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DO THE NEW CAMBODIAN TP REGULATIONS REDUCE THE BURDEN ON TAXPAYERS?

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With the updated transfer pricing ("**TP**") regulations that were issued by the Ministry of Economy and Finance via Prakas No. 574 on September 19, 2024 (**"Prakas 574**") entering into effect on January 1, 2025 (and the abrogation of the prior regulations under Prakas No. 986), we take a look at what this means for taxpayers, particularly in terms of the TP documentation requirements.

1. TP documentation can be reused

Article 17 of Prakas 574 introduces a provision that allows taxpayers to reuse their TP documentation from the previous tax year provided there have been no significant changes in the controlled transactions and comparability factors that would affect the TP methodology used. The only update required is the annual revision of financial indicators for comparables.

In essence, instead of preparing new TP documentation each year from the ground up, taxpayers can reuse the prior year's documentation, as long as core factors, such as intercompany transactions and comparability conditions, remain unchanged. By requiring only updates to the financial indicators for comparables, rather than a complete overhaul of TP documentation, this provision substantially alleviates the administrative burden on taxpayers.

2. Exemption from TP documentation obligation

As outlined in Paragraph 2, Article 17 of Prakas 574, Cambodian taxpayers are exempt from the obligation to prepare TP documentation for a tax year if they meet both of the following criteria for that year:

- The annual turnover is less than KHR8 billion (approximately US$2 million) and total assets are valued at less than KHR4 billion (approximately US$1 million); and
- The total value of all controlled transactions except loan transactions is less than KHR1 billion (approximately US$250,000).

For businesses that fall within these thresholds, the requirement to prepare comprehensive TP documentation is waived. This provision particularly benefits smaller enterprises or those with limited cross-border transactions, while enabling the tax authorities to focus their resources on larger, more complex transactions.

3. Exemption for intercompany loans

Prakas 574 maintains the exemption on loan transactions from related parties having to comply with the arm's length principle if taxpayers can provide the supporting loan documents specified under Notification No. 10979 GDT.

In addition, Prakas 574 further simplifies the compliance process for certain businesses by allowing resident taxpayers that are not banks or financial institutions to bypass the need for detailed supporting loan documentation if they are one of the following:

- An enterprise that has been incorporated for less than three taxable years, counting from the date of tax registration.

- A single-member private limited company that enters into a loan transaction with a shareholder, with a loan balance for any period of less than KHR3 billion (approximately US$750,000).
- A sole proprietorship with a loan from the owner, spouse, or dependent children.

4. Other important notes

Arm's length range

Cambodia's approach to TP, as outlined in the Article 7 of Prakas 574, presents a relatively straightforward and taxpayer-friendly method of ensuring compliance with the arm's length principle. Under this rule, no TP adjustments are made if the financial indicators for controlled transactions fall within the arm's length range, provided the appropriate TP method is used. However, if the financial indicators fall outside this range, the transfer price must be adjusted to the median of the arm's length range, with the caveat that such an adjustment must not lead to a tax reduction or tax loss.

Attribution of profits to a permanent establishment

If a non-resident taxpayer has a permanent establishment ("**PE**") in Cambodia, the taxpayer must allocate gross income, any deductible amount, or other benefits in a manner that properly reflects the income between the PE and the non-resident taxpayer. The taxable income allocated to the PE and the non-resident taxpayer is then treated as the taxable income of two separate and independent enterprises. This ensures that income is taxed where it is economically generated and in accordance with the activities carried out by the PE in Cambodia.

Cambodia's profit attribution rules for PEs are broadly consistent with the OECD's general framework, ensuring that profits are attributed based on the economic activities performed by the PE. Compared to neighboring countries, Cambodia's rules appear simpler and more flexible, which may benefit businesses seeking a less complex PE tax regime, but it also means that businesses may need to take extra care in ensuring their income allocation is fully compliant with international standards, especially when operating in multiple jurisdictions with more stringent rules.

TP adjustment – Primary vs secondary adjustment

The introduction of primary and secondary adjustments in Cambodia's new TP regulations marks a significant step in aligning the country's tax framework with international standards, particularly those outlined by the OECD Guidelines. This change is designed to mitigate base erosion and profit shifting, and enhance tax compliance among multinational enterprises ("**MNEs**") operating in the country.

- Primary adjustment refers to an initial adjustment made by the tax administration of the taxpayer's taxable income as a result of applying the arm's length principle to transactions between the taxpayer and related parties. This means that if the tax authorities find that a taxpayer has underreported income or overreported expenses in related party transactions, a primary adjustment will be made to correct the reported taxable income.
- Secondary adjustment refers to an adjustment that arises from imposing tax as a result of a primary adjustment. Secondary transactions may take the form of constructive dividends, equity contributions, or loans. Secondary adjustments ensure that any excess profits or adjustments made during the primary adjustment process are properly accounted for in the financial transactions between related entities.

For MNEs operating in Cambodia, the adoption of primary and secondary adjustments introduces a layer of complexity to their TP documentation and compliance obligations. MNEs will now need to ensure that intercompany transactions are priced in accordance with the arm's length principle to avoid the potential for primary adjustments. The risk of secondary adjustments further underscores the importance of maintaining robust TP documentation to support the pricing of related party transactions.

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