



## Cambodia introduces transfer pricing rules

### Global Transfer Pricing Alert 2017-056

Cambodia's Ministry of Economy and Finance (MEF) issued the country's first transfer pricing regulations on 10 October. The rules, which apply from the date of issuance and adopt the arm's length principle as articulated in the OECD's [transfer pricing guidelines](#), focus on the procedure for allocating income and expenses among related parties and on the interpretation of relevant concepts.

The regulations -- Prakas No. 986 -- cover key issues, such as the application of the arm's length principle, comparable transactions, transfer pricing methods, documentation, and penalties for noncompliance. Specific rules apply to intangible property and intragroup services.

#### Overview

The regulations define "transfer price" as the price at which goods, services, or property are transferred between related parties. The pricing of related-party transactions can shift benefits from one related party to another through an increase or decrease in the price of goods, services, or property to an amount that is not at market value, or the "arm's length price," of an uncontrolled transaction.

Transactions between related parties must be conducted on arm's length terms. The regulations allow the Cambodian tax authorities to make adjustments to income and expenses to prevent the shifting of profits between Cambodian taxpayers and their related parties.

#### Definition of related parties

A related party is defined in the regulation as a relative of the taxpayer or an enterprise that controls or is controlled by the

taxpayer or is under common control with the taxpayer. The term “control” means ownership of 20 percent or more of the equity shares of an enterprise or the voting power in the enterprise’s board of directors. Both transactions with domestic and foreign entities fall within the scope of the transfer pricing regulations.

### **Targeted transactions**

The regulations do not identify specific transactions that are targeted for review by the tax authorities, but they do highlight intangible assets and intragroup services as areas of focus.

If intangible property is managed or used by related parties, the following steps are necessary to determine the party that is the owner of the property and to support this determination:

- Determine the party that bears the economically significant risks, such as risks relating to the development, enhancement, maintenance, protection, and exploitation of the intangible property that is managed or used in operations.
- Inspect the agreement between the parties to determine legal ownership by examining the registration conditions and licensing terms, as well as other legal documents that provide evidence of the legal ownership and other rights and obligations, including plans for allocating significant risks between the related parties.
- Analyze the 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.
- Examine the level of consistency between the conditions of the agreement and the actual practices of each party.
- Demonstrate that the actual controlled transaction relates to the development, enhancement, maintenance, protection, and exploitation of the intangible property.
- Determine the arm’s length price for the relevant transactions in a manner that is consistent with the functions, assets, and risk profiles of the parties involved.

For transactions involving intangible property, the arm’s length compensation for each party involved should entitle the enterprise to a share of the benefits that is consistent with the actual practices of the parties. This includes a requirement that the share be based on the expenses borne and investment made by the party in question, in relation to the development, enhancement, maintenance, protection, and exploitation of the intangible property.

The regulations specifically state that intragroup services must be necessary to the taxpayer’s business and result in economic benefits, and the service fees must be set at arm’s length. The analysis to support the amount of the service fee requires a functional analysis of group members to determine the relationship between the services and the relevant actions of the members. The arm’s length price for services within a

group must be set in accordance with any conditions provided for comparable transactions, the arm's length range, and the relevant transfer pricing methods.

### **Transfer pricing methods**

The regulations recognize the five transfer pricing methods permitted under the OECD guidelines:

- The comparable uncontrolled price method
- The resale price method
- The cost plus method
- The profit split method
- The transactional net margin method

Taxpayers must produce evidence and supporting documentation to justify the appropriateness of the method used, and provide this information to the tax authorities as described below. When there is insufficient support to demonstrate the suitability of the selected method, the tax authorities have the right to determine the appropriate method the taxpayer should use.

### **Application of the arm's length principle**

To comply with the arm's length principle, taxpayers must conduct a comparability analysis to assess the arm's length nature of the price of a controlled transaction and this analysis must meet one of the following two conditions:

- There are no significant differences between the controlled transaction and the comparable transactions that could affect the market price; or
- Reasonably accurate adjustments can be made to eliminate the effects of any significant differences.

The "arm's length range" is a set of finance-related indicators (such as prices or profit margins) determined from comparable uncontrolled transactions by applying the appropriate transfer pricing method. The controlled transaction will 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 will be adjusted to the median of the arm's length range.

### **Documentation**

The regulations introduce documentation requirements for taxpayers engaged in related-party transactions. Taxpayers are required to issue invoices for all transactions and to maintain accounting records, legal documents, and other financial documents as determined under the relevant provisions in the Law on Taxation. These documents must be retained for 10 years from the tax year end for the year in which the transaction took place, and must be submitted as required by the tax authorities.

Cambodian taxpayers with related-party transactions must prepare transfer pricing documentation that details the related-party transactions and the methods used to justify the

arm's length nature of a transaction. Information on the following is required:

- General information on the enterprise and related parties (related parties' structure, business strategies, etc.);
- Information about the related-party transaction(s) (transaction documents, including those related to the supply, transport and payment, products, agreements, etc.); and
- Information relating to the transfer pricing method (pricing policy, market information, documents supporting the selected transfer pricing method, and other related documents).

Under current law, certain information on related parties must be provided in the tax on profit (TOP) return.

The documents above must be submitted to the tax authorities upon request.

### Penalties

The regulations provide for the imposition of various penalties for failure to comply with the transfer pricing documentation requirements, including revocation of the company's certificate of tax compliance and criminal prosecution of individuals in managerial positions (and possible imprisonment).

### Comments

The issuance of transfer pricing regulations is a major development in Cambodia's tax law. With formal guidelines and procedures for mandatory documentation, the tax authorities have sent a clear message that the regulations will be enforced.

Taxpayers should note the following significant points:

- **Deadline for submission of the required documentation:** The regulations do not provide a specific deadline for the submission of transfer pricing documentation. However, taxpayers are required to retain the required documentation and submit it to the tax authorities upon request. Thus, the documents must be prepared in advance of the deadline for submitting the TOP return (three months after the tax year end, that is, 31 March 2018 for the 2017 returns for calendar-year taxpayers), to avoid or minimize possible risks associated with transfer pricing audits and to complete the information required to be disclosed in the TOP return.
- **Database used for benchmarking:** There is no specific provision in the regulations stating the required database needed for a benchmarking analysis. However, in most countries, a local database is the primary source of information; if a local database cannot be utilized, a regional database may be used. In Cambodia, due to the lack of a local database and financial information for benchmarking purposes, confirmation from the tax authorities is needed to ensure that regional databases may be used.

- **Data to be used in benchmarking:** The regulations do not specify whether single-year or multiple-year data should be used for benchmarking purposes. However, based on the OECD transfer pricing guidelines, multiple-year data should be used to enhance the reliability of a comparability analysis. Most countries use three to five years of data for benchmarking purposes.
- **Arm's length range:** There are no specific instructions in the regulations for determining the arm's length range. However, in an example provided in the regulations, a full range (minimum to maximum), as opposed to an interquartile range (25 percent to 75 percent), was used by the tax authorities. There is still a need for confirmation from the tax authorities regarding to this issue.
- **Loan transactions:** The interest rate for related-party loan transactions must be set according to the arm's length standard. Thus, guidance issued in 2014 (Circular No. 151), which provides that the interest rate on a loan can be set lower than the market rate, or even at a zero rate, will be superseded by the transfer pricing regulations.
- **Prior-year transactions:** The regulations are unclear on whether prior-year transfer pricing documentation must be prepared by taxpayers and accepted by the tax authorities. Hence, clarification from the tax authorities is needed on this point.
- **Advance pricing arrangements (APAs):** APAs are agreements between taxpayers and the tax authorities in one or more jurisdictions that aim to prevent transfer pricing disputes relating to the arm's length principle. The regulations do not cover APAs.

Hopefully, the tax authorities will issue additional clarifications on the above points.

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- [Arm's length standard](#)
- [Transfer pricing alerts](#)

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