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WHAT TO KNOW ABOUT THE LEGAL AND TAX IMPLICATIONS OF OFFICIAL DEVELOPMENT ASSISTANCE PROJECTS IN CAMBODIA

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Get to the point.

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WHAT IS THE REQUIRED COMPANY STRUCTURE FOR SELECTED BIDDERS TO UNDERTAKE AN ODA PROJECT?

Typical entity forms for doing business in Cambodia

Briefly, a foreign business must register an entity in Cambodia in order to carry on a business, but it is not necessary to be in the form of a company. According to the Law on Commercial Enterprise (“LCE”) of Cambodia, a foreign business may choose one of the following three forms:

- A commercial representative office;
- A branch of the overseas company, whereby all of its liabilities are still with the overseas company; or
- A subsidiary, which is a new company that can assume liability independently from the overseas parent company.

Of the three forms, commercial representative offices are the most restricted in terms of the scope of business allowed; under the LCE, they are prohibited from conducting most business activities. Consequently, branches and subsidiaries are the more common forms used by foreign investors to carry out projects in Cambodia.

Form of entity for undertaking ODA projects in Cambodia

The typical ODA project in Cambodia will be a government tendered project funded by ODA from another government or international organization. Since the enactment of the Public Private Partnerships Law (“PPP Law”) in 2021, the Cambodian government tends to apply the PPP Law to the general management of government projects, while taking into account the ODA funder’s specific requirements.

Therefore, it is useful to look at the PPP Law and its three-volume standard operating procedures (“SOP”) to understand the specific requirements of the form of entity for ODA projects.

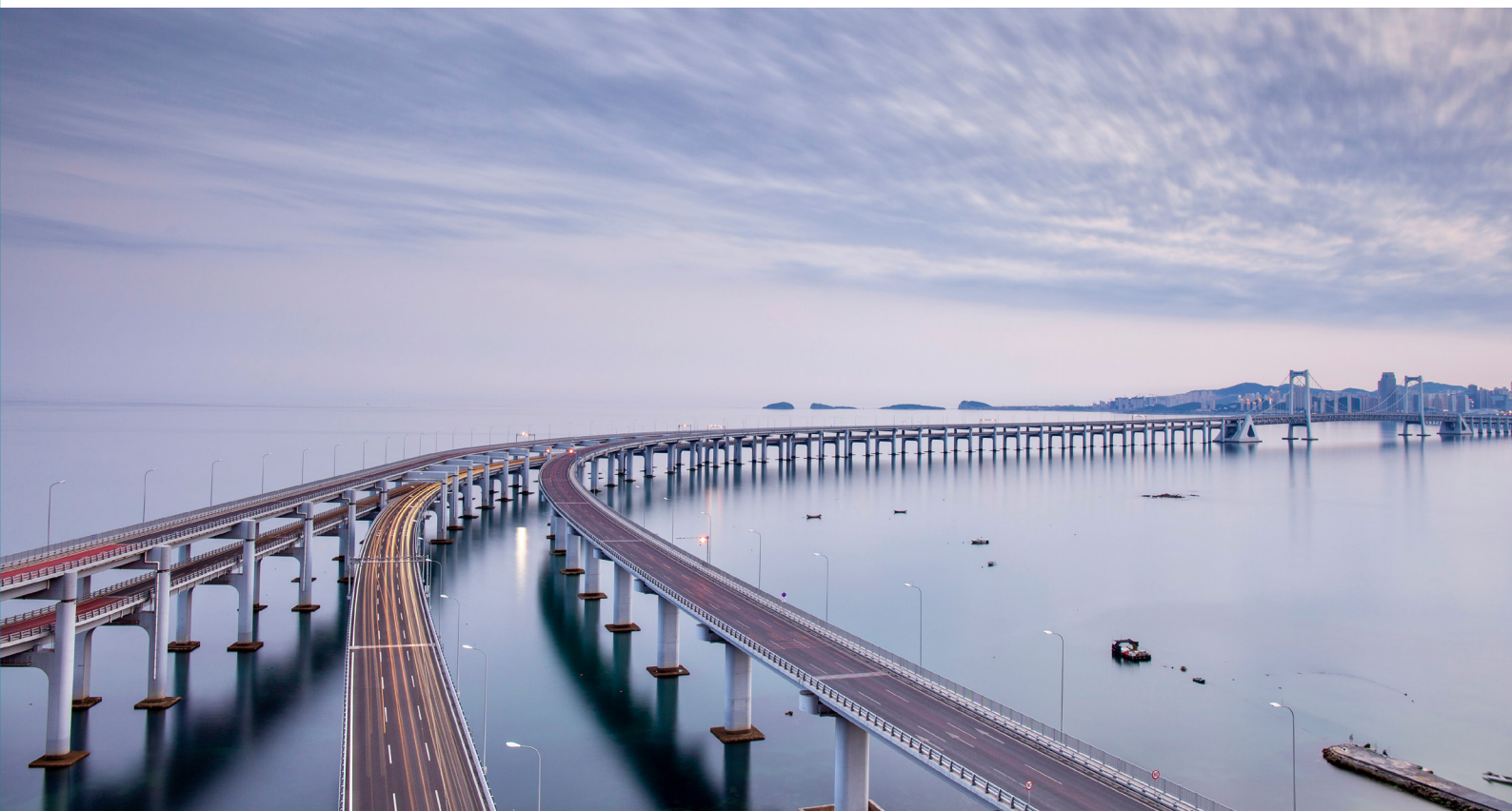
Article 7 of the PPP Law provides that the private entity with the right to enter into a contract must be: (i) an entity legally registered in Cambodia; or (ii) a foreign commercial firm registered in Cambodia or that has a special purpose company registered in Cambodia; or (iii) a public organization that has been specially delegated power in accordance with other laws and regulations.

Thus, in conjunction with our discussion in section above, the two possible forms for a foreign investor to undertake an ODA project in Cambodia are a branch or a subsidiary. The LCE permits a branch to *“regularly buy and sell goods and services and engage in manufacturing, processing and construction the same as a local company except any acts that are prohibited for a natural or legal person who is a foreigner.”* Since the law expressly permits a branch to carry out construction services, setting up a branch is a common option for a foreign construction contractor to construct projects in Cambodia. On the other hand, a subsidiary enables the foreign investor to conduct any business that is not restricted for foreign investment.

In addition, bidders of ODA projects should carefully check the bidding documents for any special requirement regarding the form of entity.

PARTICULAR ISSUES FOR BIDDERS

In this part, we will look at the PPP Law and its SOP for guidance. The PPP Law provides that by default, the selection of the private partner for solicited projects will be



implemented through a competitive bidding methodology. Direct negotiation or selection may only be used with the approval of the Cambodian government.

Bidder criteria

The qualifications for bidders will be set out in the project information memorandum for each project. The SOP provides some sample bidder criteria, which are subject to change depending on the specifications of the particular project. According to the sample project information memorandum provided in the SOP, we summarize below the following criteria for bidders at the pre-qualification stage:

- Is an individual or legal entity duly registered in its home country; or a consortium comprised of the aforesaid parties.
- Of the bidder, a consortium member, or a contractor, at least two of the three meet the technical qualifications.
- Has past experience of 15 years in the required field, relevant experience in operations and maintenance, a certificate of past project completion, etc.
- Has the required certification, e.g. ISO 9001/ISO 14001 certification, certificates of key personnel.
- Has the required financial capability qualifications.

In principle, no restriction should be imposed on the ownership structure of a pre-qualified bidder, subject to the existing laws of Cambodia.

Two-step bidding procedure

The default procedure for the selection of bidders is a two-stage, two-envelope process with pre-qualification bidding. One exception is that for projects costing US\$50 million or less, the head of the implementation government agency (“IA”) may use a single-stage, two-envelope process without pre-qualification bidding.

The difference between the single-stage process and the two-stage process is that the latter includes the extra step of a pre-qualification exercise. Under this, before bidders submit their bid, the IA will first call for submission of pre-qualification documents to verify potential bidders that meet the predetermined criteria. Typically, it will shortlist three to five prospective bidders as pre-qualified and only issue tender documents to those shortlisted bidders. This means that bidders who miss the pre-qualification step will not be eligible to participate in the subsequent bidding process.

Therefore, bidders should pay attention to the bidding procedures used for the specific project and ensure they don't miss the pre-qualification stage.

Pre-qualification conference and pre-bid conference

In the two-stage process, the IA will hold two conferences with bidders: one before submission of the pre-qualification documents, usually within 30 days from the publication of the invitation to pre-qualify; the other before submission of

the bid, usually within 14 to 45 days from issuance of the bidding documents. Both conferences allow bidders to raise questions with the IA to clarify the terms of the bidding documents and criteria. The IA will prepare minutes of the conference, have the bidders who attend the conference sign the minutes, and provide a copy to them.

These conferences may lead to amendment of the pre-qualification criteria or the bidding documents. Therefore, bidders should ensure that they attend the conferences and maintain records of them.

Technical and financial evaluation of the bid

According to the SOP, the bidding documents will prescribe the weight assigned to the technical bid and the financial bid—normally 30% for the technical bid and 70% for the financial bid. The maximum total score is normally 1,000; thus, usually the maximum total score for the technical bid is 300 and the maximum total score for the financial bid is 700. The evaluated score between the technical bid and the financial bid may be adjusted based on this ratio.

Bid security

The amount of bid security will vary depending on size of the project. The amount should be reasonable, normally not exceeding US\$1 million. The validity period of the bid security will be at least 60 days after the expiry of the bid validity period.

Issues for bidders before submitting a tender or signing a contract

Timeline of the bidding process

Although the PPP Law and the SOP do not provide a detailed timeline for each phase in the whole project cycle or for the bidding process, occasionally, they indicate the timeline for a particular step. Consequently, there is not a complete timeline for the full project cycle. Based on current practice and our experience, the procurement of bidders and the contracting process will take about three to six months.

Time limitation for negotiation of the contract

Upon selection of the highest-ranked bidder, the IA will commence negotiation with that bidder to conclude the project contract. It is expressly provided in the PPP Law that if the negotiations cannot be completed within six months from the date the bidder was invited to begin negotiations, the IA may invite the next-ranked bidder to negotiate the contract instead.

Although this is not a compulsory rule for termination of negotiations with the original bidder, it is advisable for bidders to conclude negotiations as quickly as possible.

Establishment of the project entity

While a foreign entity may participate as a bidder, it will usually be required to establish and register an entity in Cambodia when it comes to performance of the project

contract. It is not necessary to form the entity in Cambodia before signing the project contract. The SOP allows the winning bidder to complete establishment of the entity within a maximum of 60 working days after the signing of the project contract. In such a scenario, the newly-established entity will sign a novation agreement with the winning bidder to assume all of the bidder's rights and contractual obligations under the project contract within 14 working days after the entity is established.

It is also worth noting that a number of actions will be required to be undertaken by the IA and the winning bidder's project entity before the construction of the project can commence. For example, the project entity will need to complete the detailed engineering design, obtain the environmental approvals, enter into a construction contract with the main contractor, and other such conditions. Similarly, the IA will need to approve the detailed engineering design within a given timeframe, provide the agreed land for commencement of construction, and such other conditions. Therefore, the winning bidder needs to work with the IA closely to observe the deadlines.

Governing law and dispute resolution

The PPP Law requires all PPP contracts to be governed by Cambodian law. However, the private partner may select the governing law applicable to any ancillary agreements relating to implementation of the PPP contract, unless a public entity of Cambodia is a party to such agreement.

The PPP Law does not restrict the type of dispute resolution mechanism used for disputes arising between the IA and the private partner. The dispute resolution mechanism will be negotiated and stipulated in the PPP contract. In practice, we have seen foreign arbitration clauses being accepted by

the Cambodian government. The parties may also agree on a different mechanism when the dispute involves a foreign entity (e.g. international arbitration), or when it only involves Cambodian entities (e.g. domestic arbitration).

WHAT ARE THE TAX OBLIGATIONS FOR AN ODA PROJECT?

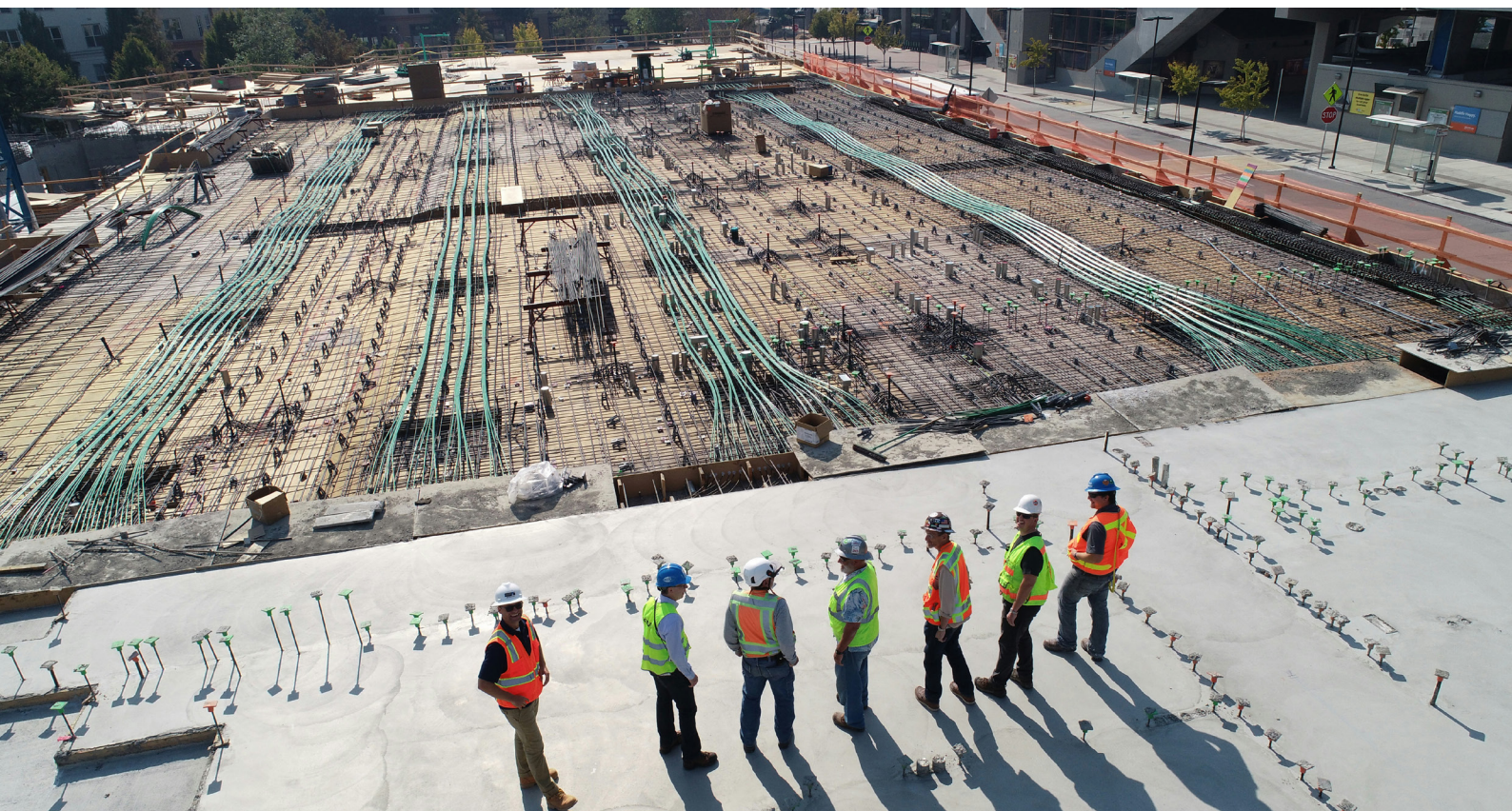
ODA encompasses bilateral and multilateral aid provided to developing countries such as Cambodia. Bilateral aid, specifically designed to assist nations directly, involves financial and investment cooperation, often in the form of concessional loans and grants. Notably, the Japan International Cooperation Agency ("JICA") offers concessional loans as part of its ODA, providing vital long-term, low-interest financing for development endeavors.¹

Many of these development projects in Cambodia receive backing through concessional loan agreements established between JICA and the Royal Government of Cambodia. Consequently, within the framework of these ODA projects, specific tax exemptions are granted to facilitate smoother implementation and foster economic growth.

Scope of ODA project tax exemptions

The tax exemptions within the framework of an ODA project in Cambodia are specifically tailored to facilitate the project's success. These exemptions usually encompass: (i) duty-free import and re-export privileges for construction materials, tools, and equipment needed for implementing the ODA

¹ JICA. "Official Development Assistance (ODA) and ODA Loans." Accessed on 19 February 2024 and retrieved from: https://www.jica.go.jp/english/activities/schemes/finance_co/overseas/index.html.





project; (ii) value added tax exemption for the project bidder and its direct subcontractors on transactions directly tied to the project benefit; (iii) withholding tax (“**WHT**”) and corporate income tax exemptions for the project bidder on income earned under the project scope; and (iv) Tax on Salary (“**TOS**”) and Fringe Benefit Tax exemptions for the employees of the project bidder working on the ODA project.

However, it is crucial to note that these exemptions only apply to activities directly related to the ODA project. Transactions beyond this scope are subject to tax under Cambodia’s tax laws and regulations. Therefore, understanding the scope of the tax exemptions under the ODA project is crucial for investors to ensure compliance and leverage the financial benefits.

Tax obligations for ODA project participants

Under Cambodia’s Law on Taxation dated 16 May 2023 (“**LOT**”), companies involved in project implementation through an ODA agreement, whether in the form of a branch or a subsidiary, are subject to specific tax obligations. Registration for tax purposes is mandatory for entities organized, managed, or having their principal place of business within Cambodia. This registration involves obtaining a tax identification number for unique identification in all tax-related matters. These entities are further obligated to file both monthly and annual tax returns to comply with Cambodia’s tax laws and regulations. The tax year in Cambodia runs from 1 January to 31 December, and tax returns are due by 31 March of the following year.

In cases where the tax exemptions under an ODA project do not apply, companies are obligated to withhold TOS, FBT, and WHT on certain payments. For instance, if a project bidder’s branch that is engaged under an ODA project to construct a road, employs a salesperson for business development unrelated to the project, the branch is required to deduct, withhold, and pay TOS and FBT on behalf of that salesperson.

Tax authority’s challenge: WHT on branch profit remittance

In light of recent tax dispute cases, ODA bidders, particularly those operating as branches in Cambodia, should be vigilant regarding profit remittance to their headquarters in Japan. One significant issue arises from tax audits conducted by the General Department of Taxation (“**GDT**”), as exemplified by the recent case involving the imposition of WHT on assumed dividend payouts.

In these cases, the GDT asserts that the transfer of profits from the branch to its head office should be treated as dividends. This implies that the branch, as a separate legal entity, is distributing profits to its parent company, like dividends paid to shareholders. Consequently, the GDT seeks to levy WHT on these assumed dividends, which is a tax withheld by the payer (the branch, in this case) on behalf of the recipient (the head office) and remitted to the GDT.

However, this approach is contentious, especially in the context of branches of foreign companies involved in ODA projects. As per Article 271 of the LCE, branches are not distinct legal entities from their head offices but rather extensions of the same entity. Therefore, the transfer of profits from a branch to its head office does not constitute dividends, since dividends are payments made to shareholders, and a company cannot pay dividends to itself.

This dispute underscores the importance of clarifying the legal and economic substance of profit remittances in the context of ODA-funded projects to avoid unnecessary tax burdens and ensure compliance with tax regulations.

Tax authority's challenge: TOS for foreign employees under ODA projects

In certain tax dispute cases, the GDT has initiated reassessments challenging TOS for Japanese (or other foreign) employees within the framework of ODA projects. These reassessments often hinge on assumed salaries, with the GDT considering that the monthly income should be higher than the actual figure. For example, a GDT audit might assume a monthly salary of US\$3,000 for a Japanese employee when the actual salary is US\$1,500. In other instances, suspicions may arise about members of a board of directors receiving salaries when, in reality, they are not.

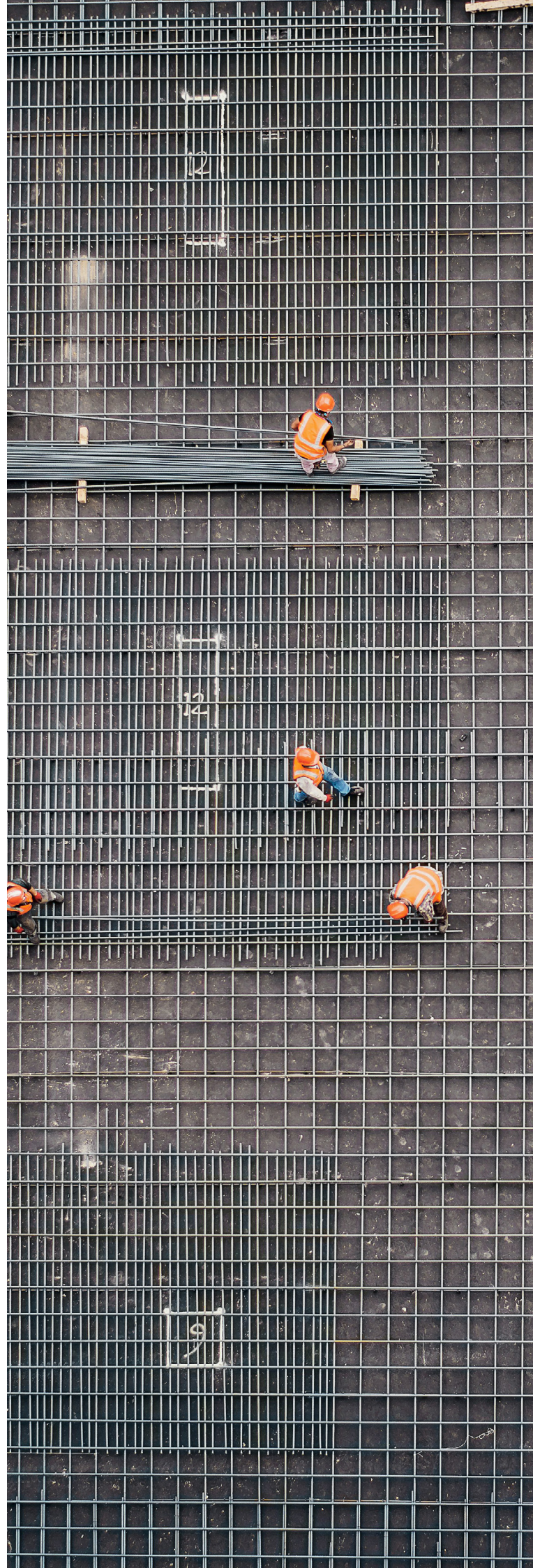
However, the LOT clearly outlines provisions emphasizing the use of actual income for tax assessments. Article 42(6) specifically defines Cambodian-sourced salary as wages earned within the country, emphasizing the importance of relying on actual income rather than inflated assumptions. Additionally, Article 46 highlights the taxable monthly salary for resident employees, which includes the total amount earned from both Cambodian and foreign sources. These emphasize that actual income should be used for determining the taxes owed. Imposing TOS based on assumed, unearned income contradicts this fundamental principle of salary paid by an employer to an employee.

Thus it is important for ODA project participants to be aware of these issues to ensure compliance with the LOT and mitigate the tax risks associated with GDT challenges on TOS for foreign employees.

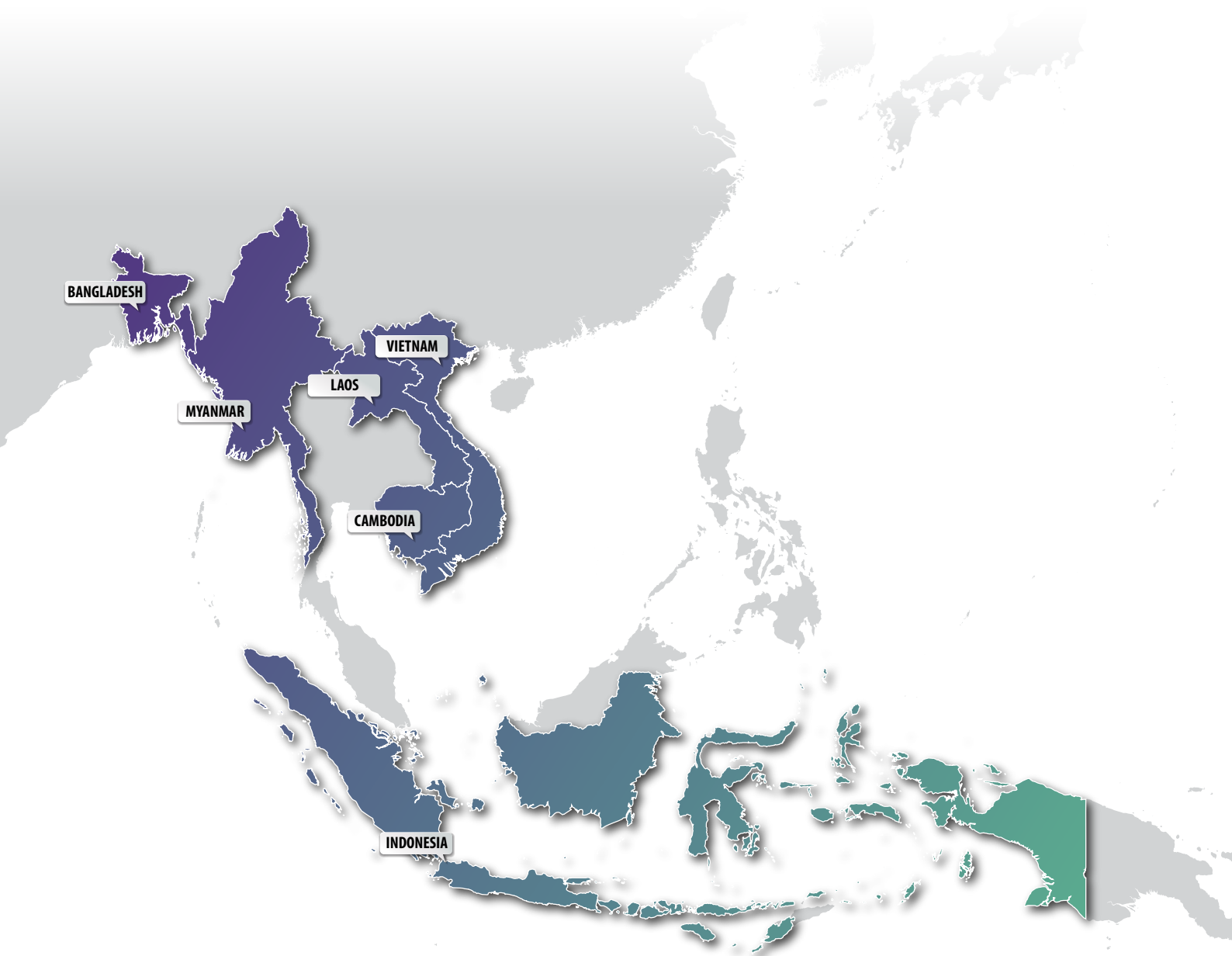
QUALIFICATIONS

The laws and regulations of Cambodia are not systematically published, including directives and instructions, and may be supplemented or contradicted by undocumented practice. Such practice may not have been ruled upon by the courts or enacted by legislative bodies and it may be subject to change without notice.

Our legal and tax advice is based on our understanding of Cambodian laws, regulations, and official practice. Importantly, it cannot be excluded that the authorities or the courts will adopt an interpretation or application of the law that is not in accordance with our advice.



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