One of the key tax considerations that should be kept in mind in any investment project in Cambodia is the availability of the benefits under Cambodia's investment incentives, specifically the tax incentives once the investment project is registered as a qualified investment project ("QIP").

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HOW ARE POWER PROJECTS TAXED IN CAMBODIA

Typical power plant project structure with QIP status

One of the key tax considerations that should be kept in mind in any investment project in Cambodia is the availability of the benefits under Cambodia's investment incentives, specifically the tax incentives once the investment project is registered as a qualified investment project ("**QIP**").

To obtain QIP, the investor is required to register the investment project with the Council for the Development of Cambodia ("**CDC**") and receive a Final Registration Certificate under the Law on Investment.

In light of the QIP registration, a typical power plant structure should generally include the following contractual agreements as shown in the diagram.

The tax regime of the project company itself

From a corporate income tax perspective, taxpayers in Cambodia are subject to either Tax on Income ("**TOI**") (which is what is commonly known as corporate income tax) or minimum tax ("**MT**"), whichever is greater. MT is a separate and distinct tax from TOI, and is calculated at 1% of annual turnover. In addition, taxpayers are subject to a Prepayment of Tax on Income ("**PTOI**") calculated at 1% of monthly turnover. It should be noted that PTOI is not actually a separate tax, but rather is a prepayment of either MT or TOI.

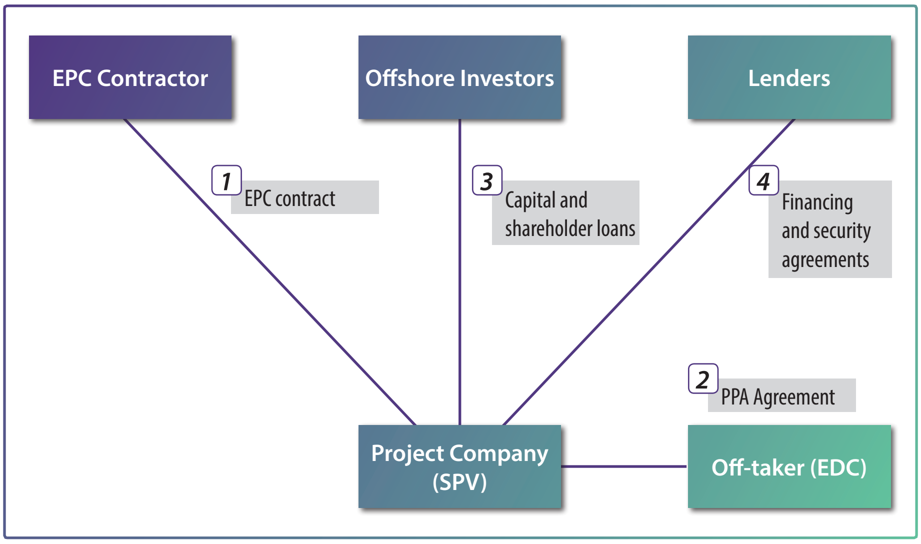
QIP companies benefit from a deferral of TOI during which investment activity

Highlights of this note

- Typical power plant project structure with QIP status
- The tax regime of the project company itself
- Tax Treatment of the construction of the plant
- The Power Purchase Agreement (PPA)
- Financing the project and interest expense limitations

income is exempt from TOI for the tax deferral period. In addition, they are exempt from having to pay PTOI.

The tax deferral period for most QIP electricity generation projects ranges from six to nine years and is divided into three sections: (1) the trigger period, which begins upon issuance of the Final Registration Certificate and ends either upon the first year of profit or three years after revenue is first derived; (2) a three-year period; and (3) the priority period, which for investment projects in the backbone infrastructure sector is stipulated as one year for investment capital below US$10 million, two years for investment capital between US$10 million and US$30 million, and three years for investment capital of more than US$30 million.



Repatriating profit from a Cambodia power project, even a project with QIP status, is in practice one of a sponsor's main preoccupations. A key problem here is that even tax-exempt profits will be subject to corporate income tax once it is distributed. In other words, it should be regarded as a tax deferral incentive as opposed to a pure tax holiday incentive, as later on, any distribution of income generated during this time will be subject to the additional dividend distribution tax ("**ADDT**"), which taxes income not previously subject to TOI at the usual rate of 20%. It is worthwhile mentioning that based on internal discussions with the General Department of Taxation ("**GDT**"), there is currently a proposal to abolish the ADDT, but no decision has yet been made on it.

Taking into account the project company's QIP status, the following Cambodian tax implications will generally arise under a typical power plant contract structure.

Tax treatment of the construction of the plant

Various taxes apply when an engineering, procurement, and construction ("**EPC**") provider constructs a power plant:

Import taxes (customs duty and import VAT)

The QIP project is exempt from import duties on the import of construction materials and equipment, which must be approved in advance by the CDC under a master list. However, one of the key points to keep in mind is that the importation of equipment under the EPC contract concluded between the project company and the EPC contractor is not exempt from import VAT of 10%, resulting in an additional tax cost for the project company.

There is a possibility that the GDT will grant an exemption depending on the size of the investment capital, the project's economic impact, and other relevant factors, but this is done on a case-by-case basis.

Engineering services rendered offshore

While a special purpose vehicle ("**SPV**") with QIP status is granted customs duty exemption and corporate income tax deferral, the SPV will still be subject to withholding tax ("**WHT**") on payments to non-residents. Accordingly, 14% WHT must be withheld and remitted by the SPV to the GDT on any income sourced from Cambodia, including fees for technical services rendered, which can be reduced to 10% WHT under the applicable Avoidance of Double Taxation Agreement ("**DTA**") concluded between Cambodia and the other contracting state.

In order to access DTA benefits, it is necessary to obtain advance approval from the GDT to utilize the reduced or exempt WHT under the applicable DTA, which includes obtaining a certificate of residence, and documentation proving shareholding, and the relevant agreements.

Engineering services rendered onshore

WHT at the rate of 15% needs to be withheld and remitted to the GDT on payments made to unregistered Cambodian service providers. The Cambodian project company is exempt from WHT obligations on payments made to registered Cambodian service providers as long as they are supported by valid tax invoices.

The Power Purchase Agreement

The supply of electricity by the project company to the electricity company of Cambodia, Electricite du Cambodge ("**EDC**") is VAT exempt and there are no Cambodian WHT implications triggered on the payment to the project company by EDC.

Financing the project and interest expense limitations

Interest paid to an offshore lender will be subject to 14% WHT, which is reduced to 10% WHT under the respective DTA. In addition, the 14% WHT may generally be exempted if the interest is paid to a government authority in another state, including the national bank of the other state, any ministry or department thereof, and any local authority.

Similar to the mechanism to claim WHT relief for technical service fees paid abroad, advance approval from the GDT is required in order to benefit from the reduced WHT rate or to obtain WHT exemption, as the case may be.

From a thin capitalization perspective, as a general rule, although no specific debt-to-equity ratio is considered a safe harbor for purposes of claiming the full interest expenses as a tax deduction, there are other provisions that may potentially disallow the interest expense incurred. The other provisions restrict the deductibility of the interest expense incurred to the total interest income, if any, plus 50% of the net non-interest income (i.e. net profits excluding interest income and interest expense). The excess non-deductible interest expense can be carried forward to the following tax years indefinitely.

In addition, there is a further limitation on the deduction of interest expenses with regard to related party loans. For loans from related parties, the allowable tax-deductible interest rate should be determined based on the arm's length principle, which may include funding via interest-free loans.

From a shareholder loan perspective, the interest-free loans would need to be supported by the following transfer pricing documentation to substantiate the non-charging of interest:

- A loan contract that clearly states the term of the loan
- A business plan that outlines the purpose of the loan
- Documents discussing the basis for the non-charging of interest on the loan
- A board of directors' resolution accepting the loan borrowing and the terms and conditions attached to the loan

While it is common practice for shareholder loans to be provided interest-free in financing the operations of a Cambodian project company, the GDT may impose an arm's length interest rate, which could have commercial and tax cash flow implications for the Cambodian project company in situations where the abovementioned transfer pricing documentation has either not been prepared or fails to show evidence of the commercial rationale behind the borrowing.

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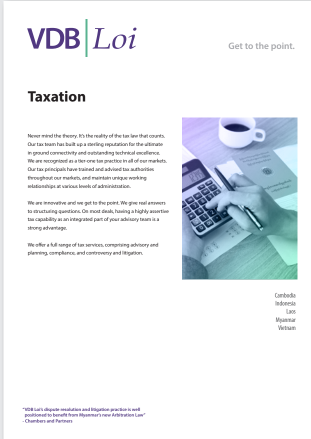
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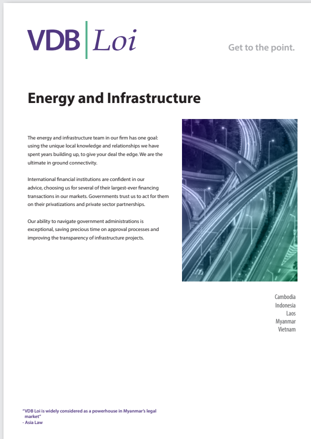
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