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ASEAN Path

Permanent establishment practices and perplexities in CMLV

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ASEAN Path is a series of white papers prepared by DFDL's experts aiming to assess, in more depth, compelling issues arising from the regional economic integration under the auspices of the Association of Southeast Asian Nations ("ASEAN") Economic Community Blueprint. The articles are based on an in-depth legal analysis of the local and ASEAN legal framework from the perspective of a practitioner assisting foreign and ASEAN investors in their investments and operations throughout various ASEAN Member States. All articles are accessible on our website: www.dfdl.com.

Permanent establishment practices and perplexities in CMLV

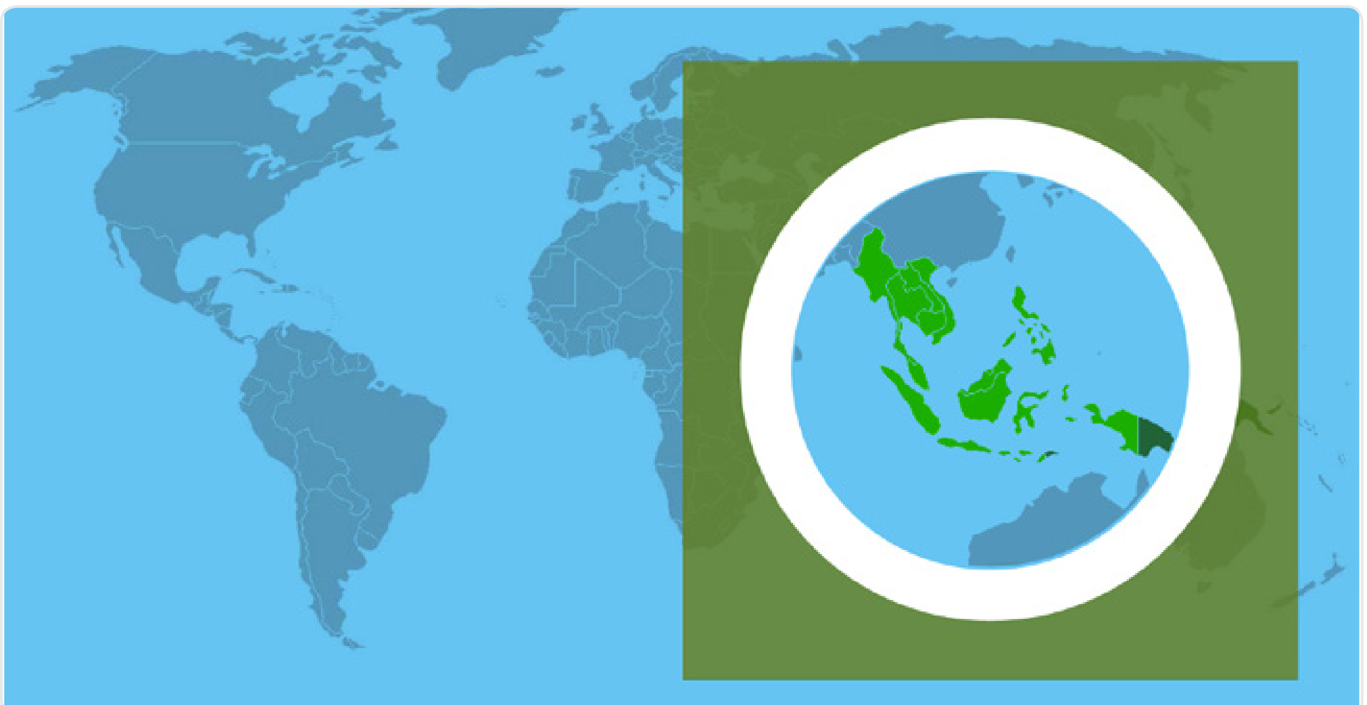
An examination of individual cases of taxable presence rules in Cambodia, Myanmar, Lao PDR and Vietnam

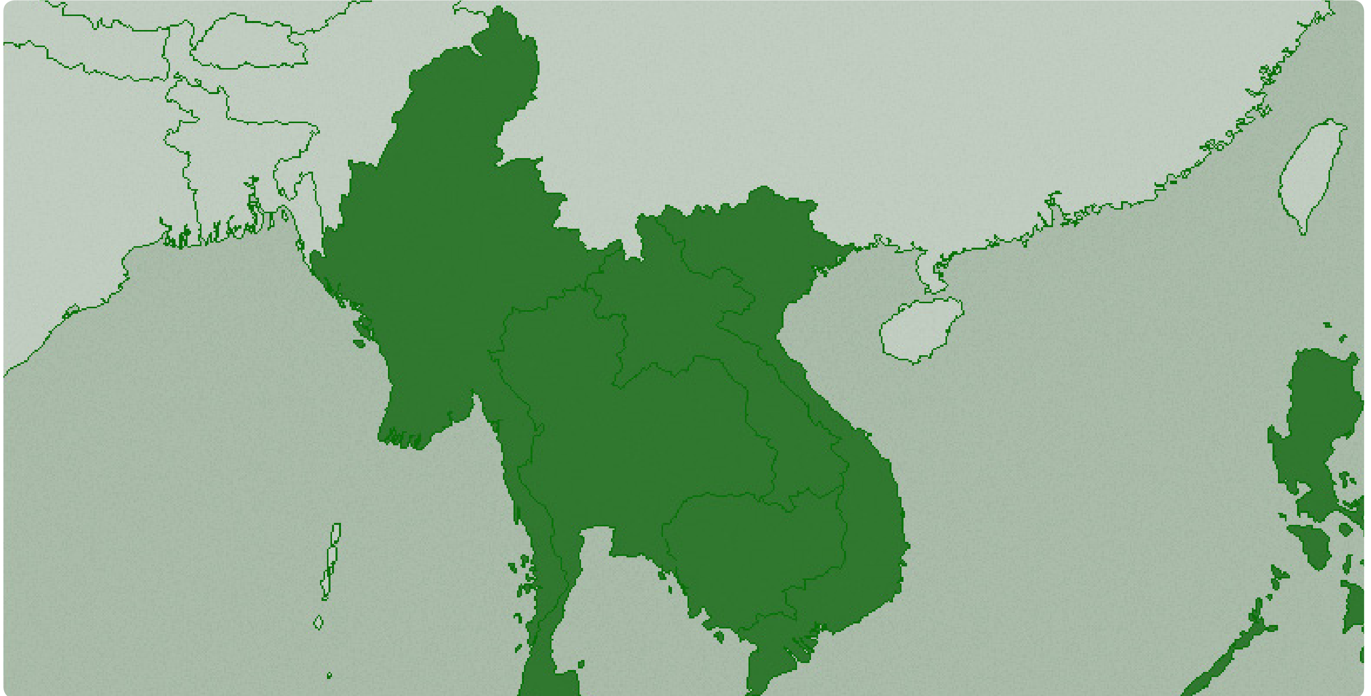
The PE risk question

Analysis and mitigation of Permanent Establishment ("PE") risks are often at the very heart of cross-border tax planning for companies seeking to minimize taxable presence in a state.

At its simplest definition, a PE is a fixed place of business through which the business of an enterprise is wholly or partly carried on. A PE risk is said to arise when a non-resident foreign entity conducting activities in a particular jurisdiction is considered to have established a taxable presence, which would, under applicable rules, require the non-resident foreign entity to register itself as a branch for tax purposes in that jurisdiction. The failure to register and file the regular tax returns can result in administrative penalties, including surcharges and interests.

With the exception of Cambodia, PE issues in CLMV are generally relevant only when applying the PE concepts in the context of a Double Taxation Treaty ("DTT"). Under most DTTs, the profits of an enterprise resident in a foreign state will not be taxable in the other state unless the enterprise carries on business activities in the other state through a PE situated therein (as defined in Article 5 of most DTTs).





Cambodia

Under Cambodia's Law on Taxation ("LOT") and related regulations, a PE is comprehensively defined as "a fixed place of business or a resident agent in Cambodia through which a non-resident person carries out business, wholly or partially, in Cambodia. A permanent establishment includes any other association or connection or means through which a non-resident person engages in economic activities in Cambodia." (Article 3.4)

The term, "economic activities" is defined as the "regular or continuous or from time to time activity of a person, whether or not for profit, in the supply of, or the intent to supply, of goods and services to other persons for the purpose of obtaining any benefit." (Article 88 of the LOT)

The law enumerates instances where a PE is deemed to exist, such as: a place of management; a branch of a foreign enterprise, an agency; an office of a foreign enterprise; construction sites; provision of services, etc. but the emuneration is NOT considered as exclusive.

The above PE provisions are rarely enforced by the Cambodian tax authorities in practice, but there have been recent cases where the tax authoities compelled non-residents to register a branch.

The rarity of enforcement is due to certain administrative limitations, such as (i) the absence of detailed procedures to compel the tax registration of unregistered PEs and (ii) the absence of detailed procedures to estimate, assess and collect taxes from the head office of the unregistered PE. Further, Cambodia has not adopted any PE profit attribution rules.

In practice, when a non-resident foreign entity earns income in Cambodia, the withholding tax ("WHT") provisions would be applicable (i.e., the payer of the income withholds the taxes prior to making payment to the recipient). This is generally sufficient for the Cambodian tax authorities from a tax revenue collection perspective. Where WHT is made, the tax authorities may let the non-registration of the PE slide.

Payments made by a resident taxpayer to a non-resident are subject to the following WHT:

Class of income	WHT rates for payments to non-residents
Interest	14%
Royalties, rental and other income connected to the use of the property	14%
Management and technical fees*	14%
Dividends	14%

*Note: While these fees are not currently defined in the LOT and tax regulations, the GDT will, in practice, adopt a very broad definition of management fees and technical services.

The obligation to withhold is on the resident payer. If the resident fails to withhold, there is no mechanism by which the Cambodian tax authorities can go after the non-resident recipient.

This does not, however, mean that the PE issue is to be completely ignored. The provisions are a veritable can of worms when they are eventually imposed.

For instance, the term, "economic activities" includes activities whether or not for profit. Thus Cambodia's PE definition does not have the usual exceptions found in most domestic PE rules. It does not have (i) the preparatory or auxiliary function exception; or (ii) the independent agency exception.

There is, thus, legal basis for the Cambodian authorities to either require registration or attribute income to the PE. The lack of clear guidance lends to the exercise of much administrative discretion. Thus, there is a risk and must be approached with caution.

Lao PDR

Lao PDR applies a source-based rule, whereby a non-resident enterprise will be subject to profit tax if it derives income from sources in the Lao PDR. This tax is paid by means of a withholding that is applied by the Lao enterprise which remits the income and is calculated on a deemed profit basis.

Before making payments to foreign enterprises, the Lao-registered project owners, business operators or enterprises, must withhold Profit Tax using the "deemed method" of calculating Profit Tax. Under the this method, the basis for calculation of the Profit Tax payable is the gross income multiplied by the "profit ratio" for specific types of activity. Article 21 of the Tax Implementation Guidelines provides further details of what profit ratio applies to which activities. The deemed profit is then multiplied by the general profit tax rate of 24%, resulting in the "effective tax rate".

Under the Lao Amended Tax Law, non-residents are subject to WHT when they derive income from sources in the Lao PDR. The tax due is calculated by applying the "deemed profit method", i.e. the gross income is multiplied by the "profit ratio" for each specific type of activity as summarized as follows:

Class of income	Deemed Profit Rate	Tax Rate	Effective Rate
Commercial/Trade	5%	24%	1.2%
Manufacturing	8%	24%	1.92%
Transportation & Construction	10%	24%	2.4%
General Services	20%	24%	4.8%

An important aspect to mention here is that the WHT is applied irrespective of the place of performance of services or location of the project.

A DTT may provide that the business profits of a foreign entity will not be subject to tax in the Lao PDR, unless the profits are attributable to a PE in the Lao PDR. In other words, if the foreign entity has a PE pursuant to the DTT, the Lao PDR would have taxing rights on the income of the PE.

Myanmar

Similar to the Lao PDR, there are no domestic PE rules in Myanmar. Under local law, non-resident foreign companies are subject to tax on their Myanmar source income regardless of whether there is a PE in Myanmar. Under the Myanmar tax law and regulations, non-resident foreign corporations are subject to income tax at the rate of 35% on their Myanmar-source income or subject to a final WHT for certain payments.

The WHT notifications are quite general and may lend to various interpretations (such as, for instance, is leasing covered by the WHT or not). Notification 41-2010 as amended provides:

Witholding Tax	WHT rates for payments to non-residents
Interest	15%
Royalties paid for the use of licenses, trademarks, patent right, etc.	20%
Payments of contracts and buying goods within the country under relevant contracts, agreement or any kinds of agreement, performed for State organizations, city development committees, cooperative societies, registered companies and non-government organizations	3.5%
Payments of contracts and buying goods inside Myanmar by the consistent contracts or agreement performed for the un-registered foreign entities and foreign companies	3.5%

In practice, the 35% income tax rate on (net) total income imposed by law on non-residents is charged only against registered branch offices and non-resident individuals. Unregistered foreign entities conducting business activities in Myanmar are generally subject to the final WHT regime.

As in the case of the Lao PDR, the PE concept comes into play under a DTT to which Myanmar is a signatory. It is interesting to note that a few DTTs provide for specific rules regarding deduction of expenses with respect to a PE or taxation of a PE.

For instance, under the Myanmar-Malaysia DTT, in determining the profits of a PE, executive and general administrative expenses are allowed as deductible expenses insofar as they are reasonably allocable to the PE, whether incurred in Myanmar or elsewhere. In short, this implies that a PE of a Malaysian entity would be able to declare income tax returns based on its net income, rather than be taxed under the WHT regime. However, despite this provision in the DTT, the practice of taxing a non-resident on its net income has yet to take root in practice Myanmar.

The above notwithstanding, there are nevertheless two major risks for a non-resident foreign company which may or may not have a PE in Myanmar:

First, in case the local payer fails to withhold the tax, the Income Tax Law ("ITL") provides that the tax authorities may have recourse to collect the unpaid tax against the property of the non-resident found in Myanmar.

The tax authority is also given much discretion. Under the Income Tax Rules, if the Township Revenue Officer is of the opinion that a non-resident foreigner's income cannot be definitely known, the Township Revenue Officer may compute the income for income-tax assessment by one of various methods including computing at a rate "considered reasonable" by the Township Revenue Officer based on the gross receipts of the non-resident.

Second, for legal regulatory purposes, we wish to highlight that the regulatory policy on registration of non-resident entities remains unclear. The general regulatory policy is that a foreign corporation is required to obtain a local license in order to carry on a business in Myanmar. However, there is no statutory definition of what constitutes "carrying on a business." There is also no clear guidance on the level of activity that would require registration by a foreign company in Myanmar as a local entity or as a PE.

At this time, it appears that Myanmar's policy on how a foreign entity may carry on a business in the country is addressed on a case-to-case basis. However, the basis or standards used for each case remains unclear.

There are still many issues on WHT in Myanmar. For instance, there are interpretations that the WHT Notification covers only services, hence, leases are not subject to WHT. Another issue is the case of branch offices, which by definition are non-residents, but by being registered are generally subject to CIT on their net income.

Among the jurisdictions discussed, Myanmar appears farthest from maturity in terms of precedents.

Vietnam

Compared to the other three, the Vietnam system is relatively more developed. However, its system remains a square peg in the round hole of conventional PEs.

Under local Vietnamese regulations (Circular 78-2014), a PE of foreign companies include "manufacturing and business facilities and through these facilities, the foreign companies shall conduct a part or all of their production and business activities in Vietnam to earn income, mainly include:

Branches, executive offices, factories, workshops, means of transportation, mining, oil and gas field or other sites of extraction of natural resources in Vietnam; construction sites, works of construction, installation or assembly; establishments providing services, including consultancy services through employees or an organization or individual; agents for foreign enterprises; representatives in Vietnam in the case of authorized representatives to sign contracts in the name of foreign enterprises or non-authorized representatives to sign contracts in the name of foreign enterprises but regularly delivering goods or providing services in Vietnam."

The definition of a PE under Vietnam's domestic tax law is quite broad. Note that with respect to provision of services, there is no requirement on the length of time in which the services take place. In other words, providing services even for a day would constitute a PE in Vietnam.

Vietnam takes a simplified approach in imposing withholding tax on foreign entities with Vietnam-sourced income via the foreign contractor tax ("FCT") regime. Under the FCT regime, a foreign entity (also referred to as foreign contractor) is subject to withholding tax on deemed corporate income tax (CIT) and VAT rates.

A foreign contractor may comply with the FCT regulations through the following three methods, which may be elected by the foreign contractor:

Method	Description
The deemed method	Where the Vietnamese payer withholds the FCT as a final withholding tax from its gross payments to the foreign contractor based on the FCT rates.
The deduction method	Where the foreign contractor accounts for its own CIT and VAT as if it is a Vietnamese tax payer (i.e., adopt the full Vietnamese Accounting System). The current CIT rate of 22% applies on net taxable income. The VAT rate of 10% generally applies, and VAT payable is equal to the difference between output VAT and input VAT.
The hybrid method	Where CIT is computed based on the deemed system and VAT is computed based on the deduction method (combination of the withholding method and the deduction method). Under this method, VAT is filed on the conventional deduction method (output VAT less input VAT), while CIT is computed on the deemed tax rates under the withholding method.

The most common method for a foreign contractor is the deemed method, which is also the default method. The foreign contractor must elect the deduction method or hybrid method if it does not want to be taxed under the deemed method and if it satisfies certain criteria (i.e., having a PE in Vietnam).

The tax regulations provide that where a DTT to which Vietnam is a signatory contains different provisions relating to resident establishments, such treaty shall prevail. Under an applicable DTT, if a PE exists, then Vietnam will have taxing rights over the relevant income (i.e., by way of the FCT).

Summary

Cambodia has yet to conclude any DTTs; it is thus no surprise that the concept of a PE is rarely applied despite a comprehensive local definition. In the Lao PDR and Myanmar, even if a PE is deemed to exist, the traditional consequences of having a PE, such as the required registration of the PE, filing of tax returns and risk of tax penalty, will not necessarily arise. In Vietnam, the existence of a PE allows the non-resident foreign entity an option to pay taxes on its own (i.e., under the deduction method or hybrid method).

In all the foregoing jurisdictions, except Cambodia, the application of the DTT is critical for determining which jurisdiction has taxing rights with respect to a PE.

Finally, clearly, the application of the PE concept may differ in CMLV compared to the rules that some multinational companies are familiar with. Understanding how a local tax system works, and impact under an applicable DTT, will always be key to averting fears of PE risks.

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