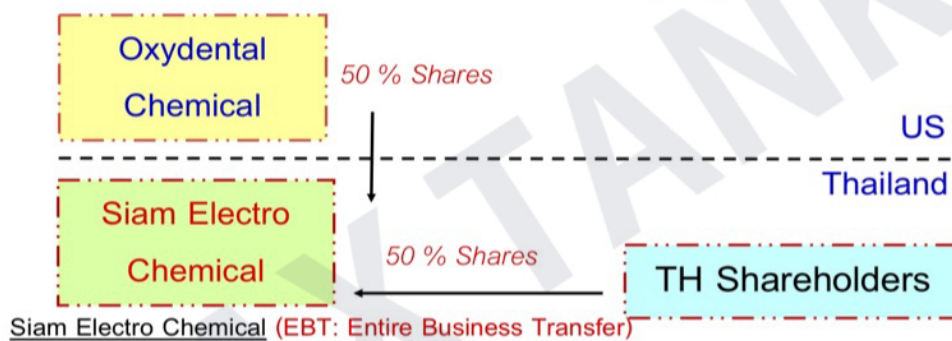


When share premium is regarded as taxable income under 'substance over form' concept

As we know, share premium is recorded as a part of shareholders' equity on a balance sheet. It comes from shareholders in return of shares. Therefore, the share premium does not appear in profit and loss accounts for accounting purposes. However, in some situation, the Thai Revenue Department (TRD) considered that the share premium is a nature of taxable income for the company. In OxyChem and NEC's cases, substance over form concept was applied. The TRD did not allow legal form and legal documents in the way of determining taxable income for corporate taxpayer.

Share Premium Case (Case No. 5812/2557)



Siam Electro Chemical (EBT: Entire Business Transfer)

- Loss with negative book value of share
- Capital increase of THB 900 M
- 1,000 share (par @100) with share premium of THB 900,000,000 by US shareholder

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Tax planning strategy

It is common when share premium is paid upon issuance of new shares to reflect the real value of the company. The Civil and Commercial Code of Thailand allows companies to issue share at the price greater than par value. By practice of Thai corporate law, the company will specify share premium in its list of company objectives and register with the Ministry of Commerce. The share premium portion will be recorded as part of shareholders' equity. In the past, share premium was used as strategic tax planning in Thailand in order to inject fund from parent company into the deficit subsidiary companies without giving rise to income.

Share premium or Subsidy

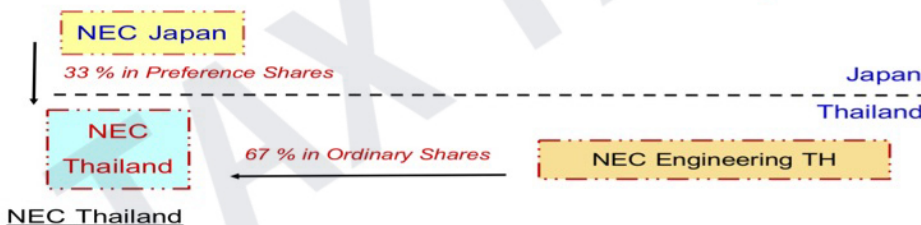
It does not seem like share premium could have something to do with tax liability. Until 2014, the TRD had their view that share premium payment in OxyChem was set up in order to subsidize the company without corporate income tax liability. The case was brought to the Supreme Court to determine the fact whether the share premium was taxable.

The Court decision was finally based on the fact that the company was in deficit status with huge losses and becoming insolvency status, and there were no reasons the new shares would be issued with large amount of premium. In this case, the share premium was regarded as subsidy and subject to corporate income tax (refer to the Supreme Court Case No. 5812/2557).

It happened the same way with NEC. In 2016, the Supreme Court Case No. 2050/2559 also ruled in favor of the TRD. Given that the share premium was paid in excessive amount, it was regarded as subsidy from the parent company.

NEC Case (Share Premium) (Case No. 2050/2559)

Substance over form - Subsidy



- Loss with negative book value of share / Capital increase of THB 410 M
- 1 share (@1,000) with share premium of THB 409,999,000 by NEC JP

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ONE Law's Comments

In view of both cases, it appears that the TRD adopts the concept of substance over form when considering tax liabilities arising from transactions. We note that a share premium payment must be valid both "by law" and "by tax". Although companies arrange for share capital increase and share premium properly according to the Civil and Commercial Code (valid "By Law" i.e. Legal



Form), the TRD would nevertheless require justifiable reasons behind the share premium. When it comes to determining share value and its premium, consideration should be given whether the company itself has hidden economic value or future revenue expectation that could be reflected through share premium. If not, paying share premium would not be reasonable and might give rise to corporate income tax liability for the company (valid “By Tax” i.e. Economic Substance).

Thai companies need to be careful when proceeding with the corporate restructure and dealing with capital and financial transactions. What we have learnt from the above 2 tax cases reminds us to ensure that legal form and economic substance of transaction are concurrent with justifiable grounds. In addition, a tax lawyer should earlier be involved in restructure planning process to work along with corporate lawyer and financial advisor in order to mitigate possible tax risk in which Thai tax authorities may pick up in the future.

Taking a look around in Asian countries’ in terms of tax treatments on share premium, it is interesting how we found that Indian court strictly applies provision of the law on tax impact from share premium. In one of the recent rulings (ITA No. 4860/ Mumbai/ 2016), the company received share premium and spent it on day-to-day operation. Under the Company Act of India, the company was not allowed to spend the share premium on its operating expense. Therefore, it was the tax officer view that the share premium lost its character and became ‘income’ of the company. However, the Court viewed it differently and ruled that despite the violation of the Company Act, the share premium could never be regarded as income of the company. The violation of any laws should not have tax implication for taxpayer unless the provision of the law specifies so. It seems that in India, the significance of substance does not override legal form. We are not saying that Thailand should or should not follow the Indian court due to different legal systems and domestic laws.

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Article Keywords: Share Premium, Subsidy, Corporate Reorganization, Substance Over Form, Economic Substance, Justifiable Grounds, Capital Restructure, Tax Avoidance, Tax Planning

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