Cambodia Development Resource Institute

Fiscal Decentralisation: An Exploratory Study on Existing Taxation and Options for Commune/Sangkat Own Source Revenues

Background Paper for the National Workshop
on Commune/Sangkat Own Source Revenues in Cambodia
August 2004

Eng Netra and Caroline Rusten

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Eng Netra and Caroline Rusten

Executive Summary

Background
The 2002 election of Commune/*Sangkat* Councils has established a lowest level of government in Cambodia. Intergovernmental transfers averaging about USD8,000 on average per year, such as those provided through the Commune/*Sangkat* Fund (CSF), is the only source of discretionary fund that can be used for local development projects prioritised in the commune development plan. The CSF is an indispensable source of revenues. The Law on the Administration and Management of Commune/Sangkat authorises the Commune Councils to establish own source revenues from three main sources including tax revenues, non-tax revenues, and service fees. However, the law does not specify the types, levels, and collection procedures for these sources. Like local governments around the world, Commune Councils in Cambodia will need to develop local sources of revenue if they are to function effectively. Locally derived revenues also provide important sources of income to supplement national transfers and serve as a means for citizens to contribute to the costs of the local public services they receive. The Commune Councils are to have near- and long- term own revenue system, as the financing system of local government progress and mature.

This study is to contribute this process of developing a commune own source revenue system. It is further envisaged that the result of this study will assist the Ministry of Economy and Finance (MEF) to design a pilot project that allows a certain communes to have own source revenues.

Objectives of the study

(i) To document and understand the existing tax and non-tax collections of the provincial level (those revenues included in the *Salakhet*), which are the most likely options to be shared with the commune/*sangkat*

(ii) To identify and analyse potential sources that can be shared and/or reassigned to the Commune Councils that can be used to pilot a number of communes/*sangkats*;

(iii) To provide recommendations for discussion during the National Workshop on Commune/*Sangkat* Own Source Revenues in July 2004

Method
The study examines current collection of tax and non-tax revenues at the commune levels which might have potential for sharing and/or reassigned to the Commune Councils. Based on data collected from seven communes in four provinces—Tramkok and Chumreah Pen in Takeo, Somroung and Kork Chork in Siem Reap, Prey Noup in Sihanoukville, and Boeung Pralit and Olympic in Phnom Penh, the study investigates provincial revenues sources which include tax on unused land, tax on transfers, tax on means of transportation, *patente* tax, slaughtering tax, public lighting tax, market *pheasies*, and user fees.

The study conducted with close collaboration with the Department of Local Finance of MEF and Department of Local Administration of Ministry of Interior (MOI). In addition to desk study, the fieldwork included semi-structured and structured interviews with key stakeholders at different levels of government and administration, and informal discussions with business owners and local people.

Table A: Brief profile of study communes/*sangkats*

	Siem Reap		**Takeo**		**Sihanouk Ville**	**Phnom Penh**	
	Somroung	Kork Chork	Tramkok	Chumreah Pen	Prey Noup	Boueng Pralit	Olympic
Population	8,724	16,253	10,960	12,296	6,395	10,537	7,856

CSF in Riel	36,587,000	55,764,000	20,664,000	48,869,000	30,378,000	19,704,000	16,322,000

Source: Commune Database 2003 (Seila 2003)

Recommendations for Commune Own Source Revenues

For the pilot phase, tax sharing (rather than tax reassignment) may be the best option given the current institutional capacity and potential local level tax yields. It is seen as a learning-by-doing process in which the communes could assume responsibility for actual tax collections while continue to work closely with the District Tax Offices and the Provincial/Municipal (PM) Tax Branches. This process also creates space that allows the communes and the district/province to check and monitor one another's performance. This may help reduce rent seeking in revenue collection. In addition, through tax sharing options the communes are less burdened by paperwork (such as issuing regulations), and to control funds since revenue collections might be consolidated into the accounts of the PM Tax Branch at the Provincial Treasury. Furthermore, the suggested sharing options are, to some extent, proposed by the provincial level and the commune councils and therefore likely to be accepted by stakeholders.

Tax on means of transportation should be shared with communes. The communes already assist in the collection of this tax, albeit in an informal way. It is a relatively simple tax to collect and there is potential for continued growth of the tax base. The communes could take some responsibility for local road maintenance with the revenues derived from this tax.

Despite the fact that some provinces have already informally shared revenues from tax on means of transportation with the communes, a true commune source of revenue should be formalized on the basis of rules (rather than on informal negotiation). The fixed percentage of the tax collections to be shared with the communes will be decided by the NCSC in consultation with relevant ministries. The share could be determined simply by designating a percentage that would provide a certain amount of revenue to the communes, or it could be more specifically tied to the estimate of the commune road maintenance costs. In the latter case, taxpayers could be informed that a portion of the communes' tax share would be used specifically for this purpose.

A 50 percent share of revenue collected from tax on means of transportation can be a sharing option. Potential revenues for the rural communes are Riel 438,000 and Riel 17 million for the urban communes (Table 2).

Patente tax should be reassigned and/or shared with communes. All types and sizes of business currently pay *patente* tax, and it is easy for communes to identify local businesses. The base is fairly stable and tends to grow over time. Devoting this revenue to visible local services may improve taxpayer compliance, which is currently poor in many areas.

In the survey areas, *patente* taxes are already informally shared where the communes assist the district Tax Office with collection. Sharing should be formalized under the commune budget according to clear rules. One option, for example, would be to assign the tax bases of all businesses within the estimated (small business) regime[1] from the province to the commune, leaving the province with the real (larger businesses) regime. Another option would be to share some portions of revenues from the estimated and the real regime businesses with the communes.

Market pheasie is one significant source of revenue for both rural and urban communes. The provinces currently outsource market management, including *pheasie* collection, to the private sector. The communes might be able to manage or even take over ownership of smaller

[1] According to the Law on Taxation (1997), the tax regime is a taxation system which categorise businesses and taxpayers into different legal obligations for tax collection purposes.

markets. *Pheasie* is a relatively simple revenue to collect and can be significant in areas with busy markets. It also creates linkages between revenue expenditures, as some portion of the collected funds could be used for local market services, such as cleaning, waste collection and maintaining order.

One option would be to assign small and unregistered markets to the communes, and allow them to manage the markets themselves or outsource this function (leaving revenues from the larger markets to the PM). Another option is to consider possibilities for sharing revenue collection from provincial markets with the communes because some communes would realize little revenue from their market or do not have one within their boundaries.

Table B. Impact of PM sharing selected revenues with the communes

	Siem Reap		Takeo		Sihanouk Ville	Phnom Penh	
	Somroung	Kork Chork	Tramkok	Chumreah Pen	Prey Noup	Boueng Pralit	Olympic
Shared transportation tax 50%	1,645,000	2,549,750	438,150	493,350	2,509,050	17,676,750	13,131,300
Shared *patente* tax 20%	950,977	1,771,690	12,465	218,155	871,760	934,231	696,528
Reassigned small market *pheasie* to CS	1,260,000	no local market	11,520,000	no local market	3,960,000	3,600,000	no local market
Total CS revenues from potential shared sources	*3,855,977*	*4,321,440*	*11,970,615*	*711,505*	*7,340,810*	*22,210,981*	*13,827,528*
As % of CSF	11%	8%	58%	1.50%	24%	113%	85%

Commune Service levy is a new potential revenue source. It could be used to help finance commune services for which direct user charges cannot be easily collected. The commune service levy could raise significant revenues and might be the only major source of revenue in some communes.

The commune service levy could be collected from every household and business within the communes as an annual fixed fee that would depend on (i) the category of land use (agricultural, residential, commercial); (ii) the size classification of land used; and perhaps (iii) a few basic characteristics of the land use (developed or undeveloped, size and quality of structure, etc.). Of course, more work would have to be done to develop an appropriate classification system and to assign appropriate charges to each category.

A hypothetic calculation of service levy collection from two case study communes indicates that this revenue source is quite substantial (Table 3).

Table C. Impact of proposed commune service levy in two CS

	Chumreah Pen, Takeo	Prey Noup, Sihanouk Ville
Collection from CS service levy in two CS	103,070,000	24,680,000
As % of CSF	211%	81%

General Conclusions

The process to move forward with commune own sources of revenue looks promising and feasible. The results from the national workshop in July 2004 shows that there is broad support to pilot the sharing of selected provincial revenues and consider how the communes can adopt user charges. The commune service levy, given sensitivity about land taxes in Cambodia, was not ruled out, but the discussion made clear that additional research would be needed before considering this option for piloting. Other ideas for sharing of revenues with the communes, like unused land taxes, were also mentioned.

Remaining Challenges

- Fiscal decentralisation: First, a discussion is needed on how to account for the revenues and what other services that the communes could provide with the extra sources of funds available through such sharing and reassignment. Second, several management questions will have to be addressed. Third is how to correct the differences between urban sangkats and rural communes because the potential yield for commune service levy in urban sangkat will be more substantial than in rural communes. Fourth is the discussion of future district level whether district will become another level of sub-national government with own plan, administration, and budget.

- Institutional Support: The Department of Local Finance (DoLF) of the MEF will take responsibility to provide capacity building and support for the communes. The other important issue is the need to improve and strengthen collaboration and communication between DoLF and DoLA in order to better target the types of support provided to the communes.

- Regulatory framework: Clarification and/or amendments of LMAC article 74 will be urgent to authorise the communes to collect taxes and levies. The local contribution will need to be restructured and regulated. Also, the design of CSF allocation will need to be revised to include mechanism to address fiscal imbalance, and to create incentives for local revenue efforts as the communes have own source revenues.

Organisation of the Working Paper

Chapter one provides background and potential challenges related to the introduction of communes own source revenue. It also discusses the study framework and methodology. *Chapter two* provides an overview of the current sub-national tax collection, and a summary of options for local government own-source revenues. *Chapter three* presents findings and recommendations for commune own source revenues. *Chapter four* provides general conclusions and discusses the way forward and remaining challenges regarding introducing a commune own source revenues.

Annex One presents all formal PM taxes currently collected. All sources are discussed, regardless of whether they are candidates for sharing between the PM and the communes or reassignment. Each tax is discussed from two angles. The first considers each tax individually and considers options for sharing and reassignment based on current practice, particularly with respect to informal communes roles in the collection process. The second considers each tax in a *holistic manner,* such that options for reassignment and/or sharing are placed in the context of the need for consolidation and reform of many current taxes.

Annex Two presents similar information and analysis for non-tax sources including land service fees, license fees, and civil registration fees.

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List of Abbreviations

CDP	Commune Development Plan
CDRI	Cambodia Development Resource Institute
CS	Commune/*Sangkat*
CSF	Commune/*Sangkat* Fund
DLMUPC	Department of Land Management, Urban Planning
DoLA	Department of Local Administration, MOI
DoLF	Department of Local Finance, MEF
FY	Fiscal Year
LAMC	Law on the Administration and Management of Commune/*Sangkat*
LMAP	Land Management and Administration Project
MEF	Ministry of Economy and Finance
MOI	Ministry of Interior
NGOs	Non Governmental Organisations
OWSD	Open Window Service Delivery Project
PFM	Public Financial Management
PM	Province/Municipality
RGC	Royal Government of Cambodia
UNCDF	United Nations Capital Development Fund
USD	United States Dollar

Khmer words

Khan	Urban district
Patente	A French word. *Patente* tax is an annual business license tax collected from all established businesses in Cambodia.
Pheasie	Fee that a private company is allowed to collect under an agreement with the government. It is usually collected on a daily or monthly basis at market, parking areas…
Prakas	Announcements issued by the government ministries
Riel	Cambodian currency
Salakhet	Provincial governor's office.
Sangkat	Urban commune

Notes

USD1 = Riel 4,000

1 Hectare = 10,000 square meters

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1 Background

1.1. Rationale for the study

With the Law on Election of Commune/Sangkat Councils of 14 February 2001 and the Law on Administration and Management of Commune/Sangkat (LAMC) of 19 March 2001, crucial legislation was in place to carry out the first commune elections ever in February 2002. The RGC's Governance Action Plan (2001) broadly identified three objectives of decentralisation as to: (i) promote democracy, good governance and quality of life; (ii) giver ordinary people greater opportunities to determine their future; and (iii) ensure sustainable development, including the delivery of basic services.

In essence, the Cambodian reform process is still at its starting phase, and the fiscal decentralisation process is yet to be designed. The commune councils are empowered to be an autonomous administrative unit, to promote local development, and have own source revenues from tax and non-tax revenues. At present the law does not specify specific sources of revenues that can be raised by the Commune Councils. The only discretionary fund for the communes is Commune/Sangkat Fund, averaging about USD8,000 on average per year which can be spent on local development priorities. The current reform process is struggling with how to take incremental, realistic steps toward the decentralisation of revenue raising power and responsibility of service delivery to local government level.

The RGC regards decentralisation as a process whereby capacity, understanding of decentralised governance, and funds go along with the responsibility given to the Commune/Sangkat Councils will be addressed. This 'learning-by-doing' approach is crucial in the context within which the decentralisation reform evolved. Many elected commune councils have little or no service delivery capacity or political credibility with the people; they are just provided some administrative functions and a few service responsibilities (Rusten et al. 2004; Smoke 2003). In this light, a mandate has been given to the communes, although several capacity building-, financial-, and legal issues are still to be solved. The result of this study is to contribute to a process of developing a commune own source revenue system. It is further envisaged that the result of this study will assist the Ministry of Economy and Finance (MEF) to design a pilot project that allows a certain communes to have own source revenues.

Like local governments around the world, Commune Councils in Cambodia will need to develop local sources of revenue if they are to be autonomous and to improve accountability and allocative efficiency. Intergovernmental transfers, such as those provided through the CSF, are an indispensable source of revenue in most countries. However, to depend on only one and easily earned source of revenues could create space that allows the authority to avoid making efforts that are necessary to put in place mechanism and measure for own revenue generations which constitutes a responsive, accountable and transparent authority for the people (Merat 2003: 6). Also, a well functioning local revenue system can increase the fiscal autonomy of the commune councils.

Another important aspect for own-source revenue is that locally derived revenues provide important sources of income to supplement national transfers and serve as a means for citizens to contribute to the costs of the local public services they receive. The rational behind this move has been well documented and widely promoted for countries around the world by Balh and Linn (1992). Other literatures also show that when people feel the direct burden in sharing locally provided services they tend demand more from their authority. In this sense, cost sharing improves and enhances participation and accountability (Merat 2004). Ultimately, capacity building of commune councillors can be improved and enhanced to meet the local-level service needs.

Achieving such goals will require time and commitment from all the levels of government and stakeholders. First, it requires adjustment to the existing laws and policy. The commune and sangkat councils in Cambodia have the *permissive authority* to collect taxes and fees according to the LAMC of 2001. However, the Law does not provide any details related to how this shall take place, and what can be taxed. Therefore, how to operationalise the *mandate* for local governments to collect taxes has to be worked out. This can be done by issuing sub-decrees and relevant guidelines, which currently are not existent (see Oberndorf 2004). Before such sub-decrees and guidelines can be issued, it is necessary to establish (i) the type of taxes and levies that can be shared and/or reassigned from the PM to the communes; and (ii) potential new taxes and fees available to the communes.

Second, the process of developing the local revenue system will need to be aligned with other reforms and administrative framework in the public sector. For example, the process of sharing and reassigning existing taxes will not place any extra burden on local people as, in principle, these revenues are currently being collected. Sharing and reassigning existing taxes can have significant impact on the PM revenue sources which will need to be dealt with under a broader fiscal reform framework to compensate the revenue loss for the PM. The challenge at this starting phase of commune own source revenue development is therefore to identify taxes and levies that would not place extra burden on the local people, and would not have significant impact on the provincial revenue system. This is also important to ensure that there is likely rapid success resulted from the beginning stage of commune own source revenues.

1.2. Funding Sources of the Commune Councils

1.2.1. Commune/Sangkat Fund

The Commune/Sangkat Fund (CSF) was established by the Sub-decree on the Establishment of the Commune/Sangkat Fund of 2002. The CSF is fund transfers from the central government recurrent revenues and donors' grants according to formula-based allocations for disbursement to individual communes. The contribution from RGC budget in FY2002 is USD5 million, of 1.2 percent of recurrent domestic revenues (World Bank 2002).

On average each commune receives about USD8,000 per year from the CSF. The communes can use this fund to finance local development priorities identified through the commune development planning process. This funding has reached the communes and enabled them to provide some small-scale infrastructure projects.

1.2.2. Own Source Revenues from Taxes and Non-Taxes: The communes councils have the legal right to raise tax and non-tax sources, and to charge for services. The laws also allow the communes to receive total or partial transfers of incomes from national taxes and non-tax sources, but do not provide details about how this can be done. Currently the commune does not collect any tax except local contribution for development projects.

At present the communes collect local contribution. Local contribution is mandated by law to function as a matching fund to the CSF development fund, which is collected from local citizens and can only be used to finance the development programmes/projects of the commune. The total contribution required is usually 10% of the amount of CSF allocation for the development fund. The total collection varies from Riel 400,000 to 5 million. The collection process can be time consuming and difficult because it is a volunteered contribution from the people. A discussion about how to regulate the practice and whether local contribution should remain shall take place before a pilot project of commune own source revenues proceeds.

1.2.3. Revenues from Agency Functions

The only fees and revenues received by the commune from performing agency functions are the civil registration fees. Present collection of civil registration come from birth, death, and marriage certificates for which people have to pay a flat fee of 400 Riel per certificate. The minimal administrative revenues so far collected by the commune averaging about riel 40,000 per year or 2% of the CSF (Rusten et al 2004:148). This revenue are collected and kept by the commune clerk at his house (ibid).

1.3. Potential challenges for the introduction of commune own source revenue

1.3.1. Transparency and Accountability: a general concern for trust building

Transparency and accountability are major concerns at present and will be equally crucial for the future in reassigning and/or sharing some taxes and levies between the PM and the communes. As discussed in Rusten *et al.* (2004), a real challenge for decentralisation reform, is to enhance the trust of local people in local government. Transparency and accountability by the communes vis-à-vis the electorate are critical aspects of developing trust.

Pilot experiments to support transparency might need to be introduced as part of the taxation experimentation process that MEF is developing. For example, in reassigning or sharing taxes between the provinces and the communes, it would be possible to place notice boards at the communes council building to provide an overview of who pays what type of taxes and the amount paid. Also, the councils will ensure that communities have regular access to information on budget allocation decision and fund receives. Confident building can be strengthened through visible achievements as taxes are collected. This will potentially discourage rent seeking and help to create a demand for transparency among local people. This process has been initiated with some success through the project implementation of the Seila programme (Rusten et al. 2004; Rudengren and Ojendal 2002).

The initiative of the RGC to embark on Public Financial Management (PFM) Reform (RGC 2004) is an important part of this trust building process for local government as well as the public sector in Cambodia.

1.3.2. Challenges related to management of funds

One aspect related to the concern of accountability is the actual management of funds related to (i) how to store the funds; and (ii) how to account for the funds. First of all, few of the commune council offices have a safety box. In fact, some communes do not even have a commune council office. Therefore, the secure storage of funds collected from taxes would pose a major challenge. At the moment, for example, the clerk keeps the funds from local contributions and from civil registration at his/her house. Usually, the clerk will forward the funds to the Provincial Treasury when the deposits have reached approximately 50,000 Riel (see Rusten *et al.* 2004). A process of sharing and reassigning tax revenues to the commune would therefore cause a major challenge simply in terms of maintaining the funds. Secondly, the communes would require the accountants in charge of the commune funds to be stationed at the commune office. At the moment, commune accountants work at the Provincial Treasury and are provided by the state as part of the support and supervision function of the sub- national level to local governments.

Through the Asian Development Bank Commune Councils Development Project, about 420 commune offices are being built that have safety boxes and office equipment as part of the construction[2]. This will provide a secure place to store the collected funds. Another option for the communes to ensure security would be to deposit the funds at existing commercial banks or bank branches at the district level. This can relieve some of the current problems of cash access, lack of safe places to keep the funds, and the cost of long distance travel. It would also lessen the current burden on the commune related to the transfer of funds from the commune level to

[2] Interview with Mr. Leng Vy, Director of DOLA, MOI in November 2004.

the provincial level, as the distance and travel time would decrease. Commune accountants would, however, still be needed.

1.3.3. Responsibility and resource: A capacity challenge

One of the common lessons learned from decentralisation reforms around the world is that even when there are local level resources available to meet the decentralised responsibility, the results have rarely been improved service delivery and enhanced poverty reduction. It has often been the case that such resources are poorly used by inexperienced, ill-trained and underpaid staff (Turner 1997). This is a crucial and relevant concern for Cambodia, as the newly elected councils have no previous experience related to the collection, management and use of local resources because such responsibilities have always rested somewhere else. Also, currently the only staff working for the councils - the clerks - is employed by the MOI.

Another important issue is that communes might not have access to skilled people that can be employed to perform revenue collection and other administrative tasks. This is a current concern in most communes. Even the commune clerks do not want to work at the commune offices (see Rusten et al. 2004). This issue can be addressed by strengthening the current support structure to the communes from the PM and district offices, especially related to the deployment of tax and finance officials, and through the provision of more training materials and training programmes.

1.3.4. Disparities between urban sangkat and rural communes

Decentralisation experience from many developing countries treats urban councils differently from rural councils for a number of reasons (El Mensi 2003; Smoke 2001 and 2003). The present reform system treats the urban and rural councils the same. There are three main reasons that rural communes and urban *sangkats* should be differentiated. First, different levels of capacity and resource are available to urban compared to rural areas. Hence, the type of support and resources required by the urban *sangkats* and rural communes are not the same. Second, some types of activities and/or approaches to implementing programmes might be appropriate for urban councils, but may be different for rural councils. Third, urban sangkats tend to have similar service needs. Therefore, a more integrated planning and budgeting process for the *sangkats* are preferred due to important of economies of scale and externalities. On the one hand, rural councils in Cambodia have been the prime focus for capacity strengthening, and have therefore been advanced compared to urban *sangkats*. On the other hand, rural communes lack both significant sources for revenue collection, and skilled human resources. It is therefore critical that rural and urban areas should have different revenue structures.

1.3.5. Existing informal taxation[3] and rent seeking[4]

Commune councils are currently involved in many revenue-generating activities such as issuing small business licenses, residential permission, and other administrative papers. However, income from such activities has not been accounted for in the commune budget rather for personal benefits because of a lack of clear management and monitoring. Moreover, there are cases where commune funds have been used for illegitimate purposes and even individual needs (see Rusten et al. 2004). The problems associated with informal taxation and rent seeking are extensive and common problem, and not ones that can easily be solved. Realising that informal taxation cannot easily be solved, the process of identifying new potential taxes has to avoid tapping into areas that are currently in the 'grey' areas. This is to avoid, at least during this initial step, a 'double' taxation resulting from formal and informal taxation, which would place an extra burden on poor people. In the future, it will be important to start tapping into some of these sources as well.

[3] Informal taxation means activity that tax collections are being collected from taxpayers but are not recorded and accounted for in the official registry for tax payment.

[4] Economists Defined ' Rent seeking' as the situations where people use resources both for productive purposes and to gain an advantage in dividing up the benefits of economic activities (Rose-Ackerman 1999: 2)

1.4. Objectives of the study

(i) To document and understand the existing tax and non-tax collections of the provincial level (those revenues included in the *Salakhet*), which are the most likely options to be shared with the communes;

(iv) To identify and analyse potential sources that can be shared and/or reassigned to the Commune Councils that can be used to pilot a number of communes;

(ii) To provide recommendations for discussion during the National Workshop on Commune/Sangkat Own Source Revenues in July 2004.

1.5. Methodology

1.5.1. Defining the framework

Fiscal decentralisation has become the most trendy reform in many developing countries during the 1990s because of the dissatisfactory results of the centralised economies (World Bank 2000). Fiscal decentralisation refers to the transfer of resource raising powers from higher levels to lower levels in political systems (Manor 2003:1). Being close to the people, it is believed that local governments can best identify local needs and response to those needs in appropriate form and level of services (Crook and Manor 1998). Furthermore, it is argued that people are more willing to pay taxes and contributions for services that they can directly benefit. In order to achieve these expected outcomes, local governments needs adequate power and resources. Indeed this is the problems where in many decentralised governments of higher levels are reluctant to provide resources and power to the local governments (Manor 2003).

The commune councils in Cambodia need resources and resource raising powers to perform their roles and response to needs of their constituents. Developing a local government own source revenue system should follow three basic principles (Bahl and Linn 1992; Bird and Vaillancourt 1998). First is the 'finance follows function' approach in which revenues should be phased in according to the level of devolved responsibility for service delivery, and their technical and administrative capability as well as the potential outcomes. This is seen as difficult in the actual implementation given the complexity of matching revenue sources to expenditure needs. Second is the principle related to the first principle, is that local taxation should avoid making economic distortions by taxing factors of production. This indicates that benefit taxes should be collected from mobile economic units so that taxpayers can decide whether to pay taxes and receive the benefits. However, local government should also tax immobile tax bases for the provision of generalised benefits. Third is the subsidiarity principle which provides that revenue raising powers should be assigned to the lowest level possible of government that are able to best manage them unless there are reasons not to do so (such as negative externality).

The three principles provide a general framework for revenue assignment. Smoke further summarises four basic suggestions regarding defining a local government taxation system (Oates, 1972 quote from Smoke 2001:7). Local taxes should: (i) have minimal impact on economic behaviours; (ii) have clear benefits and costs linkages to service delivery; (iii) meet basic equity standard; and (iv) be simple and have minimal administrative and compliance costs. A number of major tax sources are usually prescribed for local governments, which include property taxes, excises, personal income taxes, payroll taxes, general sale taxes, business taxes, and user charges.

Experience in many decentralised governances in developing countries illustrates that own source revenue system and practice is weak both in term of limited power and ability to raise their own revenues (Smoke 2001:10). The local revenue structure in these countries varies significantly from relying on only intergovernmental transfers, to relying on shared percentage of national taxes and having only few modest independent non-taxes sources especially from user fees and development levies, to having independent local tax bases and revenue sources (ibid). Cambodia is similar to these countries. It is important to emphasise some rationales what local governments in Cambodia should start with its own local revenue structure. First, local governments in Cambodia still have limited capacity. Second, commune councils are significantly dependent on resources and technical support from higher level. Third, local participation and grassroots democracy is still in infancy stage.

It is therefore appropriate at this starting phase that a local revenue structure should rely on tax sharing of the provincial taxes (not the national taxes) to the commune councils. There are two possible options. First is sharing of taxes from the provinces to the communes means that the tax sources have a nationwide base and rates, but within a fixed proportion of the tax revenue (on a tax-by-tax basis) being allocated to the communes based on revenue accruing within the commune jurisdiction or other criteria typically population, expenditure needs, and/or tax capacity. Sharing of tax would allow the taxes to be collected locally by the communes, and be shared with higher levels. Second instrument for local revenues is sharing through reassignment of certain tax and non-tax sources whereby the communes are given the authority to own the revenue sources but the province (and the national) level are still the ones who would define tax bases and set tax rates. This option would restrict the provincial level from exempting taxpayers or narrowing the base for taxes where the provincial level has little or no revenue at stake (Fox and Wallich 1999:293). It would also enable the communes to have more flexibility over the collected revenues.

There are two problems as a result of assigning a local own revenue source. One is that national government can inherently collect most taxes more efficiently than local governments. This problem creates the vertical imbalance. Currently, Cambodia is a high degree of fiscal centralisation, and its consequence is huge vertical imbalance between national level and sub-national levels. This issue will need to be addressed in a consolidated manner for assigning revenues and expenditure responsibilities of the different level of government. Also, the Public Financial Management Reforms of the RGC will partly solve this problem.

Two is that the potential tax bases that can be accessed by the local governments vary significantly from area to area. This problem gives to rise to horizontal imbalance. In Cambodia this is an issue yet as most communes are fairly common in their resource endowment and size. The CSF transfers should be the instruments to correct this issue. Still, there are huge different between urban communes in municipalities and rural communes in the provinces. This issue will need to be addressed in decentralisation reform policy.

<u>1.5.2. Selection of revenue sources</u>

According to the general framework and consultancy recommendations from Smoke and Prud'Homme (2000), El Mensi (2003), Smoke (2003), some near-term and medium term sources for commune own source revenues in Cambodia are: (i) user fees for selected communes services, (ii) sharing of certain tax collections, and (iii) commune service levy. There are several reasons for selecting these revenue sources.

(i) They are simple to collect and easy to enforce that do not require high technical capacity and significant additional resources to administer;

(ii) The revenue sources to be shared/reassigned to the communes will not create double taxation and place extra burden on poor people;

(iii) The revenue sources to be shared/reassigned to the communes will not create significant negative impacts on the existing revenue system of the provinces;

(iv) These revenue sources are locally derived and have potential for continued growth of revenue bases;

(v) There is already involvement of the commune councils in the collection process of these revenue sources;

(vi) These sources share some of the characteristics that are commonly considered as *ideal* local government taxes.

Distribution and equity issues arise when the communes start introducing user fees and collecting taxes. The collected fees and tax sharing revenues can be directly used by the communes for local public services and have little benefits from economics of scale. By doing this the communes will be able to address distribution issue. On the equity issue, there are two possibilities that the issue will be dealt with. First is how payments relate to income levels; presumably those who are expected to pay taxes on means of transportation and business licenses are not the poorest people. The market pheasie is collected depending on the size of stall of vendors; the bigger stall the more fees is collected. Also, service levy will initially collect at a flat rate from land owners, but eventually a progressive rate will be developed based on a number of land characteristics. So there should be some positive equity effect from these revenue sources. Second, to the extent that involving the communes brings some people into the tax net who were not paying before, we have improved horizontal equity which means businesses of a certain turnover, vehicle owners, land owners etc., are being treated more equally and fairly.

Based on these recommendations and on fieldwork conducted in the sample communes and the available data on PM tax collection, a number of feasible options for piloting communes own-source revenues have been identified. Table 1.1 summary indicates that two taxes would be candidates for sharing, while the remaining six would be candidates for overall tax reform and consolidation in the context of developing local government own-source revenues.

Table 1.1: Candidates for developing local government own source revenues

	Name of Source	**Candidate Proposed for**		
		Sharing	Reassignment	Overall Tax Reform
1	Tax on Unused Land			√
2	Tax on Transfers			√
3	*Patente* Tax	√	√	
4	Tax on business turnover			√
5	Tax on profit			√
6	Slaughtering Tax			√
7	Tax on Means of Transportation	√		
8	Public Lighting Tax			√
9	*Pheasie* (market fees)		√	
10	User Fees		√	
11	Commune Service Levy	To be developed and piloted		

1.5.3. Selection of Communes

This study is based on field research in seven communes in four PM. These are Chumreah Pen and Tramkok commune Takeo province; Kok Chork and Samroung communes, Siem Reap province; sangkat Prey Nup, Sihanouk Ville; and sangkat Olympic and sangkat Boeung Pralit, Phnom Penh. The selection of these communes was based on the following criteria: (i) previous experience from CDRI in the communes; (ii) differentiating between rural poor, rural well-off, and urban communes; (iii) differences in revenue sources and available tax bases; and (iv) some engagement of communes councils in tax collections. The limited study sample is to be illustrative in providing background information for discussion, and cannot be regarded as representative for the whole country.

Table 1.2: Brief profile of study communes/sangkat

	Siem Reap		Takeo		Sihanouk Ville	Phnom Penh	
	Somroung	Kork Chork	Tramkok	Chumreah Pen	Prey Noup	Boueng Pralit	Olympic
Population	8,724	16,253	10,960	12,296	6,395	10,537	7,856
CSF in Riel	36,587,000	55,764,000	20,664,000	48,869,000	30,378,000	19,704,000	16,322,000

Source: Commune Database 2003 (Seila 2003)

1.5.4. Fieldwork method

The fieldwork and interview processes used were: (i) semi-structured interviews with key stakeholders at different levels of governments and the administration; (ii) structured questionnaires for some data collection, such as tax revenues and land information; and (iii) informal discussions with business-owners and vendors.

2 Overview of sub-national tax collection

This chapter reviews the nature and management of provincial tax collection processes. It also highlights different practices and challenges.

2.1. Types of Taxes Currently Collected

In Cambodia, 16 different types of taxes are collected under the Law on Taxation of 1997. Whether a given tax is collected in a particular place depends on the local tax base and on whether there is a local tax administration. In some areas, revenue is collected from all 16 categories, while in other areas revenue is derived from only a few of these categories.

Among the 16 tax categories, there is a clear division according to the level of government. Both the national and provincial/municipal governments are entitled to receive revenues from tax collection. The national government gets revenues from ten taxes. These are tax on salary, tax on profit, tax on business turnover, tax on renting property, withholding taxes, value added taxes, stamp taxes, special taxes, tax revenues from fines and penalties, and other tax revenues from selling papers and documents.

The provincial and municipal government are entitled to receive the remaining 6 categories of tax collection. These categories are tax on unused land, tax on transfers, tax on means of transportation, *patente* tax, slaughtering tax, and public lighting tax. On an annual basis, the MEF issues a Prakas to delegate revenue collection responsibilities and propose a budget for the allocation of these revenues for the provincial and municipal government. This Prakas authorises the province and municipality to collect the different categories of revenue from tax and non-tax sources (with specific collection amounts).

2.2. Tax Regimes

The tax regime is a taxation system which categorises businesses and taxpayers according to different legal obligations for tax collection purposes. According to the Law on Taxation of 1997, there are three tax regimes. These are the real regime, the simplified regime, and the estimated regime. Currently, only two types of regimes are being used. These are the 'real regime' and the 'estimated regime'. Then real regime and the estimated regime are characterised by the amount of annual turnover and type of business license. Real regime consists of all businesses with licenses approved by the Ministry of Commerce, and with turnover above 200 million Riel per year. Usually real regime businesses keep accounting records and financial statements. The businesses within the 'real regime' are supervised by the provincial/municipal Tax Branch (PM Tax Branch).

Estimated regime refers to businesses with annual turnover below Riel 200 million. These businesses get their license approved by provincial or municipal offices. Usually, they are not required to keep proper accounting records and financial statements, and are supervised by the district/*khan* Tax Office (District Tax Office). Most of the small enterprises and business activities at the commune and village level are classified within this estimated regime to enable assessment and calculation of tax.

2.3. Who Collect Taxes

The administration of tax collection in Cambodia operates at three levels, with each level having separate responsibilities. Within the MEF, the National Tax Authority is the sole body authorised to manage the collection of all categories of taxes. It has branch offices in every province and municipality, and other offices in almost every district.

There is a division of labour between the PM Tax Branch and the District Tax Office. The PM Tax Branch has overall responsibilities to ensure that all taxes are collected and to supervise the District Tax Office. Where there is no District Tax Office, the PM Tax Branch collects the taxes. A further division of labour is according to tax regimes, in which the PM Tax Branch collects taxes from businesses in 'real regime'.

The District Tax Office is delegated most of the tax categories. Two or three staff of the District Tax Offices are in charge of collecting from eight to 15 communes within the district jurisdiction. In terms of the tax regimes, the District Tax Offices are responsible for collecting taxes from businesses in the 'estimated regime'. The types of taxes that the District Tax Office commonly collects are tax on business turnover, tax on profit, tax on means of transportation, tax on transfers, unused land tax, *patente* tax, slaughtering tax, and public lighting tax. A discussion of the collection process for each of these taxes will be provided in Chapter Four below.

2.4. Assessment and Calculation

The tax authority is responsible for informing and explaining to taxpayers about their tax liability. This is important for businesses within the estimated regime, since records are rarely kept, and tax registration of the businesses is not common. With regard to the calculation of tax on business turnover, for example, the tax authority is supposed to determine an amount of a business's annual turnover through a rough assessment and calculation with consultation with the taxpayers. This procedure is rarely used in practice, as it is time consuming and the District Tax Office rarely requests information on business turnover and capital investment for the assessment and calculation. Therefore, businesses in the estimated regime usually pay different categories and amount of taxes as requested by the District Tax Office.

The calculation of tax is a challenge in Cambodia due to vague regulations and guidelines. Few businesses are aware of the different categories of taxes and are not informed about why, what and how much tax they are supposed to pay. For example, even for the most basic and common taxes currently collected from vendors (such as *patente* tax and tax on business turnover), businesses are still not certain about the actual amount to be paid, who collect them, and where the collection goes. There is room for negotiation and bargaining between taxpayers and tax collectors. This creates space for rent seeking and non-uniform tax collection across time and location.

2.5. Enforcement and Monitoring

The National Tax Department prepares annual implementation plans by outlining the categories and amounts of taxes to be collected by the PM Tax Branches. The Department is also responsible for ensuring that the PM tax collection is inspected and the account is audited. Therefore, each PM Tax Branch has the responsibilities for ensuring that the actual tax amount collected corresponds to the planned figures.

The PM Tax Branches collaborate with the District Tax Offices to prepare a detailed work plan and registers for tax collection. The District Tax Offices usually prepare two registers as a basis for, and evidence of, tax collection within each district: (i) Register for Tax on Business Turnover and for Tax on Profit; and (ii) Register for *Patente* Tax. A copy of these registers is available at the PM Tax Branch.

The first register, Register for Tax on Business Turnover and for Tax on Profit, is prepared monthly, and has data on types of businesses, estimated monthly turnovers, applicable tax rates, amount of tax to be collected, and contact addresses. The second register, Register for *Patente* tax, is prepared annually and details all types of businesses that are subject to *patente* tax collection in the district.

The collection of the taxes with registers is tightly enforced, and fines are regularly and strictly observed. For the tax authority, these two registries enable them to revisit and re-classify businesses on a quarterly or semi-annual basis in order to update the amount of tax due, and the tax regime classification. Most of the businesses registered in the two registers tend to be located around market areas at the district level, as these businesses are easier to control and reach for tax collection than those in more remote areas. According to staff at several District Tax Offices, tax collection from businesses far away from the district office rarely takes place, if at all.

Besides these two registries, there are no other registers or record books for the collection of other categories of tax. The collections of other taxes are monitored through receipt books filled in as payments are collected.

2.6. Overall Challenges with Current Tax Collection

The current tax collection system in Cambodia faces a number of challenges. One is the poor quality of basic data available to the tax authority and a lack of tax records and registers, as well as a lack of competent staff. Therefore, tax collection from large businesses tends to be emphasised.

Another challenge, which is widely acknowledged by other public servants as well, is low salary and inadequate incentives for the tax authorities. Staff of tax administration is under the payroll of the National Tax Department, and hence receive the same amount of salary and incentive package of other public officials. Having considered this issue, government officials in general are permissive about rent seeking (see World Bank 2003 and Hughes and Conway 2003). It is even more obvious for the tax administrators given the opportunity and space for manoeuvring in tax corruption. It is common for civil servants to get involved in tax collection because they can benefit from their "responsibilities".

Another equally important set of challenge has been the problem of very little or no taxpayer education; limited information dissemination; lack of transparency; limited assistance provided by the tax authorities to the taxpayers. In practice, it is clear neither to the tax collectors nor to the taxpayers what types of taxes are being collected, which institutions are responsible; and how these taxes are being calculated. Citizens are also not well informed about their obligations. Initiative to address this is crucial in Cambodia. An effort to educate taxpayers can help reduce opportunity for rent seeking by tax authority and to improve the current tax administration.

2.7. Overview of major revenue sources from tax and non-tax revenues of the provinces

A discussion of communes own-source revenues cannot proceed without understanding the overall RGC revenue structure. Of greatest relevance are the current revenue sources of the province (those included in the *Salakhet*[5]), which are the most likely options to be shared with the communes. There are six main sources of tax revenue currently assigned to the province. In

[5] Salakhet refers to provincial governor's office.

addition, the province collects other non-tax revenue sources, such as *pheasie*[6] (market fees) and user fees. A detailed discussion for each of the sources is presented in Annex One and Annex Two, which includes information about who collect the tax, frequency and timing, tax rates, monitoring and procedure for collection, analysis and observations with regard to collection, and options and rationale for sharing and/or reassignment and the rationales for this.

Table 2.1 summarises sources and amount of tax collection of the provinces, and provides a comparison between planned and actual collection for FY 2003. These provinces usually collect their largest shares from: tax on transfers; tax on mean of transportation; and *patente* tax. Moreover, collection of *patente* tax and tax on transfers usually meets the targeted amounts[7], whereas collection of tax on means of transportation is quite low.

Table 2.1. Tax collection for the *Salakhet* budget

Revenue Sources from Tax Collection *Salakhet* Budget 2003	Siem Reap		Takeo		Sihanouk Ville		Phnom Penh	
	Planned amount	Actual amount	Planned amount	Actual amount	Planned amount	Actual amount	Planned amount	Actual amount
Patente tax	390	448	71	78	170	133	580	546
Unused Land tax	300	168	2	0.426	450	185	300	230
Tax on Transfers	600	1,230	10	18	550	272	3,500	3,304
Slaughtering tax	60	68	46	45	30	31	300	170
Tax on Means of Transportation	570	235	314	69	500	129	6,730	3,367
Public Lighting tax	80	148	2	3	10	5	40	51
Market Pheasies	180	152	225	124	300	-	0	Note[8]

Sources: Figures (in million Riel) received from the PM Tax Branches.

[6] *Pheasie* is a daily market fee collected from vendors.

[7] Targeted amounts refer to the planned amount of tax revenue of which each PM Tax Branch is responsible for the collection. The target amounts are calculated based on previous years' actual figures with current period fluctuation of the tax bases.

[8] Market *pheasie* collection in Phnom Penh is not recorded in the municipal budget. There are about 22 markets currently outsourced to private contractors. Estimate income is over USD1 million for three years. Contractors do not have to deposit this amount to the municipality but will use the money for road maintenance on behalf of the municipality.

3 Recommendations for Commune Own Source Revenues

Four sources for revenue sharing and reassignment from the province to the commune have been suggested. These include (i) tax on means of transportation; (ii) *patente* tax; (iii) *pheasie* collection from markets; and (iv) user fees. The chapter address how the sharing of these taxes can be arranged and other relevant issues, such as the percentage to be shared, and the roles and services that the communes will provide. In some cases, these options will have significant implications for PM revenues, and consideration would have to be given to how to replace the revenues lost by the PM as part of overall public sector fiscal reforms.

This chapter will also examine potential new revenue source from service levy based on land and property characteristics. Concrete recommendations will be provided on how these options can be implemented and how significant the revenue collection is compared with the CSF. This discussion is based on two case studies in Takeo, and Sihanouk Ville.

3.1 Tax on means of transportation

Background information

All motor driven means of transportation are subject to tax on means of transportation. This tax is collected annually by the District Tax Office according to the rates set by a Prakas of the MEF. The tax amount varies from riel 3,000 to 1.2 million depending on the different categories of vehicles. Revenue from tax on means of transportation is often the second most important sources of revenues for *Salakhet*. Collection of tax on means of transportation is fairly simple.

Observations and Analysis

Management of the tax collection is based on previous year's figure when preparing the tax collection plan. It is common that the District Tax Office conducts information dissemination to commune and village level representatives before the actual tax collection starts. This is to request local authority assistance to mobilise and inform citizens on the tax collection. The major challenges in collection of this tax are due to poor collection, and lack of enforcement[9].

The District Tax Office places their collection stations at the commune offices to speed up the collection process, but rarely assign any responsibilities to the commune. Some communes are however collecting tax on means of transportation on behalf of the District Tax Office. In such cases, arrangements are made for revenue sharing. For normal motorbikes subjected to Riel 4,000 of tax collection, actual collection will be Riel 5,000 in which Riel 500 is for the commune, Riel 400 for paperwork, and Riel 100 is for the district staff. This is illegal and none of this revenue is recorded as commune or district income but rather seen as individual earnings.

Recommendations and Potential Commune Roles

Tax on means of transportation is a *candidate for sharing* between the province and the commune. The reasons for this is that (i) the communes already assist the District Tax Office in the collection of this tax; (ii) the collection of such tax is fairly simple; and (iii) with incentives and potential revenue sources received from this tax collection, it is a fairly good chance that the commune would be able to collect taxes from all available tax bases within its jurisdiction; and (iv) it would also be sensible for the communes to collect this tax as most of these vehicles and means of transportation use local roads and services. Therefore, revenues collected from this source could belong to the local governments for them to spend on maintenance of local public infrastructure. The commune councils are keenly interested in experimenting collection of this tax.

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[9] Read further discussion on this issue in Annex One.

Furthermore, it makes sense to *share* this tax. One major reason for this is that taxation on means of transportation would be one of the very few taxable items in the poorest communes that do not have markets or slaughterhouses and where opportunities for taxation of land are minimal. Another argument for the reassignment of this tax is that the communes use own resources on provision and maintenance of local public infrastructure, often the CSF. Therefore, taxation on means of transportation would allow the communes to renovate their infrastructure projects. A share of the tax would need to be assigned to the provincial budget for the renovation of the provincial and national road network.

The figures in table 3.1 show the amount of revenue sharing based on actual amount collected in 2003 under the 50 percent sharing option, which varies from Riel 438,150 to 17,676,750. This huge variation is due to variation in the size of councils, lack of records, big different in number of vehicles by type, and difference between rural and urban councils. Impact on provincial revenues from sharing tax collection with the communes is very minimal--only one percent of the total collections as shown in Table 3.1 (if the pilot project decide to choose the 50% sharing option in the selected communes).

The tax sharing experiment will be a result from collaborative work between the District Tax Office and the commune councils. It is important that some tasks will still remain with the District Tax Office because the CS lack managerial capacity and also to minimise the administrative costs. The communes could be required to perform the following functions:

- Prepare a vehicle registration list which the commune councils are responsible to collect data, register vehicles and update the list regularly. The on-going October 2004 household survey in Phnom Penh to document ownership of type and number of vehicles is being collected by the village chiefs.
- Disseminate and inform villagers about the tax through village meetings and public posting of regulations and guidelines on the tax.
- Assign staff to perform actual collection of the tax at the commune office.
- Record amount of collection and prepare deposit of revenues to the Provincial Treasury.
- Enforce tax collection from all tax dues.

Table 3.1: Shared revenues from tax on means of transportation for the CS (Figures are in Riel)

	Tramkok, Takeo	Chumreah Pen, Takeo	Somroung, Siem Reap	Kork Chork, Siem Reap	Prey Noup, Sihanoukville	Boeung Pralit, Phnom Penh	Olympic, Phnom Penh
Actual revenues	2,032,000	1,921,000	675,000*	4,320,000**	2,750,000	100,979,000*	95,062,000*
Number of means of transportation	566	522	470**	782**	155	1,369**	1749**
50% sharing option[10]	438,150	493,350	1,645,000	2,549,750	2,509,050	17,676,750	13,131,300
Impact on provincial tax collection[11]	931,500		41,947,750		2,509,050	30,808,050	
	1%		1%		2%	1%	

Source: Figures provided by the PM Tax Branches for FY 2003.

* These are average figures resulted from dividing district/*khan*'s tax revenues by number of communes/sangkats.

** Figures received from the commune councils based on their database.

Tax sharing arrangement

The fixed percentage of the tax collections to be shared with the CS will be decided by the NCSC in consultation with relevant ministries. It can be done in two ways. The share could be

[10] The figure is calculated based on the 2003 CS population average.

[11] This is to compare the suggested sharing amount with the communes and the total collections the provincial currently have (in figures and in percentage).

determined simply by designating a percentage that would provide a certain amount of revenue to the CS, which can be an extension from the current informal sharing practice.

The other option could be more specifically tied to the estimate of the CS road maintenance costs borne by the communes. In this case, taxpayers could be informed that a portion of the CS tax share would be used specifically for this purpose. Expenses for road maintenance and construction are currently borne by NGOs and the Ministry of Rural Development, with limited commune councils and local beneficiary contributions. Standard costs to build one kilometre of new communal road are about Riel 40 million (USD10000) and about Riel 1.2 million (USD300) for regular maintenance costs.[12] The provincial roads are more expensive, with one kilometre of new road costs Riel 80 million (USD20000) and maintenance costs Riel 3 million (USD750).[13]

The following may be suggested:

a. A 50 percent sharing option of the revenue collection from tax on means of transportation to the communes. This is because the communes should be able to receive at least Riel one million from the shared revenue to cover one kilometre of road maintenance.
b. Inform taxpayers that this percentage covers also administrative costs so that informal taxation can be reduced or eliminated.
c. Tighten tax collection from all available tax bases in the commune.

Conclusion

This reassignment of collection responsibility to the commune is likely to ensure a timely implementation of tax collection, and a broadening of the tax bases. Also, it may contribute to the elimination of extra charges for administrative expenses (eg tax form and gas for officers) currently borne by taxpayers.

Result from the July 2004 National Workshop indicates that the provincial governors agree and are willing to share 20% of collection from tax on means of transportation with the communes for the pilot project.

3.2 *Patente* tax

Background information

Patente tax is collected annually by the District Tax Office. Collection amount ranges from Riel 15,000 to 1.4 million as regulated by a Prakas of the MEF. Upon payment of the *Patente* Tax the business will be provided with a Patent Certificate, which is prepared and issued by the Provincial Tax Department. This tax is collected at the business site. The majority of the *patente* tax income at the district level comes from vendors at and around the market compounds. The collection is fairly simple.

Observation and Analysis

The challenges with the *Patente* Tax are chiefly related to the collection process. One problem is that businesses are established without a proper notification to the relevant authorities. A second problem is that due to distance between the commune centres and some smaller business areas, small-scale businesses and vendors can easily avoid the tax officers. And these problems are compounded by the fact that the District Tax Office often needs to visit the business several times to be able to collect the full tax amount while there are only two to three staff at the office.

[12] Interviewed with Director of Department of Rural Development in Sihanouk Ville in May 2004.
[13] Ibid.

Therefore within the CS survey areas the communes are already informally assist the district Tax Office with collection, and receive some incomes.

Revenue collection from this source can be significantly increased if business registration is conducted thoroughly and regularly with assistance from commune or village authorities. Also in order to reduce payment resistance and rent seeking in the collection, it is important that information on *patente* tax categories are publicly posted at the market compound or the commune house.

Recommendations and Potential Commune Roles

The *Patente* Tax is a *candidate for sharing through reassignment of the tax collection.* This means the mandate to collect all *Patente* Tax in the commune could be handed over to the commune. The reason for this sharing through a reassignment of the collection process is that (i) the commune councils are able to monitor all types of businesses in the communes as well as the whereabouts of all businesspeople; (ii) the commune councils welcome the opportunity to be involved in the registration of all taxable businesses; to update the list, and to help collect the tax; (iii) collection by the commune council would require less travel and hence incur less administrative expenses, an amount which currently tend to be charged from the taxpayers; and (iv) it would require more proper records of all *patente* tax collections that what is currently the case. This would reduce the current rent seeking by the communes, as they tend to informally collect *Patente* Tax from businesses that are out of reach of the district tax authorities.

Sharing amount of *patente* tax for each of the study commune ranges from Riel 12,465 to 1,771,690 based on the 20 percent sharing option (Table 3.2). Impact on provincial revenues from sharing tax collection with the communes is very minimal for both options.

The potential roles of communes can be identified with continued supports from the district and provincial level for the reasons that communes still lack competent staff and in order to minimise administrative costs.

- Each commune prepares a *patente* tax register and updates the list regularly.
- Based on the register list the communes will get assistance from the district Tax Office to classify businesses into their *patente* tax categories ready for tax collection.
- The communes collect *patente* tax based on the list.
- The PM Tax Branch issues and authorises patent certificates while the communes deliver them to taxpayers as tax collected.
- The communes are responsible to prepare reports for revenue collection and have them available for review and audit.
- All collected revenues are deposited into the commune bank account or the treasury.

Table 3.2: Shared revenues from estimated regime *patente* tax for the CS (Figures are in Riel)

	Tramkok, Takeo	Chumreah Pen, Takeo	Somroung, Siem Reap	Kork Chork, Siem Reap	Prey Noup, Sihanoukville	Boeung Pralit, Phnom Penh	Olympic, Phnom Penh
Actual revenues collected in the commune	1,395,000	180,000	315,000	600,000	435,000	10,319,000	5,993,000
Number of businesses in the estimated regime in the commune	101	40	17	50	25	240	134

Reassign the estimated regime to in the commune	1,395,000	180,000	315,000	600,000	435,000	10,319,000	5,993,000
Impact on provincial tax collection[14]	1,575,000		915,000		435,000	16,312,000	
	0.20%		0.20%		0.30%	0.30%	
20% sharing option of total provincial collection[15]	12,465	218,155	950,977	1,771,690	871,760	934,231	696,528
Impact on provincial tax collection[16]	230,620		2,722,667		871,760	1,630,759	
	0.20%		0.60%		0.60%	0.30%	

Source: Figures provided by the PM Tax Branches for FY 2003.

Tax sharing arrangement

One option, for example, would be to assign the tax bases of all businesses within the "estimated" (small business) regime from the PM to the CS, leaving the PM with the "real" (larger businesses) regime. Another option would be to share some portions of both the "estimated" and "real" regime revenue with the CS.

Based on the two feasible options, the following can be proposed:

a. First option: Reassign tax bases of all businesses within the estimated regime from the province to the commune (i.e., province keeps the big businesses classified in the real regime).
b. Second option: Share 20 percent of total provincial collection to the communes because there are quite a small number of businesses within each commune as the base for *patente* tax (See table 3.2). Besides revenue sharing should be substantial for it to have meaningful effects on commune expenditure.
c. Ensure transparent tax collection and collect only the legal tax due through open process of tax assessment and collection.
d. Enforce *patente* tax collection from all tax bases within the commune.

Conclusion

One of the most attractive incentives for the communes related to collection and retaining of revenues from *patente* tax is the opportunity for the councils to play a key role in promoting local economic development. This is a respond to the commune councils' demand for more resources and activities in promoting rural economic growth as frequently discussed in the CDP. A remaining challenge is that the commune councils need intensive training to help build skills to enable the commune to collect the *patente* tax. Another challenge is to identify the types of assistance that the commune councils need in order to assess annual business turnover for *patente* taxation.

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[14] This is to compare the suggested sharing amount with the communes and the total collections the provincial currently have (in figures and in percentage).

[15] The figure is calculated based on the 2003 CS population average.

[16] This is to compare the suggested sharing amount with the communes and the total collections the provincial currently have (in figures and in percentage).

Agreement from the July 2004 National Workshop shows that the provincial governors agree and are willing to share 20% of total collection from *patente* tax with the communes for the pilot project.

3.3 *Pheasie* collection

Background information

Pheasies are collected in several places including markets, parking areas for vehicles and boats, and slaughtering places. All vendors and users are supposed to pay pheasie. Pheasie is often collected daily while it is acceptable if vendors prefer to pay monthly. Common to most provinces, private contractors manage and collect pheasie under the direct authority of the provincial Department of Economy and Finance. Pheasie collection is around riel 200 to 500 per day. This fee is strictly enforced and collected by the contractors. No one can escape pheasie payment. In return for the right to collect pheasies, the private contractors are supposed to provide cleaning and waste collection services for the markets. Collection of *pheasie* from markets is simple and easy to enforce.

Observations and Analysis

For other rather small commune markets there are several challenges with the collection of *pheasie*. It is not clear at the moment whether the village or commune chiefs are involved in the collection of this *pheasie* for markets that are not under the supervision of the Provincial Department of Economy and Finance. Anecdotal information seems to indicate that this *pheasie* is collected by the district office. In addition, other authorities (i.e. police) collect other fees from businessmen around the markets for security and safety services these authorities provide. None of these fees are officially recorded.

For medium and large markets, vendors raise a lot of problems and concerns regarding performance of the private contractors. One common complain is poor quality of services provided by contractors such as cleaning, trash collection and order. Another problem is that contractors often collect other fees from vendors through upgrading of market and selling of new stands. The contractors are not permitted to do this. Another critical issue is that vendors and people around the market are not able to raise their problems with the contractors or demand changes or improvement of the contractors' performance because they usually base at the provincial level. Many vendors say they are not satisfied with the contractors and rather have their commune councils to take over.[17]

A suggestion may therefore be that *pheasie* collection be rearranged because: (i) private contractors have been outsourced because the PM and district face difficulty in collecting unregistered vendors and therefore profit is extracting out of local economy; (ii) there is no linkage between the revenue raised and the expenditures made for local development. Some revenues from *pheasie* collection should target for local services such are cleaning, waste collection and order of the market areas

Recommendations and Potential Commune Roles

The *pheasie* is a *candidate for sharing through reassignment* of the fee collection. This means that instead of organising a competitive bidding process, the mandate to collect all market *pheasie* in the commune could be handed over to the commune. The reason for this sharing is that (i) if the commune councils are to collect *pheasie* and provide services the development of the market becomes commune mandate and can be part of the commune plan; (ii) the councils can then be responsive to demand and complaints of the vendors; (iii) the commune councils are able to closely monitor the business activities as well as the whereabouts of all businesspeople; (iv) the commune councils welcome the opportunity to be involved in the registration of all

[17] Interviews with commune level markets in Takeo and Sihanouk municipality in May 2004. Rusten et al (20040 also shows the same results.

taxable businesses, to update the list, and to help in the collection of other taxes; and (v) even if the communes pay a fix amount to the province/district in a sharing agreement, the profit which currently falls on private contractors would in the future fall on the commune. This will allow the commune to reinvest the profit for example in market upgrading. Currently, such reinvestment of profit to the benefit of all does not take place.

The roles of the communes will be to:
- Provide necessary services to ensure safe and clean market areas.
- Provide security and order for vendors and users of the market.
- Collect daily *pheasie* from all vendors in according to common practice.
- Revenue collection from *pheasie* should be separated from other revenue sources of the communes. This is to make sure that there are link between revenue collected from and expenditure made to the market.
- Create enabling environment for businesses in the market to improve and grow.
- Invest and upgrade the market as necessary.
- Post and inform about revenue collection and expenditures publicly.
- Deposit collected revenue at the commune account or treasury with proper record keeping and reporting.

Sharing or reassigning of market pheasies

The option for sharing or reassignment for market *pheasie* collection discussed in this paper concentrates on local small and unregistered markets. This leaves the big and well-structured markets for the province to tax. Table 3.3 provide example of communal markets that are informally taxed except the one in Tramkok commune. Since the total amount of *pheasie* collection from these markets is quite small, a percentage sharing of this revenue collection would be insignificant and may not be encouraging and profitable for both the commune and the province.

There are two options available for the process towards a sharing/reassignment of this revenue. One conservative option is simply to reassign the *pheasie* collection mandate to the commune but keep the current system that will ensure a fixed profit to the district/province. In other words, this allows for a sharing between the commune and the district/province. Another more radical option would be to simply reassign the entire *pheasie* collection as well as the entire profit to the commune. In other words, this allow for a reassignment of the *pheasie* from the province to the commune.

Table 3.3. Reassignment of small market *pheasie* from the province and the commune

Name of commune	Description of market	Current *pheasie* collection	Feasible sharing arrangement	Shared revenue to the CS
Tramkok, Takeo	One medium 160 vendors 200 Riel	11,520,000 Riel	Reassign to the CS	11,520,000 Riel
Chumreah Pen, Takeo	No market	-	-	-
Somroung, Siem Reap	One small 35 vendors 100 Riel	1,260,000 Riel	Reassign to the CS	1,260,000 Riel
Kork Chork, Siem Reap	Private owner No *pheasie*	-	-	-
Prey Noup, Sihanoukville	One small 55 vendors 200 Riel	3,960,000 Riel	Reassign to the CS	3,960,000 Riel
Boeung Pralit, Phnom Penh	One small 50 vendors 200 Riel	3,600,000 Riel	Reassign to the CS	3,600,000 Riel
Olympic, Phnom Penh	No market	-	-	-

Conclusion

The proposal to reassign commune markets to the communes is strongly supported by the province, the district, the commune, and vendors and villagers. Examples from all the markets visited show that vendors prefer the commune councils to manage and collect *pheasie* since they believe that the commune councils are closer to them and are more responsive to their problems and concerns (see also Rusten et al. 2004). Therefore, this process might become a real testing ground for the commune councils to be responsive and accountable to their constituencies. The communes will succeed or fail depending upon their management capacity over the *pheasie* revenues, their quality for service provided, and their commitment to eliminate rent seeking.

3.4 User fees

User fee is often considered as one of the best revenue sources used to improve the allocative efficiency; that means providing services that people want and are willing to contribute to the costs. User fee is also important mean for resource mobilisation for raising additional revenues. In Cambodia, CS could also adopt user fees (that are easy and simple to collect) to generate additional resources for operation and maintenance for a number of local services, and that is common sources of local revenue internationally. Users of specific local services have to share in the actual costs of providing those services.

CS will have to identify the services for which direct charges can be collected and set fees that meet local revenue needs for the service following national guidelines. Emerging issues need to be address are (i) level of responsibility for communes in public service delivery either solely or shared responsibility with PM (agency functions), and (ii) the funding and operating mechanism that these services shall be delivered (El Mensi 2003). These issues will need to be addressed in regulation for how much devolution of responsibility will be given to the communes regarding the types of services the communes are expected to deliver and under which funding and operating mechanisms.

Feasible services that can be candidates for rural communes include rural water supply and small-scale irrigation, solid waste management, maintenance of school buildings and other small infrastructures. User fees have high potential revenues for most peri-urban and urban communes. Possible services that the commune councils can provide and collect user fees are solid waste collection, and domestic drinking water (wells and piped system). A number of selected communes in Takeo and Kompot province currently provide piped water system through private contractors. Several sangkats in Phnom Penh collect waste disposal from each households for on behalf of the Phnom Penh Municipality Waste Management Authority[18]. There are more examples where the commune councils engage in service delivery and collect user fees either as own function or as agency function.

Possible Arrangements

In order to start piloting user fees for the CS, we need to:

- Identify services that can be directly charged for (or shared with the PM)
- For new charges, determine costs of service provision and set appropriate charges within Royal Government guidelines
- Develop CS procedures for collecting, recording, and enforcing payment of user charges.

Conclusion

It is possible for the communes to provide services as a form of service delivery and as a mean to raise additional income for the communes. The LAMC authorises the communes to raise own funds to finance services provided that the communes can provide.

[18] See also CDRI study on public service delivery at the commune level by Eng et al forthcoming.

3.5 Commune Service Levy

Background and rationale

The majority of communes in Cambodia are rural communes that support almost 80 percent of the population. Over 70 percent of the total population depend on agriculture for their livelihoods. This results in a large agricultural output and employment within this sector. Agricultural outputs and employment tend to be informal, and not targeted for tax collection. Recognising the limited technical capacity of the tax authority and the government's pro-poor policy not to tax farmers and agricultural output, one might look for a more rational strategy to increase revenue collection and economic returns on land.

One possible option is to introduce a pro-poor land tax to generate local revenues and discourage speculative land acquisition[19]. This will address concerns over large-scale landholdings, since most large-scale land holders are motivated by expectations that land will increase in value irrespective of investment efforts. Also, a pro-poor land tax might address the current challenge in revenue collection from land. Despite the fact that there is a four percent tax on unused land, Cambodia still holds a large volume of unused land. This has resulted in extensive areas of good quality land remaining unused or underused. More research is required for an introduction of a land tax since there are a number of key issues to be discussed.

At this initial stage, however, the discussion might focus on possible options to introduce service levy based on land and property characteristics. It may make the case, given the political and institutional condition in Cambodia, to pilot the collection of such levies in a number of communes in the medium term before moving forward with property tax in the longer term.

Therefore, the MEF has proposed a general commune service levy as an initial option to help finance local public services provided by the communes for which direct user charges cannot be easily collected (Smoke 2003). Experience elsewhere also indicates that a commune service levy is a very common general revenue source for local governments internationally. The commune service levy could raise significant revenues and might be the only major source of revenue in some communes, and the potential for revenue yield and growth is high. In addition, each council is likely to decide on how to spend the collection, to determine bases and rates for collection, and to supervise collection administration.

Objectives and outputs

The main objectives are (i) to establish a significant revenue source for the CS, and (ii) to serve as a means for citizens to contribute to the costs of the local public services they receive. The introduction of service levy will be a stepping-stone toward introducing a property tax and it is seen, in the immediate term, to enhance revenue-generating capacity of the communes; strengthen administrative and technical skills of the communes; and to overcoming reluctant of villagers with tax payment.

The outputs from collecting commune service levy including increasing local revenues from land resources for commune councils, updating and improving information on property and land database, and improving local public services.

Identification of revenue bases

Commune service levy can be collected as an annual compulsory contribution paid by residents of CS (see El Mensi 2003). The CS can collect from every household residences and business within the commune in agreement with a national average, depending on (i) the categories of land use (agricultural land, residential land, and commercial land) that each family and business possesses; (ii) the classification of land size; and (iii) the types and sizes of structure on the land.

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[19] Interviews with Project Director of LMAP and some provincial governors in early 2004.

This is very relevant criteria to use as a proxy for different levels of income group in Cambodia, according to a national survey in 1999, as each household possess 1.37 plots of land with a total land size of about one hectare (Chan et al. 2001).

Using these criteria to assess the commune service levy would be most appropriate. That means the communes must have access to reliable data and records on land and property in the communes. Nonetheless, The communes do not keep any land and property records, and such reliable data are not available at national and provincial level in Cambodia. The research team spend a considerable time with different authorities at national, provincial and commune level to try to collect current database on land and property but the results are minimal. The most reliable and available information collected from DLMUPC are (i) different land use classifications; (ii) number of land plots, and (iii) average plot size. These data are used in the two case studies to project potential amount of commune service levy collections.

As an initial test in piloting a commune service levy, one option is suggested by designating an annual fixed fee. The commune service levy would be assessed on land classification and disparity between rural and urban communes. Hypothetically, Table 3.4 suggests a possible simple rate for collecting commune service levy by only differentiating between land categories and rural/urban communes. Suggested amounts of commune service levy presented in Table 3.4 are consolidated from suggestions received from the provincial governors and the commune councils.

Table 3.4. Fixed rate for commune service levy

	Rural Communes	Urban Sangkats
Agricultural Land	10,000	10,000
Residential Land	20,000	30,000
Commercial Land	30,000	40,000

Possible roles of the CS

The roles of communes could include the following:

- Record and update a communal land register regularly with assistance from Land Management and Administration Project (LMAP) and the current land register;
- Classify plots for levy collection based on MEF regulations and the CS register list;
- Assess and collect the appropriate levy payments from each liable payer;
- Prepare collection records and reports for public review and audit;
- Deposit revenues into the PM treasury or a CS bank account;
- Enforce collection.

Conclusion

Local governments will administer service levy and decide on their expenditure targets. It will be necessary that revenues from commune service levy must have strong correspondence to expenditure responsibilities of the communes to deliver services. These local services not only answer to local demand but also benefit community beyond the direct beneficiary group (the group who pay for the service costs). It is, moreover, a response to government strategy for local development and rural economic growth.

There are several issues that need to be solved before a final design of commune service levy can be implemented. First, there must be clear expenditure assignments for service responsibility to the communes. This will help to address the problems regarding trust to the commune councils, and a lack of clarity with respect to obligations and reasons for paying (Rusten et al. 2004). Second, how to gather support from relevant key stakeholders particularly the national governments to introduce any levies related to land. A carefully design of an acceptable and feasible tax and/or levies related to land and property is required. An immediate need is to prepare a reliable and up-to-date register and record of land and property for each commune. Collecting and improving information on land use and property ownership has to start so that the CS can use the information to further develop regulations and enforcement of the commune service levy.

Case studies

Chumreah Pen Commune, Takeo province

Background facts: The commune has 19 villages and 2,369 families with total population of 12,296. The development fund in 2002 was Riel 39.7 million, and Riel 36.3 million in 2003. The area of the commune is 3,832 hectares, of which 1705 hectares are for rice production. Aaverage size of farmland is less than 0.70 hectares. Overall, about 99 percent of the villagers are farmers. Other income generating activities include wage labor, garment workers, and others.[20]

Chumreah Pen is considered a rural commune. The commune has a number of businesses and shops. These are: (i) 20 rice millers, (ii) five winemakers, (iii) 15 battery chargers, (iv) four electricity supplier, (v) five repair shops, (vi) 19 food and service providers, and (vii) several other businesses.

Assessed potential collection: Collection from service levy for this commune would mainly cover 60 percent of the total land, as the other 40 percent is state land.[21] Since the data for land size classification is not officially released, the average land size is used instead as the base for the calculation of potential tax collection. Figures (0.14 - 0.20 hectare per plot) of an estimated average land size received from the DLMUPC correspond with the commune council's estimation. The commune might be able to collect as much as Riel 103,070,000 of the land plots from the two land categories. Table 5.5 provides summary of all this information.

Table 3.5. Land use and collection of commune service levy in Chumreah Pen commune

Land use classification	Land use total ha*	Land use as % of total land	Average land size (hectare)	Number of land plots*	Applicable levies of collection	Potential collected amount**
Farming/crops	1705 ha	44%	0.20	7163	10,000	71,630,000
Residential	605 ha	16%	0.14	1572	20,000	31,440,000
Commercial	na	-	-	na	30,000	-
State	1522 ha	40%	10	87	-	-
Total	3832 ha	100%	-	8822 plots	-	**103,070,000**

*Figures received from DLMUPC Office in Takeo province.

** Potential collected amount receives by multiplying number of land plots with applicable levies of collection.

Sangkat Prey Noup, Sihanouk Ville

Background facts: The elected council of the *sangkat* has five members. The *sangkat* consists of five villages with a total of 1,037 families (a population of 6,395). In 2003 the *sangkat* has two major sources of revenues: Riel 29 million from CSF and Riel 20,000 from civil registration. Total size of the *sangkat* is 2,624 hectares and total 2,872 plots. The three categories of land use are: (i) 80 percent or 2,080 hectares of the land are for rice farming; (ii) 2 percent or 60 hectare are residents; and (iii) the other 18 percent is state land.

Prey Noup is considered an urban commune. The *sangkat* supports a small market near the *sangkat* office. This market operates daily and supplies durable and endurable goods. There are about 55 vendors. There are several other small businesses including rice millers, food catering services, and fishing.

[20] Interview with the commune councillors in May 2004.

[21] Data received from DLMUP for categories of land use and ownership of the commune.

Assessed potential collection: In total the sangkat can collect as much as Riel 24,680,000 annually from a service levy from 80% of households. Of this total amount, Riel 22,970,000 is from agricultural land. About Riel 1,710,000 are levies from residential land (Table 5.6).

Table 3.6. Land use and collection of commune service levy in *sangkat* Prey Noup

Land use classification	Land use total ha*	Land use as % of total land	Number of land plots*	Applicable levies of collection	Potential collected amount**
Farming/crops	2080 ha	80%	2297	10,000	22,970,000
Residential	60 ha	2%	57	30,000	1,710,000
Commercial	na	na	-	40,000	-
State	484 ha	18%	518	na	na
Total	2624 ha	100%	2872 plots	-	**24,680,000**

*Figures received from DLMUPC Office in Sihanouk Ville Municipality.

** Potential collected amount receives by multiplying number of land plots with applicable levies of collection.

4 General Conclusions

The process of introducing local taxation in Cambodia is complicated and a long process because people are not used to paying taxes in exchange for government services. With limit time and scope, however, the objective of the paper is to identify potential sources of revenues that can be shared and reassigned to the communes on a pilot project before scaling up to national coverage.

The paper identifies four options for initial development of commune own source revenue in Cambodia. These options include (i) sharing of tax revenues from tax on means of transportation; (ii) partial reassignment and/or sharing of *patente* tax and *pheasie*; (iii) adoption of service-specific user charges; and (iv) development of a commune service levy based on simple land and property characteristics to help cover the cost of services that cannot be directly charged for.

4.1. The Way Forward

The process to move forward with commune own sources of revenue looks promising and feasible. The results from the national workshop in July 2004 shows that there is broad support to pilot the sharing of selected provincial revenues and consider how the CS can adopt user charges. The commune service levy, given sensitivity about land taxes in Cambodia, was not ruled out, but the discussion made clear that additional research would be needed before considering this option for piloting. Other ideas for sharing of revenues with the CS, like unused land taxes, were also mentioned.

The MEF with support from UNCDF/UNDP is in the process of designing a tax-sharing project to be piloted in a small number of communes in 2005. This pilot project could follow the experimentation and piloting tradition of the Seila programme (see Rusten et al. 2004). This approach has proved to be constructive and useful in terms of designing structures and systems that can be scaled up. Such experiments should be followed over a period of time and lessons learned should be fed into the reform approach as a "process oriented" way of designing fiscal decentralisation reform.

There are three goals the pilot project will achieve. These goals are to: (i) establish the principle of sharing provincial revenues with communes; (ii) increase revenue base identification collection through cooperation with the communes, thereby benefiting both provinces and communes; and (iii) establish the principle that revenue due to the communes is protected for commune uses and not diverted to other uses by provincial treasury. Within these three broad goals, there are various specific indicators that could be developed to follow up on the pilot project. The communes play an active role in base identification and revenue collection, and therefore the revenue bases and yields are increased. In addition, collected revenues are shared in full with the communes according to regulations rather than through informal negotiation. Revenues are for the communes are available in a timely manner. Importantly, local taxes and revenue sources must be assigned along with modest level of delegated responsibility and selected sources, and that rapid success can be secured from implementing a local government own source revenue system.

4.2. Remaining Challenges

<u>*Fiscal decentralisation*</u>

Several general issues need immediate and long-term attention. First, a discussion is needed on how to account for the revenues and what other services that the communes could provide with the extra sources of funds available through such sharing and reassignment. Indeed, fiscal decentralisation is not only about assigning and devolving revenue sources to the communes. The purpose of financial resources is to allow the communes to deliver services to their people and to develop their locality. It is important that appropriate service responsibilities, specifically functions, to be assigned and devolved to the communes are identified and that sufficient matching funds is provided through a mix of transfer and own revenues.

Second, several management questions will have to be addressed. For example, one issue is the financial management of the funds. UNCDF plans to pilot two possible options for financial management of commune funds. One option is to use treasure offices at the district level to allow the communes easier access to the commune funds. This will then also ease the process of flow of funds such as taxes, levies and the local contribution from the commune to the commune accounts at the district treasuries. The other option is to pilot a commune banking system. This would require that the communes hire commune accountants.

Third is how to correct the differences between urban sangkats and rural communes because the potential yield for commune service levy in urban sangkat will be more substantial than in rural communes. This can be done through the CSF transfers.

Fourth is related to role and responsibility of district level in the future under the broad decentralisation and deconcentration reform. District is now an extended arm of the province. The question is whether the district will become another level of sub-national government with its own function, budget, administration, and own source revenue system. Therefore, revenue assignment for commune will be more relevant to discuss with the district level.

Institutional Support

The Department of Local Finance (DoLF) of the MEF will take responsibility to provide capacity building and support for the communes. If the communes are to implement tax and revenue collection, whether who will take this responsibility as collectors and whether new staff will be hired. The DoLF should also improve and strengthen the monitoring and auditing of the commune accounts and reports, and whether a social auditing mechanism can be established at the local level. Currently the capacity the DoLF is limited to having several national staff responsible for budgeting and monitoring of the provincial and commune level.

The other important issue is the need to improve and strengthen collaboration and communication between DoLF and DoLA in order to better target the types of support provided to the communes.

Regulatory framework

Clarification and/or amendments of LMAC article 74 will be urgent to authorise the communes to collect taxes and levies. Other relevant regulations that might need clarification and changes are also foreseen such as the Law on Taxation, and the PM Budget Law. Another related issue concerns the current arrangement of local contribution. It will create dual burden on local people if they have to contribute to commune development activities at the same time also pay taxes and charges to the communes. The local contribution will need to be restructured and regulated. Also, the design of CSF allocation will need to be revised to include mechanism to address fiscal imbalance, and to create incentives for local revenue efforts as the communes have own source revenues.

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APPENDIX ONE: Overview of Taxes Currently Collected

A discussion of CS own-source revenues cannot proceed without understanding the overall RGC revenue structure. Of greatest relevance are the current revenue sources of the PM (those included in the *Salakhet*[22]), which are the most likely options to be shared with the CS. The main sources of tax revenue currently assigned to the PM are: (i) tax on unused land; (ii) tax on property transfers; (iii) tax on means of transportation; (iv) *patente*[23] tax (business license); (v) slaughtering tax; and (vi) public lighting tax. The PM collects other non-tax revenue sources, such as *pheasie*[24] (market fees) and user charges.

This chapter presents the different formal taxes that are currently being collected in Cambodia, and that is part of the provincial budget, the *Salakhet*. Each of these taxes are discussed with a separate sub-chapter identifying:

(i) Background Information and Facts on who collect the tax, frequency and timing, tax rates, monitoring and procedures
(ii) Analysis and Observations related to collection challenges, and
(iii) Options for Sharing or Reassignment and the Rationale for this. It should be noted that the discussions on options for sharing and reassignment look at each of the taxes both in *isolation* from other potential taxes, and in a *holistic manner* where overall consideration of tax candidates for reform and consolidation is taken into consideration.

1. Tax on Unused Land

1.2 Background Information & Facts

Who collects	The Provincial Tax Branch and the District Tax Office are responsible for collection of tax on unused land. These collections are assisted by a team for assessment and collection of unused land at the provincial and district level.
Identification of tax base	Unused land above 1200 square meters is liable for two percent taxation. A plot of land is considered to be unused land if the land (i) has yields less than 80 percent of the value of the land, and (ii) is occupied less than 182 days per years. The value of land to be used for tax calculation is determined in Decisions issued by the Committee for Land Appraisal and Valuation of Unused Land.[25]
Assessment and calculation	Two Decisions define unused land and set taxable value on land for tax collection. Each province and municipality has a set of rates of land value. The rates of land value vary according to location and region. For example, a piece of land in *sangkat* Beoung Pralit is worth between Riel 40,000 to 100,000 per square meter while a piece of land in Tram Kok commune is worth between Riel 500 to 4000 per square meter. Owners of unused land are responsible to declare and pay tax. However, in practice, for any piece of land that is considered

[22] Salakhet refers to provincial governor's office.
[23] *Patente* is a French word. *Patente* tax is an annual business license tax collected from all established businesses in Cambodia.
[24] *Pheasie* is a daily market fee collected from vendors.
[25] The First Decision governs tax collection for the period from its first collection in 1996 until 1998. The tax collection for this period uses a set of land values in US dollars to calculate tax amount based on geographical location. The Second Decision governs tax collection from 1998 until the present. Currently, calculation of taxes on unused land applies rates set forth in both Decisions.

	unused, the District Tax Office has to contact the landowner to come and pay tax.
Where the collections go	*Salakhet* budget
Purpose of taxation	The purpose of imposing such taxes is to prevent land value speculation, to provide incentives for land investment, and to raise revenue for the state budget.
Frequency and timing	Annual tax to be collected during fiscal mid year.
Enforcement and monitoring	The Committee for Land Appraisal and Valuation of Unused Land issues relevant regulations and guidelines, which include value of unused land and incentive sharing scheme among collectors. The ccommittee is an inter-ministerial body chaired by the MEF. The tax collection is controlled and monitored by the Registration of Land Transfer and kept at the Department of Land Management at the provincial/municipal level. In Siem Reap annual data collection of land and property information is conducted jointly by the PM Tax Branch and the Department of Land Management. In practice, information about unused land is monitored through local authorities such as village and commune chiefs. Also, another important way to keep track of unused land is through ownership transfer processes. Enforcement responsibility rests at the tax authority. The evasion rate for this tax is extremely high. However, revenues received from penalty is almost nothing because it is often the case that unused land belongs to the rich and powerful.

1.2 Observation & Analysis

In most provinces except Phnom Penh municipality, revenues collected from unused land tax is minimal because of the great difficulty in mobilising owners to pay taxes and the low value of unused land. For example, collection in 2002 for Takeo is Riel 3 million while Phnom Penh collects Riel 274 million. There is potential for both municipalities and provinces to collect a lot more revenue from this tax source than what is currently being collected if land registration is used and enforcement in tax collection is tight. Moreover, urban and semi-urban areas have a higher potential to collect unused land tax than rural areas because land value is higher and there are bigger unused plots of land in urban and better off areas as there are more speculation transactions of land value (for instance in Siem Reap town). Anecdotal information suggests that not less than 20 percent of current collection from land-owners (calculated based on selling price of land) is informal fees.

Despite the fact that Phnom Penh earns quite a huge amount of income from the Tax on Unused Land, collection in 2000 made up 10 percent of the potential tax collection.[26] There are three main reasons for that. First, it is the result of no proper land registration records, which leads to no clear overview of land ownership and how to keep track of the potential taxpayers. This is because a lot of land transactions take place through the commune authorities only because land transaction registration through the proper channels is a complicated and costly exercise (see also Chan and Scharya 2002). Second, the criteria used to determine and categorise land into unused/used land have not been clarified and enforced. Third, the committee to assess unused

[26] See Royal Government of Cambodia (2002:31).

land at the district is not active. Due to this, it is difficult to build capacity to enhance a proper registration process.

Overall the key challenge in collection of this tax is lack of willingness among the taxpayers to declare and pay taxes despite the fact that some degrees of fine are enforced (only if tax on transfers is collected).

1.3 Options for Reassignment or Sharing and the Rationale for this

Current practice

The Committee for Land Appraisal and Valuation of Unused Land has issued a Prakas to initiate an 'Incentive Scheme' in order to involve and encourage relevant authorities at the different levels to help collect revenues and enforce compliance. Phnom Penh Tax Branch manages the Incentive Scheme. This Prakas authorises sharing of the total revenue collection (of the municipal and *salakhet* budget) in which (i) one percent share is given to the Committee on Valuation of Unused Land; (ii) two percent is for Sub-Committee at the province; (iii) one percent gives to the team at the district; and (iv) one percent gives to the individuals at the commune level who help the team at the district level. This income is not recorded as official revenue source but functions in fact as a salary supplement to compensate for individual contribution.

At the local level, the commune and village chief are the main individuals involved in the actual tax collection. They usually receive one percent of the total amount of tax collected. This income functions currently as their personal income. In 2003, Riel 2.3 million of revenues were allocated from the total collection of unused land taxes (Riel 230 million) for the *sangkats* and communes in Phnom Penh municipality. About 20 *sangkats* and communes get their cash from the Phnom Penh Tax Branch. On average a *sangkat* would receive Riel 30,000 to Riel 50,000 per year.

Future options: candidate for sharing

Seen in isolation, taxation of unused land could be a *candidate for sharing* between the province and the commune. The reason for this is that (i) the communes already play a role in the identification of unused land within the commune territory; (ii) there is a current practice of sharing of the revenue as a compensation for the involvement by the council; and (iii) the commune council would be in a good position to categorise used/unused land (once the criteria are clear) and inform the District Tax Office as they are on site.

Seen in a holistic manner, this tax can be shared. The reason for this is that for the poorest communes, tax on land (both used and unused) is probably one of the very few taxable items. The chief concern with taxation on land is that it might contradict the pro-poor policy of the government not to tax farmland. However, a category rating of land may lessen the burden on the poor.

In order to estimate a reasonable share to the commune, it is necessary to work out what input the commune would have to be prepared to contribute. For example, what type of activities would be required as input by the commune in order to categorise land as used/unused. First of all, a simple mapping of the area and the plots would be necessary. Are there simple methods by which the communes can do this by themselves? Second, the criteria to be used for classification must be established or clarified. Finally, the time and materials needed to do this properly must be established.

One option would be to pilot this activity in some communes and *sangkats* in order to get an understanding of what this exercise implies in terms of the challenges mentioned above. A more detailed suggestion of how the revenues can be shared can be worked out after such piloting.

2. Tax on Transfers (of ownership)

2.1 Background Information & Facts

Who collects	The tax payment is to be made to either the PM Tax Branch or the District Tax Office.
Identification of tax base	The tax is subjected to all types of ownership transfers including sales of vehicle, land and properties.
Assessment and calculation	The tax rate is four percent of the market value of the transferred property. The tax amount is to be paid by the buyer.
Purpose of taxation	The purpose of this tax is to keep track of property movement, and to ensure revenue collection for the government.
Where the collections go	*Salakhet* budget
Frequency and timing	The tax payment is made when documentation and the registration process of a new property owner is completed by the district and provincial Land Management Office.
Enforcement and monitoring	The District Office of Land Management is responsible to provide necessary services in this transferring process. Also the commune and village level are usually invited to sign and stamp as witness on transferring documents for the position as local authority. It is the responsibility of the new owners to register payment of tax on transfers. The tax authority is not responsible for getting hold of new property owners to collect this tax. The transfer of property is not legally bound and validated before the tax on transfers have been paid.

2.2 Observation & Analysis

The process by which transfer of ownership is practiced starts at the village level and moves up to the ministry. Usually it would start with the District Office of Land Management, which provides paperwork and assists citizens in completing the necessary forms. The papers then have to pass through the village and commune chiefs for their signature and verification of ownership status of the property. Afterwards the district governor must sign and agree before the papers can pass to the District and Provincial Land Management Office. The new owners will have to pay tax on transfers at the district or province before the land transfer process is complete. Among these actors, only the District Land Management Office keeps records and registration of the transactions.

Currently, the collection from this tax is not based on market value of property since there is not yet an established committee to assess market value of property and hence the District Tax Office is the one to assess and collect. Anecdotal information indicates that on average only about 60 percent of market value of property is commonly declared for tax payment purposes.[27] Furthermore, the majority of the ownership transfers are done at the district level because the new owners get a receipt of transfer acknowledgement with stamp and signature from the District Land Management Office.

Collection of this tax is under-exploited for three reasons:

[27] Interviews with Departments of Tax in Takeo and Phnom Penh in January and February 2004.

(i) Tax evasion is high because the four percent tax rate is very high (according to the District Tax Office and Land Management Office[28]);

(ii) The majority of the transactions take place within the commune administration, meaning all paperwork is completed with the signature of the commune chief and the Land Management Office. During this process no collection is mandated, however a bulk amount of money is collected as service fees and rent. Thus most collection is shared between staff of the District Office of Land Management, the village chief and the commune chief;

(iii) Registration of property transfer is not yet mandatory and hence a receipt of transfer acknowledgement can be used for most transactions (i.e. credit access). Ownership transfer transactions are often performed outside the official protocol. Due to the problems to register property transfer as well as transfers of ownership for vehicles and other mobile objects, the existing overviews are insufficient and to a large extent incorrect.

The revenue collection from Tax on Transfers seems to be the second most lucrative tax revenue for the municipalities and the provinces. In 2003, Takeo province collected Riel 12 million, Siem Reap collected Riel 1,230 million, and Phnom Penh collected Riel 3,304 million. These revenues are significant despite the fact that there is extensive rent seeking in the transfer process leaving much revenue unrecorded and not accounted for. Quite a significant amount of informal income for the staff of the local authority is derived from performing this task. The rate for such informal fees varies with the size, value and location of the land. It can range from USD20 to USD1000.[29]

2.3 Options for Reassignment or Sharing and the Rationale for this

Current practice

It is common that the commune and village levels are asked to collaborate with district offices in order to monitor and verify transferring transactions. Although there is no formal sharing of revenue collected from this tax, there is huge amount of informal collection and sharing take place among the various offices across several levels.

Future option: candidate for sharing or no change?

Seen in isolation, Taxation on Transfers could be a *candidate for sharing* between the province and the commune. The reason for this is that (i) the commune and village chiefs are already involved both in the paper work and in the collection process itself; (ii) there is a current practice of informal fees sharing between the province and the commune chief/village chief; and (iii) the village and commune chiefs have a good overview over transfers taking place at the commune and village level.

A share of Taxation on Transfer to the commune would officially recognise the contribution by the village and the commune chief in the work to transfer property. This could potentially reduce the informal fees sharing that allows for personal rent seeking, and rather allow the commune council as an institution to gather revenue from transfers. This revenue will then become part of the commune revenue for the benefit of the entire commune.

The challenge with allowing the commune to participate in the registration of property transfers is to find ways to ensure that the same piece of property is not sold to more than one buyer. Currently, there is no centralised computerised monitoring system. Although the commune will have overview of owners that reside in the commune it will be difficult if not impossible for the commune to have overview over land transactions that takes place at higher levels of government. This is a particular challenge related to valuable land, for instance in the coastal zone.

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[28] Interviews in Takeo and Phnom Penh in January 2004.

[29] Interviews with tax authority, land management offices, and commune level representatives in January and March 2004.

Until a more nationwide and accessible land register is in place, one opportunity is that the commune is in charge of clarifying the local ownership at the commune level, and that this clarification process can be taxed by the commune. Furthermore, as emphasised by the Ministry of Land Management and Urban Planning and Construction,[30] there is a need to establish the position of a local land administrator at the commune level. This individual can be the commune chief who will be responsible for the keeping of the Land Register, to supervise land transfer transactions, to collect relevant fees, and to certify land documents.

It would be important that the communes participate in the estimation of a reasonable share to the commune of the tax on transfers. None of the interviewees for this study voiced any clear percent share that they would like to receive. Sharing of this tax would provide the communes with a significant amount of money compared to current sources of revenues available to the commune/*sangkats*.

Seen in a holistic manner, however, a sharing of the tax on transfer might not be recommended. This is because other reforms will need to take place first. One among them would be to establish a local land/property administrator with necessary responsibility delegated from the PM Department of Land Management.

3. *Patente* tax

3.1 Background Information & Facts

Who collects — The District Tax Office visits all business sites at the beginning of each year to collect the taxes.

Identification of tax base — Any type and size of business is subjected to pay *Patente* Tax. These are typically vendors, grocery stores, food stalls, small shops along the street, and other small and medium sized businesses. Also, *Patente* Tax is collected from rented houses and land.

Assessment and calculation — The *Patente* Tax is calculated based on the business turnover of the previous year according to categories set forward by Prakas of the MEF as presented below. The *Patente* Tax ranges from Riel 1.4 million as the highest to Riel 15,000 as the lowest tax charge.

Table 4.1: Patente Tax calculations

Patente Tax's classifications	Annual Turnover (Riel)		Amount of annual *Patente* tax (Riel)
	Commercial and Industrial businesses	Services excepted food and hotel business	
1	0 - 7,500,000	0 - 3,000,000	15,000
2	7,500,001 - 12,500,000	3,000,000 - 5,000,000	21,000
3	12,500,001 - 25,000,000	5,000,001 - 10,000,000	27,000
4	25,000,001 - 30,000,000	10,000,001 - 12,000,000	40,000
5	30,000,001 - 37,500,000	12,000,001 - 15,000,000	60,000
6	37,500,001 - 50,000,000	15,000,001 - 20,000,000	90,000
7	50,000,001 - 62,000,000	20,000,001 - 24,800,000	140,000
8	62,000,001 - 75,000,000	24,800,001 - 30,000,000	180,000
9	75,000,001 - 100,000,000	30,000,001 - 40,000,000	240,000
10	100,000,001 - 1000,000,000	40,000,001 - 400,000,000	

[30] Interviewed with the Director of Land Management and Administration Project of the Ministry of Land Management and Urban Planning and Construction in January 2004.

	and over add 1%	and over add 2.5%	

Source: Law on Finance for Management, 1995.

Where the collections go	*Salakhet* budget
Purpose of taxation	The purpose of the *Patente* Tax is to keep control and a register of all business activities and to enable income collection from business activities to the state.
Frequency and timing	Payable annually between January and March.
Enforcement and monitoring	Upon payment of the *Patente* Tax the business will be provided with a Patent Certificate. This certificate is prepared and issued by the Provincial Tax Department. A *patente* tax register prepared by the District Tax Office and kept at both the Provincial and District Tax Office controls this tax. Penalty for late payment is 40 percent of the calculated *Patente* Tax plus a two percent interest rate. Fines for tax evasion are Riel 500,000 for businesses in the estimated regime and Riel 2 million for businesses in the real regime.

3.2 Observation & Analysis

The challenges with the *Patente* Tax are chiefly related to the collection process. One problem is that businesses are established without a proper notification to the relevant authorities. A second problem is that many of them simply refuse to comply with the tax regulations. A third problem is that due to distance between the commune centres and some smaller business areas, small-scale businesses and vendors can easily avoid the tax officers.

The vendors met during this study emphasise that the resistance to pay the tax among the small-scale business people is due to the fact that the *Patente* Tax base for calculation is often incorrect, and hence they believe that an over-charge is being collected.

3.3 Options for Reassignment or Sharing and the Rationale for this

Current practice

This tax is collected at the business site. The collection process can be time consuming as the District Tax Office often needs to visit the business many times to be able to collect the full tax amount. The majority of the *patente* tax income at the district level comes from vendors at and around the market compound of the district. The collection is fairly simple and less problematic compared to collection of tax on business turnover. Hence, revenue collection from this source can be significantly increased if business registration is conducted thoroughly and regularly with assistance from commune or village authorities. Also in order to reduce payment resistance and rent seeking in the collection, it is important that information on *patente* tax categories are publicly posted at the market compound or the commune house.

Future options: Candidate for sharing through reassignment of the collection process

Seen in an isolated manner, the *Patente* Tax is a *candidate for sharing through reassignment of the tax collection.* This means the mandate to collect all *Patente* Tax in the commune could be handed over to the commune. The reason for this sharing through a reassignment of the collection process is that (i) the commune councils are able to monitor all types of businesses in the communes as well as the whereabouts of all businesspeople; (ii) the commune councils welcome the opportunity to be involved in the registration of all taxable businesses; to update the list, and to help collect the tax; (iii) collection by the commune council would require less travel and hence incur less administrative expenses, an amount which currently tend to be charged from the taxpayers; and (iv) it would require more proper records of all *patente* tax collections that what is currently the case. This would reduce the current rent seeking by the communes, as they tend to informally collect *Patente* Tax from businesses that are out of reach of the district tax authorities.

Seen in a holistic manner, the *Patente* Tax would also be considered a candidate for sharing because it would enable the communes to tax income made on local markets and business activities. These are local businesses that the communes most probably would be able to render services to in return for the taxes collected.

4. Tax of Business Turnover

4.1 Background Information & Facts

Who collects	The District Tax Office collects the Tax on Business Turnover.
Identification of tax base	Tax on Business Turnover is collected from every business in all sectors. Hence, all businesses that pay *Patente* Tax are also liable to pay Tax on Business Turnover.[31]
Assessment and calculation	The tax rate is two percent of the total monthly turnover. The law also indicates that there are some exceptions to this tax rate, i.e. one percent for businesses related to industry, crafting and mining, and ten percent for hotels, nightclubs, etc. Anecdotal information[32] indicates that current practice is that small businesses are subjected to Tax on Business Turnover only if the turnover is equal to or higher than Riel 250,000.[33] For contract type business the calculation rate is based on the bidding price.
Where the collections go	National budget
Purpose of taxation	To improve revenues from tax collection of the government and to impose tax collection on users of services.
Frequency and timing	The tax is collected on a monthly basis.
Enforcement and monitoring	The District Tax Office conducts a mid-year reassessment to estimate average business turnover. A registration for Tax on Business Turnover is prepared and kept at the District Tax Office. This provides the basis for tax calculation and collection.

4.2 Observation & Analysis

It is not clear what process that is being used in the calculation and estimation of business turnover. The criteria used to calculate turnover is based on actual assessment by the District Tax Office and on living standards in the areas of taxation. In practice, the turnover rate is the result of a negotiated agreement between the taxpayer and the tax officials. There is great space for rent seeking between tax authority and taxpayers over the actual tax base. Most businesses listed in the register of tax on business turnover are vendors and small shops around market compounds that are also listed in the *Patente* Tax records.

[31] With the exception of several cases of small businesses like mobile vendors and informal sectors that are not registered. Interview with district Tax Office in Takeo and Siem Reap in March 2004.
[32] Figures are collected from interview with province Department of Tax in Takeo Province in January 2004.
[33] Ibid.

4.3 Options for Reassignment or Sharing and the Rationale for this

Current practice

Revenue collection from tax on business turnover is transferred to the national treasury with no sharing of any of this tax revenue with other levels of government. Current practice for this tax collection is not measurable with business activities (number of tax bases) at the local level. There is potential for higher level of collection if tighter control is exercised over business registration and clear criteria to estimate turnover of business is strictly followed (no exception). These measures could also help decrease chances for rent seeking and under (over) charges of tax amount from businesses. For example in Sout Nikorm district, Siem Reap province, 205 businesses were registered in 2003 (in estimated regime), with a total turnover equal to Riel 3,876 million, generating Riel 8.5 million for tax income. In Samroung district in Takeo province there are 82 businesses in 2003 with a total amount of turnover equal to Riel 23 million and yields Riel 5.5 million (or about Riel 464,000 per month). These businesses are commonly found around central district areas which means there are at least dozens other businesses located at the commune level.

Future Option: Candidate for reform and consolidation

Seen in an isolated manner, Tax on Business Turnover would be a *candidate for reassignment* from the national to the commune for a specified size and types of businesses such as vendors and shops located within commune market. The reason for this is that (i) Tax on Business Turnover for this types of businesses appears to be small scale and localised and hence the commune would have a fairly good overview of the turnover that might be subjected to taxation; and (ii) it would probably be feasible for the commune to keep records for tax on business turnover along with the *Patente* Tax record.

Seen in a holistic manner, Tax on Business Turnover is most likely to be a candidate for reform and consolidation with other types of income taxes. To give the communes a share of a tax that is likely to be taken away from them or be reformed would only create unnecessary expectations by the communes and a waste of time by all partners involved in the reassignment exercise. Also, this is a national tax, and the income is considered crucial to run the state apparatus.

5. Tax on Profit

5.1 Background Information & Facts

Who collects	The District Tax Office collects the Tax on Profit
Identification of tax base	The tax is collected from any business that generates taxable profits above Riel 6 million per year, which is about Riel 500,000 per month.
Assessment and calculation	The Tax on Profit is collected based on business turnover and will be used to determine the base profit for the taxable amount. The taxable amount is not the profit amount, but a nominal amount calculated by the tax authority according to their formula.

Table 4.2: Tax on Profit calculations

Share of annual profit to be used to calculate tax on profit	Tax rates
0 Riel - 6,000,000 Riel	0%
6,000,001 Riel - 15,000,000 Riel	5%
15,000,001 Riel - 102,000,000 Riel	10%
102,000,001 Riel - 150,000,000	15%
Above 150,000,000 Riel	20%

Source: Prakas of MEF on Tax on Profit for Lump Sum Businesses, 1994.

Where the collections go	National budget
Purpose of taxation	Revenue sources
Frequency and timing	The tax is collected on a monthly basis.
Enforcement and monitoring	Collection of this tax is monitored and followed up by the register for tax on profit. Small businesses usually pay taxes on profit at the same time with payment of tax on business turnover. A receipt for both taxes is provided when payment is made to the tax authority.

5.2 Observation & Analysis

In practice most of the businesses at the commune and *sangkat* level pay tax on profit. However, they are usually not able to distinguish between Tax on Business Turnover and Tax on Profit because both taxes seem to be collected at the same time and even recorded within one receipt. The receipt states amount for Tax on Business Turnover only, while in reality it covers both taxes. Hence, most vendors and businessmen seem to be unaware that they pay Tax on Profit.

5.3 Options for Reassignment or Sharing and the Rationale for this

Current practice

The Tax on Profit is collected together with the Tax on Business Turnover and perceived as the same. Anecdotal information[34] indicates that vendors are not informed that the collected tax is actually tax on profit. Collection from this tax source is minimal as few businesses at the commune and *sangkat* level generate sufficient profit to be taxable, and also it is difficult to estimate taxable profit for businesses in the estimated regime.

Future options: Candidate for reform and consolidation

It is only relevant to regard this tax in a *holistic manner* because in practice at the commune level, no one seems to be able to distinguish between the Tax on Business Turnover and Tax on Profit. These are both national taxes and are likely to be candidates for reform and consolidation. For this reason and because both play a crucial role in the running of the state apparatus, this tax is not a likely candidate for sharing and reassignment but rather for reform into a more general national income tax.

6. Slaughtering Tax

6.1 Background Information & Facts

Who collects	The tax is collected by either the Provincial/Municipal Tax Department or the District Tax Office. The actual collection takes place with assistance from the Department of Agriculture.
Identification of tax base	All pig and cow slaughtered for consumption at slaughterhouses and private houses (usually at a market place) are subject for slaughtering tax.

[34] Interview with vendors in Takeo, Phnom Penh and Siem Reap January-March 2004.

Assessment and calculation	The tax is based on number of head of animals slaughtered for consumption. The rate is Riel 3000 per cow and Riel 1500 per pig in all municipalities and provinces.
Where the collections go	*Salakhet* budget
Purpose of taxation	To control number of animal slaughtered and to ensure sanitation and safety of meat for consumption.
Frequency and timing	The District Tax Office visits slaughterhouses on a daily basis or at least on the average every ten days to calculate the actual number of animals. To ease the burden of the tax authority in common this tax is collected on monthly basis and clearly depends on declaration of head of animals by the slaughters.
Enforcement and monitoring	There is no such formal record to monitor the number of animal slaughtered prepared by the tax authority. However, this is somewhat an agreed estimate number reported by the slaughters and verified by veterinarians of the Agriculture Office (who is checking on meat quality).

6.2 Observation & Analysis

All the slaughterhouses visited during this study are owned and supervised by a private contractor who gets permission to conduct slaughtering business in the areas over a number of years. These contractors are responsible to pay taxes and fees just as other types of businesses. Among those taxes, the contractors have to pay slaughtering taxes to the Provincial Department of Tax. Rarely does the Provincial Department of Tax collect this tax directly as they assign the collection duty to the contractors to collect from all businesses and slaughters who operate within the authorised compound. The collection amount and method vary between provinces. For example in Takeo, a slaughter business pays daily an amount of Riel 8,500 per head of animal slaughtered to the contractor. This amount includes *pheasie*, slaughtering tax, and *patente* tax (or if tax on business turnover is also included is not sure according to the interview with slaughters). In Siem Reap, a contractor in Siem Reap district collects Riel 6,000 per pig and Riel 7,000 per cow from slaughters on a daily basis as collection for *pheasie* and slaughtering tax.

6.3 Options for reassignment and Sharing and the Rationale for this

Current practice

The tax collection is usually done through collaboration between the tax authority and the slaughterhouse contractor. The contractor collects all taxes and fees from individual small slaughtering businesses (stationed at one particular slaughterhouse) and pays the total collected amount to the tax authority.

Future option: Candidate for sharing

*Seen in an isolated manner, t*he slaughtering tax is a *candidate for sharing* between the province and the commune. The reason is that (i) the commune would easily be able to keep an overview of the slaughtering activities than the provincial officials; (ii) the actual registration and collection of the slaughtering tax from the animal owners is being collected by the slaughtering house itself. This means that the actual collection by the tax authority would be quite a simple procedure and would not pose much challenges for the commune; and (iii) sharing of revenue from this tax to the commune would enable them to closely monitor movement of animals especially cows within the commune level in order to tackle issues like diseases and cattle rustling.

Seen in a holistic manner, it makes sense to share this tax. This would enable the communes to provide services to smaller slaughtering houses in return for the taxes. It is however suggested that the tax sharing be practiced differently than the suggestions put forward for the other taxes discussed above. An option is that taxation of smaller slaughterhouses located at a commune market which slaughters a few heads of cow and pig can be reassigned to the commune, while taxation on bigger slaughterhouses remains with the province.

7. Tax on Means of Transportation

7.1 Background Information & Facts

Who collects	The District Tax Office collects this tax
Identification of tax base	Motor driven means of transportation, such as vehicles, motorbikes, ships, etc. There are tax breaks for state vehicles in some sectors like defence and health as well as non-governmental organisations.
Assessment and calculation	The rates are calculated according to horsepower of the means of transportation, ranging from Riel 3000 for a motorbike to Riel 1.2 million for a ship. The rates are calculated and set annually by Prakas of the MEF.
Where the collections go	*Salakhet* budget
Purpose of taxation	To raise revenues
Frequency and timing	The tax is being collected on an annual basis. The collection process takes up from three to four months
Enforcement and monitoring	The tax payer receives a receipt and a sticker (vignette) for the number plate. Fine and penalty is enforced after the end of the collection period with the rate of 100 percent of tax amount. Usually police puts street barriers to enforce payment of the taxes.

7.2 Observation & Analysis

Management of the tax collection is based on previous year's figure when preparing the tax collection plan. Before the collection the tax authority usually conducts a meeting with the local authorities (commune and village level) to inform them about the location and the duration of the tax collection. This helps the District Tax Office to spread information and mobilise people to pay tax.

The major challenges in collection of this tax are: (i) limited law enforcement in rural areas leads to difficulties collecting this tax; (ii) fake tax stickers are widely available which further complicates monitoring and law enforcement; and (iii) a large number of illegal imported vehicles such as right-hand wheel cars and smuggled motors are not currently taxed.

7.3 Options for reassignment or sharing and the Rationale for this

<u>Current practice</u>

Revenue from tax on means of transportation is often the second most important sources of revenues for *Salakhet*. Collection of tax on means of transportation is fairly simple. It is usually collected according to the plan figures set forth and approved by the national Tax Department. It is common that the District Tax Office conducts information dissemination to commune and village level representatives before the actual tax collection starts. This is to request local authority assistance to mobilise and inform citizens on the tax collection.

Usually owners of vehicles and other means of transportation have the obligation to come and pay these annual taxes at the District Tax Office. A receipt and tax sticker is provided as payment is collected. At the end of the collection period, the remaining receipts and tax stickers are collected by the national Tax Department.

In some areas, the District Tax Office places their collection stations at the commune offices to speed up the collection process, but rarely assign any responsibilities to the commune. Some communes are however collecting tax on means of transportation on behalf of the District Tax Office. In such cases, arrangements are made for revenue sharing. For normal motorbikes subjected to Riel 4,000 of tax collection, actual collection will be Riel 5,000 in which Riel 500 is for the commune, Riel 400 for paperwork, and Riel 100 is for the district staff. This is illegal and none of this revenue is recorded as commune or district income but rather seen as individual earnings.

A common challenge with the current collection of tax on means of transportation has been the selling of tax stickers after the collection period ends. It means that tax authority can still provide and collect taxes during the penalty period. For example, the actual tax amount is Riel 100,000 if paid during the collection period. The owner of the vehicle has to pay Riel 180,000 compare to Riel 200,000 if the owner is penalised (penalty rate is 100 percent plus interest rates if apply). Of the Riel 180,000 the vehicle owner pays to the tax agent, the owner saves Riel 20,000 whereas the tax agent earns Riel 80,000.

Another challenge with this tax collection is the issue of under-collection. As discussed with the District Tax Office of all the places visited, once the required tax amount has been collected, the staff would stop collecting. Hence, not all required taxpayers actually pay tax. Information from market surveys clearly shows that this gives space for extensive nepotism (Rusten *et al.* 2004).

<u>Future option: candidate for sharing</u>
Seen in an isolated manner, tax on means of transportation could be a *candidate for reassignment* from the province to the commune. The reasons for this is that (i) the communes already assist the District Tax Office in the collection of this tax; (ii) the collection of such tax is fairly simple; and (iii) with incentives and potential revenue sources received from this tax collection, it is a fairly good chance that the commune would be able to collect taxes from all available tax bases within its jurisdiction; and (iv) it would also be sensible for the communes to collect this tax as most of these vehicles and means of transportation use local roads and services. Therefore, revenues collected from this source could belong to the local governments for them to spend on construction and maintenance of local public infrastructure.

The commune councils are keenly interested in experimenting collection of this tax. This can be done through simple collection of a few types of means of transportation, such as vehicles and motorbikes.

Seen in a holistic manner, it makes sense to *share* this tax. One major reason for this is that taxation on means of transportation would be one of the very few taxable items in the poorest communes that do not have markets or slaughterhouses and where opportunities for taxation of land are minimal. Another argument for the reassignment of this tax is that the communes use own resources on provision and maintenance of infrastructure, often the Commune/Sangkat Fund (CSF). Therefore, taxation on means of transportation would allow the communes to renovate their infrastructure projects. A share of the tax would need to be assigned to the provincial budget for the renovation of the provincial and national road network.

8. Public Lighting Tax

8.1 Background Facts & Information

Who collects	This tax is collected by the district Tax Office
Identification of tax base	Sales of tobacco and cigarettes.
Assessment and calculation	The rate for collection is fixed at three percent of sales levied from all selling points which include producers, distributors, wholesalers, and retailers until the products reach the final consumer.
Where the collections go	*Salakhet* budget
Purpose of taxation	To be used for expenses on public lighting
Frequency and timing	Collected on monthly basis
Enforcement and monitoring	The collection is enforced and tightly monitored by the tax authority at either district or provincial level.

8.2 Observation & Analysis

The collection of the Public Lighting Tax seems to be more successful in urban areas than the rural areas. In Phnom Penh, revenue from public lighting tax is Riel 51 million in 2003 of the 7,668 municipality's total tax collection. For some other provinces collection from this tax is very low compared to Phnom Penh. For example, Takeo collected less than Riel 3 million from this source in 2003 of the Riel 213 million total collections.

From 2003, the revenue collection from this tax was assigned for the building and maintenance of provincial roads (not public lighting).

8.3 Options for Reassignment or Sharing and the Rationale for this

Current practice

Public lighting tax are taxed at each point of sale, and therefore there is double taxation of the same goods. Collection of this tax is often derived from producers, wholesalers, distributors, hotels, restaurants, and sellers. Current collection of this tax is mainly from producers, wholesalers and distributors because it is difficult to collect from retailers. The calculation of the tax is based on actual amount of sales reported monthly from tobacco and cigarettes.

Future options: No change recommended

Seen in an isolated manner, this tax is not suitable for sharing or reassignment between the province and the commune for the reason that collection of this tax is quite complicated and the potential revenue at the commune level would most probably be fairly low.

Also, *seen in a holistic manner,* the commune is not likely (neither now nor in the future) to be able to provide any of the services that are linked to this tax.

APPENDIX TWO: Revenues from non-tax sources

In addition to taxes, another major source of revenues for the commune/*sangkat* and the *Salakhet* is revenues from properties, and revenues from providing *administrative services* and official papers. Properties include markets, parking space, slaughterhouses, and other facilities. Administrative services are civil registration, land registration fees, and other administrative and management services.

Each of these sources of revenue is presented with a separate sub-chapter identifying:

(i) Background Information and facts on management, who collect the fees, frequency and timing, informal fees, monitoring and procedures.
(ii) Analysis and Observations related to collection challenges, and
(iii) Options for Sharing or Reassignment and the Rationale for this.

1. *Pheasie*

1.1 Background facts

Who collects	Private contractors who win a public bidding process; an event organised annually by the provincial authorities. Provincial Department of Economic and Finance directly supervises the contractors.
Identification of revenue base	*Pheasie*s are collected in several places including markets, parking areas for vehicles and boats, and slaughtering places. All businesses, vendors and users are supposed to pay *pheasie*.
Assessment and calculation	Commonly, the contractors collect *pheasie* based on fixed amount set in the guidelines provided by MEF and detailed instructions supported in the annual contract.
Where the collection go	The contract price goes to the *Salakhet* budget.
Purpose of collection	To outsource *pheasie* collection and management of market operation to private agents.
Frequency and timing	*Pheasie* is often collected daily while it is acceptable if vendors prefer to pay monthly.
Enforcement and monitoring	The charge is strictly enforced and collected by the contractors to cover the contract price deposited at the Treasury. No one can escape *pheasie* payment. The Provincial Department of Economics and Finance rarely conducts on site monitoring and inspection.
Informal collections	There are some complains in areas where contractors raise *pheasie* collection from Riel 200 to 300 per day after several months of services.

1.2 Observation and analysis

All revenue from markets that are contracted out by bidding goes to the *Salakhet* budget. Under this system, the selected bidder will pay a fixed annual amount to the Provincial Department of Economy and Finance, and the contractors will be solely responsible for the organisation of the *pheasie* collection from vendors and also benefit from the profit. On rare occasions contractors are able to secure their contracts with the province for up to 15 years. Sihanouk Ville is an example of this.[35]

For other rather small commune markets there are several challenges with the collection of *pheasie*. It is not clear at the moment whether the village or commune chiefs are involved in the collection of this *pheasie* for markets that are not under the supervision of the Provincial Department of Economy and Finance. Anecdotal information seems to indicate that this *pheasie* is collected by the district office. In addition, other authorities (i.e. police) collect other fees from businessmen around the markets for security and safety services these authorities provide. None of these fees are officially recorded.

Another current challenge is that there seems to be a tendency to integrate both small and large markets within one district/*khan* under one or two contractors only. For example, in Sihanouk Ville, two contractors collect *pheasie* from all markets. The reasons for this apparent monopoly seems to be that it is easy to control and supervise fewer contractors.

In the study areas, vendors commune councils raise a lot of problems and concerns. One common complain is poor quality of services provided by contractors such as cleaning, trash collection and order. Another problem is that contractors often collect other fees from vendors through upgrading of market and selling of new stands. The contractors are not permitted to do this. Another critical issue is that vendors and people around the market are not able to raise their problems with the contractors or demand changes or improvement of the contractors' performance. Many vendors say they are not satisfied with the contractors and rather have their commune councils to take over.[36]

1.3 Options for sharing and reassignment and the rationales for this

The *pheasie* is a *candidate for sharing through reassignment of the tax collection.* This means that instead of organising a competitive bidding process, the mandate to collect all market *pheasie* in the commune could be handed over to the commune. The reason for this sharing is that (i) if the commune councils are to collect *pheasie* and provide services the development of the market can be part of the CDP; (ii) the councils can then be responsive to demand and complaints of the vendors; (iii) the commune councils are able to closely monitor the business activities as well as the whereabouts of all businesspeople; (iv) the commune councils welcome the opportunity to be involved in the registration of all taxable businesses, to update the list, and to help in the collection; and (v) even if the communes pay a fix amount to the province/district in a sharing agreement, the profit which currently falls on private contractors would in the future fall on the commune. This will allow the commune to reinvest the profit for example in market upgrading. Currently, such reinvestment of profit to the benefit of all does not take place.

There are two options available for the process towards a sharing/reassignment of this revenue. One conservative option is simply to reassign the *pheasie* collection mandate to the commune but keep the current system that will ensure a fixed profit to the district. In other words, this allows for a sharing between the commune and the district/province. Another more radical option would be to simply reassign the entire *pheasie* collection as well as the entire profit to the commune. In other words, this allow for a reassignment of the *pheasie* from the province to the commune.

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[35] Interviewed with the Provincial Department of Economy and Finance in Sihanouk Ville in May 2004.

[36] Interviews with commune level markets in Takeo and Sihanouk municipality in May 2004.

2. Civil registration fees

2.1 Background facts

Who collects	Commune and *sangkat* councils are authorised to collect fees from providing civil registration papers including birth, death, and marriage certificates.
Identification of revenue base	Population at the commune and *sangkat* level
Assessment and calculation	The rates of fees for collection for the different types of papers and certificates range from Riel 400 to 1000 as stated in the Prakas of MOI.
Where the collection go	The formal revenue collected by the commune and *sangkat* is recorded in the commune accounts for the councils' use. Revenues from informal fees are shared among the staff and sometimes are used to support the councils' office (pay for electricity, office stationary and maintenance).
Purpose of the collection	Revenue sources for the councils from providing administrative services.
Frequency and timing	One time payment as request submitted.
Enforcement and monitoring	There is no penalty imposed. Currently less than 50 percent of commune/sangkat (CS) population register their birth, marriage and death.
Informal collection	The amount of informal collected fees currently collected by the commune and sangkat clerk (on top of the formal fees) vary significantly between rural and urban communes. Even if informal fees are not demanded, people often tend to offer payment in the range of Riel 500 to 1000 per page in addition to the cost of the paper/certificate itself. In urban commune/*sangkat* it is common that people have to pay substantial informal fee (for example, in Phnom Penh, verification and certification of a birth certificate would cost USD10 to USD20).[37] In study material, an average amount of informal collection from civil registration can be as high as USD200 and as low as USD15 per month.

2.2 Observation and analysis

Both rural and urban communes seem to collect some amount of revenue from this source in which some sharing over revenues from informal collection have been noticed. Communes and *sangkat*s in well-off areas have charged higher fees in order to be able to generate some amount of own revenues for councils' staff salary and other expenses of the office.

[37] The issue was discussed during a National Workshop for the sangkat councils in Phnom Penh in October 2003.

2.3 Options for sharing and reassignment and the rationales for this

There seems to be a need to revise the amount of fees collected for civil registration to capture the current practice and initiative. One option for this suggestion is to separate rural and urban communes/*sangkats* and set different fee levels for the rural and the urban areas according to the capacity of the councils to collect and the ability of the people to pay. There have been suggestions to start collecting Riel 10,000 for each civil registration paper for the *sangkats* in Phnom Penh, and between Riel 1,000 - 3,000 for communes in rural areas.[38]

3. Informal & Regularised: Licence and permission fees from businesses

This fee is a regularised but completely informal fee. This means that the fee is not legally recognised and no official accounts exist. It is regularised in the sense that all business operators are aware of this commonly charged fees and the chargeable amounts are also fairly well known and established.

3.1 Background facts

Who collects	These licences are issued by a number of line departments depending on the nature of the business. It is the responsibility of the departments to make sure that all businesses are registered and licensed before operation can start.
Identification of revenue base	Many different types of licences and permissions are required depending on size and type of business. For example, the Department of Industry supervises rice millers, crafting, food/catering businesses, and carving.
Assessment and calculation	Legally, no fee is required from businesses for this service. Even so businesses are asked to cover expenses incurred to the staff of the line department for the services provided. Usually, these fees include costs of the paperwork, travel expenses of the staff involved, and service fees. For commune level businesses, the fees to get a licence range from Riel 5,000 to 20,000.
Where do the revenues go	These informal fees go to individuals who are involved in the process of issuing business licences.
Purpose of collection	To generate revenues informally
Frequency and timing	Upon request of business owners
Enforcement and monitoring	Businesses will be penalised if they operate without proper licenses issued by the relevant agencies. Monitoring is conducted as part of business survey and tax collection.
Informal collection	Examples from Siem Reap shows that these fees are collected from 1128 businesses by the province Department of Industry alone (of which 269 are going to delegate to the district level)

[38] Speech of H.E. Sak Setha, at a training session for the officials from line ministries at the Councils of Administrative Reform (October 2003).

3.2 Observation and analysis

Providing licence and registration services to new and existing businesses is supposed to be free of charge especially for local and small businesses. These services are to ensure that only authorised and registered businesses operate, and that adequate information is kept by the responsible line departments for management purposes. It is the obligation of the line departments to do this work while businesses have the obligation to inform and assist the authority to fulfil their duties.

Generally, businesses are asked to cover expenses and provide some service fees to the authority involved in order to facilitate the delivery of this service.

The commune and village level also engage in this process, especially for new businesses. There are two ways the local authorities are involved. First, before the provincial departments can issue licences for a business, the commune and village authorities are asked to provide approval over location and nature of the new business. In such cases, the commune and the village get commission fees from the district or province level. Second, the business-owners request the commune and the village authorities for permission to establish the businesses. In such cases, the business-owners pay the commune and the village fees, ranging from Riel 10,000 to 200,000. Small businesses do not usually need to get any further permission from the provincial departments.

3.3 Options for sharing and reassignment and the rationales for this

It is important to look at means for how the process of providing permission and licence can be restructured to formalise all the costs currently borne by business-owners. For example, as part of the Open Window Service Delivery Project[39] (OWSD), Siem Reap Department of Industry plans to delegate businesses with capital investment below five million Riel to the district to manage and collect fees.[40]

4. Fees from provision of land services

4.1 Background facts

Who collects	The Department of Land Management collects the fees from the provision of land related services.
Identification of revenue base	These fees are collected from services on both construction land and production land.
Assessment and calculation	Two types of fees are currently collected by the Department. One is the *service fee for certificate of land ownership recognition*. This service fee is charged from current/existing land owners who would like to request for a certificate of land ownership. This service is provided upon owners' requests. The service fees are charged on a fixed rate regardless of land size or commercial use. There is a rural/urban distinction in the fee rate. -Construction Land Urban: Riel 350,000 per certificate issued Rural: Riel 100,000 per certificate issued -Production land

[39] OWSD is a pilot project to create a role for the districts in servicing the people by simplified procedures on issues that are currently under the provincial authorities.
[40] Interviews with the Provincial Department of Industry and Energy in Siem Reap in March 2004.

	Urban and rural: Riel 5,000 per certificate issued The other is the *Service fee for certificate of ownership transfer*. This service is provided by the Department of Land Management for all transactions covering land transfers. It is one step in the transfer of ownership process and to be finalised with the payment of tax on transfers (to be collected by the tax authority). -Construction land Urban: Riel 80,000 per transfer transaction Rural: Riel 100,000 per transfer transaction -Production land Urban and rural: Riel 50,000 per transfer transaction
Where the collection go	The revenue collection from these service fees are shared between the national budget (75 percent), the provincial level (the *Salakhet*) (15 percent) and the commune level (10 percent). As explained below, the communes (especially rural communes) rarely receive their share of this fee.
Purpose of collection	Revenue generation. For instance, the total collection for 2003 for the *Salakhet* is above Riel 5 million in Siem Reap and Riel 12 million in Takeo.
Enforcement and monitoring	This is done by the Ministry of land management and relevant local authority.
Informal collection	According to some interviews the collecting officials usually ask for some amount of fees for the services provided in addition to the official amount to be collected. These informal fees are at minimal USD10 per transaction.

4.2 Observation and analysis

The collection process is fairly simple and currently involves the district, the commune and the Provincial Department of Land Management. The amount of fees is within an acceptable and reasonable range and should therefore encourage people to use the services. The revenues collected from these fees are quite low, however, as a result of high surcharges and time consuming services.

4.3 Options for sharing and reassignment and the rationales for this

Under the current Prakas, a sharing scheme among the national, the provincial and the commune level already exists. The immediate challenge is to implement the Prakas which enforces the percent sharing of each level to be allocated to their individual account. Even after the Prakas came into effects (2003), the communes rarely receive any share from these fees.[41].

[41] Interviews with commune councils in the study communes in 2004.