What do we "EXPECT" from the Board?

What tax do the directors pay when company pays "insurance premium" for them?

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Certain types of director compensations can have an explicit negative impact on the company's performance through its financial statements if the company do not treat the cost properly pursuant to a) applicable law; b) accounting principle; and c) tax principles. The compensations we are talking about include Directors and Officers Liability Insurance (D&O Insurance), Credit Life Insurance, and Key Man Insurance.

In the previous Article (Article 10th), director compensation in the form of company car is considered as a non-financial benefit. According to the Supreme Court precedent case, the company director does not have to include company car in the calculation of their personal income tax. Therefore, the benefit from company car is not considered as a taxable income for the director. On the other hand, the company may record the company car as an asset and depreciate or deduct it as expense in the corporate income tax calculation.

Moreover, there are various forms of directorship including (1) director of a limited company; (2) director of a public limited company; (3) director by position; (4) qualified director by law; and (5) director appointed by the state. Directorship is not considered as providing of service that is subject to value added tax as per stipulated in the legislation by the Revenue Department since 2015. In conclusion, director compensation is not subject to value added tax.

In this 11th Article of the series, we will still discuss about the non-financial director compensation but will emphasize on the compensation that has a clear monetary value which includes non-life insurance protection, life insurance protection, and relevant insurance premium.

D&O Insurance Premium

Why does a coverage under the insurance policy have monetizable value?

The Public Limited Companies Act (the latest amended version is about to become effective) has an interesting new issue about directors of public companies that the Ministry of Commerce has proposed to amend the act as set forth.

a) If the registrar of public company has detected any law violating transaction, the registrar (Department of Business Development) can reveal information concerning such violation such as relevant laws violated and information of violator (participants). This is considered as a strict method in law enforcement.

In this case, the director of public companies are exposed to a high risk because of any abusive action or abusive inaction could lead to eventual social sanction. Therefore, the authority must be fully confident in its data before enforcing this law, otherwise it could be double-edge sword for both the authority itself and the director of a public company.

At present, the Department of Business Development has enforced a mild method in law enforcement by specifying information concerning the failure to file for financial statements by companies in the first page of the company affidavit to inform everyone that they should be cautious when engaging with the company that fails to the annual financial statements.

b) In a situation that the Chairman or director of a public company violates the law and is fined while performing duty as the company representative, the new legislation prohibits the company from paying fine for the director. Therefore, the director himself will be liable for such fine.

This means the directors must be more cautious in performing their duties. Although directors are already obliged to the legal liability, they will also be exposed to financial cost or more financial risk as they represent shareholders and assume the agency status. Should directors have to shoulder any potential fines by themselves, it will add more burden to them and become financial risk factor that will make them work prudently to prevent any mistake that could lead to the violation of law and eventual legal fine.

From corporate perspective, most companies had been paying fines on behalf of their directors and had been treating such fines as a corporate expenses which are tax deductible.

However, in 2016, there was a key tax case that changed the tax perspective of the Thai companies up until now. It was the case of a liquor company that imported liquor and had misdeclare import price of the goods, causing it subject to pay a criminal fine to the Customs Department. This company treated this criminal fine imposed under the Customs Act as a deductible expense for the corporate income tax calculation. In this case, the Revenue Department categorized fine imposed under the Customs Act as a non-deductible expense which cannot be booked as a corporate income tax expense even though it has been accounted for as an expense for accounting purposes. The Supreme Court ruled in this case that ***"criminal fine is the penalty for the law violator and should not be allowed to be booked as tax expense because it will encourage the violator to commit crimes"***.

Afterward, in 2017, the "Taxation Consideration Committee" had published a ruling in the Royal Gazette as it offered comment to the Revenue Department to back the tax case in 2016 and make it effective for other cases as well. Key substance of the ruling is that ***"non-deductible expenses include fine and /or tax penalty and criminal fine of any tax laws"***.

Consequently, the aforementioned ruling of taxation consideration about the criminal fine is confined to the tax law boundary only and are not applicable with other criminal fine under other laws.

By comparing tax law and the Public Limited Companies Act which is currently under the ongoing amendment, both may have a different legal perspective but do share similar goals such as:

(1) Tax Governance - Taxation should be a tool to prevent and discourage tax violator from using criminal fine on tax law as a deductible expense.

(2)Legal Governance – Prohibiting companies from paying fine on behalf of their directors which will encourage them to perform their duties prudently with extreme cautious and preventing them from committing wrongdoing without paying penalty because companies take care of the fines for them.

The answer to the question of why the value of insurance coverage that the company bought for directors matters to both the company and the Board? Not only that its value is monetizable in accordance with the sum insured and insurance premium, but it also emphasizes the significance of risk prevention against the company and the Board.

However, there are coverage issues to be cautious when dealing with D&O Insurance. Some policies do not cover the case of cheating director or director with gross negligence. Many policies require purchases of extended protection coverage and additional insurance premium for companies in high-risk business or in business with specific risks such as hospital, petrochemical, food, and transportation etc.

Credit Life Insurance Premium

Besides D&O insurance, there is also another type of insurance concerning directly with the director. Particularly, one considered to be the company's key man whose existence poses high risk to the company's viability.

Many family businesses, either in the form of a private company, public company, or listed company, usually have one director/executive who runs the business as a one-man show or have a group of keymen with vital roles in driving the company. Without these key directors, the company cannot continue its operations smoothly. Suppliers, customers, employees, creditors, and other stakeholders put their trust in this particular directors, not with any other. In case that one key man unexpectedly leaves the company or passes away, there is usually no successor.

This Credit Life Insurance was initiated because bank granted loan to a company on condition that it bought life insurance policy for the key man or the key director and put the bank as designated beneficiary of the policy with insurance value equal to loan amount. In a situation where the key director passed away, the insurer will pay the benefit to the bank as loan repayment for the company.

As a result, the company's debt will be repaid by the benefit of the Credit Life Insurance policy even though the Company is without a key man to drive the business forward. Therefore, the Corporate Morale Impact from the absence of key man will not be aggravated by the financial impact from bank's debt collection.

Thai Institute of Directors

Are the directors at your company aware of this case? A life insurer used to seek tax ruling with the Revenue Department in 2007 with key issues as follow:

a) The Company borrowed funds from bank with the key condition that it bought life insurance coverage for key director as a collateral for the loan and put the bank as designated beneficiary for debt repayment purpose. Once the debt has been fully repaid, the company will be the next in line to receive remaining beneficiary. The director and family members will not be eligible for beneficiary under the life Credit Life Insurance policy.

b) The company paid life insurance premium for the key director to cover loans borrowed from the bank, such insurance premium is deductible expense in corporate income tax calculation.

c) In case the key director passes away, the bank's loan will be repaid by benefit received from life insurance. Should there be any benefit left after the debt has been fully repaid, the insurer will pass on all remaining benefit to the company.

Response by the Revenue Department on the query can be summarized as follow:

(1) Life insurance premium of the key director or key man is considered as a direct expense of the company that is a tax deductible expense.

(2) Life insurance premium, paid by the company, is not considered as the director/executive's additional benefit. Therefore, it is not subject to personal income tax.

(3) Benefit from the life insurance policy of the director/executive that the company received from the insurer after paying off outstanding debt is considered as a taxable income and is subject to the calculation of corporate income tax for the company.

It should be noted that, if there was no loan agreement and there is no condition requiring life insurance of director as loan collateral and protection, it is interesting to think whether the interpretation by the Revenue Department as mentioned above would be different? This matter is worth monitoring by director and people in this field.

Key Man Insurance Premium

The most popular form of life insurance policy among corporate director is the Key Man Insurance. Factors that supports this form of insurance coverage purchase is that it generate expenses that will effectively reduce company's profit and tax burden.

Is this result alright? How do directors view this issue? Does the Revenue Department have a different perspective? And how?

Key Man Insurance is different from Credit Life Insurance as the Key Man Insurance does not require a loan agreement to be used as a collateral nor to protect bank loan. In another word, there is no external factor requiring the company to buy life insurance coverage for director or key director/executive.

The Key Man Insurance plan must comply with the (1) applicable law; (2) accounting principle; and (3) tax principle. Otherwise, it could practically lead to a misappropriate asset usage, corporate tax issue, and personal income tax issue for directors.

Practically, the Revenue Department has set a number of interpretation guideline on this matter through tax rulings.

1) Premium paid for Key Man Insurance by the company is deductible only when it is booked as business's related expenses.

In this case, the company must prove that

a) The Key Man Insurance is for the benefit of any key director/executive in general, not specifically for a particular director/executive or any other persons such as certain family member.

b) The company must establish a corporate policy that clearly determines compensation/benefit given to director/executive.

c) The Company must propose the Corporate Policy to the Board (i.e. Policy Maker Level) for an approval and prepare minutes of the meeting to concretely ratify the policy.

If practices in this matter do not follow this guideline, premium paid for Key Man Insurance is usually disallowed and will become a non-deductible expense that causes financial damage to the Company via higher tax burden.

d) The director/executive is also considered receiving additional benefit that is monetizable and must be included in the calculation of personal income tax. There is no other option and exception for the director.

Besides the three forms of life insurance bought in respect of director/executive as aforementioned, there have been a number of director/executive of listed and non-listed companies who shifted funds overseas to purchase other forms of insurance not available in Thailand such as Universal Life Insurance (UL), Variable Universal Life Insurance (VUL), or Private Placement Life Insurance (PPLI). Key reasons for directors in purchasing overseas insurance are for Inheritance Tax planning and personal & wealth tax planning. However, points of concern, in this regard, are whether the premium paid can be booked as expenses by the companies in Thailand? Does the international fund transfer to purchase insurance overseas comply with Exchange Control Law?

When the Company chooses to purchase any form of insurance for its director, considerations on the legal, accounting, and taxation aspects that could affect the company and the director/executive must be taken into account before making the decision.

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