International Tax Alert
China and Cambodia - Agreement for the Avoidance of Double Taxation

Greeting from your tax team at Deloitte Cambodia and Deloitte China. We are pleased to update you on the following tax development:

Signing of China-Cambodia Tax treaty

China and Cambodia signed an Agreement for the Avoidance of Double Taxation (DTA) on 13 October 2016. The purposes of this DTA are mainly to increase the cross-border trade and investment and to improve the mechanism for tax collection between the two countries. Once ratified, the DTA provides for, amongst others, reduced withholding tax on dividends, interest, royalties and service fees. There are also provisions to resolve treaty disputes through mutual agreement and to exchange information on tax matters as well as procedure for termination of the treaty.

Highlights of the treaty from the perspective of a potential China tax resident investor into Cambodia include:

Permanent Establishment (Article 5)

The treaty provides for the following time tests (within which it can be argued that a permanent establishment (PE) in Cambodia does not exist) for the following activities:

(i) Nine months or less for a building site, a construction, assembly or installation project, or supervisory activities in connection with the aforementioned activities; and

(ii) 90 days or less within any twelve-month period for the operation of the substantial equipment for exploration or for exploitation of the natural resources in Cambodia;

Broadly, income from the carrying on of business through a PE in Cambodia is subject to Cambodian income tax at the prevailing tax rate of 20%. Due to the operation of Article 13 (Fees for Technical Services), income arising from the activities mentioned in item (ii) above may be taxable in Cambodia via the withholding tax mechanism.

On top of the above, the Article 5 does not comprise the provision for services (including the consultancy services) by enterprise of China through the employees or other personnel engaged by such enterprise in Cambodia to determine the PE. With this regard, it is less likely that such service could constitute the PE of the enterprise of China.

Dividends, Interest and Royalties (Articles 10, 11 and 12)

Cambodia levies withholding tax at the rate of 14% for payments of dividends, interest and royalties to non-residents and these are broadly reduced to 10% under the DTA if the conditions are met. In addition:

- *Dividends*

  The reduced withholding tax rate of 10% is also applicable to Additional Tax on Dividend Distribution (APTDD)[1]. Briefly, APTDD is applicable on the distribution of profits that were subject to tax in Cambodia at rates lower than the prevailing corporate tax rate of 20%.

  Therefore, the effective tax rate for a China resident investor company on the dividends distributed from a Cambodian company out of its retained earnings that have not been subject to tax in Cambodia (e.g., where a Qualified Investment Project, or QIP, distributes dividends derived during the tax holiday period) will not exceed 10%.

  As a comparison, should there be no tax treaty, the same dividends distributed from the Cambodian company to a China resident investor company will be subject to the APTDD at a rate of 20% as well as a 14% withholding tax, leading to an effective tax rate of 34%.

  In addition, an underlying tax credit is available to a China resident investor company that owns, directly or indirectly, not less than 10%[2] of the share capital of the Cambodian dividend paying company.

- *Interest*

  While the reduced withholding tax rate of 10% is applicable to interest payment from a Cambodian company to a China resident company, a full exemption of Cambodian withholding tax is provided to interest paid by a Cambodian

1 Article 2(3)(a)(i)
2 Article 23 (1)(b)

company to financial institutions mainly owned (i.e., the ownership exceeds 50 per cent) by the Government of China.

Therefore, interest to be paid by Cambodia companies to Chinese state banks on favourable loans granted to large-scale infrastructure projects such as high-speed railways and airports in Cambodia will be able to enjoy the exemption of withholding tax in Cambodia.

- *Royalties*
  Payments made for the use of industrial, commercial or scientific information are included under the definition[3] of royalties.

We also note that:

The reduced rates under the treaty are not available to the portion of the payments that are regarded as excessive owing to a 'special relationship' between the payer and payee[4]. The treaty does not provide additional clarity on what constitutes a 'special relationship' and whether this clause can be invoked in instances of transactions between unrelated parties.

Fees for Technical Services (Article 13)

"Fees for technical services" are defined as payment of any kind in consideration for the rendering of any managerial, technical or consultancy services, including the provision by the enterprise of the services of technical or other personnel, but does not include independent personal services to which Article 15 applies.

The DTA reduces the withholding tax rate in Cambodia from 14% to 10%, unless such services are rendered through a PE in Cambodia (in which case such income, net of allowable expenses, should be taxed at 20%). Likewise, the reduced rates do not apply to the portion of the payments that are regarded as excessive owing to a 'special relationship' between the payer and payee.

Capital gains (Article 14)

Cambodia does not have a separate capital gains tax. Gains arising from the disposal of, amongst others, shares are treated as ordinary income for the purposes of Cambodian income tax and is subject to tax at the prevailing tax rate.

Potential investors would be interested to note that gains arising from the disposal of shares in a Cambodian company (if regarded as sourced in Cambodia) should prima facie be sheltered from Cambodian income tax under the DTA, provided the company is not 'land-rich[5]'.

Highlights of the treaty from the perspective of a potential Cambodia tax resident investor into China include:

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3 Article 12(3)
4 Articles 11(7), and 12(6)
5 Defined in Article 14(4) as shares that derive more than 50% of their value directly or indirectly from immovable property situated in Cambodia.

Permanent Establishment (Article 5)

A nine-month threshold is not commonly seen in tax treaties concluded by China with other countries (normally six-month) for a building site, a construction, assembly or installation project, or supervisory activities in connection with the aforementioned activities, thus the DTA provides a favourable tax treatment to Cambodian companies carrying out construction and assembly/installation etc. activities in China.

With regard to provision of services (including the consultancy services) by enterprise of Cambodia through the employees or other personnel engaged by such enterprise in China, the Chinese tax authority generally will determine whether a PE is constituted before deciding whether income tax will be imposed.

Since Article 5 does not provide a threshold of duration for determining PE of services, it is likely that such services could constitute PE in China with 25% income tax levied on profits arising from the services, regardless of the duration of services.

Dividends, Interest and Royalties (Articles 10, 11 and 12)

According to China Enterprise Income Tax Law (EIT Law), payments of dividends, interest and royalties (including rental of equipment) to non-residents are subject to withholding tax at the rate of 20%. Based on the prevailing implementation rules of EIT Law, the withholding tax rate is reduced to 10%, which is the same as the rate provided by the DTA.

Fees for Technical Services (Article 13)

As discussed above, China generally levies 25% income tax rather than withholding tax on income derived by non-residents by rendering of managerial, technical or consultancy services. Therefore, the 10% withholding tax rate provided in the DTA may not be applicable to such services rendered by Cambodian tax residents in China.

Capital gains (Article 14)

China imposes 10% income tax on gains received by non-resident companies from the disposal of shares in Chinese companies.

Potential Cambodian investors would be interested to note that gains arising from the disposal of shares in a China tax resident (unless 'land-rich[6]' in China) should be sheltered from China income tax under the DTA, regardless of shareholding percentage of the investor. Such a treatment on capital gain tax is also very favourable as compared to most tax treaties concluded by China and other jurisdictions.

Deloitte's view

This DTA is significant as it is Cambodia's second bilateral tax treaty and should be of great interest to taxpayers considering

6 Defined in Article 14(4) as shares that derive more than 50% of their value directly or indirectly from immovable property situated in Cambodia.

potential investments into Cambodia and transactions with Cambodia parties.

We understand that Cambodia is also pursuing further tax treaties with her ASEAN[7] neighbours, Japan and South Korea. Early this year, Cambodia signed DTA with Singapore (not yet effective). Going forward, we foresee that Cambodia would look to expand her treaty network beyond ASEAN, especially with significant trading partners such as United States[8] and other European countries.

The administrative procedure for the DTA's implementation in Cambodia and China (upon ratification) is likely to take some time to develop. On a practical note, the interpretation of certain Articles in the treaty (such as Article 8 International Transport) by Cambodia may require additional clarification especially where there is no comparable equivalent provision under Cambodia's domestic tax legislation.

Contacts

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7 Association of Southeast Asian Nations comprising Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.
8 Top export destination