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Cambodia: Anticipated Tax Changes in 2017

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The 2017 Law on Financial Management has yet to be formally enacted in Cambodia; however, its content has already been disseminated among most tax professionals so with that in mind the salient points of the Draft Law on Financial Management are highlighted for your reference. The Draft Law has been rubber-stamped by the Council of Ministers and when enacted the changes should take effect from January 1, 2017.

I. Minimum Tax

Echoing His Excellency Kong Vibol's announcement at the recent EuroCham Tax Forum in Phnom Penh the Draft Law on Financial Management ("the Draft Law") looks to amend Article 24 of the Law on Taxation ("LOT") regarding the imposition of the 1 percent Minimum Tax. In brief, for those taxpayers who qualify—the 1 percent monthly Pre-payment of Tax on Profit and Annual Minimum Tax obligations will no longer apply.

To recap, Minimum Tax ("MT") is a separate and distinct annual tax from Tax on Profit ("TOP"). The MT rate is calculated at 1 percent of annual turnover inclusive of all taxes except VAT, and is payable at the time a taxpayer files their annual TOP return. Currently MT is payable by all taxpayers that are subject to the Self-Declared Regime of taxation[1] except Qualified Investment Projects ("QIPs"), money exchange dealers and gold/diamond/gemstone small taxpayers (MT based on selling margin) and educational institutions (temporary suspension until 2018).

By law a self-declared regime taxpayer is required to pay either MT or TOP, but not both, so the TOP liability and MT liability of a taxpayer is compared at the time they prepare their annual TOP return. If the TOP liability calculated is greater than the MT, the taxpayer needs only to pay TOP. If not, only MT is due. If the TOP liability is higher than the MT liability then any pre-payment of the MT liability during the year can be offset against the TOP liability.

Self-declared regime taxpayers are subject to prepay their annual MT obligation on a monthly basis —referred to as Pre-Payment of Tax on Profit ("PPT"). PPT is calculated on 1 percent of the monthly turnover of a taxpayer. As noted above the monthly PPT payments can be used by a taxpayer to offset their annual MT or TOP obligation—whichever is higher.

We note that the turnover attributable to a QIP during the TOP holiday period as determined by the Law on Investment (amended) is exempt from this PPT obligation and QIPs in the garment and shoe manufacturing industry are currently suspended from the monthly PPT as are educational institutes—up to 2018.

A. Commentary

The Draft Law provides under the Amended Article 24 of the LOT that the obligation to pay MT shall be imposed on any enterprise which does not keep a proper record of accounts. Criteria outlining the bookkeeping requirements and the procedures for being exempted from MT shall be determined by Prakas to be issued by the Minister of Economy and Finance.

From what we understand, one of the main criteria required to be exempted from the 1 percent PPT and annual MT obligations will be that a taxpayer would be required to have their financial statements exter-

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nally audited by a licensed audit firm to ensure that they have not been manipulated to create a tax loss scenario where in theory no annual tax would be due—be it TOP or MT. The tax authorities may also roll out the exemption to small taxpayers first rather than providing a blanket exemption to all taxpayers.

Whatever the criteria that is produced by the tax authorities in the Prakas the move to phase out the 1 percent PPT and MT should be a welcome change for all taxpayers, in particular those who work on small margins and high turnover and for those who have cash flow issues during the year which are compounded by the monthly PPT requirements.

II. Tax on Salary

Under the Draft Law the first two tiers of the monthly Tax on Salary rates will have their ceilings raised. The salary of employees that is currently taxed at 0 percent will have its ceiling raised from US$200 to US$250 and salary that is taxed in the 5 percent tier will have its ceiling raised from the current threshold of US$312 to US$375.

This is best illustrated by comparing the tables below. Table 1 reflects the current monthly tax on salary tiers and Table 2 reflects the amended tax on salary tiers that should be in place by January 1, 2017.

Table 1. Current Rates

Monthly tax on salary effective from January 1, 2015		
Khmer Riel (KHR)	**Equivalent to US$***	**Progressive tax rate**
0–800,000	0 to 200	0%
800,001–1,250,000	200 –312	5%
1,250,001–8,500,000	312–2,125	10%
8,500,001–12,500,000	2,125–3,125	15%
Over 12,500,001	Over 3,125	20%

*Converted at KHR4000 : US$1

Table 2. Rates under the Draft Law 2017

Monthly tax on salary effective from January 1, 2017		
Khmer Riel (KHR)	**Equivalent to US$***	**Progressive tax rate**
0 –1,000,000	0–250	0%
1,000,001–1,500,000	250–375	5%
1,500,001–8,500,000	375–2,125	10%
8,500,001–12,500,000	2,125–3,125	15%
Over 12,500,001	Over 3,125	20%

*Converted at KHR 4,000 : US$1

A. Commentary

To illustrate the effect of this change: an employee who had a gross monthly salary of US$250 per month would have historically received US$250 with US$2.50 being withheld for tax on salary. Under the new amended band the same employee would receive the full US$250 with no tax on salary being required to be deducted.

An employee who currently has a gross monthly salary of US$400 would be receiving US$385.63 net per month. From January 1, 2017 they would receive US$391.25 in the hand meaning that they are better off to the tune of US$5.62 per month.

III. Rebate for Family Members

Currently an allowance of 75,000 khmer riel (approx. US$19) per month may be deducted from an employee's taxable salary base for dependent family members as follows:

- each minor dependent child; and
- an employee's spouse whose only occupation is as a homemaker (i.e. they do not work outside the home)

In order to claim a deduction for a child, the child must be under 14, or under 25 and a full-time student at an accredited institution. Each child may be used as a deduction once only. So if both parents work, only one of them may claim the deduction for the child.

Under the Draft Law the rebate amount has been increased to 150,000 khmer riel (approx. US$38).

A. Example 1

Sophea currently has a gross monthly taxable salary of US$500. Sophea has a wife that stays at home and has two children aged three and five years.

Currently Sophea would receive net US$481.30 calculated as follows:
Taxable salary base = US$500
Minus family rebate (19 x 3) = 57 = US$443
Tax on salary = US$18.70
US$0 – 200 @ 0% = US$0
US$200 – 312 @ 5% = (312-200 =112 @ 5%) = US$5.60
US$312 – 443 @ 10% = (443- 312=131 @ 10%) = US$13.10

From January 1, 2017 Sophea's gross monthly taxable salary is still US$500. However under the changes as per the Draft Law his net monthly pay would be US$492.65. That means that Sophea will receive an extra US$11.35 in the hand from January 1, 2017.
Taxable salary base = US$500
Minus family rebate (38 x 3) = 114 = US$386
Tax on salary = US$7.35
US$0 – 250 @ 0% = US$0
US$250 – 375 @ 5% = US$6.25
US$375 – 386 @ 10% = US$1.10.

IV. Progressive Tax Rates for Sole Proprietorship and Partnerships

The Draft Law has amended some key definitions in Article 3 of the LOT which need to be discussed to ascertain the criteria for a taxpayer to be able to utilize the progressive TOP rates as detailed below.

The term "legal person" has been amended by the Draft Law to mean any enterprise or organization carrying on a business whether or not officially recognized by the competent institutions of the Royal Government. The term "legal person" includes any:

- capital company;
- government institution;
- religious/charitable or non-profit organization; and
- permanent establishment of a nonresident person located in the Kingdom of Cambodia.

The term "legal person" does not include a partnership, individual or a sole proprietorship.

Under Article 20(4) of the LOT as the progressive TOP rates apply to those businesses which are not defined as a legal person, see above.

Practically what that means is that the progressive TOP rates only apply to individuals, sole proprietorships and partnerships. Tables 3 and 4 outline the current progressive TOP rates that are outlined in the LOT and the new progressive TOP rates to be effective from January 1, 2017 as set out in the Draft Law.

Table 3. Current Progressive TOP Rates

Annual Taxable Profit		Tax Rate
Khmer Riel	US$	
0–6,000,000	0–1,500	0%
6,000,001–15,000,000	1,501–3,750	5%
15,000,001–102,000,000	3,751– 25,500	10%
102,000,001–150,000,000	25,501–37,500	15%
Above 150,000,000	Above 37,500	20%

Table 4. Progressive Tax on Profit Rates effective January 1, 2017

Annual Taxable Profit		Tax Rate
Khmer Riel	US$	
0–12,000,000	0–3,000	0%
12,000,001–18,000,000	3,001–4,500	5%
18,000,001–102,000,000	4,501–25,500	10%
102,000,001–150,000,000	25,501–37,500	15%
Above 150,000,000	Above 37,500	20%

A. Commentary

The progressive TOP rates have been contained in the LOT for some time already. What makes these rates more newsworthy now is (i) the abolishment of the Estimated Tax regime from January 1, 2016; and (ii) increases in the thresholds under the Draft Law.

As noted above, practically speaking, only individuals, sole proprietorship and partnerships can take advantage of the progressive TOP rates. Prior to 2016 those businesses that fell out of those three categories either paid no tax at all or paid tax under the Estimated Tax Regime on a negotiated basis. With the abolishment of this Regime—sole proprietorship in particular that had estimated annual revenue of approximately US$62,000 were required to register as a small taxpayer under the revised Self-Declared Tax Regime.

Practically speaking it is these smaller businesses that stand to utilize the upgraded progressive rates of TOP as outlined above. By not subjecting these smaller businesses to the flat 20 percent TOP rate it is hoped that some of the anxiety and angst of those businesses currently making the transition from the Estimated Tax Regime to the Self-Declared Regime may be reduced.

V. Branches and Dividend Distributions

Many countries impose a branch profits tax on foreign corporations to prevent the advantage the absence of dividend withholding tax would otherwise provide to foreign corporations. Cambodia has no such tax but historically the tax authorities' approach in Cambodia has been to treat remittances from a branch to its overseas Principal as a dividend and impose 14 percent WHT accordingly.

The tension that of course from a legal perspective a Branch is distinguished from a Subsidiary to the extent that a Subsidiary is in itself a separate legal entity whereas a Principal and its Branch are seen as one entity—the Principal being responsible for the liabilities of its Branch. From a legal standpoint a Branch cannot distribute a dividend to its Principal as they are seen as one legal entity.

The Draft Law specifically addresses this point by amending Article 22(2)(c) of the LOT to expressly states that any remittance of Cambodian sourced income made by a Branch to an overseas Principal will (a) be subject to either 20 percent or 30 percent TOP and (b) subject to withholding tax as per Article 26 of the LOT.

VI. Dividend Distributions

The LOT currently has a number of provisions that relate to the claw-back of TOP when a taxpayer issues a dividend. This claw-back of TOP typically arises when a QIP issues a dividend that comes from retained earnings that enjoyed a TOP holiday (or reduced TOP rate under the old investment regime), or if a taxpayer issues an interim dividend from anticipated profits that have not yet been subject to TOP.

The changes to the existing provisions in the LOT look to simplify the calculation of the TOP claw-back rather than providing confusing calculations that currently exist in the LOT. Simply put, if a branch or company issues profits back to their respective principal or shareholder(s) that have not been subject to TOP in Cambodia then the Branch or Company will have to pay the corresponding TOP at the time the distribution/dividend is made.

We also note that the definition of "dividends" was one of many definitions in the LOT that have been changed under the Draft Law. The revised definition of dividend in the Draft Law no longer refers to "stock dividends" which is being excluded from the definition of dividend. This, we believe is an attempt by the authorities to prevent taxpayers trying to argue that the conversion of retained earnings to capital and then a subsequent reduction of capital constitutes a stock dividend that should be exempted from the 14 percent WHT that would typically apply on a dividend distribution to a nonresident shareholder.

VII. Other Changes of Note

In additional to the changes outlined above, the Draft Law increased the number of non-taxable supplies for VAT purposes to include:

- educational services;
- the supply of electricity and clean water;
- unprocessed agricultural products; and
- services relating to the collection and/or removal of waste material either solid or liquid.

The tax authorities were also awarded with additional discretion to issue a notification to a taxpayer or third party such as a bank, insurance company or other financial establishment to request information relating to the taxpayer with respect to suppliers, clients or bank accounts for the purpose of collecting taxes or complying with international agreements.

The Draft Law also looked at the exemption and preferential duties of Stamp Duty with respect to tenancy or ownership over concession land, property between relatives, and on all types of motorcycles,

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tractors and water vehicles up to 150 hp—a Prakas to follow with more detail.

Finally the Draft Law also looked in greater detail at the concept of Permanent Establishment and the taxation of Life Insurance Entities, making a distinction between the taxation of insurance or reinsurance activities on property or risks as opposed to insurance or re-insurance activities on life—the former being taxed at 5 percent of the gross premium received and the later at the standard TOP rate of 20 percent.

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The information provided in this article is for information purposes only, and is not intended to constitute legal advice. Legal advice should be obtained from qualified legal counsel for all specific situations.

NOTES

[1] Please note that there is only one tax regime that is in place from January 1, 2016 in Cambodia which was called the Real Regime of Taxation. The Real Regime of Taxation is made up of Small, Medium and Large Taxpayers. Under the Draft Law the term "Real Regime Taxation" is replaced with the term "Self-Declared Regime." For the purposes of this article we refer to the updated term "Self-Declared regime."