TMI EYES

TMI Associates (Thailand) Co., Ltd.

TMI EYES No. 12: Increase of Capital and Tax Liabilities

It is very common for companies to do funding for the companies to engage in a new investment or projects, or sometimes, to repay their debts. In this article, TMI will discuss potential tax risks that may occur from a capital increase, based on the recent Revenue Department's view and the Court rulings.

Increase of Capital

An increase in capital of companies is normal when the companies need funding. Sometimes, companies increase the capital by issuing new shares with a premium (the amount that exceeds the par value of the shares). The companies will just need to comply with the Civil and Commercial Code ("CCC") to increase the capital, i.e. having a special resolution approved in a shareholders' meeting, and registering such resolution and the capital increase with the Department of Business Development.

The capital and also premium injected by the shareholders will be categorized as equity as appeared in the shareholder's equity in the financial statements.

Capital can be taxable

The capital increase must however be completed with care. There are precedent cases where the Revenue Department and the Court considered that the capital increases were treated as taxable income of the companies. We provide sample cases below.

The A Danish Company had a wholly-owned subsidiary in Thailand. The Thai company made huge losses, and the Danish parent company did not want to continue the operation of the Thai company. However, the Danish parent company cannot simply dissolve the Thai subsidiary company, as it had to undergo a bankruptcy process, which was a bid deal under Danish laws. The parent companies then increased the capital of THB 300,000,000 and immediately used the capital to repay the debt. Then, the Thai subsidiary company dissolved and liquidated.

During the liquidation audit, the Revenue Department challenged that the capital increase of THB 300,000,000 should be taxable income of the Thai company, despite all legal compliances under the CCC being fully complied with. The Revenue Department then assessed corporate income tax on the capital!

The next sample is the Supreme Court Ruling 9144/2560 (2017). In this case, the plaintiff, i.e., Company A, was a major shareholder of a company (Company B), holding 99.99% in Company B. Company B was in a loss position. Company A reduced the capital of Company B, to THB 97,000,000 and then increased the capital by THB 97,000,000 by converting the debt to equity. Then, Company A increased the capital of Company B again by THB 87,000,000 and then reduced the capital by THB 87,000,000. All transactions were made during a short period. Such an increase-decrease of capital resulted the Company A having a cost of shares in Company B increased from THB 75/share to THB 520/share.

Then, Company A sold shares in Company B to Company C, a related company at the price of THB 151/share. Such sale made losses to Company A in the amount of THB 22,000,000. The Company A then realized the loss from investment for tax purposes.

The Supreme Court ruled that it is unusual for Company A to sell the shares of Company B despite Company B was having an opportunity to make profits. The Court viewed that Company A intentionally created capital increase/decrease steps to distort the fact that Company A wanted to provide a financial subsidy to Company B without Company B having to pay tax on the subsidy.

The Supreme Court then ruled that the capital that Company B received from the capital increase must be treated as taxable income of Company B according to Section 65 of the Revenue Code. In addition, the Court further ruled that Company A was not allowed to treat the loss from sales of Company B's shares as its tax-deductible expenses, as it was not related to the business of Company A under Section 65 ter (13) of the Revenue Code.

The third case would be the Supreme Court Ruling 7847/2560 (2017). A Thai company, the plaintiff in this case, increased capital in its subsidiary company to THB 252,000,000 to its subsidiary. At that time, the subsidiary was in a loss position and stopped its operation for some time. The subsidiary used the capital to repay its debts and then dissolved and liquidated the Company. The Supreme Court concurred with the assessment of the Revenue Department that the plaintiff was not allowed to use the losses from investment (capital increase) in the amount of THB 252,000,000 as its tax-deductible expenses. This is because considering the factual circumstances, the capital increase was not intended to invest in the subsidiary for profits, but to support the subsidiary financially. Therefore, the Supreme Court did not allow the company to treat the loss from investment as a tax-deductible expense as they are not incurred for profit making of the Company under Section 65 Ter (13) of the Revenue Code.

Author's Note

From the above three samples, all readers should be aware that capital increases can create a tax liability for both the shareholders and the company. The author is often asked if the shareholders can increase capital in their companies so that the companies can repay the debt, or dissolve the companies without having to go through a bankruptcy process. One of the key considerations is that the increased capital must have the object to keep the operation of the companies. If the capital increase was made only to repay the debt/avoid bankruptcy, the capital would likely be treated as income of the companies, or the shareholders cannot treat it as losses or expenses.

Therefore, all companies must take this issue into account before doing the transaction.

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