Abstract

Hybrid Financial Instrument is a type of financial instrument with terms incorporated elements of both debt and equity. There are complex terms of these instruments for fulfilling the needs of the issuers and investors to take advantages from these characteristics, which do not obviously appear in ordinary debt or equity. In addition, the continuously developed terms of these instruments cause problems regarding to the form and the actual content of the instrument. Although this type of instrument is named as debt, its significant feature is regarding the equity; as could be seen by a perpetual non-cumulative subordinated debenture.

The differences of debt and equity natures in the instrument terms greatly affect tax burden, in the contexts of both internal and international tax law. The return on debt instruments and equity instruments, which is separately taxable income, is taxed and has tax burden variously, i.e. withholding tax rate, dividends tax credit under Section 47 bis or tax exemption under Section 65 bis (10) and interest tax deduction in calculating net profit of the issuers under Section 65. If the classification of such natures cannot be considered, the aforementioned mechanisms may not work properly. Therefore, it is the most essential, for levying income tax of the hybrid financial instruments, to consider that how the characteristics of debt and equity in the instrument are combined, and whether it is debt portion or equity portion for the purpose of income tax by the Revenue Code and the Double Taxation Conventions.

In Thailand, it is apparent that taxing from the instruments provided by the Revenue Code and in practice remains unclear; albeit, many countries, such as the United States, Australia, and the Netherlands, imposed a set of provisions dealing with this matter specifically. Furthermore, there are other relevant rules other than tax rules, such as the accounting standards, the announcement of the Bank of Thailand and the criteria for classifying financial instruments of rating agency firms, determined the instrument types without considering their names and forms but their substances also taken into account.

Hence, considering an income tax of hybrid instruments in accordance with the principle of substance over form seems neutral for taxpayers and the Revenue Department, while it may cause some compliance and administrative costs. This method will reduces tax gaps and be a tool for tax authorities to prevent tax planning by using such hybrid financial instruments.