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CAMBODIA POISED TO CLARIFY PROFIT ATTRIBUTION AND TRANSFER PRICING OF CROSS BORDER SHIPPING INCOME

April 2024



Get to the point.

INTRODUCTION

The determination and taxation of the Cambodian sourced income of international shipping liners has long posed problems in this dynamic Southeast Asian country. As a longstanding manufacturing hub, imports of raw materials and export of finished and semi-finished products are hallmarks of Cambodia's robust economy.¹ However, the taxation of shipping lines has been an area of uncertainty and concern for many years. This was not alleviated when Cambodia introduced transfer pricing ("**TP**") in 2017 by means of Prakas 986.

In this note we discuss the source of the uncertainties between the shipping liners and the Cambodian tax authorities ("**the GDT**") and the way forward this author has proposed to and is discussing with the authorities. We will update the readers again on the progress of the new draft regulation once it has been issued.

HOW ARE GLOBAL SHIPPING LINES TAXED IN CAMBODIA?

Most of the global liners have over the years opened a subsidiary or a branch in Cambodia, and a minority has at least an independent agent in the country. This evolution was prompted by, besides economical and commercial reasons, the need at the time to issue invoices to clients with a local entity to avoid a hefty withholding tax of 14% on service fees paid to non-residents.² Accordingly, the model most liners follow is that the Cambodian subsidiary invoices the final customer as an agent of the liner (if in Cambodia) for Ocean Freight, Terminal Handling Charge, Document Fees and other parts of the income), and the non-resident liner invoices the same to the Cambodian subsidiary, Separately

1 Cambodia had one of the highest GDP growth rates in the region. The World Bank put Cambodia's GDP growth pre-COVID at 7.1%, exceeding its larger neighbor Thailand (2.4%), closely approximating that of Vietnam (7.4%) <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=KH-VN-TH>

2 Nowadays, the GDT no longer claims that the general 14% for services paid to non-residents applies to income for ocean freight.

or as part of the same transaction, the non-resident liner also pays a compensation to its Cambodian subsidiary agent ("**the Subsidiary**"). This agent compensation is sometimes based on cost plus over the agent's expenses, sometimes as a percentage of the gross income involved, or with fixed amounts per type of cargo. In reality, the Subsidiary usually does not do anything much besides this re-invoicing, although some larger offices also provide some import or export services or customer support services.

Cambodia has no special tax regime or tax rate for income from international transportation. Non-resident shipping lines are subject to the same tax rules as other non-residents, meaning that they are taxed on business income derived through a PE in Cambodia, or on income from services paid from or performed in Cambodia. No detailed guidance existed on how to determine the income of the agent subsidiary. Prakas 986 is a general TP regulation adopting a heavily simplified OECD approach to the arm's length principle.

Subsidiaries have generally only included in their income tax returns whatever income they were entitled to under the agency agreement. As mentioned, this was generally a modest service fee based on cost plus, or a modest percentage of the gross income that ran through the invoices of the Subsidiary, or a fixed fee.

The GDT has never really agreed with that approach. The response in tax reassessments following tax audits has not been entirely uniform or harmonized, but in most cases the GDT would reassess a part of the income that was paid to the non-resident liner either as income realized through a PE in Cambodia (for which the Subsidiary is responsible) or, if the income was booked as turnover, through disallowing the payment to the liner as an expense. The liners, on the other hand, cannot agree with this approach, citing that the tax impost is unreasonably high and not based on any clear legislation or regulation.

The end result is a confusing situation rife with uncertainties and many, many unresolved tax disputes. To escape the deadlock, this author proposed to jointly draft a new Prakas with the GDT. Below we discussed a few features of the new Draft Prakas.



ATTRIBUTION OF INCOME TO THE AGENT AND THE PE?

From the outset, the GDT took the view that two incomes need to be recognized: firstly the income of the Subsidiary Agent and, secondly the income of the PE of the non-resident liner, if any. The GDT also took the view that the mere involvement in the Cambodian market of the liner suffices in most cases to deem there is a PE³.

Our suggestion was that from a TP perspective, given the limited administrative activity carried out by the Subsidiary, and based on the OECD thoughts on the attribution of income to a PE the activity of the Agent and the PE are one and the same, and it is not possible to assign two incomes to Cambodia under these circumstances. As was pointed out in the OECD's Report on the Attribution of Profit to PEs: *"there is no presumption that a dependent agent PE will have profits attributed to it. In some circumstances, the functional and factual analysis may determine that the amount to be attributed to the dependent agent PE is negligible"*.⁴

The GDT will most likely go ahead with requiring two separate income streams, but it has agreed to lower the effective tax burden by providing a low deemed profit rate as a safe harbor.

IS COST PLUS METHOD ACCEPTABLE IN THIS CASE?

The determination of the arm's length compensation for the Subsidiary agent was a second topic of discussion for several months. Our suggestion was that a cost plus 5% was internationally acceptable and even on the high side for intra group services of a simple administrative services.

The GDT took the view that some groups have marketing activities as well in Cambodia, or perform or arrange for high value import and export services such as assistance with customs clearance.

The GDT will likely adopt several options based on the activity of the Subsidiary.

VARIOUS TAX AND TRANSFER PRICING PROBLEMS TO BE RESOLVED FOR LINERS

Besides the above mentioned issues, the GDT is likely to address a few other long standing issues in the Draft Prakas such as:

- Approval for use of receipts that do not meet all conditions for tax invoices to some degree;
- Confirmation that no additional withholding taxes apply to the income of liners;
- Confirmation of format and assumptions of TP report for logistics and shipping companies.

³ *It is indeed correct that Cambodia's law on Taxation provides in a far more extensive PE concept compared to the OECD or UN Model DTA. Any "connection" or "facilitation" may trigger a PE, and independent agents may also constitute PE's. In many cases it may be difficult to maintain that a Subsidiary which is collecting income for the liner does not constitute a PE under Cambodian domestic tax law.*

⁴ *OECD, as cited page 66.*

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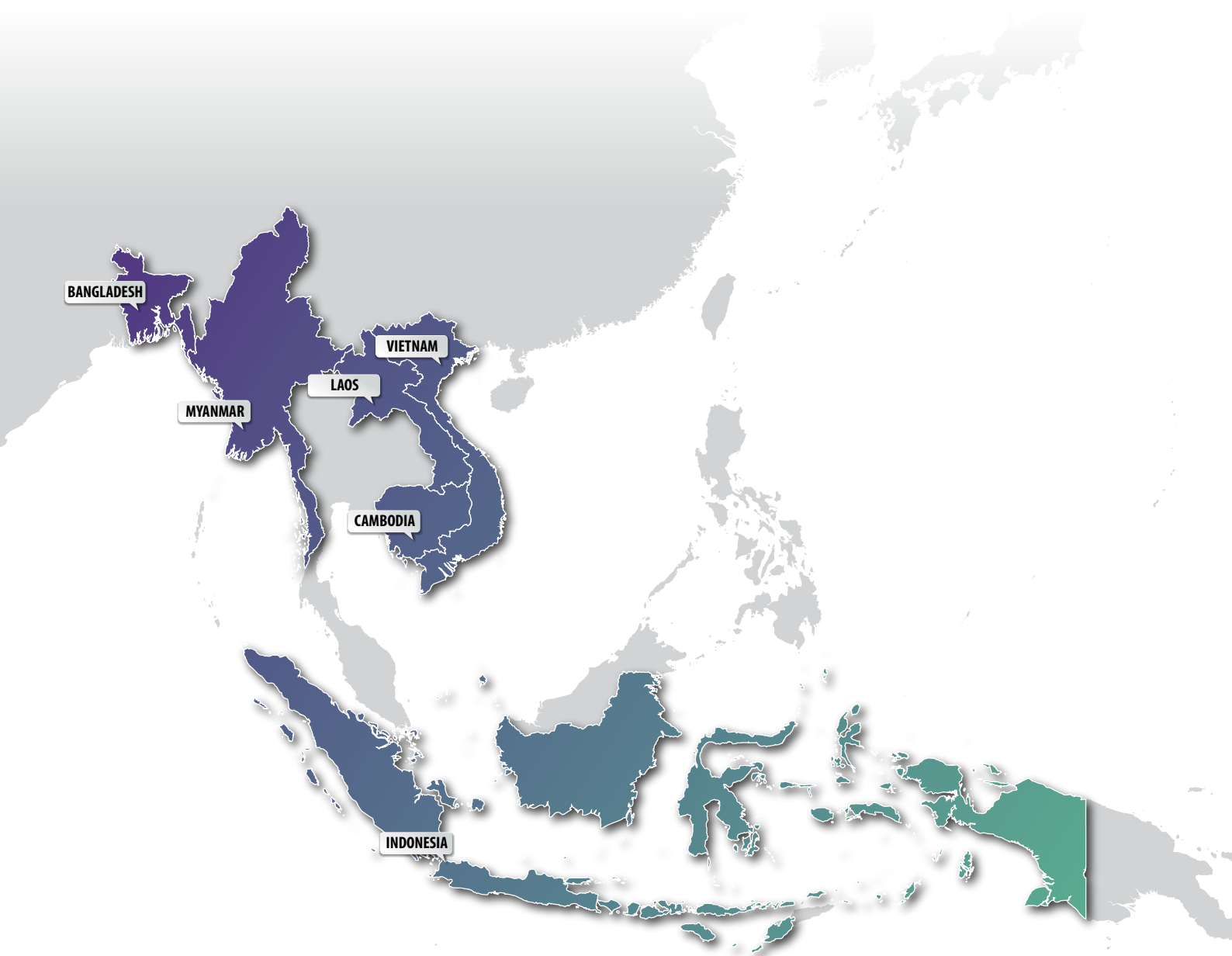
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Edwin Vanderbruggen is the Senior Partner of Andersen member firms VDB Loi Vietnam and Cambodia, and of collaborating firms VDB Loi Laos and VDB Loi Myanmar. Formerly a full-time adviser to the tax authorities in Cambodia, he has consulted for the World Bank, UNDP, the IFC and JBIC and trained tax authorities in Thailand, Myanmar and Singapore. He lectured at IPO Ufsia University (Belgium), International Tax Center Leyden (The Netherlands), Chulalongkorn University and Assumption University (Thailand), RULE University (Cambodia) and CFVG University (Vietnam). He published 9 textbooks, including the first scholarly works on TP in Thailand and international taxation in Vietnam, and over 60 scholarly articles in peer reviewed journals such as British Tax Review, Intertax, The Bulletin of International Taxation, EC Tax Review and the Asia Pacific Journal of Taxation.

Edwin leads the dedicated TP team in the region which services mostly multinational enterprises and other foreign owned companies. He also assists tax authorities in the Indochina region with TP regulation and implementation.

Edwin's hobby is Muay Thai (Thai boxing) and he is a noted movie buff. His all-time favorites are "The Godfather" and "Platoon".

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