The Laws on Investment in Cambodia

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The Cambodian economy has experienced continuous and steady growth for the last several years. The gross domestic product growth for 2013 is projected at around 7.0 percent, and is amongst the highest of the Southeast Asian nations.

Cambodia has been off of investors' radar for a long time due to its market size, the perception of a post war country and poor infrastructure. These shortfalls have been gradually resolved thanks to the regional economic integration of Cambodia, the improvement of its public infrastructure, the emerging of a middle class and political stability.

Since its accession to the World Trade Organization ("WTO") in 2004,[1] Cambodia has adopted numerous laws and regulations governing different types of business. It should be noted that several laws which were passed at the time Cambodia was practicing a planned economy remain enforceable after it liberalized its economy in 1993. However, these recent legal and regulatory developments have had a strong impact on the overall Cambodian legal and regulatory landscape. Over the last 10 (ten) years business oriented laws have become more comprehensive given the complexity of the businesses operating in Cambodia. Authorities have started to streamline their work in an efficient manner in line with the rapid growth of business. Some also expect that online filing will be used more to facilitate business registration in the future. The business regulatory framework is generally perceived as liberal.

This paper will summarize the following:

- General facts including economic performance and the reasons to invest in Cambodia;
- Legal development in relation to investment in Cambodia; and
- The common pitfalls that every investor should be aware of while investing in Cambodia.

[1] World Trade Organization, *Cambodia and the WTO,* (2013), http://www.wto.org/english/thewto_e/countries_e/cambodia_e.htm.

1. Cambodia at a Glance

With land area of 181,035 square kilometers, Cambodia is blessed with diverse natural resources. While Cambodia is a relatively small country, it is strategically located in the heart of the Association of South East Asian Nations ("ASEAN").

Cambodia has a highly dollarized economy and the United States Dollar will work for nearly all transactions.

The population of Cambodia is nearly 15 million (fifteen million) people,[2] the majority of whom are under the age of 30 (thirty) years old, indicating that Cambodia will have a primarily young and vibrant working population for many years to come. This statistic is very enticing for investors hoping to start labor intensive projects.

Through its legislation and policies since 1993, Cambodia has established an open economic system that is welcoming to all investors, local or foreign. This open economic system has led to sustained, predictable and stable growth for the past decade. With the exception of the global economic downturn, Cambodia's GDP has remained constant, ranging from 6% to 9% since the year 2000.[3]

2. Legal Development Over Past Decade

The Cambodian economy has been lauded as very liberal since its first general elections in 1993. Cambodia's commitment to the free economy is even inscribed in its 1993 Constitution.[4] As a background, in 1994, the very first law that Cambodia passed to lure investors to Cambodia was the Law on Investment.[5] The law makes available different tax incentives and investment guarantees. Since then, investors may find themselves more protected than ever. Several business-friendly principles remain applicable as of today.

In 1999, Cambodia became the ninth member of ASEAN,[6] a regional organization which makes free economy its principal foundation. However, despite its membership in ASEAN, Cambodia did not known any major legal development relating to business until its accession to the WTO in 2004.[7]

Since its accession to the WTO, several laws have been adopted with the aim to regulate business in Cambodia, including the following:

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[2] The World Bank, *Cambodia: Country at a Glance* (2013), http://www.worldbank.org/en/country/cambodia.
[3] The World Bank, CAMBODIA OVERVIEW (2013), http://www.worldbank.org/en/country/cambodia/overview.
[4] Cambodian Const. art. 60.
[5] *See generally* Royal Kram No. No. 03/NS/94, Law on Investment of The Kingdom of Cambodia, Dated 4 Aug. 1994.
[6] Association of South East Asian Nations, ASEAN MEMBER STATES (2012), http://www.asean.org/asean/asean-member-states.
[7] World Trade Organization, *Cambodia and the WTO,* (2013), http://www.wto.org/english/thewto_e/countries_e/cambodia_e.htm.

- Civil Code (2007) and Law on Implementation of Civil Code (2011)
- Code of Civil Procedure (2006)
- Law on Commercial Enterprises (2005)
- Law on Negotiable Instruments and Payment Transactions (2005)
- Law on Concession (2007)
- Law on the Issuance and Trading of Non-government Securities (2007)
- Law on State Securities/Bond (2007)
- Law on Solvency (2007)
- Law on Financial Lease (2009)
- Law on Secured Transactions (2007)
- Intellectual Property Laws (Trademarks (2002), Patents (2003) and Copyright (2003))
- Law on Anti-Corruption (2010)
- Law on Commercial Arbitration (2006) and Sub-Decree on Organization and Functioning of the NAC (2009)

a. No discrimination

Generally, all business entities are treated equally under Cambodian law whether an investor is Cambodian or foreign. All investors are subject to the same regulations, requirements and procedures. There are very few exceptions to this rule, the primary exception being the ownership of land. The Cambodian Constitution prohibits foreign entities and foreign natural persons from owning land in Cambodia.[8] However, foreign entities and foreign natural persons can own up to 70% (seventy percent) of co-owned buildings.

b. No price fixing by the Royal Government of Cambodia

The Royal Government of Cambodia ("RGC") will not, in any case, fix the price of the products or the fee of the services offered by investors.

c. No restriction on capital flow

Free flow of capital is guaranteed to investors. Cambodia does not impose any restrictions on the use of foreign currency and the conversion of foreign currencies.

d. Protection against nationalization

Cambodia has a strong policy against the nationalization of assets. To date, although the law on nationalization has not been passed, the RGC has never nationalized assets or businesses.

[8] Cambodian Const. art. 44.

Openness of economy is one of the core commitments that Cambodia made to the WTO. It is on this basis that several laws have been adopted. For instance, the Law on Commercial Enterprises authorizes a foreign entity to set up and own 100% of a subsidiary in Cambodia. This means that, unlike certain countries in the region and with a few exceptions, Cambodia does not impose restrictions on foreign shareholding in a company including those conducting business in some sensitive sectors like banking, insurance, securities and telecommunication. As such, in general, a foreign investor is not required to form a joint venture with a local partner in order to conduct business in Cambodia.

Prior to the adoption of Law on Commercial Enterprises, investors found themselves in a difficult situation when deciding to invest in Cambodia as they were unclear as to which form of legal entity suited their business model. Since the entry into force of the Law on Commercial Enterprises, the problem has been solved as several forms of business have been put in place. Investors may choose between a representative office, as a branch, or as a fully incorporated Cambodian subsidiary. Although still young, the Law on Commercial Enterprises is the first to introduce the concept of corporate governance. In term of management of the company, the law provides quite clear distinction of powers between the shareholders who are always viewed the owner of the company and the Board of Directors which take charge of general management of the company.

The Cambodian legal system also offers a range of security interests which may be created on tangible or intangible property. The 2007 Law on Secured Transaction allows the parties to create a security interest in movable properties. The law does not prescribe the form of security interest that the parties shall choose. Instead, the parties are generally free to determine the content of the contract. It should be also noted that while the registration of the new business shall be physically conducted with the Ministry of Commerce, since 2006, the filing of the security interest over movable assets may be conducted online. The filing process is very quick and more transparent.

Cambodia took another step forward in the development of its legal and economic systems when the Cambodia Securities Exchange (“CSX”) was established in 2012. With a strong commitment to make the CSX a great success for the country, the Law on the Issuance of the Public Security was passed in 2005. The Security Exchange Commission of Cambodia (“SECC”) was established at that time as the regulator overseeing the issuance of securities to the public and the issuing companies generally. The SECC is currently issuing numerous regulations covering different matters such as the conditions for a company to offer an IPO and their governance. Currently, there is 1 (one) state enterprise (Phnom Penh Water Supply Authority) listed in the CSX. The SECC is making enormous effort in drafting regulations and policy (i.e tax incentives) to lure further listings to the CSX.

The latest legal development pertaining to business in Cambodia is marked by the entry into force of the Civil Code in 2012. The Civil Code provides a general legal framework covering different issues on contracts in general. The Civil Code contains several provisions dealing with some specific contracts, for example the sale of goods, leases (short term or long term), and lending. Influenced by the Japanese Civil Code, the Civil Code is perceived as a revisionist law which revises several provisions of the laws that were passed before it. As said above, although Cambodian law prohibits foreign legal entities or foreign natural persons from owning land in Cambodia, foreign entities or foreign natural persons may consider entering into a long term lease (with maximum duration of 50 (fifty) years, renewable) as provided under the Civil Code. With the long term lease, investor may not only hold the land for a long period but also use its right on the long term lease as collateral.

Recently, regulations have been issued to make all fees applicable on different ranges of services provided by the administration more transparent.

Dispute resolution

Like other countries, traditional dispute resolution mechanisms in Cambodia rely very much on the judicial system, which is comprised of tribunals and courts. The Code of Civil Procedure was passed in 2006 and contains lengthy provisions dealing with court proceedings. The Code of Civil Procedure allows the parties to a contract to choose between a traditional form of dispute resolution through the public court system or arbitration (local or abroad). It should be also noted that Cambodia signed the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) ("New York Convention") and has set forth the procedure to enforce foreign arbitration awards via the promulgation of its Law on Approval and Implementation of UN Convention on Recognition and Enforcement of Foreign Arbitral Awards, and the New York Convention.

The National Arbitration Center ("NAC") was established by the Law on Commercial Arbitration in 2006,[9] with the purpose of resolving commercial disputes. It was officially launched in March of 2013. The NAC was established in addition to the existing Arbitration Council ("AC") which was established by the 1997 Labor Code and commissioned to resolve the collective labor disputes.[10] The AC has been lauded as the most efficient and responsive labor dispute mechanism. Its success has been recognized at the international level and by several international organizations.

[9] *See Generally* Royal Kram No. NS/KRM/0506/010, Commercial Arbitration Law of the Kingdom of Cambodia, Dated 06 Mar. 2006.
[10] Royal Kram No. CS/RKM/0397/01, On The Labor Law, Dated 13 Mar. 1997.

3. Business Regulatory Framework: Tax Perspective

The Law on Taxation was promulgated in 1997.[11] Since its promulgation, the law was amended once on 31 March 2003. While the law is not very comprehensive, from time to time, several regulations have been issued by the Ministry of Economy and Finance to implement it.

The Law on Taxation was drafted in a very traditional way aiming to provide a general legal framework on taxation. It prescribes different type of taxes and their rates, tax declaration procedure and the process to challenge the tax assessment made by the relevant tax authority in Cambodia. Given the robust development of its economy, Cambodia has put in place some specific taxation regulations (although not very comprehensive) on specific sectors.

Understanding Cambodian Tax Rates

Cambodian tax rates are generally considered competitive, compared to other countries in the region. By doing business in Cambodia, an investor would be liable to pay certain taxes such as tax on profit, withholding tax and any other specific taxes levied on the basis of the transactions that they are entering into.

A. Tax on Profit ("TOP")

According to the Law on Taxation, generally, businesses in Cambodia are liable to pay the TOP at the standard rate of 20%. Businesses in certain industries are subject to different tax rates. For example, to encourage more listings on the CSX, the RGC allows listed companies to pay the TOP at the preferential rate of 18% for 3 (three) years, provided that they have issued at least 10% of their total equities.[12] Furthermore, all companies investing in the oil and gas sector are subject to a TOP of 30% while companies operating insurance business are subject to a TOP rate of 5% of the insurance premium.

Under the Cambodian law, TOP may be exempted if an investment has Qualified Investment Project ("QIP") status or is in the rice sector.

QIP

Not all projects are eligible for QIP status. The Law on Investment provides a list of sectors which are not eligible for QIP status and the tax incentives therein.[13] For some sectors that are eligible for QIP status, the Law on Investment provides different criteria (such as the capital and scope of the investment) for the Council for the Development of Cambodia to consider if that project may or may not receive QIP status. The Council for

[11] *See Generally Royal Kram No. NS/RKM/0303/010, Law on Taxation, Dated 31 Mar. 2003.*
[12] Sub-decree No.70 ANKr.BK on Tax Incentives in Securities Sector art. 4, Dated 22 Apr. 2011.
[13] Sub-Decree No. No. 111/ANK/BK, On the Implementation of the Amendment to the Law on Investment of The Kingdom of Cambodia, sched. I, sec. II, Dated 27 September 2005.

the Development of Cambodia is the one-stop institution which receives the applications, studies the feasibility of investment projects, and grants or denies QIP status. Projects in the following sectors are eligible for QIP status:

- Agriculture and agro-industry;
- Transport and telecommunications;
- Energy and electricity;
- Labor-intensive industries, processing and manufacturing;
- Tourism;
- Human resource development; and
- Oil & gas, mining.

Among other investment incentives, a QIP holder may choose between a tax holiday on the TOP or a special depreciation. If the exemption on TOP is chosen by the QIP holder, tax holiday has a duration of at least 3 (three) years (depending on type of industries and the amount of capital investment) and shall start from the first year that an investment make profit or third year after an investment earns its first revenue, whichever is sooner.[14]

The special depreciation is an amount deductible in the first year of purchase or, if later, the first year the tangible property is placed into service by the QIP. The amount deductible is equal to 40% of the capital cost of new and/or used tangible property used in manufacturing and processing. This special depreciation will reduce the capital cost of tangible assets for normal depreciation deductions.

The tangible property used for the special depreciation has to be held for a minimum of 4 (four) years. If the QIP disposes of the asset by any means prior to end of the 4 (four) years holding period during which the special depreciation has been granted, an amount equal to the special depreciation deduction reduced by 2% of that deduction for each month that the assets have been in place, shall be re-included in the taxable profit.

Rice sector

Enterprise carrying on a business related to the growing and purchasing of paddy rice and exporting rice, regardless of whether it is a QIP or not, will receive the tax incentive

[14]Royal Kram No. RS/RKM/0303/009, the Law on Amendment of Law on Investment, art. 14, Dated 31 Mar. 2003.

similar to investments having QIP status.[15] The minimum exemption period of TOP is 3 (three) years.[16]

Investors in the rice sector must apply for those benefits to the General Department of Taxation.[17]

Figure 1: Comparative Table of the TOP Rates

Type of Company	***Tax rate***	***Note***
General business company	*20%*	*standard rate*
Insurance[18]	*5%*	*taxable on gross premium, profit of insurance company generated by other activities is taxable at 20%*
QIP	*0%*	*during tax holiday period*
Oil or natural gas production, natural resources exploitation including timber, ore, gold, and precious stones	*30%*	
Paddy rice and rice industry	*0%*	*enterprise cultivating paddy rice, purchase paddy rice, and producing processed rice for exportation during incentive period*
Listed company	*18%*	*for 3 (three) years after launch of the CSX*

B. Withholding Tax ("WHT")

Any resident taxpayers who make payments on interest, royalties, rental and other income connected to the use of property, or dividends and compensations of technical or management services paid to non-resident taxpayers shall be required to withhold the WHT at 14%.[19] Certain payments to resident taxpayers are also subject to WHT at the following rates:[20]

- Rental (10% WHT);
- Interest (15% WHT, except payment to local banks);
- Services (15% WHT, except payment to registered taxpayers with a proper VAT invoice);
- Dividend (7% for listed companies); and

[15] Royal Kram No. 779 MEF.PK, Additional Tax Incentives for Paddy Cultivation, Paddy Purchase, and Rice Production for Exportation art. 1, Dated 11 Oct. 2011.
[16] *Id.*
[17] *Id.*
[18] Royal Kram No. NS/RKM/0303/010, Law on Taxation, art. 21, Dated 31 Mar. 2003.
[19] Royal Kram No. NS/RKM/0303/010, Law on Taxation, art. 26, Dated 31 Mar. 2003.
[20] Royal Kram No. NS/RKM/0303/010, Law on Taxation, art. 25, Dated 31 Mar. 2003.

- Royalties (15% WHT).

WHT is due whenever the payment is made or when the expense is recorded.

C. Value Added Tax ("VAT")

The tax administration imposes 2 (two) VAT rates.[21] The standard VAT rate of 10% applies to all taxable supplies. Additionally, goods exported from Cambodia and services rendered outside of Cambodia will be subject to a VAT rate of 0%. Import and supply of the following products are not subject to VAT:[22]

- Fertilizer for use in agriculture;
- Plant seeds;
- Parts of cut branches of tree for growing;
- Animal medicines, foods and food grinding machines;
- Animal breeding stock including wild animals;
- Small tractors and their spare parts for family use;
- Agricultural equipment for growing seeds, grinding food and hatching eggs; and
- Pumping machines.

Comparative Tax Rates in the Mekong Region

Among Mekong-region countries, Cambodia and Thailand have the lowest TOP standard rate of 20%. Cambodia WHT rate is in line with the other countries in the region. In terms of WHT for non-resident, Cambodian WHT rate is lower than Myanmar and Thailand, but higher than Lao PDR and Vietnam.

Country	Tax on Profit (Corporate Income Tax) (Standard)	Withholding Tax (Resident)	Withholding Tax (Non-resident)	VAT (Standard)
Cambodian	20%	0%-15%	14%	0-10%
Lao PDR	24%	5-10%	5-10%	0-10%
Myanmar	25%/35%	2-15%	3.5-20%	5%

[22] Prakas No. 303 SHV.PD, Implementation of VAT on importing and supplying specific goods, section 1, Dated 23 May 2001.

Thailand	20%	1-10%	1-15%	0-7%
Vietnam	25%	5-10%	5-10%	0-10%

4. Common Pitfalls

a. Untested laws

New laws have been introduced in Cambodia, and several remain untested with the courts of Cambodia. As such, the interpretation of any obscure provision of law would be difficult.

b. Knowing Your Target Company/Due Diligence

When considering the purchase of a company, a thorough due diligence must always be considered. This means that the due diligence should cover all areas related to a company's legal compliance, financial situation, and tax compliance and future tax liability. Failure to do so can leave a purchasing investor with unwanted legal liabilities, financial obligations, and tax liabilities.

c. Investment Structure (legal, tax and land holding structure)

The structure of an investment should always be carefully considered before the investment is made in order to maximize effect and profit. As mentioned above, a foreign entity may establish itself in Cambodia as a representative office, as a branch, or as a fully incorporated Cambodian subsidiary. Each of these structures has specific legal implications such as restrictions on certain types of operations and liability to the parent company. Each of these structures also has specific tax implications as well. It is important to carefully plan the legal and tax structure beforehand.

d. Common Issues on Contract (law, language and dispute resolution)

Cambodian law grants extensive freedom to the parties of a contract to structure their contract however they would like. With few exceptions on limited subject matter, the parties may choose what law, language and dispute resolution mechanism they will use. When choosing a governing law, it is important to consider where a dispute regarding the contract will likely be resolved. Investors should know that Cambodian courts do not generally apply the laws of other countries when they are resolving a contractual dispute. Therefore, even if there is a choice of law provision in a contract, it may not be honored in Cambodia. The language of the contract and translations as well as the language of any possible dispute resolution mechanism are another consideration that parties should consider. Contracts in Cambodia are commonly found in English, French and Khmer (Cambodian). Finally, the parties should consider choosing a dispute resolution mechanism such as mediation or arbitration.

e. Understand Government Institutions

Understanding government institutions is absolutely critical to operate a successful investment in Cambodia. Cambodia has many government institutions that regulate different sectors, and they each operate differently. One challenge investors have with understanding government institutions is that many functions of the institutions are not clearly defined in published documents, and can change without notice. Therefore, understanding the government institutions at a deep level will allow investors to predict when such changes will occur and to discover such changes quickly.

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