

## **Cambodia Client Alert: Important Update on Tax Compliance Obligations for all Associations and NGOs**

*Reference: Instructions on Tax Compliance for Associations & Non-Government Organizations – Prakas No.464 SHV.Brk dated 12 April 2018 (“Prakas 464”)*

The General Department of Taxation (“**GDT**”) in recent years has been quite vocal with regard to the tax registration obligations of both Associations and Non-Government Organizations (“**NGOs**”) operating in Cambodia. The introduction of Prakas 464 earlier this month reaffirms the tax registration requirements of these bodies while elaborating further on the scope of the Tax on Income exemption provided in the Law on Taxation (“**LOT**”).

Prakas 464 makes it very clear that income derived by “social enterprises” falls outside of the scope of the Tax on Income (“**TOI**”) exemption provided by the LOT. For the sake of clarity, a social enterprise is usually an organization involved in the sale of goods and services in a particular market, but which also has specific social objectives serving as its primary purpose. In practice, Associations and NGOs operating in Cambodia may receive membership fees, donations, and grants, but they may also run social enterprises which are often related to their underlying objectives. This can include running a restaurant employing disadvantaged youths, selling products that are produced by victims of domestic abuse, or charging tuition fees for a vocational school.

Prakas 464 states not only that income from the types of activities outlined above is excluded from the TOI exemption provided under the LOT, but also that NGOs or Associations carrying out such activities must obtain a separate tax registration and maintain separate financial records for them.

Prakas 464 may require some Associations and NGOs to adequately review their current activities and assess whether a separate tax registration under their existing structure, or the creation of a separate legal entity, are required to carry out the social enterprises. There are a number of legal and tax implications associated with both options.

We provide a detailed summary of Prakas 464 below.

### **- Scope of Prakas 464**

Article 4 of Prakas 464 defines Associations and NGOs as follows:

*An “Association” refers to an organization with members that is created by individuals or entities with the aim of representing and protecting the interests of its members without seeking to make any profit or share any proceeds. An “Association” also includes a commercial, industrial or agricultural chamber.*

*An “NGO” refers to an organization that may have no members, including a foundation, created by individuals or entities other than government institutions with the aim of providing funds or services in one or more sectors to serve the public interest without seeking to make any profit or share proceeds.*

### **- Obligation to Register with the General Department of Taxation**

Prakas 464 refers to Article 101 of the LOT which provides that:

*“A legal person must register with the tax administration within 15 days after the person begins economic activity.”*

The key terms to note in Article 101 are “legal person” and “economic activity.” The 2017 Law on Financial Management amended the definition of “legal person” as contained in the Law on Taxation to include:

*“The term “legal person” includes any capital company, government institution, **religious organization, charitable organization, or nonprofit organization** or permanent establishment of a non-resident person located in the Kingdom of Cambodia.....”*

Economic activity is defined as *“the regular, continuous or occasional activity of a person, **whether or not for profit**, in the supply or intent to supply, goods or services to another person for the purpose of obtaining a benefit.”*

Article 20 of the Law on Associations and Non-Governmental Organizations (“**LANGO**”) further provides that:

*“An association or non-governmental organization, which has registered or signed a Memorandum of Understanding, shall be subjected to the existing taxation regime law, and receive incentives and enjoy exemptions in accordance with the existing laws and provisions.”*

In practical terms, most Associations and NGOs will need to register with the GDT within 15 days after duly registering with the Ministry of Interior or the Ministry of Foreign Affairs. Under the revised tax regime in place since 2016, NGOs and Associations will need to be designated as Medium Taxpayers.

#### - **Tax Exemption**

Arguably, the most important clarification brought about by Prakas 496 relates to the scope of the TOI exemption provided to qualifying entities under Article 9 of the LOT.

The LOT stipulates that donations and grants received by a taxpayer are considered to be assessable income for tax purposes.

Article 9 of the LOT provides that an exemption from TOI may apply to *“the income of any organization that is:*

- (i) Organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes; and*
- (ii) Where no part of the property or earnings of which is used for any private interest.”*

To be eligible for the TOI exemption, Associations and NGOs must submit an application to the GDT with a covering letter and copies of the following documents:

- Statute and letter of approval on registration at the Ministry of Interior, for local Associations and NGOs; and
- Memorandum of Understanding with the Ministry of Foreign Affairs and International Cooperation, for foreign Associations and NGOs.

Prakas 496 clarifies that income which is subject to the TOI exemption under Article 9 of the LOT includes:

- Funds or donations;
- Resources or assets of the Association or NGO;
- Members' contributions; and
- Other sources of income *excluding those from business activities*.

Prakas 496 does not refer to exemptions for Value Added Tax (“**VAT**”) and Tax on Salary (“**TOS**”) for employees. For completeness Article 57 of the LOT lists the activities carried out by taxpayers in Cambodia that constitute non-taxable supplies for VAT purposes. Article 57(7) outlines that the following activity may be classed as a non-taxable supply:

*“Non-profit activities in the public interest that have been recognized by the Ministry of Economy and Finance”.*

Section 1.5-1.7 of the TOS Prakas provides that employees of diplomatic missions and foreign government, international Organizations (“**IO**”), technical cooperation agencies of other governments for employment activities in an official capacity for such IOs shall not be subject to TOS. TOS exemptions may also be provided in a Memorandum of Understanding between a NGO and a Cambodian Ministry.

The key point to note with respect to both the VAT and TOS exemptions is that the Ministry of Economy and Finance are the final judge as to whether the exemptions can be enforced or not. If a NGO has no formal confirmation from the Ministry of Economy and Finance as to the validity and scope of the exemption then it is deemed void.

- ***Excluded Income***

As outlined above, income derived by Associations and NGOs from commercial activities are considered to be separate business activities that are excluded from the Prakas 496 TOI exemption.

This Prakas offers the following examples of what may constitute excluded activities:

*Example 1:*

*Organization A was created for the purpose of developing and assisting orphans and homeless people by providing free education and training on literature, cooking, hospitality, and motor vehicle repair. The Organization operates a restaurant and garage where orphans and homeless people can acquire new skills to help them obtain jobs in the future. The revenue from the restaurant and garage is used to support the organization's activities.*

*Example 2:*

*Association B was created for the purpose of developing agricultural plantations, and for plant breeding research purposes. Association B establishes a school to educate its trainees and charges tuition fees. The proceeds from the school are used to support its activities.*

Prakas 496 holds that the activities of the restaurant, garage, and vocational school are considered to be separate business activities - the proceeds of which will be subject to income tax.

Additionally, any Association or NGO that carries out such activities must register these with the GDT and maintain separate financial records for them.

### **DFDL Analysis**

Prakas 496 goes a considerable distance in providing welcome clarity on how to tax what has historically been an unclear sector. Numerous Associations and NGOs in Cambodia are still coming to terms with their tax compliance obligations, and a number of misconceptions remain among the NGO community in regard to what taxes should or should not be declared and paid.

A number of NGOs that operate in Cambodia may, for example, file monthly tax returns to declare the tax on salary for staff and WHT, but fail to submit annual Tax on Income returns due to the fact that they may be forced to pay 20% TOI on donations or grants received during the course of the year. This practice may have resulted from the Ministry of Economy and Finance being historically slow in processing TOI exemption applications.

We know now from first-hand experience that the application process for TOI exemptions has become much more stream-lined. Those Associations and NGOs that are eligible to apply for TOI exemptions should do so now.

For those Associations and NGOs carrying out social enterprise activities, the tax treatment for these activities is now quite clear. Income from those activities is taxable and a separate tax registration for these must be performed.

The DFDL tax team has a vast and varied depth of experience concerning the tax obligations of Associations and NGOs, and the relevant TOI exemption process that applies to both. As always, we stand ready to answer any questions that you may have on this and other tax issues of concern.

### **DFDL Contact**

Clint O'Connell  
Cambodia Head of Tax  
clint.oconnell@dfd.com

*Tax services required to be undertaken by a licensed tax agent in Cambodia are provided by Mekong Tax Services Co., Ltd, a member of DFDL and licensed as a Cambodian tax agent under license number – TA201701018.*