

Technical Update

Tax and Corporate Services

October 2018



Interest rules for related party loan

(Instruction no. 11946 GDT, dated 21 August 2018)

Since 1997, Article 18 of the Law on Taxation (“LoT”) in Cambodia has allowed the General Department of Taxation (“GDT”) to make adjustments to income and expenses between Cambodian taxpayers and overseas related parties (i.e. Transfer Pricing “TP”). However, interest free loans received from overseas related parties by entities in Cambodia have been accepted and excluded from adjustment. This was firstly established by tax authority practice, with formal ratification through Circular 1707 issued on and effective from 2 October 2013 and continued by Circular 151 issued on and effective from 22 January 2014.

On 10 October 2017, the Ministry of Economy and Finance (MEF) demonstrated that related party transactions would be subject to greater scrutiny in Cambodia, by issuing Prakas No. 986 MEF.PrK. (“Prakas 986”), which became effective immediately. Prakas 986 provides additional rules and guidance on acceptable TP methodologies and compliance requirements.

With Prakas 986 remaining silent on interest free loans and Circular 151 remaining effective in respect of loans received from related parties, it was understood that interest free loans remained permissible and effectively exempt from the guidelines outlined in Prakas 986. However, on 21 August 2018, the GDT issued Instruction no. 1946 (IN11946), which became effective immediately. The key changes resulting from IN11946 are:

1. *Interest rates for loan transactions between related parties must be determined in accordance with the Arm’s Length Principle as provided in the Prakas 986.*
2. *It is no longer required to submit loan documents to notify the GDT. However, taxpayers must keep, record and maintain documents as indicated in Article 18 of the Prakas 986.*

This IN11946 is only applicable for loans between related parties whereas normal loan transactions shall continue to be regulated in accordance with the Circular 151, dated 22 January 2014.

Our comments

The intention of the GDT in issuing IN11946 is to remove what it viewed as inconsistency between related party transactions having to be justified as arm’s length in line with Prakas 986, while Circular 151 allowed interest free loans between related parties. Interest free loans inbound to entities in Cambodia does not result in profit being shifted artificially out of Cambodia.

We, however, understand the GDT expects all corporate taxpayers in Cambodia with related party loan agreements to comply with IN11946. Therefore, the arm’s-length interest rate of any related party loan would now need to be analysed and documented in accordance with Prakas 986. In addition, loan agreements will need to be updated so they are consistent with the analysis and underlying information in the TP documentation.

To produce compliant documentation as required under Prakas 986 and change commercial loan agreements will take considerable time, thus we advocate for the effective date to be changed from 21 August 2018 to 1 January 2019 to allow taxpayers the time to make these changes.

The overall consequence to tax payable and cash flow will vary dependent on the level of profit/loss generated by a taxpayer. We therefore suggest taxpayers who have related party loans contact their tax advisors to better understand the potential consequences and opportunities caused by this change for their business.

We will cover updates or additional information with regards to this matter, if any, in subsequent publications.

Rules and procedures for implementation of Tax on Income and other taxes on cut, make and trim activity of Qualified Investment Projects (QIP)

(Prakas 741 MEF. Prk, dated 3 August 2018, Notification 12802 GDT, dated 6 September 2018)

The MEF issued this Prakas to set out rules and procedures for implementation of Tax on Income (Tol) and other taxes for cut, make and trim (CMT) activity of Qualified Investment Projects (QIP).

The Prakas provides for CMT service enterprises the following rules and procedures:

Condition	<ul style="list-style-type: none"> • Notify to the GDT on every CMT transaction within 30 days after entering a service contract with the goods owner by attaching, the contract to provide CMT service with details of scope, service fee and term of payment; and • maintain supporting documents as stated in Article 9 of the above Prakas
Incentive	<ul style="list-style-type: none"> • receive the same incentive for Tol as a QIP.
Tax obligation	<ul style="list-style-type: none"> • Tol: record income & expense relating to CMT services separately and: <ul style="list-style-type: none"> - report to the GDT every month as per sample schedule provided; - Prepayment of Tol and Minimum Tax basis shall include CMT service fee; and income from sales of damaged/excess goods and CMT raw materials. • Deductible expense: must implement in accordance with the law and provision on Tol. • Value Added Tax (VAT) shall be implemented as follow: <ul style="list-style-type: none"> - VAT output at 0%: supply of CMT services to support the export of processed goods; - VAT output at 10%: supply of CMT raw materials, finished goods or damaged/excess goods in the domestic market; - VAT input credit: VAT paid for domestic goods or services shall be implemented as normal; and - Must keep and record accounting record on VAT as stated in Article 50 of Sub-Decree on VAT.
Stock management obligations	<ul style="list-style-type: none"> • Must maintain a stock management records which can be easily checked and monitored for any change in stocks. Required information to be managed are: <ul style="list-style-type: none"> - CMT raw materials; - stock of finished goods; and - stock of damaged/excessed goods. • Must report the destruction/disposal of stock of goods or CMT raw material, damaged or excess, beforehand at least 7 days to the GDT, to allow them to attend to the process; and • Must provide stock management reports to the GDT every year, together with annual Tol return.
Accounting and amendments	<ul style="list-style-type: none"> • must comply with the Cambodian International Financial Reporting Standards and other provisions on taxation; • can record both CMT services and non-CMT services into a single financial report and can prepare a single Tol return; however must have separate documents and accounting records; • must amend Tol returns for any inaccuracy, within 03 (three) years counting backwards, the conditions are to be determined by the GDT *. • * As per the GDT's Notification 12802, if the above amendments are done by 31 March 2019, any resulting tax payable shall be exempted from additional tax and interest; and • must maintain supporting documents: <ol style="list-style-type: none"> a. sale transactions: CMT service contract(s), sale invoices, bank statements, domestic bank receipts, customs, letters of goods origin, logistic documents. b. import of CMT raw materials: purchase order, invoices (import), letter of goods delivered, customs, logistic documents.

Our comments

Previously, there was no clear guideline for enterprises which operates under CMT service activity model. The above Prakas provides much needed rules and procedures, as well as incentives, for those CMT enterprises. This should encourage them to become more transparent.

The Prakas does impose a higher compliance level as well as impose an administrative burden which will certainly cause difficulties. First, the requirement to notify the GDT for every new transactions within 30 days can be a huge burden on enterprises as there may regularly be several new service contracts. It is also not specified if existing contracts or a simple renewal must also be notified.

Secondly, the requirement to provide detailed CMT service fee table in a format approved by the GDT and attach with the monthly tax returns may be difficult since some enterprises would not have separate sale invoices, cash receipts for CMT service. Most likely, those enterprises would have included CMT fee with product value in their commercial invoices when exporting finished goods back to the good owners.

Finally, the requirement to notify to the GDT within 7 days before destroying any stock or material may not be practical. Disposal of material happens on a daily basis for most factories and is actually a requirement by other bodies such as the Garment Manufacturers Association of Cambodia (GMAC).

In a recent meeting between GMAC and the GDT to discuss this Prakas, the GDT provided comments and possible compromises on difficulties enterprises may face. The GDT is willing to be flexible and deal with enterprises on a case by case basis such as with the requirements to notify every new CMT transaction and disposal of materials. For example, enterprises may submit a letter to explain their case for the GDT consideration. Vouchers may be used in place of cash-receipt for the required CMT fee table.

On the other hand, the GDT verbally confirmed that the disposal of fixed assets must be subject to ToI (although exceptional case may be considered), logistic expenses such as transportation, warehousing, are not allowed for deduction and must be charged back to the good owner.

Furthermore, the GDT is also willing to give a timeframe for the taxpayers to prepare amendments of accounting records and tax returns. The GDT's **Notification No. 12802**, indicates this period to be by **31 March 2019**. Any tax payable found in an audit event however shall not be exempted from taxes.

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.



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