Recent Developments in International Taxation
Nepal

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[NTD - Current draft covers developments through since 2014/15 – final draft to cover period through May 15 2017]

A. LEGISLATIVE DEVELOPMENTS

1. SPECIAL ECONOMIC ZONE ACT 2016

(a) Government of Nepal enacted the Special Economic Zone Act 2016 ("**SEZ Act**") in 2016 in order to regulate industries established inside special economic zones (the "**SEZ**").

(b) Some of the tax incentives and benefits provided to the industries inside SEZ are briefly set out in Annex-I. In addition to the SEZ Act, Industrial Enterprises Act 2016 ("**IEA**") as well as Income Tax Act 2002 (**"ITA"**) has also set out benefits/incentives for industries inside the SEZ.

(c) The SEZ Act has guaranteed the stability of the tax incentives, benefits and other concessions provided under the said Act and other laws. The SEZ Act provides that if any provision is made in the SEZ Act or other laws adversely impacting on the benefits, concessions and facilities provided to the industries, such provisions shall not apply to the industries.

(d) Generally, the relevant tax laws and industrial enterprise law accord tax incentives and benefits and they are subject to review and change through the Finance Act, which is enacted each Fiscal Year. As the SEZ Act has guaranteed the stability of the tax incentives and benefits provided under the Act and other laws, such incentives and benefits cannot be taken away by the Finance Act. As the initial period of the license of the industries established inside the SEZ can be 30 (thirty) years and such license can be renewed further period, it appears that the benefits and incentives as available under the laws can last perpetually.

2. INDUSTRIAL ENTERPRISES ACT 2016

(a) The industrial sector in Nepal saw enactment of new Industrial Enterprises Act 2016 ("**IEA**"). The IEA has also provided various fiscal incentives to the industries. The IEA has provided various fiscal incentives to industries, most of which were repealed after the introduced of the Income Tax Act 2002 (the "**Income Tax Act**"). The Income Tax Act was introduced with the concept that all tax related incentives will be covered by the Income Tax Act and Finance Act which is enacted every year. Generally, matters related to income tax, value added tax (VAT) and custom duty are governed by the Fiscal Act.

(c) In marked departure with this principle, the IEA has introduced additional fiscal incentives. The manufacturing and export oriented industries enjoy most of the fiscal incentives. For example, the manufacturing industries (which excludes tobacco, alcoholic beverages, etc.) are entitled to 20% discount on the applicable tax rate (currently 20%) making the effective tax rate 16%. The export income from export of goods is entitled to 25% discount making the effective tax rate from export income 15%. Some of the tax benefits provided by the IEA are set out in Annex-I.

(d) Like the SEZ Act, the IEA provides statutory protection of changes in law in relation to benefits and exemption provided under the Act and other applicable laws. The stabilization provision states that no provisions shall be made to limit the benefits and exemptions prescribed under the

Act and other applicable laws. This provision is introduced against the background that, stabilization provision was set-up mostly for infrastructure projects under the applicable laws but now all industries registered under the IEA will be eligible to enjoy the benefits.

B. TREATIES:

3. DOUBLE TAX AVOIDANCE AGREEMENT

(a) Nepal has entered into Double Tax Avoidance Agreement (**DTAA**) with ten countries till date. The countries are: Republic of India, Kingdom of Norway, Kingdom of Thailand, Democratic Socialist Republic of Sri Lanka, Republic of Mauritius, Republic of Austria, Islamic Republic of Pakistan, China, Republic of Korea and Qatar.

(b) Based on the Annual Report of Inland Revenue Department (**IRD**) of the year 2014-15, negotiations being done to enter into DTAA with other countries. Some of the remarkable developments regarding DTAA with various countries in the past year have been tabulated below:

S.N.	Subject	Developments
a.	Nepal-Singapore DTAA	First Round of negotiation completed
b.	Nepal-Bangladesh DTAA	The fourth and final round of negotiation has been concluded
c.	Nepal- Malaysia DTAA	Preparation for second round of talk is ongoing
d.	Nepal-United Kingdom DTAA	Preparation for the first round of negotiation is ongoing
e.	Nepal- Oman DTAA	Nepal has completed its internal preparation for first round of talk
f.	Studies for DTAA with Baharain, UAE and Saudi Arabia	Study of Revenue efficiency post DTAA with these countries

C. CURRENT ISSUES ON TAX

4. APPLICABILITY OF CAPITAL GAIN TAX IN OFFSHORE TRANSACTION

(a) It was the general understanding amongst the accounting and legal professionals that the Income Tax Act 2002 does not attract tax on off-shore disposal of share (the "**Offshore Transaction**"). The applicability of Capital Gain Tax (the "CGT") in Offshore Transaction has been gaining a lot of attention in Nepal in relation to recent indirect divestment of shares by TeliaSonera held in Ncell to Malaysian Telecom Operator Axiata. In 2015, Axiata bought Reynolds Holding, which held a 80 percent stake in Ncell, from TeliaSonera. The reported value of the transaction was about USD 1.3 billion.

(b) Based on the reports and newspaper articles, the Office of Auditors General (OAG) has already directed the Government to collect Nepalese Rupees 32 Billion 20 Million from the Ncell, which may appear on the basis that Ncell had obligation to withhold applicable taxes (the Income Tax Act currently requires withholding obligation to withhold 15% on the entity whose shares have been transferred if such entity is a private limited entity or unlisted entity). The Public Accounts Committee (PAC) of the Legislative Parliament has since last 1 year divulged in rigorous discussions over the same issue.

(c) It appears on the basis of the newspaper reporting that the tax authorities are in the process of communicating with Ncell and TeliaSonera for submission of information and tax filing. It is not yet clear as to how the issue of CGT will be settled but this case is likely to shed light on government view of applicability of the CGT in Nepal in relation to the OffShore Transaction and will assist parties contemplating transaction related to Nepal to evaluate the practical risk arising of potential claims from the tax authorities.

Annex I : Fiscal Benefits under SEZ Act

S.N.	Industries	Benefits	
1.	All Manufacturing Industries established inside SEZ	Income Tax (IT)	100% IT Exemption for first 5 years from commencement of commercial transaction of productions. 50% IT Exemption for next 5 years. 50% IT Exemption for the following 10 years if the industry utilizes a minimum of 60% domestic raw materials.
		Dividend	100% exemption in dividend distributed for first 5 years from commencement of commercial transaction of productions. 50% exemption for next 3 years.
		VAT	0% VAT on goods and services exported by industries.
			0% VAT on raw materials and finished goods imported by industries.
		Custom Duty	Exemption of Custom Duty under Bank Guarantee and other facilities in certain goods.
			Reimbursement of Custom Duty on goods paid by the importer in case such goods are sold to industries inside SEZ under prescribed conditions.
2.	Industries inside SEZ of Himalayan and Government specified Hilly Regions	100% IT Exemption for first 10 years from commencement of commercial transaction of productions. 50% IT Exemption for next 10 years.	
3	Industries having rented land or building inside SEZ	Concessions in the rent or lease amount in following rate: First Year : 50 (Fifty) percent Second Year : 40 (Forty) percent Third Year : 25 (Twenty-five) percent	
4.*	Foreign Investors of industries inside SEZ	50% IT Exemption in the income earned through Foreign Technology or management service and Royalty	

* This exemption is provided by Income Tax Act. The exemptions under ITA are subject to amendment by Finance Act each year.

Annex II : Fiscal Concessions under IEA 2016

	Industries	Benefits
A.	**Income Tax Concessions**	
1.	All Manufacturing Industries	20% exemption on the rate of tax imposed on the income earned from such industries.
	Industries investing in construction of roads, bridge, tunnel, Ropeway, Railway, Tram, Trolleybus, Airport, Industrial Structure and Infrastructural Complex and bringing such constructions into operation	40% exemption on the rate of tax imposed on the income earned from operation of such infrastructures.
	Manufacturing industries except those producing fruits based cider, brandy or wine established in Under Developed, Undeveloped and Less Developed Region	90%, 80% and 70% exemption on rate of the income tax for up to 10 years from the date of commencement of commercial production or transaction for industries in respective regions.
	Manufacturing industries producing fruit based cider, brandy or wine established in any Under Developed Region,	40% exemption on the income tax for up to 10 years from the date of commencement of business
	Manufacturing Industries set up with the investment of at least 1 billion rupees and providing direct employment to more than 500 individuals throughout the year	100% IT Exemption for first five years from the date of commencement of business. 50% IT Exemption on for next 3 years. Industries already in operation are entitled to the above stated exemption in case they enhance their installed capacity by at least 25%, increase investment to 1 billion and provide direct employment to 500 individuals throughout the year.
	General Exemptions to All Industries	Under conditions prescribed by the Law
2.	Projects obtaining approval to commercially generate transmit or distribute Hydroelectricity by April 12 2024 A.D. (Chaitra 30, 2080 B.S.)	100% IT Exemptions for the first 10 years 50% exemptions for the next 5 years. Such exemption is entitled to Solar, Wind and Bio Mass energy as well.

		In case of industries that have already begun commercial production at the time of commencement of this Act, the exemptions applicable at the time of receiving approval would be applicable.
3.	Industries conducting research and excavation of natural gas and fuel commercially, if commence the commercial transaction by April 13 2019 A.D. (Chaitra 2075 B.S.)	100% IT Exemption for first 7 years from the date of commencement of transaction; 50% IT Exemption for next 3 years.
4.	Industries relating to Tourism Sector established with the investment of above 2 billion rupees	100% IT exemption for the first 5 years from the date of commencement of commercial transaction 50% exemption on rate of Income Tax for next 3 years Such Industries already in operation are entitled to the above stated exemption in case such industries enhance their installed capacity by 25%, increase investment to 2 billion.
	Tourism Industry including hotel, resort etc established outside the metropolitan or sub-metropolitan area with the investment of more than 50 million	100% IT exemption for the first 5 years from the date of commencement of commercial transaction 50% exemption on rate of Income Tax for next 3 years
5.	Industries related to software development, data processing, cyber café and digital mapping established inside technology park, bio-tech park and information technology park specified by Nepal Government by publishing notice in Nepal Gazette.	50% exemption on tax imposed on income of such industries
6.	Manufacturing Industries and Information and Communication Technology Industries employing 300 or more Nepalese throughout the years	15% exemption on tax imposed on income of such industries on that year (Additional 15% exemption on income tax on that year in case the industry has 50% of its employees

		from among Women, Scheduled Caste and Disabled person)
	Manufacturing Industries and Information and Communication Technology Industries employing 1200 or more Nepalese throughout the years	25% exemption on tax imposed on income of such industries on that year (Additional 15% exemption on income tax on that year in case the industry has 50% of its employees from among Women, Scheduled Caste and Disabled person)
7.	Manufacturing Industries exporting goods or commodities produced	25% exemption on the rate of tax imposed on the income earned.
B.	**VAT Exemptions**	
8.	All Industries	VAT imposed on production is reimbursed if such goods are exported, based on the quantity of export.
C.	**Custom Duty Exemptions**	
9.	Industries not having Bonded Ware House or Passbook facility	Nepal Government may refund the amount of Duty Draw Back in export of goods after determining the aggregate of costs incurred in import as prescribed in Nepal Gazette
10.	All Industries	Industries not having Bonded Ware House approval exporting goods through existing Banking Channel or Letter of Credit or selling such goods in domestic market in convertible currency
11.	Other Custom Exemptions	As prescribed by the Act
D.	Exemptions for Micro Industries	As prescribed by the Act
E. Additional Benefits for Female Entrepreneurs		Industries registered under the ownership of Female Entrepreneurs only are entitled to additional benefits and concessions as prescribed
F.	Other Exemptions and facilities	As prescribed by the Act