

PROCLAMATION
On
Measures and Procedures for the Allocation of Income and Expenses
Among Related Parties
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The Deputy Prime Minister
Minister of Economy and Finance

- Having seen the Constitution of the Kingdom of Cambodia;
- Having seen Royal Decree No. NS/RKT/0823/1981 dated 22 August 2023 on the appointment of the Royal Government of the Kingdom of Cambodia;
- Having seen Royal Decree No. NS/RKT/0224/205 dated 21 February 2024 on the appointment and supplementation of the composition of the Royal Government of the Kingdom of Cambodia;
- Having seen Royal Kram No. NS/RKM/0618/012 dated 28 June 2018 promulgating the Law on the Organization and Functioning of the Council of Ministers;
- Having seen Royal Kram No. NS/RKM/0196/18 dated 24 January 1996 promulgating the Law on the Establishment of the Ministry of Economy and Finance;
- Having seen Royal Kram No. NS/RKM/0323/001 dated 10 March 2023 promulgating the Law on the Public Financial System;
- Having seen Royal Kram No. NS/RKM/0523/004 dated 16 May 2023 promulgating the Law on Taxation;
- Having seen Sub-Decree No. 43 ANK/BK dated 28 February 2022 on the Organization and Functioning of the Ministry of Economy and Finance;
- In response to the necessary requirements of the Ministry of Economy and Finance;

Hereby decides as follows:

Chapter 1

General Provisions

Article 1: Purpose

This Proclamation aims to establish measures and procedures for the allocation of income and expenses arising from business operations among related parties.

Article 2: Scope

This Proclamation applies to all business transactions between two or more related parties, provided that at least one of the related parties is a resident taxpayer.

Article 3: Definitions

For the purposes of this Proclamation:

Related Party refers to:

- a) Any member of the taxpayer's family circle;
- b) An enterprise that directly or indirectly controls a taxpayer, or is directly or indirectly controlled by a taxpayer, or is under common control with a taxpayer, or a relationship between a permanent establishment and a non-resident taxpayer.

For the purposes of this provision, control means ownership of 20 percent or more of the value or voting rights of shares in the equity capital of an enterprise. In determining the level of control of an individual taxpayer, all

shareholdings owned directly or indirectly by the taxpayer and their related parties shall be taken into account.

Notwithstanding the above, the Tax Administration may determine the existence of direct or indirect control based on the actual circumstances of each case.

Affiliated Enterprises refer to a group of enterprises that are related parties in accordance with subparagraphs (a) and (b) of Paragraph 1 of this Article.

Transfer Price refers to the price of goods, services, or property supplied between related parties.

Controlled Transaction refers to a transaction between related parties that is generally pre-arranged. For the purposes of this provision, any transaction with a party established in a jurisdiction with a lower tax rate than the Kingdom of Cambodia shall be deemed a controlled transaction.

Uncontrolled Transaction refers to a transaction that is not a controlled transaction and is carried out between independent enterprises. An independent enterprise is a legal entity that is not a related party.

Arm's Length Principle refers to the principle for determining prices of transactions under comparable conditions conducted between independent enterprises, for comparison with transactions conducted between related parties. Prices determined under this principle are referred to as arm's length prices.

Gross Income (Gross Sales) refers to total income derived from business activities before deductions for discounts, returns, cost of goods sold, and operating expenses.

Gross Margin refers to the ratio of gross profit (gross income less cost of supply of goods, services, or property) to gross income.

Gross Profit refers to the difference between gross income and cost of goods sold.

Net Margin refers to the ratio of net income (gross profit after deduction of operating expenses) to gross income.

Mark-Up refers to the ratio of gross profit to cost.

Residual Profit refers to the remaining profit after separating routine profits derived from the production or distribution of goods or services, excluding profits attributable to unique intangibles.

Primary Adjustment refers to the initial adjustment made by the Tax Administration to taxable income after applying the arm's length principle to transactions between a taxpayer and related parties.

Secondary Adjustment refers to adjustments resulting from the reassessment of tax consequences arising from the primary adjustment, including dividends, deemed benefits, or loans.

Median refers to the middle value of a dataset arranged in ascending order. If the number of observations is odd, the median is the middle value; if even, it is the average of the two middle values.

Transfer Pricing refers to the determination of prices for transactions between related parties.

Article 4: Overview of Transfer Pricing

Transfer pricing applies to all transactions between related parties. Such transactions may shift economic benefits from one related party to another by increasing or decreasing the prices of goods, services, or property supplied, where such prices do not reflect actual market conditions as would be observed in transactions between independent enterprises.

Therefore, to ensure the appropriateness of transfer pricing among related parties, taxpayers must apply appropriate policies, methodologies, and supporting documentation, and disclose them truthfully and accurately.

Article 5: Preconditions

To appropriately allocate income and expenses in accordance with the arm's length principle, a comparability analysis must be conducted by comparing controlled transactions with uncontrolled transactions. Such comparison is acceptable if one of the following conditions is met:

- a) The transactions or enterprises being compared have no material differences that affect market price; or
- b) Reasonable and accurate adjustments can be made to eliminate the material effects of such differences.

The comparability analysis shall primarily focus on commercial and financial relationships among related parties, economic activities, and other factors affecting economic activities, including transactions involving simple products, semi-finished goods, high-technology products, computer software, or services such as consulting or engineering.

Article 6: Comparability Factors

Under the arm's length principle, comparability is determined by comparing the conditions of controlled transactions with those of independent enterprises. Relevant economic characteristics must be carefully compared based on similarity through the following factors:

Contractual terms, including:

- a) Allocation of responsibilities, risks, and benefits;
- b) Terms affecting prices or profit margins such as credit terms, payment terms, volume, warranties, etc.;
- c) Actual conduct of the parties compared to contractual terms, where actual conduct shall prevail if inconsistent with the contract.

Functional analysis, including comparison of:

- a) Functions performed (production, marketing, promotion, R&D, product design, etc.);

b) Assets used (factories, machinery, equipment), characteristics of assets, and use of intangibles;

c) Risks assumed, including market risk, financial risk, foreign exchange risk, and R&D risk.

Characteristics of goods or services, including:

a) Product form, quality, and quantity;

b) Nature and scale of services;

c) Nature of intangible assets.

Economic circumstances, including:

a) Geographic market location;

b) Market size;

c) Availability of substitute goods or services;

d) Government economic intervention.

Business strategies, including innovation, diversification, market penetration and expansion strategies, and distribution networks.

Article 7: Arm's Length Range

The arm's length range is the range of relevant financial indicators (prices or profit margins) derived from applying transfer pricing methods specified in Articles 9 to 13, based on comparable uncontrolled transactions identified through the comparability analysis in Article 6.

A controlled transaction shall not be adjusted if the tested financial indicator falls within the arm's length range. If it falls outside the range, adjustment shall be made to the median of the arm's length range, provided such adjustment does not reduce or eliminate tax revenue.

Chapter 2

Methods for Allocating Income and Expenses Among Related Parties

Article 8: Transfer Pricing Methods

To allocate income and expenses among related parties under the arm's length principle, taxpayers may apply one or more of the following methods:

- a) Comparable Uncontrolled Price Method (CUP);
- b) Resale Price Method (RPM);
- c) Cost Plus Method (CPM);
- d) Transactional Net Margin Method (TNMM);
- e) Profit Split Method (PSM).

Taxpayers must prepare and provide evidence and supporting documentation for the selected method. Where necessary, the Tax Administration may instruct or require the taxpayer to apply a method deemed appropriate to the taxpayer's actual circumstances.

Article 9: Comparable Uncontrolled Price Method (CUP)

The **CUP** method compares the price charged for goods, services, or property in a controlled transaction with the price charged in a comparable uncontrolled transaction under similar circumstances. This method is appropriate where products or services are comparable, or where reliable adjustments can be made. If material differences cannot be reliably adjusted, other methods may be applied.

Comparability analysis under the **CUP** method shall consider differences in products or services, contractual terms, quantities, timing, transport costs, marketing costs, geographic markets, and other factors affecting price.

Example 1

Enterprise A supplies 70% of its goods to a related party overseas (Enterprise B) at a price of KHR 100,000 per unit, and the remaining 30% to an independent local enterprise (Enterprise C) at a price of KHR 150,000 per unit.

Case 1

Assume that Enterprise A supplies identical goods to both Enterprise B and Enterprise C.

The transaction between Enterprise A and Enterprise C may be considered an internal comparable uncontrolled transaction for the purpose of applying the Comparable Uncontrolled Price (CUP) Method.

However, a functional analysis of Enterprise A, Enterprise B, and Enterprise C must first be conducted to identify any differences that may have a material impact on the market price.

If such differences exist, appropriate and reasonable adjustments must be made to eliminate those differences.

If there are **no material differences** affecting the market price, the CUP method may be applied using the **arm's length price of KHR 150,000 per unit**, which represents the market price.

Accordingly, the transfer price of **KHR 100,000 per unit** should be replaced by the **arm's length price of KHR 150,000 per unit**.

As a result, Enterprise A's revenue will increase after recognizing the higher arm's length price compared to the originally applied transfer price. This increase in revenue will lead to changes in profit levels, as shown in the table below.

In summary, after applying the arm's length principle, Enterprise A must make a **tax base adjustment of KHR 50,000 per unit** (KHR 60,000 – KHR 10,000). This amount of **KHR 50,000 per unit** shall be adjusted to taxable income and subsequently to other related taxes.

Case 2

If a **volume discount** applies due to different supply volumes to Enterprise B and Enterprise C, Enterprise A must make adjustments in accordance with **standard industry practices**.

Assume Enterprise A normally grants a **10% discount** for supplies exceeding **50% of total output**.

Accordingly, the price of **KHR 100,000 per unit** supplied to Enterprise B should be adjusted as follows:

- Market price: KHR 150,000
- Less: 10% volume discount (KHR 15,000)
- Adjusted arm's length price: **KHR 135,000 per unit**

However, the actual transfer price charged to Enterprise B is **KHR 100,000 per unit**.

Therefore, even after making reliable and reasonable adjustments for material differences, the CUP method shows that the transfer price of **KHR 100,000** remains **below the adjusted arm's length price of KHR 135,000**.

As such, the transfer price must be replaced with **KHR 135,000 per unit**.

In this case, Enterprise A's revenue and net profit will change accordingly. In summary, after applying the arm's length principle, Enterprise A must make a **tax base adjustment of KHR 35,000 per unit** (KHR 45,000 – KHR 10,000).

This amount shall be adjusted to taxable income and subsequently to other related taxes.

Article 10: Resale Price Method (RPM)

1. Definition

The **Resale Price Method (RPM)** compares the **gross profit margin** earned from reselling goods in a **controlled transaction** with the gross margin earned in a **comparable uncontrolled transaction**.

This method is generally most appropriate for transactions involving **distribution or resale functions**, particularly where the distributor bears **limited risks** and does not use or contribute **unique and valuable intangible assets**.

The main focus of this method is on the **value added** by the reseller prior to resale.

RPM becomes difficult to apply when:

- Goods pass through multiple stages,
- There is a long time gap between purchase and resale (during which market conditions may change), or
- The reseller adds substantial value or develops unique intangibles.

2. Application

The starting point under RPM is the **resale price** at which goods purchased from a related party are resold to an independent enterprise.

An appropriate **gross margin** is deducted from the resale price to cover:

- Distribution costs,
- Operating expenses,
- Functions performed,
- Assets used, and
- Risks assumed,

so that the reseller earns an appropriate net profit.

The arm's length price is determined by deducting the appropriate gross margin from the resale price.

Gross margin may be derived from:

- Internal comparable transactions, or
- External comparable distributors operating in the same market.

Gross margins may vary depending on the level of value added by the reseller.

3. Comparability Analysis

When assessing comparability under RPM, the following factors must be considered:

- a. Functions performed and risks assumed by the reseller
- b. Similarity of assets used
- c. Product similarity (especially when valuable intangibles are involved)
- d. Differences in business management affecting profitability
- e. Time gap between purchase and resale
- f. Exclusive or non-exclusive distribution rights
- g. Accounting differences requiring adjustments
- h. Other factors affecting gross margin

Example 2 (RPM)

- Enterprise A: multinational company producing high-quality products abroad
- Enterprise B: Cambodian subsidiary of Enterprise A
- Enterprise C: independent Cambodian enterprise
- Enterprise D: independent distributor in Cambodia

Enterprise B purchases products from Enterprise A at **KHR 7,600 per unit** and resells them to Enterprise C at **KHR 8,000 per unit**.

Enterprise D resells comparable products under similar conditions and earns a **gross margin of 10%**.

Although product differences exist, they do not materially affect the application of RPM because the comparison focuses on **gross margin**.

Enterprise B and Enterprise D perform similar distribution functions in the same market and at the same level of the value chain. Therefore, Enterprise D's **10% gross margin** can be used as the benchmark.

Enterprise B's actual gross margin is **5%** $[(8,000 - 7,600) / 8,000]$.

This must be adjusted to **10%**, requiring an adjustment to the transfer price.

To achieve a 10% margin, the transfer price must be reduced to **KHR 7,200 per unit**.

Thus, the original transfer price of **KHR 7,600** must be replaced with **KHR 7,200 per unit**.

After applying the arm's length principle, Enterprise B must make a **tax base adjustment of KHR 400 per unit** $(7,600 - 7,200)$.

This amount shall be adjusted to taxable income and other related taxes.

Article 11: Cost Plus Method (CPM)

1. Definition

The **Cost Plus Method** compares the **markup on costs** incurred in a controlled transaction with the markup earned in comparable uncontrolled transactions.

This method is generally applied when:

- Semi-finished goods are supplied between related parties,
- Manufacturing is performed under contract, or
- Services are provided between related parties.

2. Application

The starting point is the **cost base** of the supplier.

An appropriate markup is added to determine the arm's length price.

The arm's length principle requires comparison of the markup in controlled transactions with that in comparable uncontrolled transactions.

Cost base includes **direct and indirect production costs**.

Financing costs are generally excluded unless inclusion improves reliability.

Accounting methods and cost structures must be consistent and comparable.

Example 3 (CPM)

Enterprise C, a Cambodian subsidiary of multinational Enterprise A, manufactures specialized electrical components exclusively for Enterprise A.

Enterprise C purchases raw materials from independent suppliers at **KHR 2,000 per unit**.

Total production cost is **KHR 8,000 per unit**.

Enterprise C sells the components to Enterprise A at **KHR 10,000 per unit**.

Due to the customized nature of the components, no internal comparable transactions exist. External commercial databases must therefore be used.

Based on comparable independent companies, an appropriate cost-plus markup is determined and applied to assess compliance with the arm's length principle.