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# Sihanoukville’s recovery and tax incentives – treating the disease and not the patient?

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*“The good physician treats the disease; the great physician treats the patient who has the disease.”*

## Sir William Osler<sup>1</sup>

Twenty-five years before he was elected president, a certain D.J. Trump appeared at Capitol Hill to complain that Congress had closed too many tax loopholes for the real estate industry<sup>2</sup>;

“Real estate really means so many jobs... you create so many other things. They buy carpet. They buy furniture. They buy refrigerators. They buy other things that fuel the economy.”

Trump of course famously benefited from a 40-year negotiated property tax abatement when building the Grand Hyatt in New York which at the time was recovering from a painful fiscal crisis. The Trump abatement cost New York City over USD\$400 million<sup>3</sup> in forgiven, or uncollected, taxes, on a property that cost only USD\$120 million to build in 1980.

Cut to Sihanoukville, located in Preah Sihanouk Province Cambodia, in 2024 and we find ourselves in familiar territory. A province and city experiencing difficult fiscal times following a recent surge of primarily Chinese led investment in real estate driven by the legalization of the gambling sector that resulted in a short-lived boom period for the construction of casinos and hotels. This all came to a crashing halt with the ban of online gaming in 2019 quickly followed by the outbreak of Covid-19 leaving buildings half-finished and an exodus of Chinese businesses.

Conservative estimates put the current number of unfinished buildings in Sihanoukville at around 360<sup>4</sup> requiring over USD\$1 billion to complete.

## Targeted Tax Incentives

In January 2024 the recently elected Royal Government of Cambodia introduced a special program<sup>5</sup> to promote investment in Preah Sihanouk Province (“the Program”). The Program traces its origin to the ambitious Pentagonal Strategy-Phase I<sup>6</sup> that is the policy centerpiece of Prime Minister Hun Manet the Vice-President of the ruling CPP party. One of the stated goals of the Pentagonal Strategy is the concept of developing a specific region into an engine-room for economic growth for the whole country.

Preah Sihanouk Province with its deep-sea port, expressway, airports, and natural resources has been prioritized under the Pentagonal Strategy with the objective of accelerating the multi-purpose special economic zone ambitions that have been laid out for the province.

The Program provides targeted tax incentives for three (3) categories of investment projects or business activities located in Preah Sihanouk Province as follows:

- (1) Investment projects/business activities relating to unfinished buildings re-starting in 2024.
- (2) Investment projects/business activities not related to unfinished buildings starting in 2024.
- (3) Expansion of existing investment projects/business activities starting in 2024 based on specific criteria.

With respect to category one, above, the tax incentives comprise of:

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1 <https://guides.library.uab.edu/Osler>

2 <https://www.nytimes.com/2020/10/30/business/trump-taxes-real-estate.html>

3 <https://www.nytimes.com/2016/09/18/nyregion/donald-trump-tax-breaks-real-estate.html>

4 <https://www.khmertimeskh.com/501378991/a-city-transformed-over-1000-high-rise-buildings-built-or-in-progress-in-sihanoukville/>

5 <https://www.phnompenhpost.com/business/special-incentives-revitalising-p-sihanouk/>

6 <https://www.mfaic.gov.kh/files/uploads/1XK1LW4MCTK9/EN%20PENTAGONAL%20STRATEGY%20-%20PHASE%20I.pdf>

- An additional three (3) years of corporate tax exemption for existing Qualified Investment Projects (QIP) and tax registered SME's.
- An exemption of corporate tax for three (3) years for registered taxpayers that do not qualify as QIP.
- An exemption of Value-Added Tax on local supplies.
- An exemption of withholding tax on rental property for five (5) years.
- An exemption for unpaid Immovable Property Tax and associated penalties for the period 2016-2025.

## Tangible Benefits?

A deep dive into the tangible benefits of the tax incentives provided under category one above provides more questions than answers. The QIP's that currently exist in Preah Sihanouk Province would have predominately registered under the previous Law on Investment and its implementing Sub-Decree under which casino activities, real estate development, hotels classified below three (3) stars did not qualify for QIP incentives<sup>7</sup>. Given that Sihanoukville wants long-term investors who will need to be in the Cambodian market for some time a three-year corporate tax exemption may not be enough to whet the appetite of cautious investors given the current market conditions.

The exemption of Value-Added Tax on the purchase of products from local supplies echo's the new incentive provided under the 2021 Law on Investment<sup>8</sup> which already exists for QIP's in Preah Sihanouk Province and provides practically just a timing benefit for construction entities who may have upfront cashflow issues. Ironically the VAT incentive provided under the new Law on Investment and the Program should not even need to be in place if Cambodia already had a robust and functional VAT refund mechanism.

The exemption of withholding tax on rental for five (5) years does not practically help developers. Most developers, or building operators, who would complete unfinished buildings in Preah Sihanouk Province would, or should, be tax registered meaning that when they

issue tax invoices for rent to tax registered tenants there would be no applicable withholding tax.

For those unregistered property owners dealing with tax registered tenants the practice has been for some time to pass the cost of the withholding tax, incorrectly, to the tax registered tenant. For example, a lease agreement structured on a net basis for USD100 per month would require the tax registered lessee to pay USD100 to the lessor in addition to paying a non-deductible USD10 withholding tax to the tax authority. Practically it is the tenant who may benefit from the withholding tax on rental exemption not the actual property owner/lessor that it was designed for.

For a comparative analysis on immovable property taxes, it should be noted that when D.J Trump was negotiating his tax abatement in New York in the 1970's that city's annual property tax rate was in the region of USD\$8-\$9 per USD\$100<sup>9</sup> of assessed value. The current annual rate of immovable property tax in Cambodia is 0.1% or USD0.10 per USD100 of assessed value.

### The Goldilocks Doctrine

In medical terms treating the patient rather than the disease means considering what's important to the individual patient and keeping that in mind when deciding how to proceed. Arguably the current tax incentives provided for unfinished buildings in Preah Sihanouk Province provide a short-term mask for the symptoms but not actually addressing the underlying needs of the patient.

Investors require long-term certainty with respect to tax particularly if they are investing heavily in brick and mortar in a foreign jurisdiction. The basic premise for policy makers as per the frequently touted goldilocks doctrine is to get the mix just right – not too hot and not too cold. A too liberal approach by policy makers on tax could result in a D.J Trump scenario whereby the government loses out on millions of dollars of revenue. A too restrictive policy may end up scaring off would-be investors from returning.

Alternative options for consideration to the current tax incentives on offer could include pre-negotiated taxes for a long-term period, advance tax rulings (a concept used particularly in transfer pricing for related party transactions), exemptions of taxes on profit repatriation

<sup>7</sup> Annex I of Sub-Decree No. 111 ANK/BK dated 27 September 2005 on the Implementation of the Amendment to the Law on Investment of the Kingdom of Cambodia

<sup>8</sup> Article 27(1) of the Law on Investment, promulgated under Royal Kram No. NS/ RKM/1021/14, dated 15 October 2021

<sup>9</sup> <https://www.nyc.gov/site/finance/property/property-tax-rates.page>

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and comprehensive tax incentives on financing costs. Pre-negotiated taxes and rulings would remove the need for tax audits, and the inherent problems of uncertainty that they bring, while still ensuring that the Royal Cambodian government receives fixed tax revenues to go towards its annual budget needs.

Comparatively the current incentives on offer in Sihanoukville, whilst arguably fair, could be more attractive when compared to those historically provided by East African<sup>10</sup>, Pacific<sup>11</sup> or Middle Eastern<sup>12</sup> countries where investment in infrastructure and construction of commercial buildings has also been a necessity at times.

### **Compromises and solutions.**

There is no doubt that Preah Sihanouk Province is on the right track to becoming an engine-room for economic growth in Cambodia. The focus and implementation on drafting a master plan to develop the province into a 'Model Multi-Purpose SEZ (Special Economic Zone) and develop Cambodia's coastal provinces into a multi-purpose and comprehensive economic corridor' will bear fruit in the foreseeable future.

In the current environment, with global economic uncertainty and fiscal restraint, to what extent will the current tax incentives on offer for unfinished construction encourage existing investors to restart their projects in Preah Sihanouk Province or for new investors to take over?

Constructing high-rise buildings in a foreign country is not something that investors take lightly and rather than looking at short-term tax benefits that may be at play most would be looking at the long game with a view to being present in-country for decades and not necessarily a few years.

While the incentives on offer in Sihanoukville are good start they don't seem to address the more pressing tax issues that face would-be investors coming to Cambodia. These issues include unpredictable tax audits, the omission of a truly independent tax tribunal and the lack of uncertainty regarding the interpretation and

application of Cambodia's fast evolving tax regulations.

These issues will need to be addressed to make or break investors decisions on re-entering or entering the Sihanoukville market - not so much tax incentives that may mask the symptoms but may not provide a holistic look at assisting the patient.

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10 <https://actionaid.org/publications/2016/still-racing-toward-bottom-corporate-tax-incentives-east-africa>

11 <https://www.adb.org/sites/default/files/publication/939871/governance-brief-054-tax-incentives-investment.pdf>

12 <https://www.arab-reform.net/publication/which-tax-policies-for-lebanon-lessons-from-the-past-for-a-challenging-future/>