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# Taxation of PEs in the Mekong Region — Cambodia, Laos, Myanmar, Vietnam

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The Mekong region is a growing business hub in which permanent establishments are defined by and subject to different taxation rules, depending on the jurisdiction. Operators, particularly those with cross-border concerns in the region, should take note of the distinctions.

## I. Permanent Establishment Rules in Cambodia

Cambodia's permanent establishment rules are defined under the Law on Taxation and supporting regulations. The interpretation and application of PE rules in Cambodia are not developed and, in general, are quite wide in scope. Cambodia has not entered into any double tax agreements and as such, these are the only rules that determine whether or not a foreign enterprise has created a PE risk in Cambodia.

Under Cambodia's LOT and related regulations, a PE is defined as "a fixed place of business or a resident agent in Cambodia through which a non-resident person carries out business, wholly or partially, in Cambodia. A permanent establishment includes *any other association or connection or means through which a non-resident person engages in economic activities in Cambodia*".

The term "economic activities" is defined as the "regular or continuous or from time to time activity of a person, whether or not for profit, in the supply of, or the intent to supply of, goods and services to other persons for the purpose of obtaining any benefit."

The rules also identify the following as constituting a PE:

- A place of management;
- A branch/agency of a foreign enterprise;
- An office of a foreign enterprise;
- A warehouse;
- A factory;

- A workshop;
- A mine, or any other place of extraction, of natural resources;
- A farm or plantation;
- A building site, a construction project or an assembly project, or supervisory activities connected to such site or project where such site or project or activities continue for a period of more than 6 months;
- The furnishing of services, including consultancy services, by the employees or other persons of a foreign enterprise where such activities continue within Cambodia for periods aggregating more than 6 months in any 12-month period; and
- An agent who regularly exercises the authority to conclude contracts in Cambodia on behalf of a foreign enterprise.

As can be seen from the above, the mere opening up of an office or a warehouse already leads to the creation of a PE in Cambodia. It is significant that the rules do not incorporate the following OECD or UN Model Treaty exceptions:

- The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
- The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;

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- The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
- The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character; and
- The maintenance of a fixed place of business solely for any combination of activities mentioned above provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

An equally important point is that Cambodia's PE rules do not distinguish between dependent and independent agents; such distinctions are found in the above model tax conventions and incorporated into many domestic tax legislations.

## II. Permanent Establishment Rules in Lao PDR

### A. General

The Lao PDR ("Laos") Tax Law has no concept of PE under its domestic Tax Law. The PE concept is generally only applied under a double tax agreement. Laos does however have a set of rules governing the taxation of non-resident enterprises that generate income in Laos. A non-resident enterprise will be subject to Laos profit tax if it derives income from sources in Laos. For such non-resident enterprises that derive income from sources in the country, the tax is paid by means of a withholding applied by the Lao enterprise that remits the income to the non-resident. This withholding is calculated on a deemed profit basis.

Laos has concluded DTAs with several jurisdictions, including Singapore, Thailand, China, Vietnam, Malaysia and Korea. Article 5 of its DTAs generally follows the OECD model and provides that profit derived from Laos would not be subject to profit tax in Laos, unless attributable to a PE in Laos.

The profit tax is paid by means of a withholding that is applied by the Lao enterprise that remits the income and is calculated on a deemed profit basis.

The profit tax rate is 24%, which must be applied to a deemed profit rate for each type of activity. For instance, the deemed profit rate for general services is 20%. The effective tax rate is thus 4.8% for services income derived from the supply of services in Laos. The deemed profit rate for transportation and construction is 10% of business income, thus the effective tax rate is 2.4%.

The Lao entity is responsible for withholding and filing a separate tax declaration with the tax department within 30 days from the date of withholding such tax.

### B. Withholding VAT

The Lao entity also has to withhold VAT at 10% before making a payment to non-resident service providers. If the Lao entity is registered in the VAT regime, the tax withheld is required to be filed with the tax department at the same time as the monthly tax return (i.e. the 15th of the following month). If, however, the Lao entity is not registered in the VAT regime, the tax withheld is required to be filed with the tax department within 30 days from the date of payment.

Withholding VAT will apply if the supply of goods and services takes place in Laos. The determination of the place of supply of a service is made in accordance

with Articles 9 and 10 of the VAT Decree. Article 9 provides for the place and time of supply of goods, while Article 10 provides for the place of supply of services.

In general, the place of supply of a service is the place where the receiver of the service is established or has his usual residence within Laos. With respect to the supply of certain services, special rules are provided for each case.

## III. Permanent Establishment Rules in Vietnam

### A. General

Under Vietnam's Circular No: 78/2014/TT-BTC (June 18, 2014), foreign enterprises will be taxable in Vietnam if they are deemed to have created a PE in Vietnam.

Foreign companies are deemed to have a PE if they have manufacturing and business facilities through which they conduct a part or all of their production and business activities in Vietnam to earn income.

These mainly include:

- Branches, executive offices, factories, workshops, means of transportation, mining, oil and gas field or other sites of extraction of natural resources in Vietnam;
- Construction sites, constructions, installations or assembly projects;
- Establishments providing services, including consultancy services through employees, an organization or individual;
- Agents for foreign enterprises; and
- Representatives in Vietnam in the case of authorized representatives to sign contracts in the name of foreign enterprises or non-authorized representatives to sign contracts in the name of foreign enterprises, but regularly delivering goods or providing services in Vietnam.

Where Vietnam has signed a DTA that has different provisions on PEs, the provisions of that DTA will apply.

### B. Taxation of PEs

The issue of a PE arises where the foreign entity does not have a registered local entity in Vietnam. These are referred to as Foreign Contractors, which are governed by Vietnam's Foreign Contractor Tax ("FCT") Circular. The FCT includes both an income tax and Value Added Tax component.

Foreign contractors are generally taxed through the withholding tax system. Under the WHT system, Vietnamese taxpayers are required to withhold a FCT from their payments to the foreign enterprise. The WHT is a final tax and there are no further filing requirements for the foreign contractor. This is referred to as the direct method.

A foreign contractor with a PE has the option to register its PE for tax purposes. There are two methods by which a PE can be registered — the deduction method and the hybrid method.

Under the deduction method, the foreign contractor adopts the full Vietnam Accounting System ("VAS"). It pays both Corporate Income Tax and VAT as if it is a local entity — CIT on net income at 22% and 10% VAT with the ability to claim input VAT credits.

Under the hybrid method, the foreign contractor adopts a simplified VAS. It pays CIT on deemed income, similar to the withholding method, and reports 10% VAT with the ability to claim input VAT.

## C. Recent Developments

In most cases, the issue of a PE arises in Vietnam only when a foreign contractor wishes to claim exemption from the CIT portion of the FCT under a DTA. The Vietnam tax authorities have strictly construed the PE provisions of a DTA. For example, in interpreting the PE provisions of a DTA, the Vietnamese tax authorities have provided that a PE of the foreign contractor is deemed to arise where third party distributors are required by their distribution contracts to be under the control and guidance on how to conduct the business by the offshore entity<sup>1</sup>.

## IV. Permanent Establishment Rules in Myanmar

Myanmar tax law and regulations do not use the PE concept. Under Myanmar tax law, non-resident foreign entities are subject to tax on Myanmar source income without regard to the existence of a PE in Myanmar. Branches of non-resident foreign entities are subject to tax at the rate of 35% on Myanmar source income. Payments to non-resident foreign entities for the supply of goods or services are subject to a final WHT of 3.5%. There is no distinction under the law or regulations as to whether or not the non-resident has a PE in Myanmar.

Myanmar has a system by which the payer of certain types of income is required to withhold tax and remit to the tax authorities on behalf of the payee. The amount to be withheld will vary depending on the nature of the payment and if the payee is a resident or non-resident of Myanmar.

For example, the service fee income of a service provider is liable to withholding tax and the recipient is the withholding agent. The responsibility to withhold is with the Myanmar payer of the income.

The withholding rates are as follows:

Class of Income	WHT Rate for payments to residents	WHT Rate for payments to non-residents
Dividends	None	None
Interest	None	15%
Royalties	15%	20%
Purchase of goods within Myanmar and payments for other contracts performed (i.e. services)	2%	3.5%

The existence of a PE becomes relevant only with the application of a DTA. In such a case, where it can be shown that a non-resident foreign entity does not have a PE in Myanmar, it will not be subject to the tax in Myanmar.

In general, a non-resident entity in Myanmar may be taxed three ways:

- The WHT system, as discussed above;
- The reasonable deemed income assessment; and
- Under section 25 of the Union Revenue Law, “[a] foreigner residing abroad shall pay 35% income tax on his total income”.

For non-resident foreign entities without a Myanmar license, the WHT system is applied. Under the Withholding Tax Notification 41-2010, “the settlement of Withholding Tax on non-resident foreigners shall be a final assessment.” The WHT on payments to non-

residents is a final tax to be reported by the person making the payment.

The “reasonable deemed income assessment” may be applied depending on the discretion of the tax officers, in cases of a failure to withhold by the withholding agent. Section 10(a) of the Income Tax Rules provides that “if the Township Revenue Officer is the opinion that a non-resident foreigner’s income cannot be definitely known, the Township Revenue Officer may compute the income for income-tax assessment by computing at a rate considered reasonable by the Township Revenue Officer on the gross receipt of that person.”

In practice, the income deemed “reasonable” may be 10% of the total gross payments subject to 35% rate. This is equal to the effective 3.5% withholding tax rate.

Presently, the 35% rate on net income under section 25 is generally enforced against branch offices and non-resident foreign individuals.

From a regulatory perspective, foreign persons who engage in one or more of the following activities may be deemed to be “carrying on business” in the country and therefore are liable to observe the statutory formalities in relation to the incorporation of a local legal entity and other licensing and tax obligations:

- Renting any space for commercial purposes on an ongoing basis;
- Employing any person locally under a contract which is, or is deemed to be, an employment contract; and
- Entering into domestic commercial transactions (i.e. settling or issuing local invoices for services rendered by them or to them within the country) on an ongoing basis.

It appears that the policy on how a foreign entity may carry out business in the country is conducted on a case-to-case basis. In practice, foreign entities will often be able to conduct activities in Myanmar as foreign contractors without registering as a local branch or company.

## V. Conclusion

As the tax systems of the countries of the Mekong region are in the process of development, the rules of these systems are not always clearly defined. PEs and the attribution of profits to PEs are an important feature of international taxation and careful tax planning around complex PE issues is necessary to mitigate PE risks in the Mekong region. Tax treaties can help with allocating taxing rights to a jurisdiction. The tax treaty networks of Vietnam, Myanmar and Laos are expanding quickly, however, Cambodia remains the only country in the region not to have signed any tax treaties. Additionally, tax treaty relief is not always automatic and applications need to be submitted to the tax authorities for approval before treaty benefits are granted.

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### Notes

<sup>1</sup> Official Letter Number: 2067/TCT-HTQT, June 2011.