

NEPAL TAXATION

2016 Edition

1. DIRECT TAXES	1
1.1 General	1
1.2 Taxation of Companies	1
1.2.1 Introduction	1
1.2.2 Residence	2
1.2.3 Taxable Income	2
1.2.4 Capital Gains Tax	2
1.2.5 Dividends	3
1.2.6 Exempt Income	3
1.2.7 Deductions	3
1.2.8 Losses	4
1.2.9 Tax Depreciation / Capital Allowances	4
1.2.10 Amortization of Expenditure	5
1.2.11 Interest	5
1.2.12 Tax Rates	6
1.2.13 Annual tax returns	6
1.2.14 Advance Tax	7
1.2.15 Tax Payment / Refund	7
1.2.16 Fines and Penalties	7
1.2.17 Review and Appeal	7
1.3 Taxation of Individuals	7
1.3.1 Introduction	7
1.3.2 Residence	7
1.3.3 Taxation of Income	8
1.3.4 Capital Gains Tax	8
1.3.5 Dividends	8
1.3.6 Employment Income / Employee Benefits	8
1.3.7 Deductions	9
1.3.8 Personal Allowances and Rebates of Tax	9
1.3.9 Tax Rates	9
1.3.10 Tax Administration	10
1.4 International Tax	10
1.4.1 Double tax relief	10
1.4.2 Avoidance of Double Taxation Agreements	10
1.5 Anti-Tax Avoidance Rules	11
1.5.1 Introduction	11
1.5.2 Transfer Pricing	11
1.5.3 Permanent Establishment	11
1.5.4 Thin Capitalization	11
1.5.5 Controlled Foreign Company (CFC) provisions	12
1.6 Withholding Taxes	12

1.6.1	Business Income	12
1.6.2	Dividends	12
1.6.3	Payment to Employees/Workers	12
1.6.4	Contract Payments	12
1.6.5	Royalties/Technical fees/Interest/Rent/Commission/Director's fee	13
2.	TAX INCENTIVES	14
2.1	Special Economic Zones	14
2.1.1	Determination of Special Economic Zone	14
2.1.2	Privileges Received by Industries in SEZs	14
2.2	Tax Incentives	15
2.2.1	Income Tax Rates	15
2.2.2	Other Tax Incentives	16
2.2.3	Other Incentives	16
3.	INDIRECT TAXES	18
3.1	Value Added Tax	18
3.1.1	Introduction	18
3.1.2	Rate	18
3.1.3	Threshold	18
3.1.4	Tax Credit	18
3.1.5	Requirements	18
3.1.6	Offences	19
3.1.7	Highlights	19
3.1.8	Administrative Review	19
3.2	Custom Duty	19
3.2.1	Introduction	19
3.2.2	Rate	19
3.2.3	Highlights	20
3.3	Excise Duty	20
3.3.1	Introduction	20
3.3.2	License required	20
3.3.3	Rate	20
3.3.4	Administrative review	20
	CONTACT	21

1. DIRECT TAXES

1.1 GENERAL

The main objective of the tax system is to enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation. Income is taxed in accordance with the provisions of Income Tax 2002 (ITA). The salient features of the ITA are:

- a. Various concessions and incentives allowed under different Acts have been repealed and provided under the single ITA
- b. The tax liability of residents and non-residents are clearly defined
- c. Worldwide income of a resident, whether individual or company is made taxable in Nepal
- d. Income with source in Nepal is taxable in Nepal irrespective of the place of payment
- e. Specific provision for taxing capital gains is introduced
- f. Procedures for granting credit for international tax are prescribed
- g. General provision for anti-avoidance and income splitting rules introduced and
- h. Clearly defined the tax administration and payment procedures are provided

The tax is levied on income accrued or received from business, investment, employment and windfall gains. Both individual and companies are required to follow a uniform income year that runs from July 16 to the following July 15 corresponding to the Nepali Fiscal Year (NFY). All persons with assessable income are required to register with the Inland Revenue Office (IRO) and obtain a Permanent Account Number (PAN) and to file a tax return annually.

Returns are filed under a self-assessment system under which the IRO considers returns final unless they are subject to a detailed audit of the taxpayer's affairs. In practice, Assessing Officers make tax audit assessment and adjustments in the majority of the cases.

Income tax payments are made in the year in which the income is earned in the form of withholding tax and advance tax. Companies are subject to a flat rate of tax, whereas individuals are taxed at progressive rates. The Director General (DG) of Inland Revenue Department (IRD) has responsibility for the general administration of the ITA.

1.2 TAXATION OF COMPANIES

1.2.1 INTRODUCTION

Tax is levied under the provision of the Income Tax Act 2002, which provides for the imposition and collection of tax on the income of companies. Resident companies are subject to tax on their worldwide income. Non-residents are required to pay tax on their net income acquired or earned in Nepal or income with source in Nepal. Tax is levied on the net income after making deductions for certain expenses/allowances as specified in the ITA.

“Company” means a body corporate or a company formed under the Companies Act of Nepal and includes foreign company and other institutions such as Unit Trust, Co-operatives Society or group of persons other than a partnership having less than 20 partners and proprietorship firm.

1.2.2 RESIDENCE

A resident company is a company formed or established in Nepal or is effectively managed in Nepal during the income year. A resident company is taxed on worldwide income. Dual residence is not recognized for the purposes of Nepalese tax.

1.2.3 TAXABLE INCOME

Income tax is levied on the net income earned or received from each of the following:

- a. Business income;
- b. Employment income;
- c. Investment income; and
- d. Windfall gains.

The income in relation to a business consists of the profit or gain derived from conducting the business, including:

- a. Service fee;
- b. Amounts derived from the disposal of trading stock;
- c. Net gains from the disposal of business assets or liabilities;
- d. Gain on the disposal of all depreciable assets in a pool of assets;
- e. Gifts received in respect of the business;
- f. Amounts derived as consideration for accepting a restriction on the capacity to conduct business; and
- g. Amounts derived that are effectively connected with the business and that would otherwise be included in income from an investment.

In computing the income from business or investment, all actual costs are deductible to the extent they are incurred during the year by the entity in the production of income from the business. The following methodology is available for the valuation of inventory:

- a. Prime cost or absorption cost method in case of cash accounting system;
- b. Absorption cost method in case of accrual accounting system; or
- c. Choice between first-in first-out method and average cost method.

1.2.4 CAPITAL GAINS TAX

Net gains from the disposal of business assets or liabilities of a business are taxable as business income. Generally, gains are calculated as proceeds from the capital transaction less the tax basis in the relevant property. In the language of the ITA, the gain from the disposal of an asset or liability is calculated as the amount by which the sum of the incomings of the asset or liability exceeds the outgoings of the asset or liability at the time of disposal and is reduced by the following losses:

- a. The total of all losses suffered from the disposal of business assets or liabilities;
- b. Any unrelieved net loss out of any other business losses; and
- c. Any unrelieved net loss for a previous income year out of losses of any business.

Loss on the disposal of an asset or liability with a foreign source can be claimed against the above gain only to the extent that the amount includes gains on the disposal of assets or liabilities with a foreign source. A non-resident is taxed only on gains from the disposal of assets or liabilities sourced in Nepal.

1.2.5 DIVIDENDS

Dividend distributed by a resident company and partnership firms is subject to a final withholding tax at the rate of 5 percent to the resident and the non-resident person. These dividends are not taxed at the hand of the recipient. Dividends of a non-resident entity, which are distributed to a resident beneficiary, are taxed by inclusion in calculating the income of the beneficiary. Distributions of dividends, which are derived after final withholding tax, are exempted from tax.

1.2.6 EXEMPT INCOME

The following categories of income are exempt from tax:

- a. Agricultural income derived from sources in Nepal by a person other than the income from an agriculture business derived by a firm, company, or partnership; and
- b. The income of a social, religious, educational, or charitable organization of a public character registered without having a profit motive and similar other organizations approved by the Inland Revenue Department as exempt organization.

All expenses incurred in earning exempt income are not tax deductible.

1.2.7 DEDUCTIONS

All actual expenses incurred in acquiring or earning income are allowable deductions for tax purposes, if it has been incurred in that NFY by the entity, including the following:

- a. Interest;
- b. Cost of trading stock;
- c. Repair and improvement costs - amounts exceeding 7 percent of the value of depreciable assets in any income year are not deductible and are instead added to the depreciation basis of the relevant asset pool at the beginning of next income year. This limitation does not apply to the aviation industry;
- d. Pollution control expenses;
- e. Research & Development expenses;
- f. Depreciation; and
- g. Banking companies and financial institutions are allowed a deduction for impairment of non-performing assets (loan loss provision) subject to 5 percent of the total loan outstanding.

However, disclaimers, write-offs or the forgiveness of debt which is written off are not tax deductible. The ITA specifically provides that certain expenses are not deductible, such as:

- a. Domestic and personal expenses;
- b. Income tax paid in Nepal and fines and penalties paid to any government;
- c. Expenses incurred in deriving exempt income or final withholding payments;

- d. Distributions of profits;
- e. A cash payment in excess of NRs 50,000 by entities whose annual turnover exceeds NRs 2 million unless explicitly permitted;
- f. Expenses of capital nature which includes cost incurred on detailed feasibility report exploration and development cost of natural resources; and
- g. Foreign income tax.

1.2.8 LOSSES

Tax losses can be carried forward for a period of seven years and in the case of public infrastructure projects to be built, operated and transferred to GoN and projects relating to construction of power houses and generation and transmission of electricity any unrelieved loss of the past 12 years can be deducted. However, tax losses may not be carried back for set-off against taxable income of an earlier period. Losses of petroleum exploration and extradition companies can be carried forward for 12 years.

Entities which has availed full or partial tax exemption in any of the year on investment or business income are not entitled to carry forward losses incurred in these exempt years.

Capital losses from the disposal of business assets or liabilities of a business are an allowable deduction and can be claimed as a normal business expenses. However, a loss on the disposal of fixed assets can only be claimed if after being credited against the outstanding balance of the pool, the value of the pool becomes zero or negative.

1.2.9 TAX DEPRECIATION / CAPITAL ALLOWANCES

Depreciation is allowed on the acquisition cost of the following assets where such assets are used for income producing purposes:

Class	Assets Included	Depreciation Rate (%)
A	Buildings, structure and similar works of a permanent nature	5
B	Computers, fixtures, office furniture and office equipment	25
C	Automobiles, buses and minibuses	20
D	Construction and earth-moving equipment and any depreciable asset not included in another class	15
E	Intangible assets other than depreciable assets included in class D.	During the useful life of the asset

Each depreciable asset at the time it is first owned or so used, are placed in a pool referred to as pools of depreciable assets. Depreciation is calculated on the reducing balance method and is based on the pool of assets.

The pool of assets concept suggests aggregation of all assets with the same depreciation rate into a common block for computation of depreciation. Depreciation is computed at varying rates as prescribed. In the year of purchase depreciation is available for the full year, if an asset is added to the pool for more than six months. In other cases, depreciation is allowed at either two thirds or one third of the normal rate, if the addition is made for less than six or three months, respectively. Amounts derived from the disposal of an asset or assets are reduced from the written down value

of the relevant pool. However, the net book value (cost less depreciation accrued till the income year) can be claimed as expenses in case the machines, equipment and other machinery installed in a public infrastructure project which an entity constructs, operates and then transfers to GoN, and a project relating to the construction of a powerhouse and generation and transmission of power has to be replaced due to the assets being old or obsolete and thus useless. The book value of those assets remaining at the date of transfer to GoN can be claimed as expenses for such companies.

Manufacturing industries can claim additional depreciation at one third of the normal rate.

1.2.10 AMORTIZATION OF EXPENDITURE

Costs incurred in respect of natural resource prospecting, exploration and developments are treated as if they were incurred in securing the acquisition of an asset that is used in that production and depreciated.

Expenditure incurred on R&D and pollution control related to the taxpayer's business is deductible up to 50 percent of the adjusted taxable income in the income year it is incurred. Any excess cost, for which deduction is not allowed as a result of the said limitation, is capitalized and depreciated.

Intangible assets are amortized over the useful life of the asset.

1.2.11 INTEREST

Interest means the following payments or gains:

- a. A payment made or incurred under a debt obligation that is not a repayment of capital;
- b. Any gain realized by way of a discount, premium, swap payment, or similar payment; and
- c. The portion that is treated as interest in the payment made under an annuity or for acquiring an asset under an installment sale or the use of an asset under a finance lease.

The interest incurred under a debt obligation is deductible to the extent, either that the obligation was required to be incurred in the production of income or the debt was used to purchase an asset that is used in the business.

1.2.12 TAX RATES

The current corporate tax rate varies depending on the nature of the taxable income as follows:

Industry	Nature of Business	Rate of Tax (%)	Applied as
Manufacturing	Special industries* ¹ qualifying under the Industrial Enterprises Act 1992 (except related to tobacco and alcoholic beverages)	20	Flat rate
Financial	Banks and other financial institutions and insurance companies	30	Flat rate
Petroleum	Entity engaged in petroleum business under Nepal Petroleum Act, 2040	30	Flat rate
Tobacco related	Entity engaged in business of cigarette, tobacco, cigar, chewing tobacco, alcohol and beer	30	Flat rate
Other	Commercial trading/service entities and other businesses	25	Flat rate
Road, Bridge, Tunnel, Ropeway or Skybridge, Trolley bus, Tram, Export, Project to be handed over to GoN	Entity construct and operate road, bridge, tunnel, rope way or sky bridge, trolley bus, tram Taxable income under Export from Nepal Source Income Entity those involved in construction or operation of public infrastructure and to be transferred to Nepal Government or involved in construction of hydropower house and its generation and transmission.	20	Flat rate
Repatriation income	Repatriation of income by Nepal PE to non-resident person	5	Flat rate

Non-residents are taxed at 25 percent except the income from transporting passengers, mail or cargo by sea or air that is embarked in Nepal is taxed at 5 percent and 2 percent on offline transaction.

1.2.13 ANNUAL TAX RETURNS

All assesses are required to adopt uniform income year ending July 15 each year and submit tax returns within three months thereof. i.e. by October 15 of each year although extension of 3 months may be requested and generally granted. The accounts are to be audited by an auditor qualified under the laws of Nepal. Tax returns also need to be certified by the auditor and submitted along with the audited accounts within the stipulated time. However, small and medium tax payer, having annual turnover not exceeding NRs 10 Million, are waived from audit and they can self-attest their tax return.

¹ "Special industries" mean manufacturing Agro-Forest based and mineral industries classified in Section 3 of the 1992 Industrial Enterprises Act, other than industries producing cigarettes, bidis, cigars, chewing tobacco, *khaini*, *gutka*, *paan masala* and similar other products with tobacco as the basic raw material, and industries producing liquor, beer, and similar other products.

1.2.14 ADVANCE TAX

Income tax is to be paid in advance in 3 installments by all entities during an income year by January 14, April 14 and July 15 computed at the applicable rates on the estimated profits of the entity for the entire year. Advance tax to be deposited is as follows:

1 st i.e., January 14	40 percent of the total estimated tax liability for the year
2 nd i.e., April 14	70 percent of the total estimated tax liability for the year
Final i.e., July 15	100 percent of the total estimated tax liability for the year

1.2.15 TAX PAYMENT / REFUND

Income-tax payments are made in the year in which the income is earned in the form of withholding tax and advance tax. The taxpayer is required to estimate taxable income and make advance payments in three installments spread over the year. Income from services including contract payment is subject to tax withholdings that may be adjusted for the purpose of calculating advance tax.

Arrangements have been made by IRO to refund within 60 days the excess money deposited by taxpayers (in practice may take longer and too much hassle).

1.2.16 FINES AND PENALTIES

Failure to maintain records, non-submission of returns or late submission, non-payment or short payment of tax will attract late fee/ interest at prescribed rates. Submission of false or misleading returns shall attract a penalty ranging from 50 to 100 percent of tax loss. Fines including imprisonment for a term ranging from six months to two years are prescribed for not paying or evading tax.

1.2.17 REVIEW AND APPEAL

Application for Administrative Review may be submitted at IRD against revised assessment or an assessment of fees, interest and penalty within 30 days from the date of receipt of notice about the decision. While filing an application it is mandatory to deposit one third of the tax.

1.3 TAXATION OF INDIVIDUALS**1.3.1 INTRODUCTION**

As with company tax, tax on individuals is levied under the Income Tax Act 2002. Resident individuals are subject to tax on their worldwide income derived from employment, business or investment. Non-residents are subject to tax on their net income earned or sourced in Nepal.

1.3.2 RESIDENCE

A person who has resided in Nepal for a period of 183 days or more in any financial year or whose normal place of abode is Nepal are considered residents of Nepal. Dual residence is not recognized for the purpose of Nepalese tax.

There is no separate provision for taxing the income of short-term visitors. Depending on the length of stay, they will be classified as resident or non-resident and the Nepal sourced income shall be taxed accordingly.

1.3.3 TAXATION OF INCOME

Tax is levied on the total income earned or received by an individual less deductions, relief and incentives. Certain categories of income are not included in the total income of an individual but are taxed separately under special regimes, including:

- a. Rent from a house is taxed at a flat rate of 10 percent;
- b. Income from bank deposits is taxed separately at source at a flat rate of 5 percent;
- c. Gain in investment insurance of a resident natural persons and from unapproved retirement fund is taxed at a flat rate of 5 percent;
- d. Windfall gains tax is taxed at a rate of 25 percent;
- e. Returns distributed by a mutual fund to a natural person is exempt from tax;
- f. Meeting fees is taxed at a rate of 15 percent;
- g. Amount paid to a non resident person after withholding applicable taxes under remuneration, fees, commission, royalty, interest and under contractual payments are final withholdings; and
- h. Dividend received from a resident company and partnership firm is taxed as final tax withholding at a rate of 5 percent to the resident and non-resident person both.

1.3.4 CAPITAL GAINS TAX

Net gain derived in respect of disposal of shares listed in stock exchange and those not listed in the stock exchange are subjected to capital gain tax at the rate of 5 percent and 10 percent, respectively in case of individual. In case of individual the gain in respect of disposal of Non Business Chargeable Assets (NBCA) held for more than five years and for those held for less than five years are subjected to capital gain tax at the rate of 2.5 percent and 5 percent, respectively.

Net gains derived from the disposal of non-business assets, investment and liabilities is subject to tax at the rate of 10 percent in the case of individual. However, in the case of entity, it will be treated as business income and taxed at the normal applicable corporate rate.

1.3.5 DIVIDENDS

Dividends received from resident companies and partnership firms are taxed at source as a final withholding and therefore tax exempt for both resident and non-resident individual.

1.3.6 EMPLOYMENT INCOME / EMPLOYEE BENEFITS

GENERAL

Remuneration earned or received from the exercise of employment is taxed as income from employment. Employment income is defined to include:

- a. Wages, salary, leave pay, overtime pay, fees, commission, prizes, gifts, bonuses and other facilities;
- b. Personal allowances including cost of living, subsistence, rent, entertainment and transport allowance;
- c. Reimbursement of costs;
- d. Payment for the agreement to any conditions of employment;

- e. Retirement contributions; and
- f. Other payments made in respect of the employment.

TREATMENT OF RETIREMENT BENEFITS

The actual contribution, one third of the employment income or NRs 300,000 whichever is lower, contributed to the approved retirement fund are deductible from taxable income. No deduction is allowed if contributed to an unapproved retirement fund.

Retirement payments exceeding, 50 percent of the total sum or NRs 500,000 whichever is higher, received from an approved retirement fund at the time of separation is taxed at 5 percent.

In case of retirement payments from an unapproved retirement fund, the gain is taxed at 5 percent.

The tax law provides for taxation of all non-cash benefits to be valued at market rate. Housing and company cars provided to employees are valued at 2 percent and 0.5 percent, respectively of employment income.

1.3.7 DEDUCTIONS

Self-employed individuals can claim all reasonable expenses incurred in acquiring or earning income. Salaried employees are entitled to claim only specified deductions and relief.

1.3.8 PERSONAL ALLOWANCES AND REBATES OF TAX

The tax-free threshold or basic exemption is NRs 400,000 for a couple and NRs 350,000 for an individual. The exemption limit for the blind and handicapped people is 150 percent of the above. A rebate of 10 percent of the tax liability is provided to women (not with couple status) on their income from remuneration.

1.3.9 TAX RATES

RESIDENTS

Tax Banding	Tax Rates (%)
a. Tax-free threshold (to be deposited as social security tax) First NRs 350,000 for an individual or NRs 400,000 for a couple	1
b. Next NRs 100,000	15
c. Amount exceeding NRs 350,000 for an individual or NRs 400,000 for a couple but not exceeding NRs 2,500,000	25
d. Amount exceeding NRs 2,500,000	25
e. Additional tax on tax derived as per (d) above	40

NON-RESIDENTS

Tax Banding	Rate (%)
Total Income	25

1.3.10 TAX ADMINISTRATION

The tax period is the financial year of the government, which is the 12-month period generally commencing on July 16 and ending on July 15 of the following year (corresponding to NFY which commences from Shrawan and ends in Ashad).

In general, every resident and non-resident individual must file a personal income tax return by within 3 months from the end of the NFY of the following year. However, individuals who only have income from employment are not required to file tax returns subject to the condition that the annual remuneration income does not exceed NRs 4 million. An employer must submit annual tax returns for each employee showing total remuneration due or paid permissible deductions and the amount of tax due, deducted and deposited with the IRO.

An employer is obliged to deduct tax at the time of payment of salary and forward the amount withheld to the tax authorities within 25 days from the end of the month of withholding.

1.4 INTERNATIONAL TAX

1.4.1 DOUBLE TAX RELIEF

Nepal provides relief against international double taxation to residents by granting foreign tax credits. This is restricted to an amount calculated by multiplying the Nepal income tax rate to the income subject to foreign tax. Excess credits can be carried forward and adjusted only against the assessable foreign income.

In addition, double tax relief can be claimed under the provisions of existing DTAs, which Nepal has negotiated with other tax jurisdictions.

An unrelieved foreign source loss can be set off only against foreign source income and foreign tax losses cannot be claimed.

1.4.2 AVOIDANCE OF DOUBLE TAXATION AGREEMENTS

Nepal has entered into avoidance of double taxation agreements with 9 countries including India in order to provide relief from the double taxation of income of foreign investors. Some of the basic features relating to tax treatment on various incomes are as follows:

- a. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other state. This shall apply to income derived from the direct use, letting, or use in any other form of immovable property.
- b. The profits of an enterprise of a Contracting state shall be taxable only in that state unless the enterprise carries on business in the other contracting State through a permanent establishment situated therein.
- c. Profits derived by an enterprise of a Contracting State from the operation of aircraft in international traffic shall be taxable only in that State.
- d. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State. The tax shall not exceed:
 - i. 10 percent of the gross amount of the dividends if the beneficial owner is a company which owns at least ten percent of the shares of the company paying the dividends
 - ii. 15 percent of the gross amount of the dividends in all other cases

As per new tax treaty with India which has become effective 16 July 2012, the following applies:

- i. 5 percent of the gross amount of the dividends if the beneficial owner is a company which owns at least ten percent of the shares of the company paying the dividends
 - ii. 10 percent of the gross amount of the dividends in all other cases
- e. Interest arising in Contracting State and paid to a resident of the other contracting state may be taxed in that other state. The tax on interest shall not exceed 15 percent (for India 10% as per new treaty) of the gross amount of interest.
- f. Royalties arising in a Contracting state and paid to a resident of the other Contracting state may be taxed in that other State. The tax on royalties shall not exceed 15 percent of the gross amount of royalty paid.

The term "a Contracting state" and "the other Contracting state" mean India or Nepal, as the context requires.

1.5 ANTI-TAX AVOIDANCE RULES

1.5.1 INTRODUCTION

Nepal has a general anti-tax avoidance provision. If the tax authorities are of the view that any arrangement between persons who are associates that reduces or has the effect of reducing the amount of tax payable, it may disregard or vary the arrangement and distribute, appropriate or allocate the amount so as to counteract any tax advantage obtained or obtainable by the person under the said arrangement.

If a person attempts or has split their income with another person that is likely to cause a reduction in tax, the IRD may adjust amounts in calculating the income of each person to prevent any reduction in tax payable.

1.5.2 TRANSFER PRICING

The tax authorities may re-characterize or disregard an arrangement that is entered into or carried out as part of a tax avoidance scheme.

1.5.3 PERMANENT ESTABLISHMENT

A repatriated income of a Nepal-based PE of a non-resident person will be taxed at the rate of 5 percent. The income repatriated abroad in any income year shall be equal to the amount of dividend distributed by the foreign PE during the year.

1.5.4 THIN CAPITALIZATION

Interest is deductible if incurred in the course of conducting a business or investment. This is the case if the borrowed funds, for which interest is paid, are used in that production or used to acquire an asset used in that production.

The deductibility of interest paid by resident entities to controlling entities is limited. Controlling entities are organizations or persons, which are tax exempt, or non-resident persons, or associates of exempt organizations, or non-resident persons that own or control at least 25 percent of the resident entity.

Where interest is paid to a controlling entity the deduction must not exceed the sum of all interests that is to be included in the entity's taxable income plus 50 percent of the entity's taxable income

(taxable income is calculated without including any interest derived by the entity and not deducting interest expenses).

Any interest, for which a deduction is denied, may be carried forward and treated as incurred during the next income year.

1.5.5 CONTROLLED FOREIGN COMPANY (CFC) PROVISIONS

Nepal has CFC provisions which tax the income earned by foreign entities controlled by Nepalese resident persons. A controlled foreign entity is an entity not residing in Nepal, in which a resident person holds an interest and controls or may benefit from 50 percent or more of the rights to income, capital or voting power alone or with not more than four other residents.

A controlled foreign entity is treated as distributing its attributable income, calculated as if the entity were a resident entity, as a dividend to its beneficiaries in accordance with the beneficiaries' rights to that income, or, where those rights are not reasonably certain, in such manner as the Inland Revenue Department thinks appropriate tax will be imposed on dividend distributed to the beneficiaries by a controlled foreign entity.

A controlled foreign entity should distribute dividends to its beneficiaries in accordance with the beneficiaries' rights. This dividend is taxable as income of the beneficiary. Other dividends distributed by a controlled foreign entity are exempt from tax.

1.6 WITHHOLDING TAXES

Payments are subject to withholding tax as follows:

1.6.1 BUSINESS INCOME

A non-resident company carrying on business in Nepal is subject to tax in the same way as a resident company i.e. on income from a source within or deemed to be within Nepal.

1.6.2 DIVIDENDS

Dividends paid by resident companies and partnership firms are taxed at the rate of 5 percent to the resident and non- resident person both as final withholdings.

1.6.3 PAYMENT TO EMPLOYEES/WORKERS

Any amount paid to an employee or worker in lieu of employment is subject to tax withholdings at an appropriate rate. The annual gross earning of an employee is estimated at the beginning of each fiscal year and estimated tax liability ascertained. Tax is withheld each month proportionately on taxable income at the rates specified in the section 1.3.9. (Refer section 8 for tax on personal income)

1.6.4 CONTRACT PAYMENTS

Withholding tax on contract payments is 1.5 percent on payment made under a contract to a resident person (in case of nonresident 5 percent). Withholding tax on service payments to VAT registered person is only 1.5 percent whereas payment to nonresident (non VAT registered person) will attract 15 percent. Withholding taxes made by third party shall be advance tax for the company and will be adjusted against the tax liability of the company at year end at the time of filing the returns.

The tax withholding rates for services provided under the service contract by a foreign subcontractor shall attract a withholding tax rate of 15 percent from invoices raised without VAT. There will be a reverse charge of VAT (currently 13 percent) on the services so availed by a resident company in Nepal from the overseas (non registered party).

Insurance premium paid to non-resident insurance companies attracts a tax withholding of 1.5 percent which is construed as final tax withholding.

1.6.5 ROYALTIES/TECHNICAL FEES/INTEREST/RENT/COMMISSION/DIRECTOR'S FEE

These are subject to a withholding tax of 15 percent but may be reduced by the provisions of existing DTAAs negotiated by Nepal.

Payment of rent is subject to withholding tax of 10 percent.

Withholding tax is not required for payment of interest to the resident bank or financial institutions.

Where the interest is paid to a bank or financial institution carrying on a bonafide banking business, which is resident of the other contracting state and is the beneficial owner of the interest, the tax shall not exceed 10 percent of the gross amount of interest. Withholding tax is not required for payment of interest to the Central Bank or Central and State Governments.

Tax withholding obligation arises at the time the underlying liability arises.

Payments of fees, royalties, commissions, bonus, rent, interest, windfall gains to non-resident after withholding of applicable withholding taxes will construe to be final tax and it will not require filing of tax returns.

2. TAX INCENTIVES

2.1 SPECIAL ECONOMIC ZONES

The GoN aims at attracting native and foreign investment by establishing Special Economic Zone (SEZ) in potential places for exportable industries. This program is meant for relating to export processing zone, special commercial zone, tourism/entertainment sector, banking sector. The established industries that enjoy the complete service facility are needed to produce goods of international standard of which at least 70 percent has to be exported.

SEZ has reached its final phase for the construction of necessary physical infrastructure in Bhairahawa. Likewise, land acquisition, compound construction and construction of access road are underway in Simara while feasibility studies are being conducted in four sites - Dhangadi, Panchkhal, Jhapa and Nuwakot.

2.1.1 DETERMINATION OF SPECIAL ECONOMIC ZONE

GoN can prescribe any export processing area, special business area, tourism or entertainment area or any other area of Nepal as a SEZ, after publishing the notice in the Gazette, following recommendation of the Special Economic Zone Authority (Authority).

- “Export Processing Area” means the area within the SEZ developed to establish export oriented industry.
- “Special Business Area” means the area within the SEZ developed to collect goods for export, through import or collection within the country, its storage, classification, packaging and assembling.
- “Tourism or Entertainment Area” means the area within the SEZ developed to establish industry related to tourism and entertainment.

The Authority will make list of industries that may be established in the SEZ public from time to time. The list will include, productive, tourism and entertainment, information technology, agriculture, mines and forest products industry appropriate from environmental perspective, economically feasible, and export oriented in business sense.

2.1.2 PRIVILEGES RECEIVED BY INDUSTRIES IN SEZS

Certain privileges are provided in the SEZ laws, in terms of exemptions, facilities, tax benefits, etc., to industries in SEZ some of which are:

- a. Special treatment for goods or services produced in SEZ
- b. No nationalization shall be made
- c. Discount on the lease or rent of land or building
- d. Exemption from income taxes, value added taxes, excise duty, customs duty and local taxes
- e. Selling of raw materials or products to any industries in SEZ by any other industries will be deemed as export and such industries can enjoy facilities available for export
- f. The foreign investment may be repatriated
- g. Relaxation in visa provisions
- h. Use of bonded warehouse
- i. Sub-contracting within industries and accelerated rate of depreciation shall be available, along with such other facilities as may be specified by the GoN from time to time.

2.2 TAX INCENTIVES

2.2.1 INCOME TAX RATES

The tax laws provide various incentives to stimulate industrial growth and development. Following are the key tax incentives, inter alia, designed to attract inward investment:

Industry	Tax rates and Incentive
a. Special industries (mainly manufacturing other than alcoholic & tobacco producing industry)	20% (Normal Rate)
b. Industries providing direct employment to Nepalese citizens: <ul style="list-style-type: none"> - for 300 or more by Special industries and information technology industries - for 1200 or more by Special industries - to 100 Nepalese including 33% women, dalit & disabled by Special industries - Special Industry, Agro-based industry and industry related with Tourism sector providing direct employment to only Nepalese citizens provided that number of employees shall be at least 100 throughout the year 	90% of normal rate 80% of normal rate 80% of normal rate 70 % of normal rate
c. Industries established in very undeveloped area, as defined in Industrial Enterprise ITA	10% of the normal rate (for 10 yrs from the year of establishment)
d. Industries establishment in undeveloped areas, as defined in Industrial Enterprise ITA	20% of the normal rate (for 10 yrs from the year of establishment)
e. Established in underdeveloped areas, as defined in Industrial Enterprise ITA	30% of the normal rate (for 10 yrs from the year of establishment)
f. Industry established in SEZ recognized in mountain areas or hill areas by the GON	Up to 10 yrs 100% exempt and 50% rebate in subsequent years
g. Industry established in SEZ other than above locations	100% exempt up to first 5 yrs and 50% rebate in subsequent years
h. Dividend distributed by the industry established in SEZ	100% exempt for first 5 years and 50% rebate on subsequent 3 years
i. Income derived by the foreign investors from investment in SEZ (Source of income-use of foreign technology, management service fee and royalty)	50% of applicable tax rate
j. On capitalization of accumulated profit through bonus share by Special Industry, Agro-based industry or industry related with tourism for expansion of capacity of industry	No dividend tax
k. Import income of information technology industries at IT park as declared by GoN	50% of normal tax rate
l. Institution having licensed to generate, transmit, and distribute electricity shall be allowed if the commercial activities started in terms of electricity generation, generation and transmission, generation and distribution or generation, transmission, distribution before BS 2080 Chaitra (mid April 2024) and these	100% exempt up to seven years and 50% rebate on subsequent 3 years

Industry	Tax rates and Incentive
exemptions shall also be available for solar, wind and other alternative energy companies	
m. If person involved in exploration and extraction of petroleum and natural gas starts commercial operation by BS 2075 Chaitra end.	100% exempt up to 7 years and 50% rebate in subsequent 3 years
n. Income from export of goods produced by manufacturing industries	75% of normal tax rate
o. Income from construction and operation of road, bridge, airport and tunnel or income from investment in tram and trolley bus	60% of applicable tax rate (i.e.20%)
p. Income of manufacturing Industry, tourism service industry and hydropower generation, distribution and transmission industry listed in the security exchange (i.e. capital market)	85% of applicable tax rate
q. Industry established in least developed areas producing brandy, wine, cider from fruits.	60% of applicable tax rate up to ten years
r. Royalty from export of intellectual asset by a person	75% of applicable tax rate
s. Income from sale of intellectual asset by a person through transfer	50% of applicable tax rate

2.2.2 OTHER TAX INCENTIVES

- a. Traditional cottage industries are not subject to income tax and VAT.
- b. Dividends received from resident companies are taxed at 5 percent to resident and non-resident persons, as final tax.
- c. Expenditure incurred on R&D and the installation of pollution control equipment or processes is immediately deductible up to 50 percent of adjusted taxable income from taxable income. The balance is available for deduction through tax depreciation (if qualifying).
- d. Persons are allowed deduction for donation to approved institutions (i.e. educational, religious and social organizations) up to a limit of 5 percent of their adjusted taxable income not exceeding NRs 100,000.
- e. No income tax shall be levied on the income of certain cooperatives incorporated under the Cooperative ITA 2048 conducting agricultural, forestry and other agriculture based activities. Similarly, savings and credit cooperatives operating in rural areas will be exempt from income taxes.
- f. Dividend distributed by industry in SEZ will be exempt from tax for 5 years from the date of commercial transaction and will be taxed at 50 percent rebate for 3 years thereafter.

2.2.3 OTHER INCENTIVES

- a. Industries importing plant, machinery and equipment required for direct production process falling under the chapter 84 of the harmonized customs classification will attract custom duty at 2.5 percent only.
- b. Industry in SEZ will get full exemption from VAT while importing machinery, equipment, spare parts, and raw materials and up to 3 vehicles. Besides, these industries can avail certain other benefits under VAT ITA.
- c. No excise duty shall be levied on the goods to be produced by industries in SEZ.

- d. Any duties or taxes levied on the raw materials, auxiliary raw materials, etc. used for producing goods for export/deemed export are entitled to get refund of such duties and taxes based on the quantity of export. The application for this must be submitted within a year of the date of export for duty refund.
- e. Export-oriented industries may obtain the bonded warehouse facility. The raw materials for the products of such nature can be imported without paying any customs duty or sales tax by just entering the details of such transactions in a passbook made available by the Department of Customs. The quantity of such raw materials used for manufacturing of exportable products is deducted from the quantity entered in the passbook upon export of finished product. However, the industry must also submit a bank guarantee sufficient to cover the duties. The finished product must be exported within 10 months from the date of import of raw materials. The industry intending to avail of such facility must apply to the Department of Customs.

3. INDIRECT TAXES

3.1 VALUE ADDED TAX

3.1.1 INTRODUCTION

Value Added Tax (VAT) is tax based on goods and services. This tax is levied on the sale, exchange, transfer, import etc. of all goods and services apart from those specified by the law as tax-exempt. This means that this tax encompasses all types of goods and services produced in or imported into the country apart from those listed as tax-exempt by the law. VAT is considered as an improvised form of sales tax. This tax is imposed on different levels of value addition in the production and distribution process of goods and services. In short, the difference between the purchase price and the sales price of any firm is the value added.

In practice, the tax-payer does not have to calculate his value addition for the purpose of VAT. But he/she has to collect VAT on the sales price at the rate specified by the VAT Act and after deducting the tax incurred on purchases made from the amount thus collected he/she has to pay the balance amount as VAT. Under VAT each registered manufacturer and distributor must collect tax on the sales of their goods and services.

3.1.2 RATE

VAT is levied at a flat rate of 13 percent, which is applied to the invoice value. Certain specified goods are outside the scope or exempt from VAT, in which case, the applicable rate is zero. Exports of both goods and services are taxed at zero percent.

3.1.3 THRESHOLD

Threshold for compulsory registration under VAT Act is a turnover of NRs 5 million over the last 12 months in case of goods, and NRs 2 million for both services and goods. Exemptions apply inter alia, to salaried employment, banking and financial services, education and health services, agriculture produce and certain non-profit making activities.

3.1.4 TAX CREDIT

To avoid double taxation, a credit is given for VAT paid on goods and services used for the purpose of making any taxable supply (Input VAT). A credit is also given for VAT paid in respect of certain exempt supplies, e.g., exports. The principal mechanism for collecting the tax requires the taxable supplier to charge VAT on the goods or services supplied (Output VAT) to take credit for VAT paid on business expenditure (Input VAT), and to pay the net tax over to the authorities.

3.1.5 REQUIREMENTS

VAT registrants are required to:

- a. Submit VAT return and pay tax within the 25th day of the following month
- b. Provide their customers with a tax invoice
- c. Maintain purchase book, sales book, VAT account
- d. Keep their VAT records for a period of 6 years

- e. Inform the IRO of changes to the business including new address, telephone number or a reorganization of a partnership within 15 days.

3.1.6 OFFENCES

Fines will be imposed if the taxpayer fails to file returns within the specified time. The VAT Act imposes fines for failing to register. Similarly, if a registrant fails to use the registration number or clearly display the registration certificate in the business premises, fine may be imposed. Other penalties may be imposed if, for example, a registrant fails to file a return, issue invoices, keep an up-to-date account of transactions, obstructs visits by a tax officer in investigation, prepares false accounts and invoices or attempts to evade tax. Similarly, IRO/IRD may purchase or cause to purchase under invoiced goods.

3.1.7 HIGHLIGHTS

- a. Industries involved in production of plastic and poly propylene bags shall be encouraged in production of alternative products by exempting VAT in machineries imported by them and imposing only 1% custom duty.
- b. Price including VAT should compulsorily be mentioned for the goods and services exhibited in exhibitions, sales outlets, shops, hotels and restaurants and bars and showrooms.
- c. VAT shall be exempted on payment of insurance premium for insurance related business of birds, fruits, fishes and bee harvesting.
- d. Printing houses and electronic broadcasting and transmission organizations can submit their VAT returns on a trimester basis.
- e. VAT shall be exempt and custom duty of 1 percent shall be levied on the equipment related to treatment of cancer, heart and kidney imported by health institutions recognized by Government of Nepal. Similar exemptions shall also be available for lab equipment required for treatment of disease

3.1.8 ADMINISTRATIVE REVIEW

A taxpayer who is not satisfied with the tax assessment can submit an application to the DG of IRD for administrative review within 30 days from the time of receiving such decision.

3.2 CUSTOM DUTY

3.2.1 INTRODUCTION

Customs duty is calculated on transaction value which includes CIF Nepal border on the import of goods. The valuation is determined by a valuation committee who generally enhances the transaction value declared by the parties by 5 to 10 percent or as the case may be. In case there is under invoicing, the custom official can revalue the goods based on current market value and collect customs duty on such amount or purchase the goods at the under invoiced value as it so considers.

Customs Service Fee (CSF) of NRs 500 per declaration form will be charged at the time of import of goods into Nepal.

3.2.2 RATE

Custom duty ranges from 0-80 percent on the transaction value.

3.2.3 HIGHLIGHTS

- Goods of Indian origin being imported from India can be imported on concession of 5 percent on custom duty up to 30 percent. But 3 percent concession can be obtained on goods for which customs duty is above 30 percent (where custom duty is levied on value).
- Industry involved in disposal of used battery and reproduction shall be exempt from VAT and only 1% of custom shall be levied.
- Custom duty of 1% only shall be imposed on equipment and mills/machineries required business relating to agriculture, irrigation and animal husbandry.
- Goods imported by projects funded by foreign assistance and those enjoying duty facilities as per decision of Government of Nepal shall be levied with custom duty of 1% only.
- Custom duty of 1% shall be imposed on paper imported by publication houses for printing newspaper.
- Large electric vehicles to be used as public transportation shall be exempted from excise duty and the applicable custom duty shall only be 1%.
- Industries involved in production of plastic and polypropylene bags shall be encouraged in production of alternative products by exempting VAT in machineries imported by them and imposing only 1% custom duty.
- Custom duty exemption of 2/3rd shall be allowed for bullets transporting LP gas Custom duty of 1% only shall be imposed on vehicles transporting fishes and meat and tankers transporting milk.

3.3 EXCISE DUTY

3.3.1 INTRODUCTION

Excise duty is payable on the manufacture of movable goods and also on import of certain goods. The excise duty is governed and regulated by the Excise Act 2058, Excise Regulation 2059. As provisioned in the law, the excise commodities are closely controlled and supervised by the GoN from their production to selling stage.

3.3.2 LICENSE REQUIRED

No one is allowed to manufacture, import, sell and store excisable goods without obtaining license. Likewise, the law prohibits import of excisable services without having license. Person, firm or institutions who need such license may submit a prescribed application form before excise officer at the concerned IROs.

3.3.3 RATE

The rate of excise duty generally ranges from 0-40 percent. Exports are exempt from excise duty.

3.3.4 ADMINISTRATIVE REVIEW

Provision is made for an administrative review at IRD if the decision made by excise officer is not acceptable to the taxpayer. In such case, taxpayer has to submit and appeal within 35 days from the date of receipt of the decision made by excise officer. Taxpayer can approach to Revenue Tribunal if he is not satisfied with the IRD's decision.

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