or calibrations”*

The word *“minimal”* is also defined as *“activity that does not require any special skills, machines, tools or equipment for production or installation”.*

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2. Office of Industrial Economics Notification dated 19 June 2016

This Notification outlines the Essential Production Process (“EPP”) criteria that FZ operators must also meet for goods that are produced in an FZ for sale in the domestic market. Specific EPP criteria have been set by the Office of Industrial Economics for each of the following sectors and types of goods:

Sector	Type of goods
Automobiles and components	<ol style="list-style-type: none"> 1) Passenger cars, pick-ups and vans 2) Trucks 3) Tractors, tractors for agricultural use and cement-mixing trucks 4) Motorcycles, motorcycles that uses electricity, electric bicycles and electric motorcycles 5) Truck body-cabs 6) Automobile exhaust pipes and their components 7) Truck roofs 8) Safety belts 9) Safety airbags 10) Shock absorbers 11) Car floors, left wheel arches and beam reinforcements 12) Components of motorcycles - windshields, exhaust pipes, footrests, handlebars, front mudguards, covers, sidecar covers, clutch covers, chain covers, rear covers, cover seats, tank covers, side covers, left side caps 13) Carts 14) Trailer axles for axle modular trailers 15) Engines 16) Rear-view mirrors
Food	Processed foods and drinks

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2. Office of Industrial Economics Notification dated 19 June 2016 (Con't)

Sector	Type of goods
Chemical	<p>Basic chemicals, such as follows:</p> <ul style="list-style-type: none"> ▶ Inorganic chemicals ▶ Organic chemicals ▶ Miscellaneous chemicals <p>Downstream chemicals, such as follows:</p> <ul style="list-style-type: none"> ▶ Fertilizers ▶ Paint ▶ Cosmetics ▶ Soap, surfactants
Petrochemical	<p>All types of plastic resin, such as follows:</p> <ul style="list-style-type: none"> ▶ Polyethylene Polypropylenes or polyolefins ▶ Polystyrenes ▶ Polymers of vinyl chloride or halogenated olefins ▶ Polymers of vinyl acetate or vinyl ester ▶ Acrylic polymers ▶ Polyacetal / Polyether / epoxsi-resin / Polycarbonate / Alcid-resin/ Polyalilester / polyester ▶ Polyamide ▶ Amino-resins / Phenolic-resins / Poly-urethanes ▶ Recyclable plastic resins ▶ Plastic resin compounds
Plastic	<p>Products of plastic that have any of the following features:</p> <ul style="list-style-type: none"> ▶ Parts or ready-made products ▶ Plastic bottle products ▶ Plastic profiles or pipes ▶ Plastic film, bags or sheets ▶ Plastic fiber or woven products ▶ Products molded from plastic sheets ▶ Pressed plastic products ▶ Large, hallow plastic products

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2. Office of Industrial Economics Notification dated 19 June 2016 (Con't)

Sector	Type of goods
Rubber	<ol style="list-style-type: none"> 1) Rubber used in vehicle production, such as aircraft, car, truck, bicycle or motorbike tires, rubber tracks, and solid tires 2) Rubber used in engineering work such as belts, flooring, rubber rail pads, rubber bearing pads 3) Rubber parts for vehicles; such as rubber door seals or gaskets 4) General rubber parts such as electronic parts made from rubber, synthetic rubber, silicone, etc. 5) Rubber products used for medical purposes such as medical gloves and rubber urethral catheters 6) General rubber products such as industrial gloves, kitchenware, rubber pads, condoms, rubber thread for mattresses and natural latex pillows 7) Unvulcanized rubber compound in its basic form or in the form of sheets, thin sheets, or strips. 8) Rubber scraps
Bag and Leather	Some bags and leather goods
Paper	Coated papers
Paper packaging	Paper boxes, cartons, etc.
Textile, garment and industrial fabrics	Textiles, garments, and industrial fabrics, such as: <ul style="list-style-type: none"> ▶ Cloth ▶ Rooftop tents ▶ Overnight tents ▶ Parts of other products made from fabrics ▶ Apparel
Gems and jewelry,	Gems and jewelry, such as: <ul style="list-style-type: none"> ▶ Gemstones ▶ Diamonds ▶ Pearls ▶ Gemstone jewelry made of silver, gold or other precious metals ▶ Artificial-gemstone jewelry
Iron and steel	Hot rolled and cold rolled steel
Copper	Copper tubes for use in air conditioners, cooling machines, refrigerators

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2. Office of Industrial Economics Notification dated 19 June 2016 (Con't)

Sector	Type of goods
Aluminium	<ol style="list-style-type: none"> 1) Aluminium profiles 2) Aluminium hollow profiles 3) Building fixtures made of aluminium, such as doors, windows, building supports 4) Foil condom packaging
Machinery, parts, equipment and machinery components	<ol style="list-style-type: none"> 1) Rotary cultivators 2) Molds <ul style="list-style-type: none"> ▶ Steel injection molds ▶ Sand injection molds ▶ Plastic injection molds 3) Combine harvesters 4) Mowers
Electrical and electronic	<ol style="list-style-type: none"> 1) Air conditioners for use in buildings: <ul style="list-style-type: none"> ▶ Condensing units for air conditioners ▶ Fan coil units for air conditioners 2) Power supply 3) Car radios 4) Switches for separating circuits and cutting electrical circuits: <ul style="list-style-type: none"> ▶ Switchgear
Medical equipment	<ol style="list-style-type: none"> 1) Blood collection tubes for medical purpose 2) Spectacle lenses

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Using the automobile sector as an example, the respective EPP criteria applicable to the production of passenger cars, pick-up and vans and engines are as follows:

Sector	EPP criteria
Passenger cars, pick-ups and vans	<p>1) The essential production process is a process whereby the machinery/ equipment is used in the production of bodies, body painting and assembly of complete and ready-to-use passenger cars, pick-ups and vans, as well as the quality checking system.</p> <p>Note :</p> <ul style="list-style-type: none"> i) Production of bodies means the assembly of a body from unpainted components, by means such as welding. ii) Body painting means the painting of an assembled body to prevent rusting or for decoration, by means such as electroplating or spraying. iii) Assembly means assembly of car components, including a painted body, into a complete car that is ready to use, including installation of the power system (e.g. - engine), transmission system and wiring harness. iv) Quality checking means the final quality checking process, which includes testing the safety equipment and automobile functions. <p>2) To be eligible for duty reduction a manufacturer must comply with all essential production processes for the production of not less than 2000 units per year (one or more models) by June 2019. Automobiles eligible for duty reduction must at least pass the essential production process requirements for the assembly and quality checking systems.</p> <p>3) A manufacturer who does not have all the essential production processes required for manufacturing of one or more models on the date the duty reduction request is filed must submit an investment plan for production process expansion to the Customs Department to support the consideration of the duty reduction request.</p> <p>4) New manufacturers (any business operator who did not operate in an FZ or IEAT area prior to 19 June 2016) must meet all of the essential production process requirements, including the annual 2000 units production requirement, within 5 years from the first day of production.</p>
Engines	The machinery/equipment used in the assembly of complete engines, as well as the quality checking system.

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Conclusion

It is crucial for existing or prospective FZ operators to familiarize themselves with these FZ rules, assess key areas of their business operations, including local procurement conditions and financials that are likely to be impacted, and assess their current compliance with the requirements for goods produced in an FZ for the domestic market. Businesses who supply FZ operators will also be impacted by the requirement to meet the substantial operation process (SOP) criteria for materials or parts that are eligible to be treated as Thai originating materials by FZ operators.

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