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Cambodia | Tax and Advisory Services | 5 August 2019

Cambodia tax alert
Seniority Indemnity Payments Now Required

Overview

New Article 89 of the Labor Law (LL) has replaced Cambodia's dismissal indemnity regime with a seniority indemnity regime, which is a significant change in the domestic labor law landscape. The new law, which is effective as from 2019 onward, requires an employer to compensate all employees who have open-ended employment contracts (called contracts of undetermined duration (UDC) in the law) with seniority indemnity payments instead of making a dismissal indemnity payment.

Seniority indemnity payments represent better labor protection for Cambodian employees. Previously, the dismissal indemnity was applicable only if an employee was unilaterally terminated (except in cases of serious employee misconduct) with a one-time indemnity payment made at the termination of the employment depending on the length of employment and up to six months of wages and other benefits. Under the seniority indemnity regime, an employer is required to pay an employee up to 15 days of wages or salary and other benefits biannually (i.e. in June and December 2019 onward). The seniority indemnity does not need to be paid where an employee resigns or is terminated due to serious misconduct.

Announcements and instructions addressing the seniority indemnity payment regime clarify earlier guidance (Prakas 443 from the Ministry of Labor and Vocational Training (MLVT) dated 21 September 2018) and explain how the regime applies before and after 1 January 2019.

Seniority indemnity back payments for periods before 2019

Pursuant to Prakas 443, for periods prior to 2019, seniority indemnity back payments for employees working in the textile, garment and footwear sectors equalled 30 days' wages per year, while payments for employees in other sectors totalled only 15 days' wages per year.

Instruction 057/19 dated 10 June 2019 annuls Prakas 443 and provides that, for periods before 2019, employees working in the textile, garment and footwear sectors are entitled to seniority indemnity back payments of 15 days of wages per year.

Instruction 042/19 dated 22 March 2019 states that, in contrast to Prakas 443, employees earning their seniority before 2019 and currently employed outside the textile, garment and footwear sectors are entitled to a maximum seniority indemnity back payment totalling six days of wages per year instead of 15 days.

Delayed implementation in other sectors

Instruction 042/19 postpones the effective date of the pre-2019 seniority indemnity back payments for other sectors until December 2021 to give employers time to prepare financially. However, during the deferral period, an employee (or his/her heirs) who is terminated for any reason other than serious misconduct, or who retires or is deceased, continues to be entitled to receive the entire amount of the seniority indemnity (i.e. six days' wages per year).

Seniority indemnity back payment calculation for textile, garment, and footwear sectors

Instruction 057/19 provides that the maximum seniority indemnity back payment amount that may be made to a single employee is no more than six months of the average annual gross wages, which is limited to wages for a total of 156 days from 2008 to 2018 (six days only in 2018).

A full-time employee who has worked continuously for up to six months is entitled to 7.5 days of seniority indemnity back payments. If the length of service is longer than six months, it is treated as a full year and the employee is entitled to 15 days of payments.

The instruction explains how to calculate seniority indemnity back payments for pre-2019 periods in three steps, as follows:

1. Monthly average gross wages are total gross wages received divided by the total number of months in which they were received;
2. Daily average gross wages are monthly average gross wages divided by 26 days; and
3. An annual seniority indemnity back payment equals daily average gross wages multiplied by 15 days, and 6 days for 2018.

Seniority indemnity payments for periods after 1 January 2019

Prakas 443 stated that an employee who worked for more than six months would receive a payment equal to 15 days' wages and other benefits annually, and if the employee worked for less than six months, he/she would receive 7.5 days of seniority indemnity payments.

Instruction 058/19 explains that, as long as an employee is employed until the end of June or December, he/she will be eligible for 7.5 days of wages and other benefits for each half year. The employment period will exclude the probation period and required retention period provided in Instruction 50/19 dated 17 May 2019 and follow the calculation principles discussed below. However, if the employee resigns before the end of June or December, he/she will not be eligible for the payment.

Implementation

The rules for seniority indemnity payments after 1 January 2019 apply as from 2019, with the first payment for the period from January to June 2019 made in June 2019 to employees across all industries.

Seniority indemnity payment calculation

Instruction 058/19 explains how to calculate the seniority indemnity as follows:

1. Monthly average wages and benefits are the sum of wages and benefits for a semester divided by six months or the actual number of months of employment;

2. Daily average wages and benefits are monthly average wages and benefits divided by 22, 24 or 26 days depending on the enterprise's number of actual working days in the month; and
3. The seniority indemnity payment for each semester equals daily average wages and benefits multiplied by 7.5.

Timing of seniority indemnity payment

Wages or salaries generally are paid twice a month. The seniority indemnity will be paid together with wages in the second payment of June and December. For tax purposes, employers must segregate monthly wages/salaries from seniority indemnity payments.

Calculation principles

Instructions 057/19 and 058/19 provide the following seven principles for calculating seniority indemnity payments before and after 1 January 2019:

1. The employment period begins after the employment agreement is signed and the employee is hired on a full-time basis, exclusive of any probation period.

2. A confirmed employee who has worked for at least 21 days is considered to have worked for one month and is eligible to receive a seniority indemnity payment if he/she works until the end of June or December.

3. For periods before 2019, gross wages do not include fringe benefits such as health care benefits, occupational risk premiums or overtime compensation. For periods after 1 January 2019, wages/salaries and benefits are pre-tax amounts.

4. If an employee retires or dies in 2019, the employer must pay the employee or his/her heirs the entire amount of the pre-2019 seniority indemnity immediately. The employer also must pay the employee or his/her heirs the semi-annual seniority indemnity, which is equivalent to seven days of wages/salaries and benefits if the employee has worked six months or less and has not yet received the payment.

5. For both periods prior to and after 1 January 2019, the period of employment includes time taken for maternity leave, work-related accidents and sick leave. Benefits such as occupational risk benefits and health care benefits received during leave are excluded from the seniority indemnity calculation.

6. The seniority indemnity is paid together with wages or salaries in the second wage/salary payment of June and December. At that time, employees in the textile, garment and footwear sectors who are entitled to pre-2019 seniority indemnity back payments and employees in all sectors who are entitled to payments after 1 January 2019 will receive:
   - The second half of their wages/salary for June or December;
   - The semester's seniority indemnity payment totalling 7.5 days of wages and other benefits; and
   - Pre-2019, seniority indemnity back payments, if applicable.

7. For documentation purposes, the employer and employee should keep proof of payment with both parties' signatures and thumbprints or another document of equal probative value.

Fixed duration contract (FDC) and UDC

Notification 023/19 dated 8 July 2019 reiterates the rules regarding the payment of pre- and post-1 January 2019 seniority indemnity for employees in the textile, garment and footwear sectors and provides also the following:

1. As provided in the new article 89 of the labor law, the seniority indemnity will apply to employees who are employed under a UDC only.
2. Employees employed under an FDC will receive a severance pay at the expiration of their contract, which should be proportional to their

wages/salaries and the duration of their contract, and to the amount of severance pay agreed in the collective bargaining agreement. Otherwise, the severance payment should be at least 5% of the wages/salaries paid during the duration of the contract.
3. Employees who are employed under an FDC exceeding the two-year legal duration limit, and who received a 5% severance pay may not request seniority indemnity back payments from their employers as per article 89.
4. An FDC that exceeds the legal duration should be automatically converted into a UDC by the end of 2019 and the employer should pay the seniority indemnity as from the date of conversion as per new article 89, Prakas 443 and the relevant instructions.
5. Pre-2019 seniority indemnity back payments and new seniority indemnity payments made after 1 January 2019 will be tax-exempt (subject to the clarification of Instruction 003, discussed below).
6. Employees who resign or have committed serious misconduct will not receive the seniority indemnity.

Instruction 050/15 dated 17 May 2019 states that an FDC must have a maximum duration of two years and can be renewed for a total cumulative period not exceeding four years. If the initial duration exceeds two years or the total cumulative duration exceeds four years, the contract will be automatically converted to a UDC. The lapse period between two FDCs must be at least one month.

Employees of diplomatic representatives, United Nations (UN) agencies and international organizations – Ineligibility for seniority indemnity

Letter 468 dated 4 April 2019 from the Council of Ministry and Prakas 44/19 dated 5 April 2019 provide that employees working for foreign diplomatic representatives, UN agencies and international organizations in Cambodia are not eligible to receive the pre- and post-1 January 2019 seniority indemnity as provided in Prakas 442 and 443 and relevant regulations.

Tax treatment

Instruction 003 issued by the Ministry of Economy and Finance dated 11 April 2019 provides that pre- and post-1 January 2019 seniority indemnity payments are exempt from the Tax on Salary (TOS) but only for Cambodian nationals employed across all sectors.

Employers may deduct payments in the tax year that they are made. Services related to employee searches, employee training, sending employees or trainees to work overseas and managing them while abroad are exempt from VAT.

Comments

The MLVT has not yet issued guidance regarding how to calculate pre-2019 seniority indemnity back payments for employees in sectors other than the textile, garment and footwear sectors. Since the implementation of these rules is suspended until December 2021, it is likely that the MLVT will issue new guidance.

Seniority indemnity payments received by Cambodian employees are exempt from the TOS but these payments are taxable in the hands of expatriate employees. Therefore, taxpayers may wish to request that the tax exemption be extended to expatriate employees. Updates on this issue will be provided as they arise.

If you have any questions, or would like additional information on the topics covered in this alert, please contact:

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