

VDB | *Loi*

Legal and Tax



**FASTEN YOUR SEATBELTS:  
TURBULENCE AHEAD FOR THE TAXATION  
OF INTERNATIONAL AIRLINES IN  
CAMBODIA**

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If you think air travel already got too expensive, you will not be happy to hear that ticket prices to and from Cambodia might be ready to fly even higher. On 26 September 2023, a recent industry meeting facilitated by the International Air Transport Association (IATA), the airport operator and the General Department of Taxation (GDT), attended by more than 30 airlines serving Cambodia and VDB Loi, highlighted the many tax uncertainties the sector says it faces. True, there are a few new tax laws that may have an effect on how foreign airlines are taxed (such as the revision of the definition of permanent establishment). But the unavoidable vagueness of longstanding general tax rules when applied to international aviation (which is something we see in many countries) plus the impact of the rise of booking tickets online in the last decade, are creating most of the turbulence. Here is what lies ahead on the radar, so to speak.

### **Is the 10% Cambodian tax on airline tickets also applicable to tickets bought online?**

Cambodia has a tax on airline tickets (actually included in the so-called Specific Tax, similar to alcohol, telecoms and tobacco products) since back in 1997, which is now set at 10% of the fare. Back in 1997, it was not difficult to levy this tax. All passengers needed one of those traditional ticket slips with the red carbon copy sheet (if you can remember) issued by the airline or its agent before checking in. Passengers departing from Cambodia as the first leg of their trip could rarely get a ticket any other way. These tickets were all the tax tried to include. Buying a return ticket Bangkok-Phnom Penh- Bangkok, for example, is not subject to the 10% tax, because that trip is not sold in Cambodia. The regulations state that only the “domestic sale of tickets” is subject to tax.

Then came e-commerce. Nowadays, most if not all the tickets sold departing Cambodia are booked and sold online. Chances are you go and by your ticket from an agent, that is booked on a (separate) online platform too. So, in the digital age, what is “a domestic sale”?

A regulation of 1997, long before rise of e-commerce in Cambodia, refers for the scope of the ticket tax to “passengers departing from Cambodia” as “considered sold in Cambodia”, and the GDT has recently publicly stated that it believes this means that airlines need to pay tax on tickets not sold in Cambodia in a traditional way, but also online. In that sense, “domestic sale” is kind of a misnomer. But that 1997 regulation also refers to “giving a ticket” to the passenger, which is difficult to connect with what happens in the internet age.

All said, many airlines recognize their online sales as sales in the head office, not in the Cambodia branch, even if they have one. They may consider their Cambodia branches are not involved at all in selling online tickets that happen to depart from Cambodia. For example, an employer in France purchasing a ticket online for its employee to travel to France for training.

When the GDT sticks to its interpretation, and certainly if it pours that into a new regulation, this may have to change. It is true that for a tax to apply fairly, it should not matter whether the purchase is old school or online, but we see distortions like this all over the spectrum in the wake of e-commerce.

## Which international airlines should pay income tax in Cambodia?

The mainstream global principle is that it is too complex to make international airlines pay income tax in each country they fly. Their revenue and expenses are simply too scattered. So, the OECD and the United Nations Double Tax Agreements (DTA) models propose, and the IATA strongly recommends, that only the state of residence of an airline is the one that gets to tax its income, not every state where they land or depart. That principle is also accepted by Cambodia's in its DTAs art. 8, which means airlines from for example Singapore, Hong Kong, Thailand and Vietnam are (since that DTA went into effect) not taxable on their income from international air traffic in Cambodia. But Cambodia has air routes with non-DTA countries too, and there are millions of legacy disputes piling up for DTA airlines from the period before that DTA has entered into force.

One big issue is which airlines are deemed to tax a taxable presence in Cambodia, a so-called Permanent Establishment (PE). If an airline registers a commercial branch here, this automatically triggers a PE. But many airlines do not do that, but still make money from sources in Cambodia. They go for example through other airlines or through agents. This is also made possible since tickets can be booked online, without an office or agent in Cambodia. These airlines may not realize that having a connection through another airline, or having an agent, even an independent agent may in many situations trigger having a PE in Cambodia, with the obligation to pay income tax here. The definition of PE was in fact enlarged in 2023 to cast a wider net. But there are no specific rules on PE's for airlines and enforcement on airlines that do not report to have a branch is not easy.

## What is the taxable profit of the Cambodian branch of a non-DTA airline?

Say the airline does have a branch in Cambodia, how should revenue, expenses and net profit be determined? Cambodia's tax laws and rules only have general, non-aviation guidelines for these questions. Internationally, there are several widely used formulas for this (the Maritime, Calcutta and the Massachusetts formulas for profit determination) and it would be best for everyone if the GDT picks one or more for national use. That has not yet happened, but the GDT did recently and for the first time publicly take the view that every passenger that is uplifted from a Cambodian airport (whether on a return voyage or not) triggers income tax in Cambodia if there is no DTA. An US\$800 ticket from Cambodia to Overseas and back must be for US\$400 included in the Cambodia sourced income of the non-DTA airline. The same goes for a passenger from Overseas who travels to Cambodia and back with a return ticket. In this "Uplift method", which is also used in many other countries including Australia, it does not matter where the ticket was sold.

This particular approach to allocating international non-





DTA airline income to Cambodia is in and of itself not internationally unprecedented at all, but airlines will need some time adjusting to the new interpretation. And the tax cost of some air travel is more likely to lift off rather than descend because of it.

### **Leasing of aircraft**

One final tax uncertainty that affects airlines, perhaps even some of the DTA ones, is the potential for 14% (or 10%) withholding tax on the leasing of aircraft. Say an airline based overseas has a branch in Cambodia and leases an airplane from a lessor in a third country. The airline pays lease fees and might allocate some of the lease costs of that plane to its Cambodian branch, as the aircraft is occasionally used on that route. In a number of tax audits, the GDT has taken the view that (part of) the lease fee paid by the airline lessee to the lessor is subject to Cambodian withholding tax, because the fee is partially allocated to the branch. Another view is that because Cambodia does not have a withholding tax on lease fees per se, the aircraft lessor should be taxable in Cambodia only if it has a PE in Cambodia, which is rarely the case.

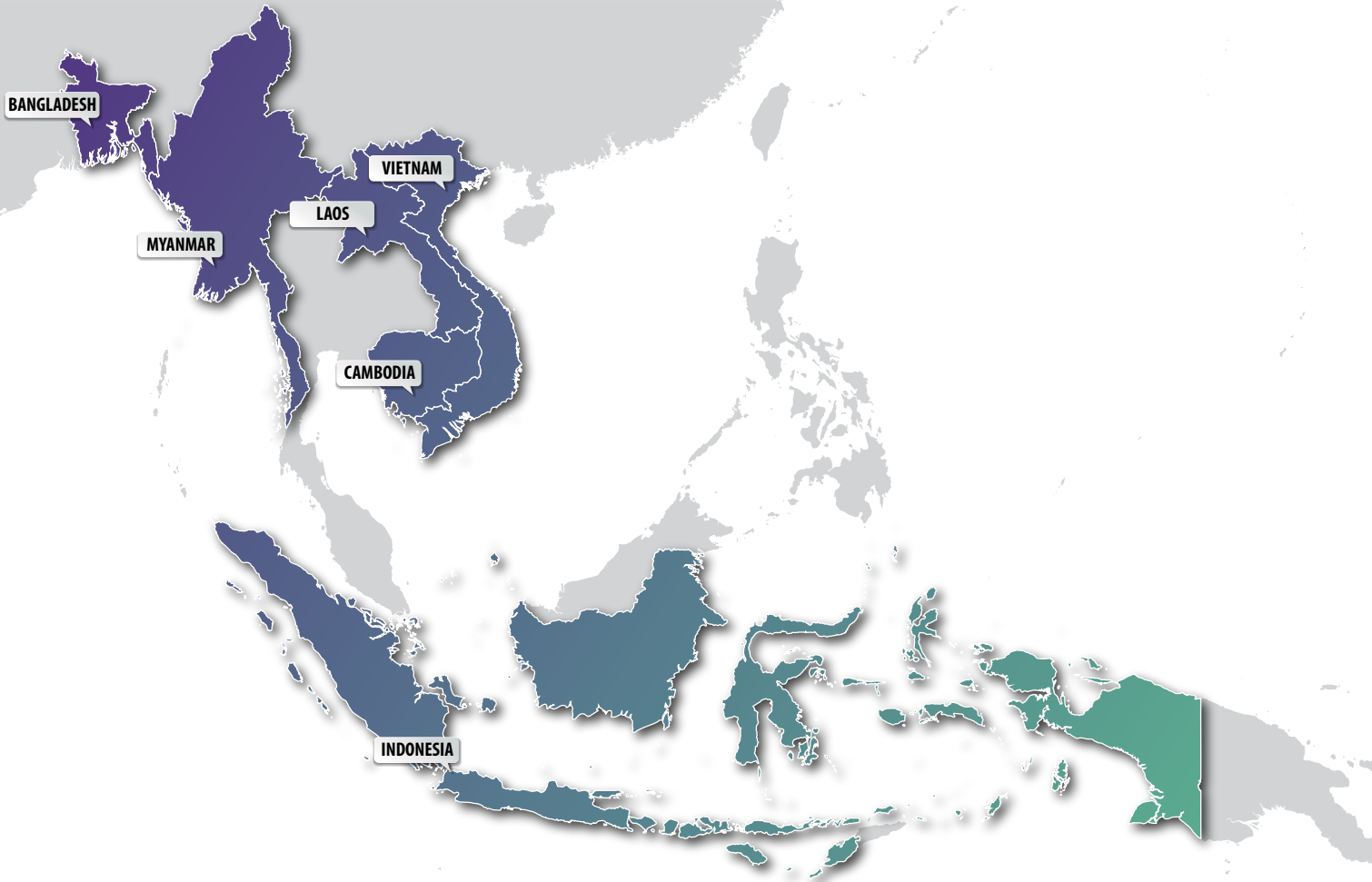
Reasonable people can disagree on interpretations of tax laws. What is clear though, is that this leasing tax issue uncertainty is again one more hot issue among foreign airlines in Cambodia.

### **A pragmatic way forward**

It is frustrating for the private sector that disputed tax claims rack up, but it is equally frustrating for the GDT that a small minority of airlines simply declare nothing at all, as if airplanes had been flying empty for years. Along the same lines, it is not possible from a public policy perspective to maintain a Specific Tax on tickets sold in Cambodia if taxpayers would be allowed to escape that tax with one click of the mouse. Mutual suspicions, sometimes justified ones, trigger a spiral of more and more imposing tax officials, understandably seeking to “at least tax something”, and generally compliant airlines increasingly withdrawing.

An open dialogue between the GDT and the private sector is really the best way forward to reduce uncertainty and frustrations on both sides, and that is exactly what the GDT was doing with the recent airline tax event. An important and productive first step was made. The next step should probably be, in my modest opinion, a new or updated regulation to address these issues comprehensively, in detail, rather than only in broad strokes. When such new regulation is issued, I would suggest the GDT focuses on enforcing present compliance rather than the past, before e.g. the revenue of non-DTA branches of airlines was clearly defined, or a clear position was taken on sharing aircrafts that were leased to airline head offices. Until such a comprehensive regulation is drafted, best in consultation with the industry, we all better buckle up.

# VDB Loi in the region



## BANGLADESH

UTC Building, 19<sup>th</sup> Floor  
Unit 1922, 8 Pantho Path  
Karwanbazar, Dhaka 1215  
T: +880 0 961 188 6739  
WhatsApp: +95 0 997 532 7699

## CAMBODIA

No. 33, Street 294 (corner of  
Street 29)  
Sangkat Tonle Bassac  
Khan Chamkarmorn  
Phnom Penh 120101  
T: +855 23 964 430~434  
F: +855 23 964 154

## INDONESIA

Plaza Bisnis Kemang, Suite 211  
Jl. Kemang Raya, No. 2  
Jakarta 12730  
T: +62 21 718 3415  
The Cityloft Sudirman  
Suite 1119, Jalan K. H. Mas  
Mansyur Kav. 121, Jakarta,  
10220  
T: +62 21 2555 6611

## LAOS

Level 4, Kolao Tower II  
23 Singha Road, Nongbone  
Village, Saysettha District  
Vientiane  
T: +856 21 454 679

## VIETNAM

Level 16, Unit 1638  
Bitexco Financial Tower  
2 Hai Trieu Street  
Ben Nghe Ward  
District 1, Ho Chi Minh City  
700000  
T: +84 708 283 668

## MYANMAR

Level 10, Units 01-05  
Junction City Office Tower  
Corner of Bogyoke Aung San  
Road and 27<sup>th</sup> Street  
Pabedan Township, Yangon  
T: +951 9253 752~756  
F: +951 9253 758

## ParkRoyal Hotel

Jade Villa No. 13/14  
Hotel Zone  
Dekhina Thiri Township  
Nay Pyi Taw  
T/F: +95 678 106 089