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Tax Consequences for Debt Settlement in Thailand

As the world economy struggles to cope with the impact of the COVID-19 pandemic, many companies and other creditors are exploring options to manage non-collectible debts. However, the tax costs and consequences of different approaches to settling debts are often overlooked when they should be key considerations, and unwary creditors are at risk of unexpected surprises. This article will analyze some common debt settlement options and their tax consequences.

Debt Offset

Offsetting debts would be regarded in the same way as if payments had been made between the two parties. If the payment is subject to withholding tax, the deemed payer will still be required to file a withholding tax return and pay withholding tax (even though nothing is deducted and no actual payment is made) to the Revenue Department within seven days after the month in which the offsetting takes place.

In addition, Thai VAT registrants who receive deemed payments subject to VAT (assuming VAT was not due before the debt offset) will be required to issue a tax invoice and report the output VAT in their monthly VAT return. If the recipient of the deemed payment does not reside in Thailand and is not a Thai VAT registrant, the deemed payer must file a self-assessed VAT return and pay the 7% VAT.

Debt Forgiveness and Write-Offs of Bad Debt

Debts that cannot be collected are written off from the creditor's accounts and recognized as expenses for accounting purposes. However, this write-off is not deductible as an expense in the creditor's income tax computation if the debt collection was not performed in accordance with the tax laws. Write-offs here include compounding debts by reducing the payable amount.

Generally, according to section 65 *bis* (9) of the Revenue Code and Ministerial Regulation No. 186, written-off bad debts can only be claimed as an expense for corporate income tax purposes if they have the following characteristics:

1. The debt arises from the business operation or in connection with the business operation, or the debt has been previously included as revenue in the company's net taxable profit computation. A classic example of non-business-related debt is a loan to a director or former director. If such a loan became bad debt and had to be written off, the amount written off would always be a non-tax-deductible expense of the company, regardless of whether the debt arose before or after that person became a director of the company.
2. The debt is claimable in the judicial system (i.e., the creditor has sufficient legal evidence to support the claim, and the relevant prescription period has not yet elapsed). It is advisable to obtain a legal opinion from outside counsel to confirm whether a debt is claimable before writing it off.

In addition to the characteristics of the debt, there are requirements on debt collection attempts that must be met before the creditor can write off the bad debt for tax purposes. The actions required depend on the size of the debt.

For a bad debt (from one debtor) exceeding THB 500,000, the company must prove that it has already carried out the following steps:

1. Demanded payment from the debtor, provable by furnishing evidence of the attempt (e.g., a demand letter).
2. Taken judicial action (e.g., a lawsuit or motion in a civil case or bankruptcy proceedings) after continued failure to collect despite the demand of payment, resulting in a court-ordered debt collection that the debtor has been unable to repay, or an initial division of the debtor's assets following a court-ordered composition or bankruptcy.

It should be noted that there are two exceptions to the requirement that a creditor take judicial action. In the first scenario, if the debtor is deceased or has disappeared and there are no assets from which to recover the debt, the judicial action requirement is excused and the creditor may proceed to write off the bad debt after taking step one (i.e., demanded payment). Likewise, the judicial action requirement will be waived if the debtor has ceased its business operations and the debts of other preferential creditors exceed the total assets of the debtor.

For bad debt between THB 100,001 and 500,000, the requirements that must be met by a company looking to write off the debt are essentially the same as above, but the threshold of required judicial action is lower. Specifically, the creditor no longer has to wait for a court order or ruling, but will have fulfilled the judicial action requirement when their motion or case (civil or bankruptcy) is accepted by the court. As with larger debts, the exceptions above apply and will result in a waiver of the judicial action requirement.

For debts that do not exceed THB 100,000 (or THB 200,000 if the creditor is a bank), the creditor may proceed to write off the bad debt for tax purposes after taking the first step above (i.e., demanded payment).

If a debtor is placed in the business reorganization process under the bankruptcy law, this may result in various debts being restructured, thus reducing the amount of debt collectible (sometimes called a "debt haircut") or even writing them off entirely. In this case, a creditor may proceed to write off, for tax purposes, whatever amount of debt is reduced or written off in the court-approved debt restructuring plan, without the need to fulfill the debt collection attempt described above.

Debt to Equity Conversion

For Thai tax purposes, there is no concept of debt to equity conversion. Such conversions are treated, for tax purposes, as the deemed payment of debt on one side and deemed payment of equity on the other side; therefore, the tax implications are as they would be if an actual payment had been made (which varies depending on the nature of the payment).

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In past financial crises, the Revenue Department would normally issue a temporary relief measure to ease the requirements for writing off bad debts. For instance, during the 2013–2014 financial year, the department issued a temporary relief measure which allowed creditors to write off bad debts restructured according to prescriptions by the Bank of Thailand and claim them as tax-deductible expenses. In that case, creditors were exempted from undertaking the normal steps to collect bad debts.

Similarly, on March 24, 2020, the cabinet approved a temporary relief measure with respect to debt restructuring by non-bank lenders. However, on this occasion, the measure does not apply to general corporate debts but rather aims to provide tax exemptions for debtors of personal loan lenders, credit card issuers, and so on. While this may be generally beneficial to the public and to SMEs, for larger creditors facing a flood of bad debts, it offers little relief.

If the financial impact from the COVID-19 pandemic becomes particularly acute, the Revenue Department might issue additional tax relief measures to support restructuring of general corporate debt which would provide stronger relief to larger institutional creditors seeking to recover bad debts. Companies in Thailand should therefore not only stay vigilant during this volatile situation to maintain control of their tax obligations—they should also keep a close eye on legal developments for the issuance of relief measures that may ease their financial burden.