



Cambodia tax alert—Cambodia Transfer Pricing Guidelines

United in purpose

The Ministry of Economy and Finance (MEF) of Cambodia has issued Prakas No. 986 (“the Prakas”) dated 10 October 2017, which focuses on the interpretation and procedure on income and expenses allocation among related parties, local, and cross-border entities. This is the first Transfer Pricing Guidelines published by the MEF. The MEF has adopted and followed the arm’s length principle from the Organisation for Economic Co-operation and Development (OECD)’s Transfer Pricing Guidelines. The Prakas covers key issues such as the application of the arm’s length principle; comparable transaction; transfer pricing methods; specific guidance on intangible property and intra-group services; documentation; and penalty for non-compliance.

Transfer pricing overview

A transfer price refers to the price by which goods, services, and property are transferred between related parties. Pricing of related party transactions can shift benefits from one related party to another through an increase or decrease of the price of goods, services, and property, which are not at market value or at the arm’s length price of an uncontrolled transaction.

Definition of related parties

Under the regulation, the term "Related Party" refers to:

1. Any member of the taxpayer's relatives.
2. An enterprise who controls or is controlled by, or is under common control with the taxpayer. The term "Control" means the ownership of 20 percent or more of direct equity share of an enterprise or voting power in the board of directors of the company.

Application of the arm's length principle

To follow the arm's length principle, the comparability analysis conducted to assess the arm's length nature of the controlled price must meet one of the two conditions below:

- The comparable transaction has no significant difference that can affect the market price.
- Reasonably accurate adjustments can be made to eliminate effects of the significant difference.

Arm's length range and transfer pricing adjustment

The arm's length range is a set of finance-related indicators (i.e., price or profit margin) determined from comparable uncontrolled transactions upon applying the appropriate transfer pricing method. The controlled transaction shall not be adjusted if its finance-related indicator falls within the arm's length range. In contrast, if the finance-related indicator falls outside the arm's length range, the indicator shall be adjusted through the median of the arm's length range.

Transfer pricing methods

To comply with the arm's length principle, taxpayers can use one or more of the methods provided as follows:

- Comparable Uncontrolled Price (CUP)
- Resale Price Method (RPM)
- Cost Plus Method (CPM)
- Transactional Net Margin Method (TNMM)
- Profit Split Method (PSM)

The taxpayers must prepare and provide evidence and supporting documents to justify the appropriateness of the methods used. In case there is insufficient reason to prove suitability of the selected method, the tax authority has the right to determine the appropriate method that should be followed by the taxpayers.

Ownership of the intangible property

For intangible property managed or used within related parties, determination of ownership must follow the steps below:

1. Determine economically significant risks such as development, enhancement, maintenance, protection, and exploitation of the intangible property that is managed or used in operation.
2. Inspect the agreement to determine legal ownership by examining registration conditions, licensing terms, and other legal documents that prove the legal ownership as well as other rights and obligations including significant risk plan within related parties.
3. Analyse functional practices, property usage, and risk management of each party associated with the development, enhancement, maintenance, protection, and exploitation of intangible property to identify the party that is responsible for managing external functions and significant economic risks.
4. Examine consistencies between agreement conditions and actual practices of each party.
5. Prove that actual controlled transaction is involved with the development, enhancement, maintenance, protection, and exploitation of the intangible property.
6. Determine arm's length price for those transactions in order to be consistent with function, asset, and risk profile of the parties involved.

For transactions involving intangible property, the arm's length compensation for all the parties involved should entitle enterprises to a share of the benefits depending on their actual practices. This includes a sharing based on the expenses and investment borne by the party in question, in relation to the development, enhancement, maintenance, protection, and exploitation of the intangible property.

Intra-group services

All documents pertaining to intra-group service transactions must be prepared for transfer pricing purposes. In analysing the services provided to a related party, the following must be examined:

1. Determine if actual services are performed.
2. Determine if the service fee is conducted at arm's length.

The analysis of the supported service fee requires a functional analysis of intra-group members in order to determine the relationship between services and relevant actions of the members. The setting of an arm's length price for services

within intra-group must be in accordance with any conditions stated in comparable conditions, arm's length range, and transfer pricing methods.

Documentation

Taxpayers are required to issue invoices for all transactions; and record and keep accounting records, legal letters, and other financial documents as determined by the relevant tax provisions. These documents must be kept for 10 years from the tax year end and shall be submitted as required by the tax authority.

More specifically, taxpayers with related party transactions are required to prepare, but is not limited to, the following documents:

1. General information of enterprise and related parties (related parties' structure, business strategies, etc.)
2. Information about the related party transaction/s (transaction documents including supply, transport and payment, product, agreement, etc.)
3. Transfer pricing method information (pricing policy, market information, documents supporting the selected transfer pricing method, and other related documents, etc.)

Some information of the related parties are required to be filled in the Tax on Profit (TOP) return. Moreover, the documents above must be submitted to the tax administration when the tax administration requests the entity to do so.

Penalty

In case of non-compliance with the documentation requirements above, the tax authority can either:

1. Revoke the certificate of tax compliance of the entity;
2. Re-evaluate the certificate of tax compliance and penalise the entity in accordance with Article 133 of the Law on Taxation of Cambodia; or
3. Sue the entity for criminal tax offenses and penalise them as provided in Article 134 to 138 of the Law on Taxation.

Deloitte's view

This is a major regulatory development in Cambodia's tax and transfer pricing environment.

With formal guidelines and procedures on mandatory documentation requirement, transfer pricing methods and penalty for non-compliance, the MEF has sent a clear message with regard to the enforcement of transfer pricing regulations.

The taxpayers should note the following significant points:

- **Deadline of submission of the required transfer pricing documents:** There is no specific deadline mentioned in the Prakas. However, taxpayers need to retain the required transfer pricing documents and submit it to the tax administration when it is required or requested to do so. Thus, the documents must be prepared in advance of the TOP return submission deadline in order to avoid or minimise possible risks associated with transfer pricing audit and to complete information required to be disclosed in the TOP return.
- **Database used for benchmarking:** There is no specific provisions in the Prakas that states the required database needed for benchmarking analysis. However, in most countries, the local database is the primary source of information. If the local database cannot be utilised, a regional database shall be allowed to be used. In Cambodia, due to the lack of a local database and financial information for benchmarking purposes, confirmation from the tax authority shall be secured to ensure that regional databases may be used.
- **Selective tested year:** The Prakas did not clarify whether single or multiple year data should be used. However, based on the OECD guidelines, multiple year data should be used to enhance the reliability of comparability analysis. Most of the countries use three to five year data for benchmarking purposes.
- **Arm's length range:** There are no specific instruction on the arm's length range in the Prakas. However, based on the example stated in the Prakas, full range (minimum to maximum) as opposed to interquartile range (25% to 75%) was used by the tax administration. There is still a need for confirmation from the tax administration with regard to this issue.
- **Loan transaction:** Interest rate on related party loan transactions must be set according to the arm's length standard. Thus, the Circular No. 151, issued on 22 January 2014, which provides that interest expense can be charged lower than the market rate or even at a zero rate, shall be superseded by the Prakas.
- **Previous year transaction:** The Prakas is not clear on whether the previous year transfer pricing documentation should be prepared and accepted by the tax authority. Hence, clarification from the tax administration is also needed for this point.
- **Advance Pricing Arrangements (APAs):** APAs are agreements between the taxpayers and the tax authorities in one or more jurisdictions attempting to prevent transfer

pricing disputes on arm's length principle. The Prakas has not covered this matter yet.

Deloitte will seek additional clarifications on the above points to provide you with a thorough understanding of Cambodia's transfer pricing guidelines, and we will keep you updated of any developments.

Deloitte Southeast Asia has transfer pricing specialists in Cambodia who can deal with transfer pricing matters including transfer pricing documentation, consultancy, and audit.

If you have any questions, or need assistance on the above matter, please contact:

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