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INVESTMENT IN CAMBODIA

March 2024

FOREIGN DIRECT INVESTMENT

Following where China has been spending and investing its Belt & Road Initiative ("**BRI**") capital can provide FDI clues and reveal new opportunities in recipient countries. As infrastructure builds start to yield productive user cashflows and the need for subsequent support services arises, case studies for investment potential become apparent. In this new series, we will be examining where China has spent its money and where returns on investment exist for foreign investors by piggybacking on opportunities created by the BRI build.

Cambodia has long been a Chinese partner. This has accelerated over the past few years as BRI projects have begun to take hold with China expanding its reach into Southeast Asia to develop both infrastructure and trade relations and upgrade local wealth. Cambodia is an interesting example of how, in conjunction with the China-ASEAN Free Trade Area and the recent Regional Comprehensive Economic Partnership ("**RCEP**") agreement (Cambodia is a member of both), China has been combining development with free trade.

Some of these developments have taken ingenious paths—the development of casinos to generate capital from mainland Chinese gamblers (often involved in money laundering or other illicit money), which was subsequently reinvested in infrastructure is a quirky case in point— but it worked.

In this new series, in which we examine China's BRI investments in all ASEAN nations, we look at how its finance and development is impacting Cambodia and where future development lies.

China-Cambodia BRI Background

During 2012-2017, China invested over US$15 billion (£12.36 billion)—US$11 billion in the energy sector alone—in building Cambodia's infrastructure, which also included expressways, ports, and airports. The US$1.9 billion (£1.57 billion) expressway that links Phnom Penh with Sihanoukville, a port town and vacation destination, is located 12 km from the Sihanoukville Autonomous Port, the sole international and commercial deep-sea port in Cambodia (through which some 90% of Cambodia's imports and exports transported by sea pass).

In 2021, China-Cambodia bilateral trade reached US$11.2 billion.

Casinos & Real Estate

Throughout the period 2015-2018, real estate for factories (many relocating from China) and tourism (led by casinos) boomed around the expressway corridor to the Sihanoukville special economic zone ("**SSEZ**"). This was partially a recreation of the China Macao model.

The SSEZ has become recognized as a high-profile example of cooperation between China and Cambodia under the BRI. Launched in 2008 as a future home of manufacturing, led by garments and textiles, the SSEZ is now home to 170 companies as well as university buildings, legal service centers, libraries, and shops. By the end of 2021, the SSEZ had provided nearly 30,000 jobs to locals. It is of note that it was the original casino developments that prompted this development, through careful government planning and oversight to ensure the financial benefits were reinvested into manufacturing, production, retail, and educational facilities.

Infrastructure Investment

Cambodia Airports: In November 2020, Cambodia Airport Investment (a domestic Cambodian JV/OCIC) chose the Metallurgical Corporation of China (MCC) to design and build the airfield for its US$1.5 billion (£1.24 billion) international airport in Kandal province south of Phnom Penh. The US$400 million (£330 million) deal,

MCC's largest foreign contract in 2021, will be executed by its Shanghai Baoye Group subsidiary. The airport is due to be completed by the end of 2022, allowing flights to begin in 2023.

Chinese investment is also planned for the US$3.8 billion (£3.13 billion) Dara Sakor airport and resort. About US$1.1 billion (£910 million) of the total cost of the Takhmao airport will come from China Development Bank and US$280 million (£231 million) from the OCIC.

Other Chinese Investments

- In June 2021, Celllcard (Cambodia) chose ZTE as its 5G partner.
- In 2018, Xiaomi partnered with SEATEL, a fast-growing domestic telecommunications network.
- In March 2019, Alibaba announced plans to make Cambodia its logistics hub for the Greater Mekong region, which has a population of about 300 million.
- In 2019, Alibaba announced a partnership with DaraPay to allow Chinese customers to use their Alipay wallets in Cambodia.
- In 2022, Cellcard and Tencent announced plans to expand an e-sports platform, both domestically and regionally.
- After the COVID-19-related downturn of 2020, the two countries set a goal of reaching 5 million tourists by 2025, and 8 million by 2030.

Inbound FDI from China (2021)

Chinese investment in Cambodia increased significantly in 2021 despite the negative effect of the COVID-19 pandemic. Cambodia attracted fixed-asset investment of US$2.32 billion from China in 2021, up 67% from US$1.39 billion from 2020, according to a report from the Council for the Development of Cambodia ("**CDC**"). China remained the top foreign investor in Cambodia, accounting for 53.4% of the total investment of US$4.35 billion the Kingdom approved in 2020.

Estimation

Cambodia's growth rebounded to an estimated 3.0% in 2021 after a contraction of -3.1% in 2020. The government implemented policies to mitigate the negative impact of COVID-19 on businesses and people's incomes and to support economic recovery. Growth is expected to be 5% over 2022, although there are inflationary concerns. According to the World Bank, over the past two decades, Cambodia has undergone a significant transition, reaching lower middle-income status in 2015, and it aspires to attain upper middle-income status by 2030.

LOCAL TAX REGIME

Cambodia operates a self-assessment tax system where taxpayers are responsible for calculating and paying their taxes on their own. The main taxes levied are income tax (corporate (referred to as Tax on Income or "**TOI**") and individual), value added tax ("**VAT**"), property tax, and specific taxes on goods and services ("**ST**") (further details are provided in the Overview of Taxation and Investment Policies below).

Foreign Direct Investment

- **FDI Incentives**: Cambodia actively encourages FDI through various incentives, including tax exemptions, tax holidays, and reduced tax rates (further details are provided in the Overview of Taxation and Investment Policies below). The specific incentives available depend on the industry, location, and investment amount. The CDC provides comprehensive information on available incentives. For an entity permitted by the CDC, the law on investment and subsequent decrees provide for the

following incentives:

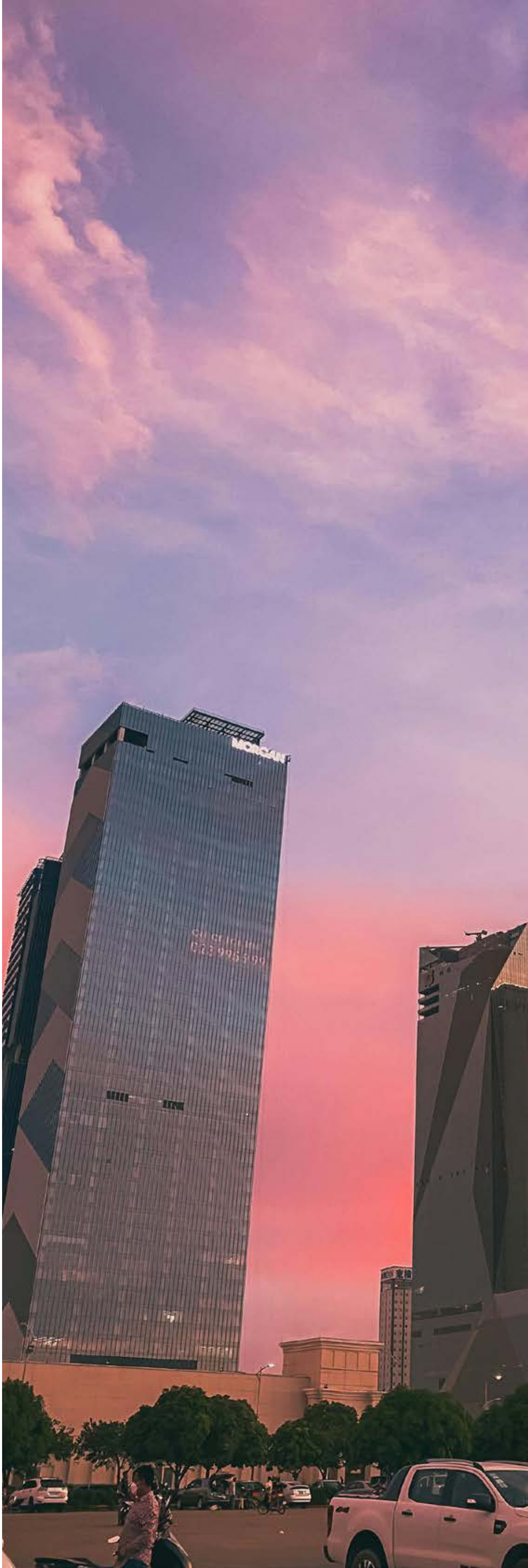
  - A TOI rate of 9%, compared to the standard TOI rate of 20% for business entities not receiving CDC investment incentives. Natural resource companies, including timber and oil companies and companies mining gold and precious stones, are subject to a 30% corporate profit tax rate.
  - An exemption from TOI for up to nine years depending on the type, level, and location of the investment.
  - A five-year loss carry-forward
  - Tax-free distribution of dividends, profits, and proceeds of the investment
  - Tax-free repatriation of profits
  - 100% exemption from import duties on construction materials, machinery and equipment, spare parts, raw materials and semi-finished products, and packaging materials for most projects for the construction period and the first year of operation. The period of exemption from customs duties for the above items can be extended for export-oriented projects with a minimum of 80% of production set aside for export and projects located in a special development zone, although these have not yet been specified.

- **Double Taxation Agreements**: Cambodia has signed double taxation agreements with over 70 countries, reducing the risk of double taxation on profits earned in Cambodia. Moreover, China and Cambodia signed a double taxation agreement on 13 October 2016.
- **Free Trade Agreement**: The Free Trade Agreement between China and Cambodia went into effect on 1 January 2022. Under the agreement, over 90% of tariff lines in trade in goods for both sides enjoy zero tariff, and the two sides will also strengthen cooperation in service trade, investment, BRI, e-commerce, economic technology, etc. China and Cambodia will actively promote the implementation of the agreement so that the businesses and people of both countries fully benefit from it.

Overview of Taxation and Investment Policies

Tax on Income: The TOI rate in Cambodia is 20%. However, there are a number of tax incentives available to businesses, such as tax holidays and exemptions. For example, businesses that are classified as Qualified Investment Projects ("**QIPs**") by the CDC may be eligible for a tax holiday of up to nine years. Small taxpayers are not obliged to pay TOI, unlike medium and large taxpayers.

Indirect Tax: The Cambodian indirect tax system is based on a VAT system. VAT is a tax on the consumption of goods and services. The standard VAT rate is 10%. There are also a number of reduced VAT rates, such as a 0% rate for certain essential goods and services. Taxpayers are not obliged to pay VAT because of the automatic calculation between the input and output of the VAT itself.



Property Tax: This is a direct tax imposed on the value of immovable property, including land and buildings. The tax rate in Cambodia is 0.1% on a tax base of 80% of the value of the property. The assessed value of the property is determined by the General Department of Taxation ("**GDT**").

Tax Rates: Article 20 of the Law on Taxation ("**LOT**") specifies the following tax rates:

- 20% for taxable income realized by a legal person.
- 30% for taxable income realized under an oil or natural gas production sharing a contract and the exploitation of natural resources including timber, ore, gold, and precious stones.
- 5% on the gross premium income for insurance companies.
- 0% for the taxable income of QIPs during the tax exemption period as determined by the CDC.

Tax Penalties: Tax penalties are imposed for violations of the LOT and its regulations, ranging from 10% to 40% of the tax amount due, together with interest that is charged at 1.5% per month. Generally, ordinary negligence is subject to a penalty of 10% of the unpaid taxes, while serious negligence is subject to 25%. Obstructing the implementation of the tax provisions, fraud, or other criminal acts carry more substantial penalties of 40% of the unpaid taxes. Other penalties may include fines, closure of the business, and potentially, criminal sanctions depending on the nature and severity of the offense. Repeat offenses generally garner more severe penalties.

Some examples of violations and the accompanying fines are provided in the table below:

NON-COMPLIANCE	PENALTY
Failure to register, update tax information, or file a tax declaration, despite receiving a warning letter	KHR5 million (~US$1,250)
• Failure to keep proper accounting records and documents • Failure to issue invoices • Failure to provide the information requested • Not permitting the GDT to check the entity's accounting records and documents	KHR10 million (~US$2,500)

Transfer Pricing: Under Article 18 of the LOT, the GDT is empowered to make adjustments to income and expenses between Cambodian taxpayers and overseas related parties. In 2018, Cambodian began implementing formal transfer pricing ("TP") regulations that were introduced on 10 October 2017 via Prakas No. 986 MEF.PrK, which provides the rules and procedures for the allocation of income and expenses among related parties. It also covers the application of the arm's length principle, TP methodologies, guidance on intangible property and intragroup services, documentation requirements, and penalties for non-compliance. Cambodian companies or local subsidiaries of foreign companies that have transactions (i.e. sales/purchases of goods or services, loans, or royalty transactions) with their related parties are required to disclose them when filing their annual TOI return. In addition, they must prepare and maintain comprehensive TP documentation that meets the requirements specified in the Cambodian TP regulations; this TP documentation must be made available to the GDT upon request. There are no safe harbor provisions allowing for an exemption from this mandatory TP documentation requirement.

Basic Tax Incentives: QIPs registered under the 2021 Investment Law are eligible for these incentives—either a TOI exemption period or an accelerated depreciation exemption. These incentives are available to both export/domestic and supporting QIPs.

Option 1: Exemption from TOI

Under this option, QIPs receive the following tax exemptions:

- TOI exemption: For 3-9 years, depending on the investment activity class based on the technology level and priority sector of the QIP. The TOI exemption period starts in the year in which the initial activity-related income is received. There are three investment activity classes for QIP investment activities based on their technological sophistication (high, medium, or low) or alignment with a priority sector designated by the Cambodian government, which determine the TOI exemption period, as follows:
    - Class 1 = Nine years
    - Class 2 = Six years
    - Class 3 = Three years
- After the TOI exemption period ends, QIPs are entitled to pay graduated reduced TOI rates for an additional six years. For a QIP that is subject to the standard TOI rate of 20%, the graduated reduced TOI rates are:
    - Years 1-2: 5% (25% of the 20% TOI)
    - Years 3-4: 10% (50% of the 20% TOI)
    - Years 5-6: 15% (75% of the 20% TOI)
- Exemption from Prepayment of TOI: For the same period as the TOI exemption.
- Exemption from Minimum Tax: Provided that annual external audited financial statements are maintained.
- Exemption from export duty: Unless otherwise provided for in other laws and regulations.

Option 2: Special depreciation

- Depreciation of capital expenditures on new or used tangible assets used in manufacturing and processing activities at a special rate of 40% for the first year.
- Eligibility to deduct up to 200% of specific expenses for a period that correlates to the investment class of the QIP.
- Exemption from Prepayment of TOI: For a period that correlates to the investment class of the QIP.
- Exemption from Minimum Tax: Provided that annual external audited financial statements are maintained.
- Exemption from export duty: Unless otherwise provided for in other laws and regulations.

Customs Duty and Other Incentives for QIPs: In addition to the basic tax incentives, QIPs also enjoy customs duty and other incentives.

Customs duty incentives

- QIPs can import construction materials, construction equipment, and production equipment without paying customs duties, ST, or VAT.
- Export QIPs and supporting industry QIPs can also import production inputs without paying customs duties, ST, or VAT. However, if the production inputs are not used in the production line, the QIP must pay customs duties, ST, and VAT in accordance with the law.
- Certain investment activities can import construction materials, construction equipment, and production equipment without paying customs duties, ST, or VAT. However, they are not eligible for tax incentives after receiving a QIP certificate.
- Certain domestically-oriented QIPs can import production inputs without paying customs duties, ST, or VAT.
- Domestically-oriented QIPs that can directly export or supply production inputs to export QIPs may be entitled to have their customs duties, ST, and VAT refunded or reserved for the payment of future import taxes, in accordance with the law.

Additional incentives

In addition to the basic incentives set out above, investment activities registered as QIPs receive additional incentives as follows:

- Zero-rated (0%) VAT on locally-produced production inputs for the implementation of the QIP.
- A 150% deduction from the tax base for the following expenses:
    - Research, development and innovation
    - Human resource development via vocational training for Cambodian workers
    - Construction of accommodation, canteens, food courts, nurseries, and other facilities for workers
    - Modernization of production line machinery
    - Welfare promotion for Cambodian workers (e.g. home-to-work transportation, food courts with free of charge or affordable meals, nurseries, and other facilities)
    - Investment/construction of infrastructure for waste treatment

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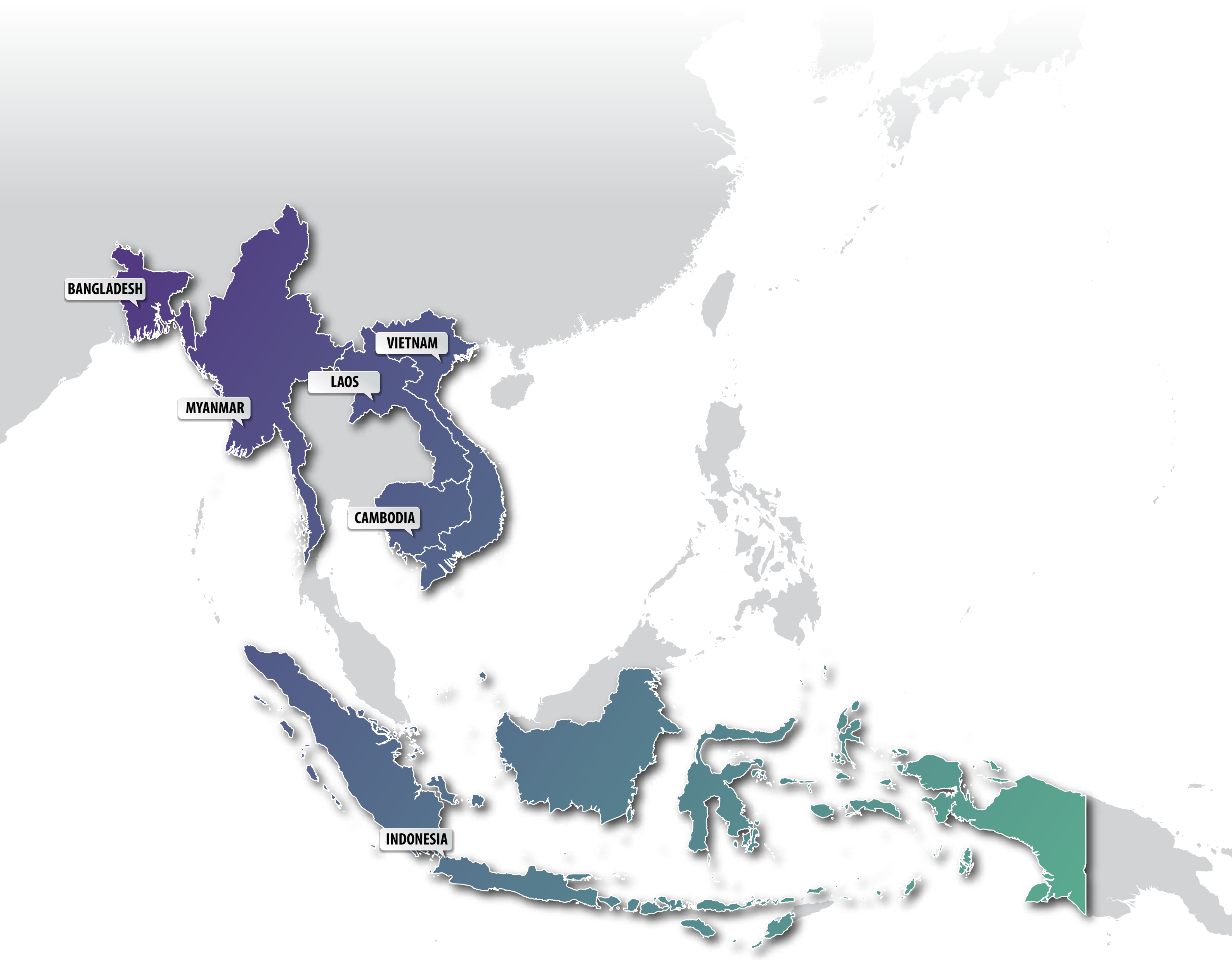

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