CHARTERED ACCOUNTANCY PROFESSIONAL (CAP)-III

Study Material

On

ADVANCED TAXATION

Education Division

The Institute of Chartered Accountants of Nepal

Publisher : **The Institute of Chartered Accountants of Nepal**
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Price : Rs.500/-

First Edition : May, 2012

Second Edition : December, 2014

Third Edition : September 2019

Fourth Edition : June 2021

Designed & Printed at: Print and Art Service
Bagbazar, Kathmandu, Tel: 4244419

PREFACE

This study material on the subject of "Advanced Taxation" has been exclusively designed and developed for the students of Chartered Accountancy Professional [CAP]-III Level. It aims to provide the expert knowledge of direct and indirect taxes as well as to make the students to acquire the ability to apply the expert knowledge in actual practice.

It broadly covers the chapters of Terms, basis of tax, calculation of incomes, tax accounting and timing, Quantification and characterization, Computation of net gains and losses from assets, Special Provisions, Depreciation provisions, Administration and Documentation Administration, Withholding and Payments of Tax, Returns and Assessments, Collection, Remission and refund, Legal Remedies, Interest, Fees, Penalties Offences, International Taxation, Tax Settlement Commission, Circulars, Excise Act, 2058 and Excise Rules, Value Added Tax Act, 2052 and Rules , and Customs Act, 2019 and Rules.

Students are requested to accustom with the syllabus of the subject and read each topic thoroughly for understanding on the chapter. We believe this material will be of great help to the students of CAP-III. However, they are advised not to rely solely on this material. They should update themselves and refer recommended text-books given in the CA Education Scheme and Syllabus along with other relevant materials in the subject.

Last but not least, we acknowledge the efforts of CA. Prabin Raj Kafle, who has meticulously assisted for updating this study material with the recent updates and building the material in comprehensive shape.

Due care has been taken to make every chapter simple, comprehensive and relevant for the students. In case students need any clarification, creative feedbacks or suggestions for further improvement on the material, they may be forwarded at the Education Division.

June, 2021

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The Institute of Chartered Accountants of Nepal

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Whereas, it is expedient to amend the existing laws concerning revenue collection, reduction, increment, concession of tax and revenue administration to enforce the finance ordinance of the Government of Nepal for the fiscal year 2078/079 (2021/022).

In absence of the parliamentary session, President of Nepal has issued this ordinance after recommendation made by the Cabinet Ministers as per in Section 114(1) of Constitution of Nepal. (Date: 2078.2.15/29.05.2021)

SECTION WISE APPLICABILITY OF FINANCE ORDINANCE, 2078

Section	Heading	Date of Applicability
1	Short title and commencement	From 29.05.2021
2	Custom Duty Annexure 1 (Custom Duty related to Section 2(1)) Annexure 2 (Custom Duty for Export of Goods from Nepal to Foreign Country related to Section 2(2))	From 29.05.2021
3	Custom Service Fee	From 29.05.2021
4	Agricultural Reform Fee	From 29.05.2021
5	Excise Duty	From 29.05.2021
6	Value Added Tax	From 29.05.2021
7	Health Risk Tax	From 29.05.2021
8	Education Service Fee	From 29.05.2021
9	Infrastructure Development Tax	From 29.05.2021
10	Road Construction Charges Annexure 3	From 29.05.2021
11	Road Maintenance and Improvement Charges	From 29.05.2021
12	Film Development Fee Annexure 4	From 29.05.2021
13	Pollution Control Fee	From 29.05.2021
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15	Telecommunication Service Charge	From 16.07.2021
16	Casino Royalty	From 16.07.2021
17	Provision regarding Social Security Fund	From 16.07.2021
18	Rate may be increased, reduced or exempted	From 16.07.2021
19	Simplification of procedure or removal of obstruction	From 16.07.2021

20	Special provision for waiver of accumulated fees, additional fines and remaining interest if withdrawal of ongoing administrative appeals or of cases ongoing in the Revenue Tribunal or Court and making payment of assessed amount of tax	From 29.05.2021
21	Special provision for waiver of outstanding payables	From 29.05.2021
22	Special provision for waiver of tax, interest, additional fees and fines by issuing the certificate of origin	From 29.05.2021
23	Special provision for waiver of additional fees, interest, fines for trekking and tour package	From 29.05.2021
24	Special provision for waiver of additional fees and interest for Health Service Provider Organization	From 29.05.2021
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31	Special provision for deduction of expenditure allocated for corporate social responsibility in equipment and materials necessary for construction of COVID-19 specialized hospital	From 29.05.2021
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PROVISIONS APPLICABLE FROM 17.07.2021

Amendments in Income Tax Act, 2058 (Section 37 of Finance Ordinance, 2078)

Section	New Provision
2(Da)	**Non-Business Chargeable Asset** Means land, buildings and interest-in-entity, or securities, other than the following assets: 1) Business Assets, Depreciable Assets or Trading Stocks. 2) Private house of a Natural person in the following conditions: (Ka) Under continued ownership for 10 years or more, and (Kha) Stayed in the house for 10 years or more continuously or at different times by the person. Explanation: "Private House" for the purpose of this clause means building, the land occupied by the building and additional land equal to area of land occupied by building or 1-ropani [5,476 st-508.7370m2] whichever is lower. 3) Interest in Retirement Fund of a Beneficiary. 4) Land and private house of a Natural Person which has been disposed of at a price of less than 1-million Rupees, or 5) Assets disposed of through transfer by any means, other than sale and purchase within three generations.
2(Ka Ma)	**Service Fee** Means any fee paid to a Person according to Market Price for the services provided; the term includes commissions, meeting allowances, management fees, or technical services fees.
4(4)	**Calculation of tax and tax rates** Notwithstanding subsection (2), the income tax payable by a resident Natural Person under section 3 (Ka) in any income year, who meets all of the following conditions, is equal to the amount provided in Section 1(7) of Schedule-1. (Ka) a resident Natural Person's income for an income-year consists exclusively of income from a business having a source in Nepal; (Ka1) has not claimed tax credits for medical treatment expenses under Section 51 and tax withholding under Section 93 and if the taxable income and turnover of the business does not exceed the threshold of Rs. 300,000 and 30,00,000 respectively, and
4(4Ka)	**Calculation of tax and tax rates** Notwithstanding subsection (2), the income tax payable by a resident natural person under section 3 (Ka) on the basis of turnover in any income year, who meets the following conditions, is equal to the amount provided in Section 1(17) of Schedule-1. (Ka) Taxable income of natural person should be only from business having source in Nepal.

4(4Ka)	Taxable income from business Rs. 1,000,000 and turnover of business more than Rs 3,000,000 but less than Rs 10,000,000. (Gha) Income shall not be from professional services like service provided from Doctor, Engineer, Auditor, Lawyer, sports player, actor, consultant
10(Thha)	**Income exempts from Tax** Income earned as per its objectives by Mutual Funds approved from Securities Board of Nepal.
10(Dda)	**Income exempts from tax** Income earned as per its objectives by Educational Institute established with the objective of not for earning and distributing profit as per the agreement with Government of Nepal (GON) or concerned entity of GON.
11(1)	**Business Exemption and Concessions** An agricultural income derived from sources in Nepal during an income year by a person, other than the income from an agriculture business derived by a registered firm, or company, or partnership, or a corporate body, or through the land above the holding ceiling as prescribed in the Land Act, 2021, is exempt from income tax. **But, if any income is earned by carrying on agricultural business by being registered as any firm, company, partnership firm and other corporate body, 50 % tax on applicable income tax shall be exempted.**
11(3Nga)	**Business Exemption and Concessions** Following tax rebate shall be allowed on Income from export having source in Nepal during any Income Year: (Ka) If resident natural person required to pay tax at 20% on Income then 25% of such tax amount and if required to pay at 30% on Income then 50% of such tax amount (Kha) 20% on applicable Income Tax on Income of an Entity (Ga) Additional 25% 35% on tax amount after availing rebate as per clause (Ka) or (Kha) on income received from Export of Manufactured goods by manufacturing based industry
11(3Da)	**Business Exemption and Concessions** 50% rebate on Income Tax upto 3 years and 25% rebate on income tax upto 5 years thereafter from the date of operating transaction by Special industry operating after incorporating or shifting in Industrial Area or Rural Industrial Area.
11(3Dha)	**Business Exemption and Concessions** 20 % tax is exempted on the income earned from sale of raw material or subsidiary raw material, produced within country, to Special Industry.

11(3Na)	**Business Exemption and Concessions** 100 % tax exemption is provided up to 5 years from date of commencement to the startup business as prescribed by department established by utilizing innovative knowledge, concept, skill, technology, system having annual transaction up to 1 crore rupees.
11(3Pa)	**Business Exemption and Concessions** If the special industry which is in operation in Kathmandu valley is shifted and operated outside Kathmandu valley, 100 % tax exemption is provided up to 3 years of shifting and operation of business and 50 % tax exemption is provided up to additional 2 years.
11(3Fa)	**Business Exemption and Concessions** If an industry produces a new product by utilizing only used materials that directly affects the environment as raw material, 50 % tax exemption is provided up to 3 years from date of operation and 25 % tax exemption is provided up to next 2 years.
12Ga	**Seed Capital provided to startup business** Seed capital provided by any person up to 1 lakh rupees to maximum 5 startup business other than the associated person, is allowed for deduction at the time of calculation of taxable income.
47Ka(6) and (7)	**Special provision related to disposal in case of merger of business** i. As per Sub Section (6) of Section 47Ka, The entity of same class Entity willing to get merged under Sub Setion (1) should submit expression of interest to Inland Revenue Department within 2078 2079 Ashad end. ii. As per Sub Section (7) of Section 47Ka, The entities submitting expression of interest to get merged under Sub Section (1) should complete the merger process 2079 2080 Ashad end.
75(2)	**Public Circular** The Department shall make public circulars issued under subsection (1) available to the public on website of department or national level newpaper, or telecast or publish through any other electronic medium.
79(1)(Ka)	**Service of documents** As per Sub Section (1) of Section 79, A document to be served on a person under this Act shall be considered as sufficiently served in the following circumstances: - (Ka) sent to the address through fax electronic mail address or related other electronic medium of any person;
88(1)(8)	**Withholding Tax** As per Clause (8) of Sub Section (1) of Section 88, Withholding Tax at 2.5% shall be deducted on Payment made for transport services.

88(9)	**Withholding Tax** As per Clause (9) of Sub Section (1) of Section 88, Resident BFIs taking loan from foreign bank or other financial institution in foreign currency and investing in specified areas prescribed by NRB, then TDS of 10% is to be deducted on such interest payment.
88(11)	**Withholding Tax** TDS is deducted at the rate of 5 % on payment of registration fee, education fee, and exam fee to foreign university or school.
88(12)	**Withholding Tax** TDS is deducted at the rate of 5 % on payment of interest on deposit to Life Insurance Company by resident Bank and Financial Institutions.
88(4)(Kha 1) and (Nga)	As per Sub Section (4) of Section 88, Notwithstanding subsections (1), (2) and (3), this section does not apply to the following payments- **(Kha 1) Payment of interest on loan provided to each other by Co- operative bank and Co-operatives.**
92(1)(Tta)	**Final Withholding Payment** As per Sub Section (1) of Section 92, The following payments shall be treated as final withholding payments: Payment for rent of vehicle or transport vehicle and payment for carriage service of a natural person except of sole proprietorship firm.
95Ka(2)(Ka)	**To recover advance tax** As per Sub Section (2) of Section 95Ka, following advance tax will be recovered on the gain calculated under section 37 in case gain from disposal of interest in resident entity by a person except by a resident entity registered under prevailing law for carrying out transactions of buying and selling of securities: (Ka) In case of gain from disposal of interest of an entity listed in Securities Exchange Board of Nepal, by the entity of which deals in securities exchange Market- 5% of the profit in case of disposal of interest in an entity having ownership of more than 365 days and advance tax will be deducted at the rate of 7.5 percent of the profit in case of disposal of interest in an entity having ownership of less than 365 days ,10% on the gain from resident entity and 25% on the gain from others.
95Ka(4)	**To recover advance tax**
95Ka(6Kha)	**To recover advance tax** As per Sub Section (6Kha) of Section 95Ka, If any person receives payment in foreign currency by providing software or similar electronic service outside Nepal, the bank, financial institution or money transfer entity shall recover advance tax at the rate of 1 % on payment received.

96(2)(Ga)(3)	Duty of person submitting income tax return As per Clause (Ga) of Sub Section (2) of Section 96, have attached the following to the return of income:- (1) …….. (2) any statement provided to the person under subsection (4); (4) any other information that the Department prescribes.
116(5) and (6)	**Appeal to the revenue tribunal** i) As per Sub Section (1) of Section 116, A person (the appellant) who is aggrieved by a decision on an objection under section 115 may appeal to the Revenue Tribunal in accordance with the Revenue Tribunal Act, 2031. ii) As per Sub Section (5) of Section 116, While making appeal to the Revenue Tribunal u/s 116(1), 100 % of undisputed tax and 50 % of disputed tax, charges and interest shall be provided as deposit or bank guarantee of such amount shall be provided. iii) As per Sub Section (6) of Section 116, While calculating amount of deposit or bank guarantee u/s 116(5), the 25% tax amount deposited for administrative review in Inland Revenue Department shall also be considered.
Schedule 1 Section 1(4) (Kha)(3)	**Tax rate and benefit for natural person** As per Sub Section (4) of Section 1 of Schedule 1, Subject to Sub Section (3) the following Natural Person shall be taxed as follows: - (Ka) the greater of the following amounts shall be taxed at the rates specified in Sub Section (1) or (2) as though it were the only taxable income of the Natural Person or couple, as the case requires; and (1) the total of Natural Person or couple's taxable income less the gains; or (2) Rs. 400,000, in the case of Natural Person, or Rs 450,000, in the case of a couple, (Kha) the balance of the taxable income is taxed at the rate of 10 percent. But, (1) Tax shall be levied at 2.5% if the ownership is more than 5 years of the NBCA (land and house and land) disposed off. (2) Tax shall be levied at 5% if the ownership is less than 5 years of the NBCA (land and House and land) disposed off. (3) Tax shall be levied at the rate of five percent on the profit earned from the disposal of interest in entity listed in the Securities Board of Nepal and having ownership of more than 365 days and tax shall be levied at the rate of 7.5 percent on the profit earned from the disposal of interest in entity listed in the Securities Board of Nepal and having ownership of less than 365 days.

Schedule 1 Section 1(9Ka)	**Pension exemption** Notwithstanding this section, if any Natural Person has pension income, the tax amount shall be calculated after deducting 25% amount of exemption limit under subsection 1(Ka) for a single natural person and 2(Ka) for a couple from taxable income. But, the amount to be reduced will not exceed the ceiling prescribed.
Schedule 1 Section 1(16Ka)	**Private House Insurance Premium** If any resident natural person insures the private building, which is in his/her ownership, in resident insurance company, lower of annual insurance premium amount or 5000 rupees shall be deducted on calculation of taxable income.
Schedule 1 Section 1(17)	**Transactions based tax** In computing tax as per section 4 (4ka), tax shall be levied as per section 4(4) on transaction up to 30 lakh rupees. In case of transaction exceeding 30 lakh rupees, tax shall be levied as below: (Ka) for a person conducting transaction of goods including gas, cigarette by adding up to three percent commission or value addition and having transaction exceeding 30 lakh rupees up to 50 lakh 0.25 percent of transaction, and in case of transaction exceeding 50 lakh rupees up to 1 crore rupees, 0.3 percent of the transaction turnover, (Kha) for a person conducting a business other than that mentioned in clause (Ka), Transaction exceeding 30 lakh rupees up to 50 lakh rupees- 1 percent of the transaction, Transaction exceeding 50 lakh rupees up to 1 crore rupees- 0.8 percent of the transaction, (Ga) for a person conducting a service business, 2 percent of the transaction amount.

Income Tax (12th Amendment) Rules, 2078

Rule	New Provision
5 Ka(1)	**Provision related to renewal** As per Sub Rule (1) of Rule 5Ka, Tax exempt entity registered as tax exempt under Rule 3 shall renew tax exemption certificate within 1 year form the end of Income Year.

PROVISIONS APPLICABLE FROM 29.05.2021

Amendments in VAT Act, 2052 (Section 35)

Section	New Provision
10(2)	If any goods or services transacted by a person is declared taxable, such a person shall file an application for registration, in the prescribed format to the Tax Officer, within thirty days from the date of imposition of such tax or the date of commencement of such transaction.
10Ga	**Biometric Registration Procedure:** Person registered as per this Act, should update registration related information and documents in biometric registration procedure as specified by the deparment.
16(3)	**Accounts of transaction to be maintained** A registered person shall use, for the purpose of keeping accounts, the purchase book and sales book certified by the concerned tax officer. A registered or unregistered person with transaction of taxable goods or services shall use for the purpose of keeping accounts, purchase register and sales register for every financial year verified by himself/herself. Tax Officer may inspect such book at any time.
16(3Ka)	**Accounts of transaction to be maintained**
16Kha	**Treatment of credit on loss of assets** Credit will be allowed as prescribed for the tax paid on loss and damage of goods by reason of arson, theft, accident, wear and tear or disruptive activity or expiry of consumption date of the goods.
20(4Kha)	**Assessment by tax officer** Notwithstanding, anything written in sub-sec 4, tax officer shall not conduct reassessment of tax where, the revenue tribunal or other authorized court has already amended or reduced the determined tax. However, such bodies may order for reassessment of tax, and tax officer may assess the tax.
21(1)(Jha)	Collection of tax in case of failure As per Sub Section (1) of Section 21, if the tax due by any taxpayer is not paid within a specified period, the tax officer, with the pre-approval of the Director General, may collect the tax by using any or all of the following methods: (Jha) by publication or transmission or enlisting on the website of department the name of taxpayer who has not submitted tax within the limit prescribed.
29(1)(Chha 1)	Penalty on special cases As per sub section (1) of section 29, a tax officer may impose the following fines if a person commits the following offences: Note:

32Kha(2)	**Public Circular** The department shall make available the circulars issued under Sub Section (1) in the web site of department or publish in national level newpaper or other electronic medium for the information of general public.
33	**Deposits** (1) While making an appeal to the Revenue Tribunal pursuant to this Act, entire of the undisputed amount of tax has to be paid out of the amount of tax assessed, and a deposit equivalent to fifty percent of the disputed amount of tax and fine or a bank guarantee for such amount has to be furnished. (2) While calculating the amount of security deposit and bank guarantee as per sub-section (1) above, 25% amount deposited in Department for administrative review shall also be considered.

VAT (23rd Amendment) Rules, 2078

Rule	New Provision
6Ga(1)	Provision regarding contract or supplyGovernment body or organization wholly or partly owned by Nepal Government at the time of making payment against tender agreement or contract for supply of goods or service or goods and services to respective contractor or supplier, should deposit 50% 30% of tax payable amount, in the name of contractor or supplier at respective revenue code and pay only balance amount of tax to them.
7Kha	**Period to update the record** Registered person shall update their record in the biometric system as per Section 10Ga of the Act within the end of Asar 2078.
23(1)(Chha)	**Maintain records** (Chha) Purchase register as per Schedule 8 (Ja) Sales Register as per Schedule 9
25	**Certification of books of sales and purchases** (1) Record of every tax period related to sale and purchase as per Section 16(3) shall be kept in sale and purchase register self certified by tax payer. (2) Tax payer who has obtained approval to issue invoice from electronic medium or other tax payer specified by department shall at the time of submission of tax return of every tax period as per Rule 26 have to submit detail of purchase and sale transation in the format prescribed by the department through electronic medium.
26(3Kha)	Submission of tax return of tax period If so intended by the brick industries, printing, printing and electronic publications or broadcasting houses, hotel, tourism and cinema hall the Department may fix a tax period of four months for filing the return for such taxpayers.

31	Serving of tax assessment notice (a) As per Sub Rule (1) of Rule 31, Any document to be provided or submitted as follows to any person as per the Act shall be treated as provided or submitted customarily (Ka) If send through address fax, email or similar other electronic medium of any person, (Kha) If submitted to the concerned person personally or to his/her representative or to his/her employees and in case of entity, to its director or representative appointed by him/her or his/her employees, or (Ga) If sent through registry post to the extent known residence, office, business or other address of the person. (b) As per Sub Rule (2) of Rule 31, Document shall be treated as customarily if signed by the authorized officer of department propery disclosing name and position, document encrypted or encoded through computer technology, applying stamp or writing in such documents submitted or provided as per this rule. (c) As per Sub Rule (3) of Rule 31, If documents not submitted as per Sub Rule (1) and (2), then information of notice related to order in the name of such person shall be provided by telecasting or publishing in radio, television or national level daily news paper. Information provided accordingly shall be deemd to be received by recipient.
39Ka	Treatment of tax credit on loss of assets (a) As per Sub Rule (1) of Rule 39Ka, application should be filed within 30 days goods lost or damaged due to incidents like fire, theft, accident, breakage or riotous activity or due to expiry of consumption date for offsetting the tax paid on those goods along with the evidence of writing off the goods from stock or having to be sold at low price due to those reasons. (b) As per Sub Rule (2) of Rule 39Ka, the tax officer may allow credit for the tax paid on the damaged goods on finding lost or damaged or expiry of consumption date upon checking the application filed under Sub Rule (1). But the tax payer may offset the amount to the extent of amount received under compensation on goods insured.
41(1)	Goods or Services In Respect of Which Tax May not be deducted: For the purpose of Section 17 of the Act, tax may not be deducted in respect of the following goods or services: (Ka) Beverages, (Kha) Alcohol or alcohol mixed beverages such as liquor and beers; (Ga) Petrol for vehicle (Gha) Entertainment expenses.
Annexure 8 and 9	Annexure 8 and Annexure 9 of Rule Format of Purchase Register and Sales Register has been changed.

Amendments in Excise Duty Act, 2058 (Section 36)

Section	New Provision
4Gha(2)	**Control of sale and distribution** Entrepreneur other than hotel, restaurant and party palace business doing transaction of alcohol shall only do business of alcohol and tobacco products.
9(6Ka)	Provision related to license As per Sub Section (6Ka) of Section 9, Licensed manufacturer or importer if fails to renew within the time limit mentioned in Sub Section (5) can renew within first 3 month from the date of such expiry by paying 50% of renewal fee and within three months after that shall pay 100 % penalty.
9(6 Kha)	License of licensee not renewing within the stiputaled time period as per Sub Section (5) or (6) shall be auto cancelled.
16(2)(Ga1)	**Punishment** As per Sub Section (2) of Section 16, If licensee producing or importing alcohol, cigarette and tobacco Products conduct undermentioned offence so as to evade, hide or cheat excise duty then by holding amount against such offence, penalty of 200% of such holding amount or Rs. 1 Lakh whichever is higher or 1year imprisonment or both shall be charged: (Ga 1) Produces, issuance, stores, sells and distributes using other's brand name with or without disclosing brand name.
16(3)	**Punishment** The claimed amount pursuant to Clause (Nga) of Sub-section (1) and Sub-section (2) shall be fixed by adding the value of the excisable goods or unbranded 70 UP liquor determined based on the strength, quantity and shape of goods wherein the excise duty sticker has been used or may be used, and the excise duty charged on such excisable goods. If the goods and services whose claimed amount is to be fixed has already been sold, their claimed amount shall be fixed based on the selling price of such goods and services.
16(6)	Punishment Notwithstanding Sub Section (4) (5) vehicle shall be seized if owner of vehicle using it by himself even if vehicle has been registered as to be used on hire.
19(6Ka) and (6Kha)	Provisions relating to administrative review and appeal: (6Ka) 100% of undisputed excise duty amount and 50% of disputed excise duty amount and penalty shall be provided as security or as bank guarantee to make appeal to Revenue Tribunal as per Sub Section (6). (6Kha) While calculating the amount of security deposit or bank guarantee pursuant to (6Ka) above, the amount of 25% of excise duty deposited in the Inland Revenue Department for administrative review shall also be considered.

Please reffer page from 31 to 162 of Finance Ordinance, 2078 for amendment in relevant excise duty rate. Link is presented here under: ***https://ird.gov.np/public/pdf/130060699.pdf***

Excise Duty (22nd Amendment) Rules, 2078

Rule	New Provision
6Kha	**Procedure of providing information of excise duty assessment order** (a) As per Sub Rule (1) of Rule 6Kha, Any document to be provided or submitted as follows to any person as per the Act shall be treated as provided or submitted customarily. (Ka) If send through address fax, email or similar other electronic medium of any person, (Kha) If submitted to the concerned person personally or to his/her representative or to his/her employees and in case of entity, to its director or representative appointed by him/her or his/her employees, or (Ga) If sent through registry post to the extent known residence, office, business or other address of the person. (b) As per Sub Rule (2) of Rule 6Kha, Document shall be treated as customarily if signed by the authorized officer of department propery disclosing name and position, document encrypted or encoded through computer technology, applying stamp or writing in such documents submitted or provided as per this rule. (c) As per Sub Rule (3) of Rule 6Kha, If documents not submitted as per Sub Rule (1) and (2), then information of notice related to order in the name of such person shall be provided by telecasting or publishing in radio, television or national level daily news paper. Information provided accordingly shall be deemd to be received by recipient.
Annexure 2 S. No. 2(Ka) (6)	Annexure 2 (Related to Rule 3 and 5) **License and Renewal Fee** The license fee and renewal fee of the goods and services for which license is to be obtained are as follows: 2 On sale and distribution of liquor Tourist standard restaurant, resort and party palace selling and distributing local or foreign liquors by opening the lid of the bottles Rs. 8500
Annexure 2 S. No. 3(Thha)	Annexure 2 (Related to Rule 3 and 5) **License and Renewal Fee** On imports and purchase, sell and production of other goods. (Thha) Goods other than mentioned in (Ka) to (Yna) however excisable at the time of Import then for the purpose of import Rs. 12000

Amendments in Custom Duty Act, 2064 (Section 38)

Section	New Provision
18(7)	**Declaration form to be filled up and submitted** Matters like nature, brand, model, shape, size, unit, producer and other related information for identification of goods to be imported as per this section shall be declared in declaration form.
34	**Power to make post clearance audit** (1) Director General or Custom Examiner shall have power to examine books of accounts and records related to export and import and likewise: banking statements, computer systems of exporter or importer to ascertain: (Ka) Declaration if done or not as according to Section 18 (7) (Kha) If goods are as declared or not (Ga) Custom value of goods is correct or not (Gha) Classification of goods and subheadings if proper or not (Nga) Applicable fees and charges as per other Acts paid or not while importing or exporting gods (Cha) Goods imported in full or partial subsidy as per this act or other prevailing act imported by prescribed importer and used for the prescribed purpose or not. (Chha) Uniformity of goods in terms of shape, weight, unit between import documents and importer's official documents. (2) While checking as per Sub Section (1), in cases of difference in custom duty because of difference in valuation, classification of goods and missing of fees and charges as per other Acts: lessened custom duty to be recovered and 100 % of such amount to be imposed as fine. (3) While checking as per Sub Section (1), in case of less custom duty levied due to: difference in nature of goods, declaration of lesser quantity, lessened custom duty to be recovered and fine as per Section 57 to be imposed. (4) 5% fine shall be levied if goods are imported without declaring as required by Subsection (1) (ka). However, if goods cannot be classified because of complex nature of goods above mentioned penalty shall not be levied. (5) Penalty as per Section 57 (20) for violation of Subsection (1) (Cha). (6) 5% of applicable custom duty shall be imposed if uniformity cannot be established between import documents and importer's official documents as mentioned in Sub Section (1)(Chha). (7) If exporter or importer is subject to additional duty or fines and penalties, he shall be informed accordingly and 15 days for justification shall be provided. (8) In case information as per Subsection (7) has been obtained, concerned person shall provide justification within 15 days.

34	(9) If justification has been received after such recipient or if no justification has been received after end of 15 days, additional duty and charges shall be assessed and information regarding same shall be provided to concerned exporter or importer and if no additional duty and charges needs to be applied information shall be provided accordingly. (10) When order for paying additional duty and charges has been obtained same should be paid within 35 days and 15 % interest p.a. shall be imposed from the date of such order when additional duty and charges are not paid. (11) If such amount is not paid, it can be recovered from movable or immovable property of concerned exporter or importer. (12) If such amount cannot be recovered as per Sub Section (11), it shall be recovered as government due. (13) As per Sub Section (13) of Section 34, Pursuant to this section, The director general or the customs examiner shall, if necessary, require submission of documents relating to the importer/exporter, businesses owned by the importer/exporter, payment of goods, bank accounts, profit and loss statement, tax details, invoices or other such required documents from concerned bank or Financial institution, and any other organization or individual related to importers/exporter' business. When asked upon, the organization or individual should compulsory furnish the documents as required. (14) Director General or Custom Examiner while examining as per Subsection (1) can summon and interrogate the concerned person and ask for justifications and obtain evidences in written form. (15) Notice can be issued personally or publicly for purpose of Sub Section (14). (16) If not presence within the time mentioned in Sub Section (15) or not submitted evidence in written or documents by concerned importer or exporter, charges shall be levied as per Section 57 (15 ka) and inspection and examination from the available documents shall be done by stopping its import and export related transaction. (17) Re-examination can be done if additional information is obtained after carrying out examination as per Subsection (16). (18) Examination as per this section can be done till 4 years after clearance of goods. If it is proved that exporter or importer has submitted false writing or paper and has deposited the duty amount less than the actual, Customs Inspector with the approval of Director General may audit beyond 4 years. (19) Communication of notice or time limit or notice of justification or custom duty or oder of penalty required by this section shall be done through email of such concerned importer and exporter. Notice, information or order send through such email shall be deemed to be received by the concerned person.

62(1)	Appeal A person who is not satisfied with the customs duty determined by the Customs Officer or other employee under this Act or with any order or punishment or decision issued or made by customs officer, except any decision or order referred to in Section 13, or with direction given by director general or custom examiner for paying custom and related charges, as per section 34 or with any decision made by the valuation review committee formed pursuant to Section 61 may make an appeal to the Revenue Tribunal within thirty five days after the date of the determination of such customs duty or the imposition of punishment or the making of decision.
89Kha	**To obtain export import identification number** i) No business of export and import shall be done without taking import export reference number. ii) But person prescribed can do business of export and import without taking import export reference number. iii) As per Sub Section (2) of Section 89Kha, The export of import identification number taken as per Section 89Kha (1) shall be renewed as prescribed. iv) As per Sub Section (3) of Section 89Kha, The renewal fee as prescribed shall have to be paid during renewal as per Section 89Kha (2). v) As per Sub Section (4) of Section 89Kha, Without renewal, the export or import transaction cannot be performed using such import or export identification number. vi) As per Sub Section (5) of Section 89Kha, If it is not renewed within the prescribed time, the identification number shall be automatically cancelled. vii) As per Sub Section (6) of Section 89Kha, Administration of export or import identification number under this section shall be done by prescribed entity published in Nepal Gazette by Nepal Government and unitl the publication of such notice custom department shall perform administrative work related to such identification number. viii) As per Sub Section (7) of Section 89Kha, Other provisions related to import export reference number shall be as prescribed.
89Nga	**Work to be done through national single window policy** (1) In order to manage international business Nepal Government may develop national single window policy and appoint any entity for its implementation. (2) Unless any entity appointed as per Sub Section (1), Department will implement national single window policy. (3) Entity related to import or export will be associated in national single window policy developed by Nepal government. (4) Notwithstanding any thing contained in this act and other prevailing laws enity related to import or export associated with single window policy should perform as per the procedure of sub section (1). (5) Other provision related to single window policy shall be as prescribed.

93	Power to make directives or procedure The Department may, subject to this Act or the Rules framed under this Act, make directives or procedures on following subjects and apply thereof: (Ka) Relating to valuation of goods, (Kha) Relating to clearance of goods as per selectivity system, (Ga) Relating to Post Clearance Audit, (Gha) Relating to clearance of relief materials, (Nga) Relating to electronic declaration, clearance of goods and revenue payment, (Cha) Relating to providing Export Import Code (Chha) Relating to other subject on execution of work of customs. (Chha 1) Procedure of national single window policy

Please reffer page from 178 to 347 of Finance Ordinance, 2078 for amendment in relevant Custom Duty rate. Link is presented here under: ***https://ird.gov.np/public/pdf/130060699.pdf***

Custom Duty (12th Amendment) Rules, 2078

Rule	New Provision
27(2)	Other provisions for post clearance audit (a) As per Sub Rule (1) of Rule 27, For the purpose of sub section (2) of section 34 of the Act, in order to determine whether the transaction value of the goods as declared by the importer or exporter is realistic or not, the value may be determined through the application of the all or any methods as stipulated in section 13 of the Act. (b) For the purpose of Section 34(3) of the Act, in order to determine the quantity of the goods imported or exported physical verification of stock may be conducted. (c) As per Sub Rule (3) of Rule 27, In order to determine the reality of the value as declared in the customs office at the time of import, the ledger of transaction may be checked from the sales of the product up to the retail level. (d) As per Sub Rule (4) of Rule 27, In order to do post clearance audit, the Customs Inspector or the Director General should notify the concerned importer or exporter about the date and time of audit in advance, to the extent practicable.
66Ga1	**Export or Import reference number may be provided** Department or Custom Office prescribed by the department may provide export or import reference number to exporter or importer.

66Ga2	**Export or Import reference number not required** Export or Import reference number is not required if brought in or take away of personal goods according to the notice of goods to be brought in or take away by the visitors, import of goods up to Rs. 10,000 at a time or export of goods up to Rs. 1,000,000 But, person who has already obtained export or import reference number shall mention export or import reference number compulsorily at the time of export or import of goods of any value.
66Gha(1)	Renewal of import or export identification number As per the Section 89Kha of the Customs Act, the exporter or importer prior to the financial year has to renew the identification number of export or import by providing the application to the department or the custom office as prescribed by the department. But, any industry willing to renew export or import reference number for five financial year at once, then they can do so by paying the applicable lump sum charge.
66Gha1	Export or Import special reference number can be provided (1) Department or custom office prescribed by the department may provide special reference number for the purpose of import or export of following goods to the following entity : (Ka) Import or export for non business purpose by Government Entity, Public Organisation, Government Project, Diplomatic Mission or Non Government Organisation (Kha) Import of necessary raw material, machine equipment and its spare parts for manufacture by Micro Entity, Cottage and Small Industries registered as per Industrial Enterprises Act, 2076. (Ga) One time import Industries other than mentioned in (Kha) above of necessary machine, equipment or its spare parts for establishment of such industries. (Gha) Other export or import prescribed by the Department (2) Notwithstanding any thing contained in Sub Section (1), Department or custom office prescribed by the department may provide special reference number to the person import or exporting for the purpose of donation, gift or relief on occasional basis. (3) No bank guarantee is required while providing import or export special reference number as per Sub Section (1) and (2) (4) Import or export special reference number provided as per Sub Section (1) (Ga) shall be auto cancelled after import of such goods.

66Cha	Provision related to National One Window Policy Entity associated with one window policy shall provide through such policy the license related to import or export, approval letter, certificate, recommendation or information as per prevailing laws.

Special provision for waiver of accumulated fees, additional fines and remaining interest if withdrawal of ongoing administrative appeals or of cases ongoing in the Revenue Tribunal or Court and making payment of assessed amount of tax (Section 20)

New Provision
Fees, additional charges, penalties and remaining interest on taxes shall be waived in case taxpayer withdraws the appeals made to various levels (Administrative Review, Revenue Tribunal or in the Courts) on account of dispute for tax assessment order issued till 15 July 2020 (Ashad end 2077) under the Income Tax Act, 2058, Value Added Tax Act, 2052 and Excise Act 2058 and pays the assessed principal taxes including 50% of the applicable interest (interest calculated up to application date of availing this waiver facility) by 15 December 2021 (Mangsir end 2078). However, this waiver facility is not applicable to cases pertaining to falsified and fake invoices.

Special provision for waiver of outstanding payables (Section 21)

Section 21	New Provision
(1)	If 75 % of overdue amount that could not be recovered till date relating to assessments carried out as per the Excise Duty Act 2015, Income Tax Act 2031, Acts repealed by Value Added Tax Act 2052 (Hotel Tax, Entertainment Tax, Contract Tax, Sales Tax Act) is paid within 2078 Poush End then accumulated fines, fees, interest and remaining excise duty or tax shall be waived.
(2)	If applicable tax or duty along with 50% of interest applicable up to the date submitting of applications is paid within 2078 Poush end for assessments or amended assessments carried out in respect of tax or excise duty as per VAT Act 2052, Excise Duty Act 2058 and Income Tax Act 2058 within 2076 Ashad end then, applicable fees, fines and penalty shall be waived. This provision is not applicable for cases relating to assessments carried out in respect of false and duplicate invoices.
(3)	Non-profit motive community hospital or health organization and transport service provider providing transport service through electronic network shall be provided waiver of overdue of tax assessment or reassessment as per VAT Act 2052 and Income Tax Act 2058 by IRO conducted before 15 Jestha, 2078 and if they are not under the legal proceeding for this matter, if applied within Poush End 2078 for waiver of such an overdue.

Special provision for waiver of tax, interest, additional fees and fines by issuing the certificate of origin (Section 22)

New Provision
Unpaid applicable VAT and interest, additional fees and fines on VAT for certificate of origin issued up to 28 May 2021 (14 Jestha 2078) for goods to be exported shall be exempted in the case of entities issuing certificate of origin.

Special provision for waiver of additional fees, interest, fines for trekking and tour package (Section 23)

Section 23	New Provision
(1)	Persons engaged in travel and trekking agency related transaction and treating taxable transactions as tax exempt and not collecting and depositing VAT thereon shall be waived of additional charges, interest and penalties if such person makes self-declaration of taxable transaction up to 28 May 2021 (14 Jestha 2078) and deposit VAT on such transactions within 14 January 2022 (Poush end 2078).
(2)	In case person deposits outstanding dues (principal VAT dues) on the tax-exempt transaction as per Sub Section (1) within 14 January 2022 (Poush end 2078) based on assessment order made by IRO then additional charges, interest and penalties charged on it shall be waived.
(3)	In case such person withdraws cases filed for administrative review or at revenue tribunal on tax assessment as per sub section (2) and pays assessed tax within 14 January 2022 (Poush end 2078) then additional charges, interest and penalties charged on it shall be waived.

Special provision for waiver of additional fees and interest for Health Service Provider Organization (Section 24)

Section 24	New Provision
	Where the Health Service Provider Organizations have balance input VAT after adjusting with output VAT, and deposits the balance payable after debit adjustment of such Input VAT on account of the health service as a result of declaration of non-applicability of VAT on items that were previously taxable within 16th July 2022 (Ashad end, 2079). then any additional fee and interest on such payables shall be waived.

Special Provision for deduction of rental expenses related to transportation vehicle (Section 25)

Section 25	New Provision
	Transportation of Goods Service Providers for the operation of its business, if paid the rental expenses for transportation vehicle to the natural persons not registered in PAN in the FY 2076/77, withholds and pays the TDS as per proviso (8) of Section 88(1) of Income Tax Act, 2058 then such expenses shall be deductible while computing taxable income of FY 2076-77, even when no invoice of such transaction as per Section 21(1)(Gha2) is available.

Special provision for renewal of excise duty license (Section 26)

Section 26	New Provision
(1)	If licensee under Excise Act, 2058 who had failed to renew license within prescribed date and wishes to renew and continue transactions pays renewal fees within 16 August 2021 (Shrawan end 2078) for each year of default shall be waived from penal charges.
(2)	If the renewal of the excise license is not done within the time frame mentioned in Sub Section (1) then the registration will be automatically cancelled.

Special provision for tax exemption on transactions affected by COVID-19 (Section 28)

Section 28	New Provision
(1)	Taxpayers having annual turnover upto 20 lakh per annum and having income upto NPR 2 lakh and paying tax as per Section 4 (4) of Income Tax Act are provided 90 % exemption in applicable tax of 2077-78.
(2)	Taxpayers having transactions from 20 lakh to 50 lakh and paying tax as per Section 4(4Ka) of Income Tax Act are provided with 75 % exemption in tax of 2077-78.
(3)	Person having business transactions up to 1 crore shall be provided 50 % exemption on tax applicable of 2077-78 as per Income Tax Act.
(4)	Hotel, Travel, Trekking, Film Business (Production, distribution and screening), party palace, media house, transportation and aviation business having transaction above NPR. 1 crore shall be subject to 1 % tax in fiscal year 2077/78 on taxable income as per Income Tax Act, 2058.
(5)	If there is loss for business mentioned in (4) for the Year 2076-77 and 2077-78 above, the claimable period of loss as per Section 20(1) shall be extended by 3 years.

Special provision regarding contribution made to fund for prevention, control and treatment of corona infection (Section 29)

Section 29	New Provision
	Donation to Corona Infection Relief, Control and Treatment Fund in FY 2077/78 established by Central, Province or Local Government of Nepal will be allowed for deduction for the computation of total taxable income to any person.

Special provision for deduction of expenditure allocated for corporate social responsibility in equipment and materials necessary for construction of COVID-19 specialized hospital (Section 31)

Section 31	New Provision
	Out of the amount set aside for Corporate Social Responsibility (CSR) in the FY 2020-21 (2077-78), the expenses incurred for the construction of specialized hospitals and for providing health equipment and materials related to the treatment of COVID 19 to the designated medical institutions as prescribed by Ministry of Health and Population, GoN are deductible for the computation of taxable income.

Special provision for amount deposited in approved retirement fund transferred to social security fund (Section 32)

Section 32	New Provision
	If amount deposited in approved retirement fund is transferred to Social Security Fund established under Contribution Based Social Security Fund Act,2074 by involved or to be involved contributor witin 13 April 2022 (Chaitra end 2078), withholding tax applicable as per section 88 of Income Tax Act on retirement payment shall be waived.

Special provision for waiver of renewal fees for Private Firm and Company (Section 33)

Section 33	New Provision
	Private firms and companies that are registered under Private Firm Registration Act, 2014 and Companies Act, 2063 and have not submitted its annual returns up to FY 2018-19 (2075-76) and failing to renew its business, if submit such returns and deposit 10% of applicable fees and penalties by 17 October 2021 (2078 Ashoj end) then remaining fees and penalty shall be waived.

INCOME TAX

CHAPTER 1

INTRODUCTION AND DEFINITIONS

Meaning of Tax

Economist Plehn has defined tax as "Taxes are, in general, compulsory contribution of wealth levied upon persons, natural or corporate, to defray the expenses incurred in conferring a common benefit upon the residents of the state."

Tax can be levied only by Government. The government may be central, provincial or local. According to the Constitution of Nepal, no taxes shall be levied without framing and enforcing an Act. In Nepal, the Government has implemented a number of Acts to implement various taxes.

The taxes are levied on natural or corporate persons.

Professor Seligman has defined tax as "A compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred."

Most of the tax Acts have defined tax as "tax levied as per the Act and it also includes fines, penalty, interest, etc. charged for infringement of provisions of the Act and Rules and Directives framed under the Act".

Description of Fees, Fines and Penalties to be treated as Tax under Tax Law

A bank or a finance company charges penal interest for delay in payment of interest or installment. It is neither charged under any prevailing Act nor received by government and so such penal interest could not be treated as tax. In the same way the penalty payable to any person for breach of conditions of a contract is also not treated as tax. It should be clearly understood that tax is levied by government, but not by any private party.

Civil Aviation Authority is fully owned Nepal Government (GON) company. It charges passenger fee from each passenger embarking from Nepal. The fee is being charged as per byelaws of the Company, but not as per any Act of Nepal Government. That is why; the fee is revenue of the company.

From the clarification in the Box above, the term tax shall be clearly understood as:

- The revenue being collected as per the provisions of any prevailing Acts.
- The revenue that goes to the fund of any government.

Clear distinction shall be made for **tax revenue** and **non-tax revenue.**

Revenues other than tax revenues are called non-tax revenues. Those revenues which are collected for supply of services by any government department or offices shall be treated as non-tax revenues.

Registrar of Companies are charging registration fee from companies. In the same way, it charges penalties on the companies which make infringement of the Companies Act. These fees and penalties are treated as non-tax revenues.

Government may charge royalty for any long-term assets provided to any person for use. Such royalties are also called non-tax revenues.

Casino royalty is being charged by GON as royalty for operating a casino but does not provide any government asset to use. So the casino royalty is classified as tax revenue.

List of Tax Revenues

Custom duty, Custom service Charge, Agriculture development duty, Excise duty, VAT, Service tax, Vehicle duties; Registration fees, service fees, and rokka charges, Movies development duty, Local development charges, Pollution control charges, Telephone ownership fees, Tourism service fees, Casual income tax, Casino royalty, Telecommunication service fees, Roads construction, maintenance and development charge, Forest product fees and Income tax

Objectives of Taxation

The fundamental object of charging tax is to raise fund for government to meet its administrative and developmental expenses. But the tax framework is designed to collect tax from "haves" to provide direct or indirect benefits to "have-nots". The government has adopted the taxation system to achieve social as well as economic harmonization in the country.

The other objectives of the charging tax are as follows:

- **Raising revenue:** For the purpose of meeting out the administrative and developmental expenses of the Government.
- **Prevention of concentration of wealth in a few hands:** As the concentration of wealth in few hands may create economic, political and social disparities.
- **Redistribution of wealth for the common good:** As the persons earning more in comparison to the persons earning less have to contribute more amounts to the public fund so that the government could provide facilities to the downtrodden persons by providing employments and other jobs for earning.
- **Maintenance of welfare state:** As government has to expend lot of money for education, health and creation of employment for common persons, it is the duty of the government to insure economic stability in the country.
- **To encourage the national needs based industries:** Charges high rates of taxes on the imported goods in comparison to the goods produced in the country and by providing tax incentives to the businesses earning from foreign currencies.
- **Increasing savings and investment:** Provides tax exemptions on savings and also on income from private investments. This objective is based on the thinking that 'rather to pay tax invest the money'.

Types of Taxes in Nepal

Taxes are classified into two:

- Direct taxes and
- Indirect taxes.

Dr. Dalton defines direct tax as, **"*a direct tax*** is really paid by the person on whom it is legally imposed". In case of direct tax, the ultimate burden of the tax to bear the expenses is of the legal payee. Legal payee means the person who is liable to pay the tax but not the person who actually pays the amount on behalf of others: like manager, agent, representative etc. Income tax, property tax, registration of property tax, casual income tax, etc. are some of the examples of direct taxes. Neither the legal payee can claim the tax from any other person nor can it make the tax a component of cost of goods.

Dr. Dalton says that **"*an indirect tax*** is imposed on one person but paid partly or wholly by another". The payee of the tax shifts the burden on another person. One example of indirect tax is Value Added Tax (VAT). VAT is being paid by business persons but the ultimate burden of the tax goes to the consumers. The business persons can make the tax as component of cost of the goods or services or can charge it as an additional charge on the price of the goods or services. Custom duty, local development charges, special duty, excise duty, etc. are other examples of indirect taxes.

Concept of Income and Meaning of Income Tax

Income, as defined in the Framework for the preparation and presentation of financial statements, is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

Income Tax Act, 2058 as well recognizes that income encompasses both revenue and gains. Revenue is treated as gross receipt from the disposal of goods. Gain is treated as gross receipt of the property less the total outflows to acquire it.

Income tax is charged on the taxable income. Taxable income is derived by deducting the allowed expenditures from the revenues and the gains. So the formula may be framed like this:

Revenue + gains – allowable expenses = Income

Income Taxes are collected in Period basis, and thus, income derived for a certain period is considered for taxation purpose. Nepalese Income Tax Act has encompassed the period of 12 months beginning from 1_{st} of Shrawan every year and ending on End of Ashadh of next year as Income Year, for which the tax is calculated, and paid.

Income Tax Act, 2058 has classified the Income into four different headings:

- Income from Business
- Income from Employment
- Income from Investment
- Windfall Gains

Income from business is derived by deducting allowed expenses of the business from the revenues

of the business. In the same way the income from employment and investment are derived.

Income as shown by financial statements may differ from the taxable income.

Income tax is payable on the income. Thus, income tax is defined as tax chargeable on income of a person as per the relevant income tax Act.

History of Income Tax in Nepal

The practice of charging tax on Income in Nepal has begun long ago. We will describe the history of taxation in Nepal by dividing the period into four different era with regard to the progress of income tax Act in Nepal: ***before 2019 B.S., after 2019 B.S. to 2031 B.S, after 2031 B.S. to 2058 B.S., and after 2058 B.S.***

- **Period before 2019 B.S.:**

  During this period, the formal income tax Act was not in existence to charge income tax on income from any source. There had been certain development in charging Income Tax to frame an Income Tax Act, 2019 in this period. The progress has been explained as follows:

- **Finance Act, 2016:**

  Provision was made to charge income tax on income from employment and business, dividing the total taxable incomes in 10 slabs and income tax was charged on each slab at the rates ranging 5% to 25%.

  - Some relaxations of income tax were given to small scale, middle and big industries.
  - Business Income and Employment Act, 2017:
  - This Act was enforced from Jestha 02, 2017. The following were the basic features of this Act:
  - Some basic terms with regard to income, business, employment, etc were defined;
  - Procedures of tax assessment and collections were provided;
  - Some tax exempted persons are defined;
  - Provision for withholding tax was introduced;
  - Filing of tax returns was made compulsory for some of the taxpayers;
  - Provisions of charging penalties and procedures of appeal against an assessment were provided; and
  - Rates for charging income tax were left on the Finance Act of the relevant year.

- **Period after 2019 and up to 2031:**

  Nepal Income Tax Act, 2019 was enforced from Shrawan 09, 2019. This was the first income

tax Act enforced to charge income tax on incomes from various sources. The following were the main features of the Act:

- Sources of income were classified into: business, employment, profession, house and land rent, investment, agriculture, insurance business, agency, and other sources.
- Some more terms like- person, couple, family, partnership firms, non-resident persons, etc were defined.
- Provision was made for appointment of assessment committees in each area.
- Methods of calculation of taxable income under different heads were set.
- Provision was made to enter into an agreement with a foreign country with regard to income tax.
- Provision was made to make a revised return.
- Provisions with regard to set off and carry forward of losses were incorporated, and
- Provided to establish an Income Tax Department.

- **Finance Act, 2020:**
  - A provision to charge income tax on a resident taxpayer on an income earned and accrued in Nepal and also on an income accrued in outside Nepal but received in Nepal, was introduced.
  - An exemption limit of Rs. 6,000 was prescribed for all the taxpayers.
  - Provision was made to charge income tax on income earned by a person exceeding the exemption limit, dividing the total taxable incomes in 12 slabs and income tax was charged on each slab at the rates ranging 4% to 30%.
- **Finance Act, 2021:**
  - A flat rate of income tax @ 8% was charged on an amount received by a foreign film distributor from Nepal.
- **Finance Act, 2022:**
  - The initial exemption limit was withdrawn for corporate taxpayers.
  - A tax exemption was allowed on interest from government bonds.
  - Different rates of income tax were imposed on house and land rent.
- **Finance Act, 2024:**
  - The initial tax exemption limits were fixed at Rs. 3,000 for an individual, Rs. 4,500 for a couple and Rs. 6,000 for a family.
  - Provision was made to charge income tax on income earned by a person exceeding

the exemption limit, dividing the total taxable incomes in 11 slabs and income tax was charged on each slab at the rates ranging 5% to 55%.

- A flat rate of income tax at 45% was fixed for corporate taxpayers.

- **Finance Act, 2025:**

  - The initial exemption limit was withdrawn for non-resident taxpayers.

  - The slabs of taxable incomes were reduced to 5 and the rates of tax were charged ranging 15% to 55%.

- **Finance Act, 2026:**

  - A provision was made regarding clubbing of incomes from a partnership firm, land and house rent and from foreign investment with other income of the individual for calculation of tax.

- **Finance Act, 2027:**

  - Industries are compelled to file a tax return.

  - Tax exemption available to an industry was limited to income from industrial activities only.

- **Finance Act, 2029:**

  - Foreign investors in Nepal were required to make certain deposits at the tax office for registration.

  - Partnership firms were treated as separate persons for tax purpose.

- **Finance Act, 2030:**

  - Additional tax exemption was allowed on allowances received by a member of Rastriya Panchayat and also on an agricultural income of a person having not more than 10 bighas of land.

- **Period after 2031 and up to 2058:**

  - During the year 2031, Income Tax Act, 2019 was completely replaced by Income Tax Act, 2031 with effect from Kartik 05, 2031. The new Act was divided in to 66 Sections. The various amendments in the Act along with the notable changes are given hereunder:

- **Income Tax (1st amendment) Act, 2034; effective from 2034.05.22.**

  - The provision that the expenses incurred with regard to tax-exempted income is not available for deduction was incorporated.

  - Conditions were provided for extension of time for filing tax returns.

- **Income Tax (2nd amendment) Act, 2036; effective from 2036.08.05.**

- Method of tax assessment of small taxpayers was determined.

- **Income Tax (3rd amendment) Act, 2037; effective from 2037.06.02.**
  - A post of Director General was created.
  - The allowable repair expenses were limited to 10% of the rent amount.
- **Income Tax (4th amendment) Act, 2041, effective from 2041.07.27.**
  - The provisions regarding registration with income tax office were amended.
  - Income received was defined as either it actually received or an entry passed in the book of accounts.
  - Limitation was imposed on advertisement and guest entertainment expenses up to 2% and 1% respectively of gross income.
  - The method of calculation of taxable profit of a petroleum industry and a cooperative society was determined.
  - GON was authorized to waive tax amount payable by any taxpayer.
- **Income Tax (5th amendment) Act, 2042, effective from 2042.06.23.**
  - Provision was made for awarding an individual providing any information of tax evasion to government.
- **Income Tax (6th amendment) Act, 2043; effective from 2043.06.22.**
  - Provision was introduced to enter into written agreement for rent in case the monthly rent amount exceeds Rs. 25,000.
  - Responsibility of management of a private limited to pay tax was imposed.
- **Income Tax (7th amendment) Act, 2046; effective from 2046.06.11.**
  - Definition of net income was added.
  - Restriction was imposed on deductible interest expenses for an amount of more than Rs. 20,000 in a year to a person in case the interest is payable to other than a corporate body without registration of the loan deed.
  - The pre-production or pre-operation expenses are allowed to be deducted in five equal annual installments.
- **Income Tax (8th amendment) Act, 2049; effective from 2050.03.10.**
  - Definitions of agricultural income and gross income were added.
  - Income earned in foreign country regarding activities conducted in Nepal is made taxable in Nepal.
  - Certain allowances were excluded from taxable income from employment.

- The concept of deemed rent for particular area was introduced.
- Salary to an individual more than Rs. 25,000 per month can be allowed for deduction only in case permission is taken from GON.
- The provisions regarding self-tax assessment were introduced.
- Banks and finance companies were allowed to deduct loan loss provision as expenses up to 3% of the total loan outstanding.
- Provisions regarding tax audit and registration of tax auditor were introduced.
- Provided to make payment more than Rs. 20,000 at a time through bank only.

• **Some Basic Features of Income Tax Act, 2031:**

- Detailed definitions were given for the various terms used in the Act like: income, gross profit, net profit, taxpayer, individual, couple, family, partnership firm, company, tax, income year, tax assessment, Director General of tax, tax officers, principal officer of a company, income from agriculture, income from business; industry; profession and vocation, income from employment, income from house and land rent, preoperative expenses, loss, work of a public interest, non-resident person, etc.
- Incomes were classified into five heads: income from agriculture, income from business, industry, profession and vocation, income from employment, income from house and land rent, and income from other sources.
- Provision was made in such a way that a resident person had to pay tax on income earned in Nepal and also on income accrued and received outside Nepal by entering into a transaction within Nepal. Here 'received' means actual receipt or showing an income by passing an entry in the books. In the same tune, a non-resident person had to pay tax on income earned and received in Nepal and also on an income, which is earned in Nepal by residing outside Nepal, and received outside Nepal.
- Expenses incurred for tax-exempted incomes were not allowed to deduct from taxable incomes.
- Provisions regarding self-assessment, filing of a tax return, appointment of a committee for tax assessment for small tax payers, procedures of tax assessments, filing of revised tax returns, calculation of taxable income and methods of charging tax on different taxpayers like: firm, private limited companies, minor, disabled individuals, individuals, couple, family, non-resident persons, deceased individual, entities engaged in petroleum products, individual and entities engaged in agricultural products, etc were incorporated in the Act.
- Provisions regarding tax assessment by the authorities under certain circumstances were also made a fundamental part of the Act. Set off and carry forward of losses, right of a tax officer to order for filling a tax return, assessment of tax, bases of assessment by authorities, certification of tax return, jeopardy assessment, appeal against the an assessment order, provisions regarding withholding taxes, etc were also the fundamental features of the Act.

- Provisions regarding tax exempted incomes, disallowed expenses, restrictions and limitations on certain expenses, deferred revenue expenditures, period for keeping the books of accounts safely, right of tax officer to order for audit of the accounts, responsibility of an auditor for information provided to tax office after conducting audit, right of a tax officer to search and seizer of movable and immovable property, documents, books of accounts and any other papers or goods related to the business, etc of a taxpayer, etc were incorporated in the Act.

Defects of Previous Tax Acts in Nepal:

Some of the basis defects of the previous income tax Acts were as described under:

- **Limited tax nets:**

  The previous Acts had limited scope with regard to coverage of international income of a resident person, capital gain tax etc. So many exemptions from taxations are not provided by the Act but by the Finance Acts. So many other Acts have interrupted the provisions of income tax Act by providing different exemptions and concessions.

- **Effect of different Acts on Income Tax Act:**

  So many Acts had provisions regarding exemptions or concessions in the rate of income tax and the provisions were superseding the provisions of prevailing Income Tax Acts. Nepal Rastra Bank Act, 2053, Provident Fund Act, 2019, Nepal Petroleum Act, 2040, Industrial Enterprise Act, 2076, Electricity Act, Pokhara University Act, 2053, are some of the Acts having provisions regarding income tax. To know a tax liability, a person, for example, had to know which Act may prevail the existing income tax provision.

- **Unclear and insufficient:**

  Clear definitions of the terms used, detailed description of the provisions, lack of economic terms, etc were also the defects of the previous income tax Acts. The definition of a resident person was not given clearly. Terms like characterization, transfer pricing, etc were not included in the Acts.

- **Unscientific presentation:**

  The Acts were divided amongst different Sections without subject-wise chapters.

- **Unlimited powers of tax officers:**

  Tax officers were provided with unlimited powers for assessment and imposing penalties. Accounts were treated as secondary evidence for tax assessment. Best judgment assessments, which were based on estimations and assumptions, were common methods of assessment.

- **Unequal treatments:**

  The tax rates were being determined on the basis of nature of the person, organization, income, etc but the principle that higher gainer should pay tax by high rates was seldom implemented. Perquisites and fringe benefits were not covered by the taxation.

- **Double appeal system:**

  A taxpayer had option to apply to Director General or to Revenue Tribunal against any assessment made by a tax officer.

Relations with Constitution, Tax Acts, Tax Rules and Finance Acts as Regard to Income Taxation:

- **Constitution of Nepal:**

  The Constitution of any country is a supreme law. All the Acts, decisions of the courts, and other directives from government should be within the purview of the Constitution. According to the Constitution of Nepal, 'no tax shall be levied and collected except when permitted by law.' Without framing and enforcing a law no tax can be levied on any person. An Act can be enforced only after getting done the approval of the both the Houses of Parliament of Nepal and also the Red Seal of the President. Constitution of Nepal has given some guiding principles like equality, justice to all, proper representation, etc. While framing a law these principles shall be applied, otherwise, the provision of the law which is against the principles shall be treated as null and void. Income Tax Act of Nepal is formulated according to the provisions and theme of the Constitution of Nepal.

- **Income Tax Act:**

  With effect from 19.12.2058 the Income Tax Act, 2058 is the prevailing Act for charging income tax. This Act has a clear provision that for income tax no other Acts can supersede it. The coverage of the Act is wide enough to cover the calculation of taxable income, rates of income tax, rights of a taxpayer, powers of a tax officer, etc. This Act is formulated and passed by Parliament and approved by red seal of the King.

- **Finance Act or Order:**

  Finance Acts or Finance Order are the Acts which are effective for the period for which these are issued. Finance Act is generally issued for one income year. As the life of a Finance Order is of only six months it can be replaced only with a new Finance Order. Income Tax Act, 2058 has a provision that Finance Act or Finance Order can replace any provision of the Income Tax Act for the period. Finance Act or Finance Order can amend any of the provisions of the Income Tax Act but the amended provision is applicable for the period for which the Finance Act or Order is effective.

- **Income Tax Rules:**

  Income Tax Rules are framed by the cabinet. These rules are framed to clarify the provisions of the Act. Rules are framed only when the Act specifies that the provision shall be applicable as per the Rules. Rules are framed as per the demand of the Act. Rules cannot contravene the provisions of the Act. The contravening Rules shall be treated as null and void.

- **Income Tax Directive:**

  Pursuant to the power conferred in Sec. 139 of Income Tax Act, 2058; Inland Revenue Department has issued Income Tax Directive in 2077. The Directive has been placed after

the Income Tax Act, and the Income Tax Regulation for Income Tax purpose. The directive is above the public circular. Any circular that contradicts with the directive will automatically become void. The interpretation and examples in the directive are equivalent to circulars issued u/s 74.

- **Supreme Court Decisions**

  Supreme Court of Nepal is the ultimate body to interpret the constitution and law of Nepal. The decisions of Supreme Court are binding while interpreting the tax provisions. *Vide its decision on 2064/4/23 B.S. in Mahendra Raj Pandey Vs. Nepal Rastra Bank (Supreme Court- collection of Precedents 2066, Part 10- Industry, Commerce & Tax- pg. 135), Supreme Court has decided that in case there is no tax related laws or in case of existence in law- if there is dispute in Interpretation of Tax provisions; such provisions shall be interpreted in favour of tax payers.* Students are advised to follow the same principle if there is dispute in interpreting provisions of Income Tax Act.

Income Tax Act, 2058

Need of New Act to replace Income Tax Act, 2031

The age old Act, having eight amendments and several transitional provisions through Financial Acts, has created a thrust for a new and quite revised Act for income tax. Globalization of the trade, establishment of new kinds of foreign entities in Nepal, emerging complications in business relationships, establishment of joint venture enterprises in which more than one foreign country is associated, etc. are the new features, which are felt to be incorporated in Income Tax Act.

Project to draft New Act

Lecturer Dr. Peter A. Harris, technical advisor to IMF, prepared the draft of this Act. The entire project was funded/financed by International Monetary Fund. Harvard Institute for International Development, which is a branch of Harvard University, had fully cooperated with Nepal in reforming tax laws. The VAT Act, 2052 is based on the draft given by the Institute. The Institute's contribution to reforming income tax also is notable.

GON had worked hard and taken the help of FNCCI to give the final shape to the Act. It had conducted several round of talks with advocates, chartered accountants, foreign tax consultants, business houses, and all other concerned personalities.

Difficulty was faced mainly due to translation of the draft in Nepali language. Each and every word was translated in Nepali language; however, the words are very difficult to understand even by the tax consultants and chartered accountants. It had created misunderstandings in the businessmen.

Inland Revenue Department came up with several publications of booklets and established a special office named by 'Customers Service Center' for easy understanding of the Act.

- **Features of Income Tax Act, 2058**

The designing of the chapters of the Act reflects the features of Income Tax Act, 2058.

Chapter No.	Sections	Headings	Contents
1	2	Definitions	Some of the important terms defined are: retirement fund, company, entity, withholding tax, transaction, non-business chargeable asset, business asset, tax-exempted organizations and incomes, trust, long-term contracts, disposal, underlying ownership, market price, unit trust, foreign permanent establishment, foreign controlled entity, Associated person, adjusted taxable profit, transfer pricing, characterization, etc.
2	3-6	Basis of taxation	Income are classified in four headings: • Income from business, • Income from employment, • Income from investment, and • Windfall Gain Taxpayers are classified as follows: i. Those having taxable income as per the Act; ii. Those foreign permanent establishments repatriating income to its parent organization; iii. Those having final withholding incomes; and iv. Those having two or more than two source of income as described above. The method of calculation of taxable income and assessable income are given.
3	7-9	Components of incomes	Components of each head of income, i.e. income from business, income from employment and income from investment; are discussed in detail. Incomes escaped from the sections are not taxable under this Act.
4	10-12	Tax concession and donations	Clear provisions are given about the tax exemption on certain incomes. Certain tax concessions are also allowed on certain specified incomes. Conditions and limitation on allowing donation for tax purpose are specified.

5	13-21	Deductions, set off and carry forward of losses and disallowed expenses.	Detailed provisions are given for general and specific expenses incurred to run a business or/and an investment. Certain conditions and limitations are specified for few of the expenses. Provisions for set off of losses; inter-source adjustments and inter-head adjustments, are provided. Carry forward of losses are allowed under given circumstances. Certain expenses are not allowed for deduction.

Definitions of Different Terms Used in Income Tax:

Definitions of some of the different terms used in Income Tax Act, 2058 are given hereunder.

- **INCOME YEAR [SEC. 2(jha)]:**

  The basic idea to pay tax lies on the concept of "Income Year" as the taxes are paid in period basis. Income Tax Act, 2058 (Sec. 2(jha) defines it as "a period beginning from Shrawan 1 of any year and ending on Ashad end of next year.

  Nepal follows Bikram Sambat Calendar. So, these months like Ashad, Shrawan etc are the names and periods according to the standard Nepali calendar (Bikram Sambat) and the last day of Ashad falls on nearby 15th July.

  Income Year is the year in which income is earned. Different countries have adopted different periods for income year as per their customs and convenience. However, an income year, normally, consists of near about 365 days. Income of the income year of an assessee is taxed at the rates prescribed by the Income Tax Act as amended by the relevant Finance Act or Finance Order.

Income Year in Different Cases

- **Income Year in the Case of Newly Set up Business, Profession, Industry, etc:**

  In the case of newly set up business, the "Income Year" starts from the date of setting up of the source of income and ends on the last day of following Ashad. An income year can never exceed a period of 12 months, but in case of a newly set up business, the income year may be of less than 12 months. The period may even be of a single day.

  Setting up of an income source starts from the date of certification of incorporation or registration from respective Government office or from the day of the actual starting of business activities, depending on the earlier date.

- **A Certain Portion of the Financial Year as Income Year (Jeopardy Tax Assessments- Sec.100):**

  Section 100 of Income Tax Act, 2058 has specified certain circumstances under which the Inland Revenue Office (IRO) may order a tax payer to submit a Tax Return for the period from

Shrawan 1 of the respective year and up to the date specified by the office but before the last day of the closing of the income year if:

- The taxpayer becomes bankrupt, is wound up or goes in to liquidation.
- The taxpayer is about to leave Nepal immediately.
- The taxpayer is about to cease his business activities in Nepal for some other reasons, or
- The IRO considers any other circumstance as appropriate for the order.

In case a taxpayer receives a notice from the IRO, it has to submit a Tax Return for the period as specified in the notice.

If the taxpayer has continued the business for the whole Income Year, the taxpayer has to file a new Tax Return as per Section 96 of the Act, ignoring the Tax Return submitted under Section 100. If the taxpayer has paid any amount under the obligation of Section 100, it can claim the amount as advance tax paid for the Income Year.

- **A Certain Portion of the Financial Year as Income Year (Change in Ownership- Sec.57):**

  In case the ownership of any entity changed by 50% or more in period of 3 years as described in Sec. 57, then the entity shall have portion of financial year as income years. In that case, entity having majority old beneficiaries have income year since Shrawan 1 to day before changes in ownership and another income year for same entity (new) shall be date of new ownership to Ashad-end.

- **Person:**

  Income Tax has defined Person as "Natural Person" and "Entity".

- **Natural person**

  The term "Natural person" is defined by Sec. 2(wa) as follows:

  A individual natural person;

  A proprietorship firm 100% owned by a single natural person;

  A couple elected as a single natural person under Section 50 (couple filing jointly);

Sec- 50: Couple filing jointly

Each of the spouses is treated as a separate natural person for tax assessment. But Section 50 of the Act has the provision that a couple can choose to be treated as single taxpayer for a particular Income Year. In case the couple elects to be a single individual, the income of both the spouses shall be taxed in a single hand as that of one individual.

- The couple is permitted to be treated as a single individual taxpayer irrespective of whether such an option was taken in any previous year. Spouses may file individually for an income year and may file jointly in another income year.

- In case the couple has chosen to be treated as a single individual for tax purpose, either of the spouses will be either jointly or separately responsible for the payment of the tax, even they divorced or separated or filed separately latter.
- The option is allowed only to a married couple, if each of the spouses is alive on the date of signing the Tax Return for the Income Year. Because the next couple has to sign on the Tax Return as a token of the acceptance of the election.
- Spouses, both having own permanent account number may adopt this facility.
- Either of the spouses can be an assessee and the next spouse may give the consent.

Finance Ordinance, 2062 and consecutive Finance Acts have introduced a new Sub-section (3) to Section 50 that a widow or a widower, having the burden to look after dependents, are treated as couple for the purpose of income tax (qualified widow(er). Moreover, the widow or the widower should have dependents and for whom s/he is responsible to look after. The provision is not clear as to dependents, but in general terms these include minor daughter and/or son and may be old-aged parents.

- **Entity**

  "Entity" means the following organization or body:

- **Company {Sec. 2(da)}:**

  According to Income Tax Act, 2058, company is further classified as **company** and **deemed company**. In general terms, a company is an entity, which is incorporated under the Company Act. It may be a private or a public company. But as per the definition given by the Income Tax Act, the following entities are also included in the term company, which are called deemed companies. Wherever, the word company is used in Income Tax Act, it includes company as well as deemed companies.

  The following entities are also called company for the purpose of income tax:

  - **A corporate body established under any Law that is in effect during the time. (Eg. ICAN)**

  - **An unincorporated association, committee, institution, society, or a group of persons other than a partnership.**

  - **A Trust** {Sec. 2(na)}; A 'Trust' is an arrangement whereby an individual or a group of individuals hold property as a trustee.

  - **A Partnership** having twenty or more partners: A partnership firm having less than twenty partners is called 'partnership' for the tax purpose, but in case the firm has twenty or more partners, that firm is recognized as a company for the purpose of income tax.

  - **A Retirement Fund** {Sec. 2(gha)};

    A Retirement Fund is an entity established for the purpose of accepting retirement contributions in order to provide retirement benefits to the beneficiaries or their dependents.

    A Retirement Fund may be an entity established solely for accepting a retirement

contribution, like Employees' Provident Fund (EPF). Here, EPF itself is retirement fund for tax purpose.

A Retirement Fund may be a branch or a division of an entity. A Retirement Fund established by Citizen Investment Trust (CIT) is a good example. Here, funds established by CIT are retirement fund(s) and CIT itself is a trust and hence company for tax purpose.

Any other person can establish a Retirement Fund with the permission of Inland Revenue Department; are Approved Retirement Fund. If any person established retirement fund but not approval granted, they are also retirement fund (unapproved retirement fund).

Some special characteristics of a Retirement fund:

- Recognized by Law to operate as the Retirement Fund.
- Receives contribution to a Retirement Fund scheme from individuals.
- Invests the contribution for the benefit of the beneficiaries, and
- Makes payment to the beneficiary on his retirement or to a dependent of the beneficiary on his death.

- **A Unit Trust** {Sec.2 (tra)}: The definition given in the Act for a Unit Trust is that it is an organization of at least twenty individuals who hold the units of the organization. The individuals are called unit holders. The unit has a face value. The unit holders have a right to sale the units at the prevailing market price. When the Unit Trust declares the dividend, the unit holders are entitled to receive it in proportion to their holding of the unit on the date of book closure. There is little difference between a mutual fund and a Unit Trust.
- **A Joint Venture:** The Income Tax Act has not defined the term joint venture. In general term, 'Joint Venture' stands for an association of persons established under agreement to perform any special task or assignment. A joint venture may be between two governments, a government and other institution, two corporate bodies, etc. In common words, a joint venture is a work of partnership between two entities established for a common, yet limited object.
- **A Foreign Company:** It is an entity, which has acquired the status of a corporate body in a country other than Nepal under the Rules of that country. The company is not registered under Nepal Company Act, so it is not a company but for the purpose of income tax it is treated as company.
- **A Foreign Institution** *(if taken as a company by the Director General (DG) of Inland Revenue Department (IRD)):* if any institution, which is registered and established in a foreign country, establishes its office in Nepal or is temporarily involved in certain activities in Nepal, it is called as an entity for the purpose of income tax. But, if the DG of IRD issues an order recognizing a particular foreign institution as a company, that entity shall be treated as a company for income tax purpose.
- **Other Entities:**

  The following are the entities, but are not the deemed companies:

  - Partnership {Sec. 2(be)}; A firm, having more than one natural person as owner is called a partnership. But the term does not include:

- A joint venture; and
- A partnership having twenty or more partners. (Such a partnership is said to be a company in Income Tax).

  In a firm, husband and wife, father and son/daughter, brothers, and other relatives can be partners. A partnership is dissolved as soon as any one of the partners expires, retires or becomes insane.

- **Rural Municipality, Municipality or District Coordination Committee.**
- **Government of Nepal, Province Government or Local level Government.**
- **A Foreign Government or a Political Sub-Division of the Foreign Government, or a Public International Organization Established under a Treaty:** Here treaty means treaty between Nepal government and the foreign government or a political sub-division of the foreign government whereby, these governments or the public international organizations are allowed to enhance their activities in Nepal by establishing a unit in Nepal, such as UNDP, JICA, CTEVT, etc. These are treated as entity in Nepal for income tax purpose.
- **A Foreign Permanent Establishment** {Sec. 2(ay)}: A Foreign Permanent Establishment (FPE) is a permanent establishment of such a person who is a resident of some other country. The person may be a company or a partnership registered in a foreign country, a trust established abroad, a foreign government or its political sub-division up to village level, etc. When any one of these foreign persons establishes a permanent establishment in Nepal under the same incorporated status as it has been in the foreign country, without getting any new incorporated status in Nepal, the permanent establishment is said to be a foreign permanent establishment.

  Further tests of a Foreign Permanent Establishment

  - It is entirely owned by a foreign person. Owner foreign person may be controlled foreign entity too.
  - It is a branch, a division, warehouse, construction site, factory, sales outlet or a site office of a foreign person. (but, place where the commercial transaction has not done and for just display is not a permanent establishment.
  - It hasn't got any incorporated status in Nepal.
  - It has its effective control and management situated outside Nepal. The control and management of a unit is usually situated at a place where the head, the seat and the directing power are situated. It refers to the "head and brain" which directs the policy affairs, financial issues, profit disposals and other vital things concerning the management of the unit.
- **Permanent Establishment** {Section 2(bb)}: 'Permanent Establishment' (PE) means an establishment where a person wholly or partly carries on a business. The establishment refers to the head office, factory premises, site office, branch office, etc. In addition to that, these under noted establishments are also defined as PE:

  - **Agency PE:** An establishment where a person wholly or partly carries on a business through an agent, when the agent is not a general agent of independent status.

- **Fixed Base PE:** An establishment where a person has, is using, or is installing main equipment or machineries (factory premises). Establishment for displaying equipments or stock only are not PE.

- **Service PE:** One or more establishments within a country where a person furnishes, whether through employees or otherwise, technical, professional, or consultancy services for a period or periods aggregating more than 90 days within any 12 months.

- **Fixed Site PE (Construction Site):** An establishment where a person is engaged in a construction, assembly, or installation project for 90 days or more, and a place where a person is conducting supervisory activities in relation to such a project.

Further clarification of the term "permanent establishment"

Permanent Establishment is:

a place of management;

- a branch;
- an office;
- a factory;
- a workshop;
- a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
- a warehouse, in relation to a person providing storage facilities for others; and
- a farm or plantation.

It also encompasses:

- a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only where such site, project or activities continue for a period of more than CERTAIN days (90 days or more);
- the furnishing of services, including consultancy services, by a resident of one of the Contracting States through employees or other personnel, provided activities of that nature continue (for the same or a connected project) within the other Contracting State for a period or periods aggregating more than CERTAIN (90) days within any twelve-month period.

The term "permanent establishment", usually, does not include:

- the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
- the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
- the maintenance of a fixed place of business solely for any combination of activities mentioned in sub-paragraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

- **Controlled Foreign Entities** (Sec. 69): The clarification clause of Section 69 has defined 'Controlled Foreign Entities (CFE)' as a non-resident entity in which a resident person or its associated persons (up to 4) holds an interest, directly or indirectly, through one or more interposed non-resident entities.

Examples to clarify CFE:

- Dahal Ltd., a resident holds 60% shares in Varanashi Ltd. (India), resident directly holding the control, so latter is CFE for the former.
- Lamsal Ltd., a resident holds 60% shares in Chennai Ltd. (India) and Cheenai Ltd. holds 55% shares in Karanchi Ltd. (Pakistan), both foreign entity are under control of Lamsal Ltd. and both are CFEs. In this case, Karanchi Ltd. has controlled by Lamsal Ltd. via interposed entity (associated person) Chennai Ltd.
- Rana Ltd., a resident holds 52% shares in John Ltd. (UK) and 20% shares in Johannesburg Ltd. (South Africa). John Ltd. holds 35% shares in Johannesburg Ltd. in this case, controlling shares has under the control of Rana Ltd. (20% directly and 35% by interposed entity). Both the foreign entities are CFE for Rana Ltd.
- Kunwar, Dhanchanda, resident has 25% shares in Arthur Ltd. (Hongkong), his daughter Manchan Kunwar holds 35% shares in the same company. The company is CFE for both Dhanchanda and Manchan (two associated persons-relatives controlling).
- Rupakheti Ltd. is controlled by Mr. Rupakheti (20%) and Mrs. Vatsa (80%), all residents. Mrs. Vatsa invest 25% shares in Singapore Ltd. where Rupakheti Ltd. holds 30% shares. Here, Singapore Ltd. is CFE for Mrs. Vatsa (not for Mr. Rupakheti and Rupakheti Ltd.)

- **Income {Sec. 2(h)}**

  Section 2(h) defines "Income" as the total amount received (receivable in case of the accrued method of accounting) from business, employment, windfall gain and investment and an aggregate of such income as calculated in accordance with the Income Tax Act, 2058.

- **Turnover**

  "Turnover" is also a word defined by the Act under Section 2(ja1) as the total receipt calculated as per Section 7, 8 and 9. It means turnover is the total amount received or receivable from business, employment and investment. Thus, turnover includes income from business, employment and investment of a person. It does not include the final withholding taxed income.

- **Non Business Chargeable Assets {Section 2 (dda)}**

  "Non Business Chargeable Assets" mean lands, buildings and interest in any entity, or securities, other than following assets:

  a. Business assets, depreciable assets or trading stocks

  b. Private residence of a natural person in the following conditions:

i. Under continued ownership for ten or more years, and

ii. Lived in total for ten or more years continuously or at different times by the person.

Explanation: For the purpose of this clause, 'private residence' means house and the land covered by the house or One Ropani land whichever is lower.

c. An interest of a beneficiary in a retirement fund,

d. Land, land and building and private residence of a natural person which has been disposed of at a price of less than one million rupees, or

e. Assets disposed of through transfer by any means, other than sale and purchase within three generations.

- **Taxable Income and Classification of Income Heads (Sec- 5)**

The taxable income of any person in an income year shall be equal to the amount assessed by deducting the amounts claimed for deduction, if any, under section 12, 12Ka, 12Kha or 63 or under all four sections from the total amount of assessable income (sec- 6) calculated under the act for the following income heads:

- Income from business (Sec. 7);
- Income from employment (Sec. 8);
- Income from investment (Sec. 9); and
- Income from windfall gain (Sec. 5, 6, 88A).

- **Income from Business {Sec. 2 (ar)}**

Business includes a trade, an industry, a profession, a vocation, and other business transactions. A trading, a production, a commission agency, an audit firm, a legal advisory work, a repair shop, etc are some of the examples of business activities.

The total of all receipts as per Section 7(2) excluding the receipts as per Section 7(3) less deductible expense and loss (as per Sec. 13-21) is income from business.

- **Income from Employment {Sec. 2(aj)}**

Any income received from an employer in return for some service is called an income from employment. Such income may be received in the form of salary, wage, allowance, commission, reimbursement of personal expenses, awards, perquisites, retirement benefits, leave encashment, etc. The fundamental feature of an income from employment is that there is a relation of employer and employee as the payer and payee. Income received in connection with a service, even when the service has been terminated, is also classified as income from employment.

The total of all receipts as per Section 8(2) excluding the receipts as per Section 8(3) constitutes income from employment.

- **Income from Investment {Sec. 2(al)}**

  If a person hands over its property to another person for the latter's use, and, in return, receives a certain consideration, the consideration is said to be an income from investment. Rent for a vehicle, lease rental for a land or building, interest for loans and advances, interest for debentures or bonds, dividend for equity investment, net gain from the disposal of non-business chargeable assets, etc are some of the examples of income from investment. However, investment does not include the act of holding assets for personal use by the person owning the asset or employment or business.

  The total of all receipts as per Section 9(2) excluding the receipts as per Section 9(3) less deductible expense and loss (as per Sec. 13-21) is income from investment.

- **Income from Windfall Gain**

  "Windfall gain" means lottery, gift, prize, baksis, award for wining (jitauri) and any other type windfall gains.

Formulas				
All receipts as per Sec 7(2) (Inclusions) less all deductible expense and loss (deductions)	excluding	Sec. 10: Tax exempted income. Sec. 54: Not taxable dividend. Sec. 69: Not taxable dividend from a controlled foreign entity. Sec. 92: Income, which is subject to final withholding tax.	=	Income from business
All receipts as per Sec 8(2)	excluding	Sec. 10: Tax exempted income Sec. 92: Income, which is subject to final withholding tax.	=	Income from employment
All receipts as per Sec 9(2) (Inclusions) less all deductible expense and loss (deductions)	excluding	Sec 10: Tax exempted income. Sec. 54: Not taxable dividend. Sec. 69: Not taxable dividend from controlled foreign entity. Sec. 92: Income, which is subject to final withholding tax.	=	Income from investment.
Income from business + Income from employment + Income from investment of a person = Assessable Income of the person.				

- **Assessable Income (Sec. 6)**

  Assessable income is the total of income from business, income from employment, income from investment and income from windfall gain. Computing an assessable income needs to exclude the tax exempted income from agriculture, tax exempted income of a cooperative society, and/or tax exempted income of an unit having a public infrastructure as specified by

Sec. 11 and/or income of an approved retirement fund under Section 64. Assessable income includes windfall gain, which is final withholding tax income, if it is derived from Nepal and is included in taxable income, if it is derived from non-resident person.

Section 11 allows exemption of tax on certain incomes along with allowing certain concessionary rate of tax on certain other incomes. Section 6 says that all the exemption and the concessions allowed as per Section 11 are excluded to arrive at assessable income. But it is not practicable to exclude the income from assessable income on which concessionary tax rates are applicable, so it is suggested that those incomes that are 100% exempted from the income tax band shall only be excluded from assessable income.

For a resident person, the total income earned all over the world, is assessable income, irrespective of the country of the income generation. A resident person should include one's income in the assessable income, even when the source of income is located in a foreign country since the tax is levied in global income.

For a resident person, assessable income = Total income from a source located in Nepal + Total income from a source located outside Nepal.

But for a non-resident person the income from a source located in Nepal is assessable income. Income of a non-resident from a source located outside Nepal is not taxable in Nepal.

For a non-resident person, assessable income = Total income from a source located in Nepal.

In Summary:

Particulars	***For Resident****	***For Non-resident***
Income from employment	Taxed even source in any country	Taxed having source in Nepal only
Income from business	Taxed even source in any country	Taxed having source in Nepal only
Income from investments	Taxed even source in any country	Taxed having source in Nepal only
Windfall gain income	Taxed even source in any country (since IY 2068/69)	Taxed having source in Nepal only

- Only the income having source in Nepal shall be final; any income which is final withholding tax in Nepal is earned outside Nepal is taxable irrespective whether it is final in source country or not or in Nepal or not.

- Resident having foreign source income is allowed foreign tax credit (u/s71) irrespective of whether Nepal has entered into DTAA with the country or not.

- **Taxable Income (Sec. 5)**

Taxable income is determined by ***reducing*** the ***amount of donation*** (subject to limitation under Sec.12), ***expenditure incurred for heritage protection and development of sports*** (subject to

limitation u/s 12Ka), ***expenditure incurred for prime minister relief fund and reconstruction fund established by Government of Nepal*** (subject to limitation under section 12Kha) and ***contribution to approved retirement fund*** (subject to limitation under Sec. 63) from the assessable income.

- **Donation and Contribution (Section 12)**

  - The amount of donation given or contribution made to any tax-exempt organizations recognized by IRD, can be claimed for reduction from Assessable Income to arrive at the taxable income of the year in which the payment is made.

  - A ceiling is imposed on such payment of up to 5% of the Adjusted Taxable Income for the income year or Rs. 100,000, whichever is lower.

  - But if GON has notified in the Nepal Gazette that donation could be given in certain circumstances for a particular purpose, the amount could be claimed as per the conditions given in the same notification.

- **Expenditure incurred for Heritage protection or Development of Sports (Sec 12ka)**

  Finance Act, 2064 has introduced new section 12ka for allowing additional donation and contribution for reduction from taxable profit.

  If all the following conditions are satisfied, the expenditure incurred by a person on conservation and promotion of ancient, religious or cultural heritages established in Nepal; and/or construction of public infrastructure related to the development of games and sports, the following sum is deductible from Assessable Income to arrive at Taxable Income

  Conditions:

  - The person shall be a Company

  - The person shall obtain prior approval of IRD to incur such expenditure.

  Amount of Claim

  - The limit of claim of expenditure is limited to minimum of the following:

  - Actual expenditure incurred

  - 10% of the assessable income during the year

  - Rs. 10 Lakhs

- **Contribution on Prime Minister Disaster Relief Fund and Reconstruction Fund Established by the Government of Nepal (Sec 12Kha)**

  Finance Act, 2072 has introduced new section 12Kha for allowing additional donation and contribution for reduction from taxable profit.

  The contribution made by a person in an income year to Prime Minister Disaster Relief Fund

and Reconstruction Fund established by the Government of Nepal while calculating taxable income for that income year.

- **Contribution to Approved Retirement Fund (Sec 63)**

  According to section 63(2), a participant natural person who has contributed to an approved retirement fund is entitled reduction from the Assessable Income to arrive at Taxable Income, the amount so contributed to the approved retirement subject to limitation prescribed by rules.

  Limit of such Reduction/Deduction

  The limit of such claim shall be lower of following:

  - Actual contribution to Approved Retirement Fund
  - 1/3rd of Assessable Income during the Income Year
  - Rs. 300,000

  Provided that rupees five hundred thousand or one third of the assessable income whichever is lower shall be deducted from taxable income of beneficiary natural person who contributes in social security fund established under contributory social security fund Act 2074.

Summary Table for Assessable Income & Taxable Income

Assessable Income from Business	*XXX*
Assessable Income from Employment	*XXX*
Assessable Income from Investment	*XXX*
Assessable Income from Windfall Gain	*XXX*
TOTAL ASSESSABLE INCOME	*XXX*
Less:	
Contribution to Approved Retirement Fund (in case of Natural Person) u/s 63	*XXX*
Expenditure u/s 12Ka	*XXX*
Contribution u/s 12Kha	*XXX*
Donation u/s 12	*XXX*
Donation prescribed by Nepal Government in Nepal Gazette	
Donation u/s 12 (1) and (2)- Donation to Exempt Organization	
TAXABLE INCOME	*XXX*

- **Balance Taxable Income**

  The term has not been defined by Income Tax Act. IRD has used this terminology to indicate the taxable income on which we shall levy the applicable tax rate to arrive at tax liability of a resident natural person. Balance Taxable Income is arrived after deducting different benefits (also called Zero Rated Tax), from the Taxable Income.

  The concept will be discussed in Chapter 2 while calculating tax of a resident natural person.

- **Adjusted Taxable Income {Sec. 2 (bd1)}**

  Finance Ordinance, 2060 has introduced a new Sub-section 2 (bd1) to define the new term "Adjusted Taxable Income". The term has been defined to avoid the complexities created by the sentences used in Section 12, 17 and 18 of the Act. Adjusted Taxable Income means the taxable income before deduction of permitted amount for **donation** under Section 12, providing for **expenses on interes**t as per Section 14 (2)*, **pollution control cost** under Section 17, and **research and development expenses** under Section 18.

  - Added by Finance Ordinances, 2061 and onwards.

  As clarified by Income Tax Manual 2066 (Updated 2073), the Adjusted Taxable Income shall be calculated and defined separately for each of Sec. 12, 14(2), 17 and 18. The summary of definition of Adjusted Taxable Income is presented in following table for the ease of students.

You should remember:

- Calculate Taxable Income without including Interest Income, Interest Expenses and Donation (include actual Pollution Control Cost and Research & Development Cost)- which is *Adjusted Taxable Income for the purpose of Sec 14 (2).*
- Calculate Taxable Income from all Businesses without including Pollution Control Cost and Donation (include actual Interest Income, Interest Expenses and Research & Development Cost) - which is *Adjusted Taxable Income for the purpose of Sec 17.*
- Calculate Taxable Income from all Businesses without including Research & Development Cost and Donation (include actual Pollution Control Cost, Interest Income, and Interest Expenses) - which is *Adjusted Taxable Income for the purpose of Sec 18.*
- Calculate Normal Assessable Income (Income should include Interest Income, and the expenses shall include Interest Expenses determined u/s 14 (2), Pollution Control Cost as per Sec 17, Research & Development Cost as per Sec 18). Deduct Contribution to Approved Retirement Fund (Allowable, in case of Natural Person), Expenditure u/s 12Ka, and Donation as prescribed by Nepal Government in Nepal Gazette u/s 12 (3) from Assessable Income - which is *Adjusted Taxable Income for the purpose of Sec 12 (1) and 12 (2).*

- **Market value:**

  Section 2 (ae) has defined "market value" as the normal buying and selling prices for the asset or services in the ordinary course of a business amongst unrelated parties.

- **Associated Person {Sec 2 (bd)}:**

  The Associated Person means a person or a group of persons who may reasonably be expected to act in accordance with the intention of the other and includes the following:

  - Relatives of a natural person. *(The relations included in the list of relatives of a natural person are: wife, husband, son, daughter, adopted son, adopted daughter, father, mother, grandfather, grand mother, brother, sister-in-law, sister, father–in-law, mother-in-law, brother-in-law, uncle, aunt, nephew, niece, grandson, and granddaughter)*
  - Partner of a natural person.
  - Foreign permanent establishment with its owner.
  - An entity with a person who, either alone or together with an Associated person or Associated persons, controls or may benefit from 50% or more of the rights to income, capital, or voting power of the entity, as the case requires, either directly or through one or more interposed entities; or a person who is a Associated of such a person.

Examples to clarify associated persons:

- Mr. Dahal and Mrs. Luitel are spouse, both are associated person for each other.
- Mr. Dahal and Mrs. Luitel, spouse, each invested 30% shares in Chunatal Ltd. Here, all three parties are associated person each other.
- Mr. Dahal and Mrs. Luitel are spouse; Mr. Dahal and Mr. Adhikari are partners. Mr. Adhikari is 30% shareholder in Panchkhal Ltd and Mrs. Luitel holds 25%. In that case, all the persons are associated persons.

The following persons are not treated as associated persons:

- Employee of the person, and
- Persons not prescribed by the Department as Associated ones.

Importance of Concept of Associated Persons

The ear-marking concept for associated person for tax, is the transactions amongst associated person, would normally be in value other than market price. In some case, commercial relations between associated persons would be such mechanical, that no one can guess for their association. In such cases, Department may prescribe that those are not associated person for tax purpose.

Example: Mr. Dhanes is 60% shareholder in Dahal Ltd; so, associated Mr. Dhanes and Dahal Ltd. Mr. Madhav is son of Mr. Dhanes, engaged in court case since last 15 years. After court decision, half of shareholding in Dahal Ltd. transferred to Mr. Madhav (now each father and son are 30% shareholder). By normal definition of associated person, here Mr. Dhanes, Mr. Madhav and Dahal Ltd. are associated person, but in such sever case, if IRD prescribe these are not associated person, all three persons deemed as separate and independent person- i.e. not an associated person.

- **Resident and Non-resident Persons:**

  Income Tax Act, 2058; through Sec 6 levies tax on global income in case of resident person and in Nepal source Income in case of Nonresident person. Thus, an income accrued to a person during an income year outside Nepal, whether it is taxable in Nepal or not, depends upon the residential status of the person during the year. The Act under Section 2 (ao) has set different conditions to determine the residential status of a person during an income year.

  The residential status is determined each income year on the basis of given conditions. A person may be a resident in one income year but may not be a resident in next income year.

  The residential status is not determined by the citizenship of Nepal. A Nepali citizen may be a non-resident in an income year and an American citizen may be a resident in Nepal for a year.

  We shall discuss different conditions for different types of persons defined in the Act in the following sections of this textbook.

- **Residential Status for a Natural Person:**

  A natural person (individual) is a resident in Nepal for an income year, if s/he satisfies any of the following three conditions:

  - **If the habitual (Normal) Place of Abode is in Nepal:**

    "Normal place of abode" is not defined in the Act. Income Tax Manual, 2077 has clarified the habitual place of abode as the place where the major economic activities of a person is concentrated during the Income Year.

    Example to clarify "Habitual Place of Abode:"

    - Ram Bahadur is a permanent resident of Kohalpur, Banke. He has been in Kuwait since Shrawan 25, 2077 for the purpose of employment and will be returning to Nepal on 2078 Shrawan. In this case he has habitual place of abode in Kuwait for Income Year 2077/78 since his economic activities are concentrated in Kuwait,
    - If in the above case, Mr. Ram Bahadur has been outside Nepal for more than 183 days in any Income Year for the promotion of his business of Nepal; the habitual place of abode would have been in Nepal since his economic activities are concentrated in Nepal.

  - If s/he is Present in Nepal for 183 days or more during a period of 365 consecutive days:

    In case a natural person is present physically in Nepal for 183 days or more during a period of 365 consecutive days, his/her status shall be of a resident during an income year in which the 183rd day of his physical presence during a period of consecutive 365 days falls.

    *Income Tax Manual has modified the concept of moving period of 365 days and now it is computed for the stays within an income y*ear.

Example to clarify the effect of physical presence in Nepal:

Krishna Dhakal has a business in USA but he usually visits Kathmandu to manage his business here. A manager runs the Business at Kathmandu. Dhakal first visited Nepal in 2019 and after that he has frequently visited Nepal and the record of his presence in Nepal is as follows:

Jan 20, 2020 to March 15,2020 = 56 days

June 20, 2020 to July 5, 2020 = 15 days

Sept 1, 2020 to Oct 20, 2020 = 50 days

Dec 1, 2020 to Feb.1, 2021 = 63 days

March 25, 2021 to April 14, 2021 = 20 days

July 1, 2021 to Aug 25, 2021 = 56 days.

More information:

Income year 2076-77 ends on July 15, 2019.

Income Year 2077-78 ends on July 16, 2020

Answer:

Computation of the residential status of Dhakal during the years from 2076-77 to 2077-78:

For income year 2076-77 his presence in Nepal was only for 71 days out of the consecutive 365 days ending on July 5, 2019. So he is a non-resident for the income year 2076-77.

For income year 2077-78, his stay for the income year is 148 days, so he is non-resident :

Sept 1, 2020 to Oct 20, 2020	= 50 days
Dec 1, 2020 to Feb.1, 2021	= 63 days
March 25, 2021 to April 14, 2021	= 20 days
July 1, 2021 to July 16, 2021	= 16 days
	= 149 days

For income year 2077-78, his stay is 40 days (July 17 to August 25, 2021); again he is non-resident.

From the above example, the day of arrival in Nepal and day of departure from Nepal as the days of stay in Nepal.

The presence in Nepal means being within the political boundary of Nepal but not necessarily at a single place in Nepal. One may be present in Kathmandu at one time and in Biratnagar at another, but for the purpose of determining the residential status all the presences in Nepal shall be counted. There are some critical points under these concepts as:

- *Residential status is normally based on tax laws of Nepal, but it shall also be affected by Double Tax Avoidance Agreement (DTAA) too.* ***Students are advised to go through Article 4 for residential status under model DTAA or signed DTAA****. The possibility of being resident in more than one country as per the law of respective land cannot be overruled in case any person is from non-DTAA country. But, in case of DTAA with the country such dual residency is eliminated through the following procedure in general:*

In case an individual is a resident of both Contracting States (in case of DTAA), then the residential status of such individual is determined as follows:

- *he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interests);*
- *if the State in which he has his center of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;*
- *if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;*
- *if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.*

Where by reason of the provisions of above, a person other than an individual is a resident of both Contracting States, and then the competent authorities of the Contracting States shall determine that the person is a resident of a Contracting State for the purposes of the Agreement by mutual agreement.

(Copied from Article 4 of DTAA signed with China)

Examples to clarify the elimination of dual residency as per DTAA

DTAA State Residence- Mr. Om Br. Thapa, permanent inhabitants of Chitwan, is working in Karachi since last 3 years. He comes and returns every year and stayed around half period in Nepal and remits 50% of earnings in home.

His stay is in Pakistan and source of income thereto. But, as per Article 4 of DTAA with Pakistan, his normal place of domicile in Nepal and cannot be taxed as resident in Pakistan. He is Nepal resident.

DTAA State Residence- Mr. Jharkhande, Indian national and resident based on Indian Income Tax Act, 1961, businessman in Mumbai, stayed 190 days in last 365 days ended in Ashadh-end and returned then.

In this case, his stay is 200 days so, he seems as resident, but in Article 4 of DTAA with Nepal and India, he is resident of India also. If any person is resident in both countries, then the status of normal place is watched, so, he is in India and resident for India not for Nepal.

DTAA State Residence- Mr. Deshain, Indian national and resident for Indian tax purpose, businessman in Mumbai, arrived Nepal on Ashadh 20 and returned on Push 23.

In this case also, Indian Resident, as per Article 4 of DTAA with Nepal and India, if normal place of adobe is in India and resident for India, the person cannot be resident for Nepal. So, both income years, he is non-resident.

- *Transit travel are not counted as stay in Nepal for computing purpose. Examples are:*

Crossing in travel – Mr Amarkhande, Silguri based Indian, works in Birgunj, for 180 days and returned home resigning from his job. Some days later, he got employment in Uttarakhanda, India and travel through Kakadbhitta- Mahendranagar route. On Narayagarh, there was an unlimited strike and he compel to stay for 10 days.

The act is silence on the day count procedure. Internationally, 'traveling through' period is not counted for residency (but travel for period is counted). Hence, his stay of 10 days is not qualified for resident. And he is non-resident even day counts is more than 183 days.

Pass through approach- Entities are taxed separately than its beneficiaries, but there are numerous cases where the tax of entity is incidence based on the status of its beneficiaries. This approach of tax is called pass-through approach in tax terminology. Briefly, in the following cases, tax incidence is taken place based on pass-through approach:

Income from employment and exemptions u/s 10 (some are based on nationality too, even nationality is not determining factor for tax).

- Interest paid by exempt-controlled entity to its exempted controller –Sec. 14(2).
- Personal and domestic expense u/s 21.
- Benefits of non-market transfer Sec. 45.
- Change of ownership, Sec. 57.
- Dividend stripping, Sec. 58.
- Source of income from security sale (Sec. 67)
- Interest and dividend payments, Sec. 67(6).
- Controlled Foreign Entities, Sec. 69
- Conduit Company cases in Sec. 73(5).
- Tax on trust, Sec. 44 and Sch. 1 Sec. 2(5).
- Tax incident on an entity could be different based on their shareholders residential status due to test under pass-through approach.
- For example, repatriation of foreign permanent establishment is taxed at 5% but, portion of repatriation that may be the part of Income of a Resident is not taxed at all.

- **An Employee of GON deputed in Foreign Country by Government of Nepal:**

In case a natural person is an employee of GON during the year, his presence in Nepal or outside Nepal shall not be counted for determining his residential status. Even during his posting outside Nepal during the whole year, it will be treated as a resident of Nepal for tax purpose.

Any remuneration paid by GON is deemed having source in Nepal based on Sec. 67(6), so, it is taxed in Nepal. In the residency test, the employee of government is resident as per this provision, which is against the general tax principle on which Income Tax Act, 2058 is based.

1.9.10.2 Residential Status in case of an Entity:

S.N.	Kinds of Entities	Conditions for being a Resident.
1	Partnership	A partnership in Nepal is always a resident.
2	A trust	A trust is a resident in Nepal if anyone of these conditions is satisfied: • The trust is established in Nepal. • The trustee of the trust is a resident of Nepal during the year or, • A person or a group of persons of whom one of them is a resident in Nepal for the income year controls the trust, directly or indirectly through one or more interposed entities.
3	Company	A company is a resident of Nepal if any one of the following two conditions is satisfied: • The company is incorporated in Nepal under any prevailing law in Nepal. • The company has its management effective in Nepal during the income year. The control and management of a unit is usually situated at a place where the head, the seat and the directing power are situated. It refers to "head and brain" which directs the affairs of policy, finance, disposal of profit and vital things concerning the management of the unit.
4	Entity of Foreign Government, Foreign State Government or Local Body of Foreign Government	The entity is resident in Nepal, if it satisfies any of the following two conditions: • In case it is Incorporated under the law in force in Nepal • In case the management is effective in Nepal during the Income Year The tax Act has not described the way for management to be effective in Nepal.

Government of Nepal, Province Government, Rural Municipality, Municipalities, or District Coordination Committee, any entity or organization established under treaty, and Foreign Permanent Establishment are always Resident of Nepal.

- **Underlying Ownership {Sec 2 (aa)}:** Underlying ownership in an entity means an ownership created on the basis of an interest held in an entity directly or indirectly through one or more interposed entities by a natural person or by an entity in which no individual has an interest.

  Underlying ownership in an asset owned by an entity means an ownership of the asset that is determined on the basis of proportion to the ownership held by the persons having underlying ownership of the entity.

- **Electronic Means {S 2 (katha1)}**

  Electronic means is IRD approved means of transmission including computer, fax, E-mail, Internet, electronic cash machine and fiscal printer.

- **Tax {Section 2(n)}:** 'Tax' means income tax imposed under this Act, including the following:

  In relation to the assets of tax debtors (persons with tax arrears), the expenses mentioned in Clause (a) of Sub-Section (8) of Section 104 which the Department has incurred in consideration of the claim or auction sale.

  Amounts to be paid under Section 90 by advance tax deduction (withholding) persons or by tax-deductible persons (withholdee), or amounts to be paid under Section 94 by advance under Section 95A or amounts to be paid according to tax assessments made under Sections 99, 100 and 101.

  Amounts to be paid to the Department in relation to the tax liability of a third party under Sub-Section 2 of Section 107, Sub-Section 3 or 4 of Section 108, Sub-Section 1 of Section 109, and Sub-Section of 1 of Section 110.

  Amounts as mentioned in Chapter 22 which are to be paid in consideration of fees and interest, and

  Fines as mentioned in Section 129 which are to be paid on the order of the Department.

CHAPTER: 2

Basis of Taxation & Basis of Accounting

Basis of Taxation

- **Responsibility to pay Tax**

  The following persons are responsible to pay tax:

  - Person having taxable income in Nepal
  - Foreign Permanent Establishment repatriating Income from Nepal
  - Person receiving final withholding incomes in Nepal

- **Method to Calculate Tax**
- **Calculation of Tax of a Natural Person**

  A natural person shall calculate assessable income from business, investment, employment and windfall gain and derive taxable income and balance taxable income as prescribed by the Act.

  The method to calculate tax of a natural person is presented in tabular form as follows:

Assessable Income from Business	*XXX*
Assessable Income from Employment	*XXX*
Assessable Income from Investment	*XXX*
Assessable Income from Windfall Gain	*XXX*
TOTAL ASSESSABLE INCOME	*XXX*
• *Less: Allowable Deductions*	
• *Contribution to Approved Retirement Fund (in case of Natural Person) u/s 63*	*XXX*
• *Expenditure u/s 12Ka- not allowed for a natural person*	*XXX*
• *Contribution u/s 12Kha*	*XXX*
• *Donation u/s 12*	*XXX*
- *Donation prescribed by Nepal Government in Nepal Gazette*	
- *Donation u/s 12 (1) and (2)- Donation to Exempt Organization*	
TAXABLE INCOME	*XXX*
Less: Allowable Reductions	
• *Benefit for residing in Remote Area*	*XXX*
• *Employee of Government of Nepal deriving "Foreign Allowance" due to deputation in foreign diplomatic missions of Nepal*	*XXX*
• *Reduction, if the resident natural person is Incapacitated*	*XXX*
• *Reduction of Investment Insurance paid during any Income Year*	*XXX*

• *Reduction of Health Insurance paid during any Income Year*		*XXX*
Balance Taxable Income		*XXX*
Statement of Tax Liability		
In case of Couple	*In case of an Individual*	
First Rs. 450,000 1% *Next Rs. 100,000 10%* *Next Rs. 200,000 20%* *Next Rs. 1,250,000 30%* *Balance 30%* *Surcharge on Tax of Balance Amount 20%* *(Effective Tax Rate for Balance Income: 36%)*	*First Rs. 400,000 1%* *Next Rs. 100,000 10%* *Next Rs. 200,000 20%* *Next Rs. 1,300,000 30%* *Balance 30%* *Surcharge on Tax of Balance Amount 20%* *(Effective Tax Rate for Balance Income: 36%)*	
Less: Tax Credits • *Female Tax credit* • *Foreign Tax Credit* • *Medical Tax Credit u/s-51*		 *XX* *XX* *XX*
Less: Advance Taxes paid (either directly or through Withholding Agents) during the year		*XX*
Payable Tax Liability		*XXX*

- **Exception to the above Rule**

  There is one exception to the above rule which is described in Sec 4 (3) of Income Tax Act, 2058. If all the following conditions are satisfied, the tax payable by a **Resident Natural Person** is equivalent to the tax calculated and paid by the employer u/s 87 of the Act:

  Conditions:

  - The person shall derive income only from employment having source in Nepal.
  - The employer shall be resident during the Income Year and the person shall have only one employer at a time.
  - The person shall only claim the Contribution to Approved Retirement Fund paid by the employer and Medical Tax Credit on medical expenditure incurred by the employer and the person shall not claim Donation u/s 12 for deduction.

- **Calculation of tax of an Entity**

The tabular form of tax calculation method of an entity is presented below:

Assessable Income from Business	*XXX*
Assessable Income from Employment	*XXX*
Assessable Income from Investment	*XXX*
Assessable Income from Windfall Gain	*XXX*
TOTAL ASSESSABLE INCOME- u/s 6	*XXX*
Less: Allowable Deductions	
Contribution to Approved Retirement Fund (in case of Natural Person) u/s/ 63	*XXX*
Expenditure u/s 12Ka	*XXX*
Contribution u/s 12Kha	*XXX*
Donation u/s 12	*XXX*
Donation prescribed by Nepal Government in Nepal Gazette	*XXX*
Donation u/s 12 (1) and (2)- Donation to Exempt Organization	
TAXABLE INCOME u/s 5	*XXX*
Tax Liability: *Taxable Income X Applicable Tax Rate*	

- **Presumptive Taxation**

Income Tax Act has presumed the tax liability of certain taxpayer and the taxpayer are relieved from detailed calculation of tax liability as described above. Such taxpayers are required to pay prescribed tax amount for the specific Income Year. *If all the following* conditions are satisfied, the tax paid as explained below shall be the tax liability of such person, and the person is relieved from detailed calculation of tax liability:

Conditions:

- The person shall be a Resident Natural Person,
- The person shall derive Income only from Business having source in Nepal during the Income Year,
- The person shall not claim Medical Tax Credit (as per Sec 51) and Advance tax arising out of Withholding Taxes (as per Sec 93),
- The Income from the Business (Turnover) shall not be more than Rs. 20 Lakhs and the profit from such business shall not exceed Rs. 2 Lakhs.
- Not registered in Value Added Tax (VAT).
- The person shall elect this Section to be applied in writing, i.e. the person shall make a written application (a specific form is developed by IRD on which the person shall make a tick to opt this facility) to IRD to pay presumptive tax.

Amount of Tax to be paid:

Area of conducting Business	Amount of Tax (Rs.)
Metropolitan City and Sub Metropolitan City	7,500
Municipality	4,000
Rural Municipality	2,500

- **Turnover Basis Taxation**

Income Tax Act has presumed the tax liability of certain taxpayer and the taxpayer are relieved from detailed calculation of tax liability as described above. Such taxpayers are required to pay prescribed tax amount for the specific Income Year on the basis of turnover. If all the following conditions are satisfied, the tax paid as explained below shall be the tax liability of such person, and the person is relieved from detailed calculation of tax liability:

Conditions:

- The person shall be a Resident Natural Person,
- The person shall derive Income only from Business having source in Nepal during the Income Year,
- Annual turnover of the business exceeds 20 lakh rupees but is less than 50 lakh rupees.
- Not registered in Value Added Tax (VAT).
- Income does not include income from consultancy and expert service provided by natural person including doctor, engineer, auditor, lawyers, sportsman, artist and consultant.

Amount of Tax to be paid: For the purpose of computation of tax as per Section 4(4Ka) on the basis of turnover, transaction up to Rs. 2,000,000 shall be taxed as per Section 4(4) of the Act and transaction in excess of it shall be taxed at the following rate: -

Particulars	Percentage of Tax on Turnover
Person conducting transaction of gas, cigarette by adding commission of price upto 3% (i.e., Markup 3%)	0.25%
Person conducting business other than business mentioned above	0.75%
Person conducting business of service	2%

Basis of Accounting

- Comments on Basis of Accounting

The taxpayer, other than natural person while calculating Income from business or investment and company, shall follow the basis of accounting as prescribed by IRD. In lack of such circular in this regard from IRD, the taxpayer may choose any basis of accounting for the first time of application of basis of accounting.

Person	Income Source	Basis of Accounting
Natural Person	Employment, Investment	Cash Basis
Natural Person	Business	Cash Basis or Accrual Basis
Company	Business, Investment	Accrual Basis
Entity other than Company (e.g. Partnership)	Business, Investment	Cash Basis or Accrual Basis

- **Change in Basis of Accounting**

  A person shall file an application to IRD to change the basis of accounting. In case IRD deems that the change in basis of accounting reflect the income in fair way, IRD may give permission to change the basis of accounting.

- **Effect of Change in Basis of Accounting**

  In case of change in basis of accounting, the taxpayer shall make necessary adjustments in income calculation in the Income Year when the basis of accounting is changed in such a way that no amount included, deducted, or to be included or deducted in calculating the person's income of the income year of the change is omitted or repeated.

- **Method of Accounting (Rule 8)**

  In case the Income Tax Act has prescribed specific accounting method, then such method shall be followed for the purpose of tax accounting. Taxpayer shall follow prevailing accounting standards of Nepal in case the Act has not specified any accounting method. In lack of prevailing standards related to accounting of some matters in Nepal, the taxpayer shall follow the accounting standards prescribed by IRD in line with the prevailing international principles and practices.

Comments on Basis of Accounting

The Act has recognized either both the cash bases of accounting or accrued bases of accounting with certain conditions.

Cash basis of accounting (Sec- 23) means that an income is recognized when it is received in cash and an expense is recognized when a cash payment has been made.

Accrual basis of accounting (Sec- 24) is also called mercantile system of accountancy. Under such a system income or expenses are recognized at the time of execution of a transaction or the happening of an event. In other words, an income is recognized when the person is entitled to receive the amount. But an expense is recognized when all of these conditions are satisfied:

When a person is obliged to make a payment;

- The value of the obligation has been accurately determined; and
- The person has received consideration from other persons.
- In case the above conditions are not satisfied, an expense is recognized only when the payment is made.

Conditions applicable for cash or mercantile system of accounting (Sec- 22):

- A natural person having an income from employment and income from investment only has to adopt cash system of accounting.
- A company has to adopt the mercantile system of accounting.

- Others (business of natural person and entity other than company) are allowed to select either of the two.

But banking businesses have to keep accounts and records according to instructions and regulations given by Nepal Rastra Bank. The Section 24(3ka) has given an authority to IRD to accept the accounting procedures followed by banking businesses as per the instructions given by NRB. For example, as per the instructions, interest income on sub-standard, doubtful and bad loans should be accounted for in the books as income as and when received in cash. All the Banks and Finance companies are following the instruction and IRD has not raised any objection on the point.

However, cooperatives may recognize their interest income under Cash basis of accounting.

A person, who has been given a choice to select any one of the bases and has selected any one during an income year, has to follow the same system for the coming income years also. But if the person wants to shift for another basis in any current year, it has to get a written approval of IRD u/s-22. It is up to IRD to give conditional approval or unconditional approval. IRD may give the permission with a condition to adjust the income of the year in which it wants to shift from the previous basis in such a way that no amount included, deducted, or to be included or deducted in calculating the person's income of the income year of the change is omitted or repeated.

- **Accounting Records & Books of Account for Tax Accounting:**

  According to Section 81, every person, liable to pay tax as per this Act, has to keep records and documents as specified by IRD. Moreover, the Section compels a person to keep the following records and documents:

  - All records and documents those are necessary to explain the information provided or to be provided in tax returns and in other documents to be filed with IRD or Inland Revenue Office (IRO).
  - All documents and records that are sufficient to determine the actual tax liability of the person, and
  - All documents and records those are sufficient to prove the validity of the expenses shown in the books.

  It is, therefore, necessary to keep the supporting vouchers and documents, books, subsidiary books, registers, etc with regard to every transaction or event that has happened during the year.

  Section 81(2) has allowed a person to keep accounts and record either in English or in Nepali language. In case a person keeps accounts and records in any other language, it has to get them translated into Nepali from an authorized person on its own cost.

- **Transaction in Currency other than Nepali Rupees (Section 28):**

  In case a person enters into a transaction in a currency other than Nepali Rupees, it has to enter the transaction into its records and accounts by converting the amounts into equivalent Nepali currency at the rate available at the time of the transaction (spot rate).

According to Section 28(3), IRD may issue a circular asking a person to use the suggested average rate of exchange instead of spot rate for such translation specifying the condition for such use. In case of a person have foreign branches or any permanent establishment in foreign country or for controlled foreign entities, conversion of each transaction into local currency is practically complex and administratively cost-consuming, in such a case, person may apply for average rate conversion.

- **Period of Keeping the Records Safely {Section 81 (2)}:**

  According to Section 81 (2), every person, who is required to keep accounts and records, is also required to keep these records and accounts safely for five years starting from the following year of the respective income year. The records and accounts for the income year 2077-78 have to be kept safely up to the end of Ashad, 2083.

CHAPTER: 3

TAX EXEMPTION AND TAX CONCESSION

Section 10, 11 and 11ka of Income Tax Act, 2058 has allowed exemption of tax on certain income and discusses about the business concessions. We shall deal with the exemptions and concessions in this chapter. *Students are advised to update themselves with the amendments in Income Tax Act as the Act is subject to change through Finance Act/Order/Ordinance of each year. The discussions in this book are based on the provisions applicable for Income Year 2076/77 and 2077/78 and which is applicable for Examination of June 2021 and onwards.*

Tax Exemptions

Section 10 deals with exempted amounts. The effect of the exemption is the person deriving such amount as Income is not required to pay any Tax on such Income and the person making payments of such amounts is relieved from withholding tax on such payments. The lists of such amounts are discussed in the following sub-headings.

- **Income Derived by a Person**

  When a Foreign Country or an International Organization enters into a bilateral or a multilateral treaty with Nepal Government and, as per the term of agreement, if the person is exempted from income tax for the income derived from the source as specified in the agreement, the income from the specified source is exempted from tax. The following are the conditions of exemption:

  - The person must be either a foreign country or an international organization.
  - The person enters into a bilateral or a multilateral treaty with GON.
  - One of the terms of the agreement contains one or more specified sources of income in Nepal.
  - There should be terms and conditions of exemption of tax on the income from the sources as specified in the agreement.
  - The person should be resident of Nepal due to attachment with the assignment as agreed in the treaty only; so, above benefit is not allowed for nationals of Nepal.
  - All the conditions specified above should be complied with to have the tax exemption. In case of Nepal residents (and nationals), the country which pays for that employment levies tax on the income and Nepal also levies tax on the same income. In this case, Nepal levies tax at full (resident having source of income in Nepal) and no foreign tax credit is allowed (and hence the income is taxed in two jurisdiction, i.e. double taxation).

- **Income of a natural person (Condition 1)**

  Income derived by a natural person from an employment of a public service of a foreign government is exempted from income tax if both the following conditions are satisfied:

  The individual is a resident of Nepal only because his/her employment in Nepal or he is a non-resident of Nepal; and

  The payment of the income is made from the public fund of the foreign government.

  Examples are income of a foreign diplomats or *foreign staff* in a diplomatic mission in Nepal.

- **Income Derived by a natural person (Condition 2)**

  The income derived by a natural person, who is not a citizen of Nepal and is a resident of Nepal only because of his employment or is a nonresident of Nepal or the income derived by a member of his immediate family, from a public fund of a foreign government is exempted from income tax.

  Examples are income of a foreign diplomats or staff in a diplomatic mission in Nepal and income of a *family member of foreign diplomats or foreign staff* in a diplomatic mission in Nepal.

- **Income Derived by a natural person (Condition 3)**

  The salary-income derived by a *foreign national employed by GON* is exempted from tax, as per the terms of appointment. The conditions for the tax exemption are:

  The individual is not a citizen of Nepal;

  He is appointed by GON; and

  Tax exemption on the salary payable to him is a term of his appointment.

  This tax exemption is available up to employment with GON, a provision that will be terminated if the person obtains the citizenship of Nepal. The Act has not specified the government body that warrants such exemption. The examples may be *the consultants employed by GON who get such facilities in various projects,* in such cases the exemption is warranted by the project itself (in form of request for proposal, RFP).

- **Social Security Allowances Paid by GON, Province Government or Local level Government.**
- **Amount Received as Gift, Bequest, Inheritance, or Scholarship** *(except as required to be included in calculating the taxable income from business under Section 7, from employment under Section 8 and from investment under Section 9 or wind-fall gains under Sec. 5/88A)*

  Any Income of Government of Nepal, Province Government or Local level Government is exempted from tax.

- Amounts derived Nepal Rastra Bank as per its objective is exempted from income tax.
- **Amount Derived by a Tax-Exempt Organization**

  Amount derived by a tax-exempt organization in the form of:

Donation,

Gift, and/or

A contribution that is directly related to the objective of the organization and the person making such contribution shall not expect any consideration in return of such contribution.

"Contribution that is related directly to the objective" has not been defined and clarified anywhere in the Act.

If the tax-exempt organization provides any benefit (e.g. distributions or equivalents; or capital refund to is beneficiaries; or other tax avoidances schemes), which is neither according to the object of the organization nor given in consideration of assets provided to the organization, to a person, the benefit of tax exemption is not available to the organization.

Even if the exemption certificate is granted to the organization, any income that is beyond the objective of the organization and the business income or investments income

are taxable. By these concepts, tax-exempt organization is not tax-exempt in organizational form, but exemption is allowed in events covered by the certificate only.

Definition of Tax Exempted Organizations {Section 2 (dh)}

- An organization registered in Inland Revenue Department as tax exempted organization and established with either of these two objectives:
  - Established without having a profit motive, and have social, religious, educational, or charitable objectives.
  - An amateur sporting association formed for the purpose of promoting social or sporting amenities without having an aim to distribute the income among its members.
- A political party registered with the Election Commission.

  Provided that, any entity, giving benefit to any person from the assets of, and amounts derived by the entity except in pursuit of the entity's function as per its objectives or as payment for assets or services rendered to the entity by the person, is not exempted from tax under this clause.

- **Pension Received by a Nepali Citizen**

  The pension income of a Nepalese citizen retired from army or police services of a foreign country is exempted from income tax, provided the amount is payable from the public fund of that country.

- **Drinking Water and Sanitation Consumer Organization**

  Amount earned as per its objective by Drinking Water and Sanitation Consumer Organization registered as per Water Resources Act, 2049

- **Business Concessions**

  Business Concessions and exemptions in certain Income are dealt in with Section 11 and 11Ka of the Act. We shall discuss the business exemptions, concessions and facilities in the following Sections.

- **Income from Agriculture {Sec. 11(1)}**

  Income from agriculture is exempted from income tax, *if the land is owned and cultivated by a farmer (natural person) within the limit as prescribed in Land Act, 2021.*

  The following agricultural income is not exempt for tax:

  If the income is derived by a Person who carries on agricultural activities after registering as a firm, a partnership, a company or a corporate body.

  In case An industrial unit that does not hold the land for industrial purpose as specified by a notification from GON and as per the terms of the notification under Section 12 (d) of Land Act, 2021; and

  An agro-industrial unit has not held the land for agro- based industries as specified by a notification from GON and as per the terms of the notification under Section 12 (e) of Land Act, 2021.

  Definition of Agricultural Income (Clarification clause in Sec 11)

  Agricultural income means an income from crop farming on public or private land and also deriving rent from tenant (kut) using the land.

  The following activities may be treated as agricultural business:

  Cultivation of crops, primary procession to make them saleable, and the sales of the crop. The sale of the grass or other byproducts is also taken under the agricultural business; and

  Rent/kut derived by the farmer from a tenant who uses the land for farming.

- Income Derived by Certain Cooperative Society {Sec 11 (2)}

  Income of a cooperative society that has been incorporated under Cooperative Societies Act, 2074; earned from any one or more activities stated below is exempted from income tax.

- **Activities Based on Agriculture and Forest Products**

  Activities Based on Agriculture and Forest Products denote the following:

  - Sericulture and silk production.
  - Horticulture and fruit procession and production.
  - Tea gardening and processing.

- Coffee farming and processing.
- Cultivation of herbs and procession.
- Vegetable seeds farming.
- Rubber farming.
- Floriculture and production.
- Leasehold forestry.
- Agro forestry.
- Animal husbandry.
- Dairy industry.
- Poultry farming.
- Fishery.
- Bee keeping.
- Honey production.
- Business related to agriculture and forest: such as
- Cold storage for vegetable etc.
- Industries based on agro-products or forest products.
- Trading of agricultural seeds, insecticides, fertilizers, and agricultural tools (otherwise than the machinery operated).

- **Income of a Saving and Credit Cooperative Society**

  As per section 11 (2), the income of a cooperative society on rural municipality is exempted from tax. Dividend distributed by the above mentioned cooperative societies are also exempt from tax.

Tax Concessions

- **Special Industry Fully Operated during the year**

  As per Section 11(2Kha), Following rebate will be allowed on Income Tax for Special Industry fully operated during any Income Year:

  (Ka) 1/3 of Tax on income of Resident Natural Person if required to pay tax at 30%

  (Kha) 20% of Income Tax on income of an Entity

  (Ga) Person availing benefit as per Clause (Ka) and (Kha) is also eligible if any for another tax rebate as per this section.

- **Income of Special Industry & Information Technology Industry**
- **On the basis of Direct Employment (Sec 11 (3) (Ka))**

  - If any special industry & Information Technology Industry provided direct employment to *100 or more Nepalese national* during the whole Income Year, the effective tax rate for income of such industry will be reduced to 90% of applicable tax rate

  - If any special industry & Information Technology Industry provided direct employment to *300 or more Nepalese national* during the whole Income Year, the effective tax rate for income of such industry will be reduced to 80% of applicable tax rate

  - If any special industry & Information Technology Industry provided direct employment to *500 or more Nepalese national* during the whole Income Year, the effective tax rate for income of such industry will be reduced to 75% of applicable tax rate

  - If any special industry & Information Technology Industry provided direct employment to *1000 or more Nepalese national* during the whole Income Year, the effective tax rate for income of such industry will be reduced to 70% of applicable tax rate

  - If any special industry & Information Technology Industry provided direct employment to *100 or more Nepalese national*, out of which *one-third of the total employees are represented by women, oppressed/down-trodden people or disabled individual;* during the whole Income Year, additional rebate of 10% will be provided in addition to above.

- **On the basis of Area of Establishment (Sec 11 (3) (Kha)**

  - If any special industry is operated in *Remote area, the income of such industry is taxed at 10% of applicable tax rate for ten Income Years from the date of commercial production or transaction.*

  - If any special industry is operated in *Undeveloped Area,* the income of such industry is taxed at 20% of applicable tax rate for ten Income Years *from the date of commercial production or transaction.*

  - If any special industry is operated in Underdeveloped Area, the income of such industry is taxed at 30% of applicable tax rate for ten Income Years from the date of commercial production or transaction.

- **On the basis of Direct Employment and Capital Investment (Sec 11 (3) (Ga)**

  If any special industry and tourism industry (other than casino) establishing with capital investment of more than one billion Rupees and providing direct employment to more than five hundred individuals throughout the year then 100% tax exemption for five years from the date of commencement of transaction and 50% exemption on applicable tax for three years thereafter will be provided.

  However, for existing such industries if they increase capital investment to two billion and there is at least 25% capacity enhancement and providing direct employment to more than three hundred employment throughout the year, 100% tax exemption for five years from commercial operation of capacity enhancement and 50% exemption on applicable tax for three years thereafter.

Definition of Special Industry (Clarification Clause of Sec 11)

"Special Industry" means agro and forest based industries, mineral based industries or manufacturing/production based industries as specified in Sec 17 of Industrial Enterprises Act, 2076 except:

- Those producing cigarette, bidi, cigar, chewing tobacco, gutka, paan masala or similar other products using tobacco as basic raw material, and/or
- Those producing alcohol, beer or similar other products.

"Remote", "Undeveloped", and "Underdeveloped" Areas are prescribed in Schedule 10 of Industrial Enterprises Act, 2076.

Applicable Tax Rate for Special Industry for Income Year 2077/78 is 20%.

- **Income of an Industry Established at Notified Specific Economic Zone (Section 11(3Ka))**
- **Exemption/Concession in Income of the Industry**
- In case the industry is established at specified economic zone situated at Himali districts or at any hilly districts notified by Nepal government, the industry shall avail a tax exemption for ten years from the commencement of the business of the industry. After expiry of the 10 years, a tax concession of 50% of the tax rate applicable shall be available.
- Any industry established at any other specified economic zone shall avail tax exemption for 5 years from the commencement of the business of the industry. After expiry of the 5 years, a tax concession of 50% of the tax rate applicable shall be available.
- **Exemption/Concession in Distribution Tax**

  The industries established at any specified economic zone shall avail tax exemption on distribution of dividend for 5 years from the commencement of the business. The industries are entitled to exemption of 50% of applicable tax rate for a maximum period of 3 years after expiry of first 5 years on such distribution.

- **Exemption/Concession in Income of Foreign Investor**

  Foreign Investors are entitled to tax concessions at 50% on income generated as service fee or royalty for technology transfer, or management service fee for management services provided in the industries established at any specified economic zone.

- **Exemptions/Concessions to Manufacturing & Other Industries**

  Export by Manufacturing Industries (Sec 11(3Nga)

  Following tax rebate shall be allowed on Income from export having source in Nepal during any Income Year:

  (Ka) If resident natural person required to pay tax at 20% on Income then 25% of such tax amount and if required to pay at 30% on Income then 50% of such tax amount

  (Kha) 20% on applicable Income Tax on Income of an Entity

(Ga) Additional 25% on tax amount after availing rebate as per clause (Ka) or

(Kha) On income received from Export of Manufactured goods by manufacturing based industry

- **Entities Listed in Recognized Stock Exchange (Sec 11(3Chha)**

  Following listed industries are entitled to concessions at 15% on applicable tax rate:

  - Manufacturing/Production based industries
  - Tourism Service
  - Entities transmission, distribution and production of hydroelectricity
  - Entities working in software development, statistical processing, cyber café, digital mapping after being established in Technology Park, Biotech Park and Information Technology Park prescribed by Government of Nepal by publishing notification in Nepal gazette.

- **Industries Producing Brandy, Cider, wine (Sec (3Ja)**

  Entities established in remote areas producing brandy, cider, or wine based on fruits are entitled to concessions at 40% and 25% of applicable tax rate in very undeveloped area and undeveloped area for 10 years from commencement of operation.

- **Other Concessions/Exemptions**
- **Concessions to Petro-exploration Industries (Sec 11 (3Kha)**

  If any industry involved in exploration and extraction of minerals, petroleum and natural gases initiates its operation within BS 2080 Chaitra, such industry will be entitled to 100% exemption of Income Tax for first Seven years from the date of business operation (date-to-date, not 7 income years) and 50% exemption in Income Tax for Three subsequent 3 years (date-to-date).

- **Concessions in case of Electricity Production (Sec 11 (3Gha))**

  The person who is permitted to production, distribution and transmission of electricity, if initiates commercial production, distribution or transmission of hydro-electricity within BS 2080 Chaitra; such person will be entitled to 100% exemption of Income Tax for first Ten years from the date of commercial production of hydroelectricity (date-to-date, not 10 income years) and 50% exemption in Income Tax for Five subsequent years (date-to-date). This facility is also entitled to electricity produced from solar, bio or wind energy.

  The entities that are already in commercial production before the application of this provision are entitled to facilities prevailing on the date of such commercial production.

- **Concessions in case of construction and operation of Roads, Bridge, Airport, Tunnel way; or operation of Tram or Trolley Bus (Sec 11 (3Cha):**

  Following tax rebate shall be allowed for 10 years from the date of commence of commercial operation to any Entity earning income from following activity:

(Ka) Operated any trolley bus, or tram then 40%

(Kha) Operated any rope way, cable car, sky bridge after construction then 40% ; or

(Ga) Operating after Construction and operation of Road, Bridge, Tunnel Way, Tunnel, Railway, Airport then50%

- **Royalty Income on Export of Intellectual Property (Sec 11 (3Jha))**

  The person is entitled to concessions at 25% of applicable tax rate, if the person receives royalty income from export of intellectual property.

- **Income on Disposal of Intellectual Property through Sales (Sec 11 (3Yna))**

  The person is entitled to concessions at 50% of applicable tax rate, if the person generates income from sale of intellectual property.

- **Concessions on conversion of private company into public company (Sec 11 (3Dda)**

  If a private company with paid up capital Rs. 500 million or more conducts operation by converting into public company, the company is entitled to concession of 10% of applicable tax rate for three years from the date of conversion,

  However, the same provision is not applicable to companies specified in section 12 of the Companies Act, 2063.

- **Concession to domestic tea production and processing, diary and garment industries (Sec 11 (3Ddha)**

  The person is entitled to concession of 50% of applicable tax rate, in case the person conducts:

  - domestic tea production and processing industry
  - domestic dairy industry trading on milk substance
  - domestic garment and textile industry

- **Concession to community based health institution (Sec 11 (3Na)**

  Concession of 20% on applicable tax rate is provided on taxable income of health institution operated by community based organization.

- **Concession on Micro Entrepreneurial Industry (Sec 11 (3Ta))**

  Concession of 100% on applicable tax rate is provided for seven years from the date of commencement of business for micro entrepreneurial industry. Further, concession for additional three years is provided if such micro entrepreneurial industry is run by woman entrepreneur.

- As per Section 11(3 Tha), Rebate of 20% shall be allowed on Tax on taxable income in any income year of an entity wholly engaged in the projects conducted by any entity so as to build public infrastructure, own, operate and transfer it to the GON and in power generation, transmission, or distribution.

- **Limitation on the concessions available {S 11(7)}**

  In cases when the industries are entitled to time-bound exemptions/concessions under Sec 11, and the industries are operated after acquiring assets of industries that have already entertained such facilities; then the period of such time-bound concessions shall be considered after including the period of use of such assets by previous industries.

  For example; B Ltd. is a special industry operating in Remote Area established on Baisakh 2070. In this case, the effective tax rate for B Ltd. is 10% of applicable tax rate (2% in case of IY 2070/71) beginning from IY 2070/71 and ending on IY 2080/81. Suppose, B Ltd. sells all its assets on 2077/78 to A Ltd. In this case A Ltd. is entitled to effective tax rate of 10% of applicable tax rate till IY 2080/81 only since the concession period shall be counted based on the utilization of assets of the industry, not on the status of the industry.

- **Income Derived by an Approved Retirement Fund {Section 64(2)}**

  Income derived by an approved retirement fund is exempt from income tax. The definition and method of calculating the income and other related provisions are given in the Chapter 4.

CHAPTER: 4

INCOME FROM BUSINESS

Introduction to Business Income:

Business includes trade, commerce, production, profession, vocation, etc. The activity of a trade starts from the moment a good is purchased or otherwise acquired with an intention to sell it for some profit. It is not necessary that the good is sold in due course and profit is acquired there-from. It's not only the purchase and sale of goods that constitutes a trade but a sale of services is also included in the definition. The transportations of goods and human beings, tourism trade, etc. are examples of the trade of services.

Though commerce is something similar to trade, it is used especially when the trade takes place between two countries.

- **Some Basic Characteristics of a Business:**

  A business is said to be a business irrespective of whether:

  - **The Business Activities have not commenced yet:**

    - A production unit legally constitutes a business when it is incorporated or registered in the respective government department.

    - A business is deemed to be established when a person has taken effective measures to establish it. Such measures may include, registration in respective department, taking a shop on hire, purchase of furniture and office equipment, etc.

    - That is why Section 2 (kaja) says that a prospective (future) business is also treated as a business.

  - **The Business has Closed Its Business Activities:**

    The business has closed its business activities forever but all the effects concerning the business are not over even then the remaining activities of the business are treated as business activities.

    That is why Section 2 (kaja) says that a past business is also treated as a business.

Components of Income From Business {Section 7 (2)}:

Section 7 (2) of Income Tax Act, 2058 specifies certain income to be included in forming part of income from business. Each income that is a part of income from business is specified and so there is no chance for assumption of any other income, which is not specified in the Section, to be included in income from business. The detailed discussion of each component is given here under:

- **Service fee:**

  A consideration that is received by a person in lieu of some service provided to another person is called a service fee. Such a fee may be received for providing professional service or vocational service.

But service fee does not include the income from employment.

  Sometimes some services are provided along with the supply of goods under a single contract. In that case, it is very difficult to identify the consideration receivable as a service fee or a sale. In such case, Para 13 of NAS 18 Revenue shall assist to identify the service part and goods sales part.

- **Amount Derived From the Disposal of Trading Stock:**

  For a person engaged in a trading of whatever items, the particular items are the trading stock for him. Furniture is a trading stock for a dealer in furniture. In the same way, a plotted land is a trading stock for a property dealer. But for a dealer in furniture, the furniture used by him is not a trading stock. The amount derived from the disposal of the trading stock is included in the income from business as a major component.

  But the amount derived by disposal of business assets like land, securities, etc. and of depreciable assets like furniture, computer, vehicles, is not included in this sub-head of income from business.

  For a production unit the amount derived by disposal of its main product, byproducts, production scrap, unused and damaged packing materials, raw materials, semi-finished goods, etc are taken in this sub-head of income from business.

  The word used is "disposal" for sales in this Act. The meaning of the word disposal is given in Section 2 (z) as the disposal of an asset or a liability including sale or transfer as mentioned in Section 40.

  Section 40 says that a disposal happens when a person parts with its ownership over the assets. So disposal of trading stock means the trader parts with the ownership of the trading stock.

  Section 40 is very much advanced in saying that the disposal of a trading stock happens under circumstances like, leasing to another person under finance lease or the goods being destroyed, lost, expired, or if in any way they are not in existence. The real meaning of the word "disposal" is transfer of ownership from a person but it does not count that the ownership is handed over to another person.

  The income from business in this sub-head is any amount derived on disposal of a trading stock. In case of fire, expiry, loss, etc of goods, the person derives no amount and so there is no income to the person but even then there is a disposal of the goods.

Leasing of property and sales under annuities and installments:

Leasing of a property or good is, generally, treated as investment, but a finance lease is treated as disposal of a trading stock, if leased asset was a trading stock on the books of lessor. The detailed discussion on conditions and treatment of Finance Lease arrangement is dealt with in Chapter 5.

Amount of Sales of Damaged Goods

The amount of sales of damaged goods is as declared by the person in lack of evidences substantiating otherwise. It is held in the case of Tax Office, Dharan Vs Ganesh Ferrosing Industries (P) Ltd. (Decided by SC on 2062/8/15) that the selling price of damaged and wastages cannot be ascertained in the lack of related legal provisions regarding the same, and the amount declared by the taxpayer is valid in lack of other substantiating evidence.

- **Net Gains From the Disposal of the Person's Business Assets or Liabilities of the Business as Calculated under Chapter 8 of Income Tax Act, 2058.**

"Business Assets" means any assets used in a business either for its own use or for the purpose of an investment. But a depreciable asset and trading stock are excluded from this definition. It means a piece of land, an interest in any entity, and a security held by a person is classified as business assets {Section 2(kata)}.

The calculation of Net Gain on Disposal of Business Liability has been discussed in detailed in Chapter 5.

- **Amount Deemed to be Gain on Disposal of Depreciable Assets of a Business as per Section 4 (2)(a) of Schedule 2 of the Act (Balancing Charge)**

Depreciable Assets:

Section 2 (kara) has defined depreciable assets as assets used in generating income by a person from a business or investment and that are likely to lose their value because of wear and tear, obsolescence, or the passing away of time. Depreciable assets include both tangible and intangible ones. The classification of depreciable assets, cost of depreciable assets, depreciable basis or absorbed or unabsorbed additions have been discussed in Chapter 4.8.7.

Gain or Loss from the Disposal of Depreciable Assets:

Computation to be done on pool based (not on individual asset), the formula shall be

Pool-based computation		Assets remains at year-end	Pool itself dissolved
Opening Depreciation Base	A	+	+
Absorbed addition	B	+	+
Disposal proceeds (received or receivables)	C	-	-
Terminal Depreciation	A+B-C	NA	+ve
Balancing Charge	A+B-C	-ve	-ve
Depreciation Base	A+B-C	+ve	NA

Hence, if disposal proceeds exceed outgoings (opening depreciation base+ absorbed addition), the amount is includible in inclusion for the purpose of profit and gain (so-called balancing charge). Loss (in case of dissolution of pool) is allowed as depreciation (so-called terminal depreciation).

- **Gifts Received by a Person in Respect of the Business:**

  Any gift received by a person in connection with the business should be taken as income from the business. If the gift received is an object instead of cash, the prevailing market price of the gift should be treated as income.

- **Amount Derived by a Person in Consideration of its Accepting a Restriction on the Capacity to Conduct a Business:**

  A person has a fundamental right to trade in any commodities or services that are not restricted by any prevailing Act or Rules. In the case of a person accepting an extra amount in consideration of accepting a restriction imposed by some interested person, the amount will be treated as income from business.

- **Any Income Derived is of a Nature of Income From Investment if it Directly Relates with the Business of the Person:**

  Interest accrued on deposits with dealers or producers is one of the examples of the amount derived that are effectively connected with the business and that would otherwise be included in calculating the person's income from investment. Under this provision almost investments income of an entity and firms are taxed under income from business (so, practically, income from investments is tuned to nil except gain for land and security sale of a natural person's non-business chargeable assets).

- **Other Amounts being Included in the Income From Business under Chapter 6 or 7 or under Section 56 or 60 of the Act:**

- **Change in Basis of Accounting {Section 22 (6)}:**

  In case a person adopted a cash basis of accounting system in the previous year, but for the current income year he seeks the permission of IRD for adopting an accrued system of accounting, IRD may give the permission with a condition to adjust the income of the year in such a way that This facility is possible for a business conducted by proprietorship firm and partnership firm.

  If permission is granted for imposing such a condition, the amount specified with the permission should be included in the income from business under this sub-head.

- **Gain from Exchange Fluctuation {Section 24 (4)}:**

  There may be possibility that a person has booked any payment receivable or payable according to accrual system of accounting, and the amount so booked differs at the time of the payment, due to exchange fluctuation or any other reason.

  In such cases, the difference in amount should be adjusted during the income year when the payment is made from the income from business under this sub-head.

Example to explain gain or loss from exchange fluctuation:

M/s Prakash Stores issued an invoice to a party in USA on Jestha 15 for $ 5000. On the same date the firm credited sales account and debited debtors account by Rs. 380,000 assuming that the spot exchange rate was Rs.76.

On Shrawan 20, the firm received a bank advice for Rs. 391,250 for the amount received from the party. The difference of Rs. 391,250- 380,000 = Rs. 11,250 should be included in the income from business under this sub-head during the income year when such amount is received.

- **Recovery of Bad Debts {Section 25 (1)}:**

  In case of repetitive failure to recover debts after adopting for such recover, the person may write off such debt booking expense against it. Let us assume that the same has been allowed for tax purpose. During the current income year the debtor has paid the amount to him or the person writing off such debt, somehow, becomes able to recover the amount.

  In this case the person should treat the amount as his taxable income from business under this sub-head.

  In case, written off bad debts were not allowed as deduction for tax purpose at the time of write-off; in such cases there will be no question of including the write back of such debts as Income for tax purpose.

  Similarly, in case a person shows an amount as expenses as per the accrual system of accounting during any previous income year and later on, the person, who has a right to receive the amount, disclaims the entitlement to receive the amount or in case of a debt, the person writes off the debts as bad, the person who is liable to pay the amount or debt should include the amount in his income from business under this sub-head.

  Suppose, Bhudha magar Impex could not recover some bills from Jardag amounting Rs. 200,000 and write these dues off. This written off is allowed as expense in the year of written off (as this is the case of practically remote condition of recovering dues). After 5 years of written off, Jardag paid the due. Then in the year of receipt, it is includible in inclusion. Further suppose, out of Rs. 200,000, tax allowed Rs. 150,000 as bad debt in the year of written off; then only Rs. 150,000 from recovery of whole Rs. 200,000 is includible in inclusion in the year of receipt.

  What shall be the tax impact, if the receivable of Rs. 200,000 were refund with interest/delay damage of Rs. 30,000 after 5 years?

  In such case, interest shall be included in income at full, irrespective of bad debt allowed as expense or not.

  Dahal Ltd. claimed Rs. 300,000 as bank interest expense for the purpose of Sec. 14 based on accrual accounting. On the settlement of interest expense, bank allowed 10% remissions. In such case, these remissions (deduction already allowed u/s 14) are includible in inclusion according to Sec. 25 (the tax return file of the concern year of deduction cannot be opened so far).

- **Income from a Long-Term Contract {Section 26 (1)}:**

  Definition of Long Term Contract

  "Long Term Contract" means the contract of following conditions:

  - The contract is for production, installation, construction, or the services related to the production, installation or construction, and the term of the contract is more than one year, or
  - The contract is "Deferred Return" Contract except in cases when the contact is "Excluded Contract" and the term of contract is more than 12 Months.

  "Deferred Return Contract" means, according to Rule 10 of Income Tax Rules, 2059; a contract a deferred return contract, if any party to a contract does not declare the information related to the estimated profit and estimated loss for the period of every six months starting from the commencement of the contract, as required by IRD.

  In simple words, we can say that the deferred return is a term used for the return, which would be accurately calculated on the completion of the contract. If the condition is such that the partial performance of the contract can be identified, as a single contract and the consideration for the part would be calculated justifiably, then the contract is not treated as that of deferred return.

  The Section further says that an excluded contract is not taken as a deferred return contract. Rule 11 of the Income Tax Rules has defined excluded contracts as any one of these:

  - Any contract that is executed solely because the parties to the contract have an inherent interest in the entity.
  - Any contract that is executed solely because one of the parties to the contract has had the membership of a retirement fund.
  - Any contract for investment insurance (Life insurance).

  Person filing his/her income tax under presumptive tax payer's benefits need not account long-term contract as per Sec. 26, even the period of contract is more than 12 months. Based on this principle, if a person adopts himself/herself as presumptive tax payer, then the person shall be presumptive until end of contract having tenure more than 12 months.

  According to the Section, the net gain from a long-term contract during a particular income year should be calculated on the basis of the percentage of completion of the contract. At the end of each financial year, a percentage of the total work is to be calculated on the basis of the work completed. *'International Financial Reporting Standard 15: Revenue From Contract with Customers' or 'Nepal Financial Reporting Standard 15: Revenue From Contract with Customers'* has suggested the following three alternative methods to measure the work performed.

  - The proportion that contract costs incurred for the work performed to date bear to the estimated total contract costs.

Survey of the work performed. Or

- Completion of a physical proportion of the contract.
- To calculate the gain for an income year from a long-term contract, it is suggested that these figures be calculated:
- The Contracted amount on the day of the balance sheet. It includes contracted amount as per signing of contract plus or minus variations (but excludes price adjustments or actual payments). So,

  Contract Amount = Original Contract amount ±Variation Orders (VOs)

- The estimated contract cost on the day of the balance sheet (at each reporting date, the estimation may different), and
- The percentage of the completion of the contract on the day of the balance sheet; based on real site expense.

The estimated contract revenue and the estimated contract cost mean an estimation of the revenue and cost of the entire contract. The formula may be something like this:

Real cost at the year-end (cumulative)	A
Estimated cost at the year-end (including real cost occurred)	B
Percentage of Completion	C=A/B*100%
Contract Amount (including VOs)	D
Cumulative Revenue	E=D*C
Cumulative Deduction	A

In the revenue, exact received of running bills or price adjustments, if any, is not consider.

Example to explain recognition of gain from a long-term contract during an income year:

Prakash Construction Co. entered into an agreement with Deurali Trade to construct a building for the administrative block of Deurali Trade. The main points of the agreement are as follows:

Contract Amount	Rs. 150,000,000		
Contract Period	3 years		
Date of contract	Magh 1		
	Estimated Cost of remaining works	Actual cost Incurred for completed works	Variation order (each) (±)
Income Year 1	135,000,000	27,000,000	
Income Year 2	135,000,000	78,000,000	+2,000,000
Income Year 3	140,000,000	120,000,000	+1,000,000
Income Year 4	-	141,000,000	-500,000

The project was completed 2 weeks earlier than contracted period. A bonus of 0.5% per week was agreed in the initial contract maximum limit is 10%. Price adjustment payments were Rs. 1.500.000 in total.

		Income Year 1	**Income Year 2**	**Income Year 3**	**Income Year 4**
Cumulative Expense	A	27,000,000	78,000,000	120,000,000	141,000,000
Estimated Cost	B	135,000,000	135,000,000	140,000,000	141,000,000
Percentage of completion	C=A/B	20.00%	57.77%	85.71%	100.00%
Contract Amount Initial	D	150,000,000	150,000,000	150,000,000	150,000,000
Variation Order	E= sum of VO		2,000,000	3,000,000	2,500,000
Contract Amount Adjusted	F=D+E	150,000,000	152,000,000	153,000,000	152,500,000
Cumulative Revenue	G=F*C	30,000,000	87,810,400	131,136,300	152,500,000
Price Adjustments	H				1,500,000
	I				1,500,000
Cumulative Revenue	J=G+H+I	30,000,000	87,810,400	131,136,300	155,500,000
Cumulative Expense	K	27,000,000	78,000,000	120,000,000	141,000,000
Cumulative Gain	L	3,000,000	9,810,400	11,136,300	14,500,000
Prior Year Gain	M=Lt-1	-	3,000,000	9,810,400	11,136,300
This Year Gain	N=L-M	3,000,000	6,810,400	1,325,900	3,363,700

Overhead expense is to be deducted after computing these calculations for each contract. The three years contracts from Magh 1 has completed in 2 weeks earlier of 3 years means it has 4 income year.

- **Interest Rate Lower than Market Rate {Sec. 27(1)(d)}:**

  In cases where the rate of interest on loans or advances paid by a person during an income year is lower than the prevailing market rate of interest, the amount, to the extent it is lower, should be included in the income from business.

- **Indirect Advantage from Associated Person (Sec. 29):**

  In case a person acquires an indirect advantage of a payment made by a payer or his Associated Person, or the payee authorizes another person to receive the amount, the Department may, by written notice, treat the person who receives the advantage or authorizes another person to receive the amount, as he receives the amount. In case IRD has issued a notice to a person to include an amount in his taxable business income under this Section, he should include the amount under this sub-head.

- **Compensation Received (Sec. 31):**

  Compensation received by a person or someone related to him in connection with his business, either due to an insurance policy taken or otherwise, to cover any one of the risks noted hereunder, is to be included in income from business under this sub-head:

  - Income received or likely to be receivable, or the compensation for any amount that is to be included in the taxable business income.

  - Loss incurred by the person or likely to be incurred, or the compensation for any amount that is to be deducted for computation of the taxable income.

  Compensation is included in income at gross and corresponding expense is allowed in the concern head of deduction; so in case, trading stock is lost and compensation thereto is income whereas loss stock is deducted as per Sec. 15 (Cost of trading stock disposed= opening stock + addition-closing stock, physical stock at market value or cost lower basis).

  In case person, having loss of asset and probable (or actual compensation) wish to apply Sec. 46 (involuntary with replacement), then only compensation is not includible in inclusion, a written notice under Sec. 46 need to file with income tax return.

- **Distribution of Income Otherwise than Out of Profit {Sec. 56(3)}:**

  In case an entity distributes dividend out of any amount other than profit, the amount of dividend will be treated as income from business under this sub-head.

  Examples of such dividends may be taken as follows:

Balance sheet before distribution

	Carrying Amount	Tax Base	Market Value
Paid up capital	1,000,000	1,000,000	
Retained Earnings	1,000,000	950,000	
Business Liability	1,000,000	1,000,000	975,000

	Carrying Amount	Tax Base	Market Value
	3,000,000	2,950,000	975,000
Trading Stock	1,000,000	1,000,000	1,200,000
Depreciable assets	1,000,000	900,000	1,100,000
Business Assets	1,000,000	1,050,000	950,000
	3,000,000	2,950,000	3,250,000
Net-worth	2,000,000	1,950,000	2,275,000

As per Company Act, 2063, distributable profit for the company is Rs. 1,000,000. Assuming AGM of the company declared the dividend of Rs. 100,000. Then the tax impact shall be:

Distributable amount as per Sec. 53(4) is Rs. 1,275,000 (2,275,000-1,000,000); out of which Rs. 950,000 is distribution from tax-paid retained earnings (tax base of RE) and remaining is distributable amount in which corporate tax has not been paid. In the given case, actual distribution is Rs. 1,000,000, so whole amount is distribution and Rs. 50,000 (1,000,000-950,000) is includible in inclusion for income from business under Sec. 56(3).

- **Change in Ownership (Section 57)**

  This is not a separate source of inclusion for taxation purpose, rather a separate situation of levying tax. In case any entity, the controlling ownership of which is changed, then the entity is required to compute tax till the period of such change in ownership as separate Income Year and a return shall be filed within 3 months of such change in ownership and the entity shall file another tax return for remaining period till next Ashad as separate Income Year.

  The financial statements are prepared as per relevant statute and Nepal Accounting standards for the whole Income (Financial) Year. The taxpayer shall prepare separate statements to charge Tax as per the essence of Sec 57 of the Act.

  What accounts for change in controlling ownership?

  If the controlling ownership is changed by 50% or more in total shares within a period of 3 years (each day is end of any three years period, so this impact need to compute on each day of transfer of shares, provided, transfer of shares by the owner having less than 1% is not counted for computing 50% purpose). Shareholdings of the shareholders holding less than 1% by the associated person of shareholders holding 1% or more are taken into counting scheme.

  Effect- The entity said disposing controlling shares need to file income tax return for the period of Shrawan 1 to the date when such change in ownership becomes effective as separate income year. This return, as per Sec. 96, is required to be filed within 3 months from date of change of ownership.

  All the assets and liabilities deemed to be disposed at market value as per Sec 41 of Income Tax

Act, 2058. Due to disposal of all assets, there is no any requirement to compute depreciation, but terminal depreciation or balancing charge shall be calculated as per Schedule 2 of the Act.

The loss, if any, unrelieved is not transferred to new entity.

For the tax purpose, a separate entity is deemed to be formed that procures the assets and liabilities disposed by the entity through the disposal of controlling shares by the existing shareholders to new shareholders. The tax base of all assets is market price (on which the entity said disposing controlling shares disposed). Depreciation need to be computed on pooling date base. Accounting goodwill shall not be tax base, because, no goodwill is recognized under Sec. 49.

***Responsibility to file Tax Return*-** The tax return to be filed within 3 months from date of transfer of control, new management is responsible for filing return, complying tax impacts. The tax effect, if any, would be a good basis for negotiation of share prices.

Conceptual example:

Tax Base Balance Sheet as on controlling shares transfer including impacts

Head	Carrying Amount	Tax Base	Market Price	Impact on return	Remarks
Share Capital (equity and preference)	1000	1000			
Retained Earning	1000	2450			
Long-term debt	1000	1000	1050	-50	Sec. 37
Current liabilities	1000	1000	975	25	Sec. 37
Provision	1000	0			
	5000	5450	2025		
PPE	1000	900	1050	150	Sch. 2
Investments	1000	1050	1025	-25	Sec. 37
Trading Stock	1000	1000	1100	100	Sec. 15/7
Receivables	1000	1000	950	-50	Sec. 37
Banks	1000	1000	975	-25	Sec. 37
Loss unrelieved		500		-500	Sec. 36

Income from business for effect of ownership change:

Sales (plus normal sales)	1100
Balancing Charge	150
Net Gain*	0
Inclusion	1,250.00

Deduction	
COGS (plus normal)	1000
Income from ownership change	250
After tax profit (tax @25%)	187.5

*Net Gain u/s 36	
Gain on gain items u/s 37	25
Loss during year u/s 37	-150
Prior year loss u/s 37	-500
Net Gain u/s 36	0
Unrelieved forever	-625

Tax Base of new controller's entity

Head	Tax Base for new
Share Capital (equity and preference)	1000
Retained Earnings*	2012.5
Long-term debt	1050
Current liabilities	975
Tax payables	62.5
Provision	0
	5100
PPE	1050
Investments	1025
Trading Stock	1100
Receivables	950
Banks	975
Loss unrelieved	0
	5100

*Distribution of these retained earnings (2450+250*0.75-625=2012.50) is taxed in the hand of old shareholders (existing old and disposing old, both) as per Sec. 58.

- **Section 47Ka: Merger non-applicability of Sec. 57**

  Applicability of Sec. 57 is not applicable for qualifying cases of merger of bank/FIs and insurance business. Again, this is not source of income as inclusion and this is for transitional period of two year.

  Conditions for granting non-applicability of Sec. 57 under Sec. 47Ka:

- This is allowed for application of intend to merger till 2078 Ashad end and merger to be completed till 2079 Ashad end. .
- Applied for merger of Bank and FIs or merger of insurance business (similar nature).
- Equally applicable for amalgamation (two entities merged and third entity formed) or absorption (one entity takes the business and corporate structure of another entity). Entity being taking over another entity is transferor (legal wording, merging entity) and entity which is merged with another is transferee (legal wording, non-existed entity disposing by merger).

Effects of granting non-applicability of Sec. 57 under Sec. 47Ka:

- Eligible loss of transferee is accumulated and allowed for set of with merged entity at 1/7th each year. This gives benefits of loss set off period of 14 years till. *Interestingly, if so merged entity demerged, allowed loss is reversed in the hand of merged entity and taxed at the rate applicable for income year of merger (not demerger). This is levied in the year of demerg*er as separate taxing person, but income tax return file is not reopen for this purpose.
- Unlike in Sec. 57, the valuation is done as follows:

Head	Valuation as per	
	Sec. 57	Sec. 47Ka
Trading Stock	Mkt. Value	Tax Base u/s 15
Depreciable Assets	Mkt. Value	Tax Base u/Sch 2
Business Assets	Mkt. Value	Tax Base u/s 38(2)
Total Assets		
Paid up capital	0	
Retained Earnings	0	
Business Liabilities	Mkt. Value	Min (Mkt, Tax Base u/s 39(2)

- The assets are transferred at tax base, so no profit or gain will be raised. In case of liability, the gain (if any) is includible. Transferee need to file its last return showing above valuation.
- In case, any assets or liability raised after merger and acquisition, against the events before than that, then above valuation is not accepted. In such case, market price is basis (u/s 27), if other valuation is not warranted by other sections of the act.

Reduced rate for non-applicability of Sec. 57 under Sec. 47Ka:

- In case of merger and acquisition, employees' retirement requires with additional compensation; such compensation (additional portion only) is taxed at half of applicable rate of tax. Remaining payments (as per terms and conditions of the employment) is taxed at normal rate.
- Gain on disposal of shares from the merged entity is not taxed for the period of 2 years from date of merger.

- Tax on distribution from the merged entity is not taxed for the period of 2 years from date of merger.

Obviously, above waivers are not horizontal equity for the similar cases of incomes.

Section 60: Income of a General Insurance:

An income from a general insurance business shall be included in the income from business for tax purpose.

- **Exempt Amounts and Final Withholding Incomes:**

  Whatever mentioned about the inclusion of the receipts for tax purpose as explained in point no. 3.1 above, those incomes which are exempted from the tax as per Section 10 of the Act and those incomes which are subject to final withholding of tax are excluded from the income from business for tax purpose. For this purpose, concessional income under Sec. 11 is includible but not excluded from Assessable income according to Sec. 6.

Allowable Expenses in Computing the Net Income from Business:

Notes to Students for ease of Remembering:

- Students should note the Basis of Accounting as per Sec. 22 of the Act.
- Students should identify whether the expenditure in question is expressly not deductible u/s 21 of the Act. There are SIX EXPENDITURES that are expressly not deductible under the Act.
- Then, students should revisit the provisions of Sec. 14-20 to determine whether the expenditure discussed in those Sections are allowable or not. Such Expenditures are Interest Expenses (u/s 14), Cost of Trading Stock (Sec. 15), Repair & Improvement Expenses (Sec. 16), Pollution Control Cost (Sec. 17), Research & Development Cost (Sec. 18), Depreciation (Sec. 19 & Schedule 2) and Set off & Carry Forward of Losses (sec. 20). That means, these expenditures indicated in this paragraph are dealt in with the section specified herein. However, for allowed deduction under these sections, expenses should be passed through section 13 too.
- For all other expenditure that are not disallowed u/s 21 and not covered by Sec. 14-20 are checked for its allowance for tax purpose by applying THREE PRINCIPLES specified in Section 13 of the Act.

Discussions in this Section of this Chapter have been done in Reverse Order from 4-2 and the basis of accounting has been dealt with in Chapter 2.

- **General Deductions (Sec 13):**

  Subject to the discussions in Notes to Students Section above, all the expenses incurred by a person, in connection with the earning from the business, shall be deducted from the income of the business in computing the profit or gain from income from the business. The basic three guiding principles as specified by the Section are as under:

- **Matching of Year**- In order to claim deduction, it is necessary that the expenditure shall be related to the Income Year for which the tax has been calculated. In case when a person adopts a cash basis of accounting, the expenditure paid during the year shall be deducted for tax purpose. Similarly, in case when accrued system of accounting is adopted, the expenditure accrued during the income year shall be deducted.

- **Matching of Person** -In order to avail the deduction, it is necessary that the person, the tax of whom is being calculated, shall incur the expenditure. The person, who is debiting the expenditure in his accounts, should be obliged to bear it because the transactions relate to his business. The other person must have an enforceable right to recover the amount from him.

- **Matching of Inclusion-** In order to claim deduction, the expenditure should have been incurred in connection with the person's business or in connection with his income-generating source. The expenditure should be helpful, directly or indirectly, in generating the income from the business.

- **Interest Expenses (Sec. 14):**

When a person borrows a fund from another person for a business purpose and, in consideration of utilization of the fund for his own benefit, incurs certain expenditure, such expenditure is known as interest.

Definition of Interest as per Act

Interest means the following payment or gain:

- Payment under debt obligation except for payment of Principal

- Discount, Premium, alteration payment under Debt Obligation, or any other gain received under similar payments

- The amount that are received as Interest under Sec 32 of the Act in making payments the use of any assets under finance lease or sale of asset under annuity or installment sales

Interest is an allowable expenditure if it is paid on the borrowed capital but not on one's own capital. A proprietor cannot charge interest as allowable expenditure on his own capital. There is no difference in the provision whether the capital invested in the firm by the proprietor is in the shape of fixed capital, variable capital, advances, or loans.

Interest paid or payable by one unit of the person to another unit is not allowed deduction. Head office may charge interest on the capital employed by branches, divisions, etc., but such an interest is not allowed for deduction. Such adjustments may be beneficial for internal assessment of the branches or the divisions but on the whole they affect nothing.

Conditions to Claim Interest Expenditure

ALL the following conditions shall be satisfied to claim interest expenditure for deduction in any Income Year:

- The interest shall be accrued/paid during the Income Year,
- The interest shall be /accrued/paid against debt obligation that is raised to generate income from business, and
- The interest shall be accrued/ paid on debt obligation borrowed for the asset that has been used during the Income Year or for any other cases in the normal course of business.

Notes to the Students:
Students should note that there are THREE types of Interest Expenditures dealt in with the Section.
- Interest on borrowed funds for Capital Expenditures
- Interest on other borrowed funds used in Business
- Interest on borrowed funds for Capital Expenditures or other borrowed funds used in Business that has been paid to CONTROLLING ENTITY by RESIDENT ENTITY CONTROLLED BY EXEMPT ORGANIZATION. *This concept has been introduced in the Act to address some issues of "THIN CAPITALIZATION".*

Students should also know the definition of "Resident Entity controlled by Exempt Organization" and the definition of "Adjusted Taxable Income" for this purpose.
The payments under Finance Lease arrangement of use of asset, or sale of asset through annuity or installment arrangement shall be classified into Principal portion and Interest potion. This is another type of Interest Expense that shall be claimed as Expenditure u/s 32 of the Act.

From the above conditions, the following guiding principles are derived to make the interest expenses allowable during the income year:

- *In case of Debt Obligation that has been created for Capital Expenditure (Purchase/Creation of Asset):*

Guiding Principle:

The Asset shall be used during the Income Year for the Interest Expenses to be claimed as deduction.

If the loan is borrowed for purchase of an asset, the asset must have been *put to use during the income year*. If the purchased/installed/produced asset has not used during the income year, interest on borrowed loan is to be capitalized (interest during construction, IDC). If the assets so procured are used in the business for *at least a day during the Income Year, then interest accrued/paid for the whole income year* is allowed as deduction.

Example: Machinery procured in year 1 at Rs. 20 millions (80% loan at 12% p.a.) Installation period is 2 and a half a year. Put to use is on Chatra-end of 3rd year. In this case, tax and accounting treatments (under allowed alternative treatments) is:

	Machinery Value		Interest Expense	
	Tax Base	**Carrying Amount**	**In taxation**	**in accounting**
Machinery Cost	20,000,000	20,000,000		
Interest Year 1	1,440,000	1,440,000	-	0
Interest Year 2	1,920,000	1,920,000	-	0

Interest Year 3	-	1,440,000	1,920,000	480,000
Total at year 3	23,360,000	24,800,000	1,920,000	480,000
Temporary Difference	1,440,000			

Depreciation has not been computed above, assuming loan has taken on Kartik 1 of year 1.

- *In case of Interest on Debt Obligation that has been used in Business:*

  Guiding Principle

  The borrowed that is not for capital expenditure but for other purpose shall be used during the Income Year to generate Income from business.

  It is immaterial whether (or not) any profit has actually risen due to the use of the capital. The management alone is authorized to decide the need of the borrowed capital. But if the borrowed capital has not been put to use in business during the income year, the interest paid or payable is not allowed to be deducted as expenditure.

  Iteration 1: Suppose the loan amount is allowed to be used by the owners for their personal purpose, in that case also the interest on the portion of loan utilized by the owners (siphoned-out loan) is not allowable for deduction (This will be discussed in detail in Expense not deductible Section).

  Iteration 2: If the loan amount is utilized for refund of loans or advances from the owners, in that case the interest is fully deductible.

- *Interest paid to* ***CONTROLLING ENTITY by RESIDENT ENTITY CONTROLLED BY EXEMPT ORGANIZATION (Sec 14 (2)):***

  Definition of 'Entity Controlled by Exempt Organization':

  Clarification Clause of Section 14

  An entity is deemed to be Resident Entity Controlled by Exempt Organization for any Income Year in case the Entity is Resident during the Income Year and the following entities or persons hold at least 25% shares at any time during the Income Year:

  - Exempt organization and/or its associated person,
  - Persons availing facilities and concessions u/s 11 of the Act and/or their associated person,
  - Non-resident person and/or its associated person, or
  - Any combination of above category

  In case the persons that avail concessions or exemptions under the Act or that are subject to lower tax rate (E.g., WHT rate is generally less than normal tax rate and amounts attracting WHT are final for Non-resident person) hold 25% or more shares for just a second during

the Income Year of a resident entity, then such resident entity is deemed as "Resident Entity Controlled by Exempt Organization" for the purpose of Sec 14 (2).

Concept of THIN CAPITALIZATION:

The businesses are operated through owner's capital and borrowed capital. The leverage ratio (Debt Equity) is generally prescribed for lending purpose, but, it is subjective and judgmental in case to case basis. The charges on Owner's Capital are generally deemed as Distribution and in Income Tax, they are not deductible. Instead Tax authorities levy certain TAX on such distribution. Thus, there may be cases of double taxation on distributions.

However, the case is different if the Capital is borrowed capital. The charge on such capital is deductible for tax purpose. In Nepalese perspective, Sec 14 of the Tax Act has allowed such deduction. Thus, there is possibility that the owner's inject funds as LOAN instead of CAPITAL for deduction in Tax. Tax authorities cannot limit such arrangement but lays certain provisions in Income Tax Act to discourage such practice. The practice of injecting capital in the form of debt as part of Tax avoidance scheme is Thin Capitalization.

Sec 14(2) of the Act, somehow, discourages such planning arrangement and limits the extent of use of loan instead of Capital or if the leverage is high, the maximum limit of interest expenses is based on the total income of the entity.

In case a *Resident Entity Controlled by Exempt Organization pays interest to* ***The Controlling Entity (Condition 1: Interest shall be paid to the Entity that controls the entity as per the definition in Clarification Clause), the interest paid (Condition 2: (a) If the interest is paid for loans that have been used to create/purchase asset, the asset shall be used during the year; OR (b) In other cases, the loan shall be used in business during the Income Year)*** during the year shall be claimed subject to *the* ***lower of following amounts:***

- Actual Interest paid to Controlling Entity, OR
- Sum of the following:
  - The amount of interest income derived by the entity during the income year.
  - *50% of the entity's adjusted taxable income for the income year. Adjusted Taxable Income shall be calculated without including the interest income in INCOME and the interest expenses in EXPENSE but deducting actual pollution control expense and research-development expense without any limitations. (Refer to Chapter 1 for clarification of Adjusted Taxable Income)*

Students should remember that the interest expenses shall be classified into three different categories discussed in this Section of this Chapter. Student should not mix up the interest paid to other organizations with interest paid to Controlling Entity. The limit as described above shall be limited to the Interest paid to the Controlling Entity only.

Example to explain the Limitation u/s 14 (2):

The profit and loss account of G.R. Enterprise Pvt. Ltd; owned by Mr. Thomas (non-resident), for the year ended Ashad 31, 2077 shows following:

Income from commission and fees	Rs. 500,000
Interest income	Rs. 20,000
Total income	Rs. 520,000
Adm. Expenses	Rs. 300,000
Interest expenses	Rs. 100,000
(Out of which Rs.40,000 is payable to Mr. Thomas rest to the bank)	
Depreciation	Rs. 100,000
Total expenses	Rs. 500,000
Net profit	Rs. 20,000

The interest expenses allowable due to the limitation under the sub-section are as under:

Interest income	Rs. 20,000

50% of the adjusted taxable profit before the interest income and interest expenses.
(Rs. 20,000+100,000-20,000)*50%= Rs. 50,000
Total interest expenses allowed Rs. 70,000
Thus, the company is allowed interest expense as :m
Paid or payable to Bank (fully) Rs.60,000 and paid to exempt controller Rs. 40,000 (upto Rs. 70,000); so whole the interest is allowed as deduction.

Interest Portion on Deferred Payments:

Any assets purchased under deferred payment condition the present market value on a cash term or on a credit term of a reasonable period shall be treated as cost of the assets and the remaining amount payable shall be treated as expenses during the year in which the amount is accrued. The better classification for such expenses shall be interest expenses as it is payable due to the financial arrangements. The installment purchases, hire-purchase deliveries, conditional deferred payments, etc are examples of such transactions.

For example:

An Enterprise has an established business at New Road, Kathmandu, but due to some unavoidable circumstances it wants to sell its business. On Shrawan 1, 2073, B Pvt. Ltd. had entered into an agreement with A Enterprises to purchase the business under the following conditions:

For the entire business B Pvt. Ltd. will immediately pay Rs. 80 lakhs as the purchase price. In addition to that, the purchaser shall pay Rs. 10 lakhs on Ashad 31, 2077. The payment shall be without any interest and without any other conditions. The buyer shall make a further payment of Rs.10 lakhs in case the actual profits for the four-year period exceed the cumulative forecast profit of Rs. 120 lakhs. The additional amount shall be payable as on Ashad 31, 2077 without any interest.

Actual profits are Rs. 15 lakhs during the year ending on Ashad 32, 2074. However, cumulative actual profits are Rs. 80 lakhs by the end of the year ended on Ashad 31, 2075. Management of B Pvt. Ltd. concludes at the end of the second year that payment of the additional Rs. 10 lakhs is probable. Actual profits exceed forecast profits for the final two years.

How should the deferred and contingent amounts affect the accounting for the purchase consideration and how the interest expenses are recorded?

Answer:

The purchase consideration is Rs. 80 lakhs plus the present value of the guaranteed minimum payment of Rs. 10 lakhs at the acquisition date. It is supposed that the present value of Rs. 10 lakhs, which is payable after 4 years shall be Rs. 6.50 lakhs. The Rs. 10 lakhs represents deferred purchase consideration and is a financing transaction. The buyer records Rs. 86.50 lakhs as its cost of investment, together with a provision for the deferred consideration of Rs. 6.50 lakhs. The discount of Rs. 3.50 lakhs is a finance cost and is recorded as interest expense over the four-year period.

An additional amount is payable if B Pvt. Ltd. achieves the minimum fixed level of performance. The Rs. 10 lakhs represents contingent consideration. Management concludes at the date of acquisition that payment is not probable as the forecast profit levels are too aggressive. It reaches the same conclusion at the end of year one as actual results are below forecast.

Management of the B Pvt. Ltd. revises its estimate at the end of the second year and concludes that payment of the contingent consideration is probable. An adjustment is made to the purchase consideration to record the discounted present value of the Rs. 10 lakhs. The revision to purchase consideration results in the recognition of additional goodwill (in taxation accounting concept of goodwill is not perceived rather it is treated as outgoings for the assets acquired at the point of inception for individual assets; computation basis is given in Sec. 49) and a liability. The Rs. 10 lakhs minus discounted present value shall be recorded as interest expenses over the remaining two years.

Interest Expense incurred on Loan obtained pledging the bonds of third party unrelated to the company *(Tax Office, Dharan Vs. Ganesh Ferrosing Industries (P) Ltd. {Part 10- Industry, Commerce & Tax; Precedent Collection, 2066- Pg. 21)*

It was held that the loan utilized for the purpose of business can be claimed for deduction irrespective of the way how the loan has been obtained.

- **Cost of Trading Stock (Sec. 15):**

The cost of trading stock means the cost of sales. In other words, the cost of trading goods sold during the year is the cost of trading stock. Provisions with regard to the determination of cost of sales are clearly stated in the Section.

The formula given by the Section for arriving at the value of cost of sales is given hereunder:

The opening value of the trading stock	Rs. xxxxxx
Plus: The cost of purchases, cost of production or the	
Cost of acquisition of trading stock during the year	Rs. xxxxxx
Minus: The cost of closing stock	Rs. xxxxxx
Cost of sales	Rs. xxxxxx

- **Valuation of Opening Stock:**

  The valuation of opening stock is the value that is assigned to the closing stock of the previous year.

- **Valuation of purchases:**

  The purchases are valued at the cost incurred for the goods brought to the business place.

  Components of Cost of Purchases

  The components of the cost of purchases may include:

  - The invoice value of the purchases;
  - Transportation up to the business place;
  - Custom etc. up to the extent it is not refundable;
  - Transit insurance;
  - Clearance expenses;
  - Loading and unloading expenses;
  - Bank charges for honoring the documents;
  - Other direct expenses.

  In the case of a production unit the cost of production is derived as follows:

  If a person keeps accounts on a cash basis, he may choose either the prime cost basis or the **absorption cost basis** as a method of valuation. But the person keeping accounts on an accrued basis has no choice other than to adopt the absorption cost basis of valuation.

  Cost of Production under Prime Cost Basis:

  The formula given for the prime cost basis of valuation by the Section is as follows:

  - Direct material consumption cost
  - Plus: Direct labor cost
  - Plus: Variable factory overheads

  (Even if the person follows cash basis of accounting, all three components as above are variable cost items in accrual basis)

  In the variable overhead, cost of repairs and improvement and the depreciation from the variable factory overheads are not being included (allowed separately).

  Power and fuel expenses, direct consumable store consumption, etc. may be the examples of variable factory overheads.

Cost of Production under Absorption Cost Basis:

The formula given for the absorption cost basis of valuation by the Section is as follows:

Direct material consumption cost

Plus: Direct labor cost
Plus: Variable factory overheads
Plus: Fixed factory overheads

In this method also, cost of repairs and improvement and the depreciation from the variable or fixed factory overheads are excluded.

Factory staff salary, factory electricity expenses, other administrative expenses incurred at a factory are some of the examples of fixed factory overheads.

- **Valuation of Closing Stock:**

Valuation of the closing stock of a business for an income year is done at a lower of the followings:

- Cost of the trading stock that remains till the end of the year.
- Market price of the trading stock on the end of the year.

Cost formula to be used:

In case the person cannot use Specific Identification Method for stock valuation, the person shall use either the First in First out Method or the Weighted Average Method for valuation.

A person, who has made a choice to select one method of valuation, has to adopt the same method for coming income years also. The change in the method is possible with prior permission of IRD or the respective IRO.

Points for Students:

Here are some critical points for valuation as:

- Any expense, which is addition for this year is to be tested as per Sec. 21 or Sec. 13.
- Mixed cost formulae for separate items or storages are allowed (obviously, consistency in valuation is required).
- Accounting stock cost is always higher than tax stock cost due to factory repair and factory depreciation impact, if any. Hence, there would be deferred tax in accounting.
- Person adopting cash-basis need to account the stock related items in accrual (whether in prime costing or in absorption costing).
- In case, an error is identified in the earlier income tax return, the error cannot be rectified

as restated based on NAS 02. In such cases, opening stock is the closing stock for earlier year. The taxpayer may address the impact in the stock of current Income Year with retrospective impact on taxation due to such error so as to avoid fees u/s 120 of the Act. Excess Cost claimed due to error in previous Income Year requires a tax payer to pay additional tax along with interest u/s 118 and 119. However, based on Sec 13, one cannot claim additional expenses if such expense of previous Income Year is claim at less than actual. However, it's up to a taxpayer to address such impact in the Income Year when it is identified OR wait for IRD for amended assessment u/s 101.

- Financial cost is not deemed as part of trading stock.

- **Repairs and Improvement Expenses (Sec. 16):**
- **Conditions to claim Repair & Improvement Expenses u/s 16 (Sec 16 (1)):**

ALL the **FOUR** following conditions shall be satisfied to claim Repair & Improvement Expenses u/s 16:

- The Expenditure shall be incurred during the Income Year.
- The Expenditure shall be incurred on Depreciable Asset,
- The depreciable asset shall be owned by the person, and
- The depreciable asset shall be used to generate income is allowed to be deducted from taxable income.

Claim of OTHER REPAIR AND MAINTENANCE cost:

The Repair & maintenance cost incurred for following assets are allowed separately than Sec. 16:

- Repair of trading stock – Sec. 15
- Repair of pollution control equipments- Sec. 17
- Repair of non-business chargeable assets or business assets- Sec. 38
- Repair of third party assets and intangible assets (Pool E) – Sec. 13
- Repair of depreciable assets or other assets if the asset is used by the owner, is not allowed as deduction as per Sec. 56.

- **Limit of Repair & Improvement Cost {Sec. 16(2)}:**

The Repair & Improvement Cost shall be allowed subject to the LOWER of following TWO Limits:

- Actual Repair & Improvement Expenses incurred during the Year for "Depreciable Asset of specific POOL of such Assets", or
- 7% of the Closing depreciable basis of the respective Pool at the end of the income year

Exception to the Limitation:

The Aviation companies are allowed to claim all the Repair & Improvement Expenses incurred on an *overall checking (overhauling) of the aircraft in terms of the standards fixed by Civil Aviation Authorities of Nepal (CAAN).*

That means, for the person who is engaged in providing air transport facilities, have to book the expenses on repairs and improvement on the overall checking (overhauling) of the aircraft in a separate than routine repairs of 7%.

Comments on the Rule Above

A person shall segregate pool-wise Repair & Improvement Expenses for Taxation purpose. E.g., expenses incurred to repair furniture, fixture, computer, office equipment, and statistical processing equipment shall be clubbed under Pool B. With the help of depreciation sheet, the closing depreciation base of respective pool shall be determined. The ACTUAL expenditure for a Pool shall be compared with 7% of such CLOSING DEPRECIATION BASE. The minimum of the two is allowable. ACTUAL minus 7% of CLOSING DEPRECIATION BASE shall be capitalized to arrive at the Opening Depreciation Base for next year of respective Pool.

The limit is not applicable to person operating air transport facilities on repairs and improvement on the overall checking (overhauling) of the aircraft. The person shall separately identify the amount as per the standard of CAAN. The excess of expenditure than the standard prescribed by CAAN, if any, shall be clubbed in Repair & Improvement Expenditure of Pool D.

- **Treatment of Excess of Repair & Improvement Expense over the Limit of 7% {Sec. 16(3)}:**

The portion of the expenses that cannot be claimed due to the limit of 7% during the year are allowed to be capitalized to the carrying amount of the respective pool of the assets but depreciation on that portion is allowed only a year after the capitalization.

The word 'depreciable bases' will be discussed later in Chapter 4.4.7- Depreciation.

Example to explain the concept of allowable repair expenses:

The following are the extracts regarding assets accounts and repair and improvement accounts from the books of Mahesh Brothers for the income year end. Amounts are given in thousands:

Assets	Depreciable basis	Amount of repair and improvement
Block B		
Furniture and fixtures	100	4.32
Computers	200	12.25
Other office equipment	50	2.76
Total of block B	350	19.33
Block C		

Vehicles	300	12.15
Block D		
Plant and Machinery	600	67.25
Tools and equipments	100	0
Misc. assets	70	2.20
Total of Block D	**770**	**69.45**

Question: Calculate the amount of repair and improvement allowed to be deducted from the income of the year.

Solution: The expenses on repairs and improvement are considered block-wise and the figures of such expenses incurred on individual assets are not considered for such calculation. Thus, the following table shows the solution. During the income year, the limitation of 7% applied. Amounts are given in thousands.

Block	Depreciable basis	7% of D.B.	Actual expenses	Allowed repair	Capitalized portion
B	350	24.5	19.33	19.33	0
C	300	21	12.15	12.15	0
D	770	53.9	69.45	53.9	15.55
				85.38	15.55

- **Pollution Control Costs (PCC) (Sec. 17):**

  Definition (Clarification Clause of Section 17):

  "Pollution Control Cost" means the cost incurred by a person on a process adopted to control pollution or to protect or sustain the environment.

  In other words, a cost incurred to install a process to recycle the pollutants so that the substance may not pollute either of air, water or soil, is called pollution control cost. In the pollution control expense, both the capital expenditure and revenue expenditure are included.

  Example of Pollution Control Cost

  Installation of a carbon plant in a chimney of an industry; installation of a recycling plant in a chemical factory so that pollutants may not mix with air, water or soil; installation of equipment on a chimney to burn dangerous gases, etc are examples of pollution control costs.

- **Condition**

  The two Conditions:

  - The Pollution Control Cost shall be incurred for the operation of business, and
  - The cost shall be incurred during the Income Year.

- **Limit of Pollution Control Cost:**

  Pollution Control Cost is deductible for Taxation purpose subject to the minimum of following TWO:

  - Actual Cost incurred during the Income Year (Sec 17 (1)), or
  - 50% of Adjusted Taxable Income from businesses (Sec 17 (2))

  Comments on Above

  Most of the expenses on pollution control are of capital nature. However, such expenses are also allowable u/s 17 as deduction to arrive at Assessable Income and Taxable Income of a person. Sec 17 (2) prescribes the limit of 50% of Adjusted Taxable Income from all Businesses of the Person.

  For the computation of Adjusted Taxable Income, one shall deduct Actual Research & Development Expenditure incurred during the Income Year, and actual Interest Expenses and include actual Interest Income.

  The example and further details to calculate Adjusted Taxable Income (ATI) for the purpose of Sec 17 has been discussed in Chapter 2.

- **Treatment of Portion of PCC that cannot be allowed due to the Limit of 50% of ATI from all Businesses Unabsorbed Portion:**

  In case incurred Pollution control Cost cannot be claimed due to the maximum limit of 50% of Adjusted Taxable Income from all Businesses during the Income Year, such excess of *incurred Pollution control* Cost over *50% of Adjusted Taxable Income from all Businesses* shall be capitalized in Pool D to arrive at the Opening Depreciation Base for following Income Year.

- **Research and Development (R & D) Cost (Section 18)**

  Definition (Clarification clause in Section 18):

  'Research and development' cost is the cost incurred by a person for the purpose of further development of an established business and for improvement of the production process and the products.

  This Section is applicable to the research and development cost which is incurred in order to develop something new like a new process of production, a new mechanism of production, a new and improved product, to carry out a study on consumers' choice, etc. In the research and development expense, both capital expense and revenue expense included.

  Exception of the application of this Section:

  Research and development costs incurred in respect of conducting feasibility study of prospecting natural resource, or its exploration and development, are not allowed to be deducted under this Section. Such expenditures are treated as part of assets of Pool D.

- **Limit of Research & Development Cost:**

  Research & Development Cost is deductible for Taxation purpose subject to the minimum of following TWO:

  - Actual Cost incurred during the Income Year (Sec 18 (1)), or
  - 50% of Adjusted Taxable Income from businesses (Sec 18 (2))

  Comments on Above

R & D expenses are also allowable u/s 18 as deduction to arrive at Assessable Income and Taxable Income of a person. Sec 18 (2) prescribes the limit of 50% of Adjusted Taxable Income from all Businesses of the Person.

For the computation of Adjusted Taxable Income, one shall deduct Actual Pollution Control Expenditure incurred during the Income Year, and actual Interest Expenses and include actual Interest Income.

The example and further details to calculate Adjusted Taxable Income (ATI) for the purpose of Sec 18 has been discussed in Chapter 2.

- **Treatment of Portion of R & D Cost that cannot be allowed due to the Limit of 50% of ATI from all Businesses:**

  In case incurred R & D Cost cannot be claimed due to the maximum limit of 50% of Adjusted Taxable Income from all Businesses during the Income Year, such excess of *incurred R & D Cost* over *50% of Adjusted Taxable Income from all Businesses* shall be capitalized in Pool D to arrive at the Opening Depreciation Base for following Income Year.

- **Depreciation Allowance (Sec.19):**
- **Introduction**

  Definition of Depreciation:

  The Income Tax Act has not defined the meaning of word 'depreciation'. However, the word depreciable asset is clearly defined. The following is the definition of Depreciation as per International Accounting Standard 16 on Property, Plant & Equipment and Depreciation.

  Depreciation: Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

  Depreciable amount: Depreciable amount is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value. The formula may be as follows:

  Cost of the asset up to its installation or the revalued value – residual value at the end of the useful life of the asset = Depreciable amount.

  Useful life: Useful life is either the period of time over which an asset is expected to be used by the enterprise, or the number of production or similar units expected to be obtained from the asset by the enterprise.

In simple words, depreciation is a cost of wear and tear in a depreciable asset caused by its normal use.

Usually, three methods are suggested for charging depreciation as per applicable accounting standards and practices. They are: written down value method, straight-line method, and unit production method.

A person shall calculate depreciation as per applicable accounting standard for the purpose of financial accounting. Since we are bound by the requirement of Income Tax Act, 2058, we shall follow the accounting method prescribed by the Act to compute depreciation. Only in the case when the methods are not prescribed under the Act, a person is allowed to follow applicable accounting standards of Nepal in lack of which applicable accounting practices prescribed by IRD shall be followed.

Section 19 of the Act prescribes the conditions for depreciation. The rates and methods of depreciation are prescribed by Schedule 2 of Income Tax Act, 2058.

Since, depreciation is charged as per I/NAS 16 for the purpose of financial accounting and is calculated as per Schedule 2 and Section 19 for income tax purpose, there may be some temporary differences on the claim of depreciation. Due to these differences in the computing method, the will be the implication of deferred tax in the financial accounting.

- **Conditions to claim Depreciation (Sec. 19 (1))**

  ALL the following FOUR conditions shall be satisfied to compute depreciation u/s 19 and Schedule 2 of Income Tax Act, 2058:

  - **Ownership of Asset:** The asset shall be owned by the person who is claiming such depreciation.

    For this purpose, an asset is deemed to be owned in case a person is using any asset under finance lease arrangement.

  - **Use of Asset (Condition 1):** The asset shall be used during the Income Year.

    However, in case of loss of asset due to any reason, it is deemed that the asset is disposed off at Zero value and thus, Zero is deducted from the respected Pool as Disposal Proceeds. In such case, depreciation can be claimed normally without excluding the WDV value of such lost asset as the Income Tax Act follows POOL Concept of asset. Pool concept of asset does not recognize the individual identity of asset once the asset is added to the Pool. Thus, the condition of use of asset is only significant for the first time. It is also significant in case any asset is kept idle without using it.

  - **Use of Asset (Condition 2):** The asset shall be used to generate income from business.

  - **Nature/Type of Asset:** The asset shall be a depreciable asset.

- **Definition of Depreciable Asset**

  It means any asset that is used in business or investment and the value of which deteriorates due to wear and tear, passage of time or in course of age.

  The term does not include trading stock.

- **Classification of Depreciable Assets**

  Income Tax Act does not recognize the individual identity of asset unlike Nepal/International Accounting Standards. It is based on Pool concepts. All the tangible assets are classified into FOUR different Pools and one Pool is assigned to Intangible asset. Once an asset is clubbed with other assets of the same pool, the asset lefts its individual identity and is determined by group identity for the purpose of Taxation.

  Pools of Assets

Block	*Classes*
A	Buildings + Structures + Other Works of Permanent Nature
B	Computers + Statistical Processing Equipment + Furniture + Fixtures + Office Equipment
C	Automobiles + Bus + Minibus
D	Production Equipment + Earthmoving Equipment + Pollution Control Cost Capitalized Under Section 17(3) + Research And Development Cost Capitalized Under Section 18(3) + Expenses Incurred On Prospecting, Extracting or Developing Natural Resource + Other Depreciable Tangible Assets not falling under Pool A, B and C.
E	Intangible assets (except fall on Block D; goodwill is not tax asset, which is spread within assets and liability as per Sec. 49), Leasehold Assets

For the purpose of income tax, a person may disclose the pool-wise presentation of tangible assets but the intangible assets MUST be presented separately as per their classes.

Cost of Depreciable Assets:

Since the Income Tax Act is silent about the cost of depreciable asset, the principle prescribed by N/IAS 16 and N/IAS 38 shall be followed while identifying the Cost of Tangible and Intangible Depreciable Asset respectively.

Para 16 of N/IAS 16 explains the elements of cost of Property, Plant & Equipment (Tangible Depreciable Asset) as follows:

The cost of an item of property, plant and equipment comprises:

- Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

- Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

- The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

  Students are advised to go through respective NASs/NFRSs for further details of elements of cost of tangible and intangible assets. Students should note that some expenditures incurred for the repair of PPE is qualified for capitalization under the prevailing accounting standard, however, it is claimed u/s 16 and is capitalized in the Pool only if, it exceeds 7% of the Closing Depreciation Base of the respective Pool.

Examples of Cost of Depreciable Assets

- *In case of purchased depreciable asset, the cost incurred to the date of put to use is to be taken as basis (refundable cost or duties are excluded in the cost) as specified in N/IAS 16.*

- *In case of self-developed or constructed assets, the Cost (i.e. outgoings of such self-developed or constructed asset) shall be the market value of that asset when it is changed to depreciable assets (on put to use date) from capital work-in-progress as per Sec. 41 and 40(3) (d).*

- *As per Section 1(3) of Schedule 2 of the Act, any expenses incurred in respect of natural resource prospecting, exploration, and development, is treated as the expenses incurred on acquisition of the assets. Such cost shall be capitalized under Pool D.*

- *The repair and Improvement Cost that is not allowed as pe*r Sec 16 (2) forms part of cost of depreciable asset, though it's not a physical asset.

- **Depreciable Base:**

  Depreciable base is that amount on which depreciation is calculated for the income year. The depreciable base is different for Pools of Tangible assets and Pool of Intangible Asset.

  In this book, we have used the term "Closing Depreciation Base" for the depreciable base on which the depreciation rate is applied to calculate depreciation. The term "Opening Depreciation Base for next year" has been used to indicate the Opening Balance of Depreciable base for next Income Year.

- **Closing Depreciation Base for Tangible Asset**

  It is arrived as follows:

	Particulars	**Amount**
	Depreciated amount of the block carried from the previous year *(Opening Depreciation Base for next year identified in Previous Income Year)*	
Plus	Absorbed Additions	
Less	Disposals during the Year	
=	Closing Depreciation Base for Year	

- **Closing Depreciation Base for Tangible Asset**

  It is arrived as follows:

	Particulars	Amount
	Depreciated amount of the block carried from the previous year (Opening Depreciation Base for next year identified in Previous Income Year)	
Plus	Absorbed Additions of the same class of Intangible Asset	
=	Closing Depreciation Base for Year	

Treatment of Additions of Depreciable Asset

Income Tax Act has prescribed specific treatment of additions during the year. Unlike the requirement of N/IAS 16 that requires the PPE to be added on "Available for use" basis, the Act requires the addition of assets on the basis of ***latter of "Put to Use" date or "Invoice Date" (Sec 2 (5) (ka) of Schedule 2).***

On the basis of above benchmark for additions of depreciable asset, the additions of during an Income Year shall be categorized as follows:

- Additions up to Poush
- Additions from Magh to Chaitra
- Additions from Baisakh to Ashad

- **Absorption of Additions of Depreciable Asset**

  In financial accounting, the depreciation of PPE and depreciable Intangible assets are begun when the assets are Available for Use on the basis of actual use during a financial year. The Income Tax has prescribed a specific formula to absorb the additions in the Pool of Assets and the additions are termed as "Absorbed Additions".

  The Depreciable Assets are absorbed as under as per the requirement of Income Tax Act (Sec. 2 (5) (Ka) of Schedule 2:

  - **Additions up to Poush-** 100% of the cost
  - **Additions from Magh to Chaitra-** 2/3rd of the Cost of the Assets
  - **Additions from Baisakh to Ashad-** 1/3rd of the Cost of the Assets

  One-third of the cost of additions from Magh to Chaitra and two-third of additions from Baisakh to Ashad are unabsorbed additions of the Depreciable Asset. Such unabsorbed additions are added to calculate the "Opening Depreciation Base for Next Year".

Comments of Editor

The concept of additions' absorption in Income Tax is a unique concept. The impact of this

treatment is the assets added to the Pool till Poush are allowed to be depreciated at full value, though the asset may not be used for whole year. Similarly, if the asset has been added to the Pool on Ashad end date, the person is allowed to claim depreciation equivalent to that of four months (1/3 of 12 months) instead of ONE day in financial accounting purpose. Students should not mix up the idea of addition studied in applicable accounting standard with the requirement of Income Tax Act, and separately memorize the provision of the Act.

- **Rate of Depreciation:**

  Income Tax Act, 2058 has prescribed the following rates for charging depreciation for an income year on depreciable basis at the end of the year of each block:

  - Pool A: 5%
  - Pool B: 25%
  - Pool C: 20%
  - Pool D: 15%

- **Accelerated Depreciation**

  Some Entities (strictly entities, natural person are not allowed for accelerated depreciation) are allowed additional one third of the basic rate of depreciation as additional depreciation allowance. Such benefit provided by the Act is termed in this book as "Accelerated Depreciation".

- **Entities entitled to Accelerated Depreciation**

  The following entities are entitled to accelerated depreciation under Income Tax Act, 2058:

  - The entity that is involved in operating Special Industries specified in Sec. 11 of the Act during the whole Income Year, Entities referred to in section 19 (2) and Section 11(2Kha), (3Cha), (3Tha) and Section 2(3) of Schedule-1 shall be entitled to an additional depreciation rate added by 1/3 in the depreciation rates referred to in Sub Section (1) applicable to pools of depreciable assets in Class A, B, C, and D. (In this case, the entity that is involved in operation of special industry for part of Income Year is not entitled to such benefit). As defined by Sec. 11, Special Industry means the Production based Industries except industries using tobacco as basic raw materials and those producing alcohol or similar products.
  - The entity that is involved in operation after construction of road, bridge, tunnel, rope way, or overhead bridge. (To claim accelerated depreciation, the entity shall construct and operate road, bridge, tunnel, rope way or overhead Bridge. If the entity operates without constructing or constructs without operating such infrastructures, the entity is not entitled to the facility)
  - The entity that operates trolley bus or tram.
  - Cooperatives incorporated under Cooperative Act, 2074 and that are not conducting tax-exempt transactions.

- The entity that constructs and operates public infrastructure projects that are ultimately handed over to Government of Nepal (i.e. projects undertaken under Build-Operate-Transfer BOT mechanism)

- The entity that is involved in construction, production, distribution and transmission of electricity and power generation houses.

- **Rate of Accelerated Depreciation**

  The entities are allowed the benefit of accelerated depreciation on Assets of Pool A to D and not on Pool E. The rate of accelerated depreciation is as follows:

  Pool A- 6.67%

  Pool B- 33.33%

  Pool C- 26.67%

  Pool D- 20%

- **Depreciation on Intangible Assets:**

  Rate of Depreciation

  The rate of depreciation is determined by dividing 100 by the useful life of the intangible asset.

  Useful life of Intangible Asset

  While determining the useful life of the Intangible asset, the life is rounded off to nearest half year. *The Income Tax Act has not clarified the process of rounding off the life into nearest half year. Whether 5 years 9 months is rounded off to 6 years or 5.5 years is judgmental till the period.*

  Depreciation Amount

  The amount of depreciation on intangible asset for each year of its useful life is calculated by multiplying the cost of the individual asset in the Pool E by the rate of depreciation.

  Method of Depreciation

  The Income Tax Manual has prescribed Straight Line Method of depreciation for each class of asset of Pool E. The method of depreciation for assets of Pool A to Pool D is Written Down Value (also called Diminishing Balance Method).

  Earlier Income Tax Manual, 2066 has prescribed WDV method of depreciation for Pool E which is converted to SLM at the time when the Manual was updated in 2068 B.S. The Manual is silent about the depreciation treatment of depreciated asset of Pool E that has already been depreciated in WDV Method.

  Example to calculate Depreciation of Intangible Asset

  Suppose a company has purchased a copyright for six years and two months for Rs. two lacs.

- The rate of depreciation will be 100/6= 16.67% (6 years two months rounded off to nearest half year as 6 years. For this purpose, the concept of universally accepted principle of mathematical rounding off has been used)

- The amount of depreciation for the year, if the asset is added till Poush- 200,000 X 16.67% = Rs. 33,333.33

- **Disposal of Depreciable Asset**

- **Disposal of Partial Assets of Pool**

In case of disposal of an individual asset or partial assets of the pool (not the whole pool), the proceeds from such disposal is deducted to arrive at the closing depreciation base of the pool. There are two possible outcomes of such disposal:

- **The disposal proceed is less than the sum of Opening Depreciation Base and Absorbed Additions:**

In this case, the resulting value after deducting the disposal proceeds is the Closing Depreciation Base for the year.

- **The disposal Proceeds is greater than the sum of Opening Depreciation Base and Absorbed Additions:**

The detail of this outcome is discussed in Balancing Charge Section of this Chapter.

- **Disposal of a Pool**

This concept requires the disposal of all assets of the pool. In case all assets of the pool are disposed, the gain/loss on disposal of depreciable asset is calculated as under:

Opening Depreciation Base of the Pool

Add: Additions during the year (Regardless of the date of addition)

Less: Disposal Proceeds of the assets of the Pool

= Loss/ (Gain)

The gain is included in Income from Disposal of Depreciable Asset under Section 7 (2) (gha)

The treatment of Loss on such disposal is discussed in Terminal Depreciation Section of this Chapter.

- **Treatment of Repair & Improvement Expenses incurred for the Pool**

In case of disposal of entire asset of a pool, there will be no question of capitalizing the Repair & Improvement Expenses incurred for the asset of such pool. That means, such expenditures are claimed under the criteria laid down by Section 13 of the Act.

- **Terminal Depreciation**

  Concept

  The allowance as depreciation of the balance of the pool of asset is termed as "Terminal Depreciation" in this Chapter. The Act has allowed Terminal Depreciation in the following THREE cases:

  - **Loss on Disposal of a Pool of Depreciable Asset:**

    In case there is loss on disposal of an entire pool of depreciable asset, the loss is claimed as terminal depreciation, i.e. the total loss amount is treated as part of depreciation expense and claimed u/s 19.

  - **Assets of Pool D of the entity undertaking Public Infrastructure Projects under BOT (Sec 19):**

    - *When Equipments, machineries, or structures are replaced*

      This is one of the two cases when the machineries, Equipments or structures (in Pool D) possess an individual identity. When the equipment, machineries or structures are replaced, the replacing asset (the new asset added to the pool) is added to the pool under normal criteria prescribed by the Act, but the Written Down Value of replaced asset (the asset in the place of which new asset is added to the pool) is allowed as terminal depreciation in the year when such asset is replaced. In this case, the WDV value of the replaced asset as at the beginning of the year of replacement shall be calculated.

    - *When the project is transferred to Government of Nepal*

      In the Income Year when the project is transferred to Government of Nepal as per the agreement, the entity is allowed to claim the total of Written Down Value of the machineries, equipments and structures existing on the date of such transfer as terminal depreciation.

- **Assets of Pool D of the entity undertaking electric power generation, distribution and transmission (Sec 19):**

  - *When equipments, machineries, or structures are replaced*

    This is one of the two cases when the machineries, equipments or structures (in Pool D) possess an individual identity. When the equipment, machineries or structures are replaced, the replacing asset (the new asset added to the pool) is added to the pool under normal criteria prescribed by the Act, but the Written Down Value of replaced asset (the asset in the place of which new asset is added to the pool) is allowed as terminal depreciation in the year when such asset is replaced. In this case, the WDV value of the replaced asset as at the beginning of the year of replacement shall be calculated.

- When the projects are transferred to Government of Nepal

  In the Income Year when the project is transferred to Government of Nepal as per the agreement, the entity is allowed to claim the total of Written Down Value of the machineries, equipments and structures existing on the date of such transfer as terminal depreciation.

- **Balance of Opening Depreciation Base for Next Year below a minimum Threshold**

  In case the balance of opening depreciation base of a pool (A to D) calculated for next year is less than Rs. 2,000; such balance is allowable as terminal depreciation in the year when such balance is below the threshold of Rs. 2,000.

  Section 2 (6) of Schedule 2 of the Act prescribes such treatment of terminal depreciation in case the amount of difference of Depreciation from Closing Depreciation Base is less than Rs. 2,000. Literal interpretation of the provision would be charging terminal depreciation if the criteria are fulfilled but it would not be logical to claim terminal depreciation even in the case when there is balance of additional amount of unabsorbed addition and excess of Repair & Improvement in the Pool.

- **Balancing Charge**

  In the case of disposal of partial assets of a pool and if the disposal proceeds exceed the sum of Opening Depreciation Base & Absorbed Additions of Assets in the Pool during the year, the Closing Depreciation Base becomes Negative. The Closing Depreciation Base of the Pool cannot be Negative as per Restrictive Clause of Section 2 (3) of Schedule 2 of the Act. Such negative amount is included in Business Income as per Sec 7 (2) (Gha) of the Act. The Negative amount (excess of disposal proceeds over the sum of Opening Depreciation base) is termed as balancing charge in this Chapter.

  - **Treatment of Unabsorbed Additions**

    Though the Closing Depreciation Base is negative, but the pool remaining assets that have not been disposed off. Thus, unabsorbed additions will be added to the Pool to arrive at the Opening Depreciation Base for next Year.

  - **Treatment of Repair & Improvement Expenses incurred for the Pool**

    The value of Closing Depreciation Base will be Nil. Thus, 7% of Closing Depreciation Base will also be Nil. That means, whole Repair & Improvement expenses incurred for the pool is not allowed for tax purpose and will be added to the Pool to arrive at the Opening Depreciation Base for next Year.

- **Specific Cases of Depreciation**

  - Purchase of Power generating Asset by Production/Manufacturing Industries (Sec. 3 (3) **of Schedule 2)**

    In case production based/manufacturing industries purchase power generating asset during any Income year, such industries are entitled to claim 50% of Cost of the Asset as Depreciation during the Income Year.

Income Tax Manual, 2066 (Updated 2073), has treated the additions of such asset in Pool D as normal addition and calculated depreciation in normal procedure as per the Act. In addition to the normal depreciation allowed in such asset, additional depreciation equivalent to 50% of Cost of the Power Generating Asset has been allowed as depreciation and normal depreciation shall be allowed for deduction for remaining amount like any other assets.

- **Purchase of Fiscal Printer or Electronic Cash Register to issue Invoice (Sec. 3 (4) of Schedule 2)**

  100% of the Cost of the fiscal printer or electronic cash register procured for the purpose of issuing invoice is allowed as depreciation in the year when such asset is purchased, irrespective of the date of purchase.

- **Expenses not Deductible (Section 21):**

The expenses that are listed below may satisfy all the conditions laid down by Sec. 13 or even by Sec. 14-20, but are not deductible for tax purpose.

- **Expenses of Domestic or Personal Nature:**

Expenses of domestic nature or personal nature incurred on proprietor are never allowed for deduction.

The following expenses listed in (a) below are Expenses of Domestic and Personal *Nature* unless such expenditure fulfills any of the criteria laid down in (b) below *(if such expenditure fulfills any of the conditions prescribed in (b) below, such expenditure is nor treated as expense of personal and domestic nature and is treated as normal business/investment expenditure) as per the Clarification Clause to Section 21:*

- The following expenses including the *interest incurred in the loan used for personal purpose and the private expenditure of a natural person:*
  - Expenses of very personal nature incurred for an individual in providing residence, meals, refreshment, entertainment, or other leisure activities
  - Expenses incurred by an individual on conveyance from residence to office and office to residence. But the Section does not cover conveyance expenses incurred for business purposes.
  - Expenses incurred on an individual for clothing which is also suitable to wear outside of work.
  - Expenses incurred on education and training. But the expenses incurred on such training or education, that are directly related to the business, but that does not lead to a degree or diploma, are allowed for deduction.

Examples of such Expenses

- If an entity has taken a loan from a bank and allowed a certain amount to be used by a partner without any interest (siphoned out). The interest on such loan is an example of personal expenses.

- The dress provided by banks to their staffs as the uniform is also suitable to wear outside office. The example of dress that may be worn only in work place are gown used by doctors while conducting surgery, clothes worn by fire-fighters, etc.

- If the following conditions are satisfied, the above expenditure are excluded from Expenses of Personal and Domestic Nature. But other expenditure incurred to make a payment to a natural person or the expenses incurred for a third person except to the extent of following are Expenses of Personal and Domestic Nature:

- In case the payment is included in calculating the income of the individual- such as house rent, driver facility, gardener, servant, telephone in residence, or etc provided to an employee. If the expenses are included in the taxable income of the individual, the expenses are allowed for deduction to the person.

- The individual makes a return payment of an equal market value to the person as a consideration for the payment.

- Small amount incurred in this respect for which keeping an individual account is impracticable, for tea, stationary, awards, emergency medical facility or any other expenses as provided by IRD up to Rs. 500 at a time (as per Rule 6).

- **Taxes & Penalties paid:**

  Income Tax paid under this Act:

  Income tax including interest, fines, penalty, etc paid under the Income Tax Act is treated as charge to capital and are not allowed for deduction. However, taxes paid to provincial and local government is deductible from taxable income. *(Students are advised to go through the definition of Tax as per the Act for the better understanding of different amounts that are not deductible under the scope the definition of Tax)*

  Indirect Taxes and penalties:

  Indirect taxes are part of cost of the purchases and so these are allowed for deduction. But penalties on these indirect taxes are created due to non-compliance of government's Act or Rules, not allowed for deduction. The expenses not allowed are as follows:

  - Tax, penalty, fines, interest, etc payable under the Income Tax Act.

  - Penalties or fines of similar nature payable to any Government or its local bodies for breach of any Act or Rules or Regulations framed under the Acts.

    Note: Penalties or fine paid to other entities (Not related to Government Law) e.g. fine paid to Bank, is allowed for deduction.

- **Expenses Incurred for Tax Exempted Income:**

  Expenses to the extent incurred by a person while deriving income exempt under Section 10 or final withholding payments are not allowed for deduction.

- Salary or Wages expenses other than casual nature of wages payment upto Rs. 3,000 distributed to Employees or Workers not having Permanent Account Number (PAN).
- Expenses in excess of Rs. 2,000 incurred on invoice not containing Permanent Account Number (PAN). However, such limitation is not applicable when goods related to agriculture, forest, animal and other household items directly purchased from natural person not doing business transaction.
- **Payment in Cash for More Than Rs.50,000:**

  For the payments above Rs. 50,000 to be covered under Expenses not deductible, ALL the following three criteria shall be satisfied:

  Criteria:

  - The turnover of the person must be more than Rs. 20 Lakhs during the Income Year
  - The payment must be above Rs. 50,000 at a time

    The term used here is 'at a time'. Thus, the allowability of payment of more than Rs. 50,000 in cash during a day is judgmental in practice. But if it asked in question, such payment is allowable provided that the payment does not exceed Rs. 50,000.

  - The payment must not be made to the following persons or in the following conditions
    - Payment made to GON, Constitutional bodies, corporate having ownership of GON, Banks, and Financial institutions.
    - Payment to a farmer or a producer for primary agro products even in the case where the farmer himself primarily processes the product.
    - Payment of a retirement contribution or a retirement payment.
    - Payment made in such areas where banking services are not available.
    - An area not having banking services means the area where there are no banking facilities within the surrounding of 10 kilometers.
    - Payment made on the day when banking services are closed or there is unavoidable circumstances that the payment shall be made in cash.
    - Payment is made through the bank account of the payee.

Definition of Cash Payment (Clarification Clause Ga of Section 21):

Cash payment means a payment made through any other ways other than:

- payment that is made in the bank accounts of the payee through Letter of Credit, account payee cheque, draft, money order, telegraphic transfer, money transfer, hundi, or
- any other kind of transfer between banks and financial institutions.

- **Distribution of an income:**

  Distribution of income is not allowed for deduction. Employee Bonus is not a distribution of income, even though this is fully depended on the profit of the institution.

- **Residual Provision:**

  Any other amount that is expressly not denied by the above paragraphs but denied by other provisions included in Chapters 5, 6, 7, 10, 11, 12 or 13 of the Act are also not allowed for deduction. Expenses for bribe or corruption are example.

- **Expenditure of Capital Nature:**

  Expenditures of capital nature are not allowed to be deducted. But they are allowed under the provisions of Section 14-20 and 71.

  Definition of Expenditure of Capital Nature (Clarification Clause (e) of Section 21)

  The following expenditures are expenditure of capital nature:

  - Expenses incurred in respect of prospecting, exploration, and development of natural resource.

  - Expenses incurred in acquisition of assets having a useful life of more than twelve months.

  - Expenses incurred on the disposal of a liability.

- **Some Specific Provisions for Banking Business:**

  Treatment of Income from Banking Business as having derived from separate Business

  In case a person is run a banking business along with other businesses, it has to treat the banking business as being run by a separate person. It means the accounts, activities, transactions; etc related to the banking business should be kept separate from the same of other businesses.

  Treatment of Loan Loss Provision provided as per the Directive of NRB (Sec. 59 (1Ka))

  - A banking business is allowed a deduction of a loss of loan provided by it according to the regulation of Nepal Rastra Bank subject to a maximum ceiling of 5% of the outstanding loan as on the last day of the income year.

  - Actual expenses for a loan loss, if incurred, should be deducted from the provision outstanding on that date. In case it is deducted as an expense, it is not allowed for tax purpose.

  - In case the amount of loan loss provision is capitalized or utilized for distribution, or for payment of dividend in any income year, up to that amount it should be included in the taxable income of the income year.

Commentary on Claim of Loan Loss Provision

Section 59 (1Ka) has set the maximum limit up to which the bank can claim its regulatory Loan Loss Provision as expenses. In principle, the estimates are not allowed as deduction for tax purpose. Thus, the provision has been introduced to deal with the bank's need to allow its Loan Loss Provision as Expenses. The banks may treat the Loan Loss Provision as follows in Tax as per the prevailing provisions:

- Claim Loan Loss Provision as Expense to the extent of 5% of Loan Outstanding as on Year End and does not claim any expenses relating to the book Write off of Loans or Write Off of Loans leaving the claim on such debt

- Do not claim LLP Expenses u/s 59 (1Ka) and claim bad debt u/s 25 (Banks can claim the book write off of loans as expenses for tax purpose as the write off is warranted through the NRB Directive)- This claim can be made for either book write off of debts or write off of debts leaving the claim or both.

Going through the provisions of the Act, a bank cannot claim Written off Expenses (Bad debt write off) as Expenses for Tax purpose, however, contravening the provisions of the Act; IRD has issued a circular allowing claim of bad debt and loan loss provision expenses of any year to the extent of 5% of Loan outstanding as at year end before the Write off of such loans.

Since the Circulars are binding to the Tax offices, the circular, even though, contravenes the provisions of the Act but benefits the tax payer. So, the act of taxpayer as per the Circular is valid in the eye of law.

Students are advised to follow the interpretation of Income Tax Manual (Updated 2073) to calculate the extent of claimable Loan Loss Provision Expenses during any Income Year.

You have to note the following to calculate the LLP claim:

- Total Loan before Write Off (This is Net Loan as appeared in the Balance Sheet Plus Total Loan Loss Provision Plus Loan written off as appeared in Note 4.7.4 of FS of Bank).
- Calculate 5% of above
- Identify the amount of Loan Loss Provision & Loan Write Off Claim up to Previous Income Year
- Calculate the difference between (b) and (c) above, i.e. the maximum limit available for LLP claim
- Identify the Total Expenses debited in Income Statement (This includes both LLP Expense & Loan Write off Expense)
- Compare (d) and (e) and allow the lower of (d) or (e) as LLP & Loan Write off Claim.

Students should also note that there are other interpretations of the provisions for academic discussion. The Examiner may provide marks if the problems are solved logically substantiating the interpretation in line with the Act.

- **Some Specific Provisions for General Insurance Business:**

  General Insurance Business to be treated as Separate Business

  If a person is running a general insurance business along with other businesses, it has to treat the insurance business as being run by a separate person. It means the accounts, activities, transaction; etc. related to the general insurance business should be kept separate from the same of other businesses.

  Inclusions in Income

  For a general insurance business along with other receipts as specified by the Act, these receipts are also to be included in computing the taxable income:

  - Amount derived during the year as a premium or a reinsurance premium on the risk covered by the business.
  - Amount derived by it during the year under any contract of re-insurance, guarantee, security, or indemnity in respect of the payment to be made by it as an insurer.

  Generally, such an amount includes the commission to be received from a re-insurer and a portion of claim covered by the re-insurance. In practice, an insurer shows its portion of the claim as expenses during the year and as recoverable for the portion of re-insurer.

  Deductions from Income of a General Insurance Business

  For a general insurance business along with other expenses allowed by the Act, these expenses incurred during the year are also allowed for deduction:

  - Payments made during the year by an insurer in the capacity of the business of general insurance. Accordingly, the amounts of claims paid during the year are deductible expenses.
  - Payments made as re-insurance premium to the re-insurer, guarantor, etc.
  - Sum of the following as reserved in Risk Bearing Fund
    - 50% of the net insurance premium credited to the income statement during the year, and
    - 115% of the claims lodged but not accepted by the company as at the end of the year.

  The company shall include the amount apportioned in Risk Bearing Fund claimed as expenses while calculating the taxable income of subsequent income year.

- **Some Specific Provisions for Investment Insurance Business.**

  Investment Insurance Business to be treated as separate Business

  Investment Insurance business includes Life insurance business. If a person is running an investment insurance business along with other businesses, it has to treat the insurance business as being run by a separate person. It means the accounts, activities; transaction etc.

related to the investment insurance business should be kept separate from the same of other businesses.

Inclusions in Income

In computing the income from investment insurance, all the amounts, which are required to be included as per the other provisions of the Act, should be included in computing the income for the year except the following amounts:

- Amounts derived in respect of insurance as a premium and a re-insurance premium.
- Amount derived by it during the year under any contract of re-insurance, guarantee, security, or indemnity in respect of the payment to be made by it as an insurer.

Deductions allowed from Income

In computing the income from investment insurance, all the amounts, which are required to be deducted as per the other provisions of the Act, should be deducted in computing income for the year except the following amounts:

- Payments made during the year by an insurer in the capacity of the business of investment insurance. Accordingly, an amount of policy matured or an amount payable in case of the casualty happened against which the policy was taken, are not allowed to be deducted as expenses.
- Payments made as re-insurance premium to the re-insurer, guarantor, etc.

Note to the Students

In investment insurance business, Inflows for company in form of premium or re-insurance are not income or liability. Similarly, outflows to the insurer or re-insurance is not expense or outgoings for assets. By this provision, insurance related receipt and payments are not income nor expense nor liability nor assets. In fact, these are treated similar to CAPITAL. Inflows are similar to capital receipt and payment is refund thereto. The additional payment (the gain) is taxed on the hands of recipient. Of course, payments over normal deposits (which might be over tax-paid income) is not distribution over profit for the purpose of Sec. 56(3). In fact, gain is taxed like distribution, but provisions covered by Sec. 52-58 not applied in this case.

- Some Specific Provisions for a Retirement Fund:

Retirement Fund to be treated as Separate Person

If a person is running a retirement fund along with other businesses, it has to treat the retirement fund as being run by a separate person. It means the accounts, activities, transaction; etc related to the retirement fund should be kept separate from the same of other businesses.

Types of Retirement Funds

Retirement funds are classified into two types: approved and unapproved retirement funds.

- **Approved Retirement Fund:**

  According to Section 63(1), Employees Provident Fund established under Employees Provident Fund Act, 2019, Retirement Fund operated by Social Security Fund established under Contribution Based Social Security Fund Act 2074, retirement fund operated by Pension Fund established under Pension Fund Act, 2075 and retirement fund established by Citizen Investment Trust established under Citizen Investment Trust Act, 2047, are duly-approved retirement funds. But if a person wants to establish an approved retirement fund, it has to obtain a written and prior permission from IRD.

  Procedure to obtain Approval for a Retirement Fund:

  The procedure and conditions of obtaining permission for a retirement fund are given in Rule 20 of Income Tax Rules, 2059. The set procedures are as follows:

  Application to be filed for approval

  A person that is willing to establish approved retirement fund shall make an application to IRD after fulfilling all the following conditions:

  - The retirement fund received from the beneficiary shall be invested in such investments that are approved under the Rules.

  Commentary on Approved Investments

  Approved Investments mean the investments as follows (Clarification Clause to Rule 20):

  - Investment in Citizens Investment Trust established under prevailing law
  - Investment in Debt-paper (Bonds) issued by GON.
  - Investment in the banks and financial institutions operated under prevailing banking laws.
  - Consortium Financing with other B/FI
  - Investment to the beneficiaries otherwise than the shareholders of the Fund.

- The paid up capital of the Fund shall be at least Rs. 10 Million.
- The number of beneficiary, employee or labors shall be at least 1000.
- In case the retirement fund accepts retirement contribution of the employees from the employer, the management of the retirement fund shall be independent of the employer. This clause is not attracted when the employee of any organization manages the retirement fund.
- The retirement contribution for the month of Ashad shall be deposited within one month of booking the expenses and that for other months shall be deposited within 15 days of booking such expenses.
- The retirement fund shall make payments to the beneficiary only in the following conditions:
  - The employee or labor retires from the job,

- The beneficiary attains the age of 58 years, or
- The beneficiary dies or s/he becomes permanently disable.

- The financial statements of the retirement fund shall be audited annually.

Department may suspend the status of Approved Retirement Fund

In case a retirement fund does not fulfill the conditions as above after obtaining the status of approved retirement fund, IRD may cancel such status.

Tax on the Income of Approved Retirement Fund

- The incomes of approved retirement fund are not taxable (Sec. 64 (2)).
- In the calculation of income of a retirement fund, these amounts are not considered:
  - The contributions received from the members are not included in the income of the fund.
  - The retirement payments to the members are not included in the expenses of the fund.
  - The interest of a beneficiary in approved retirement fund is not the liability of retirement fund.

Effect if the approval of Retirement Fund is cancelled by IRD

In case an approval of an approved retirement fund is withdrawn by IRD, it has to pay income tax at 25% on the amount calculated as follows:

- Contributions received by the fund from the day when approval is granted to the day when the approval is withdrawn
- Add: Any other amount that would be included in the income if the approval were not granted
- Less: Retirement payments made from the day when the approval is granted to the day when the approval is withdrawn.

- **Unapproved Retirement Funds:**

The retirement funds, other than approved retirement funds, are called unapproved retirement funds.

According to Rule 20 (3), IRD has power to withdraw the approval, if the fund does not function according to the conditions set for it. On withdrawal of the approval the fund is converted into un-approved retirement fund.

Amendment to section 65 by Finance Act, 2064 has further clarified that the fund in which there is no any contribution of the employee (noncontributory fund), the payment from the fund shall not be treated as received from an unapproved retirement fund. For example: gratuity or compulsory retirement compensation etc. shall not be taken as received from unapproved retirement fund.

CHAPTER: 5

NET GAIN ON DISPOSAL OF ASSET &LIABILITY

Asset & Liability

The chapter covers the gain on disposal of business asset, business liability, non business asset of investment, non business liability of investment, and Non Business Chargeable Asset and the term asset and liability covers these terms accordingly. The gain on disposal of business asset and business liability is included in calculating Income from Business u/s 7 (2) (ga). The gain on disposal of non business asset of investment, non business liability of investment, and Non Business Chargeable Asset are part of Investment Income u/s 9 (2) (kha).

- **Disposal of an Asset or Liability**

  Definition of Disposal of Asset or Liability

  The Asset or Liability are deemed to be disposed of under the conditions prescribed in Section 40.

  The Act uses the term 'disposal' for both actual disposal and deemed disposal.

  When a person parts with ownership of an asset or liability, it constitutes a real disposal. A sale on installments is also an example of a real disposal, because the ownership is transferred immediately, so ownership parts with. The chapter "Sales of Goods" under Contract Act governs such disposals. According to the Act an asset is said to be disposed of when the owner parts with the ownership over the asset. It is immaterial whether the ownership is transferred to another person or not. If, for example, a horse owned by an individual dies, the individual, according to the Act, has disposed of the horse but nobody has received the ownership.

  In the same way, when a person parts with the obligation to pay a liability, the liability is supposed to be disposed of. The disposal of a liability may also be real or deemed. If a liability becomes not payable without making any payment either in cash or in kind, it is a deemed disposal and the total amount of the liability is deemed to be received from the disposal for the purpose of income tax.

  Deemed disposal is the disposal in the eye of tax but the asset or liability exists in actual.

- **Actual Disposal of an Asset (Sec 40 (1))**

  An asset is disposed off if the ownership of the asset is changed. Other conditions for actual disposal of asset is as follows:

  - In case an asset is distributed to another person.
  - In case an asset is amalgamated/merged with another asset or liability.
  - In case an asset is sold under installment sales arrangement or leased out under the arrangement of finance lease.

- In case an asset is cancelled.
- In case an asset is destroyed, lost, expired or surrendered.

- **Actual Disposal of Liability (Sec 40.2)**

  A liability is disposed off from a person if the person is released from the weight of the liability. Other conditions for actual disposal of liability are as follows:

  - In case the liability is settled.
  - In case the liability is cancelled.
  - In case the person is relieved from the liability.
  - In case the liability is merged/amalgamated with another asset or liability.

- **Deemed Disposal of an Asset or a Liability (Sec 40.3) & Tax Treatment**

  The following are the cases of deemed disposals as described in Section 40 (3) of the Act.

  - ***In case of death of Natural Person:***

    The asset and liability of a natural person is deemed to be disposed of just before the death of the natural person.

  - ***Transfer after Death (Sec 44)***

    In case any asset is disposed through transfer due to the death of a natural person, the demised natural person is deemed to receive an amount equivalent to the market value of such asset at the time of disposal, i.e. Market Value at the time of death is deemed to be the Incomings for the demised natural person. *(Students should note that the Outgoings for the Asset of the demised natural person is calculated under Sec. 38, i.e. actual outgoings is available)*

    The same amount (i.e. market value of asset at the time of death) plus any additional cost incurred in such transfer is deemed to be the Outgoings for the person to whom such asset is transferred.

  - ***Mechanism of Tax Payment in case of profit***

    In case of profit on disposal at the time of death of a natural person, the recipients specified in Section 108 shall make payments of taxes. The recipient may be rightful owner of the property, administrator of the property or the person who looks after the property.

  - ***Transfer of Land, building or deposit or interest in any Entity***

    If land, building, or security or interest in any entity is transferred within three generation; such assets do not constitute Non Business Chargeable Asset, and there will be no case of taxability of the asset so transferred after death.

    In the case when the transfer of such assets are not within three generation, the recipient

shall pay tax on disposal of land, building, or interest or security in any entity in the hand deceased natural person.

- **In case of an asset when incomings related to the asset is greater than the Outgoings for the asset**

  An asset is deemed to be disposed of when the incomings related to the asset is greater than the Outgoings for the asset. The perfect example of such disposal is deemed disposal of depreciable asset as described in Chapter 4.

- **Deemed disposal of debt obligation**

  Any debt obligation is deemed to be disposed off in the following conditions:

  - *Deemed disposal of Debt Obligation of Banks and Financial Institutions (B/FI)*

    The debt obligation of banks and financial institutions is deemed to be disposed off in case such debt obligations are converted into bad debt as per the conditions prescribed by Nepal Rastra Bank.

  - *Disposal of Debt Obligation of other persons*

    Debt obligation of persons other than B/FI is deemed to be disposed off in case the person reasonably believes that such debts cannot be recovered and the person has applied all possible efforts to recover the debt.

  Editor's Note to Students

  This is the provision laid down in Income Tax Act to classify any debt as bad. If the conditions are satisfied, any person may claim expenses for any bad debt written off during any Income Year. Though the provisions for bad debt claim of any B/FI is clear, the Act has not defined the possible efforts that shall be demonstrated to claim bad debt of persons other than B/FI.

- **Deemed disposal due to change in form of asset**

  An asset is deemed to be disposed if the form of the asset is changed just before the new form of asset is used.

  Example to clarify this concept

  Alex Auto Concern deals in trading of motorbike. As such, the motorbikes are trading stock for Alex Auto Concern. The management of the concern has decided to use two bikes for official purpose. In this case, the trading stock is deemed to be disposed and depreciable asset is deemed to be purchased by the concern.

  Tax Treatment

  As per Section 41, the disposal of the asset before the change in form shall be at Market value, i.e. the incomings for the asset is market value of the asset. The cost (Incomings) of the new asset to be created shall be equal to the incomings for changed asset. In the above example, trading stock motorbike is deemed to be disposed at Market Value and the outgoings for depreciable asset motorbike is the Market Value of trading stock motorbike.

- **Deemed disposal of an entity**

  An entity is deemed to be disposed as per the conditions specified in Section 57- Change in Control. The conditions and tax treatment due to the disposal of an entity have been discussed in detail in Chapter 4.2.8.9.

  Tax Treatment

  As per Section 41, the assets and liabilities of an entity are deemed to be disposed at Market Value as at the date of disposal. The gain/loss on such disposal is accrued to the shareholders existing at the date of disposal.

- **Deemed disposal due to the conversion of a resident natural person into non-resident**

  The asset and liability of a resident natural person except land and building owned by him/her is deemed to be disposed off just before the natural person becomes non-resident of Nepal.

  Tax Treatment

  As per Section 41, the assets and liabilities are deemed to be disposed at Market Value as at the date of disposal. At the time of actual disposal of such asset/liability, the cost of such asset/liability shall be the market value considered at the time of deemed disposal.

- Special case of Deemed Disposals:

  Expiry of Lease Term of asset under Finance Lease arrangement:

  An asset under finance lease arrangement is deemed to be disposed at Market Value existed at the date of such expiry of Finance lease.

- **Net Gains from Business Assets or Liabilities:**

  According to Section 36(1) net gain from the disposal of business assets or liabilities of a business of a person for an income year are calculated as follows:

Particulars	**Amount**
Total of all gains from the disposal of business assets or liabilities of the business during the year	XXX
Less: Total of all losses suffered from the disposal of business assets or liabilities of the business or other business during the year	XXX
Less: Any unrelieved net loss out of any business or other business of the person which were lapsed the set off period as per Sec. 20 (7 years or 12 years lapsed)	XXX
Less: Any unrelieved net loss for a previous year(s) out of the losses of the business or any other business of the person	XXX
= Net gain from disposal of business assets or liabilities	XXX

The procedure for calculation of the net gain from all the assets or liabilities disposed of during the year is set as under:

The first step: Gain or loss from the disposal of individual identifiable business assets or business liabilities is determined [Sec. 37].

The second step: Net gain or loss from all the disposals is calculated by reducing the losses from the gains. In case of any unrelieved loss of any other business of the person during the year or any unrelieved net loss for a previous year(s) or unrelieved loss from business lapsed set off period (of 7 or 12 years as the case may be) shall be reduced from the those gain.

The balance of net gain after the last step is taken to income from business as per Section 7 (2).

Note: In case the gain is not sufficient for set of above loss, tax-payer determines which loss is set off first.

- **Calculation of Gain from the Disposal of an Asset or a Liability of a Business:**

  Section 37 has given a formula to calculate gain or loss from the disposal of an asset or a liability. The formula is as under:

  Gain (Loss) from an asset or liability = *Sum of incomings associated with an asset or liability – sum of outgoings associated with the asset or liability.*

  The positive result is gain and the negative is a loss.

- **Incomings (Sec. 39):**

  An amount received or receivable on the asset or liability is said to be an incoming. So,

Incomings	=	Amount received or receivables at the point of inception of asset or liability
	+	Amount received or receivables holding period of asset or liability
	+	Amount received or receivables at the point of disposal of asset or liability

Amount received or receivables exclude insurance or other compensation (except for the purpose of Sec. 46) as per Sec. 31 and Sec. 62, Final Withholding payments and Exempt amounts.

Example to clarify Incomings & Net Incomings

- Suppose a person has sold a land for Rs. 200,000. It has incurred Rs. 5000 as commission to a broker and Rs. 5,000 to a legal consultant for document preparation. In this case the incoming is Rs. 200,000 and the net incoming is Rs. 200,000 – Rs.5,000 – Rs. 5,000 = Rs.190,000.
- Suppose a company has a land costing Rs. 500,000 in total. During the previous year, it had received Rs. 50,000 from a telecom company paid for tele-line over the land. It had received Rs. 400,000 in total from a person who took the land on hire. During the current

year the land was totally sold to three persons for Rs. 50,000, Rs. 70,000 and for Rs. 10,000. The incoming from the land is calculated as follows:

Incomings	=	Amount received or receivables at the point of inception of asset or liability	0
	+	Amount received or receivables holding period of asset or liability (tele-line over it)	50,000
	+	Amount received or receivables at the point of disposal of asset or liability (disposal proceeds)	130,000
			180,000

The hire charge is not included in the incomings because it is considered as a taxable income of the person.

Incomings for a liability means an amount received in terms of returnable to the giver at a stipulated time with or without consideration in terms of interests. Any addition to the liability until the total liability is disposed of is considered as a part of the liability and at a given time a cumulative total is taken as the net incoming. Interests due but not paid, a penalty for a breach of a condition that is payable but not paid, additional liability taken from the same person, etc are examples of additions to the existing liability. A partial payment of a liability is taken as a reduction in the net incoming. But those payments that are included in allowable expenses for calculation of the taxable income of a person are not reduced from the cumulative liability.

Example to clarify Incomings of a liability

- Suppose, Dahal Ltd. issued Rs. 5 Crores of debenture for 5 years. The entire debentures were sold out at par. In this case, incomings on the liability are Rs. 5 Crores.
- Suppose again, those debenture were issued at 5% premium and settlements should be at par, incomings is Rs. 5.25 Crores (gain is recognized at the point of disposal only).
- Suppose further, those debentures were issued at discount of 2% and to be settled at par after 5 years. If company redeems the debenture earlier than 5 years, premium per year shall be 1%; and company redeemed it on 4th year end. Then,

  Incomings = Rs. 4.9 Crores

  Outgoings = Rs. 5.05 Crores

  Gain (loss) = (Rs. 0.15 Crores)

Outgoings or Net Outgoings:

- **Outgoings or Net Outgoings of Asset:**

  Expenditures incurred to purchase, alter, add, or to develop an asset or that are directly attributed to the purchase of assets are called outgoings for acquiring the assets (somewhat similar as capital expenditure in accounting). Net outgoings for an asset on a given day

are cumulative total of the expenditures made on the asset from the day of acquiring the asset less any incomings thereon (somewhat similar to net cost in costing). Purchase price, registration expenses, brokerage or commission paid for the purchases, cost of construction, cost of alteration, cost of developments, cost of repairs, etc are components of the cost of an asset. Expenses incurred to dispose of the asset are also included in the cumulative total of the outgoings for the asset.

But those expenditures that are considered for the calculation of taxable income of the owner are not included in the outgoings for the asset. For example, if the cost of repairs of an asset is considered as an expense in the profit and loss account of the owner it is not included in the calculation of outgoings for the asset. Repair cost, if not deductible as revenue expense (u/s 13 or 16) for a business asset is outgoings.

Outgoings of Asset existed at the time of Commencement of this Act

According to Section 40 (5), the outgoings for an asset owned by a person at the time of commencement of Income Tax Act, 2058 is the amount equivalent to the Market Value of the asset at that time.

That means, for the assets acquired before Chaitra 19, 2058; irrespective of any amount of outgoings for the asset, the market value as on Chaitra 19, 2058 shall be treated as net outgoings. Any addition, alteration, repair, etc. costs incurred after Chaitra 19, 2058 are added to the market value as on that date to calculate the cumulative outgoings for the asset. This principle is applicable for the assets that have fallen within tax bracket by enactment of the act but exempted from levying tax by Income Tax Act, 2031 prevailing till that date.

Rule of calculating Outgoings:

The outgoings for each asset identifiable as a single unit should be determined separately.

Such as a land purchased, developed, registration expenses paid, brokerage or commission paid, etc should be treated as outgoings for the land. But the cost of construction of a building on the land must be treated as outgoings for the building. Land is a business asset and a building is a depreciable asset for a businessperson. That is why, the profit and loss from the disposal of the land and the building should be derived separately.

- **For a Liability:**

Outgoing for a liability is the amount that is paid for the settlement of the obligation in full or in partial.

An amount in excess of incomings over outgoings will be treated as a gain and an amount in excess of outgoings over incomings of the liability is treated as a loss according to Sec. 37.

Gain or Loss from the Disposal of a Business Asset:

The formula given for the gain or loss from the disposal of a business asset is as follows:

Cumulative incomings from the asset – cumulative outgoings for the asset = if positive gain, and if negative loss.

- **Special Conditions of Disposals**
- **Disposal due to Finance Lease Arrangement**

The asset is disposed (as per Sec 40 (1)) when a person sells it in installment or s/he enters into finance lease arrangement.

Conditions to satisfy for a lease arrangement to qualify as Finance Lease (Sec 32.5)

- If any of the following conditions is satisfied, a leasing arrangement shall be classified as finance lease:
- In case the lease agreement includes a clause that the ownership of the asset is transferred after the end of lease term,
- The lessee has the option to purchase the asset at predetermined or fixed price at the expiry of lease term,
- The term of lease is more than 75% of the useful life of the asset,
- The expected market price at the end of lease term is less than 20% of the market price prevailing at the inception of the lease
- In case of a lease that is started before the last 25% of the useful life of the asset, the present value of minimum lease rental is 90% or more of the market value of the asset prevailing at the inception of the lease term
- The discount factor to determine present value of minimum lease rental shall be General Interest Rate
- The leased assets are of such a specialized nature that only the lessee can use them without major modifications

Incomings for Lessor/seller:

The disposal of asset shall be at Market value prevailing at the inception of finance lease or when the asset is sold in installment (Sec 42 (1)).

Outgoings for Lessee/Purchaser:

The outgoings for the person purchasing such asset in finance lease or in installment shall be the Market Value prevailing at the time of such disposal.

Tax Treatment of Lease Payments (Sec 32)

- The lease payments or installment payments received from the lessee (or person purchasing asset in installments or annuities) shall be divided into principal portion and interest portion.
- The amount equivalent to the market value as on the inception of lease or as on the sales of asset shall be considered as principal portion. The remaining amount shall be considered as interest portion.
- The lessor/seller shall provide a repayment schedule at the time of sales or inception of

lease; the schedule shall clearly divide the total lease/installment payment into principal and interest portion.

If such repayment schedule is not prepared, the payments of lease rentals or installments shall be segregated into principal and interest portion assuming as if the interest on annuity, installment sales or finance lease is compounded semi-annually.

The students should note that such interest rate shall be identified using trial and error method. The rate shall be the rate that equates the present value of lease payments as if the payments are made semi-annually.

- The principal portion shall be treated as Capital Refund (for which allowance in tax is not provided- Capital allowances are provided in case of depreciable asset u/s 19 & Schedule 2) and the interest portion shall be treated as Interest (that can be claimed under Sec. 14 of the Act).
- The lease is treated as asset of the lessee and the lessor is treated as debtor of the lessee.

Exception to Market Value Concept of Disposal

The market value disposal concept u/s 42 is not applied in case of application of Sec. 45.

Transfer to Spouse or Ex-spouse

Exception to Market Value Rule in Income Tax Act:

This is specific case of disposal where the asset of a natural person is disposed through transfer to his/her spouse or ex-spouse as part of divorce settlement or settlement after living apart after partition.

A husband may be required by law to transfer some part of his asset to his former wife as part of divorce settlement. There may also be the cases when husband/wife decides to live apart without having divorce; but the husband (or may be wife) is required to transfer some of his asset in the name of wife (or husband, as the case may be). In such case, if market value concept is applied, the transferor may have to pay tax without realizing any profit on such transfer due to the difference between the cost (till the date of transfer) of the asset and the market value of the asset, which is normally greater.

In this case, if any of the spouses opts Sec. 43 to be applied in writing, the transfer shall be at cost of the asset incurred till the date of such transfer.

The transferee is deemed to purchase the asset at the amount equivalent to the Incomings received by the transferor.

Comment of Editor

This provision shifts the tax burden in profit accrual due to increase in market value of the asset towards the transferee. The transferee, himself/herself, will calculate the profit when the asset is sold as follows:

Profit = Selling Price of the asset - the cost of asset to the transferor - any subsequent cost incurred for that asset by the transferee.

The option is available only if any of the spouses elects this provision to be applied in writing. The option exercised merely by the transferor is sufficient to apply the cost concept. The consent of the spouse is not required at all.

Test Your Understanding

What will happen if any of the spouses does not elect Sec. 43 to be applied in writing?

Refer Endnote 1 of Income Tax Section of the Book for answer

- **Transfer within Associated Persons or Other Non Market Transfers**
- **Transfer at Higher of Cost/Incomings or Market value**
  - **Transfer of Asset**

    In case all the following conditions are satisfied, the asset of a person is deemed to be disposed off at HIGHER of the Cost of the asset (Net Outgoings for the asset incurred till the date of transfer) or Market Value as at the date of transfer:

    Conditions:

    - The asset shall be transferred to associated person or any other person, and
    - The asset shall be transferred without receiving any consideration.
  - Transfer of Liability

    In case all the following conditions are satisfied, the liability of a person is deemed to be disposed off at HIGHER of the Net Incomings from the Liability or Market Value as at the date of transfer:

    Conditions:

    - The liability shall be transferred to associated person or any other person, and
    - The liability shall be transferred without receiving any consideration
  - Transfer at Cost

    Sometimes a new entity may be formed by any entity with majority shareholdings. The consideration for the shares in the entity may be in kind. In such case, the share consideration may be trading stock, business asset, depreciable asset or non business chargeable asset. The Income Tax Act contains the provisions to pass on the tax liability on the gain accrual due to increase/decrease in market value of the asset or liability to transferee associated person if some conditions prescribed by the Act are satisfied.

    The perfect example of such new entity may be the conversion of an independent department of an entity to form a separate legal entity transferring all the assets and liabilities of the department to the new entity.

    Here goes the detailed provision of the Act to deal with such transfer:

- **Transfer of Trading Stock or Business Asset**

  If all the following conditions are satisfied, the trading stock or business asset is deemed to be transferred at Cost (Net Outgoings for the asset):

  Conditions

  - The transferee shall be an associated person,
  - The business asset or trading stock shall be used as business asset, trading stock or depreciable asset of business by the transferee,
  - The transferor and the transferee shall be resident person at the time of transfer and the transferee shall not be an exempt organization,
  - The underlying ownership of the transferor over the asset shall be at least 50%, and
  - The transferor and the transferee shall make a joint application to elect this Section to be applied in writing.

- **Transfer of Depreciable asset of Business**

  If all the following conditions are satisfied, the depreciable asset of business is deemed to be transferred at the Written down Balance computed as per Section 4 of schedule 2 of the Act:

  Conditions

  - The transferee shall be an associated person,
  - The depreciable asset of business shall be used as business asset, trading stock or depreciable asset of business by the transferee,
  - The transferor and the transferee shall be resident person at the time of transfer and the transferee shall not be an exempt organization,
  - The underlying ownership of the transferor over the asset shall be at least 50%, and
  - The transferor and the transferee shall make a joint application to elect this Section to be applied in writing

- **Transfer of Depreciable Asset of Investment**

  If all the following conditions are satisfied, the depreciable asset of investment is deemed to be transferred at the Written down Balance computed as per Section 4 of schedule 2 of the Act:

  Conditions

  - The transferee shall be an associated person,

- The depreciable asset of investment shall be used as business asset, trading stock non business chargeable asset or depreciable asset by the transferee,
- The transferor and the transferee shall be resident person at the time of transfer and the transferee shall not be an exempt organization,
- The underlying ownership of the transferor over the asset shall be at least 50%, and
- The transferor and the transferee shall make a joint application to elect this Section to be applied in writing

- **Transfer of Non Business Chargeable Asset**

  If all the following conditions are satisfied, the Non Business Chargeable asset is deemed to be transferred at Cost (Net Outgoings for the asset).

  Conditions

  - The transferee shall be an associated person,
  - The Non Business Chargeable asset shall be used as business asset, trading stock, depreciable asset, or non business chargeable asset by the transferee,
  - The transferor and the transferee shall be resident person at the time of transfer and the transferee shall not be an exempt organization,
  - The underlying ownership of the transferor over the asset shall be at least 50%, and
  - The transferor and the transferee shall make a joint application to elect this Section to be applied in writing.

- **Transfer of Liability**

  In case all the following conditions are satisfied, the liability of a person is deemed to be transferred at Net Incomings from the Liability received till the date of such transfer.

  Conditions

  - The transferee shall be an associated person
  - The liability shall be transferred to generate income from business or investment of the transferee,
  - The transferor and the transferee shall be resident person at the time of transfer and the transferee shall not be an exempt organization,
  - The underlying weight of the transferor over the liability shall be at least 50%, and
  - The transferor and the transferee shall make a joint application to elect this Section to be applied in writing

- **Special case to determine Outgoings for Asset transferred within Three Generation**
- Finance Ordinance 2070 has inserted a separate clause (ga) in Sec 45 (1) to clarify the Outgoings of the transferee receiving any asset through transfer within three generation. As such, the outgoings for the transferee shall be the amount equivalent to the Net Outgoings for the asset (cost) incurred by the transferred.
- **Involuntary Disposal with Replacement (Sec 46)**

  Example of Involuntary disposal:

  Example 1: Nepal Infrastructure Development Company Ltd. is constructing Tunnel way from Balkhu to Hetauda. While constructing the road the company has to acquire land that falls within the periphery of the road. In this case, the land is acquired compulsorily paying compensation to the owner regardless of the consent of the owner. The land is disposed by the owner without his/her consent, i.e. involuntarily.

  Example 2: The factory of MXN Noodles is caught by fire. The depreciable asset of the entity is completely destroyed. This is also the case of involuntary disposal of asset.

  The Act contains specific provisions to relieve the tax payer from payment of tax on accrual of gain due to increase in Market Value in case of involuntary disposal with replacement.

- **Disposal of Asset**

  In case all the following conditions are satisfied, the gain on involuntary disposal of asset shall be calculated as follows:

  Conditions:

  - The disposal of asset shall be an actual disposal (See Chapter 5.2.1 for conditions of actual disposal),
  - The disposal of asset shall be an involuntary disposal,
  - The person disposing any asset involuntarily shall acquire similar kind asset within one year of such disposal, and
  - The person disposing the asset shall make an application to elect this Section to be applied in writing.

  Method of Calculation of Gain

  Gain = Incomings from the Asset – Outgoings for the Asset

  Tips to Students

  Students should identify the Cost (Net Outgoings) of the Replaced Asset, Sales Proceeds (Net Incomings) from the involuntary disposal of Replaced Asset, and the Cost (Net Outgoings) of the Replacing Asset. [The Assets that has been disposed involuntarily is Replaced Asset and the asset acquired within one year is Replacing Asset].

  The Incomings shall be as follows:

- Cost (Net Outgoings) of the Replaced Asset, Plus
- Sales Proceeds (Net Incomings) from the involuntary disposal of Replaced Asset Less the Cost (Net Outgoings) of the Replacing Asset (if Sales Proceeds (Net Incomings) from the involuntary disposal of Replaced Asset is greater than the Cost (Net Outgoings) of the Replacing Asset)

The Outgoings shall be as follows:

- Cost (Net Outgoings) of the Replaced Asset, Plus
- the Cost (Net Outgoings) of the Replacing Asset Less Sales Proceeds (Net Incomings) from the involuntary disposal of Replaced Asset (if the Cost (Net Outgoings) of the Replacing Asset is greater than Sales Proceeds (Net Incomings) from the involuntary disposal of Replaced Asset)

- **Disposal of Liability**

In case all the following conditions are satisfied, the gain on involuntary disposal of liability shall be calculated as follows:

Conditions:

- The disposal of liability shall be an actual disposal (See Chapter 5.2.2 for conditions of actual disposal),
- The disposal of liability shall be an involuntary disposal,
- The person disposing any liability involuntarily shall acquire similar kind liability within one year of such disposal, and
- The person disposing the liability shall make an application to elect this Section to be applied in writing.

Method of Calculation of Gain

Gain = Incomings from the Liability – Outgoings for the Liability

Tips to Students

Students should identify the Net Incomings of the Replaced Liability, Cost incurred (Net outgoings) for the involuntary disposal of Replaced Liability, and the Net Incomings of the Replacing Liability. [The Liability that has been disposed involuntarily is Replaced Liability and the asset acquired within one year is Replacing Liability].

The Incomings shall be as follows:

- Net Incomings of the Replaced Liability, Plus
- Net Incomings of the Replacing Liability Less Cost incurred (Net outgoings) for the involuntary disposal of Replaced Liability (if Net Incomings of the Replacing Liability is greater than Cost incurred (Net outgoings) for the involuntary disposal of Replaced Liability)

The Outgoings shall be as follows:

- Net Incomings of the Replaced Liability, Plus
- Cost incurred (Net outgoings) for the involuntary disposal of Replaced Liability Less Net Incomings of the Replacing Liability (if Cost incurred (Net outgoings) for the involuntary disposal of Replaced Liability is greater than Net Incomings of the Replacing Liability)

- **Conditions for Involuntary Disposal of Securities**

  The conditions for involuntary disposal of securities by replacement of securities with another security due to the change in interest in any entity or reconstruction of the entity are as follows:

  - The security of any person shall be involuntarily disposed if the security is replaced by another security of the same entity or of another entity due to the merger or reconstruction of any entity,
  - The entity or the owner of the security shall file an application to IRD for approval of such involuntary disposal of security, and
  - IRD may permit such disposal as involuntary disposal based upon the application of the entity or the owner.

- **Disposal due to Merger of Asset or Liability (Sec 47)**
- **Disposal of Asset due to Merger of Asset with another Asset**

  In case a person disposes an asset through relinquishment or merger due to the effect of obtaining another asset, the effect of the same shall be as follows for tax purpose:

  In case of Net Outgoings incurred for the merging asset:

  - The amount equivalent to such Net Outgoings is deemed to be received regarding the merging asset,
  - The amount equivalent to such Net Outgoings is deemed to be the Outgoings for the merged asset

- **Disposal of Liability due to Merger of Liability with another Asset**

  In case a person disposes a liability through relinquishment or merger due to the effect of obtaining another asset, the effect of the same shall be as follows for tax purpose:

  In case of Net Incomings from the merging liability:

  - The amount equivalent to such Net Incomings is deemed to be Outgoings regarding the disposal of merging liability,
  - The amount equivalent to such Net Incomings is deemed to be the Incomings for the merged asset

- **Disposal of Asset due to Merger of Asset with another Liability**

  In case a person disposes an asset through relinquishment or merger due to the effect of obtaining another liability, the effect of the same shall be as follows for tax purpose:

  In case of Net Outgoings incurred for the merging asset:

  - The amount equivalent to such Net Outgoings is deemed to be received regarding the disposal of merging asset,
  - The amount equivalent to such Net Outgoings is deemed to be the Outgoings for the merged liability

- **Disposal of Liability due to Merger of Liability with another Liability**

  In case a person disposes any liability through relinquishment or merger due to the effect of obtaining another liability, the effect of the same shall be as follows for tax purpose:

  In case of Net Incomings from the merging asset:

  - The amount equivalent to such Net Incomings is deemed to be Outgoings regarding the disposal of merging liability,
  - The amount equivalent to such Net Incomings is deemed to be the Incomings for the merged liability

  The above provision is also applied in the following conditions:

  - The person sales or receives any asset
  - The person receives the asset hired before under Finance Lease
  - The liability under guarantee is transferred from the transferee

- **Special Relief in case of Merger of B/FI or Insurance Companies (sec 47Ka)**

  Special relief is granted in the merger of Banks and Financial Institution and Insurance Companies.

  Conditions to be fulfilled for the relief:

  - The entities shall register Memorandum of Understanding for merger in Inland Revenue Department within Ashad 2077.
  - The entities shall complete the merger process within Ashad 2078.

  Notes to the students

  These conditions have been amended through different Finance Act & Ordinance. Students should update themselves with the latest provisions amended by latest Finance Act/ Ordinance for the year when they appear examinations.

Relief

- The provisions of Sec 57 (2) (ka), (Kha), (Gha), (Nga), (Cha), and (Chha) are not applied.
- The business loss, if any, of merging entity shall be allowed as deduction in seven equal installments in seven Income Years after Merger. In case of de-merger before complete allowance of unrelieved loss, the entity shall be tax on such allowed unrelieved loss at the tax rate prevailing on the year of merger or acquisition.
- The entity shall withhold tax on additional retirement benefit (except for that entitled as per the Employee Service By-Law of the Company), if any, on mandatory retirement due to merger at half the applicable rate.
- There shall be no Capital gain Tax on gain on disposal of shares of the merged entity for two years (from the date of merger) after merger for the shareholders existing at the date of such merger and acquisition.
- There shall be no dividend tax on distribution of profit to shareholders of merged entity in the register existing in the date of merger within two years from the date of merger.

Effect of Merger on Disposal of Asset & Liability:

- **In case of Trading Stock or Business Asset:**
  - The transferor is deemed to receive the amount equivalent to the Net Outgoings of the Trading Stock or Business Asset,
  - The transferee is deemed to incur cost equivalent to the amount received by the transferor.
- **In case of Depreciable Asset:**
  - The transferor is deemed to receive the Written Down Balance of Pool of Depreciable Asset as at the date of merger arrived as per Section 4 of Schedule 2 of the Act,
  - The transferee is deemed to incur cost equivalent to the amount received by the transferor.
- **In case of disposal of Liability:**
  - The Outgoings for the disposal of liability for the transferor shall be deemed to be lower of market value of liability or Net Incomings from such liability,
  - The transferee is deemed to receive amount equivalent to the Outgoings for transferor.

CHAPTER: 6

INCOME FROM EMPLOYMENT

Definition of Employment:

Employment is defined by the Act under Section 2(aj) as "employment that includes a past, present or prospective employment."

In general terms, the act of performing a certain job for the person, who appoints one for the job, in consideration of a regular payment is called an employment. That is why; the income from an employment can be generated only when a relation of employer and employee or master and servant has been established between a payer and a payee. Whatever the employee derives from the employment in the shape of a regular salary, allowance, overtime payment, bonus, etc. is included in the income from employment.

Generally, an employment is known as a long-term employment but, in legal terms, an employment last for a short period and may also be a part time one. A natural person may have more than one employment on a day.

The employer may be any person like a natural person (a proprietorship firm), an entity, GON, province government, local level government an institution, an organization, a foreigner, etc. but the employee is always an individual (a natural person). A husband and a wife working in the same entity are treated as creation of two employments, one for husband and another for wife. The employee must be present physically at the place of work to perform his or her duties. The employment is awarded on the basis of his/her ability, education, experience, honesty, behavior, etc. and so a proxy is nowhere allowed to work on behalf of the employee.

A written appointment letter does not always qualify an individual to be an employee but an oral appointment or even the behavior of the employer and employee is sufficient to treat the individual as an employee.

To determine the status of an individual as employed, there must be an employer-employee relationship. If there is employer-employee relationship, the income of an individual shall be treated as income from employment. The Income Tax Act has not defined any conditions to determine the employer-employee relationship.

Employer-Employee Relationships

There must be employer-employee relationship to include any income under Income from Employment. Income Tax Act has not defined such relationships. However, following tests are available in UK to determine a person's employment status and has been extracted in this book for the reference of the students to understand the difference easily:

To determine the status of an individual it is necessary to establish the terms of the relationship between the individual and the organization paying for the work.

- An employee is deemed to have a 'contract of service' with an employer, whereas aself-employed individual is deemed to have a 'contract for services',i.e. a supplier/client contract where the individual is contracted to provide his services to the client organization which pays for the services.

Factors to determine the status of an individual

Income Tax Act, Regulations under the Act or any directives issued by IRD has not specified any rules about the ways to distinguish between the "Contract of Service (employee)" and "Contract for Service (Consultant)". The following criteria may become the factors that may be considered to identify the differences between them and used by many countries to identify whether the person is employed by the organization or just a consultant of the entity. The difference between the "Contract of Service (employee)" and "Contract for Service (Consultant)" in Taxation Law is that the amount received by the employees from the employer forms part of assessable income from employment and the amount received by the consultant is treated as "Service Fee" and forms part of assessable income from Business.

Criteria to distinguish "Contract for Service" and "Contract of Service":

- **Degree of control**

A **self-employed individual** usually controls his own work, is not supervised in the performance of the work, and is contracted to produce a result.

Once the contract has been completed, a self-employed individual has no right to expect further work from the organisation, but equally has no obligation to take on further work with the organisation if he does not wish to do so.

However, **an employee** usually expects the employer to specify each task to be performed, to determine where, when and how it is to be performed, and to control and supervise the performance of each task. Once a task is completed, an employee has the right to expect further work and has an obligation to perform the work.

- **Provision of the tools of the trade**

A **self-employed individual** is usually expected to provide his own equipment and materials for the work to be performed. However, an **employee** would expect the employer to provide the tools required to perform the tasks expected of him.

- **Degree of financial risk**

A **self-employed individual** runs the risk of losing his own personal assets and capital if the business operates at a loss and/or fails. He is also personally responsible for the cost of his mistakes and the correction of sub-standard work.

However, **an employee** bears no personal financial risk. He will be paid whether or not the business is profitable and is not personally responsible for the cost of correcting mistakes.

- **Ability to delegate work**

A **self-employed individua**l is usually contracted to produce a result, but he may subcontract and delegate work to others. This is often referred to as the ability to provide a substitute.

An **employee** has an obligation to perform the tasks asked of him. Delegation to another employee within the same organization is normal business practice; however an employee has no right to delegate work to others outside the organization.

- **The client base**

A **self-employed individual** will usually have a wide client base with a number of customers. However, an employee normally works for one employer only and is often prevented from working for others under the terms of his employment contract.

- **Extent of enjoyment of normal employment rights**

An employee is entitled to normal employment rights such as the receipt of an agreed remuneration package. In addition, the individual and the employer are protected by employment law.

Bylaw, an employee has the right to claim holiday pay, statutory sick pay etc. However, he is also subject to the disciplinary rules of the organisation. He is usually paid at regular intervals, and his tax and national insurance are deducted at source under the PAYE (pay-as-you-earn) scheme.

A **self-employed individual** is not entitled to the same rights and is not protected by employment law. He will not be paid unless the work is satisfactorily completed and he has no entitlement to holiday pay or sick pay. To be paid he must issue an invoice for the work performed and he will receive the income gross. It is his responsibility to self-assess the tax due on his trading profits.

Income from Employment:

Whatever the employee receives from the present, past or prospective employers in consideration of the work s/he performed or for the work to be performed by him, is said the income of the employee from the employment.

Section 8 of the Act specifies all the payments described below as amounts to be included in income from employment. In this case, a payment means:

- A payment made by the employer;
- A payment made by an associate of the employer; or
- A payment made by a third party under an arrangement with the employer or an associate of the employer.

- **Components of Income from Employment:**

  The following incomes are to be included in income from employment for tax purpose:

- **Salary and Wages:**

  The amount being paid regularly for regular work performed on the basis of daily, weekly, or monthly attendance, are called salary, wages, remuneration, emoluments, allowances, etc. Such payments are the major component of income from employment.

  In case of grade system, salary is sum of basic salary plus grade to the person. There are two types of grade system (later is less practical now-a-days):

  Simple grade system like- Rs. 20,000-500(12)-26,000

  In this type, first Rs. 20,000 is basic salary, which is allowed in the year of appointment. After completion of a year, one grade of Rs. 500 is added as grade. After completion of total grade (by way of yearly increment or by prize grades), maximum grade payment shall be Rs. 6000.

  Efficiency-bar grade system like- Rs. 20,000-500(5)-22,500 EB- 1000(7)-29,500

  In this type, normal grade is limited to 5, thereafter management checks efficiency of the employee, if employee passes it, further grade is allowed; otherwise, grade is limited to 5 (Rs.2,500)

- **Allowances for Specific works:**

  Allowances being given for some specific circumstances, posts, or posting are included here. For e.g. dearness allowance, remote area allowance, technical post allowance, dangerous work allowance, etc.

- **Other Allowances:**

  Other allowances like entertainment allowance, standard of living allowance, etc are also included in the taxable salary. An allowance given for conveyance to and from the office is a taxable allowance.

- **Reimbursement of Expenses:**

  Reimbursement of expenses not included in Income:

  Reimbursement of expenses incurred by an employee for the business of the employer is not included in income from employment. When an employee is in a business tour, his total expenses including lodging, boarding, local conveyance, tickets for means of transport, fuel for the means of transport, etc. are to be borne by his/her employer and are not included in income from the employment.

  Reimbursements to be included in Income:

  In case the employer reimburses the expenses incurred by the employee for personal goods purchased, even during the tour period, the amount is treated as income from employment of the employee. Sometimes, an employer allows a medical cost or similar for the employee or family members, and then such reimbursement is included in income from employment.

  An employee has his/her own car and s/he is using it for official purposes and for which s/

he is getting Rs. 2,000 per month from the employer. The expenditure on fuel etc. incurred in running the car for office work is deducted from the allowance of Rs. 2,000 per month and the balance will be treated as an allowance to be included in income.

- **Fees, Commission, etc.:**

  Amount being received regularly for a regular performance of duty on the basis of the quantity or volume of work performed - such as fees, commission, etc.

- **Overtime Payments:**

  Amount being received occasionally for the time spent on the job for more than the stipulated time - such as overtime payments.

- **Leave Encashment:**

  Amount being received occasionally for not availing of the allowed leave benefit. According to Rule 20(b) of Income Tax Rules, 2059, an amount payable for leave accumulated up to Chaitra 18, 2058 is not included in taxable income.

  Suppose on Shrawan 15, 2061, Mr. Jagat Lama received Rs.250,000 as leave encashment from his employer. As per the record of the employer, as on Chaitra 18, 2058, the leave encashment payable to Mr. Lama was Rs.150,000. In this case, the amount of leave encashment accrued after Chaitra 19, 2058, (Rs. 100,000) shall only be included in the taxable income of Mr. Lama.

  That is why; it is advised to all the employers, who are paying leave encashment facility to their employees, to calculate an amount of leave encashment payable to its employees on the date of the commencement of the Act (Chaitra 18, 2058).

- **Awards, Prizes, Gifts, etc:**

  Amount or the market value of any awards, prizes, gifts etc received from an employer. But an amount of or the market value of any awards, prizes, gifts, or any benefits received from any person other than the employer, is not included in taxable income, because, as per Section 10(f), these benefits are exempted from income tax.

  But the gifts, awards, prizes, etc. received from any person other than the employer are subject to Casual Income Tax of 25% on the amount or the market value of the benefits. The burden of deduction of tax and deposit to Revenue is on the payer.

- **Bonus or Incentives:**

  Bonus or incentives provided by an employer.

- **Perquisites:**

  The value of any other facility provided by an employer to an employee under the terms of employment. Such facilities include residence facility, vehicle facility, facility for driver for vehicles, facility of house maids, gardeners, telephone facility for his/her residence, etc. All facilities other than residence and vehicle are included in income from employment of the employee on the basis of the actual expenses incurred by the employer. But Rule 13 of

the Income Tax Rules has quantified the residence facility and the vehicle facility and the quantified amount is only included in the income from employment irrespective of the expenses borne by the employer in providing the facility.

The quantified amounts are as follows:

- **For residence facility:**

  This includes residence facility provided to the family members of the employee. No difference is made between furnished or unfurnished accommodation or whole building or part thereon. In case the employer is providing an amount for house rent, the amount is included in income from employment rather than the quantified amount.

  The quantified amount for house facility is 2% of the salary regularly being provided during the year. Here, the salary being paid regularly means the basic salary and grades.

  A case of concessionary house facility, the quantification is similar with free accommodation. Suppose an employer has provided a house facility to one of his/her employees against a payment of Rs. 2000 per month. The regular salary for employee was Rs. 500,000. In this case, the quantified amount of the house facility comes to Rs. 10,000 for the year; irrespective of Rs. 24,000 for the house facility in total to the employer.

- **For vehicle facility:**

  In case an employer has provided a vehicle to an employee for his exclusive use or for a part time use, an amount equal to 0.5% of the salary regularly being paid is the quantified amount to be included in the income from employment.

  Example:

Pradeep is an employee of R. Enterprises and during the income year he received total salaries as follows:

Basic pay Rs.10,000 per month	Rs.120,000
Dearness allowance	Rs. 24,000
Provident fund 10% of the basic pay and dearness allowance	Rs. 14,400
Bonus for received	Rs. 10,000
Dasain expenses for one month	Rs. 12,000
Total cash salary	Rs.180,400

R. Enterprises has allotted a house for his residence for which it is paying Rs.6,000 per month as rent and has also offered a car for his exclusive use. The firm is paying Rs.3,000 to the driver for the car provided to him.

Question: Calculate the income from employment of Pradeep for income year 2076-77.

Answer: Calculation of income from employment of Pradeep for income year 2076-77.

Basic salary	Rs. 120,000
Dearness allowance	Rs. 24,000
PF contribution of employer	Rs. 14,400
Bonus	Rs. 10,000
Dashain expenses	Rs. 12,000
Perquisite for residence facility	
2% of Rs.120,000	Rs. 2,400
Perquisite for vehicle facility	
0.5% of Rs.120,000	Rs 600
Driver's salary	Rs. 0
Total income from employment	Rs183,400

- **Reimbursement of Personal Expenses:**

  Reimbursement of personal and domestic expenses of an employee or a person related to him/her is included in the income from employment.

- **Amount Received in Compensation:**

  Any amount received in compensation of accepting any limitation with regard to the terms of employment is also included in computing taxable income from employment.

- **Payments for Termination of Employment:**

  Any amount received for redundancy or a loss or termination of the employment is considered as part of taxable income.

- **Employer's Contribution to the Retirement Fund and Retirement Payments:**

  Any contribution to the retirement fund of an employee by an employer is included in computing income from employment.

  In the same way, any retirement payments received from an employer is included in computing income from employment. But according to Rule 20 (6) of Income Tax Rules, 2059,

a tax exemption is available on an amount of gratuity received by an employee from his/her employer to an extent the amount of gratuity accrued for payable on the date of the commencement of the Act.

Suppose on Shrawan 15, 2061, Mr. Jagat Lama received Rs.300,000 as gratuity from his employer. As per the record of the employer, as on Chaitra 18, 2058, the gratuity payable to Mr. Lama, supposing that he is retiring on the date, was Rs.250,000. In this case, the amount of gratuity accrued after Chaitra 19, 2058, (Rs. 50,000) shall only be included in the taxable income of Mr. Lama.

As per Income Tax Manual, such amount of exemption is computed on the accrued months as on 2058.12.18 with the salary rate at the time of retirement. Similarly, all the retirement payments (except pension) are subject of final withholding tax, so not included in income at all.

- **Retirement Payment From GON:**

In case GON pays retirement payment to an employee, an amount equal to 50% of the payment or Rs.500,000 whichever is higher is deducted from the amount paid and the remaining balance, if any, is treated as income from the disposal of non-business chargeable assets. According to Section 88(1) read with Section 92(1)(g), the amount remaining after the deduction shall be charged with 5% income tax as final withholding tax.

Mr. Gopal Pant takes retirement, on Jesth 15, under a scheme from Finance Ministry and receives Rs. 1,000,000 as a compensation for the earlier retirement, and Rs. 600,000 as an amount of gratuity. As per the service record of Mr. Pant with the Ministry, the amount of gratuity accrued, as on Chaitra 18, 2058, was Rs. 500,000. In such a case, the tax liability of Mr. Pant for the retirement payment received shall be as under:

Compensation received	Rs. 1,000,000
Gratuity received	Rs. 600,000
Total amount	Rs. 1,600,000
Less: Amount of gratuity accrued as on 18.12.2058:	Rs. 500,000
Balance	Rs. 1,100,000
Less: 50% of Rs. 1,100,000 or Rs. 500,000 whichever is Higher	Rs. 550,000
Remaining amount	Rs. 550,000
Tax amount 5% on Rs. 550,000	Rs. 27,500

This tax is a final withholding tax for Mr. Pant.

- **Any Other Payment by the Employer:**

Any other payment made in connection with the employment is also included in computing income from employment.

- **Loan at Concessionary Interest Rate{Sec. 27(1)(d)}:**

  In cases where the rate of interest on loans or advances paid by an employee to the employer during an income year is lower than the prevailing market rate of interest, the amount, to the extent it is lower, shall be included in the income from employment.

  The Market rate of Interest is not clarified/ defined by The Income Tax Act, Regulation, Circular or Manual. Thus, there is confusion regarding the market rate of interest. The rates of different banks and finance companies differ and range from 2.5% to 12% under different terms. This ambiguity has not addressed till by IRD.

- **Payments made by an Employer for Medical Allowance:**

  Medical allowance paid by an employer to an employee is included in taxable income of the employee under the head income from employment. But, in case the medical allowance is payable as per the terms of employment and payable on his/her retirement, the amount up to Rs. 180,000 accrued for the employees in roll as at Chaitra 18, 2058 shall be exempted from inclusion in the taxable income of the employee. An amount in excess of the limit shall be deemed as retirement payments, so it is final withholding.

- **Payments not Included in the Income:**

  There are certain payments specified by Sec. 8 (3) that are not part of employment Income. The lists of such amounts are as follows:

  - Any amount received by an employee that is exempted under Section 10 of the Act.
  - Any amount received that is subject to final withholding of tax.
  - Working hour meals or refreshments provided by the employer in equal terms for all the employees at work-place.
  - Any reimbursement of expenses incurred by the employee:
  - That serves the purpose of the business of the employer; or
  - That would otherwise be deductible in calculating the individual's income from the business or investment.
  - Any prescribed small amounts, which are too small and thus unreasonable or administratively impracticable to make accounting for them. The amount prescribed by the Rule is Rs. 500 at a time. The expenses prescribed by the Rule include tea expenses, stationery expenses, prizes, gifts, emergency medical facility, or other such payments as specified by IRD.

- **Deduction from income from employment:**

  The Act hasn't provided for any deduction for computing income from employment. This means that are included in the payments for computing income from employment are the final inclusions in taxable income.

- **Employment with the foreign employer**

  If a person has employment with foreign employer, there would be the numerous tax complications and alternatives like:

Foreign-Employer	Employee	Source situation
Resident (PE)	Resident	Nepal
Resident (PE)	Non-resident	Nepal
Non-resident	Non-resident	Nepal
Non-resident	Non-resident	Other than Nepal
Non-resident	Resident	Other than Nepal
Non-resident	Resident	Nepal

  Foreign employer would be from the state with which Nepal has entered into DTAA. In some cases, employee would have diplomatic presence in Nepal too.

  In such situations, income from employee shall be taxed under following principles:

  - In case, the payment has made from permanent establishment of foreign enterprise (foreign employer for the purpose of employment), then the income of employee is taxed as same as paid by a local entity (PE are equivalent to local entity for this purpose). In this case, tax rate and computing model is same as if it was a local company and tax benefits are allowed for the employee.
  - In case, non-resident foreign employer employed resident employee:
    - If the employee is resident, all the income is taxed on global basis and foreign tax credit is allowed, if any.
    - In case of pension income of the ex-security personnel for foreign state public fund, it is exempt.

  In case, non-resident foreign employer employed non-resident employee:

  - In case the income is having source in Nepal, it is taxed (without progressive rate benefits) at 25%. For employment source in Nepal, physical presence is must. Physical presence of resident of other contracting state under DTAA having presence of less than 183 days is deemed earned that employment in own country of residence, not in Nepal. Example: Mr. Rahaman, Pakistan resident has employment in Nepal and draws Rs. 500,000, then
    - If this payment given by any resident of Nepal, it is taxed in Nepal at 25% (since he is resident of Pakistan)
    - If this payment given by any PE of Pakistan entity in Nepal, it is taxed in Nepal at 25% (since he is resident of Pakistan)
    - If this payment given by any Pakistan enterprise and his stay is less than 183 days, it is taxed in Pakistan rather in Nepal (based on Article 15(2) of DTAA)

- If this payment given by any Pakistan enterprise and his stay is 183 days or more, it is taxed in Nepal (based on Article 15 of DTAA) as non-resident.

- In employment outside Nepal, no Nepal tax implications thereto.

In case, non-resident foreign employer (diplomatic) employed employees in Nepal:

- In case of foreign nationals and family members, if their stay in Nepal is solely based on the employment in that mission, the income is exempt as per Sec. 10.

- In case, Nepali nationals, it is taxed as usual (would be double tax and no foreign tax credit is allowed.

CHAPTER: 7

INCOME FROM INVESTMENT

Investment:

Section 2(al) defines investment as the holding of one or more properties or the investment in a property subject to the fact that:

- The property should not be used by the owner himself; or
- The property must not be a business or an employment.

The Section further says that the holding of a non-business chargeable asset is also known as an investment.

Investment, in general sense, is an act of letting out a property by an owner to somebody else for his/her exclusive use for the period of letting out. An amount given to another person for his utilization is also said to be an investment. The three points given below are the basic requirements for an investment:

- A person has the legal ownership of a property;
- The owner transfers the right to use the property to another person; and
- For such a transfer of right the owner receives certain consideration from the transferee.

The holding of a cash balance in safe custody or in a non-interest-bearing current account of a bank cannot be treated as an investment. But the holding of an asset other than cash is also said to be an investment. A person purchases, constructs, or otherwise acquires a property for one of these three purposes:

- For his personal use;
- For his business use; and
- For his investment use.

So the holding of a property that is neither for one's personal use nor for business use is said to be an investment.

Kinds of Assets Under Investment:

An asset may be tangible or intangible. It may be a current or a fixed asset. A patent right, copy-right, a lease holds right, etc. are the some examples of intangible assets.

Income From Investment (Section 9):

Section 9 of the Act enumerates the receipts or receivables to be included in one's income from investment. These receipts are as follows:

Notes to Students:

Almost income from investments to a natural person is final withholding taxed if paid from resident. Almost income from investments to an entity is taxed under business. So, practically, there are very few items those taxed under income from investments (taxable income). Disposal of land, building or securities of a natural person and receipts from non-resident are taxed under taxable income from income from investment.

- **Dividend**:

  Dividend is a payment made by an entity to its beneficiaries in consideration of the capital employed by them. Section 2 (kala) has defined a beneficiary as the person having an interest in an entity. Section 2(ma) has defined an interest in an entity as a right, including a contingent right, to participate in the income and capital of the entity. Partners for a partnership, shareholders for a company, members for a cooperative society, etc are examples of beneficiaries.

  Dividend is paid out of the current year's profit or from the retained earnings. 'Distribution of profit' is the phrase used for dividend in the Act. According to Section 53 the distributions below are treated as dividend:

  - A payment made by an entity to any of its beneficiaries in any capacity, or
  - A capitalization of income.

  The Section covers each and every payment made by an entity to its beneficiaries but the Sub-section (2) of Section 53 has excluded the following payments to the beneficiaries from the distribution of profit:

  - In case a beneficiary receives some benefit for goods or services provided to the entity, the payment is not treated as distribution of profit. But in case the entity makes a payment in excess of the consideration payable for the goods or services provided to it, the excess amount shall be treated as a distribution of the profit;
  - In case a payment by the entity to its beneficiary is included in the latter's taxable income, the payment is not treated as a distribution of profit. *Salary for an executive post, interest for a loan provided, rent for the property let out, paid to partners or shareholders are not treated as a distribution of profit if the partners or the shareholders have included the salary, interest or the rent in their taxable income.*
  - If a payment to the beneficiary is subject to the final withholding tax, it is not treated as dividend.

- **Distribution of Profit or Return on Capital:**

  Section 53 (3) says that a distribution by an entity to its beneficiaries shall be treated as a distribution of profit or a return on capital only if it reduces the value of the entity's assets and liabilities.

  A capitalization of profit does not reduce the value of an entity's assets and liabilities. But if the distribution is by way of a payment in cash or its equivalent, the cash or equivalent goes out thereby resulting in a reduction in the assets and at the same time the retained earnings or capital is also paid out resulting in a reduction in the liability.

Sometimes, an entity returns a part or the total of capital contributed by its beneficiaries along with or without profit. The Act says that a clear distinction should be made between a distribution of profit and a return of capital. In simple words, a return of capital results in either a reduction of the value per share or other measurement of reconstruction for the purpose of Sec. 55(1). This includes, inter alia, internal reconstruction, buy back of shares, redemption of preference share, or surrender of share. But when a return of capital is made along with profit, the return of up to the face value or paid up value of the share is treated as return of the capital and the balance amount is treated as dividend. In such case, investments in treasury stock (which is not allowed in companies as per company law), payment to the shareholder by the entity is not counted as neither capital refund not distribution, but normal investments as per Sec. 55(2). Capital refund or distribution is not computed in case of external reconstruction, under Sec. 46(3) or Sec. 57.

- **Capitalization of Profit:**

  Capitalization of profit means a retained earning when the credited-to-capital account of individual beneficiaries is in proportion to their holding. 'Bonus shares' is phrase used for the capitalization of profit. Bonus share from securities premium account is not capitalization of profit, so not a distribution.

  Procedure for Declaration of Dividend:

  For the purpose of Company law, in case of a company, the shareholders have no right to receive a dividend regularly. In case of profit, the Board of Directors may propose a rate of dividend and when the proposal is accepted by the general meeting, the dividend is said to be declared and payable. An interim dividend becomes payable when it is declared by the Board of Directors of a company. The amount of interim dividend is later on adjusted against the amount of the final dividend. Sometimes, the dividend payable on preference shares is confused as interest because it is payable at a fixed rate. The dividend payable on preference shares becomes payable only when the company runs in profit and the Board of Directors proposes it and it is approved by the general meeting.

  But for the purpose of taxation, any payments (in cash, kind or other ways) with or without resolution from Board of Director or Annual General Meeting or what so-ever would qualify as distribution.

- **Tax Implications on Dividend (Section 54):**

  Tax is levied on dividend paid by a company to its shareholders and partnership to its partner but the dividend paid by other entities is exempt from tax (practically there will be no entities, the dividend of which is exempted from tax).

  Dividend paid by a resident company or partnership is subject to 5% final withholding tax. The dividend is the final tax and the beneficiary does not have to include the dividend amount in his taxable income from investment.

  In case a non-resident company pays dividend to a resident person, the amount of the dividend is to be included in income from investment of the payee. But, if the non-resident company is a controlled foreign entity, dividend from it is not included in income but treated

as incomings for the investments in CFE as per Sec. 69.

According to Section 54(3) a company that receives an amount of dividend after deduction of the tax, is not obliged to deduct tax on dividend paid by it to its shareholders out of the amount of dividend received. To get these benefits, tax payer need to keep its dividend imputation system calculations.

- **Interest:**

Interest is a consideration received for investment of cash in the shape of a bank deposit, a deposit in a finance company, a loan to a person, an investment in GON saving bonds, saving bonds issued by Nepal Rastra Bank, development bonds issued by GON, or in a debenture of a company, etc. The rate of interest, interest payable period, and maturity of the loan or deposit are generally fixed at the time of investment. Interest received during the year on such investment is included in the income from investment of the person. But a separate treatment should be given to the following interest received during the year:

- Interest received from investment in tax-free Government Securities. The interest is tax-free as declared by GON at the time of issue and so it is not included in the income from investment, that is to say it is not included in taxable income.
- When a resident bank, finance company, a listed company or an entity that has issued debentures are paying interest for deposits, debentures, bonds etc. to a natural person and in case the interest is not related to business, the interest is subject to 5% withholding tax and it is final withholding tax for the natural person. Thus, the natural person shall not include such interests in income from investment.
- Interest received from a non-resident or from a source established outside Nepal is included in income from investment.

The interest received by person to the extent of Rs. 25,000 from microfinance development bank, rural development bank, post office saving accounts and cooperatives specified in Sec 11 (2) operated in rural municipality is tax exempt income. Hence, interest income from such sources shall not be included in the income of the taxpayer.

- **Payment for Natural Resources:**

Definition of Payment for Natural Resources

Section 2(sha) defines Payment for Natural Resources as a payment made in consideration of the following activities:

- The right to extract water, minerals, or other living or non-living resource from the land; or
- Amount calculated on the basis of quantity or price of living or non-living resources extracted in whole or part from natural resources and minerals.

So the royalty payable for a right to takeout the materials or any amount paid for taking out materials from the land is included in the income from investment.

- **Rent:**

  Definition of Rent

  Rent means rent of tangible assets including house rent, and all payments including premium paid under a lease of a tangible asset.

  However, rent does not include natural resource payment and amount received as house rent by a natural person except sole proprietorship firm.

  In simple words, a consideration paid for hiring a property, land, plant and equipment, vehicle, etc. is said to be a rent. The natural person (except sole proprietorship firm) does not have to include the rent in his income.

- **Royalty:**

  Definition of Royalty

  Section 2(kaka) has defined royalty as a payment received in consideration of leasing of an intangible asset and the term royalty also includes the following payments:

  - Payment received for the use of, or a right to use a copyright, patent, design, model, plan, secret formula or process, or trademark;
  - Payment for the supply of some know-how;
  - Payment for the use of, or a right to use a cinematography film, video tape, sound recording, or any other such medium;
  - Payment for the supply of information regarding industrial, commercial, or scientific experience;
  - Payment for the supply of assistance that is ancillary to the supply of the above mentioned matters; or
  - Payment for the total or a partial forbearance with respect to the matters prescribed above.

  Royalty so received during the year is included in income from investment of the person.

- Gain from Investment Insurance:

  According to the clarification clause of Section 62 a gain from investment insurance is calculated by subtracting a sum of the premiums paid in relation to the policy, from the amount received from the policy.

  The amount of gain is calculated as under:

Particulars	Amount
Amount received from an insurance company on maturity or on death of a natural person including bonus etc.	XXX
Less: Accumulated total of premiums paid for the policy	XXX
= Gain from investment insurance	XXX

Treatment for Taxation:

- If an individual receives an amount from a non-resident insurer during a year, the amount of gain is included in income from investment of the individual during the year.
- In the case when such amount of policy is received from a resident entity, the gain is subject to final withholding tax at 5%.

- **Gain of a Beneficiary while receiving payment from Unapproved Retirement Fund:**

Exemption from Income Tax

According to Rule 20 (6), the amount received from an unapproved retirement fund that includes the contribution of the beneficiary and interest accrued on such amount till the commencement of the Act (Chaitra 18, 2058) [in case such amount is accrued from such investment in Citizens Investment Trust & Employee Provident Fund] is exempt from taxable income.

Taxation Treatment in other Cases:

- Gain on Investment in Resident Unapproved Retirement Fund is subject to 5% Final Withholding Tax. Gain is ***the payment amount from the Unapproved Retirement Fund Less the accumulated contribution of up to the retirement or death deposited by the beneficiary.*** The amount of gain is not to be included in income from investment.
- The retirement payment received from a non-resident unapproved retirement fund is included in income from investment of the individual.

The amount of gain is calculated as under:

Particulars	Amount
Amount received from an unapproved retirement fund on retirement or on death of a natural person including interest etc.	XXX
Less: Accumulated total amount due including interest as on 18.12.2058	XXX
Less: Accumulated amount of contribution from 18.12.2058 up to the retirement or death.	XXX
= Gain from investment insurance	XXX

- **Amount on Investment in an Approved Retirement Fund:**

Exemption from Levying Income Tax

The amount received from an approved retirement fund including the contribution of the beneficiary and interest accrued on the amount up to the commencement of the Act (Chaitra 18, 2058) is totally exempt from tax.

Tax Treatment of Other Payments from Approved Retirement Fund

- The gain on investment in Approved Retirement Fund is subject to 5% Final Withholding Tax.

Calculation of Gain:

Actual Payment from Approved Retirement Fund	XXX
Less: Higher of following	(XX)
50% of Payment Amount, or	XX
Rs. 500,000;	XX
Gain	XXX

- In case the approved retirement fund pays installment payments to its beneficiary, then the payment is subject of 15% withholding tax and such payment is included in taxable income of beneficiary. The withholding tax amount is treated as advance tax as per Sec. 93 and will be set off with tax payable.

- **Net Gain from the Disposal of Non-Business Chargeable Assets:**

In case, a person disposes off its non-business chargeable assets during a year and there by derives a gain as calculated under Chapter 8 of the Act, the gain is included in income from investment of the person for the year.

According to Section 36(2) net gain from the disposal of non-business chargeable assets of the investment of a person for an income year are calculated as follows:

Particulars	Amount
Total of all gains from the disposal of non-business chargeable assets of the investment during the year	XXX
Less: Total of all losses suffered from the disposal of non-business assets of the investment during the year	XXX
Less: Any unrelieved net loss out of any losses of disposal of business assets or liabilities or investment of the person for this year or previous year(s)	XXX
Less: Any unrelieved net loss for a previous year(s) out of the losses of the investment, any business, or other investment of the person having lapsed the period of set off period of 7 or 12 years, as the case may be	XXX
= Net gain from disposal of non-business assets	XXX

The procedure for calculation of the net gain from all the non-business chargeable assets disposed of during the year is set as under:

Gain or Loss from the Disposal of a Non-Business Chargeable Asset:

Cumulative incomings from the asset – cumulative outgoings for the asset = if positive gain, and if negative loss.

***Note**: 'Any unrelieved net loss for a previous year out of the losses of the business or any other business of the person' means any unrelieved loss of its businesses or of its investments incurred during the year that may no longer be deducted by reason of the time limit provided by Section 20.*

- **Balancing Charge from the Disposal of Depreciable Asset of Investment:**

In the cases when a person disposes off depreciable assets owned by it and used for investment purposes, and thereby derives a gain as calculated under Schedule 2 of the Act, the gain is

included in the income from investment of the person for the year.

The details as well as the calculation of balancing charge from the disposal of depreciable assets are given Chapter 4.4.7.11.

- **Gift Received by the Person in Respect of the Investment:**

  The gift received in cash or kind (in case of kind- the market value of the gift) is included in the income from investment.

- **Retirement Payments:**

  Any retirement payments received by the individual from any retirement fund is included in income from investment, if the contribution to the retirement fund was made from the income from investment and payments from the fund is in installment basis.

  The details about the retirement fund have already been discussed in the chapter on income from employment.

- **Any Amount Received in Compensation of Accepting any Restriction:**

  Any amount received during a year, in compensation of accepting any restriction in relation to the investment, is included in income from investment of the individual during the year.

- **Other Amounts to be Included under the Following Sections:**
- **Change in Basis of Accounting {Section 22 (6)}:**

  The person has adopting cash basis of accounting in the previous income year may seek permission of IRD for adopting an accrual system of accounting. IRD may permit the tax payer for such change with a condition to adjust the income of the year in such a way that no amount included, deducted, or to be included or deducted in calculating the person's income of the income year of the change is omitted or repeated.

  If such permission is granted imposing such a condition by IRD, the amount as specified in the permission should be included in the income from investment under this sub-head.

- **Gain from Exchange Fluctuation {Section 24 (4)}:**

  The person that is booking any payment receivable or payable according to the accrual system of accounting, and at the time of the payment, the amount may differ from the amount booked due to exchange fluctuation or any other reason, the difference in the amount shall be adjusted during the income year during when the payment is made from the income from investment under this sub-head.

- **Recovery of Bad Debts {Section 25 (1)}:**

  If a person adopted every step to recover a debt but was still unable to do so and consequently, wrote off the amount in the books as an expense, but during the current income year the debtor has paid the amount to him or he is able to recover the amount in any other way, the person should treat the amount as his taxable income from investment under this sub-head.

  If a person showed an amount as expenses as per the accrual system of accounting during any

previous income year and later on the person who has a right to receive the amount disclaims the entitlement to receive the amount or in case of a debt, the person writes off the debts as bad, the person who was liable to pay the amount or debt should include the amount in his income from investment under this sub-head.

- **Indirect Advantage from Associated Person (Sec. 29):**

  In case a person acquires an indirect advantage of a payment made by a payer or his associated person, or the payee authorizes another person to receive the amount, the Department may, by a written notice, treat the person who receives the advantage or authorizes other person to receive the amount, as he receives the amount. In case IRD has issued a notice to a person to include an amount in his taxable investment income under this Section, he should include the amount under this sub-head.

- **Compensation Received (Sec. 31):**

  Compensation received by a person or his associated person in connection with his investment, either due to an insurance policy taken or otherwise, to cover any one of the risks noted here under, is to be included in income from investment under this sub-head:

  - Income received or receivable, or the compensation for any amount that is to be included in the taxable investment income.
  - Loss incurred by the person or likely to be incurred, or the compensation for any amount that is to be deducted from the taxable income.

- **Distribution of Profit Otherwise than Out of Profit {Sec. 56(3)}:**

  In case an entity distributes dividend out of any amount other than profit, the amount of dividend will be treated as income from investment under this sub-head.

- **Amounts not Included in Taxable Income from Investment:**

  The following are the amounts that are included in taxable income from investment.

  - Amounts received, which are exempted from tax as discussed in Chapter 2 of this book, are not included in income from investment.
  - Amounts received, which are subject to final withholding of tax, are also not included in income from investment.

- **Allowable Expenses in Computing the Net Income from Investment:**

  The allowable expenses are described while discussing on the income from business. Refer to Chapter 4 for detailed discussion.

- **Expenses Expressly not Allowed for Deduction (Section 21):**

  Refer to Chapter 4.

Space for Your Notes:

CHAPTER: 8

SET OFF AND CARRY FORWARD OF LOSSES

Same year adjustment (Horizontal Set off)

- **Inter-Source Adjustment under the Same Head of Income**

  Loss means a loss incurred by a person during an income year. Loss is also assessed in the manner an income is assessed. Loss is a final result of a business or investment of a person as shown by the income statement of the person for the income year. There may be a loss from one or more transactions during the year but such a loss is never taken into consideration unless the accumulated figures of income and expenditure during an income year shows the expenditure to be higher than the income. But a problem arises when a person has more than one source of income either from business or from investment. Though it is not compulsory to maintain a separate set of books of each source of income by the person, but the person maintains and calculates the profit or loss of each source of income from business or investment separately and consolidates the profit or loss to derive the net profit or net loss of the person from all the sources at the end of the income year. In that case the question of probability of setting off the loss of one unit from profit of another unit arises.

  Suppose Ram has the following three business units:

  Ram and Sons – established for export import business in Biratnagar;

  Ram Brothers – established for taking agencies and dealerships in Kathmandu; and

  Ram Industries – established for production of garments in Birgunj.

  Ram maintains a separate set of books for each unit and prepares separate Income Statement for each unit.

  One of the matters to be discussed in this Chapter is whether the loss from Ram Brothers can be set off from the profit from either Ram and Sons or Ram Industries or partly from the profit of Ram and Sons and partly from the profit of Ram Industries.

  Such set offs are said to be inter-source adjustments. It means the loss from one source of business can be set off from the income from other source of business of the same person during the same year. In the same way, the loss from one source of investment can be set off from the income from other source of investment of the same person during the same year.

  Though the source of income falls under the same head the profits or losses from the following transactions or sources should be determined separately for application of this Chapter:

  - Profit from the disposal of non-business chargeable assets;
  - Profit from the disposal of business assets;
  - Profit or loss from a source that is exempted from tax.

- Profit or loss from sources established at each foreign country.

Profit or loss from activities or sources other than those mentioned above is termed as profit or loss from normal activities either of a business or of an investment. Losses from the disposal of non-business chargeable assets and business assets and gains and losses from disposal of depreciable assets do not need to be calculated separately because these are treated as a profit or loss from a normal business or an investment transaction.

Inter-source set off is allowed under these conditions:

- Nepal Source Loss can be set off with Nepal source gain or foreign source gain
- Foreign source loss can be set off with foreign source gain on per-country basis.
- Inter-Head Adjustment in the Same Income Year

There are four heads of incomes as specified by the Act, viz. income from business, income from employment, income from investment and income from windfall gain. The Act has rightly supposed that there is no chance of a loss from employment and income from windfall gain. That is why; there shall be option of set off with loss from business or investments only.

- **Inter-head set off is allowed under these conditions:**

  - Loss from business can be set off with gain from business or gain from investments.
  - Loss from investments can be set off only with gain from investments.
  - Loss from Nepal can be set off with gain from Nepal or from foreign, whereas loss from foreign can be set off with gain based on per-country basis.

  The set off allowed by the Act as above can be classified into two types: wide set off (Nepal source loss to be set off elsewhere, business loss to be set off to business and investments) and narrow set off (per-country basis for foreign loss, within same head for investments loss).

- **Choice for Selection**

  Where a person has a loss from one or more businesses or investments and also has income from other businesses as well as from other investments, Section 20 (6) has given it a choice to select the total loss or a part of the loss to be deducted either from the business income or from the investment income.

Carry Forward or Carry Back of Losses (Vertical Set off)

If a loss from any source of business or investments cannot be set off during the year due to a lack of income from other sources of business or investment, it may be carried forward and set off against the income from business or investment of the subsequent years {Section 20(1) and 20(2)}.

Business or investments losses can be carried forward up to 7 years if it cannot be set off earlier. In case of loss from projects developed under BOT mechanism, electric-power sector (except distribution) and exploration of petroleum product (not petrol pump), these loss can be carried forward up to 12 years, if cannot be set off earlier. In case of carried down loss, the set off behavior is same as other loss during the year (so-called Rule of Quarantine).

- **Income from any business:**

  Set off is allowed even if the income is from different source irrespective of the source of carried forward business loss. The business that suffered loss shall not be in operation for the set off of the loss, so far as the loss is related to the same person. That means the loss can be set off even if the loss generating business is not in operation and the person has diverted its business model during the year.

  - Income from investment.

- **Losses can be Carried Forward only by the Person who Incurred the Loss**

  The carried forward loss can be set off by the person who has sustained loss. None other than the persons, who has incurred the loss, has a right to set off a loss. Even a loss from a proprietor of a business cannot be set of from the income from business of a company having 100% ownership of the same proprietor or vice versa.

  In case a firm is sold to another person, the other person has no right to set off the losses of the seller against its income.

  According to Section 57(2) a loss cannot be carried forward in case the business of an entity is deemed to be disposed of under Section 57 of the Act.

- **Losses can be Carried Forward for Seven Years**

  The maximum period for which a loss can be carried forward is seven years (or 12 years- see 8.2.3 below) subsequent to the year of the loss. After that the loss is not allowed to be deducted, but unrelieved loss can be set off to computing net gain under Sec. 36(1) or Sec. 36(2).

- **Additional Period of Loss Carried Forward Allowed to Certain Persons**

  In case a loss is incurred by a unit engaged in the construction and operation of public infrastructure project that will finally be handed over to GON or the person engaged in the construction of a power station, generation and transmission of power; such person is allowed to carry forward the losses for the twelve subsequent years.

  In case a loss is sustained by an entity dealing in petroleum products as per Nepal Petroleum Act, 2040, the entity is allowed to carry forward the losses for the twelve subsequent years.

- **Losses of a Banking Business and General Insurance Business**

  Losses of a banking company and General Insurance Business can also be carried forward for seven subsequent years. The carry back facility given by the Act is withdrawn by Finance Act, 2064.

- **Special Provision for a Long-Term Contract, which is acquired by an International Competitive Bidding**

  In case a person has acquired a long-term contract under an international competitive bidding (ICB)/ Global Contract, procedure and sustained a loss in the year of completion of the contract or the year of disposal of the contract otherwise, it has to obtain permission from IRD for its better treatment as suggested by the Section 20(4).

- **Treatment of Unrelieved Losses after the expiry of Carry Forward Period**

  Losses of a person from its businesses or investments, which are unrelieved due to time limit prescribed in Section 20, shall be carried forward for unlimited period and could be set off from net gains from disposal of business assets or non-business chargeable assets as per Section 36.

CHAPTER: 9

SPECIAL PROVISIONS FOR NATURAL PERSON AND ENTITY, AND FOREIGN INCOME

Special Provisions Related to Natural Person:

- **Individual:**

  The term "Individual" is defined by Sec. 2(wa) as follows:

  - An individual;
  - A proprietorship firm 100% owned by a single natural person; and
  - A couple elected as a single natural person under Section 50.

  A widow or widower with dependents and choose to treat himself/herself as qualified widow(er) is also treated as Couple u/s 50 (3) of the Act.

- **Couple:**

  In general, each of the spouses is treated as a separate natural person for tax assessment. To facilitate the taxpayer to meet additional expenditure for married individuals, Section 50 of the Act has accommodated a provision that a couple can choose to be treated as single individual for a particular Income Year. In case the couple elects to be a single tax unit, the incomes of both the spouses shall be taxed in a single hand.

- **Editor's Comment**

  The Income Tax Act has not imagined any such situation where both the couple derives income and elects Couple assessment. In case both the couple derives income individually, they will better off with the treatment of individual tax assessment, and a rational person does not want to pay additional tax; that's why the Income Tax Act has not accommodated any such provisions of Clubbing of Income in the Act imagining the situation when married individuals want to file tax return with Joint Assessment. So the students should always be careful that the cases of joint filing of Income Tax Return by married individual, both deriving income, is always hypothetical.

  - The couple is permitted to be treated as a single taxpayer irrespective of whether such an option was taken in any previous year. Spouses, adopting the couple in one year, may elect themselves as separate taxing unit in the subsequent year(s).
  - In case the couple has chosen to be treated as a single individual for tax purpose, either of the spouses will be either jointly or separately responsible for the payment of the tax.
  - The option is allowed only to a married couple, if each of the spouses is alive on the date of signing the Tax Return for the Income Year. It's because the next couple has to sign on the Tax Return as a token of the acceptance of the election.

- Either of the spouses can be an assessee and the next spouse may give the consent.

The assets owned by couple which elects separate persons in subsequent years regarding the assets owned (under tax laws) is deemed as transferred to ex-spouse as per Sec. 43.

Finance Ordinance, 2062 and continued by subsequent Finance Acts has introduced a new Sub-section (3) to Section 50 that a widow or a widower, having burden to look after dependents, are treated as couple for the purpose of income tax. The Act or Rule is not clear, but for this purpose, a death certificate from a respective government office shall be produced in proof of being widow or widower. Moreover, the widow or the widower should have dependents and for them s/he is responsible to look after. The Section is not clear as to the definition of dependents, but in general terms these include daughter and/or son and may be parents who are not economically active.

- **Medical Tax Credit**

According to Section 51 (1) a resident natural person can claim a tax credit for approved medical expenses incurred for his or her treatment. The expenses may be paid by the individual himself or by any other person.

Eligible Medical Cost

According to Rule 17 the following medical expenses are treated as Eligible Medical Cost (EMC):

- Insurance premium paid for medical insurance policy; and
- Medical expenses incurred for the treatment of a natural person in an approved hospital, nursing home, health center, or by a doctor on the basis of the bill produced.

But the expenses incurred on cosmetic surgery are not treated as approved expenses. In case an insurance company in lieu of an insurance policy reimburses medical expenses, such expenses, to the extent of such reimbursement, are not allowed for such a tax credit.

In case the person received any compensation regarding any accident, then the medical cost to cure the accident and compensation thereto shall be excluded from medical tax credit computation.

Limit of Medical Tax credit

The limit of Medical tax Credit shall be lower of following:

- Medical Tax Credit will be available at 15% of EMC incurred during the year plus any unabsorbed tax credit carried over from the previous year.

  Qualified Medical Tax Credit = (Medical Insurance Premium + Doctor's Fee + Lab Cost + Dispensary Cost – Medical Compensation) * 15% Plus any unabsorbed tax credit carried over from the previous year

- Rs. 750
- Actual Tax Liability after allowing all tax credit before allowing Medical Tax Credit

Treatment of Excess Tax Credit due to the Limit of *Rs. 750 or Actual Tax Liability after allowing all tax credit but before allowing Medical Tax Credit*

The excess of 15% of EMC incurred during the year plus any unabsorbed tax credit carried over from the previous year over minimum of *Rs. 750 or Actual Tax Liability after allowing all tax credit but before allowing Medical Tax Credit is allowed to be carried forward to be claimed in subsequent Income year(s).*

Examples on the above are as follows:

- Mr. Rahim, resident, had unused qualified medical tax credit from earlier year was Rs.2000. During the year, Rs. 4000 paid for medical insurance premium, Rs. 6900 for medical expense regarding to cure from an accident. For the accident, he received Rs. 14,000. Medical expense for other test except than accident was Rs. 3400 and insurance compensation is Rs. 2500; for the year his tax liability is Rs. 600; then

  Qualified Medical tax credit= (4000+3400-2500)*15%= Rs.735

  Medical tax credit availed is Rs. 600 as minimum of

- Maximum amount of Rs. 750
- Qualified Medical Tax Credit+ carried down earlier year Tax Credit
  (735+2000)=Rs. 2735
- Actual tax payable Rs. 600

  So the net tax payable after medical tax credit is nil and unused medical tax credit imputation is Rs. 2135 (2735-600).

- In above case, Mr. Rahim became non-resident for this year (which was resident in last year); he shall not obtain any medical tax credit for this year nor can carry forward any medical tax credit imputation for the future (from expense for this year or from earlier year).
- Mr. Khomari, resident make his treatments in a high ranked hospital in Thailand and cost Rs. 12,00,000. Then it is eligible medical cost for the purpose of tax; so, Rs. 180,000 (Rs. 1200000*15%) is his qualified tax credit.
- Mr. Dahal (couple opted) has tax payable Rs. 70,000 before medical tax. His medical expense is Rs. 3000 and Rs. 4000 for spouse. Then, medical tax credit shall be Rs. 750 as minimum of:
- Rs.750
- Rs. 1050 (Rs. 7000*15%)
- Rs. 70,000

In case of couple, expense for both of the spouse is eligible irrespective of earning pattern.

- Mrs. Luitel expensed Rs. 30,000 during the year for medical treatment. She has not taxable income (either no income or loss) during the year. Then, medical tax credit Rs. 4,500

(30000*15%) is carried forward for the next year. Single condition is that, she required to file the income tax return (either zero-return or loss-return) for the year concerned.

- **Special Provisions Relating to Entities:**

  Principles of Taxation in Respect of Entities (Sec. 52):

  - An entity shall be liable to tax separately from the beneficiaries- corporate veil.
  - Distribution of entities shall be as either return of capital or distribution of income. *The matter is discussed in detail while dealing with the income from investment.*
  - Amount derived and expenses incurred by an entity, whether or not derived or incurred on behalf of another person, shall be treated as derived or incurred by the entity.
  - Assets owned and liabilities owed by an entity shall be treated as owned or owed by the entity and not by any other person.
  - Foreign income tax paid with respect to the income of an entity, which may be paid by a manager, beneficiary, or an entity, shall be treated as paid by the entity.
  - A transaction between an entity and its manager and/or beneficiaries shall be recognized as actual transaction subject to:
    - Otherwise than as stated in the Chapter 7: Quantification, allocation and characterization of amounts;
    - Otherwise as stated in Section 45: Transfers between associates and other non-market transfers.

International Taxation:

The jurisdiction to tax is based on the domestic legislative process from the law prepared by parliament. Parliament of each state can enact the income tax law as per their jurisdiction. In the events of cross border incomes, states exercise their jurisdiction to tax by reference to factors that has ample connection to the taxable person's taxable income; this tax on person's income is called as "residence-based taxation" or "universal taxation". Similarly, where tax is levied based on a sufficient connection between the relevant country and the taxable income derived from such country, the principle is "source-based taxation". Most countries, including Nepal apply a combination of residence-based and source-based taxation. Where residents are taxable on their worldwide income under what is generally referred to as an "unlimited tax liability"; and, non-residents are taxable only on income or deemed income from sources within another economic unit as "limited tax liability".

- **Concepts of Double Taxation:**
- **Juridical Double Taxation**

  The same income of a person may be taxable in two separate jurisdiction based on the tax laws of different countries. *For example, a resident of Nepal deriving income from USA may be responsible to pay tax on USA-based income in USA based on the legislation of USA and is also responsible to pay tax on the same income derived from USA in Nepal as per Nepalese Tax Law.* This

concept of double taxation in the same income by two different states is ***juridical double taxation.***

Other Examples to clarify Juridical Double Taxation

- The possibility of double taxation may arise in the events of domestic tax laws in the other area of tax laws. For example, Miss Komal staying in Nepal (normal place of abode or say stayed 185 days) for 2077/78 and stayed 185 days (entry dates and exit dates are inclusive) in Pakistan for tax year 2020/21 (ends on June-end). Based on domestic law of each country, Miss Komal is resident of both states. Both states levy tax based on universal taxation; hence each income of Miss Komal attracts double taxed. Similar situation may fall for entity also; for example, any company registered in Sri Lanka is resident for the purpose Sec. 79 of Income Tax Law of Sri Lanka, if its effective management is in Nepal, then it shall be the resident for Sec. 2 of Nepal tax also, such a company would meet the residence test in both countries and can therefore be taxed as a resident by both Nepal and Sri Lanka, which leads double taxation.
- The juridical double taxation may be possible due to the differing treatments of income/ expenditure in different countries as accounting standards applicable in Nepal and another state may different.
- The tax law of two or more States assumes, by their own definition, an item of income to arise from sources within their own territory that may lead to double taxation. For example, any gambling company in India bets for big prize for the winner of person who climbs at least 5 peaks with 8000 meters or more height. In such a case, the income is derived by the person is having working in Nepal (climbing of mountains) and is taxable in Nepal; whereas the bet has won in India, so it has source in India as per Indian taxation law.

- **Economic Double Taxation**

  Economic double taxation is taxation of the same income twice in the hands of two different taxpayers. An example would be where a company pays corporation tax on its profits and then when it pays a dividend out of its post-tax profits the dividend is taxed on the shareholders who receive it.

  Methods of relief for economic double taxation include imputation (in the above example, allowing the shareholder a credit for the corporation tax paid by the company) and exemption (not taxing the dividend in the hands of the shareholder)

- **Jurisdictional vacuums**

  Reversing the situation, there would be cases of under taxation or even effective non-taxation in two tax jurisdiction. It happens when there is exemption method of settlement of cross-border income. Providentially, all the tax treaties from Nepal are not based on exemption method for avoidance of double taxation, hence there is no direct jurisdictional vacuums.

- **Avoidance of double residency**

  Person's residency is measured based on domestic tax law of each states; so, there is a frequent chances of double residency. Within the tax treaties (so called DTAA), same person cannot

be resident of both contracting states. Article 4 of each treaty has defined the case of single residency. Hence cases of double taxation based on double residency of the same person are nullified. Double residency is resolved by following rules:

- ***Domicile is critical -*** the availability of a home or permanent abode for natural person and place of effective management for entity;
- ***Economic interest critical-*** the location of the taxpayer's Centre of economic interest; or,
- ***Tie-breaker clause -*** mutual agreement procedure.

- **Avoidance of double definitions**

  Cross border activities are performed within two different jurisdiction and local customs; which leads the same words with different meaning for two countries. Such ambiguity may be resolved by the tax treaties to avoid the confusion.

  For example, if any Austrian company invests in profit sharing bond with interest, then the tax on such interest is levied at the rate applicable for dividend as per Article 10 of DTAA with Austria.

- **Avoidance of double taxation**

  Avoidance of double taxation is of three types in legal parlance and three types in accounting of taxation. Legal parlance of avoidance of double taxation could be either any or all of the following:

  - ***Unilateral Legal provision*** - Sec. 71 of Income Tax Act, 2058 is good example of unilateral legal provision.
  - ***Bilateral Tax Treaties-*** Nepal entered into such tax treaties with 10 states and economies.
  - ***Multilateral Tax Treaty-*** Nepal has not entered into any such multilateral tax treaties.

  Similarly, there are three accounting methods, based on model tax treaties, for avoidance of double taxation as follows:

  - ***Credit Method-*** income tax paid by the person in the foreign income is allowed as tax credit to the extent of effective tax payable in the country of resident/second payment. [all 10 DTAA of Nepal has this method]
  - ***Expense/Deduction method-*** income tax paid by the person in the foreign income is allowed as deductible expense (otherwise income tax expense is not expense for income tax) in the country of resident/second payment.
  - ***Exemption method-*** income which is derived from foreign state is exempt in the country of resident/second payment. [Some pension income is exempt in Nepal, but this is unilateral legal provision. Governmental grant shall not be taxed in the country of resident as per Para 3 of Article 22 wit DTAA with Pakistan].

Some Critical points on cross-border taxation

There are certain critical concepts in case of international taxation like:

- *Taxation on partnership*

  Double tax benefits are available to the resident person of contracting state. In some countries, partnership is not a charging person and hence not a resident for their taxation purpose. In such cases, treaty benefits are not allowed. In all the DTAA partners of Nepal, partnership is taxing unit in their countries, till now, partnership from each 10 contracting state get treaty benefits.

- *Conduit company*

  It is an arrangement to avoid paying tax twice on an income where the country in which a parent firm is located does not have a taxation treaty with the state in which its subsidiary is located. In this method, a holding company is formed in a country which has such treaties with the both countries, to serve as a pipeline for income from the subsidiary to the parent.

  That means it is a body-corporate that is a resident of a Contracting State shall not be entitled to treaty benefits with respect to any item of income, gains or profits if it is owned or controlled directly or through one or more companies (such verification is called pass-through approach or some-times look-through approach), wherever resident, by persons who are not residents of a Contracting State. In case, any entity is controlled by other entity which is not controlled by resident Nepali or resident of contracting state is Conduit Company cannot get treaty benefits. Sec. 73(5) is in this line.

  For example, Nepal does not have tax treaty with Germany. Say a company in Germany wants to set up a subsidiary in Nepal. As it has no tax treaty, the German Company may use its subsidiary located at India to be the shareholder of the Nepalese subsidiary to obtain treaty benefit. The company in India is Conduit Company.

- *Bona fide clause*

  In case any resident of a contracting state gets treaty benefits with rubbish on its name or so-called legal within domestic laws (for example, banking interest tax is maximum at 10% in the treaty and the Blood Bank seeking such benefits), treaty benefits are not allowed.

- *Business profits*

  Business profit derived by resident of contracting state is taxed in that state only, unless the profit is derived from other state through permanent establishment. If there is not permanent establishment in the other state of a person who is resident of a state, in this case the profit is deemed to be derived in the first state only.

  For example, if any Chinese company have some income from construction site in Nepal, the construction work of which is carried out for 150 days. Though the Income Tax Act defines such site as PE when it works for more than 90 days but as per the DTAA with China, the site work shall be carried out for at least 183 days to qualify as PE. Hence, the income derived by Chinese Company is not taxable in Nepal as it is not derived by PE of Chinese Company as per Article 7 of DTAA with China.

Decided Cases

Inland Revenue Office- Area No. 2 Vs. National Insurance Co. Ltd., Tripureshwor, Kathmandu (Subject-wise Precedent Collection, 2066; S.No. – Decision Date: 2060/12/06)

The case as follows is relevant to the allocation of Head office Expenses in enterprises in Nepal. It is related to Income Tax Act, 2031; however, may be taken as reference under Income Tax Act, 2058.

Summary of the case

While determining the net income of the insurance company for IY 1991/92, the company has claimed 5% of the expenses as "Head Office Expenses", however, the tax office allowed only 3.5% as such expense.

Decision of the Case

Held that all the 5% claimed by the company as head office expenditure on the basis of the accounts of the company is allowed for deduction.

Basis of Decision

- There are no specific provisions in the Act regarding the allowability of HO Expenses; i.e. neither Act, nor the regulations has prescribed any limit to HO expenses.
- The Insurance Law also does not prescribe any such limit of H.O. Expenses.
- The expenditure is related to the generation of Income and the expenditure is incurred while monitoring the office of company operating in Kathmandu as per the accounts of the company.

Relevance as per Current Act- Editor's Comment for Academic Discussion

Income tax Act, 2058 and the rules framed thereto do not prescribe any limit to the Head office Expenditure. Income Tax Manual has spoken some words with regards to allocation of HO Expenses in the case of Permanent Establishment, but not in the case of subsidiary company, which is arbitrary. So far as the company can produce valid supporting as to the charging of Head Office Expenditure in reasonable grounds and valid basis as per generally accepted practices, the company may claim HO Expenses as per the precedent set by this case law.

- **Foreign tax credit**

The general taxation principle does not allow the double taxation of same income. Nepalese Income Tax Act that levies tax on global source for resident persons may create the situation of double taxation of same income of a resident person, i.e. one in source country and the other in Nepal. To avoid such situation of double taxation, there are some measures to address such foreign incomes. Generally, these mechanisms are of three types:

- ***Exemption Method-*** foreign income of resident is exempt from local tax
- ***Credit Method-*** foreign income is taxable in country of resident but tax paid on source country is allowed to set off (generally, to the extent of effective tax rate in country of residency)
- ***Expense Method-*** foreign tax is allowed as expense (despite tax is not expense for taxation)

Sec. 71 of Income Tax act has accommodated the last two mechanisms for foreign income and taxation for a resident, i.e. Credit method of elimination of double tax and Expense method of elimination of double tax. The person having Income from Foreign Source has option, either to claim foreign tax credit (sec. 71.1) or claim the tax paid in foreign country as deduction (Sec. 71.4)

- **Tax Credit for Income**

  The Person that has made payment of tax in foreign country on the income derived from the country may claim the tax paid in such country as Foreign Tax Credit. Such claim of foreign tax credit by a person having source of income in more than one foreign country shall be calculated separately for assessable foreign income situated in each country.

- **Limit of Foreign Tax Credit**

  The limit of Foreign Tax Credit shall be LOWER of following:

  - Tax paid in Foreign Country, or
  - Amount calculated by multiplying the Foreign Assessable Income of each country by Average Rate of Taxation in Nepal

  Definition of Average Rate of Taxation in Nepal

  As per Clarification Clause (Kha) of Section 71 of the Act, the Average Rate of Taxation in Nepal means the amount calculated as follows

  Average Rate of Tax in Nepal = Total tax calculated before tax credit for foreign income tax paid / Taxable income of the person including assessable foreign income * 100.

- **Treatment of Unclaimed Portion of Foreign Tax paid due to ceiling**

  The remaining amount of tax paid in foreign country that cannot be claimed as tax credit due to the ceiling of Average Tax Paid in Nepal (i.e. Amount calculated by multiplying the Foreign Assessable Income of each country by Average Rate of Taxation in Nepal) can be carried forward for set off from the income during subsequent years from the same country (foreign tax imputation).

Example to clarify method of Credit Claim & Calculation of Average Tax Rate in Nepal:

Question:
Prabhat has a source of income in Nepal and also in more than one foreign country. During the year, his employment income and tax paid in each foreign country is given below:

Name of the country	*Income Rs.*	*Tax paid Rs.*
USA	*2,000,000*	*800,000*
Australia	*1,500,000*	*300,000*
UAE	*1,000,000*	*50,000*
Nepal	*2,500,000*	-

Prabhat is a resident natural person during the year. Calculate his tax liability during the year.
Solution
Calculation of the tax liability of Prabhat for income year (rate has assumed effective for IY 2077-78):
Total assessable income from all the sources:

Net income from Nepal	Rs. 2,500,000
Net income from the USA	Rs. 2,000,000
Net income from Australia	Rs.1,500,000
Net income from the UAE	Rs.1,000,000
Total taxable income	Rs.7,000,000

Tax calculation in the first step	Rs.400,000Rs. 4,000
On next Rs.100,000 @10%	Rs. 10,000
On next Rs. 200,000 @20%	Rs. 40,000
On next Rs. 1,300,000 @30%	Rs. 390,000
Balance Rs. 5,400,000 @36%	Rs. 1,944,,000
Total tax	Rs. 2,388,000

Average Nepal income tax = Rs. 2,388,000/ Rs.7,000,000 X 100 = 34.11%.
Tax credit for the year shall be available for:

Country	Income Rs.	Tax paid Rs.	Tax calculated at average rate Rs.	Tax credit available for the year Rs.	Unabsorbed tax credit to be carried forward Rs.
USA	2,000,000	800,000	682,200.00	682,200.00	117,800.00
Australia	1,500,000	300,000	511,650.00	300,000.00	Nil
UAE	1,000,000	50,000	341,100.00	50,000.00	Nil
Total	4,500,000	1,150,000		1,032,200.00	117,800.00

The tax payable during the year comes to Rs. 2,388,000 – Rs. 1,032,200= Rs. 1,355,800

- **Claim of Tax paid in Foreign Country as Expense**

  In case a person elects to relinquish the tax credit facility of the tax paid in a foreign country during any income year, it can claim the tax paid in the foreign country as expenses for the income having a source in that country.

  In the above example, Prabhat may elect to relinquish the tax credit facility of the income tax paid in foreign countries, in that case the net income from the foreign sources of Rs. 3,350,000 (Rs. 4,500,000 – Rs. 1,150,000) shall be included in the taxable income. In that case Prabhat is neither able to claim the tax credit of Rs. 1,032,200 during the year, nor will be able to carry forward Rs. 117,800 for subsequent years.

CHAPTER 10

TAX ASSESSMENT, TAX RETURNS AND TAX PAYMENTS

Tax Assessments

Under the Income Tax Act, 2058; there are three types of tax assessments, viz. Self-Tax Assessment, Jeopardy Assessment & Amended Assessment.

- **Self-Assessment (Section 96, 97, 98 and 99):**

  Under Section 96, a taxpayer has an obligation to submit tax returns on time. According to Section 99, in case a person submits a tax return including the information regarding the total tax payable during the year and the tax due for payment on the date of submitting the return, it is believed that the income tax assessment is complete. In general terms the filing of an annual return is a self-assessment made by the taxpayer; which is treated as assessment unless the conditions under Sections 100 or 101 prevail.

  Even in the case of a person who does not file the annual tax return, the income tax for the year is deemed as assessed on due date of filing return (i.e. Asoj-end of Year 20X2 for Income Year 20X1/X2) under following bases:

  - The total tax liability of the taxpayer during the year is equal to the amount of withholding tax deducted by withholding agents on payments to it and the amount of advance tax paid by it; and
  - The deemed tax assessment shows that there is no more tax payable for the year by the taxpayer.

- **Jeopardy Assessment (Section 100):**

  Assessment of tax within same income year or after income year but before statutory time-limit of filing return is jeopardy assessment. Jeopardy assessment is of two types:

  - Jeopardy assessment as self-assessment {Sec. 100(1)} and
  - Jeopardy assessment by taxation authority {Sec. 100(2)}.

  Conditions for Jeopardy Assessment (Sec. 96 (5))

  If any of the following conditions are satisfied, the tax authority may demand for Jeopardy assessment:

  - The person becomes bankrupt, is wound-up, or goes into liquidation;
  - The person is about to leave Nepal indefinitely [Pay As You Go (PAYG)];
  - The person is about to leave the business; or
  - The IRD otherwise considers it appropriate.

Under any one of the above conditions the person itself may file its tax return for any part of income year (running) or for whole income year but before deadline for filing return.

If the taxpayer does not file tax return even if the conditions as above have arisen, respective IRO may serve a notice to the taxpayer to submit a tax return for the specified period of the year within specified days. In the case of a taxpayer who submits the return as per the notification or does not submit it, in either case, the income tax assessment is supposed to be made as per the provisions of Sec. 100. But Section 100 (2) has given an authority to the respective IRO to make a jeopardy assessment in the above case on the basis of the best judgment adopted by the IRO.

Time period of Jeopardy Assessment & Effect of Assessment Order

The period taken by the IRO for such a jeopardy assessment may be a part of the year or the whole year. In such a case, the notice is meant for an assessment of the whole year, and the taxpayer has to file the return within the time specified in the notice but in no way can wait for the period as specified in Section 96.

The respective IRO can make a jeopardy assessment only if it has a reasonable belief that the figures produced or deemed to be produced by the taxpayer do not exhibit the real position of the tax liability of the taxpayer for the period.

Information to be considered for Jeopardy Assessment

According to Section 100 (2), the following pieces of information are considered for the jeopardy assessment:

- Assessable income of the taxpayer from business, employment or investment, i.e. from all the sources;
- Taxable income of the taxpayer during the year and the total amount of tax due to the taxpayer; and
- In the case of a taxpayer, which is a foreign permanent establishment, the income remitted to a foreign country during the period and tax payable on such a remittance.

Opportunity to taxpayer to defend

Before issuing an order for the jeopardy assessment, the IRO has to serve a notice to the taxpayer stating the reason of disagreement over the figures given in the return filed or the figures available to the IRO. A period of seven days should be given to the taxpayer to explain and produce evidence against the IRO's contention.

Effect of Jeopardy Assessment, if the conditions for Assessment no more exist

There may be the possibility that the conditions that lead to jeopardy assessment is no more in existence and the person filing return under jeopardy assessment may be doing business/ investment/employment in normal way with going concern. In such cases:

- In case a jeopardy assessment is made for a whole year, the taxpayer is not required to submit a tax return under Section 96(1).
- In case it is for a part of the year, the taxpayer has to file a return under Section 96 (1) and the treatment of tax paid as per the jeopardy assessment shall be as an advance payment of tax and can be adjusted against the tax payable as calculated as per the self-assessment for the year.

- **Order under Section 102:**

  When the IRO has issued assessment order making jeopardy *assessment or amended assessment* (either against self-assessment or jeopardy-assessment), the taxation authority shall issue an order to the taxpayer stating the following information:

  - The total tax payable by the taxpayer for the period of assessment and the tax due to him;
  - The method of calculation of the tax liability;
  - The reason of the amended/jeopardy assessment by the IRO;
  - The period within which the tax due is payable; and
  - Where, when and how to appeal against the order if the taxpayer is not satisfied with the amended assessment.

- **Amended Assessment (Section 101):**

  Power of IRD to amend Tax returns

  Inland Revenue Department can make an amended assessment of any return filed by any taxpayer solely on the ground that the IRO thinks it appropriate to do so. The amended assessment shall be based on the IRO's best judgment and should be done in a manner that is consistent with the intention of the Act.

  Number of Amended Assessment

  In case IRD thinks it proper to do so, the assessments can be amended again and according to the IRO's best judgment for as many times as it thinks appropriate.

  Time Limit to make *amendment* in Assessment

  IRD may amend the assessment as many times as it deems appropriated but the power to make an amended assessment is within four years of:

  - In the case of an assessment under Section 99, the due date for filing the return; or
  - In the case of jeopardy assessment, the date on which the notice of assessment is served to the taxpayer under Section 102.

  Comments on Time Limit

  Based on the reassessment principle, IRD has reassessment right (method and right is as per Sec. 35- GAAR) as follows:

- Within income year (Shrawan to Ashad of earning year) – jeopardy assessment as per Sec. 100.
- After income year but before deadline of filing return (next Shrawan to Ashoj) – jeopardy assessment as per Sec. 100.
- After deadline of filing to 4 years (Kartik of next year of income to Ashoj of 5th year) - amended assessment as per Sec. 101. These 4 years starts on the date of jeopardy assessment, if whole year assessment done based on Sec. 100.

For the income year 2073-74 the return filing date is end of Ashwin, 2074 and in case time is extended the latest date may be the end of Poush, 2070. In that case the four-year period ends on either the end of Ashwin, 2078 (not on Paush, 2078).

Exception to the Time limit of Four Years

The above limitation of four years is effective for the conditions except that the tax assessment is affected by fraudulent work. In case it is proved that the tax assessment was affected by some fraudulent work, at any time, even if the four-year period has expired, the file can be reopened for amended assessment. No clear definition of the fraudulent work has been given in the Act. A clarification, in this regard, stating the probable conditions responsible for the fraudulent work should be given by IRD in time so as to avoid unnecessary litigations.

The only limitation on such an amended assessment is that the amended assessment should be completed within one year of the IRO's receipt of such information of the fraud.

Limitation of IRD if the competent court has settled the assessment

If the Revenue Tribunal or any other authorized Court has reduced the assessed tax liability, the IRO has no authority to make an amended assessment to the extent the tax liability is reduced by the Court. But, if the Court orders for a reinvestigation of the matter, the IRO can make an amended assessment.

Reasonable opportunity to Taxpayer to defend

Before issuing an order for the amended assessment, the IRO has to serve a notice to the taxpayer stating the reason of disagreement over the figures given in the return filed or the figures available to the IRO. A period of fifteen days should be given to the taxpayer to explain and produce evidence against the IRO's contention.

Issuance of Assessment Order

After IRD receives the letter of taxpayer within fifteen day's defense period and in case the IRO is not satisfied with the evidence and explanation given by the taxpayer, it can issue an order stating the information below:

- The total tax payable by the taxpayer for the year of assessment and the tax due to him;
- The method of calculation of the tax liability;

- The reason for making the amended assessment by the IRO;
- The period within which the tax due is payable; and
- Where, when and how to appeal against the order if the taxpayer is not satisfied with the amended assessment.

- **Withholding Taxes**

  Relevant Provisions of Income Tax Act for WHT

  Sections 87, 88, 88A and 89 have imposed a statutory liability of a resident person to withhold tax on payments at a specified rate while making a payment of specified incomes having source in Nepal. The obligation to deduct tax from the payment of income is vested, primarily, in the payer of the income and in case the payer does not meet his obligation the liability is jointly and severally to the recipient too.

  Taxes should be withheld at the time of actual payment to the recipient. But in case the taxpayer recognizes the expenses in the books on the basis of accrual system before the actual payment is made, the withholding tax should be deducted at the time of making accounting entry in the books.

  Conditions for Withholding of Tax

  Withholding tax is applicable if all three conditions are satisfied:

  - The payer is resident (non-resident payer is not required to withhold tax).
  - The payment is Nepal source income for the recipient.
  - Payment item covered under Sec. 87 to 89.

  If the payment is subject of withholding tax based on above principle, the withholding is MUST.

- **Withholding tax on Payment of Salaries and Wages:**

  Conditions to be satisfied

  The following conditions shall be satisfied to withhold tax on Payment by the Employer:

  - The employer shall be resident,
  - The payment shall be received by employee or laborer, and
  - The payment shall have source in Nepal

  According to Section 87 every resident employer who employs a natural person in his service in consideration of salary or wages and pays the total salary and wages including all the allowances, facilities, etc. during an income year, the employer has to calculate the employee's tax liability for the year and for each month and the tax shall be deducted from each salary payable to him/her.

  Every employer, before making first payment during the income year, shall calculate the

total salary and other benefits payable under the normal and the prevailing situation to each employee during the year and calculate his/her tax liability supposing the income from his employment is the only source of income of the employee.

In case there is a change in the total income from the employment during the year due to a certain addition or deduction in the amount, such as payment of overtime, payment of bonus, increment in salary, payment of awards, etc, the tax liability should again be recalculated according to the new estimates and the amount of withholding tax for the rest of the period should based on those recalculation.

In case any employee is getting net of tax salary, employer is required to compute tax at gross up procedure.

Any inclusion or benefits (except couple opting as single unit, which is finalized on signing of A.R.B. Form No. 7) channeled through the accounts of employer is taken as basis for computation of withholding tax on employment payment. Based on this procedure, reduction for contribution to approved retirement fund, medical tax credit, insurance premium, remote allowances, or similar benefits shall be taken into accounts, if and only if, these are under employer's information and channeled with.

- **Withholding tax on Payment of Service Fee and Investment Return**

Conditions for Withholding of Taxes

- The payer shall be resident, and
- The payment that is being made by the payer shall have source in Nepal.

A resident person has to withhold tax at a rate applicable for the income at the time of payment of the different incomes having a source in Nepal. Here income means an income for a person who receives the payment. The payment includes passing of the entry in the books for such expenses. Section 88 covers the following payments of incomes for deduction of tax at source: *interest, dividend, payment of an amount on maturity or otherwise for an investment insurance taken, payment for natural resources, rent, royalty, service charges, and retirement payments.*

The table below shows the details of withholding tax deductible incomes, conditions applicable, rate of withholding tax, and the withholding tax as the final withholding tax or an advance.

S. N.	Income	Conditions applicable	Rate %	Final withholding tax or advance payment
1	Interest	In case a resident bank, finance company, cooperative, a listed company, or any entity that has issued debentures, are paying interest for deposits, debentures, bonds etc to a natural person not in the course of conducting a business.	5	Final

2	Interest	In case a resident bank, finance company, cooperative, a listed company, or any entity that has issued debentures, are paying interest for deposits, debentures, bonds etc to a tax-exempted person under Section 2(s)	15	Final
3	Interest	In all the other cases. Exception: Paid to Banks and FIs, interest up to Rs. 25,000 paid by postal banks, micro-credits, rural cooperatives, rural development banks which is tax exempt.	15	Advance
4	Payment for natural resources having source in Nepal	In all the cases.	15	Advance
5	Rent having source in Nepal	Rent for land and/or building with or without including the attachments or equipment installed in that land or building payable to a natural person not in the course of conducting a business. However, no tax to be deducted in payment of rent to natural person. (Subject to taxation by local level)	10	Final
6	Rent having source in Nepal	Rent in all the other conditions.	10	Advance
7	Royalty having source in Nepal	In all the cases.	15	Advance
8	Service fee having source in Nepal	Service fee payable to a natural person for meeting fee and periodical teaching fee, fee for setting examination papers and fee for marking answer copies.	15	Final
9	Service fee having source in Nepal	Service fee charged by a person providing services registered for VAT purpose and issues tax invoice.	1.5	Advance
10	Inter regional interchange fee	Inter regional interchange fee payable to a bank issuing credit card.	0	N/A

11	Service fee having source in Nepal	Service fees in all the other cases. (Including sales bonus and discounts as service charge and subject to withholding tax as per this sub-section.)	15	Advance.
12	Lease rent on aircraft having source in Nepal	Lease rent for aircraft	10	Advance
13	Commission paid to a non-resident	Commission paid by a resident employment company to a non-resident.	5	Final
14	Retirement payments having source in Nepal.	Retirement payments made by GON or an approved retirement fund, on the amount calculated as per Section 65 (1)(b)	5	Final
15	Retirement payments having source in Nepal.	Retirement payments made by an unapproved retirement fund, on the amount of the gain. Here the gain means the amount received from the fund as reduced by his contribution to the fund.	5	Final
16	Dividend having source in Nepal	In all the cases. from company or from partnership	5	Final
17	Amount received from a life insurance company.	Amount received from a life insurance company for insurance on the life of the individual, on the amount of gain to the individual. Here the gain means the amount received as reduced by the cumulative total of premiums paid for the policy.	5	Final.
18	Amount received against accident insurance	Amount received from a general insurance company as compensation for an accident against any personal insurance.	none	NA
19	Rent of Transportation	Withholding of taxes on payment of rent of transshipment (1.5% if VAT invoice is issued.)	2.5	

20	Commission to reinsurance premium	Withholding of taxes of payment of commission relating to reinsurance premium to non resident insurance company	1.5	
21	Payment made to consumer committee	Withholding on payment exceeding 5 million made towards the works done through the consumer committee	1.5	
22	Payment Made to foreign bank in foreign currency for loan by Resident BFI	Resident BFIs taking loan from foreign bank in foreign currency and investing in specified areas prescribed by NRB	10%	
23	payment through payment card, e-money (wallet), mobile banking related electronic medium	No tax shall be deducted on incentive provided to consumer on purchased goods or services by making payment through payment card, e-money (wallet), mobile banking related electronic medium as per prevailing laws	No TDS	

Addition in final withholding payments (Sec 92)

- Meeting fee upto twenty thousand rupees per meeting, payments made for occasional teaching, payments made or setting up question paper or for examination of answer sheets.
- Payment of rent for vehicle or freight service of natural person except sole proprietorship firm.
- Interest or fee paid by Nepal Government to foreign government or international institution according to agreement executed between Nepal Government and foreign government or foreign institute is exempted from taxation including withholding tax.

- **Conditions under which withholding of tax is not required**

Under the given situations, the payer is not required to deduct tax at source:

- In case the payer is a natural person

  Exception:

  The natural person is required to withhold tax on the payment made in the course of conducting a business and for a payment of house rent

- In case the payee is a bank or a finance company and the payment is for interest. Any commission, service fee, bank charges, payable to a bank or a finance company is not subject to withholding tax.
- In case the payment is exempted from tax.
- In case the payment is for service provided covered by Section 87. It means income from employment.
- In case the payment is made for providing articles for newspapers and magazines.

In case the withholdee is a non-resident person during the year, the amount withheld shall be treated as final tax for him.

- **Withholding tax on Payment of Contract Cost and re-insurance:**

Conditions to be satisfied:

If all the following two conditions are satisfied, there must be the withholding of taxes u/s 89 of the Act:

- *The payer shall be a resident person and*
- *The payment shall be made for contract defined by the clarification clause of Section 89*

Payments that attract WHT

A resident person at the time of making a payment for a premium for general insurance to *Non Resident Person* or making payment of Rs. 50,000 or more related to a contract has to withhold tax at 1.5% of the amount of payment.

Calculation of Threshold of Rs. 50,000

The payment of more than Rs. 50,000 is calculated by including all the payments made within last ten days for the same contract to the same person or his associated person, which means payment made in moving 11 days period in total including the date of payment. But computation of Rs. 50,000 excludes duties and taxes associated with the payment. For example, if any contract payments constituting of Rs. 90,400 in a contract having 100% excise and 13% VAT; the contract payment is Rs. 40,000 only, which is not more than Rs. 50,000. So, no withholding is required for the payment.

The provision is applicable where the payment for the contract is higher than Rs.50,000 irrespective of the volume of total contract price of a single contract. Suppose a contract price is Rs. 200,000 but the part payments are made in five monthly installments of Rs. Rs. 40,000 each. In this case the provision of withholding tax is not applicable on payment of the contract price. But suppose the monthly installments are fixed as Rs. 60,000, Rs. 50,000, Rs. 40,000 and Rs. 50,000; in the case the withholding tax is applicable in whole payment except the payment of Rs. 40,000.

Definition of Contract or Agreement

Contract for the purpose of Sec. 89 means the following contracts:

- Contract related to the supply of goods or human resources, or

- Contract related to the construction, installation, or establishment of intangible asset or structure,
- Other works prescribed as contract by the department, and
- If the Contract related to the construction, installation, or establishment of intangible asset or structure includes the Service element, the payment related to such service element shall also be considered as part of Contract payment.

- **Different Rate of withholding tax for Non-Resident Payee:**
  - In case of payments made to non-resident for Contract or Agreement, withholding of tax shall be done at 5% of payment.
  - In the other items payable for non-resident, in case IRD has notified a different rate of withholding tax, the rate of withholding tax applicable shall be as per the notification.

- **Conditions under which withholding of tax is not required u/s 89**

  Under the following situation the payer is not required to deduct tax at source:

  - In case the payer is a natural person and the payment is not being made in the course of conducting a business.
  - In case the payment is exempted from tax.
  - In case the payment is made for a service provided Section 87 and 88 cover it.

- **Effect of DTAA in withholding tax**

  Nepal has entered into an agreement to avoid double tax in the same income with 10 countries. For the resident of other contracting state (our counter-part state), there are numerous reduced rate facilities and simplified tax payment procedures.

  - In case of resident of other contracting state has business income in Nepal, taxable income from that business is taxable in Nepal, if and only if, it runs business through a permanent establishment in Nepal. Income from business and other income are taxable as similar as company in Nepal.
  - In case any person have income from Nepal without permanent establishment, most of them are taxable by way of withholding tax, which is final as per Sec. 92 (income that are taxable by way of withholding method is final for non-resident as per Sec. 92). There are some reduced rate facilities for resident of other contracting state in the withholding rate as prescribed in Sec. 88 and 89. Some of them (which are regular and some common for all other contracting states) are as follows:

  Reduced rate facility is allowed for resident of other contracting state. In case of resident entity, that must be controlled by resident of same country or resident of Nepal (this is to be analyze based on pass-through approach for such conduit company cases). Entity that is resident in other contracting state but controlled by other state (not part of tax treaty) does not get benefits of tax treaty as per Sec. 73(5). In case any person receiving income from Nepal is not taxable as resident, but is made taxable otherwise, the reduced rate facility is not allowed; for example if other contracting state charge pro-rata personal tax on partnership, such partnership is not allowed for reduced rate facility.

- ***Withholding Tax on dividend***

  It is 5% in all cases as per Sec. 88. This rate is lower than the maximum limit of dividend for all 10 DTAAs (Maximum limit of tax on dividend has given in Article 10 of respective DTAA).

- ***Withholding Tax on employment payment***

  There will be no withholding tax on employment payment, if the employee is teacher or university researcher or similar; for the first two years of employment. (Provisions contained in Article 20 or 21 of respective tax treaties for immediate resident of China, India, Korea, Mauritius, Sri Lanka, Thailand or Qatar).

- ***Income of Student or participants or trainees***

  Income of student or participants or trainees are exempt income in temporary presence in the contracting state, such expense is beyond withholding tax for Nepal too (case-wise differences e.g. Sri Lankan in Nepal –one year maximum USD 3000).

- ***Withholding tax on interest payment***

  Withholding tax on interest is 15% in all cases with some resident related exceptions as per Sec. 88. But there are following limitations for the interest payment by resident of Nepal (Article 11 of respective tax treaties):

  - In case of interest recipient is central bank or similar organization as listed in respective tax treaties, there will be no tax on interest payment to those entities.
  - In case of bonafide banking business running by resident of Austria, India, Mauritius, Norway, Pakistan and Sri Lanka, the maximum rate of withholding tax is 10% (even Sec. 88 prescribed 15%).
  - In case of recipient is resident of Korea (Democratic), China or Qatar, the maximum rate of withholding tax is 10%.
  - In case of recipient is resident of Thailand, the maximum rate of withholding tax is 10% except for banking, Investment insurance and investment companies.
  - Interest payment for permanent establishment is similar as local company.

- ***Withholding Tax on casual income (Windfall Gain- Sec 88Ka)***

  Definition of Windfall Gain

  Windfall gain means any gain received on casual way and it includes lottery, gifts, prizes, bet, gamble, raffle, baksis, or jitaury.

  Rate of Tax

  The rate of Withholding Tax is 25% of such gain.

  In such a case, if the casual income in form of kind, the market value is taken as basis.

Exemption of Casual Gain Tax

The person is not required to pay casual gain tax on national and international level prizes up to Rs. 500,000 received for the acknowledgement of contribution in the field of literature, arts, culture, sports, journalism, science, technology and public administration.

Power of GON to exempt Casual Gain Tax

GON, by publishing notification in Nepal Gazette, may exempt casual gain tax on national and international level prizes up to Rs. 500,000 received for the acknowledgement of contribution in the field of literature, arts, culture, sports, journalism, science, technology and public administration.

- **Deemed withholding tax:**

  According to Section 90 (3) a person who is obliged by the Act to withhold tax under Section 87, 88, 88A or 89 but if does not do so, in that case it will be supposed that the tax has been withheld according to the provision at the same time when the payment is made.

- **Deposit of WHT in Revenue Office and Submission of WHT Return:**

  Time limit to submit WHT Return and WHT amount

  The total amount of withholding tax deducted or deemed to be deducted during a month according to Nepali calendar should be deposited at any IRO or a bank specified by IRD within 25 days of expiry of the month of withholding tax deduction. A Withholding Tax Return is to be filed by withholding agent within the same time period.

  Responsibility to deposit amount and submit Return

  The withholding agent (who is obliged to withholding tax) has the sole obligation to deposit the amount withhold as tax and filing return of withholding tax to the Revenue within the specified period of 25 days from month of withholding.

  Effect of Failure to file Return and Deposit WHT

  - The failure to file the withholding tax return is subject of fee under Sec. 117(3) at 2.5% p.a. of total of withholding tax computed for month and part of month basis.
  - Failure to deposit the amount of withholding tax (both deducted and deemed), an interest of 15% p.a. is levied for month and part of the month basis. In case, non-filer of withholding tax is assessed by the taxation authority, difference of withholding amount is need to withhold and reassessment by the taxation authority, is levied at 50% fee under Sec. 120(a).

  Responsibility to deposit amount in case of Deemed withholding of Tax Failure to Deposit tax by Withholding Agent within specified Time Limit

  - In case of a deemed tax deducted at source, both the withholdee and the withholding agent are jointly or separately responsible for deposit of the amount to the Revenue. The responsibility of both the parties ends on payment of the amount to Revenue.

- In case the withholding agent deposits the amount of withholding tax of deemed deduction to the Revenue, he gets a right to recover the amount from the withholdee.
- There is no charging of interest in case the withholdee deposit the deemed withholding tax within 25 days after lapse of 25 days for the withholding agent. After 50 days from closure of month of payment, both parties are liable for pay withholding tax, including interest thereto. Interest paid by any party cannot be recovered from another party.

Effect of Deposit of Withheld Tax

In case the withholding agent has withheld tax and deposited to the Revenue as per Section 90(6), then the withholding amount is deemed to be paid to the withholdee. The withholdee cannot claim the amount from the withholding agent.

Suppose a withholding agent has deducted an amount of withholding tax at a higher rate than prescribed. Unless the withholding agent has deposited the amount to Revenue, he can refund the excess amount to the withholdee but not after that. In this case, the withholdee has a right to file a refund application with IRD for the excess amount or treat the total amount of withholding tax as an advance payment of tax.

- **Deduction of withholding tax is a Proof of Advance Tax Paid to the Extent of the Amount so Deducted**
  - In case of final withholding payments: When the withholding agent has deducted the withholding tax on such payments or in case of a deemed deduction of withholding tax when the amount of tax is deposited to Revenue either by the withholding agent or the withholdee, the withholdee's final tax liability for the income shall be treated as satisfied.
  - In other cases the withholding amount shall be treated as an advance or a part payment of the tax liability for the year in which the income is derived in either of these two conditions:
    - In case the withholding agent has deducted withholding tax under Section 87 to 89 from the payment; or
    - In case of a deemed deduction under Section 90 (3) either the withholding agent or the withholdee has deposited the tax to Revenue; and

    The withheld tax or deposited without withholding tax is claimed as advance tax with the income tax return of concerned year of payment.

- **Certification for Tax Deducted at Source:**

A withholding agent has to give a certificate of withholding tax to the withholdee within 25 days of expiry of the month in which the tax is deducted. In case the withholdee is an employee of the person such a certificate should be provided within thirty days from the end of the income year or within thirty days of the termination of the service of the employee in case the employee has terminated the job during the year.

The certificate should be certified in a manner, if any, prescribed by IRD and must include the information regarding the payment of income and the amount of withholding tax under Sections 87, 88, 88A or 89. IRD has prescribed a formal format of Withholding Tax Certificate.

- **Advance Tax to be collected**

  A payer shall collect advance tax on gain on three types of transactions as described by Sec. 95A. Advance Tax is required to be collected by the person responsible for registration or similar administrative authentication.

- **Advance Tax on gain on Commodity Future Market**

  In case any person derives gain from commodity future market, the person operating that market needs to collect advance tax on that gain. The advance tax is 10% of gain on each settlement. (Since the future settlement is done by the Commodity Future Market it is some similar of withholding pattern.)

- **Advance Tax on gain on Security Market (Sec- 95A(2)**

  - Gain on Disposal of Listed Security

    In case any person gained from disposal of security, the person operating that market (Stock Exchange) needs to collect advance tax on that gain. The rate of advance tax is as follows:

    - For Resident Natural Person: 5%
    - For Resident Entity: 10%.
    - For Others: 25%

    This type of advance tax is to be collected by the person operating stock market for all types of securities it deals with (listed shares, listed stocks, listed bonds, or other transactions).

  - Gain on Disposal of Unlisted Securities

  In the cases of such securities those are not dealt in stock exchange and disposed by owner itself, the person responsible for transferring the title is responsible person to collect advance tax. The method of computation of gain on the transaction is same as stock exchange but the rate of advance tax rate is as follows:

    - For Resident Natural Person: 10%
    - For Resident Entity: 15%.
    - For Others: 25%

- **Advance Tax for language test or standardized test fee to students going abroad (Sec 95A (6ka))**

  Resident BFIs on providing foreign exchange facility for language test or standardized test fee to students going abroad, shall withhold tax at 15% at the time of providing the facility.

- **Advance Tax on Import of Agro Products (Sec 95A (7))**

  On import of following products 5% of Advance Tax shall be levied and collected as custom point:

Part 1 of HS: he-buffalo, buffalo, he-goat, boka, sheep, chyangra etc. live animals

Part 3 of HS: live, fresh or frozen fish

Part 6 of HS: fresh flowers, bulb, root, cut flowers and ornamental foliage

Part 7 of HS: fresh vegetables, potato, onion, certain roots and tubers

Part 8 of HS: fresh fruits and nuts, peel of citrus fruit or melon.

- **Advance Tax on Gain on disposal of Land and Building by natural person**

  In case any natural person disposes land and building (non-business changeable assets for the purpose of income tax laws), the gain on such disposal is subject of advance tax as:

  - 2.5% of gain in case of gain on disposal of building (or land) owned more than 5 years.
  - 5% of gain in case of gain on disposal of building (or land) owned up to 5 years.

- **Administration of Advance Tax**

  Person responsible for collection of advance tax is deemed to collect the amount of tax even if the tax is not collected in actual. In case it fails to collect such tax, it shall deposit it in the revenue accounts and the arrear can be collected from the person to whom the advance tax is levied. The total amount of advance tax collected or deemed to be collected during a month according to Nepali calendar should be deposited to Revenue at any IRO or a bank specified by IRD within 25 days of expiry of the month of withholding tax deduction. Within same period, an Advance Tax Return needs to be filed by collecting agent.

  The collecting agent (who is obliged to collect tax) has the sole obligation to deposit the amount of and filing return of withholding tax deducted to the Revenue within the specified period of 25 days from month of collection.

  Failure to file the advance tax return under section 95A, is subject of fee under Sec. 117(1) (b) at 1.5% p.a. of total of advance tax computed for month and part of month basis. Failure to deposit the amount of advance tax (both collected and deemed), an interest of 15% p.a. is levied for month and part of the month basis.

  But in case of a deemed tax collected at source, both the person on whom the tax is levied and the collecting agent are jointly or separately responsible for deposit of the amount to the Revenue. The responsibility of both the parties ends on payment of the amount to Revenue. In case the collecting agent deposits the amount of advance tax of deemed collection to the Revenue, gets a right to recover the amount from the person to whom advance is levied. There is no interest charging in case the advance tax payer deposit the deemed advance tax within 25 days after lapse of 25 days for the collecting agent. After 50 days from closure of month of payment, both parties are liable for pay advance tax, including interest thereto. Interest paid by any party cannot be recovered from another party.

- **Installment Payment of Tax:**

  A person who derives or is expected to derive any assessable income during an income year

from a business or investment shall be required to pay tax for the year in three installments as specified in Section 94. A natural person who has his income only from employment is not liable to pay the advance tax, because his employer deducts the monthly tax from his salary or wages. A person who has its income only from the final withholding payments is also not supposed to pay the installment tax, because such an income is excluded from the assessable income. A person, in case the total tax calculated on the basis of estimation for the year comes to less than Rs. 7500, is not required to pay any installments tax.

A person, at the time of the first installment payable, shall make estimation for his probable turnover and taxable income for the year. At the time of estimation the most important factors are: turnover of the previous year, turnover of the year up to the period of estimation, factors affecting the turnover of the year, net profit to turnover ratio of the previous year, factors affecting the net profit to turnover ratio during the year, etc. The person should include the estimated income from business, employment and investment for calculating the estimated taxable income. In case the person is a foreign permanent establishment the income remitted or likely to be remitted to a foreign country during the year, should also be considered for calculation of the estimated tax for the year. In case, any person has foreign source income or owned controlled foreign entity, installment tax to be paid for all the sources of income. On the basis of an estimated taxable income, the estimated total tax liability for the year should be determined by applying the rate of tax given in Annexure 1 of the Act.

At the time of the second and third installments payable, if the bases taken for the estimation are changed, a revised estimation of the turnover and taxable profit for the year should be made.

- **Deadline to Make Installments Payments and Installment Amount (Sec- 94)**

  The installments payable are given as under:

  - **First installment-** payable on or before the end of Poush- 40% of the estimated tax to the extent it is in excess of the tax paid up to the period of estimation during the year.
  - **Second installment-** payable on or before the end of Chaitra- 70% of the estimated tax to the extent it is in excess of the tax paid up to the period of estimation during the year.
  - **Third and last installment-** payable on or before the end of Ashad- 100% of the estimated tax to the extent it is in excess of the tax paid up to the period of estimation during the year.

  From the amount of installment of tax payable calculated on the basis of percentage given for each installment, the following amounts are deducted and the balance amount is payable to the Revenue:

  - Previous year's tax credit, if any.
  - Amount of withholding tax deducted from the income received up to the date of estimation.
  - Amount of deemed withholding tax under Section 90(3) in case the amount of tax has been deposited to the Revenue up to the date of estimation.

- Advance tax and installment tax paid during the year up to the date of payment of this installment.
- Tax credit available during the year on the medical expenses incurred up to the date of estimation.
- Tax credit for the tax paid up to the date of estimation in a foreign country on the foreign income included in the estimation.

Power of IRD to exempt Estimated Tax Return

Section 95 (6) has given the authority to IRD to specify that an installment payer or a class of installment payers is not required to submit the estimate.

Power of IRD to amend Estimated Tax Return

In case the tax payer has not submitted the estimation or IRD is not satisfied with the estimation filed by the tax payer, the IRD may issue a notice to the taxpayer stating the reason of dissatisfaction over the figures of estimation by the taxpayer, bases of the revised estimation by IRD, and the figures of revised estimation and make a revised estimation based on the previous year's figures of the same taxpayer.

In such circumstances the taxpayer has to deposit the amount to IRD according to the revised estimation made by the latter.

Effect of Failure to Submit Estimated Tax Return

If a person, required to file an estimated tax return fails to file it, higher of fee of Rs. 5000 or 0.01 percent of assessable income is levied as per Sec. 117(1).

Effect of Failure to deposit required Estimated Tax

In case a person, need to pay installment tax, fails to deposit the amount of installment tax, interest under Sec. 118 is levied.

- **Payment of Final Tax Liability**

At the time of submission of the annual return to IRD or any of the office of the IRO, a taxpayer has to calculate the total tax payable by him during the year and the net tax payable on the date of filing of the return. The net amount of tax payable on the date or before the date of filing the annual return is calculated by reducing the amounts of withholding taxes, advance payment of taxes, carried forward credit amount of taxes, credits for medical allowance and credits for foreign tax paid from the total tax payable during the year.

In case of jeopardy assessment under Section 100 or an amended assessment under section 101, if the taxpayer is satisfied with the order, it should pay the additional liability of tax imposed by the tax officer to the Revenue on or before the date specified for payment in the order.

CHAPTER: 11

FEES, INTEREST, PENALTIES AND APPEALS

Fines

Ignorance of law is not an excuse. The proverb is equally applicable to the Income Tax Act also. Every person having an income during the year has to meet many obligations specified in the Act, Rules and in the circulations and notifications issued by IRD. Payment of tax is not a sufficient fulfillment of the obligation but other duties like submission of return, providing true and fair information, keeping records and accounts, etc should also be performed in time to avoid penalties.

Fines are of two types: fees for non-compliance with documents, interest for nonpayment of tax on time, and fine for noncompliance of the provision of act.

- **Fees under Section 117:**
- **For Failure to Maintain Accounts and Records:**

  In case a person fails to maintain books of accounts and records as per Section 81, the person is responsible to pay ***HIGHER*** of following amount as Fees as follows:

  - 0.1% turnover or gross receipts during the year for which the person fails to maintain the accounts and records, or
  - Rs. 1,000 per annum

  The taxpayer should keep the accounts and records regularly but as per the Section these accounts should be ready on or before the date of filing the tax return. The fee is charged for the whole year of which the accounts and records are not maintained. The word 'turnover' or 'gross receipts' is used as a substitute for the sentence "assessable income derived after the inclusion of all the amounts to be included in income and before any allowed deductions".

  As per public circular dated 2064.11.3 this fee is levied in the following non-compliances:

  - If the person does not maintain documents as required under Sec. 81
  - If the person certifying the tax return denies to authenticate the accounts
  - If the tax payer does not respond to the information sought under Sec. 83(1)
  - If the person fails to file an income tax return
- **For a Delay in Submission of Estimated Tax Return as per Section 95 (1) and Annual Tax Return under Section 96(1):**
- **Failure to Submit Estimated Tax Return**

  In case a person, who has an obligation to submit an estimated tax return, fails to submit the return on time, a fee of Rs. 5,000 per return shall be charged. Delayed filing of estimated tax return does not reduce this liability.

- **Failure to submit Return u/s 96 or Delay in Filing Return**

  In case a person fails to submit final tax return (belated return) under section 96 in the deadline prescribed by IRD, the fees as follows shall be (in case income tax return is not filed, it is deemed as file the return and subject of fee under Sec. 117(2), but not a delay/belated filing) charged to the defaulter :

  - In case the person falls under the category as specified by section 4 (4) (Presumptive taxpayer), the fees is Rs. 100 per month of delay. A part of a month shall be treated as delay of one month for this section.
  - For other taxpayers the fees is higher of 0.1% of the turnover or Rs. 100 per month of delay.

- **Revised Return**

  Any person desiring to revise income tax return filed at department within the due date may revise as per the procedure prescribed by department within 30 days from the date of submission of return.

- **For Delay in Submission of Monthly Return for Withholding tax as per Section 90 (1):**

  In case a withholding agent that has deducted withholding tax during a month and failed to submit a return for the withholding tax on or before due date, the fees for such delay in submission of return is 2.5% per annum of the amount which is required to be deducted as withholding tax by him during the month, calculated on the basis of each month of delay treating a part of a month as one month.

- **For Delay in Submission of Monthly Return for advance tax as per Section 95A(9) :**

  In case a collecting agent has collected tax during a month but has failed to submit a return on due date, a fee of 1.5% per annum of the amount which is required to be collected as advance tax during the month, calculated on the basis of each month of delay treating a part of a month as one month shall be charged.

- **Interest under Section 118 for Underestimating Tax Payable by Installment:**

  In case a person pays installment tax that is lesser than the tax threshold prescribed by the Act, the person shall pay interest on shortfall amount.

  Interest Rate

  The interest rate is 15% per annum.

  Method to calculate Interest

  Following methodology to calculate interest shall be followed: (As per the provision of Income Tax Manual, 2077)

  - Compare total installments paid as follows:

Column A	Column B
Installment Amount paid plus WHT claimed	Actual Tax Liability
Till Poush end with	90% of 40% of actual tax liability
Till Chaitra end with	90% of 70% of actual tax liability
Till Ashad end with	90% of 100% of actual tax liability

- If the installment paid plus WHT considered for installment tax in each row in Column A is less than the amount calculated in Column B, Calculate the difference as follows:

Particulars	Difference
Till Poush end	90% of 40% of Actual Tax Liability Less Total Installment paid till Poush end & WHT considered in Poush end Installment
Till Chaitra end	90% of 70% of Actual Tax Liability Less Total Installment paid till Chaitra end & WHT considered in Chaitra end Installment
Till Ashad end	90% of 100% of Actual Tax Liability Less Total Installment paid till Ashad end & WHT considered in Ashad end Installment

In case, the installment paid plus WHT considered for installment tax in each row in Column A is greater than or equal to the amount calculated in Column B, there will be no case of interest payment.

- Calculate Interest as follows:

Particulars	Interest
Till Poush end	Difference * 15%* No. of Months to recover the shortfall/12
Till Chaitra end	Difference * 15%* No. of Months to recover the shortfall/12
Till Ashad end	Difference * 15%* No. of Months to recover the shortfall/12

Notes to the Students

The students shall consider the No. of Months to recover shortfall as 3 at maximum, if the shortfall of Poush end is not recovered in Magh or Falgun, that of Chaitra end is not recovered in Baisakh or Jestha, and that of Ashad end in Shrawan or Bhadra; and no more than 3.

Period of Charging Interest

The period for interest may be charged is specified as follows:

- The period starts from the day when the installment falls due for payment and up to the last day when the annual tax return is to be submitted; or
- In case the person has not assessed its tax as per section 99 (1) and the tax officer has assessed the tax as per Section 101, the period starts from when the installment falls due for payment and up to the day when the notice under Section 102 for the first time assessment under Section 101 is received by the taxpayer.

- **Interest under Section 119 for Delay or Failure to Pay Tax:**

  Rate of Interest

  The general interest rate is 15% p.a. for Income Year 2076/77. Students are advised to update themselves with the amendment in definition of General Interest Rate for rate applicable for particular Income Year.

  Interest to be charged

  Interest shall be levied on shortfall tax amount at General Interest Rate Interest for the period starting from time the amount became due for payment up to the date of payment. The interest is charged for the month of delay treating a part of a month as one month.

  While calculating the interest, the extension granted under Section 98 is ignored.

  In case a withholding agent or collecting agent has delayed in making payment of the amount of deemed withholding tax or advance tax, it cannot charge the interest to the other person.

- **Fee for Making False or Misleading Statements:**

  Fee is imposed on a person who makes a false or a misleading statement to IRD or IRO or creates such a situation, by not providing some material information or by omitting material information from the statement, so that the statement becomes misleading.

  Here a statement means a written statement given to IRD, IRO, or to any authorized officer of IRD or IRO by a taxpayer, including the following statements submitted to IRD or IRO:

  - Application, notification, return, objection, statement, or any other document prepared, given or submitted under this Act;
  - A document furnished to IRD or IRO otherwise than required by this Act;
  - Answers to questions asked by any tax officer; or
  - A statement given, by any other person on behalf of a person having reasonable knowledge about the information, to IRD or IRO.

  Such statements should be true and fairly based on accounts and records. The accounts and records may have been maintained on the basis of Nepal Accounting Standard/ Nepal Financial Reporting Standard, International Accounting Standard/ International Financial Reporting Standard, or Generally Accepted Accounting Principles but for tax purpose adjustments should be incorporated as required by the Act before furnishing the figures to IRO. Charging depreciation, for example, in the accounts as per the straight-line method cannot be called false or misleading information because the method is duly accepted by the Standards. But before producing the data to IRO, the amount of depreciation should be adjusted after a re-calculation on the basis of the provisions of Schedule 2 of the Act.

  Fee is imposed when the false or misleading statement has caused a tax differences or tax evasion.

  The false or misleading statement may be caused due to a mistake or errors in which

the taxpayer has no intention to do so. In that case the fee shall be charged at 50% of the underpayment of the tax. Such mistakes or errors may be caused by arithmetical calculations and understanding of transactions or events.

In case the false or misleading statement is caused due to fraudulent activities of the taxpayer knowingly or recklessly, the fee shall be charged at 100% of the underpayment of the tax.

- **Fee for aiding and abetting:**

  According to Section 121 a person who knowingly or negligently helps, aids, abets, or advises any taxpayer to commit any of the offences described in Chapter 23 of the Act, is also punishable with a fee of 100% of the underpayment of the tax by the taxpayer.

- **Fee against fine:**

  According to Section 119A a person on whom IRD is likely to charge in the court regarding fines for tax crimes as defined in Chapter 23 of Income Tax Act, 2058 and the person applied to accept the charges and wants to pay those fines as fee, IRD can levy the fine in form of fee.

- **Other Relevant Points with Regard to the Fees and Interest:**

  - The authority to determine the fee and/or interest under the Sections discussed above is vested with an authorized assessing officer from IRD or IRO.
  - Fee and interest chargeable under the Sections discussed above are calculated separately as per each Section involved.
  - If fee and interest chargeable under the Sections discussed above are additional liability of the taxpayer then the tax is payable by him in compliance with the other Sections of the Act. Imposing the fee and interest under the above Sections does not mean that the tax officers are not entitled to commence proceedings against the taxpayer for the criminal offences committed by the taxpayer as described in Chapter 23 of the Act.
  - The assessing officer of the IRO should serve a notification, with regard to the assessment of penalties and interest, to the taxpayer including the following statements (Section 122):
  - The reason on the basis of which the assessing office has to impose the fee and interest on the taxpayer;
  - The amount of fee and interest due for payment;
  - The method of calculation of the fee and the interest; and
  - Where, when and how to appeal against the order if the taxpayer is not satisfied with the amended assessment.
  - The notice described above can be served along with the notice to be served under Section 102.
  - The above provisions of imposing fee and interest are also applicable in the case of a self-assessment, a jeopardy assessment and each of the amended assessments. Each time the fee and the interest may be calculated according to the latest assessment.

- **Penalties for Criminal Offences:**

  In case a person commits offences, avoids payment of taxes, causes disturbances in investigation or audit from the office, collects taxes without any authority and makes false or misleading statements, s/he is punishable with penalties as stated in the Sections covered by the Chapter 23 of the Act.

- **Offence of a Failure to Pay Tax (Section 123):**

  Any person who fails to pay tax within the prescribed time without any reasonable excuse shall be liable on conviction to a fine of an amount ranging from Rs. 5,000 to Rs. 30,000 or an imprisonment for a term of not less than one month and not more than three months, or both.

- **Offence of Making a False or Misleading Statement (Section 124):**

  In case a person, who makes a false or misleading statement to IRD or IRO or creates such a situation, by not providing some material information or omitting material information from the statement, that the statement becomes misleading, s/he is liable to pay a fine of an amount ranging from Rs. 40,000 to Rs. 160,000 or an imprisonment for a term of not less than six months and not more than two years, or both.

- **Offence of Impending or Coercing Tax Administration (Section 125):**

  A person who commits the following offences shall be liable to a fine ranging from Rs. 5,000 to Rs. 20,000, or an imprisonment for a term of not less than one month and not more than three months, or both:

  - Obstructing an officer of IRD or IRO acting in the performance of duties under this Act
  - Defying any written notice issued by any officer from IRD or IRO in compliance with Section 83 with regard to the submission of documents, statement, information, physical presence, etc; or
  - Obstructing, in any way, the enforcement of the Act.

  A person who attempts to commit the above-mentioned offences shall be liable to half of the penalty chargeable on the person who has committed the offences.

- **Offences Committed by Tax Officers (Section 126):**

  Every tax officer or any employee of IRD or IRO, whether authorized for the case or not, should keep the documents, statements and information received during the course of assessment, audit, or investigation, secret and can use or provide only to the extent it is provided in Section 84. In case any officer violates the provision, he shall be liable to a fine up to Rs. 80,000, or an imprisonment for a term of not more than one year, or both.

  Any person who is not authorized by this Act to collect or attempt to collect tax or any amount in terms of tax, but does so, shall be liable to a fine of an amount ranging from Rs. 80,000 to Rs. 240,000 or an imprisonment for a term of not less than one year and not more than three years, or both.

- **Penalty to aiding and abetting:**

  According to Section 127, a person who knowingly or negligently helps, aids, abets, or advises any taxpayer to commit any offences under this Act or counsels or induces another person to commit such an offence, shall be liable to a half of the penalty that is imposed on the main offender.

  But, in case the person is a government official, the penalty shall be equal to the penalty that is charged on the main offender.

- **Offence of a Failure to Comply with the Act:**

  Any person who fails to comply with any provision of this Act, otherwise than specified in the above-mentioned Sections, shall be liable to a fine of not less than Rs. 5,000 and not more than Rs. 30,000.

- **Other Provisions Related to the Offences under Chapter 23 of the Act:**

  - In case a person accepts in writing as having committed one or more offences under this Chapter, other than those offences committed by a natural person as described in point number 12.2.4 the DG, may, at any time prior to the commencement of court proceedings, order the person to pay an amount as specified by the officer but not exceeding the amount of the fine that is likely to be imposed for committing one or more offences.

    The order issued under this Section should include the nature of offences committed, the amount of penalty payable, and the date of amount payable.

    The order issued under this Section shall be fee as no appeal is acceptable in this case. It means, in case a taxpayer has any hesitation to accept the order by DG under this Chapter, should not give the assent in writing that it has committed the offence. Its assent makes the order unchallengeable.

  - In case the taxpayer does not accept having committed one or more offences under this Chapter, the tax officer has to file an application to a District Court against the taxpayer for imposing the penalty for the offence committed by him. In case the District Court decides that the taxpayer has committed the offence, the amount of penalty and duration of the imprisonment is also finalized. The procedure for filing the lawsuit is as follows:

    - IRD or the respective IRO has to appoint a tax officer for investigation of the lawsuit, fixation of the amount of penalty chargeable, and to file the lawsuit to the District Court. The lawsuit should be filed to the District Court within 30 days of the completion of the investigation.

    - Nepal Government shall be a plaintiff in all such lawsuits.

    - Before filing the lawsuit the investigating officer should get an opinion on the lawsuit of a government advocate.

- **Departmental Action against Tax Officer (Section 133):**

  Under the following conditions, IRD can take a departmental action against a tax officer, as per the terms and conditions of his appointment:

- The tax officer has, negligently, assessed any tax liability and there-by, the tax liability of an assessee either increased or decreased; or
- The tax officer has not completed the amended assessment within the time limit prescribed by Section 101 (3).

But Section 136 gives relaxation to the tax officers by saying that an officer, who takes any action with a good motive in course of performing duties, shall not be personally liable to that action.

Appeals:

- Administrative Review:

In case a taxpayer is not satisfied with any decision of IRD or respective IRO or the tax officer, it has to file an application, as first step, to IRD for an administrative review. But in case the Director General himself, under his signature, passes an order, an advance ruling or an amended assessment, the taxpayer shall go to the Revenue Court for appeal. According to Section 114, an application against the following decisions shall be filed to IRD for an administrative review:

- Against an advance ruling issued by IRD;
- Against assessment of withholding tax and interest thereto under Sec. 90(8);
- Against an estimation of advance payment by a taxpayer made by a tax officer under Section 95 (7);
- Against a decision by a tax officer to require a taxpayer to file a return of tax under Section 96(5) or 97;
- Against a decision of a tax officer with regard to an extension of time for filing returns;
- Against a jeopardy assessment under Section 100, an amended assessment under Section 101, an assessment of expenses incurred on auction sales under Section 105 (5), or penalties imposed under Sections 117 to 121;
- Against the notification by the IRO of an amount to be set aside by a receiver under Section 108 (2);
- Against an order by a tax office to a debtor of the taxpayer to pay the amount due to the tax office instead of to the taxpayer under Section 109 (1);
- Against an order by a tax officer to a person to pay tax on behalf of a non-resident person under Section 110 (1);
- Against a decision of IRO on an application by a taxpayer for a refund of tax under Section 113 (5); and
- Against a decision of IRD on an application by a taxpayer for extension of time within which to file an objection under Section 115(3).

Though, almost all points of raising objections are covered by Section 114, the taxpayer may apply to the Revenue Tribunal for objections not covered by the Section.

Where the tax officer has not served a notice of a decision taken with regard to an application for extension of time under Section 98, an application for a refund of tax under Section 113 (3) or a notice of decision by IRD for extension of time under Section 115 (3), within 30 days of the application filed by the taxpayer, the taxpayer can treat the application as rejected by the IRD or IRO and can apply for an administrative review under Section 115.

Procedure for Administrative Review:

- ***Where to apply:***

  The application for an Administrative Review should be submitted to IRD.

- ***Time Limit:***

  - The application should be submitted to IRD within 30 days of the receipt of the notice of decision by the taxpayer.

  - In case a taxpayer is not able to submit an application within the specified days, it can apply to IRD for extension of the time, specifying the valid reasons for the delay, within seven days from the expiry of the time. IRD may, where a reasonable cause is shown, extend the time for a period not exceeding 30 days since original deadline. IRD has to serve a notice to the taxpayer in this regard.

- ***How to file:***

  - The applicant should file an application specifying in detail the grounds on which the objections are based. The application may specifically include the Section, Rules, circulars, decisions of a court, etc. if these are not considered at the time of taking a decision.

  - In case the tax officer has not considered the evidences produced, the decision is against the natural justice or against the Constitution of Nepal; the fact should also be mentioned in the application. In case the tax officer has not complied with the procedure to be adopted before the decision is taken, the fact counts more if given in the application.

  - The provision that a taxpayer, before filing the application to IRD, should deposit an amount equal to 100% of the tax and fees in which the taxpayer has no dispute with the assessment order, and 1/3rd of the rest amount payable as per the assessment order.

- ***Effect of the application:***

  - According to Section 115 (4) and (5), the enforcement of a decision taken by a tax officer with regard to the amended or jeopardy assessment, on filing the application, shall not be treated as stayed unless IRD stays the proceeding or otherwise affects the enforcement of a decision of the tax officer until the application is settled.

  - Due to this provision aggrieved person by the assessment would have double financial stress- first is dharauti which is at least one third of disputed amount, for

which the person is resisting with DG and the second is to pay whole the tax, fees and interest.

- IRD may allow or disallow the objection in whole or in part. IRD in compliance with its legal duty should serve the applicant with a written notice of the decision taken.

- Where IRD fails to serve a notice of the decision on the application within 60 days of the submission of application, the applicant may, by a notice in writing filed with IRD, treat the application as disallowed by IRD.

- **Appeal to Revenue Tribunal:**

Filing of Application to Revenue Tribunal

A taxpayer who is aggrieved by a decision of IRD on an application filed as per Section 115, or the taxpayer has supposed that the application is rejected due to expiry of a period of 60 days after filing of review application, may appeal to a Revenue Tribunal in accordance with the Revenue Tribunal Act, 2031.

Amount of Deposit

An applicant should deposit an amount equal to a sum of 1/4th of the disputed tax amount and 100% of undisputed tax amount assessed by the tax officer, and total amount of penalty imposed by him. The amount should be deposited in an office, instructed by the assessing authority.

Deadline to file Appeal application at Tribunal

An appeal to a Revenue Tribunal should be filed within 35 days of the receipt of assessment order by the taxpayer or the taxpayer receives the decision of IRD or treats the application rejected by IRD.

Responsibility of Taxpayer to inform IRD

The taxpayer, who appeals with the Revenue Tribunal, should file a copy of the notice of appeal with IRD, within 15 days of doing so.

Effect of Appeal Application

According to Section 116 (3), the enforcement of a decision taken by a tax officer with regard to the amended or jeopardy assessment, on filing the application, shall not be treated as stayed unless the Tribunal stays or otherwise affects the enforcement of a decision of the tax officer until the appeal is settled. Due to this provision aggrieved person by the assessment would have double financial stress- first is dharauti which is at 1/3rd of disputed amount, for which the person is in revenue tribunal and the second is to pay whole the tax, fees and interest.

Other Decisions not covered by Section 114

For the cases, which are not covered by Section 114; the taxpayer, according to the prevailing conditions and allowed by prevailing Acts, can file a case directly to the Revenue Tribunal.

- **Option if the taxpayer is not satisfied with the decisions of Revenue Tribunal**

  The decision of Revenue Tribunal is final. But as per Sec. 8 of Revenue Tribunal Act, 2031; a taxpayer may file writ petition if s/he not satisfied with the decisions of Revenue Tribunal as extraordinary jurisdiction of Supreme Court of Nepal if Supreme Court grants permission to make appeal to it considering that the decision of the tribunal will be reversed fully or partly because of a direct (clear) legal error on any of the following grounds:

  - Question of jurisdiction,
  - Question of having not examined the evidence that should have been examined or having examined the evidence that should not have been examined,
  - Question of violation of the procedural law that must be followed, or
  - Question of serious legal error.

CHAPTER: 12

RATE OF TAX AND TAX CREDITS

Income tax is computed on taxable income as calculated on the basis of section 5 with the rate given in Schedule 1 according to Sec. 4. For the computing the tax, progressive rate is applied for resident natural person (Sec. 1 of Schedule 1) and corporate rate is applied for the entities (Sec. 2 of Schedule 1).

In the progressive rate, inter alia, the rates are 0%, 1%, 2.5%, 5% ,7.5%, 10% ,15% ,20% ,25%, 30% and 36% including some tax concessions. Progressive tax rate facility is allowed only for resident natural persons.

Corporate rates are either 0%, 2%, 4%, 6%, 10%, 15%, 20%, 25% and 30%.

Presumptive tax payers have some fixed tax amounts (naturally, fixed tax amounts are in regressive tax in nature). Business presumption and vehicle owner are example of presumptive tax payers.

In this section the rates and related provisions are given as applied for Income Year 2076/77.

Tax on natural person:

Students are advised to go through Chapter 2 for format to calculate tax of a natural person. Some of the concepts of Zero rated tax as described below has been dealt with in the same Chapter.

Zero-rated Tax

In some of the cases, the income of a natural person has been made taxable at Zero Rate. Income Tax Manual has treated such Zero rated amounts at par with the deductions availed in the Act. The term "Zero-rated" in this book is used to describe such portion of taxable income of a Resident Natural Person that is Taxable but the applicable tax rate is Zero. The facility is availed irrespective of the form of income, that means- a person having income from non-business chargeable assets or income from employment or income from business or other incomes from investments are allowed zero-rated tax, if the item itself is not a final withholding income. The following are the items that are made taxable at Zero-rate.

- *Benefit for residing in Remote Area*
- *Zero-rated tax in Foreign Allowance received by GON Employee deputed in foreign diplomatic mission of Nepal*
- *Zero-rated Tax in Pension Income of a resident natural person*
- *Zero-rated tax in Income of a resident natural person, if the natural person is disable*
- *Zero rated tax if a resident natural person makes payment of Investment Insurance Premium*
- *Zero rated tax if a resident natural person makes payment of Health Insurance Premium*
- *Zero-rated tax on Basic Exemption Limit, if the person derives Business Income*

- **General taxation**

  A natural person has to pay income tax on the taxable income which is determined after subtraction allowed as zero-rated items (any or all seven) given above. For resident natural person, remaining taxable income is taxed at the rate of 1% (in case of income from employment; in case of business or investment this limit is taxed at 0%- see Chapter 2 for the detailed format to calculate tax of a natural person) to the extent of Rs. 350,000 for individual assessment and Rs. 4,00,000 for couples filing jointly or qualified widow(er) with dependent(s).

- **Complication on tax computation**

  Tax on Gain on Disposal of Non-Business Chargeable Assets:

  In case an income of a resident natural person includes a gain on disposal of non-business chargeable assets, the tax liability is calculated as follows:

Assessable Income from Business	***XXX***
Assessable Income from Employment	***XXX***
Assessable Income from Investment	***XXX***
Assessable Income from Windfall Gain	***XXX***
TOTAL ASSESSABLE INCOME	***XXX***
Less: Allowable Deductions	
• ***Contribution to Approved Retirement Fund (in case of Natural Person) u/s 63***	***XXX***
• ***Expenditure u/s 12Ka- not allowed for a natural person***	***XXX***
• ***Contribution u/s 12Kha***	***XXX***
▪ ***Donation u/s 12***	***XXX***
▪ ***Donation prescribed by Nepal Government in Nepal Gazette***	
▪ ***Donation u/s 12 (1) and (2)- Donation to Exempt Organization***	
TAXABLE INCOME	***XXX***
Less: Allowable Reductions	
• ***Benefit for residing in Remote Area***	***XXX***
• ***Employee of Government of Nepal deriving "Foreign Allowance" due to deputation in foreign diplomatic missions of Nepal***	***XXX***
• ***Reduction, if the resident natural person is Incapacitated***	***XXX***
• ***Reduction of Investment Insurance paid during any Income Year***	***XXX***
Balance Taxable Income	***XXX***

Notes to the Students:

1. **Segregate the Balance Taxable Amount as:**

   a. *Gain on Disposal of Land & Building with ownership less than 5 years included in Assessable Income*

   b. *Gain on Disposal of Land & Building with ownership of 5 years or more included in Assessable Income*

   c. *Gain on Disposal of Securities of Listed Companies included in Assessable Income*

   d. *Gain on Disposal of Other Investments included in Assessable Income*

   e. *Other Amounts (Balance Taxable Income Less Amounts from (a) to (d) above)*

2. **Apply the normal procedure of tax calculation for other amounts, i.e. Balance taxable amount less amounts from 1 (a) to 1 (d) above**
3. **Apply the following rate for the different Investment Income:**

   a. *Gain on Disposal of Land & Building with ownership less than 5 years included in Assessable Income: 5%*

   b. *Gain on Disposal of Land & Building with ownership 5 years or more included in Assessable Income: 2.5%*

   c. *Gain on Disposal of Securities of Listed Companies included in Assessable Income: 5%*

   d. *Gain on Disposal of Other Investments included in Assessable Income: 10%*

4. **If the Total of Balance Taxable Income is less than Sum of 1(a) to 1(d) above, then reduce the Basic Exemption Limit from the amount that attracts highest tax rate.**
5. **From the tax computed from 1-4 above deduct Medical Tax Credit or Foreign Tax credit, as the case may be.**

Presumptive Tax

Business:

The presumptive tax on business has been discussed in Chapter 2. The limits of the turnover and profit for electing payment under presumptive modality and the amount of tax are as follows for year 2058/59 to 2076/77:

IY	Turnover Limit (Rs.)	Net income Limit (Rs.)	Tax Rs.		
			Metro/ Sub-metro	Urban Municipality	Rural Municipality
2058-59	1,000,000	100,000	2,000	1,500	1,000
2059-60	1,000,000	100,000	2,000	1,500	1,000
2060-61	1,200,000	120,000	2,000	1,500	1,000
2061-62	1,200,000	120,000	2,000	1,500	1,000
2062-63	1,500,000	150,000	2,000	1,500	1,000
2063-64	1,500,000	150,000	2,000	1,500	1,000
2064-65	1,500,000	150,000	2,000	1,500	1,000
2065-66	1,500,000	150,000	3,500	2,000	1,250
2066-67	2,000,000	200,000	3,500	2,000	1,250
2067-68	2,000,000	200,000	3,500	2,000	1,250
2068-69	2,000,000	200,000	3,500	2,000	1,250
2069-70	2,000,000	200,000	3,500	2,000	1,250
2070-71	2,000,000	200,000	3,500	2,000	1,250
2071-72	2,000,000	200,000	5,000	2,500	1,250
2072-73	2,000,000	200,000	5,000	2,500	1,500
2073-74	2,000,000	200,000	5,000	2,500	1,500
2074-75	2,000,000	200,000	5,000	2,500	1,500
2075-76	2,000,000	200,000	5,000	2,500	1,500
2076-77	2,000,000	200,000	7,500	4,000	2,500
2077-78	2,000,000	200,000	7,500	4,000	2,500

Vehicles Owner

In case a resident natural person owns public vehicles, the person has to pay a fixed amount of tax per year according to per number of different vehicles. The amounts of taxes for different vehicles are as follows:

Type of Vehicle Tax **(per vehicle per annum)**

Car, Jeep, Van, Microbus

- Up to 1300 CC 4,000
- 1301 CC- 2000 CC 4,500
- 2001 CC- 2900 CC 5,000
- 2901 CC- 4,000 CC 6,000
- ·>4,000 CC 7,000

- Minibus, Mini-truck, Water tanker 6,000
- Mini Tripper 7,000
- Bus, Truck 8,000
- Dozer, loader, roller, excavator, crane 12,000
- Oil Tanker, Gas Bullet, Tripper 12,000
- Tractor 2,000
- Power Tiller 1,500
- Three wheeler, auto rickshaw, tempo 2,000

For an entity and proprietorship firm, such payment of tax shall be treated as advance tax and may be adjusted against final assessment of the tax.

- **Tax on the Income of a Non-Resident Natural Person**

  In case the person is a non-resident natural person, s/he will be charged with a flat rate of tax at 25% on his/her taxable income. Non-residents are not taxed on progressive system and some lower than that for resident's marginal tax rate of 36%.

- **Tax Concession on Certain Incomes of a Natural Person**

  - In case a natural person is engaged throughout the year in conducting a special industry, the tax chargeable income is given a concession by charging only 20% of tax. (Section 1 (14) of Schedule 1)
  - According to Section 1 (15) of Schedule 1, the concession of 50% on rate of tax on income from export of a natural person, where 20% and 30% tax rate is applicable on computation of tax pursuant to this section.

- **Tax on the Estate of Trust**

  In case a trust receives an estate of a deceased resident natural person or receives the property of an incapacitated resident natural person or others, the income from the estate to the trust will be charged treating the trust as a single individual, and in case there is any income from non-business chargeable assets that shall be charged as prescribed in Sub-section (4) of Section 1 of Schedule 1 of the Act (2.5%, 5%, 7.5% or 10% on the income from disposal of non-business chargeable assets). Similarly, tax on other taxable income is charged as that is charged for a natural person.

- **Tax Credits for Medical Expenses:**

  According to Section 51 (1) a resident natural person can claim a tax credit for approved medical expenses incurred for his or her treatment. The expenses may be paid by the individual himself or by any other person. The detail of medical tax credit and method has already been discussed in Chapter 9.1.3.

- **Tax Credit for Income Tax Paid in a Foreign Country:**

  According to Section 71 (1) a tax credit may be available to a resident person whose income

that has a source in a foreign country is included in taxable income of the person in Nepal to the extent of the amount of income tax paid in that country on that income. The detail of foreign tax credit and method has already been discussed in point 9.3.2 above.

- **Rate of Taxes on Entities**

  Normal Tax Rates

Entities	*Applicable tax rate*
General companies/firms/industries	25%
Special Industries	25%
Banks and Financial Institutions	30%
General Insurance Companies	30%
Telecommunication and Internet Service	30%
Money transfer, capital market business, securities business, merchant banking, commodity future market, stock and commodity broker business	30%
Entities engaged in the business of petroleum products	30%
Industries producing products with tobacco as basic raw material and industries producing liquors, beers and similar other products	30%
Entities involved in operation and construction of roads, bridges, tunnels (including cable-car), rope-way, sky bridge, after construction	20%
Entities involved in operation of trolley bus & tram	20%
Cooperative Societies registered as per Cooperative Act, 2074 and engaged in business other than tax exempt operated under Metropolitan, Sub-Metropolitan, Municipality and Rural-Municipality	1 0 % / 7 % / 5 % / Exempt
Export Income of an entity with source in Nepal	20%
Trust of dead or incapacitated person will be taxed as natural person	

- **Tax on Repatriation of Income by a Foreign Permanent Establishment**

  According to Sec. 2(6) of Schedule 1, Tax will be charged at 5% of the income remitted during the year to a foreign country by a foreign permanent establishment. This tax is just like a dividend tax.

- **Tax on the Income of a Non-Resident Person in Nepal from Transport or Transmission Business {Section 2(7) of Schedule 1}:**

  The gross receipts from the following activities of a non-resident person (even having PE in Nepal) are treated as the taxable income of the person from the activities:

  - A person engaged in Nepal in any road, air, water or a chartered transport services, other than transshipment from Nepal, for any of the following services:
    - The carriage of passengers who embark from within a territory of Nepal.

- The services of mail, livestock, or other movable tangible assets that are embarked from the territory of Nepal. and

- A person engaged in the transmission of messages by cable, radio, optical fiber, or satellite through an apparatus or equipment established in Nepal, irrespective of the place of origin of the messages.

Expenditures incurred in conducting such activities are neither allowed to be deducted from the taxable income from the above sources nor allowed to be deducted from any other source of income of the person.

The tax rate applicable is 5% of taxable income (which is gross receipts during the year). No tax credits shall be allowed to the person to reduce the tax payable by the person under this Section.

But the rate applicable shall be 2% only in taxable income on the disembarkation at foreign country while embarkation is not from Nepal.

Note to Students:

For this provision the non-resident person means a resident entity that is a part of a group of associated entities the main head office is situated outside Nepal. The offices situated in Nepal of foreign airlines like Kuwait Airlines, Gulf Airlines, etc. are the examples of such non-resident person falling under this section. International transportation from aero-plane or from ship having registered in (or have effective control with) contracting state under DTAA, the said tax is levied in the country having registration or effective management (normally Article 8 of respective DTAA).

CHAPTER: 13

MISCELLANEOUS

Quantification of Consideration (Section 27)

- In case a person makes a payment to another person in kind or an asset, the market price or value of the kind or the asset is supposed to be the value of the consideration.
- In case a payment is made to any third party instead of the payee, the value of the benefit of the payment is supposed to be acquired by the payee.
- In case a transaction is executed in other than Nepali currency, such a transaction should be entered in the books after translating the amount into the Nepali currency at the rate prevailing on the date of transaction. The person can get permission from IRD to apply an average rate as specified by IRD to translate the value of the transaction into the Nepali currency.
- In case an income arises from a joint investment, the income shall be divided among the partners in proportion to the underlying ownership of them (Section 30).

Transfer Pricing and Other Arrangements Between Associates (Section 33)

Power of IRD in case of Transfer pricing & Other Arrangements between Associates

In any arrangements between associated persons, operated by them according to general market practices (at arm's length), IRD or IRO may, by a notification in writing, distribute, apportion, or allocate the amounts to be included or deducted in the income between the persons as to reflect their taxable income or tax liability.

IRD or IRO may, in the process of the notification:

- Re-characterize the source and type of any income, loss, and amount of payment; or
- Allocate costs, including the head office expenses, incurred by one person in conducting a business that benefits an associate or associates also in conducting their businesses, based on the comparative turnover of the businesses

What is Transfer Pricing?

Rapid advances in technology, transportation and communication have given rise to a large number of multinational enterprises (MNEs) which have the flexibility to place their enterprises and activities anywhere in the world. A significant volume of global trade nowadays consists of international transfers of goods and services, capital (such as money) and intangibles (such as intellectual property) within an MNE group; such transfers are called "intra-group transactions". There is evidence that intra-group trade is growing steadily and arguably accounts for more than 30 per cent of all international transactions.In addition, transactions involving intangibles and multitiered services constitute a rapidly growing proportion of an MNE's commercial transactions and have greatly increased the complexities involved in analysing and understanding such transactions. The structure of transactions within an MNE groupis determined by a combination

of the market and group driven forces which can differ from the open market conditions operating between independent entities. A large and growing number of international transactions are therefore no longer governed entirely by market forces, but driven by the common interests of the entities of a group. The component parts of an MNE group, such as companies, are called "associated enterprises" in the language of transfer pricing.

In such a situation, it becomes important to establish the appropriate price, called the "transfer price", for intra-group, cross-border transfers of goods, intangibles and services. "Transfer pricing" is the general term for the pricing of cross-border, intra-firm transactions between related parties. Transfer pricing therefore refers to the setting of prices for transactions between associated enterprises involving the transfer of property or services. These transactions are also referred to as "controlled" transactions, as distinct from "uncontrolled" transactions between companies that are not associated and can be assumed to operate independently ("on an arm's length basis") in setting terms for such transactions.

Transfer pricing thus does not necessarily involve tax avoidance, as the need to set such prices is a normal aspect of how MNEs must operate. Where the pricing does not accord with internationally applicable norms or with the arm's length principle under domestic law, the tax administration may consider this to be "mis-pricing", "incorrect pricing", "unjustified pricing" or non-arm's length pricing, and issues of tax avoidance and evasion may potentially arise.

Example

A profitable computer group in Country A buys, "solid state drives" from its own subsidiary in Country B. The price the parent company in country A pays its subsidiary company in country B (the "transfer price") will determine how much profit the country B unit reports and how much local tax it pays. If the parent pays the subsidiary a price that is lower than the appropriate arm's length price, the country B unit may appear to be in financial difficulty, even if the group as a whole shows a reasonable profit margin when the completed computer is sold.

From the perspective of the tax authorities, country A's tax authorities might agree with the profit reported at their end by the computer group in country A, but their country B counterparts may not agree — they may not have the expected profit to tax on their side of the operation. If the computer company in country A bought its drives from an independent company in country B under comparable circumstances, it would pay the market price, and the supplier would pay taxes on its own profits in the normal way. This approach gives scope for the parent or subsidiary, whichever is in a low-tax jurisdiction, to be shown making a higher profit by fixing the transfer price appropriately and thereby minimizing its tax incidence.

Accordingly, when the various parts of the organization are under some form of common control, it may mean that transfer prices are not subject to the full play of market forces and the correct arm's length price, or at least an "arm's length range" of prices needs to be arrived at.

How is Arm's Length determined?

The process to arrive at the appropriate arm's length price typically involves the following processes or steps:

- Comparability analysis;
- Evaluation of transactions;
- Evaluation of separate and combined transactions;
- Use of an arm's length range or a central point in the range;
- Use of multiple year data;
- Losses;
- Location savings and location rents;
- Intentional set-off s; and
- Use of customs valuation.

Transfer Pricing Methods

There are five major Transfer Pricing Methods that are as follows:

- **Transaction Based Methods**
  - **Comparable Uncontrolled Price (CUP):**

    The CUP Method compares the price charged for a property or service transferred in a controlled transaction to the price charged for a comparable property or service transferred in a comparable uncontrolled transaction in comparable circumstances.

  - **Resale Price Method (RPM)**

    The Resale Price Method is used to determine the price to be paid by a reseller for a product purchased from an associated enterprise and resold to an independent enterprise. The purchase price is set so that the margin earned by the reseller is sufficient to allow it to cover its selling and operating expenses and make an appropriate profit.

  - **Cost Plus (C+ or CP) :**

    The Cost Plus Method is used to determine the appropriate price to be charged by a supplier of property or services to a related purchaser. The price is determined by adding to costs incurred by the supplier an appropriate gross margin so that the supplier will make an appropriate profit in the light of market conditions and functions performed.

- **Profit-based Methods**
  - **Profit comparison methods (TNMM/CPM):**

    These methods seek to determine the level of profits that would have resulted from controlled transactions by reference to the return realised by the comparable independent enterprise. The TNNM determines the net profit margin relative to an appropriate base realised from the controlled transactions by reference to the net profit margin relative to the same appropriate base realised from uncontrolled transactions.

- **Profit-split methods:**

  Profit-split methods take the combined profits earned by two related parties from one or a series of transactions and then divide those profits using an economically valid defined basis that aims at replicating the division of profits that would have been anticipated in an agreement made at arm's length. Arm's length pricing is therefore derived for both parties by working back from profit to price.

The first three methods above (i.e. CUP, RPM and CP) are often called "traditional transaction" methods and the last two are called "transactional profit methods" or "profit-based" methods. As noted above, there is growing acceptance of the practical importance of the profit-based methods. All these methods are widely accepted by national tax authorities. Students may also note that the US regulations provide for the use of additional methods applicable to global dealing operations like the Comparable Uncontrolled Transaction (CUT) Method. This method is similar to the CUP in that it determines an arm's length royalty rate for an intangible by comparison to uncontrolled transfers of comparable intangible property in comparable circumstances.

Other unspecified methods may be used to evaluate whether the amount charged in a controlled transaction is at arm's length. Any such method should be applied in accordance with the reliability considerations used to apply the specified methods described above.

An unspecified method should take into account the general principle that uncontrolled taxpayers evaluate the terms of a transaction by considering the realistic alternatives to that transaction, and only enter into a particular transaction if none of the alternatives is preferable to it. In establishing whether a controlled transaction achieves an arm's length result, an unspecified method should provide information on the prices or profits that the controlled taxpayer could have realized by choosing a realistic alternative to the controlled transaction.

Specific Issues in Transfer Pricing Dispute Resolution

- *Simultaneous Tax Examination by two countries to resolve disputes regarding the Transfer Pricing Arrangements where two jurisdictions have been involved*
- *Safe Harbour Rules*

  Applying the arm's length principle can be a fact-intensive process and can require proper judgment. It may present uncertainty and may impose a heavy administrative burden on taxpayers and tax administrations that can be exacerbated by both legislative and compliance complexity. The complexity may be overcome by applying "Safe Harbour" or "Safe Haven" rule. A safe harbour is a statutory provision that applies to a given category of taxpayers and that relieves eligible taxpayers from certain obligations otherwise imposed by the tax code by substituting exceptional, usually simpler obligations. In the specific instance of transfer pricing, the administrative requirements of a safe harbour may vary from a total relief of targeted taxpayers from the obligation to conform with a country's transfer pricing legislation and regulations to the obligation to comply with various procedural rules as a condition for qualifying for the safe harbour. These rules could, for example, require taxpayers to establish transfer prices or results in a specific way, e.g. by applying a simplified transfer pricing method provided by the tax administration, or satisfy specific information reporting

and record maintenance provisions with regard to controlled transactions. Such an approach requires a more substantial involvement from the tax administration, since the taxpayer's compliance with the procedural rules may need to be monitored.

- *Advance Pricing Arrangements*

  An advance pricing arrangement ("APA") is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparable and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations. APAs are intended to supplement the traditional administrative, judicial, and treaty mechanisms for resolving transfer pricing issues. They may be most useful when traditional mechanisms fail or are difficult to apply.

- *Arbitration to resolve dispute*

Income Splitting (Section 34)

In the case of a person attempting to split his income with another person in order to reduce his tax liability, IRD or IRO may, by a notification in writing, adjust the amount to be included or deducted in calculating the income of each of such persons to prevent any reduction in tax liability because of the splitting of the income.

The attempt to split the income may include a transfer of the following amounts so as to reduce the total tax payable by the person or an associate, either directly or indirectly through one or more interposed entities:

- Amounts to be derived or costs to be incurred: or
- An amount received or enjoyed by the transferee of an asset (i.e. derived from the asset); or the amount paid or expenses incurred in owning the asset.

In determining the amount of split income IRD or IRO shall consider the market value of any payment made for the transfer.

General Anti-Avoidance Rule (Section 35)

In case IRD or IRO thinks that a person has made such an arrangement so as to reduce the tax liability, the IRD or IRO may:

- Re-characterize an arrangement or part of an arrangement that is entered into or carried out as part of a tax avoidance scheme;
- Avoid an arrangement or part of it that does not have any material economic effect: or
- Re-characterize an arrangement or part of it, which does not reflect its materiality.

Here a General Anti-Avoidance Rule (GAAR) refers to any arrangement made by a person with the purpose of avoiding or reducing the tax liability.

Effect of International Treaties (Section 73)

GON may enter into a treaty or an agreement with other countries having the provision of giving a relief to taxpayers from double taxation, for prevention of a fiscal evasion, and for reciprocal administrative assistance in the enforcement of tax liabilities.

If a competent authority of the country requests IRD, in course of executing an agreement or a treaty, to recover a certain amount of tax due to any person according to the Regulations of that country, IRD may, by serving a notice in writing, require the person to pay the amount to IRD on or before a date specified in the notice.

In case an international agreement includes a term that Nepal will exempt income or a payment or will charge a tax at a lower rate of tax on income or a payment, the exemption or reduction shall not be available to any following entity:

- Who, for the purpose of the agreement, is a resident entity of the other contracting state; and
- 50% or more of whose underlying ownership is held by individuals or entities in which no individual has an interest and who, for the purpose of the agreement, are not residents of that other contracting state or Nepal (pass-through/ look-through approach).

Nepal Government has executed such treaty with 11 countries.

International treaties are basically adopted under UN Model or under OCED Model. Almost all the taxation treaties are similar. Organisation for Economic Cooperation and Development (OECD) has published series of documents relating to international taxation. Model Convention on Income and Capital (published in July 2010 by OECD- www.oecd.org) including its commentary has extensively described the provisions of international treaties (so called DTAA) and their implications.

Others

- **Taxpayer's Rights (Section 74)**

  The following rights are available to a taxpayer:

  - Right to get respectful behavior;
  - Right to receive any information related to tax as per the prevailing Laws;
  - Right to get an opportunity of submitting a proof in one's own favor in respect of tax matters;
  - Right to appoint lawyers or auditors for defense; and
  - Right to secrecy in respect of tax matters and to keep it inviolable.

- **Suspension of Permanent Account Number (PAN) (Section 78Ka)**

  1. In any of the following case Department may suspend Permanent Account Number:

     (Ka) Discontinuation of business-

     (Kha) In case of Entity: Closure, sale, transfer or non-existence of entity by any other way

(Ga) In case of Individual Ownership: Death of individual owner

(Gha) Mistakenly registered

2. Process of suspension of PAN as per prescribed manner.

- **Process of Suspension of Permanent Account Number (Rule 23Ka):**

1. Person or entity who needs to apply for the suspension of permanent account number as per sub section (1) of section 78Ka of the Act shall submit an application to the department within 30 days of the situation created for suspension of Permanent Account Number.
2. Income statement and tax amount up to that period shall be deposited while filing the application as per sub rule (1).
3. Department shall notify about the decision of suspension within 30 days after received the application as per sub rule (1) whether the situation seems to be appropriate in examination.

- **Provide Duplicate Copy (Rule 23Kha):**

1. Any person received permanent account number certificate as per Rule 23, loss or destruction of such certificate by other reasons shall apply for the duplicate certificate to the Department.
2. Department shall provide a duplicate copy of permanent account number registration certificate to the applicant within three days after application was filed as per sub rule (1) of rule 23Kha.

- **Service of Documents (Section 79)**

A document to be served by IRD or IRO to a person under this Act shall be considered as sufficiently served in the following circumstances:

- It is sent to the electronic mail address or transmitted on the fax of the person;
- In case of a natural person handing over the document to concerned person or his representative or employee, and in case of an entity the document being handed over to the manager of the entity or representative or employee prescribed by him; or
- It is sent by registered post at the last known address of his resident, office, business or some other place.

A document issued, served, or handed over, according to this Act, by IRD or IRO to a person, shall be treated as issued in order, if the document is duly signed by the officer whose name and designation is mentioned on the document either encrypted or encoded by means of computer technology or duly stamped.

- **Defective Documents (Section 80):**

A document issued by IRD or IRO under this Act shall not be treated as defective when it observes the following procedures.

- The documents are issued in conformity, materially, with this Act; and
- The documents are duly addressed to the person, to whom it is to be served, according to the common understanding.

The IRD or IRO can rectify a defect, detected in a document issued, in case the defect does not involve a dispute as to the interpretation of the Act or facts involving a particular person.

- **Rights of Tax Officer & Official Secrecy**
- **Right to Search and Seizure (Section 82)**

Right of Search

A tax office, after obtaining a written, and signed by the DG, approval of IRD for the specific purpose {Section 72(4)(c)}, can use the following rights of search and seizure:

- Right of full and uninterrupted access to any premises, place, document or any other asset, subject to provisions of prevailing regulations;
- Right to have a copy of, including an electronic copy, of any document to which access is obtained;
- Right to seize any document, which, according to the officer, is essential evidence in determination of tax liability according to this Act; and
- Right to seize any asset in order to have an access to a document because the tax officer thinks that the owner has not availed the necessary document.

The tax officer shall, while entering into the premises or a place for search and seizure, on request from the occupier of the premises or place or from a person having access to the documents or assets, show the letter of authority of search and seizure of the property, place and documents.

The occupier of the premises or a place or a person having access to the documents and assets, where the search and seizure operation is being conducted, on request from the officer, shall provide a reasonable facility and assistance for the effective exercise of the power.

- **Right to Retain the Documents or Assets**

The tax officer can retain the seized documents or assets up to the time as mentioned below.

- In case of a seizure of a document: as long as it is required to determine the taxpayer's tax liability or for any judicial proceeding under this Act; and
- In case of a seizure of an asset: as long as it is necessary to obtain an access to and ability to seize the documents under dispute.

The person, whose documents are seized by a tax officer, shall be allowed to examine them, and in case the person wants to get a copy or an extract of the documents, shall get these on his own cost, during the office hours and under the supervision as decided by IRD.

This Section shall apply in any case required for the purpose of implementing this Act, notwithstanding any Regulation relating to privilege or the public interest with respect to the access to documents.

- **Right to Obtain Information (Section 83)**

A tax officer may serve a notice in writing on a person, whether it is a taxpayer or not, under this Act:

- To produce or prepare and produce any document and any information as required in the notice, within the time specified in the notice;
- To attend at IRD or IRO at the specified time and place, for the purpose of interrogation by the tax officer in a matter concerning the taxation of the person or of other persons: or
- To produce the documents, which are in possession of the person, as mentioned in the notice at the time of appearing before the tax officer for interrogation.

The person who appears before the tax officer has a right to accompany with him a legal or other representative during the period of interrogation.

This Section shall apply in any case required for the purpose of implementing this Act, notwithstanding any Regulation relating to privilege or the public interest with respect to the access to a document.

- **Official Secrecy (Section 84)**

Every officer from IRD or IRO shall keep the documents and information coming to his possession or knowledge secret while performing his duties under this Act.

However, the tax officer can convey the information to the following persons under the given circumstances:

- To the extent required in order to perform the officer's duties under this Act;
- To a court or tribunal as required by them in proceedings with respect to a matter under this Act;
- To the Finance Minister;
- To any person when the disclosure is necessary for the purpose of any other fiscal law;
- To any person in the service of GON, who requires the information for revenue or statistics related works;
- To the Auditor-General or any person authorized by the Auditor-General when such a disclosure is necessary for the performance of his official duties; or
- To the competent authority of the foreign government with which Nepal has entered into an international agreement, to the extent permitted under the agreement.

Any person, court, tribunal, or authority receiving such documents and information as discussed above is also required to keep them secret, except to the minimum extent to which the disclosure is necessary.

- **Department, Inland Revenue Offices, and Office Bearers:**

Definition of Department

According to Section 2 (az), Department means Inland Revenue Department (IRD). IRD is established to work as a department of Finance Ministry to execute the matters relating to taxation. The Act, through so many Sections, has entrusted IRD with so many duties to be performed in effective execution of the Act.

Establishment of Large Taxpayers' Office, Tax Offices and Taxpayers' Service Centers

Nepal Government (GON) has the sole authority to establish an 'office for large taxpayers' and 'Inland Revenue Offices (IRO)' in any part of the country and to fix their jurisdiction. GON has to publish a notification in Nepal Gazette for the establishment of a new IRO. These IROs are treated as executing hands of IRD for the jurisdiction provided to them.

Director General, Deputy Director General & Tax Officers

The Director General (DG) is the chief executive of the IRD. Whatever may be the duties given by the Act to IRD, they are to be performed by DG either by himself or by delegating authority to his subordinates. The designations of the subordinates, in order of the high rank, are as follows: Deputy Director General (DDG), Chief Tax Administrators, Directors, Chief Tax Officers, Tax Officers, other officers and other staffs.

Power, Function & Duties of DG

<u>According to Section 72(4), subject to direction given by GON, a DG may:</u>

- Exercise any power granted to IRD under this Act;
- Delegate the exercise of any of the power, subject to some restrictions, to its subordinate officers; and
- Where GON has not established any IRO, it delegates the exercise of any of the power, subject to restrictions, to any of the officers in the civil service. The civil servant has no right of search and seizure.
- **Rights of DG that cannot be delegated**
- **Public Circulars (Sec. 75):**

  To achieve consistency in the implementation of this Act, to make the tax administration simple and to provide guidance to persons affected by this Act, including officers of IRD and IROs, DG may issue, in writing, public circulars setting out the IRD's interpretation of any Section of the Act.

  IRD shall make the public circulars available to the public by any medium as IRD may determine.

  The pubic circular issued by IRD under the signature of DG shall be binding on every officer of IRD, on IROs and on a civil servant who is authorized to work as tax officer, unless the circular is cancelled.

- **Advance Ruling (Section 76):**

  In case a person makes a written application to IRD seeking IRD's position regarding the application of this Act with respect to an arrangement proposed or entered into by the person, IRD under signature of DG may issue, in writing, an advance ruling in this regard.

  IRD shall not issue such an advance ruling on the matters under consideration of any court or decided by a court.

Under the following circumstances the ruling shall be binding on the every officer of IRD, on IROs and a civil servant who is authorized to work as tax officer:

- The applicant has made a full and true disclosure of all aspects of the arrangement relevant to the ruling; and
- The arrangement proceeds in all material respects as described in the application for the ruling.

Where the advance ruling issued by IRD contradicts with a public circular, for the person who applied for the advance ruling, the advance ruling shall be applicable.

- **Right to Specify the Form of Documentation under Section 77:**

  IRD has been entrusted with power to determine the formats of documents required under this Act. It is a duty of IRD to make these formats easily available to all the people concerned.

- **Right of Stay on a Proceeding or otherwise power to affect the enforcement of a decision of the tax officer until the application is settled under Section 115(5).**
- **Right to Allow or Disallow the Objection Filed under Section 115 in whole or in part under Section 115(7).**
- Right to **Issue a Notice** to a taxpayer to pay the required penalty (Section 129), in case the taxpayer accepts in writing that it has committed one or more offences under Chapter 23 of the Act.
- **Right of Subordinates**

  The subordinates can execute the powers entrusted to them through delegation by the DG, but they have no power to delegate their powers to their subordinates.

- **Power of Tax Officers as of a Court**

  According to Section 135 of the Act, a tax officer may exercise all such powers as are vested in a court under current Nepal law in respect to issuing summons to the concerned person, recording statements, examining evidences and directing the submission of the documents from the person.

- **Rights Regarding Use of Electronic Means:**

  Finance Act, 2064 has introduced the following sections and thereby allowing the Department to use the following rights:

  Sec. 77 (3): To receive any required information, statement and/or documents from any taxpayer through any specified electronic means.

  Sec. 81 (4): To notify a taxpayer to make a payment of tax through electronic means.

- **Right to Issue Directions (Section 139)**

  Under the provisions of this Act or the Rules, IRD has entrusted with a power to develop directives and issue it as required.

- **Right to have Cooperation from Police (Section141)**

  As and when IRD seeks cooperation of police for implementation of this Act and the Rules, it shall be the duty of the police to cooperate it.

- **Identity Card of the Tax Officers (Section 134)**

  Each tax officer shall be required to keep an identity card in a prescribed format and produce before anyone demanding the card in course of performing duties.

- **Collection of Taxes in Case of Default, Relieving Tax Payer from Tax Liability & Refund of Tax**

- **Charge of GON on Withholding Amount (Section 103)**

  IRD or IRO has a preferential right to receive withholding tax by a person over any other persons. The Withholding Tax is the amount is collected on behalf of Nepal Government (GON) and, thus, the amount is never included in the assets of the withholding agent. GON has preferential right even over any order of a court or any other law.

  The treatment of withholding tax by a person shall be as follows:

  - The amount of tax deducted or any assets acquired for tax deducted shall be treated as held as stayed in favor of GON;
  - The amount of withholding tax is not subject to attachment in respect of a debt of the withholding agent; and
  - In the event of liquidation or bankruptcy of the agent, the withholding tax does not form part of the estate in liquidation and bankruptcy of the withholding agent and the IRD or IRO has the first claim over the amount of tax or assets so acquired even before any distribution in liquidation or bankruptcy is made.

- **Charge over assets (Section 104)**

  The government has charge over the assets of the defaulter. Such charge has been created with the inclusion of Sec. 104 in the Income Tax Act. It means the government is empowered to recover Income Tax even from the person property of the tax payer.

  Definition of Defaulter:

  The term 'Defaulter' has not been defined anywhere in the Act, but for our understanding it stands for a person who has a liability to pay tax, penalty, interest, expenses on auction and creating charge, etc. under this Act within a specified date but has failed to deposit the same to the Revenue on or before the date.

  Charge over asset

  In case of a person makes default in making payment of tax, IRD or IRO has the right to create a charge on the assets of the person in favor of GON.

  Process to create charge

  IRD or IRO should send a notice to the person before creating a valid charge on the assets including

the following details:

- The details of the assets to be charged;
- The charged amount including the amount of tax due, interest or penalties payable and the cost of the auction to be incurred;
- The amount of tax to which the charge relates; and
- Any other details, if any.

The charge to be created shall not be effective until:

- If the assets on which the charge is to be created is land and/or building, the office shall inform in writing to the respective Land Revenue Office to register the charge in favor of GON so that the taxpayer is not able to dispose off the assets;
- In the case of assets being other than land and building, the office shall take a possession of the assets; and
- In any other case, the notice is served to the taxpayer as mentioned above.

Maximum Amount of Charge over Asser

The charge over asset shall be created to the extent of tax payable under the Act, interest applicable u/s 119 over such tax, and expenses incurred while creating charge and auction of asset.

Defaulter to be informed of Expenditure related to Creation of Charge & Auction of Asset

The tax office should serve a notice on the tax defaulter with respect to the amount due to him before the creation of the charge and also the expenses incurred or to be incurred on the creation of the charge or on the auction sales. The date of payment of such expenses to be made by the tax defaulter also should be mentioned in the notice.

Release of Asset

If the tax defaulter pays the entire payable amount after the charge, the tax office has to immediately release the charge on the assets adopting the following procedure:

- In the case of the land and building being the assets, the office shall inform in writing to the respective Land Revenue Office with regard to the release of the charge;
- In the case the assets are other than land and building, the office shall release the possession of the assets; and

In any other case, a release letter should be given to the taxpayer.

- **Auction of Charged Assets (Section 105)**

  After creating the charge over asset, the asset shall be auctioned to recover the dues from defaulter. The Section deals in the auction procedure and recover of dues through auction.

Information to be sent to Defaulter

Before going into the procedure of auction of the assets charged by the tax office, the tax office shall notify the tax defaulter about the method and timing for the sale of the assets. The notice can be served along with the notice to be served under Section 104 (1).

Other Procedure after Information is sent

After the notice is served as shown above, the tax office may:

- Take possession of the tangible assets referred to in the notice at any time;
- Enter into any premises described in the notice at any time for the purpose of taking possession of the tangible assets; and
- Store the tangible assets, other than land and building, at a place the tax office considers appropriate, on the cost of the tax defaulter.

Once a charge is created on the assets under Section 104, it is neither necessary nor desirable to take a re-possession of the assets.

Auction after fulfilling the due formalities as above

After completion of the legal formalities stated above, the tax office may, at the following time, sell the charged assets by a public auction or a deal with the assets in any appropriate manner:

- Where the charged assets are land and/or building, after 30 days of taking possession of the assets;
- Where the charged assets are perishable tangible assets, one day after taking possession of the assets;
- Where the charged assets are other than those referred above, after 10 days of taking possession of the assets; and
- In any other case, after 10 days of taking possession of the assets.

Treatment of Proceeds from Auction or Sale

The proceeds so received from the auction sale shall be used to pay in the following order of preference:

- Cost of the auction sales and cost incurred for the claim of asset;
- Tax including interest u/s 119; and
- The remaining balance, if any, should be refunded to the tax defaulter.

Notice to be served after auction and set off of amount received from auction

After the appropriation of the amount, the tax office shall serve a notice to the tax defaulter providing the details of the manner in which the proceeds have been applied.

Effect of Shortfall of Proceeds from Auction

In case the proceeds are not sufficient to meet the cost of auction, tax, interest, penalty etc, the tax office may take further and fresh actions as described above.

- **Order With Regard to a Prohibition to Leave Nepal (Section 106)**

Department may restrict a person leaving Nepal

When a person becomes a tax defaulter, the related tax office may serve a notice in writing to the concerned Department of GON to prevent the tax defaulter from leaving Nepal for a period of not more than 72 hours from the time of the expiry of deadline mentioned in the notice served to the defaulter to pay due tax amount.

Extension of Time Limit beyond 72 hours from the expiry of deadline

In case the time limit is to be extended, the tax office has to take a prior approval of the concerned appellate court.

Withdrawal of Order

Once the tax defaulter pays the tax or makes an arrangement for payment in satisfaction to the tax office, the office may withdraw the order.

- **Collection of Tax from Officers of Entities (Section 107)**

Definition of Office:

For the purpose of this section, the officer of an entity means a manager of the entity or a person purporting to act in the capacity of a manager.

Responsibility of Officers for Non compliance of any entity

Where an entity does not comply with the laws, the officer in charge at the time shall be responsible for that.

Where an entity fails to pay tax on or before the date on which the tax is payable, the present officer and the officer resuming the office within the previous six months shall be jointly and severally liable to pay the tax. But an officer is not supposed to be liable under these circumstances:

- Where the offence is committed by the entity without the officer's knowledge or consent; and
- Where the officer has exercised a reasonable degree of care, diligence, skill, and prudence that would have been exercised in comparative circumstances to prevent such offence.

Recovery of Tax paid by Officers as a result of default of entity

In case the officer has been made liable to pay tax under the above-mentioned provision, the officer may recover the amount from the entity; and may retain any asset including money of the entity in his possession, not exceeding the amount paid by him. In case the officer has

retained any asset, under the above-mentioned situation, the entity or any other person has no right to claim for the property.

- **Recovery of Tax from a Receiver (Section 108)**

Definition of Receiver

As per Clarification Clause to Sec. 108, the Receiver means the following person:

- A liquidator;
- A receiver appointed by a court or out of a court in respect of an asset or an entity;
- A person who has taken the assets in possession in case the asset is mortgaged to him;
- An executor, administrator, or direct heir of a deceased individual's estate; or
- Any person conducting the affairs of an incapacitated individual.

Responsibility of Receiver

A person, who is appointed as a receiver of any asset, or an entity, shall notify the respective IRO in writing about his/her appointment in such capacity within 15 days of earlier of following:

- Such appointment, or
- taking possession of an asset situated in Nepal.

Responsibility of Tax Office

The tax office shall notify the receiver, in writing, about the amount of tax payable by the person.

Responsibility of Receiver after receiving information from Tax Office

After receiving a notice from the tax office, the receiver shall be required to do as follows:

- Sell sufficient assets that come into the receiver's possession and appropriate the amount as follows:
- Set aside an amount and pay to the Revenue, for any amount due to the defaulter for tax deducted at source, but not deposited
- Pay the amount having a priority over tax; and
- Set aside and pay the amount of tax on behalf of the taxpayer as notified by the tax office.
- Deposit the amount that has been set aside on behalf of defaulter as tax in tax office

Liability of Receiver in case of Failure to deposit Tax notified by Tax Office

In case the receiver fails to set aside the amount of tax, he shall be personally liable to pay an amount equal to the tax payable to the tax office. But the receiver, on payment of the amount of tax to the tax office, gets a right to recover the amount from the tax defaulter.

- **Recovery of Tax from a Debtor of the Tax Defaulter (Section 109)**

  Power of IRD to recover Tax from Debtor of Defaulter

  In case the tax office has information about the debtors of the tax defaulter, the tax office may exercise its power under this Section to issue a notice to the debtors to pay the amount that is payable to the tax defaulter to the tax office to the extent of the tax payable by the tax defaulter. The notice shall include the time before which the amount is to be deposited with the office.

  The tax office has to serve the tax defaulter with a copy of the notice that is served to the debtor.

  Persons that can be notified to make payment owed to Defaulter

  The notice can be served to the following persons:

  - Person owing money to the tax defaulter;
  - Person holding money for, or on account of, the tax defaulter;
  - Person holding money on account of a third person for payment to the tax defaulter; or
  - Person having authority from a third person to pay money to the tax defaulter.

  Editor's Comment

  A bank, a finance company, an insurance company and any other person may be served with such a notice.

  Limitation with respect to Date in Notice

  The date mentioned for payment in the notice cannot be earlier of:

  - the date on which the money becomes payable to the tax defaulter or the money is held on behalf of the tax defaulter; and
  - the date before a copy of the notice is served to the tax defaulter.

  Effect of Payment to Tax Authority by the Debtor

  When the debtor to the tax defaulter pays the money to the tax office in compliance with the notice, the payment shall be treated as paid to the tax defaulter. The tax defaulter cannot lodge a claim on the debtor to pay the amount.

- **Recovery of Tax from an Agent of a Non-Resident (Section 110)**

  For this section, an agent of a non-resident means a person who is having the possession of assets owned by the non-resident person.

  In case a non-resident person becomes a tax defaulter, the respective tax office may serve a notice to the agent of the tax defaulter to pay the tax on behalf of the tax defaulter, within the

notified date. Such notice includes the provision of appropriating the assets of such person. But in doing so, the asset up to the market value of the amount of tax payable by the defaulter should only be appropriated, but not exceeding it.

The agent, on payment of the tax, can recover the amount from the non-resident person or can retain out of any assets including money of the tax defaulter in or coming into the possession of the agent up to the value of amount paid to the tax office.

Under such circumstances, the non-resident tax defaulter or any other persons have no right to make a claim against such assets retained by the agent.

- **Lawsuit for Unpaid Tax (Section 111)**

  In case the tax office thinks that the recovery procedure as suggested above is not sufficient to recover the amount of tax due, it can file a lawsuit against the tax defaulter for the recovery with the concerned District Court.

- **Remission of Tax (Section 112)**

  - GON may remit in whole or in part any tax that is payable by a person where the tax cannot be collected.
  - Even in case the recovery procedures are not adopted, GON can remit in whole or in part any interest or penalty chargeable under Chapter 22 of the Act.

- **Refunds and Set-off (Section 113)**

  Set off of Excess Tax Paid

  In case a person has paid an amount in excess of his tax liability under this Act during an income year, and if the tax office accepts so, the tax office can allow the person to set off the excess amount from the tax payable at present or in future. The unabsorbed amount after such a set off, if any, shall be refunded to the person.

  Refund of Excess Interest collected u/s 119

  But in case a person has paid an excess amount of interest payable under Section 119 for delay in the payment of tax, the tax office shall refund the amount without making any adjustment from further tax payable.

  Application to be filed for Tax Refund & Time Limit to file such application

  The person who seeks the refund of the excess tax paid shall make an application to the respective tax office in a prescribed format within two years of the later of:

  - The end of the income year with regard to which the excess payment was made;
  - The date on which the excess payment was made; or
  - The date on which the litigation is settled.

Responsibility of Tax Officer to decide on Refund

On receipt of an application from a taxpayer for refund of the tax, and after the tax office decides that it is proper to refund the excess amount—whether by the reason of court order or otherwise, the tax office is liable to refund the excess amount with an interest at the rate of 15% p. a. on the refundable amount for the following period:

- In case the refund relates to an excess amount paid due to withholding tax deducted by other person (Section 93), due to an excess estimation of advance tax made by the taxpayer (Section 94), or an excess amount paid at the time of jeopardy assessment (Section 100), commencing on the date of filing a return for the year under Section 96 and ending on the day the refund is made; and
- In any other case, commencing on the date the person paid the amount, which is to be refunded and ending on the day the refund is made.

Refund of Carried Forward Tax Credits

The tax credits that arise due to medical allowance under Section 51 and foreign income tax under Section 71 cannot be refunded but that can be carried forward for adjustment or set off from the tax liability of coming years as prescribed in Section 51(4) and 71(3).

Time Limit to make Refund

Finance Ordinance, 2062 and Finance Act, 2063 and 2064 has prescribed that the tax office shall refund the excess amount within 60 days of submission of application for the refund.

- **Rights of GON with Regard to Income Tax**
  - Section 132: GON or Department has a right to acquire services of specialists for the work of tax inspection and audit, and the provisions regarding official secrecy as referred to in Section 84 of the Act shall also be applied to the specialists.
  - Section 137: For the purpose of making tax administration effective, GON may issue an order or direction to IRD as required.
  - Section 138: GON may enact Rules as required for fulfilling the objectives of this Act. But the Rules must not overrule the provisions of the Act.
  - Section 140: GON may, by notification in the Nepal Gazette, amend or rectify the Schedule 2 of the Act.
- **Boundaries of the Act (Section 142)**

Income Tax Act is a super Act in matters relating to Income Tax

Notwithstanding the provisions made under the current law, no other Acts except this Act and Finance Act or Finance Ordinance shall be made capable to make changes, amendments and other tax related provisions other than the provisions relating to imposition, assessment, reduction, increment, exemption, or remission of tax to be made by amending this Act itself by annual Finance Acts. That is why; Section 143 of this Act repeals most of the prevailing

provisions regarding income tax in various Acts.

But, the Act is silent about the application of the provisions with regard to income tax which are not repealed by Section 143 of the Act; such as Sections 15(ka), (ga), (gha), (na), (ya), (tha), (ta), (tha), (da), and (dha) are still in force until these are also repealed by Finance Ordinance, 2062 and Finance Act, 2063.

Contradiction with other Acts

IRD has given an unsolicited interpretation of Section 142 of the Act disallowing the enforcement of Section 15(ka) of Industrial Enterprises Act. Resulting there from IRD has compelled the cottage industries to pay income tax on their income.

On request from Nepal Carpet Exporters' Association, Finance Ministry requested Attorney General of Nepal to provide his opinion on the interpretation on the Section 142. Attorney General has rightly pointed out that those Sections, which were not repealed by Income Tax Act, 2058, are still in force and benefits as per the Section should also be allowed. Ultimately, Finance Ministry has decided the case whereby all concerned are allowed to avail the benefits of the Sections of any other Acts prevailing at the time of commencement of Income Tax Act, 2058 but not specifically repealed by the Act.

All the carpet industries, dying industries, Pashmina industries, woolen garment industries, and any other industries, which come under the definition of cottage industries as per Industrial Enterprises Act, are allowed income tax exemption from 2058-59 to 2061-62.

IRD shall set a procedure of refund of the income tax paid by most of the cottage industries during the years.

But Income Tax Act, 2031 is still in force for the matters relating to assessment and collection of tax prior to the commencement of this Act (up to income year 2057-58) {Section 143 (4)}.

VALUE ADDED TAX

CHAPTER-1
BASIC CONCEPTS

- **Definition**
- **Value Addition**
- Law levies tax on many of the occasions and activities like:
  - On producing goods (Excise duty- Inland Indirect tax)
  - On sales or making value add in economy (Sales Tax/ Value Added Tax- Inland Indirect tax)
  - On wealth creation or contribution to value addition (Income tax- Direct tax)
  - On owning the assets (property tax, wealth tax)
  - On acquiring assets (inherent tax, succession tax, transfer tax)

Value-added tax (VAT) was first introduced as a comprehensive national tax in France in 1954 (named as Taxe sur la valeur ajoutée). Now, it has been adopted as the main form of indirect taxation by many countries in different parts of the world. Almost all countries and economy of European Union, Former Soviet States, Japan, China, Korea, and Canada etc. have adopted VAT as new forms. There is not any formal organisation that looks for VAT law. Simply, VAT is named differently in English too: "Value Added Tax" and "Value-Added Tax." In countries it is called as "Goods and Services Tax (GST)."

Principles of VAT- Origin Based & Destination Based

Value added tax is imposed on the supply within the territory on making value add (value creation). Principally, VAT may be origin-based or destination-based. In the origin-based VAT, the tax is levied at the point of value addition (exports are taxed), conversely, in the destination-based, VAT is levied at the point of consumption (import based). There are rare example of origin-based VAT, almost all states has destination-based VAT, so is the case in Nepal as well. The tax is levied at the point of use of goods or services.

Output VAT & Input VAT

A transaction for the purpose of VAT, on which VAT is imposed, is called an output and the VAT collected by the supplier is called output tax. A VAT paid purchase for making the output is known as an input, and the VAT paid on that the input is an input tax.

Example of Value Addition

Let's see a value added statements of extraction of river bed (sand) and the act of selling it to contractor. The cost of sand is nil, because earth give it at nil cost. Labor charge or equipment charge is needed say Rs. 100,000 paid for labor. The sales were for Rs. 250,000. In this case value addition is Rs. 250,000. Buyer was a trader and expense for storage of Rs. 25,000 and interest paid for fund is Rs. 10,000. Trader sales the sand at Rs. 300,000

	Input (purchase)	Output (sales)	Value addition (Sales- purchase)	Contributories
Extractor	0	250,000	250,000	Extractor- Rs. 150,000 Labor –Rs. 100,000
Trader	250,000	300,000	50,000	Trader-15,000; Lender- 10,000 Land Lord-25,000
			Value added tax=13%	Assessable income for income tax

In above statements of value addition, in the first line of extractor, the value addition is Rs. 250,000 (VAT is imposed on these value addition). Contributory for that value addition are extractor Rs. 150,000 (income from business) and labor Rs. 100,000 (income from employment). Assuming all the income was made taxable at 25%, the Value Added Statements shall be as:

VALUE ADDED STATEMENTS

Contributors	Value Add In the economy	Tax		Value added (Final and Net)	% of value add
		Indirect	Direct		
Extractor	150,000+32,500	32,500	37,500	112,500	39.82%
Labor	100,000	0	25,000	75,000	26.55%
Government		0	0	95,000	33.63%
Total Value add	282,500				

In the second line of trader, the value add is Rs. 50,000 (VAT is imposed on these value add). Contributories are required to include their contribution to pay income tax.

Hence Value Added Tax is tax on value addition (further cost plus profit) made by any person.

Imposition of VAT & Definition of VAT by IMF

VAT is imposed in respect of taxable supplies of goods and services. The intention under the International Monetary Fund defined VAT as "*VAT is that tax is imposed on every taxable transaction that adds value and this is achieved by dividing transactions into those involving "goods" and those involving "services". The definitions of goods and services are mutually exclusive (i.e., something cannot be both goods and services at the same time) and, except for money, jointly exhaustive (i.e., everything that adds value is treated as either goods or services). …. Goods are defined broadly. It includes all corporeal movable or immovable property. Movable property includes stock-in-trade and the capital goods of a business. … The definition is confined to corporeal property and, thus, incorporeal property (such as intellectual or industrial property (copyrights, patents, trademarks and the like) and shares, stocks and securities) is not treated as goods. However, incorporeal property may be treated as services for the purposes of VAT. …. The definition expressly excludes money which is separately defined.*"

VAT is charging to the person (registered or not), but the transaction covered by VAT is limiting to the coverage of territory within Nepal. This results in exclusion of foreign branches from VAT computations. If any person sends goods to its foreign branch, the transaction is deemed to be export to third-party. Similarly, in the cases when foreign branch sends goods to its head office

in Nepal, which is treated as import for the purpose of indirect taxes. That is because VAT is an indirect tax focusing on the transaction or activity rather than on the economic operator (territorial scope).

- **Definition of Terms**

  Terms defined in Value Added Tax Act, 2052 and Value Added Tax Regulation, 2053 are described in the concerned Chapters for the ease of understanding of the students and use in the specified chapters. Some common terms are described in this Chapter. English words used in the VAT law is not used as it is commonly used in English, rather the English (even Nepali in the law) words are use to explain the meaning guided by the first French VAT. For example, 'supply' has used in VAT has not common English usage meaning and its meaning adopted for French concept VAT that has been translated to English; hence, 'supply' is used for goods (even not supplied, invoiced or consideration received) or for service (even not rendered, invoiced or consideration received). Second example of wording is 'Value Added' itself, value added is not in the normal economic meaning of 'value addition', rather 'addition in tax base'.

  Definition under Section 2 :

Clause	Headings	Definitions
(Ka)	Tax	Means the Value Added Tax imposed by this Act;
(Kha)	Transaction	Means the act of supplying any goods or services;
(Ga)	Taxable Transaction	Means a transaction mentioned in sub-section (1) of Section 5;
(Gha)	Taxable Value	Means the Value of goods or services to be fixed pursuant to Section 12 and Section 12Ka.
(Nga)	Goods	Means any kind of property whether movable or immovable;
(Cha)	Services	Means anything other than goods;
(Chha)	Supply	Means the act of selling, exchanging and delivering any goods or services, or the act of granting permission thereto or of contract thereof whether or not for a consideration;
(Ja)	Consideration	Means anything to be received for money, goods, services or value;
(Jha)	Import	Means the act of importing any goods or services in Nepal pursuant to prevailing laws;
(Yna)	Export	Means the act of exporting any goods or services outside Nepal pursuant to prevailing laws;
(Tta)	Market Value	Means the price as determined pursuant to Section 13;
(Tta1)	Electronic Medium	Means Computer, Internet, Email, Facsimile, Electronic Cash Register, Fiscal Printer or similar approved media. This phrase covers any media prescribed by the Department having similar characteristics.

(Thha)	Person	Means any Natural Person, firm, company, association, institution, partnership firm, cooperative, joint business, religious endowment, or fund; and the term also includes any government body, any religious organization charitable trust or similar other bodies and branches or sub-branches there engaged, with or without the objective of profit, in taxable Transactions;
(Dda)	Registered Person	Means any person who is registered for transactions pursuant to Section 10 or Section 10(Ka) or Section 10(Kha);
(Dhha)	Registration Number	Means the number assigned pursuant to Section 10, Section 10Ka or Section 10Kha to a Registered Person;
(Nna)	Supplier	Means a person who supplies any goods or services;
(Ta)	Recipient	Means a person who receives any goods or services.
(Tha)	Taxpayer	Means any person who is engaged in a Taxable Transaction or person having liability to deposit tax;
(Tha1)	Tax Period	Means period on which Tax Payer is required to submit VAT return as motioned in Section 18
(Da)	Department	Means Inland Revenue Department
(Dha)	Director General	Means the Director General of the Department;
(Na)	Tax Officer	Means any tax officer or chief tax officer or chief tax administrator appointed for the purpose of this act by Government of Nepal and the term will denote Section Officer, Director or Deputy Director General of the Department or any other officer designated by GON empowering to use the power of a tax officer in accordance with the provisions of this Act;
(Pa)	Prescribed or As prescribed	Means prescribed or as prescribed in the Rules made under this Act.

- **Tax periods,** according to Sec. 18 is, period prescribed by Act or Rules for calculation of net VAT payable or receivable. Registered person has to adopt a month as per Nepali calendar as tax period. As per Rule 26, these different tax periods could be adopted by certain specific registered person as:
  - As per Sub Rule (1) of Rule 26, A registered person shall submit to the concerned tax officer the tax return of one-month tax period according to the Bikram Sambat, in the format referred to in Schedule -10, within 25 days of the expiry of that period.
  - Provided that the tax payer having transaction of more than Rs.20 lakh and up to Rs.1 Crore in preceeding 12 month then it should submit the tax statement within 25 Days of Shrawan, Ashwin, Marga, Magh, Chaitra and Jestha.
  - As per Sub Rule (2) of Rule 26, Notwithstanding anything contained in sub-rule (1), in case any registered person applies to the tax officer to have the tax period fixed for a tax period other than the tax period mentioned in sub-rule (1), having maintained the accounts by him using a computer system, the tax officer may, if he so deems proper after

investigations, fix, as per necessity, a separate tax period in respect of such registered person.

- As per Sub Rule (3Ka) of Rule 26, The department may fix 2 month tax period to submit tax return if the hotel and tourism entrepreneurs desire,
- As per Sub Rule (3Kha) of Rule 26, In case brick industries, printing and electronic publications or broadcasting houses, hotel, tourism, cinema hall, and transporter, the Department may fix tax period of four months. The tax period shall be Shrawan to Kartik, Marg to Falgun, and Chaitra to Ashad.
- As per Sub Rule (4) of Rule 26, A registered person whose tax period has been so fixed to be more or less than one month shall submit his tax return of that period to the tax officer in the format referred to in Schedule-10 within 25 days of the date of expiry of that period.
- As per Sub Rule (5) of Rule 26, A taxpayer shall, when submitting the tax return for the first time, submit the tax return for the remainder of the period as if the remaining period was the full tax period.

- **Tax Officer and Jurisdiction**

VAT is Tax Officer based law (as income tax is the Department based). The provisions of VAT law are vested with Tax Officer. According to Sec. 2(na), Tax Officer includes:

- Tax Officer as appoints by GON (TO);
- Chief Tax Officer (CTO);
- Chief Tax Administrator (CTA);
- Officers of IRD;
- Directors of IRD;
- Deputy Director General; and
- Any other officer designated by Nepal Government and empowered to use the power of a Tax Officer in accordance with the provisions of this Act. Under this rule, GON designated District Treasury Officer as Tax Officer in the districts not having any Inland Revenue Offices.

Appointment of Tax Officer & their Jurisdiction

Sec. 3 empowers GON, for the purpose of the Act, appoints Tax Officers in the required number and if deemed necessary, may designate any officer of Nepal Government to act as a Tax Officer. Due to these rights, GON has eased registered person in the district not having an IRO to file their returns in District Treasury Comptroller's Office (DTCO).

Jurisdiction of a Tax Officer shall as prescribed by Ministry of Finance (MOF) as per Sec. 4. Tax Officer may be specified beyond his jurisdiction by DG of the department to inspect, monitor transactions and assess tax of taxpayer.

Imposition of VAT

Concept of VAT

- Value Added Tax (VAT) is a major source of indirect taxes. As per the statistics of Government of Nepal, VAT covers almost 50% of Tax Revenue and Income Tax covers almost one-third of Tax Revenue.
- Value added tax is levied on the taxable transaction with a single rate of 13% in every point of value addition. VAT is charged on person making value addition. For any charging person dealing in the goods or services, value addition by the person is computed as a system as:

For a system of production	INPUT	PROCESS	OUTPUT
Value Addition System	INPUT	VALUE ADDITION	OUTPUT
Economic system	PURCHASE	VALUE ADDITION	SALES
Example For a manufacturer	10,000	1,000	11,000
For a trader	11,000	1,000	12,000
For a service provider	12,000	1,000	13,000

- Value addition in case of VAT is slightly different than usual use on economics. In economics, value addition means additional cost incurred plus profit on the process, but in VAT accounting, value addition means all the cost on which VAT has not been paid on purchase (or not allowed for set off) plus profit. So,
- Value addition in VAT= Sales- Purchases on which VAT has been paid or allowed
- VAT is required to be collected by Registered Persons in the transaction value on sale attracting VAT. In all examples above, VAT collection is required at sale value (output). VAT collected on the sale is called output tax. For the VAT rate of 13%, output tax on manufacturer's sale (of Rs. 11,000) (means VAT to be collected) is Rs. 1,430.
- VAT is charged on the person dealing VAT attractive goods or services. The person collects output tax (Rs. 1,420 in our example), but amount charged to the person may not be all of output tax. The person can set off the allowable input tax credits from the collection of output tax. Hence, the person on which the VAT is charged shall pay VAT in the difference of output tax and allowed quantum of input tax credits.

  Charging of VAT = output tax- allowed input tax credit

  An example to clarify the concept described above:

  In the example above, suppose the manufacturer's purchase of goods or services is Rs. 10,000 is subject of VAT paid purchase and VAT paid is allowed in full, and then VAT is imposed as follows:

  Charging of VAT = 1,430- 1,300 = 130

  - Based on above principle, VAT paid on purchase is allowed as credit (input tax credit), so, levying of VAT on VAT is impossible. Due to mathematical complications within

this formula principle, there may be some cases where a person collects/charges VAT on VAT.

- Example 1: Restaurant A, registered person, sells fast food charging VAT. It uses, Nepal Brand Oil, produced by a registered person, so oil used for restaurant is VAT attractive purchase. Assuming that oil has purchased from a retailer, unregistered with VAT; there is no direct VAT paid in the purchase (which is included in cost) and VAT is not allowed as credit.
- Example 2: In case any good is purchased on abbreviated tax invoice, then the VAT paid is not allowed as input tax. That means VAT is levied on paid VAT if the same good is sold by a registered person.

- **Charging and Reverse Charging**
  - VAT is charging to a registered person; that means VAT shall be collected only by registered person (except for some exceptions). Every registered person need to file VAT return within 25 days from the end of tax period. Any amount due on VAT shall be paid by that person.
  - In some specified cases, unregistered person shall also collect and pay the tax as a registered person (it is dealt in Chapter 6.2). Except for those exceptions, a person shall get registered and after the registration, s/he is empowered to collect tax. Sec. 20(1) empowers Tax Officer to assess tax in the person having transaction in Nepal.
  - General principle of VAT requires a registered person to collect VAT on sales and deposit the VAT, so collected, in tax office after setting it off against the VAT paid on purchases. There are some exceptions to this general principle, whereby a person, whether registered or not, shall collect VAT by himself/herself and deposit it into Revenue Office in the case of purchase; the concept is Reverse Charging of VAT as the VAT is being charged by the buyer instead of seller. Person is not required to issue any self-invoice in case of reverse charging unlike many countries that requires so.
    - **Person receiving Service from foreigners -** As per Sec. 8(2), any person, whether registered or not, in Nepal receiving service from person outside Nepal shall pay VAT for that service. *In this case, person delivering the service cannot issue VAT Invoice, so the person receiving the service shall declare and pay applicable VAT to Revenue Authority at the time of receiving service or at the time of making payment for service whichever is earlier.* If the person is registered person, it can set off such payment as other purchases.
    - **Persons developing Commercial Complexes -** According to Sec. 8(3), any person (registered or not) in Nepal engaged in constructing commercial buildings, apartments, shopping malls or similar constructions for commercial propose, the cost of which is more than Rs. 50 lakhs* shall collect VAT on the construction cost from themselves and deposit it to Revenue Authority ***in case the construction work is not carried out through a registered person.***
    - *As per Circular (Paripatra) dated 2070/07/03 all cost subject to capitalization excluding finance cost shall be included to calculate Rs. 50 lakhs. However, all taxable goods and taxable services used during construction shall be included to

calculate tax payable. Cost incurred before construction such as drawing cost, cost related to approval of drawing, finance cost, supervision charge paid to third party etc. shall not be considered for calculation of tax payable.

Transaction covered by VAT

- Value Added Tax Act, 2052 is law having territorial jurisdiction. Any law having territorial jurisdiction can be enacted within geographical boundaries of the nation only. According to Sec. 5, all the transactions within Nepal are covered by VAT.
- Goods or services imported into Nepal (transaction place is deemed in custom frontiers of Nepal for goods; and place of transaction is place where the benefits of service received in case of service- destination basis tax). Central concept of charging VAT is destination based and non-discrimination (but compensatory in nature) of indirect tax in the transaction.
- Goods or services transacted within Nepal (transaction place is as per Rule 15 and 16)
- Goods or services exported from Nepal (transaction place is deemed in custom frontiers of Nepal)

Transaction outside Nepal: If any person (whether registered in Nepal), having permanent inhabitant in Nepal or is citizen of Nepal or otherwise similar, deals in goods or services beyond above three geographical territory described above; the person is not required to charge any VAT on its transaction. But, in case the person, conducting transaction outside, Nepal brings the goods into Nepal (example EXW purchase); custom frontier is deemed to be the place of transaction.

- **Goods and services exempted from VAT**
  - Nepalese VAT Act has exempted some goods and services from the scope of charging VAT. Though VAT law is imposed in all transactions covered by above three cases described in Section 5, person dealing in items of goods or services exempted from VAT shall not collect any VAT on such goods or services. The list of such goods or services is produced in Schedule 1 of the Act.
  - The effect of such exemption to the persons dealing such goods or services is as follows:
    - The person is not required to fulfill any formalities of VAT Act, if s/he is dealing only in such goods or services listed in Schedule 1.
    - The facility of Input Tax Credit in purchase of goods or services that are used for exempted items is not allowed.
    - The person shall not collect any VAT on sales of such goods or services.
    - There is no requirement of Registration for VAT purpose, nor other requirements of submitting any returns or payment of tax for the persons dealing only in such items.

    As per Section 5 (3) notwithstanding anything contained in Section 5(1), Value Added Tax shall not be applicable on transactions of goods or services mentioned in Schedule – 1. Furthermore, no input tax credit of tax paid on purchase of such goods and services

as per Section 17 and refund as per Section 24 is allowed on purchase of such goods and services.

- The comprehensive group of the goods or services listed in Schedule 1 has been produced below, and the students are advised to go through the annual amendments in the Act to identify the actual goods or services exempted from Tax:

Group	Group Name	Group No.	Group Name
Group 1	Basic Agricultural Products	Group 8	Artistic and Sculpturing service
Group 2	Goods of basic needs	Group 9	Transportation: passengers or goods
Group 3	Livestock and Livestock products	Group 10	Professional or professional services
Group 4	Agricultural goods	Group 11	Other goods and services
Group 5	Medical treatment & similar health services	Group 12	Land and Building
Group 6	Education	Group 13	Betting, Casino, Lottery
Group 7	Books, Newspapers and Printings		

- **Transfer of Business (Sec. 5Ka):**

Under either of the following two conditions, value added tax will not be applicable on the *transfer of ownership of a business:*

- When a registered person sells its business to any other registered person; or
- A business is transferred to any inheritor after the death of an owner.

Responsibility of Transferee to maintain safe custody of records as per Law and to bear liabilities of Tax on assessments of Transactions conducted before such Transfer

In order to obtain the exemption of VAT on transfer of ownership of business, the parties shall duly fill and submit form prescribed in Annexure – 4 of VAT regulation to within 7 days of transfer.

Similarly, the transferee shall maintain such books, accounts and records as required under the VAT law for the transactions conducted by the transferee till the period prescribed by the VAT law.

Special Decision of Council of Ministers:

In case of import of goods, the Council of Ministers may waive the VAT charging at the custom point upon issuing the waiver notice in Nepal Gazette.

- **Place and time of supply**

  Place of transaction is important as VAT is imposed in the transactions in territorial basis. Similarly, VAT collected on sales is required to be paid within prescribed time-frame whether the consideration received or not, and hence, timing of supply is also important.

  Place of Supply

  Place of Supply of Goods (Rule 15)

  The place of supply of goods is as follows:

  - **Sale or Transfer of Movable Goods:** In the case of transfer/sales of movable goods, the place where such goods are sold or transferred.
  - **Immovable Goods:** In the case of any immovable goods, the location of which can't be transferred even if their ownership is changed, the place where such goods are located.
  - **Imported Goods:** In the case of imported goods, entry customs point in Nepal.
  - **Self-consumption:** In case any manufacturer or vendor supplies the goods to itself, the place where the producer or vendor of such goods resides.

  Place of Supply of Services (Rule 16)

  The place of supply of a service shall be the place where the benefit of that service is received.

  Commentary on Place of Supply

  Based on the above principle, if the location of supply of goods or service is in Nepal, then the transaction is covered by VAT.

  IMF verdict of place of supply

  IMF has developed a sample VAT law in the sample country, says Vatopia. The place of supply as suggested by it is as follows:

  12. Place of supply

  - Subject to this Act, a supply of goods takes place where the goods are delivered or made available by the supplier or, if the delivery or making available involves the goods being transported, the place where the goods are when the transportation commences.
  - A supply of thermal or electrical energy, heating, gas, refrigeration, air conditioning, or water takes place where the supply is received.
  - Subject to this section, a supply of services takes place at the location of the supplier's place of business from which the services are supplied.
  - The supply of the following goods or services takes place where the recipient uses or obtains the advantage of the goods or services –
    - transfer or assignment of a copyright, patent, license, trademark, or similar right;

- the service of a consultant, engineer, lawyer, architect, or accountant, the processing of data or supplying information, or any similar service;
- an advertising service;
- the obligation to refrain from pursuing or exercising taxable activity, employment, or a right described in this subsection;
- the supply of personnel;
- the service of an agent in procuring for the agent's principal a service described in this subsection;
- the leasing of movable property (other than transport property);
- radio and television broadcasting services; or
- electronically-supplied services.

- The supply of cultural, artistic, sporting, educational, or similar activities, or services connected with movable goods, takes place where the service is physically carried out, unless the service is described in subsection (4).
- The supply of services connected with immovable property takes place where the property is located, unless the service is described in subsection (4).
- A supply of services of, or incidental to, transport takes place where the transport occurs, unless the service is described in subsection (4).
- Services supplied from a place of business in Vatopia which would be treated as supplied outside Vatopia under subsections (4) – (7) are considered as supplied in Vatopia and are considered as exported from Vatopia for purposes of Schedule I.

Time of supply

Time of Supply of Goods

In case of supply of goods, earliest of following shall be time for supply under Sec. 6(2):

- Date of issuance of invoice, or
- Date of possession of goods/ date of removal of goods by the recipient from the supplier's business place, or
- Date of receiving consideration by the supplier

Time of Supply of Services

In case of supply of services, earliest of following shall be time for supply under Sec. 6(2):

- Date of issuance of invoice, or
- Date of rendering service, or
- Date of receiving consideration by the service provider.

Time of Supply when one or more provisions as above are enforceable at once

In the case of a transaction for which more than one provisions as prescribed above are applicable at once, the supply time shall be as prescribed by DG (Sec 6.4).

Exceptions to the General Rule of Time of Supply {Sec. 6 (3)}

The rule of time of supply as described above is not applicable in the following cases. The time of supply shall be as follows for the following transactions:

- In the case of services that are continuously provided such as, telecommunication services or similar other public services, ***when the tax invoice is issued.***
- In case of payment as per contractual provision to make payment of the value of goods or services partially in more than one installment, ***earlier of due date of such payment or the date when such payment is made.***
- In the case of used goods or service for which an offset is not allowed, the time when such goods or service are used.

- **Rate of Tax**

  There shall be single rate of 13% for VAT (Section 7). Goods or services, exempted from VAT as per Schedule 1, are not subject to VAT. In case of transaction covered by Schedule 2, the rate of tax is 0%. In summary, there are three types of VAT incidence on the transaction:

  - Single Rate - 13%
  - No VAT- Items of Schedule 1
  - Zero Rated- Transactions of Schedule 2

- **Conditions for Zero Rate of Tax**

  - Zero rated tax means tax charged at zero rates. Alternatively, zero rates means, while zero VAT is due on the supply, the supplier remains entitled to claim any input tax and is therefore entitled to a refund of that input tax if there is no output tax. The zero rates are sometimes called as exemption with credit. Schedule 2 provides a list of transactions those to be charged at 0%. The lists as appeared in Schedule 2 of the Act are produced here for the reference (*Students are advised to update themselves with the amendments in Schedule 2 by relevant Finance Acts):*
  - **Export of goods:** In case it is proved that the supply is made as follows:
    - Goods exported from Nepal;
    - Goods stored on a flight that has a destination outside Nepal; or
    - Goods stored on an international flight having destination outside Nepal for retail sales, for supplies or for consumption.

- **Services provided to any person outside Nepal:**
  - A supply of services by a person resident in Nepal to a person residing outside Nepal and having no business establishment, agent or legal representative acting on such person's behalf in Nepal.
  - A supply of goods or service by a registered person to a person residing outside Nepal.
- **Diplomatic Supply:** Import of goods or services by accredited diplomat individual or office or any individual working in duty exempted diplomat office on recommendation of Ministry for Foreign Affairs.
- **Projects exempted under any Treaty or Agreement effective on the date of enactment of VAT Act:** Any purchases of goods from a registered dealer in Nepal by any person to whom exemption of sales tax was provided as per the agreement with a project till the agreement is in force, on a recommendation of the related project, the person shall avail the zero VAT facility.
- **Supply to Industries in Special Economic Zone:** Sales of raw materials and finished goods to any industry established at notified special economic zone.
- **Power Sector Supply:** Sales of battery required for plants and equipments for use in production of solar energy duly approved by Alternative Energy Promotion Centre by a domestic producer directly to the solar power producing unit.
- **Power Sector Supply:** Sales of plants, equipments and parts thereof, machineries, penstock pipe or iron leaf used to manufacture penstock pipe required for hydro power project produced by a domestic producer and directly supplied by the producer itself to the project upon approval of Alternative Energy Promotion Centre or Department of Electricity.
- **Refund of VAT paid on Raw Materials:** The VAT paid on raw materials used to carve statue, idol, paintings, or similar handicrafts items by small and cottage industries; the products of which are exported through approved export houses is refundable.
- **No VAT on scooter used by Incapacitated persons**
- **Zero Rate Vat Facility for domestic Industries supplying directly or through contractor of projects the Machinery, tools and Construction Equipment included in approved master list of the project operated by bilateral or multilateral agreement after obtaining tax exemption from ministry of Finance, Government of Nepal**

- **Assessment and Collection of Tax**

- **Assessment of Tax**
  - There are three types of VAT assessment under the Act, i.e. self assessment (Sec. 18), jeopardy assessment (Sec. 22) and assessment by Tax Officer (Sec. 20).
    - **Self-assessment:** The registered person shall file a VAT return within 25 days of end of a tax period. The returns may be filed in documentary form or through electronic means, often called e-return. When such return filed to the tax office, the self assessment is deemed to be conducted.

- **Jeopardy assessment:** If there is a reason for Tax Officer to believe that collection of VAT is in jeopardy by way of person leaving Nepal or transferring property or removing or concealing assets, a Tax Officer, with the approval of DG, may immediately assess and collect the tax due, or about to become due.

- **Assessment by Tax Officer**

  Grounds and Conditions for assessment by Tax Officer (Sec. 20 (1)

  Under the following grounds and conditions Tax Officer can make tax assessment:

  - If a return is not submitted within the time limit;
  - If an incomplete or erroneous return is filed;
  - If a fraudulent return is filed;
  - If the Tax Officer has a reason to believe that the amount of tax is understated or otherwise incorrect;
  - If the Tax Officer has a reason to believe that the taxpayer has caused under-invoicing;
  - If under-invoicing within group companies;
  - In case person required to get registered operated business without registration;
  - In case of sales without issuing invoices; and
  - In case unregistered person collects the tax.
  - In case tax not deposited under Section 8(2) or (3).
  - For existing of situation mentioned in Section 17(4) (Goods ceases to be ued in taxable transaction)

  Assessment by tax officer is risk based sampling based on above conditions.

  Bases of the assessment (Sec. S 20 (2))

  The Tax Officer may make such tax assessment on one or more of the following bases:

  - Proof of transactions;
  - A tax audit report on transactions submitted by the concerned Tax Officer; and
  - Tax paid on a similar transaction by another person.

  Burden of proof (Sec. 20(3))

  The burden of proof lies on Tax Officer for reasons of assessment.

  Time limit for assessment (Sec. 20(4))

  Assessment by Tax Officer needs to be finalized within four years from the date of a tax return being filed. If the stipulated time expires the return so filed shall

be considered to be true and valid. For example, for a person filing VAT return monthly, assessment of VAT returns for 2071.72 (12 returns), if filed on due date, could be done till 2075 Shrawan 25 in full of 12 returns (income tax re-assessment can be done till 2076 Ashoj-end). But, in case of fraudulent return reassessment tenure is unlimited.

Opportunity to hearing (Sec. 20(5))

As per evaluation of VAT return and documents produced to the Tax Officer, any quarry or Preliminary Assessment shall be sent to the person under Rule 29(1). Reply of Preliminary Assessment to be submitted within 15 days of receipt of notice. In case the Tax Officer satisfied with the reply on Preliminary Assessment, the point raised shall be omitted and remaining points to be included in Final Assessment issuing under Rule 29(3).

- **Collection of Tax**

Registered person shall pay tax within the due date of filing the VAT return, i.e. within 25th days from the end of tax period. In case of final assessment by Tax Officer as per Rule 29(3), these amount (tax including any fee, additional duty, interest, fine etc.) within 7 days of such final assessments.

In any case on failure of tax payment on due dates, Tax Officer is authorized to, according to Sec. 21, collect the due amount from any or all of following methods:

- By offsetting the amount, if any, to be refunded (by IRD) to the taxpayer,
- By seizing movable or immovable property of the taxpayer;
- By selling through public auction all or part of the assets at one time or in an appropriate series;
- By recovering from the taxpayer's bank account or other financial institutions.
- By recovering from amounts due the tax payer by GON, or State Owned PEs or local bodies.
- By recovering from, upon pre-approval of the taxpayer, third party owes to the taxpayer; or
- By withholding import, export or transaction of the taxpayer.
- By restricting to go outside Nepal.

Procedures as prescribed in Rule 53 have been given in .

Test Your Understanding

- **Import of VAT attractive item –** Ashakheti Impex is importing an equipment costing Rs. 30,000,000 from Germany. The transportation cost is shared by both importer and seller as CIF basis. For the part of Ashakheti Impex it is Rs. 200,000 and Rs. 100,000 paid for transit insurance. Custom rate for such equipment is 15%. State Ashakheti Impex's VAT treatment.

Hint: Here, the item is subject of VAT, any item imported is deemed as transacted in custom frontier of Nepal as per Rule 15. VAT is charged on the purchase cost including all the cost incurred up to custom point. In the given case, cost incurred is Rs. 33,000,000 plus 15% custom. So, VAT required to pay is Rs. 4,933,500. For this payment, person is not required to get registered in VAT.

Cost till custom	33,000,000
Custom Duty	4,950,000
Total Cost	37,950,000
VAT @ 13%	4,933,500

VAT is levied at the import cost (DAT) plus any other duties, except VAT itself.

- **Import of VAT exempted item-** Kavarkhet Impex importing an equipment costing Rs. 300,000,000 from Germany. The transportation cost is shared by both importer and seller as DAT basis. For the part of Kavarkhet Impex it is Rs. 200,000 and Rs. 100,000 paid for transit insurance. Custom rate for such equipment is 1% under code 84 of harmonized system. State Ashakheti Impex's VAT treatment.

Hint: Here, the item is exempt from VAT according to Schedule 1. So, no VAT is charged on the import.

DAT (Delivered At Terminal means, transit cost up to customs is paid by the seller (included in purchase price) as per INCOTERMs 2010. Transit cost beyond customs (including unloading to customs or elsewhere after that) is to be paid by the buyer.

- **Earlier date-** Rupakheti Impex and Kalakheti Impex entered into a contract of sale of some furniture. For this former produced some articles of furniture and latter make them marketing as dealer. During the month, 25 units of furniture were taken by Kalakheti Impex against cost payment of Rs. 200,000 in last month. For the next month production Rs. 300,000 were paid. Rupakheti Impex issued Rs. 240,000 invoice covering 10 units of furniture issued this months and 30 units issued last months. How much is output tax?

Hint: VAT is deemed collected at the earliest of date of invoice, date of possession of goods or consideration paid. In the given case, Rs. 300,000 consideration has been received earliest as production and sale of coming month, so VAT shall be collected on this sum.

Advance payment and payment of consideration are different. In advance, the payment is done earlier, which is adjusted on the completion of event; but in payment of consideration, it is Cash Before Delivery (CBD) or Paid Before Delivery (PBD). Time of supply is critical with date of CBD/PBD not with advance (sometimes called as mobilization advance).

- **Group Company-** Sunakheti Ltd., Bhimkheti Ltd., Jamarkheti Ltd. and Karkheti Ltd. are four company owned by Mr. Uperkheti. The head office for all companies is in same place, but there are four accountants for each of the company. Mr. Uperkheti is worried about monthly VAT return for each company. Being the key person, he wants to file a single return. Is it possible?

  Does the answer is different in case, Karkheti Ltd. is filing trimester basis?

Hint: In VAT, group company or group entity is for inter-company transaction at market value and not for consolidated VAT return. There is not any concept of consolidated VAT accounting or consolidated VAT return in VAT. Even, surplus money of one unit of Group Company cannot be set off with another company.

- **Foreign Branch -** Phekurel Ltd. has a branch in Dhaka, Bangladesh, Financial Statements is prepared and monitored monthly under NASs. During the month, sale from head office is Rs. 20 millions and sale from branch is Rs. 10 millions equivalent. Calculate the amount of VAT to be paid, if input tax credit is Rs. 2 millions.

Hint: The transactions within the territory of Nepal are subject of VAT as per Section 5 of VAT Act. Any sale or purchase beyond territory of Nepal is not transaction for VAT accounting, even when the person is registered person. Here, sales from Nepal are Rs. 20 millions and output tax is Rs. 2.6 millions, if goods were sold within Nepal. However, students should note that the sale is export sale and it does not attract any VAT.

For VAT purpose, transfer of goods to its branch (foreign) is VAT attractive transaction and vice versa.

- **Foreign Head Office -** Bhekurel Ltd. is a branch of Dhaka Ltd. registered in Bangladesh. During the month, branch sells goods worth Rs.10 million. Calculate the amount of VAT to be paid to Revenue Authority, if input tax credit is nil.

Hint: In VAT, all the transaction in Nepal is subject of VAT irrespective of registration of main corporate body. Branch in Nepal is a person for VAT purpose; even the corporate person is not a registered person. Here, sales from Nepal are Rs.10 millions and output tax is Rs.1.3 millions. So VAT payable is Rs.1.3 millions.

- **Work in Nepal invoiced to foreigner-** Nepal branch of Italian Company seconded some staff to Singapore Company and invoiced Rs. 1.5 million. Latter has one assignment in Nepal performed by those seconded staff and invoiced to Nepal customer of Rs. 2 million. What is the VAT impact?

Hint: Here are three players in VAT; Singapore Company works for Nepal through seconded staff of Nepal branch of Italian company, so it should get registered and issue tax invoice to Nepal customer. VAT paid by Nepal customer is output tax for Singapore Company. Nepal branch of Italian company works in Nepal, so need to issue tax invoice to Singapore Company and to collect VAT as output tax. Payment place, currency of payment or place of invoice sending for payment is irrelevant for VAT.

Place of service delivery is critical not the person who is raising the bill or currency of settlement of consideration.

- **Auction Procedure-** What are the auction procedure in case of assets seized?

Hint: According to Rule 53, auction of seized assets to be disposed as following procedures:

  - Wholly or in part-Auction of assets may be done wholly or partially seized property.
  - Public notice- A 15 day's public notice to be issued indicating the property to be auctioned, reason for auction sale, place and date of auction.

- Witnesses- There should be witness of one representative from local authority, nearby government office and if possible the taxpayer or his representative.
- All the expenses incurred on the auction sale shall first of all be borne out of the amount realized from the auction sale; tax, charges, penalties and interest payable by the taxpayer shall then be realized from the balance; and the surplus, if any, shall be refunded.
- Stoppage of auction- In case, prior to execution of the auction sale but after issuing public notice, person wants to pay the entire amount including all the expenses relating to auction sale, tax, charges, penalties and interest due to the person, the same shall be collected and the auction sale shall be stopped. In case Tax Officer receives information that the person has deposited sufficient amount in his account in a bank or a financial institution, and if such amount is realized the remaining actions of the auction sale shall be stopped.
- Priority of payment-In partial realization, even auction of whole or part of assets and property finalized, priority of proceeds shall be as auction sale, interest, charges, penalties and tax.
- Perishable goods- According to Rule 54, perishable goods to be sold before it likely to decay, rot or wear out even the auction of assets even in case, court order for 'as it where order' till final court decision, but the property is because of prolonged period of stoppage resulting from the court order. In case the aggrieved person filing petition or appeal in court of law, win the case, the realized value to be refunded to the person. The taxpayer shall not be entitled to claim for the return of the goods or articles.

DYS

- **Key factor-**How do you determine when a transaction is deemed to have occurred and when is the VAT reportable?

  a. Is the delivery of goods the key factor?

  b. Is date of service performance critical?

  c. For continuous services is invoice date critical?

  d. Is payment date critical?

- **Inter-branch -** Are transactions in Goods between a Branch in Nepal and a Branch/ Head Office of the same Legal Entity in another country, within the scope of VAT, or are they ignored?
- **Inter-branch-** What shall be the impact in case one branch in Biratnagar sends some goods to Nepalganj Branch?

CHAPTER-2
REGISTRATION AND DEREGISTRATION

- **Registration in VAT**

Every person dealing in taxable transaction shall register themselves for VAT purpose. The persons that have been registered are "Registered Person".

Certificate of Registration (Sec 10 (4))

Tax Officer shall register the person willing to get registered making prescribed application for registration. It shall issue a unique registration number, in the prescribed form and time, together with a certificate of registration within 30 days of application to the registered person. The tax office has been issuing permanent account number (Tax Payer's Identification Number, TPIN) used for Income Tax purpose since 2058 for the purpose of VAT.

In case a person files an application for registration even if the transaction is not required to get registered, the Tax officer shall issue a letter within 7 days of application stating that the registration is not required at all (Rule 4 (2)).

The Tax Officer may require further clarification and documents as to the business of the person before registering the person. If the tax officer seeks such clarifications or documents, the same shall be provided within 7 days from date when the clarification is sought.

Process if there is Loss of registration certificate (Rule 14)

In case the registration certificate is torn, lost, or destroyed, the person shall submit an application to the respective Tax Officer for duplicate certificate with a fee of Rs. 100, according to Rule 14. Tax Officer shall issue a duplicate copy of registration certificate within 15 days from date of the receipt of the application.

Changes in description of registration

In case of any changes in particulars as mentioned in the application for registration, the registration certificate shall be amended as follows:

- In case of change in business address- before 15 days of change (Rule 9);
- In case of change in business line or objective clause- before 15 days of change (Rule 9);
- In other cases of changes- within 15 days of that event (Sec. 10(7).

Displaying the registration certificate

Registered person shall display the registration certificate in conspicuous manner (i.e. at an eye-catching place) in principal place of business or an attested copy of certificate at every branch, if it has any branch {Sec. 10(5)}.

Use of PAN

As provided in Sec.10 (6), registered person compulsorily use registration number (TPIN-now PAN) in following documents:

- Documents relating to income tax;
- Documents relating loan application for commercial or industrial purpose from any bank or finance company for an amount of Rs. 1 lakh or more;
- Documents relating to import and export.
- Documents relating to VAT (invoice, credit note, debit note, purchase book, sales book etc.) or excise or custom.

Compulsory Registration

The Permanent Account Number issued by IRD for Income Tax purpose has been used for the purpose of VAT as well since 2058. The taxpayer shall apply for VAT registration once it gets registered for Tax purpose. There have been certain cases, where the person has not registered for income tax but for VAT only. The cases of registration for VAT even in the case of transactions of exempted goods and services were numerous at the time of implementation of VAT Act in Nepal.

There are Four types of Registration in VAT, viz. Compulsory VAT Registration, Voluntary VAT Registration, Temporary VAT Registration and Forced Registration.

Compulsory VAT Registration

The conditions for compulsory VAT registration are as follows:

- **Commencing of Business dealing in existing VAT attractive Goods or Services:** The person willing to involve in taxable transaction shall register for VAT purpose, except in the cases when it is relieved from registration requirement due to the transaction below the threshold prescribed in the law as presented in Chapter 3.2 (2).
- **Transaction of Goods or services exempted under VAT, now converted to VAT attractive items**: In case the goods or services that were exempted under Schedule 1 becomes tax attractive due to the amendment in tax law, the person shall file an application for registration within 30 days of such incidence, if the person believes that the turnover of the transaction exceeds the threshold prescribed under the Act.
- **The person was not registered due to the application of threshold, but the turnover exceeds the threshold prescribed under the Act:** A person is exempted from registration in case the turnover is below some threshold prescribed under the Act (discussed in Chapter 3.2 (2)). In case there occurs such circumstance that the turnover of any 12 months exceeds the prescribed threshold, the person shall make an application for compulsory registration within 30 days of such happening.
- **Compulsory Registration in case of certain businesses in certain area:** The person dealing in following business in metropolitan city, sub-metropolitan city and other area prescribed by IRD shall register for VAT purpose regardless of the turnover of the business.

Operating following businesses anywhere in Nepal

Transaction by bricks production, Liquor, Wine, Health Club, Disco theque, Massage therapy, Motor Parts, Electronic Software, Custom Agent, Toy Business, trekking, rafting, ultra light flight, paragliding, tourist vehicle, crusher, sand mines, business operations related to slate and stone industry

Operating following businesses in metropolitan city, sub-metropolitan city or other area prescribed by IRD

Where any person operates a business of hardware, sanitary, furniture, fixture, furnishing, automobiles, electronics, marbles, Educational services, Accounting and Auditing related services catering services, party palace business, parking service, dry cleaners operated with machinery, restaurant with bar, ice-cream industry, colour lab, boutique, supplying uniform to educational institutions or health institutions or other entities.

Commentary on Other Conditions

The person, the turnover of which is less than the threshold prescribed by IRD, shall also get registered if any of the above two conditions are satisfied.

- **Exemption from requirement of Registration**

  The followings are the conditions under which a person is not required to get registered for VAT purpose:

  - **Person dealing only in Exempted Items {Sec. 10(3)}**: Person dealing exclusively in goods or services that are included in schedule 1 as exempt goods or service shall not get registered.
  - **Small Vendors (Sec. 9):** The person with the following turnover (Threshold of turnover prescribed in Rule 6) in any period of 12 months (set of moving 12 months) are relieved from the registration requirement:
    - For persons dealing in Taxable Goods: The turnover of last 12 months shall not exceed Rs. 5 Million.
    - For persons dealing in Taxable Service: The turnover of last 12 months shall not exceed Rs. 2 Million.
    - For persons dealing in both Taxable Goods & Taxable Services: The turnover of last 12 months shall not exceed Rs. 2 Million

    Turnover means the higher of Sales or Purchases. In case the sales or purchases are not specifically identifiable, the DG may prescribe the combined value as turnover.

- **Voluntary Registration**

  - Any small vendor may apply itself for VAT registration and this is called voluntary registration. After registration, either compulsorily or voluntarily, the right and duties, books of accounts etc. are same for all.

- **Temporary registration (Sec 10Ka)**

  Temporary Registration for Unregistered Person

  Any unregistered person desiring to engage in any short-term taxable transactions of goods or services at fair, show, demonstration, display, exhibition etc., shall make an application for a temporary VAT registration.

  Person responsible for Temporary Registration

  The exhibitor or organizer, if it is not registered; and the unregistered participant of such fair shall register temporarily.

  Demand of Deposit

  The tax officer shall demand 2% of total estimated income as deposit from such person filing an application for temporary registration.

  Stock Transfer Facility for Existing Registered Person

  Existing registered person can transfer goods for transaction to the place of exhibition or fair.

  Cancellation of Temporary Registration

  Within 7 days from completion of the fair, show, demonstration, display, exhibition etc., temporarily registered person has to submit VAT return of the transactions made thereon and shall cancel the registration.

  Cancellation of Registration

  - Registered person who is unable to continue his taxable business or other cases as provided in Sec. 11, may apply for Cancellation of Registration from VAT (cancellation of registration upon request). Section 11 has specified certain conditions under which Tax Officer can cancel the registration by itself (Suo motto cancellation of registration).

- ***Conditions for Cancellation of Registration:***

  According to Sec. 11(1), Tax Officer may make cancellation the VAT registration under following conditions:

  - Cessation of existence – In the case of an incorporated body, if the incorporated body is shut down, sold or transferred or otherwise ceases to exist;
  - Death of an Individual - In the case of a proprietorship or partnership firm, if the owner or any of the partners of firm dies;
  - Dissolution of Partnership Firm - In the case of a partnership firm, if it is dissolved;
  - Cessation to Transact in taxable items - If a registered person ceases to be engaged in taxable transactions;
  - Submission of Zero return - In case a registered person submits zero tax returns continuously for 1 year (may be Suo motto forced deregistration).

- Non-filer- In case the registered person does not submit tax return till the date (may be sue motto forced deregistration).
- Registration in error- If a person is registered in error (may be Suo motto forced deregistration).
- Temporary registration- In case of temporary registration under Sec. 10A, after closure.

Procedure for cancellation of registration in other cases

Registered person willing to cancel its registration, need to file an application in Form No. 11 of the Rules. Tax Officer receiving application for cancellation of registration shall make necessary inquiries and decide for cancellation of registration. The taxpayer shall produce documents for audit within 15 days of cancellation application to tax officer. The tax officer shall decide whether the cancel the registration or not within 3 months of such application and notify the applicant thereof.

Filing of VAT Return after Cancellation application

The registered person shall file monthly VAT return after applying for cancellation of registration till the earlier of expiry of 3 months from date of application or decision of tax officer to cancel registration. In case Tax Officer does not decide within 3 months, the taxpayer is not required to submit any tax return after that period as per Sec. 11(1B).

Effect of Cancellation of Registration

In case the registered person has unsold stock of inventories or capital goods on which the person has claimed input VAT credit at the time of application for cancellation of registration, the person shall pay tax on the those VAT attractive goods assuming as if the items are disposed off at market value.

According to circular dated 2055.9.5, in case the market value cannot be ascertained at the time of deregistration (and in case of self-use too), cost price shall be assumed as market price. In all cases of VAT, if it is assessed later for the acts done before deregistration, person deregistered from VAT is responsible for it.

Biometric Procedure:

As per Sub Section (1) of Section 10Ga, Person registered as per this Act, should update registration related information and documents in biometric registration procedure as specified by the department within the stipulated time.

As per Rule 7Kha, Registered person shall update its information within 2078 Ashad end as per Section 10Ga of the Act on Biometric Procedure.

CHAPTER-3
TAXABLE VALUE, COLLECTION, OFFSET AND REFUND

Central concept of VAT is that the methods of tax computation shall be easy, simple to understand and compliance cost shall be minimum. This Chapter describes the quantification requirements.

Core principles of VAT are that:

- All sales during tax period by registered person shall be included in output and VAT must be collected on taxable value of the transaction – Output and output tax.
- The VAT, so collected, can be set off with allowed VAT paid purchases made during last 12 months, if the set off is not allowed – input and input tax.
- Difference of Output VAT and Input VAT shall be paid –VAT (debit or credit)

Taxable Value

- In case of sales or self consumption, taxable value means the value of transaction on which VAT shall be charged irrespective of sales proceeds in financial accounting or in income tax. According to Sec. 12, it is amount received from the buyer as consideration. Taxable value includes cost of goods, transportation cost, transit insurance, applicable non refundable duties (except VAT) and profit of the sellers, if any.
- **Taxable Value in General**
  - ***Cash consideration:***
    - As per section 12 of the Act the taxable value is the value charged by the supplier for the goods or services where the consideration is payable in cash except VAT payable in form of cash.
    - It includes value of the invoice, any duties collected for third party including profit margin, freight and distribution expenses incurred by supplier, excise duty or other taxes except VAT less discounts, commission or any other trade discounts. Vide circular dated 2056/2/28; in case of cash consideration includes any fee or penalty, such amounts shall also be included in taxable value.
    - In case of hire-purchase or installment or credit arrangement, consideration shall be fair value measurement at the point of inception of the transaction.
  - *Import*:
    - Collection of VAT by respective Custom Office
    - In case of import of goods, respective custom office shall collect VAT on taxable value {Sec. 12(5) and Rule 48}.

- Taxable Value (Sec. 12 (5))
- Taxable value for the purpose of import shall be landed cost up-to boarder (cost paid to vendor, transit cost or other cost, DTA in case the transit cost borne by the seller) plus duty charged by the Customs Officer except VAT.
- Taxable Value in case of Significant Under-invoicing {Sec. 12 (6)}
- In case of significant under-invoicing and there is reason to be believe so, the taxable value shall be the revaluation of purchase price at market price.

- **Self consumption of Goods or Services:**
  - In case of self-use of asset, ***market value*** on the date of use is deemed as taxable value.
  - Conversion of raw materials to work-in-progress or to finished goods is not self consumption. Capital goods are also not deemed as self-use (exactly, capital goods are those, which are used by itself). In fact, in case any trading goods are used as capital asset, then it deemed as self-use. *But, the concept has been differently explained in para. 16 of Explanatory Notes to the Law on the Value Added Tax, on IMF Model as "if taxable person applies goods or services acquired for use in taxable activity to a different use, the change in use is treated as supply by the taxable person".*

- **Taxable Value in Special Condition**
  - **Taxable Value of Goods transacted under Barter system {Sec. 12 (4)}**

    In case of a barter system, the market value of goods given shall be treated as the taxable value of goods bartered. The question of the application of the rate to be taken for valuation (i.e. whether the market value of item out or item in) is not explained by the Act. Thus, the valuation is similar quantification as in NFRS 15 Revenue from Contracts with Customers.
  - **Taxable Value in case of Under-invoicing {Sec. 12(6)}**

    The value of any under-invoiced (much lower than prevailing rate) goods or services, taxable value of the goods or services shall be market value.
  - **Taxable Value in case of transaction obtaining Partial or No Consideration {Sec. 12(7)}**

    The taxable value of any goods or services that is transacted obtaining partial consideration shall be market value.

    In case of supply with no consideration (gift or self-use), VAT is levied at market price of supply.
  - **Taxable value for Wood (Sec. 12A)**
    - Taxable Value of Wood of National Forest
    - Time of Supply

- The time of supply of wood shall be earliest of the happening of following events:
  - Auction of wood,
  - Issuance of Release order, or
  - Issuance of cutting order

- **Taxable Value**

  The taxable value shall be the amount that is higher of the following:

  - Royalty amount of the wood, or
  - The amount of auction

- *Input Tax Credit to Buyer*

  Buyer, if VAT registered person can get input tax credit based on VAT paid vouchers without tax invoice.

- ***Taxable Value of wood of Private and community Forest***

  The taxable value shall be computed on the same basis applied for the wood of national forest.

- **Taxable value for notified goods {Sec. 14(6)}**

  IRD is authorized to publish public notification or to issue order in writing to specific person and prescribe the person to publish the retail price (distributor rate, wholesaler's rate and retail rates) of goods for the period specified in the notification or order. The registered person shall not sell or transfer any goods without publishing such retail price, in case the department directs so.

  Notwithstanding anything contained in Sub-rule (1) of Rule 17, when goods or services are sold under Sub-section (6) of Section 14 of the Act, tax invoices shall be issued as per the details referred to in Schedule -5Kha. (Rule 17(1Ka))

- *Effect on Transaction due to the notification*

  The registered person shall collect VAT on consumer level price from any unregistered person.

- **Taxable Value in case of used goods (Rule 33)**

  Taxable value for persons dealing in secondhand or used materials is the difference of sales amount and the cost of sales that includes the VAT paid on it.

  Taxable value for used goods =Selling value of the goods- purchase price including VAT

- ***Particulars to be maintained in Sales & Purchase Register***

  A registered person dealing used or secondhand goods shall maintain purchase register and sales register containing the following particulars:

Purchase Register	Sales Register
Date of Purchase	Date of sale
Particulars giving full information of the goods	Particulars giving full information of the goods
Buying price excluding tax	Selling price, excluding tax
Rate of tax	Taxable value = purchase price (including VAT) - the selling price (excluding VAT)
Amount of tax	Rate of tax and Amount of VAT
Total amount paid	Total amount received

- **Maintenance of Separate Records of each Item**

  In case the purchase price of every item of used goods, separate records of individual itemas of buying or selling shall be maintained.

- **Effect in case of unsatisfactory Records**

  In case a registered person is observed by Tax Officer that it has not maintained the prescribed records satisfactorily, Tax Officer may impose VAT on the total selling price of the goods sold by such taxpayer, and the Tax Officer may issue a written order requiring him to pay such tax along with the next tax return. Impact of normal sales of goods and used goods deals is explained in .

Test your Understanding

What will happen if a registered person sells its second hand furniture, the main business of which is not dealing in second hand furniture?

- **Market Value Concept**

  VAT is levied on the consideration received as cash or equivalent in almost all cases assuming that the consideration received in cash or equivalent is the taxable value (Transaction Value, TV based Tax Base). As discussed in Chapter 5.2 above, some of the transactions require levying VAT on the Market Value of such goods.

  Market value~ arm's length (Sec 13)

  Market value of supplied goods or services shall be determined on the basis of the fair value of consideration received or receivable in the transaction between unrelated independent parties at arm's length under similar circumstances as to characteristics, quality, quantity of materials, and any other relevant factors.

  Market valuation by registered person: In the following cases, transactions to be accounted at market value by the registered person itself:

  - Barter system transaction (Sec. 12(4))
  - Partial Consideration (Sec. 12(7))

- Remaining stock and capital items at the time of cancellation of registration (Sec. 11(3))
- Remaining stock and capital items at shifting to VAT Exempted business or self consumption of trading stock (Sec. 17(4) and Rule 15)

- **Valuation at Market Value by Tax Officer:**

  In the following cases, transactions may be reassessed at market value by the Tax Officer:

  - In the above cases, if the tax is not levied on Market Value by the taxpayer itself {Sec. 20 and Rule 29}
  - In the cases of Under-invoicing {Sec. 12(6), Sec. 20 and Rule 29}
  - In case the stocks appearing in the books cannot be shown physically at the time of inspection of Tax Officer (Rule 40)

  Method of determination (Rule 22)

  Tax Officer has right to fix the market price based on the transaction of similar goods. In case a Tax Officer cannot ascertain market price, the Director General has the right to prescribe the method on the basis of price of similar goods transacted by different suppliers. In a situation where market price of goods or services could not be determined as per the method prescribed by DG, DG has to determine the price on the basis inter alia, of the information received by him/her from the registered persons of similar kind in that respect.

- **Collection of Tax**

  Value Added Tax shall be collected by the registered person recognized by taxation authority. There are few exceptions when even an unregistered person shall collect VAT on transaction of taxable goods or services. In this Section of this Chapter, we shall discuss the right/duty to collect VAT by different persons.

- **Obligation of Registered Person to collect Tax**

  VAT shall be collected by registered person according to Sec. 8(1). In the case of supply of goods or services, registered person shall collect VAT on the transaction value by issuing of tax invoice.

  The recipient of service from foreign country and person construction the commercial complexes through unregistered contractor shall levy VAT on themselves and deposit it to tax office.

- **Collection of VAT from Unregistered Person**

  - Unregistered Person shall not collect VAT (Sec. 15 (1))
  - As per the general rule, an unregistered person cannot collect VAT. In case any unregistered person collects VAT on its sales, then VAT shall be assessed by the Tax Officer as per Sec. 20.

- **Cases where the Unregistered Persons are obliged to Collect VAT on Sales {Sec. 15 (3)}**

  The following unregistered persons shall collect VAT at the time of transaction of taxable goods or services:

- **Customs Offices:** In case of import, the respective custom office collects VAT on the taxable value calculated as per the Act.
- International Agencies in Nepal and Missions
- Federal, Provincial or Local Government of Nepal
- Unregistered Public Enterprises owned by Government of Nepal
- Wood Sellers: In case any person sales wood from forest (governmental, community or private forest), the person shall collect VAT, irrespective of its registration in VAT.

- **VAT Return**

Registered person shall submit tax returns in the format prescribed in Schedule 10 of VAT Regulation, 2053 within 25 days from end of tax period (Sec. 18). Time specified for this purpose may be extended in case of circumstances beyond control. Place of submitting VAT return is Tax Office in the districts where Inland Revenue Office is located or in other cases, it is District Treasury Comptroller's Office or by electronic medium

Circumstances beyond Control (Rule 35)- Students are advised to go through the rule.

- **Bank Guarantee facility (Sec 8Ka)**

Persons entitled to release goods from Custom Office by depositing Bank Guarantee

The following persons are entitled to release the goods from custom office after producing bank guarantee:

- Persons importing Raw Materials that are used to produce finished goods for export purpose
- Bonded Warehouses importing goods to sell it from Tax Free Shops

Bank Guarantee Facility to a Person importing Raw Materials that are used to produce finished goods for export purpose

Conditions to be satisfied

All the following conditions shall be satisfied to avail the facility:

- The person shall export 40% of Total Sales effected during the Last 12 months
- The exporter's value addition to the product shall be at least 10%.

Amount of Bank Guarantee

The amount of bank guarantee shall be equivalent to VAT applicable on raw materials imported for the production of goods to be exported from Nepal. That means, the person can release the portion of raw materials that will be used for production of exporting goods availing the bank guarantee facility and the VAT applicable on the remaining raw materials shall be paid in Cash.

Facility compromised

The person shall not be entitled to apply for VAT refund in the same month as prescribed by Sec 24 (4).

Release of Bank Guarantee

Bank Guarantee shall be released by the custom office as per the procedure prescribed by IRD.

- **Bank Guarantee Facility to Bonded Warehouses importing goods to sell it from Tax Free Shops**

Conditions to be satisfied

All the following conditions shall be satisfied to avail the facility:

- The bonded ware house shall import goods for selling through tax fee shops
- The person availing such facility shall sell alcohol and cigarette only to persons entitled to diplomatic privilege and duty privilege on recommendation of Ministry of Foreign Affairs.

Amount of Bank Guarantee

The amount of bank guarantee shall be equivalent to VAT applicable on import of goods to be sold through tax free shops.

Facility compromised

Release of Bank Guarantee

Bank Guarantee shall be released by the custom office as per the procedure prescribed by IRD.

- **Exemption on VAT attractive Items**

Council of Ministers in the recommendation of Ministry Of Finance issuing public notice published in Nepal Gazette may waive any import of VAT attractive items to be exempted in full. Yearly Finance Act(s) empowers GON to do so. These waivers are of two types:

- **Case to case exemption:** There are numerous examples (somewhat more than 500 cases in a year) of such waivers of VAT attractive imports. Such exemptions are mainly given to the imports of VAT attractive items usable for social or similar purpose or goods gifted from foreign nation for such purpose. Person importing goods under these terms cannot use such goods as commercial trading items.
- **Blanket exemption.** There are cases where VAT has been waived by notice for whole of the transaction in case of import or local sale or purchase.

- **Offset of Tax**

The principle of VAT adopted through the VAT Act requires a business person to be an agent of government. The ultimate burden of payment of tax rests with the final consumer. The

middlemen including the producers are just the agent for collection. The businessmen or the registered persons are allowed to set off the VAT paid on purchases by VAT collected on Sales. The process of such setting off the Input VAT from output VAT before making the payment to Revenue Authority is Offsetting of VAT.

Central conceptual principle (with some defined exception) of offset is that, VAT paid on purchase having VAT attractive output can be set off (credit of input tax based on the invoice method). VAT set off is allowed by way of input tax credit.

The form for VAT items might be taken as follows:

	Taxable Value	**Tax**
Output (+)	A	±A*13%
Input (-)	B	±B*13%
Value Add (Credit)	A-B	±(A-B)*13%
Opening Credit (-)	-	C
VAT Payable (Credit)	-	±(A-B)*13%-C

- **Input tax credit-** A Ltd. is engaged in VAT attractive industrial products. It has following purchases (Purchase price does not include VAT, and it shall be net off VAT; unless otherwise provided clearly):
  - Equipment purchased at Rs. 500,000 not installed. The security cost incurred till the date is Rs. 20,000.
  - The entire building materials for expansion have been purchased at Rs. 2,000,000.
  - Interest Rs. 15,000 and admin salary Rs. 50,000 has been paid and Rs. 30,000 is payable.
  - Office admin expenses include Rs. 113,000 paid for stationary and telephone including VAT.

  Here, the output (sales- that has actually happened or intended to happen) is VAT attractive. VAT paid purchases are:

Name of Item	**Cost paid Rs.**	**VAT paid Rs.**
Equipment	500,000	65,000
Security	20,000	2,600
Building material	2,000,000	260,000
Stationary and telephone expense	100,000	13,000
Total		

Interest is exempt items under Schedule 1 and salary is part of value add, so no VAT is required to be paid. In this case, output of A Ltd. is VAT attractive output, all VAT paid on purchase is allowed to input tax. There is not a question that whether actual sales effected this month or not or the installation might be ongoing too. Assuming the following sales of A Ltd.; the input tax (offset allowed) shall be as follows:

Sales Rs. If	VAT collected (output tax)	Input tax Credit	VAT payable (Carry forward)
500,000	65,000	340,600	(275,600)
20,00,000	260,000	340,600	(80,600)
30,00,000	390,000	340,600	49,400

- **Types of Tax Credit**

  There are four different types of Tax Credit.

  - Full Tax Credit
  - Proportionate Tax Credit
  - Partial Tax Credit
  - No Tax Credit

- **Full Tax credit**

  The following are the principles regarding the claim of full tax credit:

  - VAT paid on purchase is allowed as full set off to registered person if output is VAT attractive only. In above example output is assumed as VAT attractive, so VAT paid is fully allowed as credit.
  - In case a person deals in both VAT attractive items and exempted items, the VAT paid on purchase directly related to the VAT attractive items is allowed for full VAT credit.

  Time Period to Claim VAT

  VAT credit to be claimed within 12 months of purchase and not required to claim at the first month.

- **Proportionate Tax Credit**

  In case a person deals both in VAT attractive items and Exempted Items, the following principle shall be applicable:

  - VAT paid on purchase that is specifically identifiable to VAT attractive items is allowed at full while claiming Input VAT Credit.
  - VAT paid on purchase that is specifically identifiable to Exempted Goods is not eligible for any Tax Credit.
  - VAT paid on such goods or services that are not directly identifiable to either of the Exempted Items or Tax attracting Items shall be eligible for Proportionate Tax Credit in the proportion of Taxable Sales & Exempted Sales of the period. The VAT attributable in the proportion of Taxable Sales to Total Sales during the period shall be eligible for Input Tax Credit, whereas that attributable to Exempted Sales is not allowed for set off.

The taxpayer shall assess the balance of the proportion of Sales into Exempted & taxable at the end of each period so long as the goods or services on which proportionate tax credit is claimed is in use, and the claim of Proportionate Tax Credit shall be adjusted accordingly so as to reflect the actual pattern of use of such goods/services.

Summary of Proportionate Tax Credit

Raw materials for VAT attractive output	Full Credit	Rule 40(3)
Raw materials for VAT exempted output	No credit	Rule 40(3)
Common Cost (raw materials or overheads)	Proportionate of sales	Rule 40(4)

- **Partial Tax Credit (Rule 41 (2))**

  40% of VAT paid on purchase of automobiles shall be allowed as Tax Credit. VAT paid on the vehicles that use of which is restricted for the transportation of VAT attractive goods can be set off at full. Similarly, if the vehicle is used for official purpose by the person dealing in both Exempted and tax attractive transactions, the Input VAT Credit shall be in proportion of Sales of exempted and tax attractive items and the maximum of such claim shall be 40% of VAT paid.

  Automobiles mean the passenger carrying vehicle having three or more wheel and plying on the road.

- **No** VAT Credit

  There are some cases where VAT paid on purchase is not allowed- no credit, even if output of registered person is VAT attractive.

  The following are the list of such items, VAT paid on which are not allowable for Input Tax Credit:

  - In case output (Intended or actual sales) is exempted from VAT as per Schedule 1, VAT paid on purchase is not allowed for credit as per Sec. 5(3).
  - VAT paid on Entertainment expense is not allowed for credit (Rule 41).
  - VAT paid for consumption of beverages (soft drink, water, juice or similar).
  - VAT paid for consumption of liquor items (beer, wine, whiskey, or similar).
  - VAT paid for consumption of Petroleum Product (Petrol, Diesel and LP Gas).

  Full Tax Credit in case of main business of the person

  In case of the main business of the person is sales of beverages, liquor items or petroleum products, the person is eligible for Full VAT Credit.

  Students should note the use of any good to determine the type of VAT Credit. The use of the good is the determining factor. For example, the restaurant selling alcohol issuing tax invoice is eligible for VAT credit on purchase of such alcohol, but if the alcohol is used by the same restaurant for the guest entertainment but not as sales, the VAT paid on such alcohol falls under the category of No VAT Credit.

- **Input tax Credit on VAT paid on the lost Goods (Rule 39Ka)**

  In case the loss of asset by fire, theft, accident, accidental damages, terror, or riot compels a person to write off the goods (assets) or sale it at lower selling rate, the person shall make an application in writing to respective IRO along with evidence within 30 days of happening of such conditions.

  The tax office shall investigate the matter and finalize the quantum of tax credits to be allowed. On the basis of such investigation, the tax office may allow the taxpayer to claim Input Tax Credit of VAT paid on such assets (goods).

  In case the asset is insured, the tax office may allow the taxpayer to claim Input Tax Credit on such goods to the extent of compensation paid by the Insurance Company.

- **Input tax- Stock at the time of registration**

  Input tax credit is availed to registered person only. But, as per Rule 43 (1), a person shall apply to a Tax Officer in form of Schedule 16 of VAT Regulation, 2053 for the Input Tax Credit on any stock or capital items lying at stock at the time of registration, the claim of which can be substantiated through valid VAT creditable documents. The stock in this form is deemed to be purchased after registration. You should note one point that the purchases before 12 months cannot be taken as input for VAT computation.

- **Input tax Credit- Documents to be Maintained**

  Input tax credit is availed upon the following documentations:

  - **Input tax credit on local purchase:**
    - Tax Invoice of purchase (no abbreviated tax invoice except issued by ECR for high-speed diesel).
    - In case of purchase from governmental agency or international agency or wood-sellers, VAT paid is eligible without tax invoice as per Sec. 17(5), see .
    - PAN and name of the buyer is required to be mentioned in Tax Invoices.
    - Purchased item should be used or the purchaser has the intension to use it in the business.
  - **Input tax credit on import:**
    - Import related documents (pragyapan patra, commercial invoice, VAT paid slip, etc.).
    - In case of goods were released on dharauti, evidence supporting that dharauti has been deposited into revenue.
    - Purchased item should be used or the purchaser has the intension to use it in the business.

- Input tax credit on reverse charging
  - Imported service invoice
  - Purchased item should be used or the purchaser has the intension to use it in the business.

- **Payment of Tax**

  The excess of tax collected during a tax period (output tax) over tax paid on purchases (input tax) during the same tax period shall be paid to revenue authority within 25 days of the end of the tax period in form of cash or bank transfer. In case of delay, additional duty due to non-payment at 10% p.a. and an interest of 15% p.a. on due amount is levied.

  There are some persons who collect VAT without registering in VAT (GON, Local Authorities, Province Government, International Organizations & Missions, wood sellers). The Act is not clear on the date and method of payment of VAT so collected; whether to deposit VAT at once of collection or within 25th days of next month. As per the principle followed for other registered person, it would be the date within 25th day of end of month of collection of VAT.

  Government body or organization wholly or partly owned by Nepal Government at the time of making payment against tender agreement or contract for supply of goods or service or goods and services to respective contractor or supplier, should deposit 50% of tax payable amount, in the name of contractor or supplier at respective revenue code and pay only balance amount of tax to them. Revenue such deposited shall be informed to related contractor or supplier and amount deposited can be setoff with tax payable by related contractor or supplier.

Illustrative Problem

- **Full Credit-** Dhablakoti Ltd. is producing bottled beer. During the month, it purchased construction materials of Rs. 300,000, bottle crown of Rs. 600,000, malt of Rs. 1 million and stationary of Rs. 100,000. Construction materials were used for construction of office building. Out of bottle crown and stationary, 80% is at stock. The sale during the month is Rs. 3 million from old stock. Calculate the amount of input tax credit.

  Here, output is VAT attractive. None of the purchase are qualified for partial or no VAT, hence all the purchase are qualifying for input-tax credit.

	Taxable Value	Input tax	Output tax
Sales	3000,000		390,000
Construction Materials	300,000	39,000	
Bottle Crown	600,000	78,000	
Malt	1,000,000	130,000	
Stationary	100,000	13,000	
Total		260,000	390,000

- **Full Credit,** Sales not started- Sallakoti Ltd. is producing can beer. During the month, it purchased construction bricks of Rs. 300,000, marble of Rs. 600,000, iron rod of Rs. 1 million and stationary of Rs. 100,000. Construction materials were used for construction of factory building. Its production shall be started only upon the completion of construction of factory buildings. How much input tax credit availed?

  Here, output is VAT attractive. None of the purchase are qualified for partial or no VAT, hence all the purchase are qualifying for input-tax credit (assuming VAT registered).

	Taxable Value	**Input tax**
Construction bricks	300,000	39,000
Marble	600,000	78,000
Iron rod	1,000,000	130,000
Stationary	100,000	13,000
Total		260,000

- **Credit without Tax Invoice –** Is there any chance where input tax credit is availed without Tax Invoice?

  Tax invoice is major and default supporting to claim input tax credit. Apart from tax invoice, there are some cases where input tax is allowed without tax credit supporting:

  - Bills from Electronic Cash Register.
  - VAT paid voucher against wood from forest.
  - VAT paid voucher against reverse charging.
  - VAT paid voucher against import.
  - VAT collected by GON, Local Authorities or INGOs u/s 15(3).

- **Export and Credit-** Dharmakoti has net income of Rs. 500,000.00 from export of merchandise. Office overhead cost excluding VAT was Rs. 200,000 and gross profit was 20% on sales. 50% of cost of goods sold attracts VAT. Describe VAT consequences.

  Here, Gross profit is Rs. 700,000 so sales is Rs. 3,500,000 and cost of goods sold is Rs. 2,800,000. So, VAT paid purchase is Rs.1,600,000 (1400,000+200,000) and hence VAT paid is Rs. 208,000. Assuming export was VAT attractive items, input tax credit availed is Rs. 208,000 and can claim for refund under Sec. 24.

- **Export and Proportionate Credit-** Bastakoti Ltd. has following transaction during the month. Find VAT credit allowable for the month:

Opening Credit	10,000
Purchase net of VAT	1000,000
Salary for the month	100,000
Purchase of a car with VAT	1130,000

Purchase of Office Supplies	100,000+VAT
Sales- Local	1000,000
Sales- Export	1000,000

Out of sales, one half is VAT attractive.

Here, output is mixed- VAT exempted and VAT attractive both. Sales ratio is 50% and input cannot be related with output. In such situation, input tax credit is allowed in the proportion of sales, i.e. 50%.

	Taxable value	VAT paid	Input tax credit (50% of eligible)
Opening Credit			10,000
Purchase net of VAT	1000,000	130,000	65,000
Salary for the month	0	0	0
Purchase of a car with VAT (40%)	1,000,000	130,000	26,000
Purchase of Office Supplies	100,000	13,000	6,500
Sale- Local	500,000		65,000
Sale- Export	500,000		-
			65,000
VAT payable (refundable)			(42,500)

Since export is more than 40%, credit of Rs. 42,500 can be claimed immediately, as refund.

- **Proportionate Credit, direct relation-** Jalakoti P. Ltd. sales vegetables. During the month following sale and purchase (VAT to be adjusted) made. Determine VAT impact.

	Purchase	Sales
Garlic	20,000	10,000
Potato	20,000	30,000
Green Tea	20,000	30,000
Black Tea	20,000	10,000
Purchase of Office Supplies	20,000	10,000

Here, output is mixed- VAT exempted and VAT attractive both.

	Purchase	Sales	Remarks
Garlic	20,000	10,000	VAT attractive
Black Tea	20,000	10,000	VAT attractive
	40,000	20,000	VAT attractive
Potato	20,000	30,000	VAT Exempted
Green Tea	20,000	30,000	VAT Exempted
	40,000	60,000	
Purchase of Office Supplies	20,000		Mixed

Purchase of Garlic (HS code 0703.20.00) and black tea is VAT attractive, so purchase (Rs. 40,000 VAT Rs. 5,200) is allowed for input tax credit. Out of Office supplies, 25% is eligible for input tax credit, i.e. Rs. 650 (Rs. 20000*25%*13%).

- **Reverse Charging Credit-** Gairikoti P. Ltd. a VAT registered firm received some service from India. The bill was Rs. 100,000. Company paid Rs. 13,000 as reverse charge. During the month company has sales of Rs. 1 million. Find VAT impact.

Hint: Here VAT paid is Rs. 13,000 and collection is Rs. 130,000. VAT paid without bill is allowed as credit in the case of reverse charging.

- **Credit on dharauti-** Bhinakoti Co-operative working in Nala Kavre has imported Rs. 100,000 costing material from India on Chaitra. Custom Office confused on import code and custom rates. Preliminarily, it set 30% custom and accordingly, the goods were cleared. The confusion were sent to Custom Department, which latter on Jeth it fixed the rate of custom at 5%. On clearing goods, Bhinakoti Kept Rs. 30000 as Custom and 16,900 as VAT in dharauti. All the goods were sold during Chaitra. What shall be the VAT accounting?

  Here VAT paid is Rs. 16,900 is not on the account of VAT fixed, it was dharauti. According to Sec. 12(8), input tax credit is allowed as and when the collector settled it as consideration. Dharauti cannot be claimed as input tax in chaitra or in Baisakh. Input tax credit of Rs. 13,650 is allowed in Jeth only.

- **Assessment on market value-** Burlakoti Ltd. is a trading company sales Tibet imported garlic. During the month it sold Rs. 200,000 garlic to its dealer Durakoti in Dhulikhel at Rs. 100 per kilogram. In the mean time, dealer and director of the company became close relatives due to marriage between two families. Next month, consideration were reduced to Rs. 50 per kilogram.

  Partial consideration to be valued at market rate (Sec. 12(7).

  Remaining Stock at deregistration- Durakoti P. Ltd has following fixed assets and trading stock. The company is going to liquidate. Find VAT impact on liquidation:

	Carrying Amount Rs.	Market Value Rs.	Remarks
Property Plant and Equipments	20,000	unknown	Accumulated depreciation Rs. 100,000
Trading Stock	20,000	10,000	
Receivables			Rs. 5000 VAT credit
Liability	-20,000	-20000	

Hint: All assets deemed to be sold at market value ~Sec. 11(3).

- Credit of asset shifting to exempted business- Durakoti P. Ltd, in has shifted to exempted business, find VAT impact on liquidation.

  All assets deemed to be sold at market value ~Sec. 17(4).

- **Output tax in case of partial consideration-** Barakoti Ltd. is a trading company sales Tibet imported electric goods. Normal price is Rs.1000 per unit. One unit is sold at Rs.600 being a friend. Find VAT.

  Partial consideration to be valued at market rate (Sec. 12(7).

- **Credit in case of partial consideration-** Sidhakoti Impex purchased the goods sold by Barakoti Ltd. at Rs. 600 per unit. Normal selling price is Rs. 1000. Tax invoice was issued at Rs. 600 and it is informed that Barakoti Ltd. paid VAT at market value of Rs. 1000. How much VAT is allowed as credit?

  Partial consideration to be valued at market rate (Sec. 12(7) in case of seller, but buyer can claim input tax credit based on tax invoice i.e. paid value only.

- **Credit in barter-** Kalikoti Ghee Ltd. exports 100 quintal vanaspati ghee to Tibet under barter of 10,000 set of sandles. Market price of sandle is valued at Rs. 100 for the purpose of custom. What shall be the VAT impact?

  Here, sale value of sales is Rs. 1000,000 (market value of incoming goods as per NAS 07). VAT charging on sales is zero because of export. In case the barter is within Nepal, these value were taken as taxable value of sales.

- **Credit in barter-** Kalikoti Ghee Ltd. exports 100 quintal vanaspati ghee to Tibet under barter of 1,000 lambs. Market price of a lamb is valued at Rs. 2,000. What shall be the VAT impact?

  Here, lambs are vat exempted; but VAT on export of ghee is zero rated.

- **Credit by used goods dealer-** Mehakoti Ltd. is dealing with used goods. During the month following transaction were done. Find VAT impact.

	Purchase (including VAT)	Sales (before VAT)	Remarks
Chairs		22,000	Last month purchase Rs. 12,000
Tables	20,000	22,000	
Rack	40,000	30,000	
Black Table	10,000	8,000	
Red Table	10,000		Still in Stock

Here, VAT is chargeable in the sales value excluding VAT and purchase value with VAT and in case, there is loss tax invoice need not be issued.

Taxable Value=Sales-Purchase price including VAT on individual basis.

In the above example, Rack and black table are sold at lower then VAT included cost, in both case tax invoice need not be issued nor VAT can be offset as per Rule 19. There shall be no VAT credit or refund in case of used goods dealer. In the profit making cases:

	Purchase (including VAT)	Sales (before VAT)	Taxable Value (Sales- Purchase)	VAT (Payable)
Chairs	12,000	22,000	10,000	1,300
Tables	20,000	22,000	2,000	260

- **Used goods dealing as normal-** Mehakoti Ltd. in, if treat the transaction as normal trading, what shall be the VAT impact?

  Here, all VAT paid purchases (including overheads and other cost as usual) are eligible of input and sales during the tax period is output as:

	Taxable Value	Tax	Notes
Output	44,000.00	5,720	44,000*0.13
Input	(70,796.00)	(9,204)	80,000/1.1.3
Value Add (Credit)			

- **Delay payment by registered person-** Sapkota Impex filed VAT return for Mangsir with VAT payable Rs. 110,000. Payable amount could not be paid till Falgun. In Magh Rs. 10,000 is credit. Find fine and interest impact.

  Here 15% p.a interest under Sec. 26 and 10% p.a. additional duty under Sec. 19(2) is levied for three months (Mansir 25 to Falgun 25).

- **Delay payment by un-registered person-** Jaukota Impex sold some trees grown in the factory side and collected VAT as per Sec. 12A. VAT collected was Rs. 100,000 in Mangsir. Payable amount could not be paid till Falgun. Find fine and interest impact.

Here 15% p.a interest under Sec. 26 and 10% p.a. additional duty under Sec. 19(2) is levied, even the person is un-registered and liable for VAT. Interest and additional duty is for two months (Push 25 to falgun 25).

- **Delay payment due to assessment by Tax Officer -** Hastikota Impex paid self assessed tax on 2063 Magh. Around 4 years of filing of return, Tax Officer assessed Rs. 20,000. Find fine and interest impact.

  Here, there was payable in the month concerned, any additional tax on the month of payment is subject of 15% p.a interest under Sec. 26 and 10% p.a. additional duty under Sec. 19(2). Debit or credit position thereafter shall not be considered.

- **Delay payment due to finding an error-** Baskota Enterprise filed VAT return on due date. After 20 months from date of filing return, one bill found not totaled having Rs. 20,000 sales. What shall be VAT impact?

  This sales Rs. 20,000 is to be declared in 20th month and interest need to pay for the period.

- **Proportionate Credit-** Mixed Ltd. dealing with sale of dairy products. Following are purchase during the month, find the amount of value added tax to be paid by Mixed Ltd:

Opening Credit	10,000
Purchase of capital items net of VAT	1000,000
Wage paid to capital equipment operation	100,000
Salary for the month	100,000
Purchase of a car with VAT	1130,000
Purchase of Office Supplies	100,000+VAT
Sale-fresh milk and curd	1000,000
Sale- Ghee and Paneer	1000,000
Sale- Pasturised Milk in Plastic packet	1000,000

  During the month, plastic granules imported on 3 months earlier at Rs. 100,000 has fired and damaged. VAT credit was taken at 30% on last month. Milk Purchase ledger for the month was destroyed on the same fire.

- **Proportionate Credit, Common-** Calculate VAT credit available in the following cases:

Purchase under VAT	Rs. 300,000
Wage paid	Rs. 100,000
Telephone cost	Rs. 20,000
Other overhead attracting VAT	Rs. 50,000

  Sales books Rs. 400,000 copy Rs. 100,000

- **Loss of assets, first point credit-** Garlic was lost by fire in the month of purchase in . What shall be the VAT impact?
- **Loss of assets, credit already taken-** After laying in stock for 4 month after purchase in , stock of black tea found loss due to expiry. What shall be the VAT impact?
- **Credit on purchase before registration-** Siwakoti JV is small contractor purchased cement bags amounting Rs. 1130,000 including VAT on Chaitra. After these purchases, JV get it registered with VAT and make a construction bill of Rs. 500,000 within Chaitra. What shall be the VAT impact?
- **VAT on bad debt-** If the business writes off a Bad Debt, can VAT previously reported on a Tax Invoice/ VAT return and paid to the authorities be recovered?
- **Taxable value-** When an engineer employed by an entity in another country is seconded to an entity in Nepal, and the charge is actual cost of Rs. 100,000 plus a 5% fee of Rs. 5,000, what is the value for VAT? Is it Rs. 5000, 100000 or 105,000?

Refund of VAT

- As discussed earlier, registered person shall pay such amount of VAT collected on Sales that exceeds input tax credit available to it.

  VAT Payable = Output tax - Input tax credit

- When the difference is positive, the amount shall be paid and if the difference is negative, it shall be credit for the next tax period. According to Sec. 24(1), this credit can be set off with output tax of next tax period. By this way, there shall be continuous credits for a person too.

  VAT Credit (carried forward) = Opening Credit + Input tax - Output tax

- Registered person can claim a refund of VAT on these credits with defined conditions.

  Students shall be aware about the refund mechanism developed under prevailing VAT Act. The following are the refunds availed to different persons, and no others:

  - Refund to a Registered Person, the significant sales is local sales
  - Refund to a Registered Person having Export Sales over a threshold
  - Refund to Unregistered Persons (four different specifications in the Act)
  - Refund to a Tourist
  - Refund of Deposit kept for import of returned exported materials that will be re-exported after some modifications

- **Refund to a registered person (Sec. 24)**

  There are two cases of such refund to a registered person:

  - **To a Exporter**

    Conditions for Refund

    The excess of VAT paid on purchases over the VAT collected on sales shall be allowed to be claimed for refund during the month of such excess, if the person makes export sales of more than 40% of Total Sales during the period.

Students should be clear that the carry forward of any excess of input VAT over output VAT for continuous six months before the application of refund is waived in this circumstance and the taxpayer is allowed to claim refund of excess VAT paid in the month of such export sales.

Procedure for Refund

The tax officer shall determine whether to make refund or not. The refund in this case shall be made within 30 days of such application. In case the tax officer does not refund the VAT within 30 days, the revenue authority shall pay additional amount as interest at 15% p.a.

Effect of Application

The person making refund application cannot set off the amount of such claim as Input VAT Credit after such application in any of the subsequent months.

- **To a Normal Person**

  Facility of Set off

  In case the Input VAT on purchase is more than Output VAT on sales during any month, the excess shall be carried forward for set off from Output VAT on Sales of subsequent month.

  Claim of Refund

  The taxpayer may file a refund application, if the excess of such VAT cannot be set off within subsequent six months from the month of such excess.

  Procedure for Refund

  The tax officer shall determine whether to make refund or not. The refund in this case shall be made within 60 days of such application. In case the tax officer does not refund the VAT within 60 days, the revenue authority shall pay additional amount as interest at 15% p.a.

  Effect of Application

  The person making refund application cannot set off the amount of such claim as Input VAT Credit after such application in any of the subsequent months.

- **Refund to persons other than registered (Sec. 25 & Sec. 25Ka)**

  Persons/Events entitled to refund

  - Diplomats

    Tax paid by diplomatic persons privileged on a reciprocal basis from Ministry of Foreign Affairs, or person having diplomatic privileges engaged in Regional or International Organization or missions shall be eligible for refund.

Conditions for refund

The tax shall not be refunded for a purchase of less than Rs. 10,000 at a time; means the diplomats shall make purchase of Rs. 10000 or more for the expenditure to be eligible for VAT refund. The person paying the VAT shall make the claim of refund

Time period to apply for VAT refund

The refund application shall be filed within three years of such transactions.

- International institution

  Institutions or VAT paid by such institution for which Ministry of Finance has granted the privileges of tax exemption.

  Time period to apply for VAT refund

  The refund application shall be filed within three years of such transactions.

- **Projects under bilateral or multilateral agreement**

  Tax paid on projects operated undertaken within the state of Nepal under bilateral and multilateral agreement for which Ministry of Finance has granted permission to exempt it from VAT.

  Time period to apply for VAT refund

  The refund application shall be filed within three years of such transactions.

- **Collection by mistake**

  Any tax collected by mistake shall be refunded.

  Time period to apply for VAT refund

  The refund application shall be filed within three years of such transactions.

- **Tax refund to a foreign tourist**

  Conditions to be satisfied

  All the following conditions shall be satisfied for the claim of refund:

  - The foreign tourist visiting in Nepal shall leave Nepal from air transport,
  - The tourist shall accompany such goods with himself while leaving Nepal, i.e. goods cannot be gifted in Nepal and it shall be taken away by the tourist; and
  - The cost of goods shall be more than Rs. 25,000.

  Service Fee on such Refund

  The revenue authority shall deduct **3% of refundable amount** as service charge.

Limitations for Refund

Refund has some limitations as:

- **Small purchase by diplomats-** Diplomats purchasing any item less than Rs. 10000 at a time cannot claim refund of VAT.
- **Any consumer at the time of purchasing goods or services makes payment through electronic medium as per prevailing laws then 10% of tax payment shall be refunded as cash incentive at bank account of consumer as per the procedure specified by department.**
- **Small purchase by tourist-** Tourist purchasing and taking any item worth Rs. 25,000 or less cannot claim such refund.
- **Duty Meal-** VAT paid for inputs of duty meal for staff cannot be claimed as credit or refund for any registered person vide circular dated 2056.12.3.
    - **Relevant Person-** In case of any refund is granted to any person or institution, only obliged person can claim for refund as per Sec. 25(2) and circular dated 2056.12.3.
- **Dealer of Used goods** - VAT paid by on purchase by dealer used goods cannot be claimed for refund.
- **Refund of VAT paid on purchase of taxable goods or services within Nepal by United Nations Organization [Sec. 25(1)(Ka2)]**

  Refund of VAT paid on purchase of taxable goods or services within Nepal by United Nations Organization, it's member organization and specialized (bisistrikit) agencies while carrying out the activities as per their objectives if application for refund is received within 3 years of such procurement.

- **Refund of excess amount under contract or agreement. [Sec. 25(Ga1)]**

    - VAT withheld and deposited on behalf of the contractors or suppliers by government entity (fully or partially owned), public institution, or association for the purchase of goods and services under contract or agreement shall be adjusted against the VAT payable of the contractor.

    - The amount of VAT so deposited as mentioned in Subsection 1, if remains excess after offsetting for a continuous period of 4 months, contractor or supplier at his will shall submit an application to the tax officer for refund.

    - If application for VAT refund is received by the tax officer as per Sub section 2, the refund shall be made within 60 days from the date of application.

    - Unadjusted VAT amount as per Subsection 2 shall not be further adjusted with the VAT of next month once the application for the refund has been made.

- **Refund of Tax paid on purchase for Medicine Industry. [Sec. 25(Ga2)]**

    - VAT paid on purchase of raw materials, auxiliary raw materials and packing material of medicines from domestic industry for manufacturing by medicine industry shall be refunded four-monthly basis on making an application to IRD.

- If application for VAT refund is received by the tax officer as per sub section 1, the refund shall be made within 60 days from the date of application.

- **Provision regarding tax refund. [Rule 45]**

  While refunding the amount of tax for the purpose of Sub-sections (3) and (4) of Section 24, Section 25 , Section 25Ga1 or Section 25Ga2 of the Act, the Tax Officer shall immediately examine the evidences produced by the taxpayer for the refund of tax and refund the tax within sixty days in case of refund pursuant to Sub-section (3) of Section 24 or Section 25Ga1, and 30 days, in case of refund pursuant to Sub-section (4) of Section 24, Section 25 or Section 25Ga2, from the date of submission of refund claimed. (Rule 45(1))

  While making a claim for tax refund by an unregistered person for the purpose of Sub-section (1) of Section 25, they may file an application to the Department in the format set forth in Schedules -17 for refund pursuant to Clause (Ka) and (Ka1), in the format set forth in Schedule 17Ka for refund pursuant to Clause (Ka2), in the format set forth in Schedule-18 for refund pursuant to Clauses (Kha) and (Ga) and in the format set forth in Schedule 18Ka for refund pursuant to Section 25Ga2. (Rule 45(3))

Test Your Understanding

- **Carried forward credit-** Chamling Co-operative Ltd. working in Bhojpur has sales Rs. 500,000. During Chaitra month it purchased furniture Rs. 100,000; trading stock Rs. 400,000 (30% laid in stock under FIFO); and telephone bills Rs. 10,000. Stationary purchased and used in last month Rs. 10,000 were not claimed in VAT. All the items of sale of purchase were under Tax Invoice.

  Here, all the items are VAT attractive and output is VAT attractive. Cooperative can offset all the VAT paid purchase since there are not any no VAT items nor partial VAT items.

Particulars	Taxable Amount	Output Tax	Input Tax	Net Tax
Sales	500,000	65,000		
Purchases	520,000		67,600	
VAT Payable				
VAT Credit carried forward			2,600	

- **Carried forward credit-** Bantawa Ltd. working in Bhojpur has following sales and purchases without VAT. Can refund claim in Falgun return?

Month	Sales	Purchase
Bhadra	500,000	600,000
Aswin	520,000	500,000
Kartik	600,000	500,000
Mansir	450,000	500,000
Push	320,000	500,000
Magh	400,000	500,000
Falgun	350,000	500,000

Here, all the items are VAT attractive and output is VAT attractive. Company can offset all the VAT paid purchase since there are not any no VAT items nor partial VAT items.

Month	Sales	Purchase	Output Tax	Input Tax	Credit
Opening Credit					
Bhadra	500,000	600,000	65000	78000	-13000
Aswin	520,000	500,000	67600	65000	-10400
Kartik	600,000	500,000	78000	65000	2600
Mansir	450,000	500,000	58500	65000	-6500
Push	320,000	500,000	41600	65000	-29900
Magh	400,000	500,000	52000	65000	-42900
Falgun	350,000	500,000	45500	65000	-62400

Here, Rs. 2,600 need to pay in Kartik. None of credit reached for continuous four months and hence cannot claim any refund.

- **Carried forward credit-** Rai Ltd. working in Bhojpur has following sales and purchases without VAT. Can refund claim in Falgun return?

Month	Sales	Purchase
Bhadra	500,000	600,000
Aswin	520,000	500,000
Kartik	520,000	500,000
Mansir	450,000	500,000
Push	320,000	500,000
Magh	400,000	500,000
Falgun	350,000	500,000

Here, all the items are VAT attractive and output is VAT attractive. Company can offset all the VAT paid purchase since there are not any no VAT items nor partial VAT items.

Month	Sales	Purchase	Output Tax	Input Tax	Credit
Opening Credit					
Bhadra	500,000	600,000	65,000	78,000	-13,000
Aswin	520,000	500,000	67,600	65,000	-10,400
Kartik	520,000	500,000	67,600	65,000	-7,800
Mansir	450,000	500,000	58,500	65,000	-14,300
Push	320,000	500,000	41,600	65,000	-37,700
Magh	400,000	500,000	52,000	65,000	-50,700
Falgun	350,000	500,000	45,500	65,000	-70,200

For Falgun tax return, last continuous six month is Aswin. There is continuous credit of Rs. 7,800 for last four months. Company can claim a refund of Rs. 7,800 in Falgun.

- **Significant Export-** Rujhali Ltd. working in Terhathum has following expected sales and purchases without VAT. How much refund can it could expect?

Month	Sales	Purchase	Export	Capital Expense
Bhadra	500,000	600,000	45%	45%
Aswin	520,000	500,000	45%	45%
Kartik	600,000	500,000	45%	45%
Mansir	450,000	500,000	45%	45%
Push	320,000	500,000	45%	45%
Magh	400,000	500,000	45%	45%
Falgun	350,000	500,000	45%	45%

Here, all the items are VAT attractive and output is VAT attractive. Company can offset all the VAT paid purchase since there are not any no VAT items nor partial VAT items. VAT Credit or refund is not based on whether the purchase is for capital input or raw materials or overheads, so all the purchase is qualifying for credit or refund, as the case may be.

Month	Sales	Purchase	Export	zero rated sales	Local Sales	Output Tax	Input Tax	Credit
Bhadra	500,000	600,000	45%	225000	275,000	35,750	78,000	-42,250
Aswin	520,000	500,000	45%	234000	286,000	37,180	65,000	-27,820
Kartik	600,000	500,000	45%	270000	330,000	42,900	65,000	-22,100
Mansir	450,000	500,000	45%	202500	247,500	32,175	65,000	-32,825
Push	320,000	500,000	45%	144000	176,000	22,880	65,000	-42,120
Magh	400,000	500,000	45%	180000	220,000	28,600	65,000	-36,400
Falgun	350,000	500,000	45%	157500	192,500	25,025	65,000	-39,975

Since all the sales have significant export of 40% in all months, credit amount can be claimed every month.

- **Significant Export-** Naulakha Ltd. working in Terhathum has following sales and purchases without VAT. Company's policy of VAT refund is claim as and when eligible. How much refund it claimed in each month?

Month	Sales	Purchase	Export
Bhadra	500,000	600,000	45%
Aswin	520,000	500,000	25%
Kartik	600,000	500,000	45%
Mansir	450,000	500,000	35%

Push	320,000	500,000	45%
Magh	400,000	500,000	25%
Falgun	350,000	500,000	35%

Here, all the items are VAT attractive and output is VAT attractive. Company can offset all the VAT paid purchase since there are not any no VAT items nor partial VAT items. So all the purchase is qualifying for credit or refund, as the case may be.

Month	Sales	Purchase	Export	zero rated sales	Local Sales	Output tax	Input Tax	Credit	Refund
Bhadra	500,000	600,000	45%	225000	275,000	35,750	78,000	-42,250	42,250
Aswin	520,000	500,000	25%	130000	390,000	50,700	65,000	-14,300	
Kartik	600,000	500,000	45%	270000	330,000	42,900	65,000	-36,400	36,400
Mansir	450,000	500,000	35%	157500	292,500	38,025	65,000	-26,975	
Push	320,000	500,000	45%	144000	176,000	22,880	65,000	-69,095	69,095
Magh	400,000	500,000	25%	100000	300,000	39,000	65,000	-26,000	
Falgun	350,000	500,000	35%	122500	227,500	29,575	65,000	-61,425	

- **Refund of Reverse Charging VAT-** Thuling Ltd. working in Chatara has got some service from Kulung Inc. registered and working in the United States. Cost paid for service was Rs. 1 million. Company paid Rs. 130,000 in IRO as reverse charging payment. Apart from these services, company has not any purchase during the month. Sales amounting the month was Rs. 2 millions including 1.3 millions export. Find VAT implication.

  Here, all the items are VAT attractive and output is VAT attractive. Company can offset all the VAT paid purchase since there are not any no VAT items nor partial VAT items. So all the purchase is qualifying for credit or refund, as the case may be.

Sales	2,000,000
Local Sales	700,000
Export Sales	1,300,000
Output tax	91,000
Input Tax	130,000
Credit	39,000
Refund	39,000

CHAPTER- 4
ACCOUNTS AND RECORDS

- **Invoices**
  - Persons selling goods or services shall issue invoice. The invoice shall be issued either by registered person or by other with few exceptions.
  - Registered person shall issue invoices in prescribed formats, whereas unregistered person may form own format with minimum prescribed requirements. The VAT Regulation has prescribed the format of Invoice but not the color paper for those invoices (Some countries have also prescribed color paper).
  - Invoice should start from serial no 1 each year (circular dated 2055.3.32) and the serial number cannot be hand written (circular dated 2055.7.10). Different branch or departments within same roof can use their own serial at a time (circular dated 2054.7.29).
  - Issuing Invoices between divisions within the same legal entity is not required; but transportation of goods from one unit to another having different location within Nepal shall fulfill the conditions laid in Directives Regulating Internal Transport of Commercial Goods, 2065. Cross border transportation to own unit is an export and thus, requires issuing Invoice.
  - VAT Invoices shall be issued directly through the person's commercial invoicing systems. This means tax invoices can be used for accounting of transaction, financial statements, income tax and other revenue recognizing accounts.

- **Tax Invoice**
  - Registered person is required to issue Tax Invoice as prescribed in Schedule 5 of VAT

TAX INVOICE

Invoice No: Date of Transaction:
Seller's TPIN: Date of invoice:
Seller's Address:

Buyer's Name:
Buyer's Address:
Buyer's TPIN: Invoice No.

Mode of payment: Cash/cheque/credit/ other

SN	Particulars	Quantity	Price Per unit Rs.	Total Price Rs.
			Total	
			Discount -----%	
			Taxable Amount	
			Tax @ ---%	
			Total	

Particulars as to the kind of goods/services, size thereto, model or brand, if any, shall be indicated in the Tax Invoice. Tax invoices shall be in triplicate, the first copy goes to the buyer, and the second copy is kept in a file and shall be produced to Tax Officer as required. Invoice should be printed with 'tax invoice' on the face of it.

In case of general insurance business there is separate type of tax invoice under Schedule 5A of Regulation. There is a unique provision for issuing tax invoice that in case a used goods dealer selling any item.

- Input tax credit or refund, if any can be allowed on purchases made only through tax invoices.

- **Consumer Level Tax Invoice**

  - Inland Revenue Department can direct any person to publish the retail price of specified goods for specific period as per Sec. 14(6). In case issuance of such notice, the respective person must not sell or transfer such goods without publishing the retail price of those specified goods. In this case, according to Sec. 14(7), person while selling such goods to any unregistered person (even to distributor or wholesaler or retailers) shall have to issue the invoice at the consumer price and VAT shall be charged on the consumer price. Distributor or wholesalers' or retailers' commission or discounts shall be deducted after charging VAT. Such sales shall be invoiced under format given in Schedule 5B of VAT Regulation, 2053. The sketch function of this invoice shall be as:

SN	Particulars	Rate per unit (Consumer Price Rs.)	Total Rs.
		Total Rs.	
		VAT @ …%	
		Discount	
		Net Amount	

  - It is also provided that the person desiring to issue such invoice voluntarily while selling such goods to registered person may do so.

- **Abbreviated Tax Invoice**

  - In case a retailer request Tax Officer to issue Abbreviated Tax Invoice and if Tax Officer allows so, the retailer can issue such abbreviated tax according to Rule 18 in the form prescribed in Schedule 6.
  - Such Invoice may be issued for any sales that are not more than Rs. 10,000 including VAT and other duties. The relief for issuing such an invoice is that the name of each goods or rate or VAT amount is not required be shown and the invoice can be issued as 'miscellaneous goods' or similar.
  - There is a barrier to buyer buying goods or services through Abbreviated Tax Invoice.

That is; input tax credit cannot be claimed by the use of Abbreviated Tax Invoice. Even though the supplier is authorized to issue Abbreviated Tax Invoice, it must issue a full tax Invoice in case buyer requires a full tax invoice.

VAT collected on the sales through abbreviated tax invoice shall be computed as follows:

$$\text{Sales amount} = \frac{\text{Sales including VAT} * 100}{(100 + \text{Rate of VAT})}$$

$$\text{VAT Collected} = \frac{\text{Sales including VAT} * 100}{(100 + \text{Rate of VAT})}$$

- **Electronic Cash Register & Electronic Billing**
  - According to Rule 18A, Inland Revenue Department may direct any person to issue invoices using Electronic Cash Register Machine or through Electronic billing procedure. In both cases, separate permission for use of prescribed machine is required.
  - Section 14A provides a taxpayer shall issue an electronic invoice after prior approval of IRD. However, IRD may order any taxpayer to issue invoice through electronic means and order to link with Central Billing Monitoring System (CBMS) of IRD by publishing a notice. IRD shall prepare and implement electronic billing procedure and same shall be complied by Producers, distributors and users of such electronic means of issuing invoice. If not complied taxpayer shall be charged a penalty of Rs. 5 lakhs.

- **Debit Note & Credit Note**

For any change in matters of issued invoice due to any reason, the person shall issue debit note or credit note for such changes in value of the goods. Conceptually, person issuing invoice issues a credit note. Credit note is a crucial matter in tax accounting as many countries has policy of using pre-printed credit notes issued by government. Rule 20 has not prescribed format for debit or credit note, but person need to keep a register of such notes.

- Debit or credit note include following information:
  - Serial Number of the debit or credit note,
  - Date of issue,
  - Name, address and PAN of the supplier,
  - Recipient's name, address, and PAN if a registered person,
  - Serial number and date of the tax invoice concerned,
  - Particulars of the goods or services and reason of issuing to credit or debit,
  - Amount credited or debited,
  - Tax amount credited or debited.

- Credit or Debit Note shall be maintained in the issued note.
- **Issuance of Invoice by unregistered person**

Illustrative Problem

- **Sign in invoice-** Is there a requirement to sign the Tax Invoice before it is issued?
- **Forex invoice-** For an invoice raised in a currency other than the local VAT reporting currency,

  a. What exchange rate must be used to convert the invoice values into the local VAT reporting currency ?

  b. Is the exchange rate that must be used a daily or monthly rate?

  c. Are there any alternatives available in terms of what rate to be used?

  d. Must the foreign exchange conversion be shown on the Tax Invoice?

- **Taxable Value-** If a contract valued at Rs. 1000,000 is completed and the customer refuses to pay the full value because of commercial reasons or dispute and then contractor agrees to reduce the contract price, must contractor continue to invoice the full Rs. 1000,000 and then also a credit note for the agreed reduction, or is it sufficient to document the price change in a contract amendment and only to invoice up to the value of the amended contract value?
- **Accounts and Records**
- **Up-to Date Records of Transaction**
  - According to Sec. 16 and Rule 23, registered person shall keep its VAT and accounts up to date. In case of person has used computerized accounting system for VAT, the same shall be kept up-to-date. The attested Purchase Book and Sales Book shall be kept.
  - According to Sec. 16(3A), any unregistered person involved in business that attracts VAT with turnover of more than Rs. 1 million shall keep Purchase Book and Sales Book attesting itself.
  - Dealers dealing in used goods shall keep separate records for each purchase and sale of assets.
- **Penalty in case of Failure to keep up-to-date Records**

  In case registered person fails to keep its records up to date, there is a fine as:

  - On infringement of sub-section (1) or (2) of Section 10 and Section 5Kha or not registered as per Sub Section (1) of Section 10Ka or Sub Section (1) of Section 10Kha, Rs. 20,000 for each time. (Sec. 29(1)(ka))
  - In case attested books not maintained- Rs. 10,000 for registered person and Rs. 1000 for unregistered person~(Sec. 29(1)(chha) and ~(Sec. 29(1)(chha1).
  - Documents to be retained for the period of six years as per rule 23(7)- on failure there is a fine of Rs. 10,000 for a registered person~(Sec. 29(1)(ja).
  - VAT account record if not update - Rs. 10,000 for a registered person~(Sec. 29(1)(nga).

- VAT account record if not kept - Rs. 10,000 for a registered person~(Sec. 29(1)(chha).
- If invoice is issued by taxpayer without sale of goods/services- penalty 50% of invoice value shall be levied.
- If person required to register under VAT as per VAT Act, 2052 carries out business transaction without registering in VAT, such person shall be penalized with 50 % of VAT amount (Kar bigo) (Sec. 29(1Gha))

- **Types of Records**

  There are only three types of VAT account books. VAT shall be ascertained based on normal accounting documents. According to Rule 23 and Sec. 16, a taxpayer has to maintain the following records:

  - **VAT Account –** This is VAT ledger prescribed in Schedule 7 of Regulation. It is summery of purchase or import and sale or export including input VAT and Output VAT. Practically, this record is not in common use.
  - **Purchase book –** According to Form prescribed in Schedule 8 of Regulation, registered person and unregistered person (involved in business that attracts VAT and the turnover of which is Rs. 1 million or more) shall record all transaction of purchase and import in this book. This record is in mandatory use. In Purchase book, purchases on which input tax credits (even overheads and consumables) is claimed shall be recorded as purchase. Goods or services without VAT or with VAT, for which input tax credit is not allowed, are recorded as exempted purchase.
  - **Sales book**- According to Form prescribed in Schedule 9 of Regulation, registered person and unregistered person (involved in business that attracts VAT and the turnover of which is Rs. 1 million or more) shall record all transaction of sale and export in this book. This record is in mandatory use.
  - **Other Records:** Apart from above mentioned statutory VAT books, other documents (or computerized records if allowed by Tax Officer) to be kept by a person are as follows as per Rule 23:

    Records regarding transactions, cash, etc

    - Copies of Tax Invoices and Abbreviated Tax Invoices
    - Tax Invoices received on purchases
    - Documents regarding import and export
    - Records and copies of Debit or Credit Notes
    - Register of free or sample goods as per Rule 24.
  - **Free or Sample goods:** A registered person shall maintain separate records for any received or distributed free goods or samples (Rule 24). The Rule is silence in regards of records for free goods or sample received or distributed by an unregistered person.

- **Records of a used goods dealer:** According to Rule 33, Dealers of USED GOODS shall keep separate records for each deal of used goods. In case a registered person dealing used goods is found not to have satisfactorily maintained the records as prescribe, Tax Officer may impose VAT on the total selling price of the goods sold by such taxpayer, and the tax officer may issue a written order requiring him to pay such tax along with the next tax return.

- **Records in digital formats**

  A registered person may, with the approval of the Department, maintain the records required to be maintained using computers or another similar mechanical system or the method as prescribed by the Department.

- **Inspection of Records**

  Tax Officer may inspect the records maintained by a registered person at any time during working hours. Sec. 16 (1A) authorizes Tax Officer to have an access, as and when needed, to the computer database of the taxpayer. Data base and records shall be in normal access of Tax Officer and need to be preserved for six years.

  During the inspection, all the records shall be made available along with the details and documents relating to the records as demanded by Tax Officer. If Tax Officer seeks the copies thereto, person shall provide copy of such documents at its own cost.

  In due course of inspection, registered person shall provide necessary staff in order to assist as required by Tax Officer.

- **Certification of Records**

  There are required certification of VAT books and some records. Purchase book and Sales book need to be certified by Tax Officer. These certifications are to be done at:

  - tax-payer submits an application to the office for the certification;
  - during the period of tax audit, or
  - at the time of inspection.

  However, taxpayer who has obtained approval to issue invoice from electronic medium shall not be required to certify their sales book if the sales book is prepared automatically by the electronic medium of the taxpayer.

  Invoice to be raised from cash machine or electronic medium (Rule 18Ka)

  Department may notify requiring any taxpayer to use cash machine and such taxpayer so notified shall use cash machine to issue invoice for transaction.

  However, taxpayer who has obtained approval for raising invoice through electronic medium shall raise invoice accordingly.

EXCISE DUTY

CHAPTER 1

Introduction and Definitions

Introduction

Excise duty is one of the oldest sources of revenue for Nepal. The first code named 'Muluki Ain 1910' had codified for excise duty on some negative externalities, and the method of collection was auction basis. Rakam Bandobasta Adda, established on BS 1972 was the first separate authority for the excise. At the end of Rana regime, the duty collection was Rs. 714 thousand. The first modern Excise Duty Act was enacted in the year 2015. The Excise Duty Act, 2058 has replaced the old Act and came in force from Magh 17, 2058. After its enforcement there is no any formal amendment in the Act, but the finance ordinances and the Finance Act(s) has made fundamental amendments in key provisions of the Act. This Act has only one schedule as a part of the Act and that is stating the list of goods and services covering excise duty along with the rates of the duty on each item.

In the world history, excise is one of the major state sources since more than 2000 years. Modern days, excise is restricted to limited items (even Nepal uses extended excise system-more than 30 items in tax base). Internationally, excise is categorized as origin based or destination-based. Nepal has implemented destination based excise duty, so we levy excise on import of goods, at the rate equivalent to domestic goods.

Excise duty Act, 2015 is repealed on enforcement of this Act. Excise duty Rules, 2019 is also repealed due to enactment of these rules (2059).

Finance Act/Ordinance of each year changes the Section numbers and some fundamentals of Excise Duty Act, 2058. The provisions laid down by Finance Ordinance, 2075 is discussed in this book. Students are advised to update yearly for the amendments on relevant finance act.

Objectives of Excise Act

Excise Act, 2058 has been promulgated with the following objectives:

- To levy excise duty and collect the same on production of goods or services within the state of Nepal or import of such goods or services for the economic development of a nation through effective revenue collection and increased revenue mobilization.
- To amend the law and consolidate it.

Important Definitions

No Law can be understood without knowing the meaning assigned to certain specific terms by the relevant Act and Rules. Thus, Excise Act has defined some terms and the definition of the term for the understanding of students is reproduced below:

- **Goods and Services attracting Excise duty {Sec. 2(ka)}**

  It means the goods or services on which excise duty is applicable as per Excise Act or other prevailing law. The goods or services enlisted in the schedule forming part of the Act are excisable goods or services. The Finance Act/Ordinance of every year includes a Schedule that provides the list of goods/services attracting Excise duty and its rate.

- **Enterprises {Sec. 2 (gha)}:**

  It means any firm, company or organization that has been established under the prevailing law for the purpose of production, import, storage, or sales and distribution of excisable goods or for providing excisable services.

  For the purpose of this Act enterprise includes any form of business or non-business, government or private organizations, incorporated in Nepal or in other country dealing in or storing excisable goods or providing excisable services in Nepal.

- **Producer {Sec. 2(ja)}:**

  It means individual, firm, company, or organization that have obtained the license to produce excisable goods or providing excisable services.

- **Tobacco Based Products {Sec. 2(ja1)**

  It means tobacco or mixed tobacco products used in smoking, chewing, paan masala, gutkha, khaini or similar products and also includes cigarette, bidi, cigar.

- **Person {Section 2 (jha)}:**

  It means individual, academy, organization, association, partnership firm, cooperative society, joint venture, managers of religious trust (guthi) or fund, proprietor or the main representative or agent, institutions or branch or sub-branch of the above that undertake the following, with or without profit motive:

  - the production;
  - import of goods attracting excise duty;
  - sell or distribute them in wholesale or retail; and
  - provides services excise duty.

- **Factory/Ex-factory Price {Sec. 2 (na)}:**

  It means total of the production overheads and profit of the enterprise without adding the excise duty or other taxes.

- **Price {Sec. 2 (ta)}: Price means:**

  - The ex-factory price in the context of production of goods;
  - The price as per the invoice in the context of providing service; and
  - The price determined as per section 7(2) in context of imported goods.

Price determination in case of Import of Goods

In case of import of goods, the price for excise purpose shall be the price determined after addition ***Customs duty on the cost determined for the purpose of Customs Duty.***

Students are advised to have an understanding of Section 13 to 16 of Customs Act, 2064 to have better knowledge of price determination for excise purpose in case of import of goods.

- **Liquor {Sec. 2 (nga1)}**

  Liquor means an alcoholic substance made by organic chemical reaction in decayed fruits or starchy materials, or otherwise, having more than 0.5% alcohol contents. Liquor includes Rakshi, jand, chhyang (country liquor or beer), whisky, rum, gin, brandy, vodka, beer, wine, sherry, cider, Perry, mead, malt, industrial alcohol, rectified spirit, malt spirit, ENA (Extra Neutral Alcohol), and heads spirit.

- **Readymade liquor {Sec. 2 (nga2)}**

  Readymade liquor means all kind of alcoholic drinks having contents of less than 57.06% alcohol.

- **LP {Sec. 2 (nga3)}**

  LP (London Proof) means the strength of clean ethanol in London proof.

- **LP Liter {Sec. 2 (nga4)}**

  LP liter means 57.06% strength of clean ethanol in one liter. Strength of alcohol is computed under British system. When there is 57.06% of alcohol in one liter it is called one LP liter.

- **UP {Sec. 2 (nga5)}**

  UP (Under Proof) means the liquor containing less strength than London proof. To convert the UP strength to LP following formula is used:

  1 UP Liter =1-UP/100 LPL

  =1-40UP/100 LPL

  =0.6 LPL

- **OP {Sec. 2 (nga6)}**

  OP (Over Proof) means the liquor containing more strength than London proof. To convert the OP strength to LP following formula is used:

  1 OP Liter =1+OP/100 LPL

  =1+25OP/100 LPL

  =1.25 LPL

- **Physical Control System {Sec. 2 (nga7)}**

  Physical Control System is system design so that production, import, issue or export of excisable goods shall be controlled by Excise Officer or the person designated by the officer.

- **Self Removal (Issuance) System {Sec. 2 (nga8)}**

  Self-issuance System is system design so that production, import, issue or export of excisable goods shall be controlled by other methods than physical control system.

- **Excise Stamp {Sec. 2(Ka 1)}**

  "Excise stamp" means the ticket indicating securities mark in the format prescribed by the Department to be used in the excisable goods and this term also includes securities mark provided through electronic medium or any other mark as prescribed by the Department.

CHAPTER 2

Provisions Concerning Imposition and Collection Excise Duty and Concerning License

Imposition and Collection of Excise Duty

Principally, excise duty is levied in the conversion of natural items to commercial items (tax on conversion). Under this concept, excise duties were levied within intermediate production (for example transferring from one process to another process too); this level of excise is now rare in the world. In case of transfer of the items to another, sales tax (now value added tax) is levied (tax on sales). Now-a-days, excise is levied at the factory gate ***under physical control mechanism or self-issuance (self removal) mechanism.*** In case of import of goods or services, excise is levied as same as domestic production (which was called ***countervailing*** duty earlier). Charging the excise on import makes market of imported goods as *equivalent nature* of input.

Excise is levied by applying specific rate or ad valorem. Almost all excise duties on goods attracting excise duty is levied by applying specific rate (means defined amount of duty on defined quantity, e.g. Rs. 5 per liter). Ad valorem tax is levied in some of the items (means certain percentage of tax base, e.g. 50% of transaction value plus customs duty).

Unlike VAT, excise is levied with different rates/amounts for different items. In case there is not realistic costing mechanism or complexities in the valuation, specific rate is preferred, which is controlled through physical stock (relatively ease to count on traditional manner). But, specific rate distorts the tax-impact on inflation or bears some political pressure to up-date rates.

Alternatively, excise is classified as ***manufacturer's excise*** and ***retailer's excise.*** If excise is levied to the manufactures/importer (at consumer price) it is the former class of excise and if piecemeal excise levied in each level of marketing or excise levied at retailer only, it is the latter class.

As per law, Excise duty shall be levied on the goods or services as mentioned in the schedule at the rate mentioned against the goods or services in the same schedule. The schedule forming part of the Act states the name of the goods and services on which excise duty shall be charged, the harmonized code of the goods, unit of the goods and the rate of the excise duty.

Duties, either specific or ad valorem are yearly applied based on Yearly Finance Act/Ordinances. These rates are not reproduced here. Please update the rates from particular Finance Act of relevant year.

Price Determination for Excise Duty

- **For Domestic Production of Goods & Services**
  - ***In case of Manufacturer:*** The price for excise purpose is *Ex-factory price.*
  - ***Ex factory price means the price Applied to a price, this means the price at the factory, and does not include any other charges, such as delivery or subsequent taxes. It is also called ex mill. Source: http://www.businessdictionary.com/***

- In case of Service: The price shall be the price while selling service. It shall be determined as per the invoiced issued by the service provider.

- **For Import of Goods: It is dealt in Definition section of this book.**

Summary **Applicability**	**How to determine**
On production of goods	1. The factory price determined by the producer for excisable goods for sales from the factory; or 2. The price determined by IRD on the basis of production cost of the goods.
On import of excisable goods	Price determined for the purpose of custom duty plus the amount of custom duty charged on the goods. Value for custom duty xxx + custom duty xxx Value for excise duty xxx
On service provided	The invoice price of the service.
Reference Price	Excise Officer may fix the price for the purpose of excise.

- **Authority of IRD to determine price {Section 7(4):**

  For the purpose of recovery of excise duty, IRD is authorized to carry out a reassessment of the excisable price of goods or an additional assessment if deemed necessary.

- **Determination of Excise Duty & its Collection:**

  Responsibility to collect Excise duty

  - The responsibility to determine and collect excise duty shall be in the manufacturer producing goods and services attracting excise duty.
  - In case of import of goods, the responsibility is vested to the custom offices from where the goods are imported.
  - In case the excise duty is levied at retail level in addition to the production and import of goods or services, the importer and retailer are responsible to determine and collect excise duty.

  Set off of Excise Duty

  The matters are dealt in Chapter 2.7.

- **Imposition of Excise Duty**

- **On Domestic Production of Goods**

  The production unit is taxable while issuing the goods

- **On Import of Goods**

  Excise items are linked with customs classification of goods and commodities (called HS codes) as in the US, EU or in Japan as motivated by IMF to its members. The advantages are the comparability of trade statistics, the use of a uniform "language" in international trade based on a systematic classification that avoids linguistic differences and predictability of the cross-border traders within exporting state.

- **On services**

  Excise duty shall be charged on the services covered by the schedule forming part of Excise Duty Act, 2058. Excise duty shall be collected when the service is provided, it means when the invoice for the service is issued as per Sec. 7.

  Interestingly, there are numerous provisions regarding excise on service, but excise rate has not prescribed till date. All the excisable items are goods and duty rate structure has given on the basis of harmonized code usable for customs.

- **Time of Levying Excise Duty**

  The following is the time determined by the Act to levy excise duty:

  - **In case of Issue of Goods under Physical Control System**

    In this case, excise duty shall be levied at the time of issuance after production from the enterprises for the purpose of sales.

  - **In case of Issue of Goods & Services under Self-Removal System**

    In this case, excise duty shall be levied at the time of issuance of invoice.

  - **In case of Import of Goods**

    In this case, the custom office shall level excise duty at the custom entry point at the time of import.

  - **In case of Import of Services**

    The time to levy excise duty shall be as prescribed by IRD.

- **Time to deposit Excise duty at Revenue Accounts**

  The excise duty collected under Excise Act shall be deposited within the following time limit:

  - At the time of issuance, in the cases of goods being issued under Physical Control System.
  - Within 25th of the month immediately following the month of issuance of invoice, in the cases when the goods are issued or manufactured under self removal system.
  - At the time of import, in case of import of goods.
  - As prescribed by IRD, in case of import of service.

- **Person Liable to Pay Excise Duty:**

  According to section 4Ka these persons are liable to collect excise duty and to pay it to Revenue:

Clause	Conditions	Person liable to pay
(ka)	Domestic production of goods	The producer
(ka)	Domestic supply of Service	The service provider
(kha)	Import of goods	Name of the person mentioned on the bill of lading, or airway bill or person mentioned in the application filed for clearance.
(ga)	Auction of excisable goods	The person who accepts the auction
(gha)	When the goods sold to duty-free shop comes for resale in the market or used for other purposes	The owner of the goods who re-sales or person who reuses it.
(nga)	When the non-excisable goods convert to excisable goods	The owner of the goods when it converts to excisable goods.
(cha)	In other cases	As prescribed by IRD

- **Set off of Excise Duty/ Excise Duty credits:**

  Under the following conditions as per Sec. 3A, excise duty paid on purchases or import of the excisable goods shall be allowed for setoff from the excise duty collected on sales:

  - In case of physical control system, Excise duty paid on raw materials consumed by producer is allowed as credit with the excise duty payable on issuance of finished goods. Excise duty paid on raw materials purchased by producer is allowed as credit with the excise duty payable on self-issuance of finished goods.
  - While deducting excise duty, excise duty paid on purchase of supporting raw material and packing material shall not be deducted.
  - Excise duty paid on trading goods production or import is allowed as credit with the excise duty payable on sales of those items.
  - In case of excise paid on stock which is lost due to fire, theft, accident, RSDMDST or expiry of useful term; and in case of loss of raw materials, exemption on probable excisable finished goods; the excised duty paid on raw on such stocks or probable excise duty to be collected on deemed production shall be exempted as prescribed by the department according to Sec. 3A(5).
  - If excise duty could not be set off, application for refund can be given to Excise Officer(Sec 3Kha (5)) and and excise officer shall refund within 60 days from the date of application, if deems refundable upon inquiry and verification (Sec 3Kha(6)). In case of export of tobacco and liquor based products and paan masala, claim of refund can be made if there is value addition of at least 15%. The claim has to be made within one year from the date of expiry of submission of tax return.

The procedure is prescribed in the Excise Manual, 2068(Amendment 2075) issued by IRD that outlines the following procedure:

- The excise-return till the period immediately preceding the period of loss shall be updated and files.
- In case of insured stock, loss shall be claimed within 30 days from reimbursements from insurance company.
- In case on non-insured items, claim to be lodged with the department within 30 days from date of loss, inter alia, police report, sarjamin minute, approving evidences, etc.
- In case of expiry of time, details regarding the goods and claim of loss to be lodged within 30 days from expiry date.
- Committee (prescribed by the department) approval of loss.

Based on the wordings of the act and as per manual, no credit is allowed in case of supporting materials (packing materials, overhead items or else) paid by the person collecting excise. Credit is allowed in the direct input materials only.

- **Exemption from Excise Duty:**

The following goods or services attracting excise duty as per the Act are exempted from payment of such duties (Section 3Kha):

- **Export**

  Excise duty shall not be levied on export of excisable goods.

- **Return of Exported Goods Due to Any Reason:**

  There might be the cases when goods manufactured in Nepal exported to foreign is returned back to Nepal due to the reason that the foreign party has rejected the acceptance of goods or otherwise, after all the formality for export is completed or after the goods received by the foreign party. In such cases, in case the exporter re-import the goods with a condition that same goods shall be re-exported within 3 months of the goods so imported, the goods may be released by accepting the applicable excise duty payable on the goods as deposit and the deposit shall be refunded when the goods is re-exported.

- **Sales from duty free shops (section 3Kha):**

  Sale of excisable goods from duty free shop and from bonded warehouse is exempted from excise duty. In case of cigarette and liquor, exemption is limited to the diplomats (individual or entity) upon recommendation from Ministry Of Foreign Affairs.

  Also, there is no bar in sale and distribution of goods by a bonded warehouse other than cigarette and liquors, without charging excise duty.

  But the duty free shop or the bonded warehouse when purchasing the goods have to pay cash deposit or provide a bank guarantee for an amount equal to the excise duty chargeable on the goods.

  The release of the cash deposit or bank guarantee shall be as prescribed by IRD.

- **Some more exemptions**

  The newly added Section 4Ga has also provided the following exemptions:

  - Import of goods by diplomats or persons availing such privilege under the recommendation of Ministry of Foreign Affairs is exempted from excise duty.
  - **In Transfer of Vehicles or cancellation of Registration of Vehicles**
    - In the following cases, the excise duty is exempted while transferring vehicle:
    - Transfer to project by changing in government name plate according to the approved annual plan of the project, such vehicles not exceeding ten years from the year of original manufacturing that were imported after availing diplomatic facility or duty privilege by any foreign institution or donating agencies.
    - Transfer to government department, local bodies, community schools, or community hospitals after obtaining permission of Ministry of Finance after the completion of any project, such vehicles not exceeding ten years that were imported availing custom exemption or concession in tariff rate (except on deposit or bank guarantee) by such projects.
    - In case any diplomatic mission, project and other entities (governmental or non-governmental organization) intends to scrap and cancel the registration of any motor vehicle that was imported under duty facility and is more than 15 years old, with the approval of Ministry of Finance, excise duty shall not levied on such motor vehicle.
    - Transfer to spouse of the owner, such vehicles imported by individual for personal purpose availing partial duty exemption.
    - In the request of the United Nations, Nepal Army, Armed Police Force and Nepal Police who are going to establish peace, carrying Armed Personnel Carrier, vehicle, weapons and other items on record, return back to Nepal, excise duty shall be exempted on those items.
    - Industry producing goods using 90% or more local scrap materials.

Control in sale and distribution (Sec 4Gha)

The persons other than hotel and restaurant business, who operates liquor transactions shall make transaction of liquor and tobacco only. The licensed person operating tobacco products shall make transaction of such tobacco products from separate place. However, departmental store may operate sale transactions of liquor and tobacco products keeping separate sales counter.

Gifts and Cash Discounts (Sec 4Nga)

The liquor, Beer or Cigarette industry and importer of such goods or their sellers shall not operate any type of gift program or such industry shall not provide any rebate to distributor

while selling such products. If such an act is carried it shall be deemed to be breach of the condition of the license.

- **Systems of Issuance**

  The Act has provided two kinds of issue systems of goods for excise duty purpose. Here issue system means the point of duty to be charged on the goods or services. The systems of issuances are:

  - Physical Control System
  - Self Removal (Issuance) System

- **Issue under Physical Control System**
- **Issue from the production unit:**

  The production units producing liquor, spirit, molasses, khudo and beer shall be issued charging excise duty at the time of issuance (removes) of goods from the production unit (ex-factory not on sale) under Physical Control System.

  Liquor, spirit, molasses, khudo and beer are the goods that shall be issued under physical control system.

  Under Physical Control system, the production unit has to charge excise duty on the issue of the goods from the production unit even to its own head office or branch outside the production unit. That is why; the word used is 'issue' but not the sale, supply, exchange, etc.

  Under this system, issue of the excisable goods to its head office or any branch shall be through excise gate pass.

- **Excise Duty Stickers:**

  As per Rule 30, the producer or the importer of liquor and cigarette has to affix the excise stickers (excise tickets) on the every bottle and packet of liquor and cigarette.

  But as per sub-rule (2) of the rule, Nepal Government may prescribe that the excise sticker or ticket should be affixed on each bottle or pack of liquor and cigarette.

  In case of enterprises producing Beer, while bottling Beer in final stage, sealed Auto Flow Metre having electronic information transmission capacity shall be used. While issuing Beer by enterprise, excise stickers prescribed by the department shall be affixed on the cartoon. Upon bottling, Enterprise shall affix excise duty sticker as prescribed by the Department in cap of every bottle or in cartoon and store in Godown.

  In case of Cigar, excise stickers shall be affixed on every box, in case of Khaini or Surti, excise stickers shall be affixed on every packet, box or pack as prescribed by the department.

  The producer or the importer of liquor and cigarette has to purchase the excise sticker or ticket from any IRO by paying a prescribed amount. The production unit cannot remove or issue the goods from the factory without affixing the excise duty stickers for the specified value.

- **Payment of Excise Duty at each Issue (Sec. 4Kha (1) & Rule 6 (1)):**

  The production unit shall pay the amount of excise duty chargeable on the goods for issue in advance and remove or issue the excisable goods from the factory (under physical control system.

- **Cash Payment in lump Sum (Rule 6 (4)):**

  IRD may order producers of goods to be issued under Physical Control System to deposit the estimated excise duty payable on production during a fiscal year in advance as deposit after the evaluation of quantity of production and excise duty applicable on it. The amount so paid shall be settled against the payable excise duty as and when the goods are issued from the factory. In case of the amount so deposited falls short than the actual payable excise duty, the producer shall deposit it immediately, and in case the amount so deposited is more than the actual, the tax officer shall return the amount.

- **Self Removal System:**

  Person entitled to use System Removal System for Issuance of Excisable Goods

  Person dealing in excisable goods other than those producing liquor, spirit, molasses, cigarette and beer can adopt this system. Under this system, the issue to its head office or branch shall not be treated as issue for excise duty purpose. A person must get registered with IRD for availing the self removal system of issuing excisable goods.

  The Act is silent about the self removal system. Comprehensive procedure for self-removal has been described in Excise Manual, 2068 (Amendment 2075).

  Practical Issues in System of Issuance

  In the cases where the excise duty is applicable, the unit is normally kept under physical control of the excise officers. The excise officer-in-charge has to verify the procurement, production and sales of the excisable items. The Inland Revenue Office deputes one or more excise officers to take charge of the production unit producing excisable items. The excise officer has to verify and sign the records maintained by the unit as required by the excise rules. To avoid such physical control system, the self removal system is introduced. However, the unit has to get approval of the IRD to apply the self removal system in its production unit.

  Under Self Removal System, the IRO shall not use the physical control system in the unit, but they may adopt other methods of checking and controlling such as through statements to be submitted by the unit or through sudden visits to the unit.

  Under this system, the issues from factory to its head office or branches shall not be treated as issuance for excise purpose, but the sales by the branch shall constitute the sales of the product for excise duty purpose. It means the head office or branches of the production unit have to charge excise duty on sales of the product by charging it in the invoice issued by them.

  Vide the authority conferred through Sec. 25Ka of the Act, Inland Revenue Department has issued directives, named as "Self Removal System Directives, 2063" and "Excise Duty Manual, 2068(Amendment 2075)", with regard to the self removal system. The directive includes:

- Direction on procedure for license and renewal of the license for the system;
- Provisions regarding delivery of goods to branches;
- Accounts and records to be maintained by the licensee;
- Returns or statements to be submitted by the licensee to the office; and
- The provisions regarding sales by factory and branches.

Section 2 of the Directive provides 'price on which excise is chargeable'. According to the definition the price for excise shall be the price considered for charging VAT but before providing any discounts.

Payment of excise duty in case of self removal system

In case the taxpayer has obtained approval for self removal system, it has to pay the excise duty collected during a month up to 25th day of the end of the month in which:

- The excisable goods is issued ; or
- The invoice for excisable service is issued.

- ***License/Registration for excise duty (Section 8):***

  No transaction of goods or services attracting Excise duty without License

  No one shall manufacture, import, sell or store any excisable goods or provide excisable service, without obtaining a license as prescribed in this Act or rules.

  Application to be filed to obtain License

  Any individual, firm, company, or institution desirous of obtaining the license for excise duty purpose, must apply for the license to the excise officer in the prescribed form along with the prescribed fees.

  The format for application for the license is prescribed as annexure 1 of the rules.

  The fees payable for registration and renewal are prescribed in annexure 2 of the rules.

  Issuance of license (Rule 4)

  On receipt of an application filed by any individual, firm, company or institution, the excise officer designated by IRD may issue a license, specifying the purpose of license like: manufacture, import, sell or store of the concerned excisable goods or to provide the concerned excisable service, after investigating into the particulars mentioned in the application and even by prescribing terms and conditions as well.

  The format for license is prescribed in annexure 3 of the rules.

  Requirement of License not required (Restrictive Clause to Sec. 9 (1))

  License is not required for the following:

- Import of goods attracting excise duty under diplomatic privilege as per the recommendation of Ministry of Foreign Affairs.
- Sales or storage of goods under Self Removal System (Except production and sae and distribution of Cigarette and tobacco product).

- **Renewal of the license (Section 9):**
  - The term of license issued by excise officer shall be of one fiscal year.
  - The person shall renew the excise license within Shrawan after the expiry of a fiscal year after paying the prescribed fees.
  - If License holder, so intends, may renew the license for 3 fiscal years by paying renewal fee at a time.
  - The license holder producing bidi, tobacco, khaini, paan masala, gutkha and importing khudo or gundh and khandsari industries shall renew the license paying prescribed renewal fee.
  - The renewal requirement is waived for license holder involved in industries that produces goods under self removal system and provides service attracting excise duty other than tobacco related goods. (Sec. 9(5) (Ga))
  - In case any licensee fails to have its license renewed within the prescribed period, it may have its license renewed for one fiscal year on payment of an addition fee as follows:
    - If the renewal is requested within first 3 months of the expiry of the period (from Bhadra to Kartik end) - 25% of the fee mentioned in annexure 2 shall be charged extra.
    - If the renewal is requested within next 3 months of the expiry of the first 3 months (Mangsir to Magh) - 50% of the fee mentioned in annexure 2 shall be charged extra.
    - If the renewal is requested within next 3 months of the expiry of the first and second 3 months (Falgun to Baisakh) – 75% of the fee mentioned in annexure 2 shall be charged extra.
    - If the renewal is requested within next 3 months of the expiry of the first, second and third 3 months (Jesth to Ashad end) – 100% of the fee mentioned in annexure 2 shall be charged extra.

- **Suspension of License (Sec. 9Ka)**

  Application to be filed for Suspension

  The license-holder shall file an application for suspension of license; inter alia, the reason therefore, within 15 days of leaving the transaction of goods or services attracting excise duty.

  Decision by excise Officer

  The excise officer shall decide on the application within 15 days of receiving such application and inform the applicant about the decision.

License holder who intends to commence transaction of goods or services from the license that was suspended previously, shall give application to Excise Officer and Excise Officer after receiving such application shall give permission to commence the transaction.

If a licensee producing liquor, cigarette or tobacco goods subject to excise duty produces, releases, or sales and distributes such goods without attaching the excise duty ticket or using counterfeit ticket or reusing the ticket that was already used, or it is seen from the preliminary investigation that the excise duty has been evaded by producing and storing (such goods) without showing record of raw materials required to produce such goods, the excise duty officer may suspend the license of such licensee for up to 3 months.

Effect of Suspension

The license holder shall not file the excise return of the months immediately following the date when such acceptance of application is informed by excise officer.

The license holder is waived from the renewal requirement till the period of suspension of license.

- **Cancellation of the license:**
  - **Ipso facto cancellation {Rule 5(4)}:**

    In case the licensee fails to have its license renewed within the last period as mentioned above (within Ashad end), the license shall be treated as ipso facto cancelled.

  - **Cancellation of License (Section 10):**

    Under the following conditions IRD may cancel the license:

    - In case the terms and conditions specified in the license, are found to be violated; or
    - In case it is observed to be detrimental to public welfare.
    - In case of winding up of the license holder or the license holder applies for the cancellation of license.
    - If it appears to be detrimental to public welfare
    - If excise duty is not paid,
    - If entity holding license winds up or license holder gives application for cancellation of license.
    - If renewal is not done.

- **Procedure for Cancellation of License**

  Application to be filed for Cancellation

  The person wishing to cancel the license or the rightful dependent of the deceased person shall file an application to cancel license.

License to be cancelled

In case the excise officer obtains an application regarding the cancellation of license, the excise officer shall decide on the matter within 30 days (of application- the Rule is not clear about the notification date or decision date- it just spells out that the applicant shall be notified within 30 days) and if the reason of cancellation is appropriate, the license shall be cancelled after collecting any dues or fees/fines related to excise duty.

The licensee shall file excise return till the date when the license is cancelled.

Notification of Cancellation to Other GON Bodies

The excise officer shall notify Department of Industries, Office of Companies Registrar or other concerned bodies regarding the cancellation of license.

- **Effect of the cancellation (Rule 8):**

  In case the license is cancelled due to non-renewal or due to cancellation by IRD, the stock of excisable goods kept in godown at the time of the cancellation of the license may be sold after paying the arrears of excise duty and securing approval of IRD.

In case the arrears of excise duty are not paid, IRD shall auction the concerned commodity, collect the arrears from the proceeds thereof, and refund the balance, if any, to the concerned person.

CHAPTER 3

Duties of License-holders

Fixation of recovery level (input output ratio):

Quantity of Alcohol can be examined

As per section 10Chha, the office may examine the alcohol content and quality of the liquor produced and of substances used for production of liquors at any time. The quantity of alcohol content shall not differ by more than 1% than the disclosed standard and the quality shall not be significantly different.

Significant Discrepancy to be treated as the production of highest standard of alcohol (Sec. 10 Cha (2))

In case of significant discrepancy in recovery or in quality standards, excise duty is levied assuming the leakage used to produce the highest liquor quality.

Recovery Level

Section 10Cha has authorized the Rules to fix the input output ratio or recovery level of the following goods:

Product	Raw material	Minimum power	Minimum recovery
Rectified spirit	Khudo per quintal	65 OP	20 liters
ENA	Khudo per quintal	65 OP	19 liters
Anhydrous ethanol	Khudo (molasses) per quintal	72 OP	19 liters
ENA (Extra Neutral Alcohol)	Rectified spirit per 100 liters	-	95 liters*
Rectified spirit	Food grains per quintal	68.8 OP	30.57 liters of rectified spirit; or, 30.57*95/100 liters of ENA

Comments on Recovery Level

Any licensee who produces rectified spirit or ENA has to so set the recovery rate that at least 20 liter rectified spirit or 19 liter ENA of a minimum 65 OP, 19 literanyhdorus ethanol of a minimum 72 OP has to be produced from a quintal of molasses at the end of each month. Minimum recovery rate of ENA is 95 liter from rectified spirit per 100 liters. Recovery level of 42 liters of ENA from food grains per quintal of minimum 68.8 OP is fixed. Organisations producing wine from fruits shall produce from per kg of fruits wine of 2liter contaning 12% portion of alcohol or on basis of same percentage of alcohol produce proportionate wine. In case of production from others, it has to be as prescribed by the Department.

Any licensee who has set the recovery rate below this rate has to submit reasonable and adequate reasons therefor to the Department and obtain approval. In cases where approval is not given by the Department, the Office shall recover from the licensee all the revenues chargeable on the margin of quantity as per the maximum rate on the liquors.

The quantity so deemed to be produced shall be calculated as follows:

The quantity should be produced as per the standard (recovery level fixed) – actual quantity produced = quantity of highest quality of liquor supposed to be produced {section 10Cha}.

Amount of excise duty may be recovered by IRD = Quantity of highest quality of liquor supposed to be produced * highest rate of excise duty applicable on the liquor

The minimum recovery from Rectified Spirit to ENA was 98 as per 5th amendment in rules but the recovery level is fixed at 95 liters by 6th amendment in rules.

The recovery level of any other products shall be as prescribed by IRD.

The recovery level as above is convertible into other products based on LP Liter formulae.

*Conversion of OP into LP using- Volume * (100+OP)/100*

*Conversion of UP into LP using- Volume of UP Alcohol * (100-UP)/100*

- **Functions and duties of license-holder (Rule 13)**

  For manufacturers:

  - To submit returns or statements as prescribed by this rule in a format prescribed by IRD to excise officer within 7 days of next month.
  - To record in a daily register the particulars of goods manufactured and sold and supplied, and produce the register to the excise officer or the employee deputed by him in the course of inspection.
  - To send to the office samples of goods manufactured after having them certified by the excise officer or the employee deputed by him.
  - To have the particulars of goods kept in godown certified by the excise officer or the employee deputed by him, and kept evidence thereof.

- **For excisable service providers:**

  - To maintain on a daily basis records and accounts of invoices issued for service provided.
  - To keep a record of the invoices for excisable goods purchased during the course of providing excisable services.
  - To make available the documents mentioned in (i) above as and when demanded by the excise officer or the employee deputed by him.

- **For importers of excisable goods:**
  - In case of import of goods, the registered importer has to furnish the purchase invoices to excise officer or the employee deputed by him.
  - In case a person imports goods through letter of credit it has to furnish the following documents to the excise officer:
    - The specification of the goods imported,
    - Its classification for the custom purpose, and
    - Its unit price and quantity.
- **Duties of all the licensees:**
  - To display the license at the business place in a conspicuous manner (Rule 13).
  - The statements or returns which are required to be submitted as per the rules should be submitted to the excise officer within 7 days of the expiry of the month.
- **Specific provisions for producers of cigarette and bidi (Rule 14):**

  Statements and records should be maintained by a producer of cigarette are as follows:

S. No.	Statement required for	Annexure prescribed for format	Verification required
1	Daily record of all varieties of indigenously purchased and imported raw and unprocessed tobacco received for manufacture cigarette.	Annexure 5	Excise officer or employee deputed by him and factory manager.
2	Daily record of raw and unprocessed tobacco consumed for production of cigarette.	Annexure 6	Excise officer or employee deputed by him and factory manager or licensee.
3	A document having information about quantity of different kinds of indigenous or foreign tobacco to be consumed for production of different types of cigarette. The compounding ratio of different kinds of tobacco for production of each kind of cigarette is required.	NA	The ratio of tobacco consumption should be approved by IRD.
4	Packing of saleable manufactured cigarette in carton after checking these properly.	NA	Once the carton issued from the manufacturing unit for sales, it could not be brought back to the manufacturing unit again without approval of IRO.

5	Statement of daily packing of cigarette in large paper boxes. The statement must include the consecutive serial numbers of the package, date of packaging, and number of packages.	Annexure 7	Excise officer or employee deputed by him and factory manager or licensee.
6	Statement for cigarette kept in godown	Annexure 8	Excise officer or employee deputed by him and factory manager or licensee.
7	Demand note for issue of cigarette from godown. For taking out the cigarette from the godown the licensee has to fill in the form and get the approval of the excise officer or the employee deputed by him. Records for such demand notes should also be maintained.	Annexure 9	Factory manager or licensee

- **Department can fix the recovery rate (Rule 13A):**

  According to the power delegated under Rule 13A, department may fix the recovery rate for cigarette.

- **Manufacture, sale and supply of bidi (Rule 15):**

  Every person holding license for manufacturing bidis to maintain the accounts of raw tobacco used for manufacturing bidis. The issuance record to be kept as prescribed in Annex-9 of the Regulation.

- **Specific provisions for producers of liquor:**

  Manufacture of liquor (Rule 16):

  - Every person holding a license to manufacture liquor shall manufacture liquor using the blending of spirit manufactured from patent steel plant.
  - The licensee manufacturer must bottle liquor of 15, 25, 30, 40, 50 and 70 UP power manufactured by it in the manner prescribed by IRD.
  - The licensee manufacturer must bottle liquor of 70 UP power manufactured by it only in pet bottles of 300 ml or as prescribed by IRD.

- **Preservation of raw materials (Rule 17)**

  Any manufacturer of liquor must make arrangement for the proper preservation of molasses, spirit, and other raw materials. In case of any loss or damage resulting from the failure to preserve such raw materials, it will be deemed that the licensee has produced liquor out of the raw materials so lost. The excise officer may recover an amount of excise duty from the licensee as calculated below:

Liquor deemed to be produced from the lost raw materials X maximum rate of tariff payable on the liquor= Amount may be recovered from the licensee.

- **Batch and serial number to be indicated (Rule 18)**

  When the production process of liquor is completed, a label having the following information should be affixed to each bottle before sending the liquor to godown:

  - batch number of the product,
  - consecutive serial number,
  - name of the licensee manufacturer,
  - trade mark, and
  - the power of the liquor.

  Producer shall keep Batch Control Register as prescribed in Annex-9A of the Regulation.

- **Maintenance of records relating to wash (Rule 19)**

  - Liquor manufacturer (licensee) has to maintain records, explicitly mentioning particulars thereof, of raw materials and water used at the time of fermentation for manufacturing wash.
  - Liquor manufacturer (licensee) has to maintain records of the quantity of the wash to be distilled and vent number before pouring the wash ready for distillation into the wash distillation plant, and furnish information thereof to the excise officer or the employee deputed by him.

- **Prohibition to enter into distillery or brewery without permission (Rule 20)**

  No outsider other than the staff of the distillery and brewery may enter into the place where the liquor is being manufactured or where it is preserved or kept without the permission of the excise officer or the employee deputed by him.

- **Inspection book to be maintained (Rule 21)**

  Every liquor manufacturer (licensee) must keep an inspection book at the distillery and brewery in a format as prescribed by IRD. The excise officer or the employee deputed by him has to mention the date and time of the inspection of the production process in the inspection book. If he finds any shortcomings in the production process he has to mention the fact also in the book.

- **Accounts of liquor to be maintained (Rule 22)**

  - Manufacturer of liquor has to maintain an account of liquor distilled from wash according to the strength of the liquor in a format prescribe in annexure 10 of the rules.
  - It has to maintain the accounts of sales of liquor and excise duty chargeable on the sales in a format prescribed in annexure 11 of the rules.

- **Remission for shortage in stock (Rule 23)**

  Matters to be included in Monthly Statement

  In case the licensee manufacturer of liquor observes the shortage of liquor in stock in stock upto 1% due to evaporation, obscuration, leakage or bottling, it shall mention the fact in the monthly statement and produce the statement to the excise officer for remission.

  Excise Officer to Examine Statement

  The excise officer shall examine the statement within 30 days of the submission of such statement.

  Remission to be granted

  The excise may grant the remission of the shortage in case the reason of the shortage is justifiable and the shortage after documenting the basis of such decision.

- **Remission for shortage in stock of beer (Rule 23Ka)**

  Matters to be included in Monthly Statement

  The licensee manufacturer may submit the monthly returns in the format prescribed by the department to the Excise Duty Officer specifying the following shortages related to beer:

  - The shortage in stock shown by bottle counter than that measured by flow-meter,
  - Shortage of crown corks because of breakage or damage, such that it cannot be used in a bottle, during pasteurization, packaging or storing in the Godown, the Licensee producing beer shall submit for remission by stating such shortfall.

  Excise Officer to Examine Statement

  The excise officer has to inspect the statement within 30 days of the submission.

  Remission to be granted

  The excise officer may grant the remission of the shortage documenting the basis of decision, in case the reason of the shortage is justifiable and the shortage is up to,

  - 2% in case of Shortage of crown corks due to damages or breaks at the time of pasteurization, packaging or storage in the godown.

- **Approval needed for re-processing of old liquor (Rule 23Kha)**

  Licensee willing to produce the liquor by re-processing prepared old liquor upon return after sale and distribution or remaining in godown may reprocess such old liquor after having obtained prior approval from the Department.

- **Special provision for Sakhar and Khudo (molasses):**

  Storage of molasses (Rule 24):

Every sugar or khandsari producing units has to make appropriate condition for storage of molasses produced by it by ensuring that there is no leakage of water and sell the molasses on recommendation of the office.

In case any loss or harm occurs owing to the failure to make such appropriate arrangement of storage, no remission in the excise duty payable thereon shall be granted.

- **Accounts of molasses:**

  After production of sakhar or khudo (molasses), every sugar or khandsari mills must keep a daily record of sakhar or molasses produced, sold and in storage. The record should be kept in a format as prescribed in annexure 12 of the rules. The mill has to submit the record to the IRO every month.

- **Special provision for use of spirit or ethanol for other usage (Rule 25Ka):**

  Procedure in case Licensee Converts Spirit into Denatured Spirit

  In case a licensee wants to convert spirit into denatured spirit for other purposes, the same shall be done mixing at least 0.02% of pyridine or colchicines or methyl alcohol in rectified or herds spirit.

  IRD may direct the licensee to colour the denatured spirit as per the necessity.

  IRO shall permit the conversion of rectified spirit to denatured spirit such that the recovery of excise duty is not reduced.

  Sale of Anhydrous ethanol

  The licensee shall sell anhydrous ethanol produced for mixing with petrol to Nepal Oil Corporation or entity approved by Government of Nepal.

  Prior approval of IRO is must while selling anhydrous ethanol from enterprises.

  IRO shall permit such sales only after ensuring that at least 2% of petrol is mixed with such anhydrous ethanol.

CHAPTER 4

Excise Officers and Their Duties and Powers

Appointment of excise officer (Sec 5)

Nepal Government (NG) may appoint excise officers in the required number for the purpose of this Act. NG may also designate any officer as the officer empowered to discharge the function of an excise officer if it so deems necessary.

The jurisdiction of an excise officer shall be as prescribed by NG (Sec 6).

Power of Excise Officer to assess Excise Duty (Sec 10 Gha)

Conditions for Assessment by Officer

In case any of the following conditions is satisfied, an excise officer may assess excise duty:

- Excise return is not filed within the specified deadline,
- Inadequate or erroneous return is filed,
- Falsified return is filed,
- There is basis to believe that the licensee has shown less excise duty than actual or the duty amount is not correct,
- There is reason and basis to believe that there is under-invoicing and requirement of re-pricing or additional pricing,
- The recovery level is not met in case of fixation of recovery level,
- There is difference of more than 1% in quantity and quality of alcohol,
- Evasion of Excise Duty, or
- Transaction of goods or services attracting excise duty without obtaining License.

Assessee to be given reasonable opportunity to defend

Excise Officer shall provide a period of 15 days to licensee to submit proof of clearance.

IRD may demand re-assessment of finalized assessment

IRD may supervise the assessment process and demand re-assessment of finalized assessment.

Power of Excise Officer to Reassess the Excise duty

The following power is conferred to excise officer with regard to the assessment of excise duty u/s 10 Gha (4):

- Examination of accounts, records, documents, place or goods related to excise duty,

- Search of and sealing of transaction places or other probable places where there are evidences related to default,
- Preparation of records, books, accounts or documents or demand of information from persons responsible to prepare them,
- Seizure of or custody of accounts, documents or records located at transaction place or other related places,
- Audit of Excise duty related to transactions attracting excise duty at transaction place or office or other relevant places, or
- Demand of information from banks or financial institutions related to the transaction of excisable goods or services. It shall be the duty of Banks or Financial Institutions to furnish such information.
- **Power to search on adequate suspicion (Sec 11)**

  In case an excise officer reasonably suspects that any excisable goods is being taken out of an establishment or imported from abroad by evading excise duty, he or an employee deputed by him, may stop the individual or vehicle and demand evidence of payment of excise. Failure to produce such evidence shall be taken as evasion of excise duty.

- **Power to search, seize or arrest (Sec 12)**

  - Under the following conditions an excise officer or the employee deputed by him may search the establishment, house or compound, vehicle or place where such action is being taken:

    - In case any individual, firm, company, or institution conducts business by manufacturing, importing, selling or storing any excisable goods, or providing a excisable service without obtaining license; or

    - In case the excise officer or an employee deputed by him receives information that excise has been evaded as mentioned in section 11.

  - In case it is found in the course of a search conducted under the above sub-section that a business is being conducted by manufacturing, selling, importing, storing, or transporting any excisable goods or providing any excisable service in a manner against the provisions of this Act, the officer or employee conducting the search shall issue a warrant, arrest the person engaged in such activities, prepare a note regarding the situation, and seize the materials found there.

  - In case it is suspected that any of the offenses mentioned in this Act is being committed in any establishment, house or compound, vehicle or place, and that the offender may escape or evidence of the offence may disappear if no immediate action is taken, the excise officer or the employee deputed by him may prepare a note of the happenings and take the following actions himself or through his subordinate employees at any time;

    - Enter into such establishment, house or compound, vehicle or place;

    - Enter into such places by breaking doors or windows after providing a reasonable opportunity to people staying or living at such places, in the event of any obstacle or opposition to such entry;

- Seize excisable goods connected with the offense, as well as other materials and documents helpful in proving the offense;
- Suspend the license; but the suspension of the license could not be done for more than 7 days and the decision for which the suspension was done should be taken within 60 days; and
- Arrest persons suspected of having committed any offense.

- While entering into or searching any establishment, house or compound, vehicle or place under this section, a member of the concerned Municipal Corporation, Sub-Municipal Corporation, Urban Municipality or Rural Municipality or a local person shall be kept as witness as far as possible.
- In case any excise officer arrests any person or search any person, establishment, house or compound, vehicle or place, or seizes any excisable goods or other, he has to submit his report to the Director-General of IRD within 24 hours after such arrest, search or seizure through the quickest possible means.
- In case such actions have been taken by the subordinate employee of an excise officer, they must submit report of such actions to the excise officer or the IRD within 24 hours.
- For the purpose of conducting investigations into offenses under this Act, the excise officer shall have powers equivalent to those of a police officer under prevailing law.
- The local administration or the police must immediately extend cooperation to the excise officer in case he seeks such cooperation in making searches, seizures or arrests.

- **Power to creation of charge on assets (Rule 9):**
  - In case an excise officer or any employee deputed by him finds any person is going to export or import any excisable goods by evading excise duty, the excise officer may freeze the goods in such a manner that it may not be exported or imported.
  - In case any person fails to pay excise duty payable as per this Act or Rules within the prescribed time-limit, an excise officer may freeze his property.
  - The excise officer may request the related government office to sequester (Rokka) the property so freezed in such a way that the title to it is not transferred to any other person or its ownership is not changed. It is duty of the related office to sequester the property so requested.

- **Power to confiscate goods or property (Rule 11)**
  - In case it is proved that any excisable goods has been exported from the factory or imported without paying excise duty, the excise officer may take such goods under his custody and confiscate it.
  - In case any person is found to have manufactured, imported, sold or stored any excisable goods or provided excisable service without obtaining a license, the excise officer may confiscate all materials connected thereto.
  - In case any person is found to have manufactured, imported, sold or stored any excisable

goods or provided excisable service by preparing false accounts or forged documents, the excise officer may confiscate all materials connected thereto.

- In case any person suppresses, conceals or evades excise duty payable by him, an excise officer may confiscate the materials connected thereto as well as the equipment used in its manufacture.
- Before confiscation of any goods that he has taken into custody, the excise officer must issue a 7 days notice to the concerned person to submit evidence as to why the goods must not be confiscated.

- **Sequestration and auction of property (Sec 17)**
  - In case there are reasonable grounds for the excise officer to confiscate the property of any person under this Act or the rules framed hereunder, he may sequester the property in such a way that the title to it is not transferred to any other person or its ownership is not changed.
  - In case the property so sequestered is likely to rot or suffer damage or destruction, or in case its value is likely to decline, the excise officer shall auction it immediately and credit the proceeds thereof as income.
  - If the confiscated goods are useable on testing, it should be auctioned and credit the proceeds thereof as income. If not usable it should be destroyed on the manner prescribed by department.

- **As per rule 10 the procedure for the auction for such goods shall be as follows:**
  - The Excise officer shall affix a notice for the auction at the notice board of the excise office. The notice must include a time-limit of not more than 7 days keeping in view the condition and nature of the goods or property.
  - Such auction sale shall be conducted in presence of a representative of the local body of the place where the goods or property to be sold through auction is kept or of an employee of the nearest government office, and the concerned person or his representative, as far as possible.
  - Such auction sale shall be conducted by inviting bids by fixing minimum price of the goods or property on the basis of its current market price.

    In case it is held later that the property must be returned to the concerned person, only the proceeds of the auction shall be handed over to him.

    The concerned person shall be unable to claim for return of the property so auctioned.

- **Having power equivalent to those of a court (Sec 18)**
  - For the purpose of this Act, the excise officer shall have power equivalent to those of a court under current law in relation to summoning the concerned persons, recording their statements, examining evidence, required them to submit documents, keeping the defaulter in detention or releasing him on bail.
  - While taking action under this Act, the excise office shall adopt the procedure prescribed in Summary Trial Procedure Act, 2028.

- **Functions, duties and powers of excise officer (Rule 12)**
  - To ensure that excisable goods kept in godown are taken out for sale, supply or transportation only in his presence, and arrange for keeping records thereof in the factory of the establishment.
  - To send reports regarding the manufacture or sale or supply of excisable goods, stock kept in godown, and the amount of excise duty collected or any other information required by IRD.
  - To cause the manufacturer of excisable goods to maintain a daily register for recording excisable goods manufactured or sold in a format indicated in annexure 4 of the rules.
  - In case any excisable goods is imported through a custom point, to record in a daily register the name of the importer, the quantities of the goods imported, and the value thereof.
  - To inspect from time to time as to whether or not license-holder have performed their duties as provided by Rule 13.
  - To monthly inspect the establishment manufacturing excisable goods and determine the liability of excise duty payable by it.
  - To perform such other functions during the course of discharging his duties as prescribed by IRD under these rules.
  - In case of excisable goods issued by a license holder himself under self removal system, an excise officer must examine and certify the accounts of the licensee according to the procedure prescribed by IRD.
- **Power not to be delegated (Sec 20)**
  - The powers vested in an excise officer under section 15 (offense of hide information or assistances) and 16 (offenses and penalties) of this Act may not be delegated.
- **Realization of arrears as government dues (Sec 22)**
  - In case any person does not pay any amount due to Nepal Government under this Act and the rules framed hereunder, the excise officer shall realize such amount from him as arrears due to the Government.
  - According to Sec. 17A, if any taxpayer file an application in writing to pay due excise duty on an installment basis, department may allow the payer to pay its arrears in installments too within one year.

CHAPTER 5

Penalties, Rewards and Appeals

Penalties to the person who fails to furnish information or extended cooperation (Sec 15)

In case any person who is under obligation to furnish information about any activities that have already been conducted, or are being conducted or shall be conducted in contravention of this Act after getting information thereof, or to extend cooperation as demanded by the Inland Revenue Office or Taxpayer Service Office, does not willfully furnish such information or extend such cooperation, as the case may be, he shall be punished with imprisonment for a term not exceeding 3 months, or with a fine not exceeding Rs. 10,000, or with both, according to the nature of the offense.

Other Penalties (Sec 16)

Section	Offense	Penalty/imprisonment
16 (1)	Ka. In case of evasion, concealment or suppression of excise duty payable as per this Act. Kha. In case of involvement in production or import of excisable goods without obtaining excise license. Ga. In case the person commits any offense in contravention of this Act by preparing falsified accounts or forged documents. Gha. Production, Bottling or selling of liquor violating this Act, Rule made there under or any specification issued by department. Nga. In case of use of false excise stickers in alcohol, beer or tobacco products or production, sales or storage of such products	• Confiscation of the goods, and • Penalty equal to the amount of goods confiscated, or 1 year imprisonment, or both. • In addition to above the excise officer may suspend license for the period not exceeding 90 days u/s 16(7). • In addition to above the excise officer may suspend license for 6 months or cancel and forward for deregistration u/s 16(9). • 200% of controversy amount or Rs. 100,000 whichever is higher or imprisoned for up to 1 year or both, after seizing the controversy amount.
16 (2)	Licensee engaged in manufacturing or import of liquor, cigarette and tobacco products commits following offences to suppress, conceal or evade excise duty Ka. Supress, conceal or evade excise duty Kha. Using fake excise stickers Ga. Producing and issuing unapproved brand Gha. Producing Rum, Gin, Brandy. Vodka, Whiskey other than 25 Up to 30 UP.	• Confiscation of the goods, and • Penalty equal to 200% amount of goods confiscated, or Rs. 1 lakh, whichever is higher or 1 year imprisonment, or both.

16 (3)	On determining amount u/s 16 (1) (Nga) and 16(2) cost of such excisable goods shall be determined on the basis of capacity, quantity or size of goods to which stamp has been used or may be used and chargeable excise duty shall also be added. If the goods or services have already been sold, the sales value shall be the basis.	
16 (4) (Ka)	In case of redetermination of price or determination of additional price as per section 7 (4)	100% of the excise duty amount
16 (4) (Kha)	In case of sales or storage of goods attracting excise duty without obtaining license	5,000 to 15,000
16 (4) (Ga)	Excise return not filed u/s 10Ka	Higher of Rs. 1,000 per return or 0.05% per day of excise duty so payable under such return
16 (4) (Gha)	Failure to maintain updated accounts u/s 10Kha (1)	Rs. 10,000 and Rs. 5,000 on each instance in the event of not allowing the accounts of transactions to be inspected.
16 (4) (Nga)	In case the purchase, production, issue, sales and stock accounts are not certified by Excise officer u/s 10Kha (2)	Upto Rs. 5,000
16 (4) (Cha)	Accounts not maintained for six years u/s 10Kha (3)	Upto Rs. 10,000
16 (4) (Chha)	In case the licensee obstructs the re-examination of IRD u/s 10 Gha (3)	Rs. 5,000 for each instance
16 (4) (Ja)	In case of difference of more than 1% in quantity and quality of alcohol	Amount equivalent to 100% of shortfall of excise duty
16 (4) (Jha)	If the production ceiling is not met in case of goods and services whose ceiling is fixed	100% of additional excise duty
16 (4) (Ynga)	Violation of Section 4Gha	Rs. 10,000 for each instance
16 (4) (Tta)	Not collection or short fall of excise duty under self-removal system	100% of shortfall of excise duty
16 (4) (Ttha)	Taking credit by violation of sec 3Ka(3)	100% of amount claimed
16 (4) (Dda)	Violation of Section 4Gha (2)	Rs. 10,000 for the first time and Rs. 20,000 from subsequent violation
16 (4) (Dhha)	If MRP, production date, batch number not mentioned in liquor, cigarette and tobacco products	Goods shall be confiscated and amount of bigo or Rs. 1 lakh, whichever is higher

16 (4) (Naya)	Non usage of transparent plastic cap (shrink cap) in excise ticket (except in beer, wine, cider)	Goods shall be confiscated and amount of bigo or Rs. 1 lakh, whichever is higher
16 (4) (Ta)	Production, issue or sale of liquor, cigarette or tobacco without taking approval or copying of other brands	Goods shall be confiscated and amount of bigo or Rs. 1 lakh, whichever is higher
16 (4) (Da)	If wine producing enterprise does not carry out fermentation in patent steel tank or wooden pot	Rs. 1 lakh everytime
16 (4) (Dha)	If physical inventory is more than inventory as per purchase books on verification by excise officer to licensee using raw material for liquor and other excisable goods	100% amount on market value of excess inventory
16 (4) (Dha) (1)	If it is found that the spirit or ethanol has been used contrary to the approval granted under this Act or Rules framed thereunder	Fine equivalent to the highest rate of excise duty that can be levied on the liquor that can be prepared from such spirit or ethanol.
16 (4) (Na)	Other nature of violation of this act	Rs. 10,000 for each instance
16 (5)	The utensils or other materials directly or indirectly used for committing the offense, or the tools, machinery, equipment, and vehicle used for the production of the goods or services.	These utensils, equipments, or the vehicles shall be confiscated.
16 (5)	In case of hired vehicle is used for the activity: If the vehicle is used without permission of the owner **the vehicle shall not be seized:**	Penalty to the vehicle owner Rs. 25,000; and Penalty to the driver of the vehicle – fine not exceeding Rs. 15,000 or imprisonment not exceeding 3 months, or both, according to the nature of the offense.
16 (6)	Notwithstanding anything contained in Sub-Section (4), the concerned vehicle is registered as vehicle for hire and the vehicle owner himself has used the vehicle for the purpose-	The vehicle shall be confiscated.
16 (8)	If anyone attempts to commit offence u/s 16(1) and 16(2)	Half of punishment mentioned u/s 16(1) and 16(2)
16 (9)	In addition to punishment mentioned in Sub Section (2)	Excise officer can suspend license granted as per Section 9 up to 6 months or after cancelation of such license as per Section 10 report to related office for cancellation of registration of such industry or enterprises.

10Jha	In case of failure to pay excise duty within specified time period except for the cases of issuance under Physical control System	0.05% per day of payable excise duty in addition to penalties u/s 16

- **Appeals**
- **Departmental Review (Sec 23)**
  - In case a taxpayer is not satisfied with an order of excise officer imposing excise duty which the taxpayer thinks that it has increased its liability due to failure of the excise officer to abide by the provisions of this Act, or due to irregularities committed or negligence shown by him while making the decision for charging excise duty, the taxpayer may file an application to DG within 30 days from the date of receipt of the order. DG shall conduct investigations and, if he so deems appropriate, cancel such order and order a fresh collection of excise duty {Sub-section (1)}.
  - The taxpayer has to make a cash deposit before such application is submitted for an amount total of 100% of the undisputed amount and 1/4th of the disputed amount payable as per the order {Sub-section (1ka)}.
  - DG must conduct investigation into matter and give his decision on the application filed as per sub-section (1) within 60 days of application filed {Sub-section (2)}.
  - In case the taxpayer is even not satisfied with the order of DG, it may file an appeal against the order to Revenue Tribunal within 35 days of the order received {Sub-section (3)}.
  - But in case the taxpayer has made an appeal to Revenue Tribunal as per section 16, it is not allowed to make an application under this section. It means the taxpayer has option to appeal directly to Revenue Tribunal against the order of excise officer, or first apply to DG and even if not satisfied appeal to Revenue Tribunal.
- **Appeal to Revenue Tribunal (Sec 19)**
  - In case any taxpayer is not satisfied with decision of an excise officer, it may file an appeal to Revenue Tribunal within 35 days of the decision received by it.
  - The applicant has to submit a copy of the notice of the appeal to IRD within 15 days of the application filed.
  - It is not supposed that due to the appeal submitted the actions to be taken under section 16(1) shall be effected.

    But in case an appeal is filed against any decision of an excise officer ordering the confiscation of a property of any person under this Act or the rules framed hereunder, the authority hearing such appeal may issue orders to the excise officer to stop the confiscation of such property until a final decision is made (S 21).

    Provided that the provision of this section shall not be applicable in the circumstances mentioned in section 17 (2), like the property is likely to rot or suffer damage or destruction, or its value is likely to decline.

CHAPTER 6

Miscellaneous Provisions

Powers to frame rules and directives (Sec 25 and 25ka)

- Nepal Government is empowered to frame rules in order to implement the objectives of this Act.
- IRD is empowered to frame directives subject to this Act and the rules framed hereunder.

Excise Returns

Person responsible to file Return

The persons having responsibility to collect and assess excise duty shall file excise return.

Deadline to submit Return

The Licensee having the responsibility to collect and deposit excise duty shall file the excise duty return of one month to the Excise Duty Officer in the format as set forth in Schedule 4Nga for enterprises with self-removal system other than tobacco products and in the format as set forth in Schedule 4Cha for enterprises of tobacco product and enterprises with physical control system within twenty-five days of the next month of the Bikram Sambat calendar.

Mode of submission of Return

The return shall be submitted through online, if prescribed by IRD, or through registry from Post Office in other cases.

Return to be submitted for the month when there is no excisable Transaction

The person shall file excise return for any month within 25th of next month even if there is no excisable transaction in that month.

Maintenance of Accounts

Person responsible to keep Accounts

The persons having responsibility to file excise return shall keep accounts.

Matters to be maintained in Accounts

The accounts shall be maintained such that it discloses the following matters related to excisable goods or services, at minimum:

- Matters related to Production,
- Matters related to Sales,

- Matters related to price and quantity of purchase, consumption, and closing stock of raw materials and auxiliary raw materials used production of excisable goods or services.

Accounts to be produced to Excise Officer

The accounts shall be produced to excise officer in case the excise officer wants to inspect it.

Different Accounts to be certified from Excise Officer

The enterprises shall get the purchase, production, issue, sales and stock register certified from Excise Officer every year.

Minimum Tenure for Safe Custody of Accounts

The books of accounts and records shall be kept safely for six years.

- **Computer Processed Records acceptable as Evidence (Sec. 10Ga)**
- **Recovery of Excise Dues**

  Methods of Recovery of Dues:

  - By withholding the refundable amounts to the defaulting persons,
  - By deducting any amount payable from GON or local bodies of GON or organized institutions owned by GON,
  - By making the B/FIs deduct any amount from the interest (it includes deposit and investment in B/FI) of defaulter in that B/FI,
  - By withholding the sales, export, import or other business of that person,
  - By confiscating the current or fixed asset of such person,
  - By auctioning the asset of such person, or
  - By auctioning the stock of such person.

- **Information about offenses to be submitted (Sec 13)**

  - It shall be the duty of every person to inform the excise officer, or in case there is no Inland Revenue Department in the neighboring area, to a police officer or any other government office, about any activities already conducted, being conducted or shall be conducted in contravention of this Act by any person if he gets information thereof.
  - The informant may furnish such information either orally or in writing.
  - The office receiving such information shall forthwith notify the appropriate Inland Revenue Department accordingly.
  - In case the informant wishes to keep his name secret, he may give his introduction in a coded language.
  - While furnishing information, the informant shall not be under any obligation to disclose the source of the information.

- **Rewards (Sec 14)**

  - Any government employee or any other person who furnishes any information or clue about any activities already conducted, being conducted or shall be conducted in contravention of this Act shall be granted by the related Inland Revenue Department a reward of the following amount to be calculated on the basis of the total amount realized from the excisable goods seized from the accused after the final disposal of the case:

    - 10% of the amount to the informant;

    - 20% of the amount to the person seizes and presents the goods only;

    - 30% of the amount to the person who seizes and captures both the evidence and the offender and presents them.

    Provided that in case there is more than one informant, the reward shall be distributed among them on a proportionate basis.

    In case any employee or police seizes the goods (involved in an offense) and arrest the defaulter after receiving a clue, he shall be rewarded with 25% of the amount involved in the case. But, only 25% of the value of the seized goods shall be granted as reward in case only the goods has been seized. In case it is found that the reward involves more than Rs. 15,000 per head in one case, it shall be granted in such a manner that the figure is not exceeded.

    Schedule-2 (Relating to Rules 3 and 5)

    In case of wine and liquor industry based on fruits of least developed areas as listed in Schedule 10 of Industrial Enterprise Act, 2076 (2019), the fee as applicable under this Act shall be less by 75 percent.

CUSTOM DUTY

CHAPTER 1

Introduction and Definitions

Introduction

Customs is one of the oldest sources of revenue in the state-fund in Nepal. The custom duties are levied in case of cross-border import or export of goods. For example, customs revenue from export was Rs. 300,000 and import was Rs. 700,000 at BS 1850, which was 40% of total state revenue as mentioned in 'An Account of the Kingdom of Nipol'- Col. Karkapatrik. Computation of Customs duty (in form of sales tax) has described in 'Arthasastra' written by Kautilya Bishnu Gupta (around 250 BC).

Modern customs law has enacted under Customs Act, 2019 was enforced on 2019.8.6. Customs Rules, 2026 was made effective from 2027.1.21. Customs Act, 2019 has been repealed by Customs Act, 2064; which has been enacted since 2065 Baisakh 15.

According to preamble of the Act, the Act is for 'expedient to amend and consolidate the prevailing customs laws in order to make safe and to facilitate international trade by making customs administration systematic, transparent and accountable'.

Customs duty is levied on import and export of goods. The rates of customs duty chargeable on import or export of the goods shall be as prescribed by Finance Ordinance or Finance Act for the relevant year.

Rates for customs duty are applied from date of finance Ordinance and finance order under Samayik Kar Ain, 2012. In the date of enactment of order (even financial year starts from Shrawan 1), Customs rates are applied. Normally, the Order is issued at official time or after it during day of promulgation of the order, customs clearance is done only after that point of time.

This is a kind of indirect tax and generally the customs duty paid on import of goods is, except in case it is refundable, included in cost of the materials imported.

In local language the customs duty payable on import of goods is called import duty and for export it is called export duty.

The primary duty to pay import duty is of the importer whose name in mentioned in the bill of lading or other importation documents. The export duty is payable by the exporter unless it mentioned elsewhere in negotiation documents between the buyer and seller.

Nepal Government is empowered to establish customs offices or sub-customs offices (Chhoti Bhansar) at different locations within the territory of Nepal near boarder areas. Generally these customs offices are being established at no-man-land.

- **Definitions (S 2)**
- **General Definition**

According to Sec. 2 of the act, following terms are defined:

- ***"Duty Free Shop"*** means a shop permitted by the Government of Nepal to sell any goods imported against the bank guarantee facility to any persons who are entitled to enjoy diplomatic privileges or customs facilities or to the concerned air companies for international flight catering or for sale at any duty free shop of such flight.
- ***"Transaction Value"*** means the total amount to be set by adding freight, insurance and other related costs incurred or incurable in the transportation of goods imported by an importer up to the border of Nepal to the price actually paid or payable, directly or indirectly, by the importer to the seller of such imported goods.
- ***"Diplomatic facility"*** means such facility or privilege as to allow the exportation or importation of any goods keeping only books of record, without examining such goods and collecting duty.
- ***"Declaration"*** means the mentioning by the exporter or importer of the details of goods to be exported or imported in the declaration form or transmitting the same, as prescribed, through any electronic media.
- ***"Export Smuggling"*** means the exportation from Nepal of any goods subject to customs duty without payment of such duty or clandestinely or through illicit routes or without making declaration pursuant to this Act despite the fact that such goods are not subject to customs duty.
- ***"Import Smuggling"*** means the importation into Nepal of any goods subject to customs duty without payment of such duty or clandestinely or through illicit routes or without making declaration pursuant to this Act despite the fact that such goods are not subject to customs duty.
- ***"Examination"*** means the examination by the Customs Office of any goods to be exported or imported or documents related with such goods or of both in order to ascertain whether such goods are accordingly as declared, and this expression also includes the search or x-ray of the body or any passenger entering into Nepal from a foreign country or departing from Nepal to a foreign country.
- ***"Clearance"*** means the permission given by the Customs Officer to export or import or remove any goods from the Customs Office pursuant to this Act and the Rules framed under this Act.
- ***"Post Clearance Audit"*** means the audit referred to in Section 34.
- ***"Export"*** means the act of taking of goods out of Nepal to a foreign country.
- ***"Declaration Form"*** means the form in which an exporter or importer declares the details of goods to be exported or imported.
- ***"Import"*** means the act of bringing of goods into Nepal from a foreign country.
- ***"Bonded Warehouse"*** means a warehouse licensed by the Department to import and hold, against the bank guarantee facility, such raw materials or subsidiary manufacture goods to be exported to foreign countries or to be sold domestically at convertible foreign currencies or such goods as to be sold at a duty free shop.

- ***"Bank"*** means a commercial bank or financial institution licensed to carry on banking transactions pursuant to the prevailing law.
- ***"Bank Guarantee"*** means the guarantee given by a bank to the Customs Office against payment by itself of duty payable by any exporter or importer in exporting or importing any goods in the event of failure of such exporter or importer to pay such duty.
- ***"Bank Guarantee Facility"*** means a facility accorded to any exporter or importer to export or import any goods on the basis of bank guarantee.
- ***"Customs Officer"*** means the Chief Customs Administrator, Chief Customs Officer or Customs Officer, and this expression includes the Chief of Sub-customs Office and custom office or Section Officer, Director, Deputy Director General prescribed by Director General or the Official designated by the Ministry of Finance pursuant to Section 84.
- ***"Customs Agent"*** means the licensee as referred to in Section 51.
- ***"Customs Office***" means the Customs Office established by the Government of Nepal pursuant to Section 4, and this expression includes the premises of such Customs Office and such other area as may be prescribed by the Government of Nepal by notification in the Nepal Gazette.
- ***"Customs Godown"*** means a house, building, shed or similar other structure built in a Customs Office or any place for holding goods to be exported or imported.
- ***"Customs Duty"*** means customs duty chargeable on goods to be exported or imported in accordance with laws.
- ***"Customs Value"*** means such value of goods to be exported or imported as may be determined in accordance with the provisions of Section 13 or 16 for the purpose of determining customs duty.
- ***"Customs Area"*** means the customs area prescribed by the Government of Nepal pursuant to Section 3.
- ***"Duty"*** means each tax, charge and fee chargeable on goods to be exported or imported in accordance with law, and this expression includes customs duty.
- ***"Duty Facility"*** means such facility as to allow the exportation or importation of any goods keeping only books of record, without collecting duty, whether or not examining such goods.
- ***"Director General"*** means the Director General of the Department of Customs.
- ***"Goods"*** means any kind of movable goods or property including currency.
- ***"Person"*** means a natural person, and this expression includes any company, corporate body and firm registered pursuant to law.
- ***"Department"*** means the Department of Customs.
- ***"Demurrage"*** means the charge payable to the Government of Nepal by the exporter or importer of goods if such exporter or importer fails to take delivery of such goods stored at the customs godown run by the Customs Office within the prescribed time limit.
- ***"Motor Vehicle"*** means any conveyance to be used or used to make travel or transport goods.

Specific Definition

- **Special Economic Zone:**

  For the purpose of Sec. 12, special economic zone means a zone specified as a special economic zone by the Government of Nepal through notification in the Nepal Gazette.

- **Valuation:**

  For the purpose of valuation of goods following definition has given in Sec. 13

  - ***"Identical Goods"*** means goods which are the same in all respects, including physical characteristics, quality and reputation
  - ***"Similar Goods"*** means goods which, although not alike in all respects, have like characteristics and like component materials which enable them to perform the same functions and to be commercially interchangeable.

CHAPTER 2

Imposition of Customs Duties

Imposition of Customs Duty

According to Sec. 5 of the act, customs duty shall be chargeable on all goods to be exported or imported except those goods that enjoy customs duty exemption pursuant to this Act or the prevailing law.

Duty to be levied in case of Re-import of Exported Goods

According to Sec. 6, duty is levied in event of re-import of exported goods if:

- Any person re-imports any goods exported from Nepal after having been manufactured or finished in Nepal, such goods shall be subject to such duty as is chargeable on the importation of the goods of similar kind or to the same value, which have been manufactured or finished in a foreign country.
- Notwithstanding anything contained in sub-section (1), no customs duty shall be charged on the goods which have been returned back due to the following reasons and with following conditions:
    - Having been exported through parcel by post but could not be delivered to the concerned person and thus returned back, or
    - Having been returned back because the concerned person has refused to take delivery after clearance made by the Customs Office or after having arrived abroad, or
    - Having been returned back because of being unable to meet standard quality due to an accident or natural calamity.

Where the raw materials and subsidiary raw materials of the goods returned back pursuant to sub-section (1) were imported without paying duty, the duty chargeable on the quantity of the raw materials or subsidiary raw materials used in such goods shall also be recovered.

Exception on levying Customs duty

In the following cases, according to Sec. 7, duty is levied on import of goods:

- If any importer makes an application for not releasing any goods imported by that importer and for so leaving such goods with the Customs Office that they belong to the Government of Nepal, no duty shall be charged on such goods.
- The Government of Nepal may itself use the goods so left pursuant to sub-section (1) or auction them in accordance with other provisions under Act. In case, such goods are in such a condition that they can neither be brought into use nor be auctioned, the Customs Officer may remove such goods from the Customs Office or destroy them as prescribed; and the expenses incurred in such removal or destroy shall be recovered from the concerned importer himself or herself.

Date of Charging Custom Duty

In the case of goods subject of duty, then rate of duty is taken on the base date as described in Sec. 8. Base date is important because of rate variations of the duty. Basic principle of base date is Date of clearance. The duty of any goods to be exported or imported shall be determined according to the tariff (rate of duty) prevailing on the date on which the goods are cleared from the Customs Office.

This principle has exception as:

- **Facility or exemption:** In the case of goods imported under the diplomatic facility, duty facility or partial or full exemption, according to the tariff prevailing on the date of payment of duty of such goods,
- **Diplomatic Facility, Duty Facility, Exemption and Other Facilities**

  There are certain facilities and exemption on the customs duty in case of imports. These facilities are of three types, viz. diplomatic facility, duty facility and partial or full exemption.

> ***Recalling the Definition***
>
> According to Sec. 2(c), "diplomatic facility" or "diplomatic privilege" means such facility or privilege as to allow the exportation or importation of any goods keeping only books of record, without examining such goods and collecting duty.
>
> According to Sec. 2(z), "duty facility" means such facility as to allow the exportation or importation of any goods keeping only books of record, without collecting duty, whether or not examining such goods.

In the following cases of foreign subjects are duty facilities according to Sec. 9:

- Diplomatic facility or duty facility shall, on recommendation of the Ministry of Foreign Affairs, Government of Nepal, be accorded, (as prescribed in Rule 3), to those bodies, officials or persons who are entitled to enjoy such diplomatic facility or duty facility under any bilateral or multilateral treaty or agreement to which Nepal is a party.
- The Government of Nepal may, from time to time and by notification in the Nepal Gazette, accord the diplomatic facility or duty facility to such goods to be imported by such persons or bodies as specified in that notification.
- The Government of Nepal may, from time to time and by notification in the Nepal Gazette, accord partial or full customs duty exemption to the goods specified in that notification.
- The Government of Nepal may accord partial or full customs duty exemption to the goods to be imported in the name of any project to be operated under foreign loan or grant assistance or in the name of the contractor of such project.
- The Government of Nepal may accord partial or full customs duty exemption to the fuel to be consumed during international flight, engine of aircraft, spare parts, machine, equipment thereof, food, liquors, beer and light drinks consumed in flight by an international air service company.
- The provisions for according the duty facility to any goods to be brought again into Nepal from any part of Nepal via any abroad route shall be as prescribed.
- The provisions for according the duty facility to any goods to be sent again to a foreign country from the foreign country via Nepal shall be as prescribed.

- Government of Nepal may give total duty exemption to be imposed while importing relief materials. While giving such duty exemption, details of goods given duty rebate and time period to be got such exemption facility should be mentioned.

In the following cases of customs duty exemption and other facility to goods to be exported and imported by industry situated in special economic zone facilities according to Sec. 12:

Special Economic Zone Authority on its recommendation can provide following benefits on goods imported by the industry established in Special Economic Zone:

(Ka) Provide custom duty exemption by levying 1% custom duty for one time on 1 bus imported by the industry for pickup and drop of its employees , labour and 2 transport vehicle for the purpose of transportation of goods.

But, if such bus or transport vehicle imported on custom duty exemption is transferred or sold or through any other way transfer of ownership then full duty shall be payable as per the prevailing laws.

(Kha) Equivalent bank guarantee instead of custom duty or other duty to be paid on import of required raw materials, subsidiary raw materials (including packing material) as required to manufacture goods to be exported or to be sold at exchangeable foreign currency within country.

(Ga) Equivalent bank guarantee instead of custom duty or other duty to be paid on import of plants, machineries, machines, equipment, tools and spare parts

Explanation:

For the purposes of this Section, "Special Economic Zone" means a zone specified by Nepal Government as per the prevailing laws.

Custom office shall release Bank Gurantee on the written recommendation of Special Economic Zone Authority after completion of purpose for which bank guarantee has been taken as per Sub Section 1(Kha) or (Ga).

If any importer sells, as prescribed, any goods which that importer has imported to any industry established in the special economic zone and that importer has paid the customs duty for importing such goods, the Customs Office shall refund, as prescribed, such customs duty to that importer.

If any industry established outside the special economic zone sells any finished goods manufactured by that industry to any industry established within the special economic zone, such customs duty and other facility as is accorded in the event of export shall be accorded as if that sale were an export.

If an industry established within the special economic zone so sells any goods manufactured from the raw materials imported under the customs duty exemption that such goods are consumed in Nepal, such goods shall be allowed to be taken out of the special economic zone only after payment of duty chargeable on the raw materials used in such goods.

Industry if wants to shift from special economic zone to other than such zone then respective authority shall provide approval of shifting only if industry pays an amount of exemption other than Value Added Tax availed as per this section to the respective Custom Office.

CHAPTER 3

Value of import and export

Customs duty is levied in two bases: Ad Valorem and specific amount. Ad Valorem means a tax on goods or property expressed as a percentage of the sales price or assessed value. In specific amount, the duty is levied based on measurement of property, assets or base irrespective of value of goods.

Valuation

In case of ad valorem duty, the valuation of the transaction of import or export is needed. Valuation of importation and exportation is different based. In case of importation, under ad valorem items, all the cost (value paid for goods, transit costs up to customs area) till point of custom frontier is assumed as value of importation.

Import ad valorem valuation

For the importation, according to Sec. 13, the rules on customs valuation, annexes and interpretative notes set forth in the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 shall be pursued in determining the customs value of imported goods.

There are six prioritized valuation modules for ad valorem customs valuation. They are:

- Transaction Value (TV) based
- Price of Identical goods based
- Price of similar goods based
- Price based on deductive value
- Price based on computed value

The importer shall declare the transaction value, attaching therewith the description and documents proving the value of goods imported. If the transaction value declared by the importer is in conformity with above, the Customs Officer shall determine the customs value of the goods on the basis of such transaction value.

If such transaction value does not appear to include freight, insurance and other related expenses, the Customs Officer shall determine the transaction value by adding an estimated amount likely to be incurred for the same. The Director General may prescribe bases for fixing the estimated amount.

Customs Base (foreign currency*conversion rate)= Price paid to vendor + Transportation cost up-to Customs Area + Other cost up-to Customs Area

According to this method, the transaction value is determined on the basis of invoices produced by the consigner or its agent. It is supposed that the invoices are for the full value and the consigner has an obligation to pay to the supplier an amount equal to that mentioned in the invoice.

Transaction value is determined on two tier basis:	
Invoice price of the goods charged by the supplier	xxx
+ Direct expenses incurred to bring the goods to the customs office	xxx
= Transaction value	xxx

Invoice does mean the invoice issued by the consigner/supplier of the goods/vendor. It is named as commercial invoice in the Act.

For determination of transaction value the invoices for the followings are required:

- Invoices for the goods being imported or exported
- Invoices of the direct expenses incurred to bring the goods to the customs office.

Sometimes, the supplier of the goods charges expenses like packing charges, forwarding charges, etc. or sends the consignment with paid transport receipt(TR) and charges the transport expenses in the invoice either by adding in the price of the material or charging it separately on the invoice.

In case the expenses are included in the rate of the goods supplied, the term used for it as the prices are as per ICC INCOTERMs (now 2010) up to an agreed-destination. The destination is fixed up to which the expenses are included in the price of the goods. For example: CIF Kolkata means transport and other expenses incurred up to Kolkata (ship) and any expenses incurred from Kolkata (from unloading from ship) to the final destination shall be incurred by the consignee extra of the price charged in the invoices. For referral purpose, cost up to customs frontier shall be as follows in INCOTERMs 2010:

All the cost up to Nepal Customs (not unloaded except FOB and CFR) shall be customs base for valuation; so,

INCOTERMs	Value for Customs	
	Purchase price includes (cost borne by seller)	Buyer's additional cost (other than purchase price paid)
EXW (at seller's Place)	Purchase price paid	Transportation, insurance and other cost from seller's place to Nepal customs office
FCA at exporting cargo terminal	Purchase price paid (includes transport till terminal)	Export clearance, boarding, transportation, insurance and other cost from said terminal place to Nepal customs office
CPT at first carrier's cargo terminal	Purchase price paid (includes transport till first carrier's place)	Transportation, insurance and other cost from said carrier's place to Nepal customs office
CIP at buyer's godown	Purchase price less transportation and insurance within Nepal	-

DAT at Nepal boarder	Purchase price	-
DAP at buyer's godown	Purchase price less transportation and insurance within Nepal	-
DDP at buyer's godown	Purchase price less transportation and insurance within Nepal	-
FAS at seller's port	Purchase price (includes transport till port alongside)	Boarding, transportation, and other cost from said terminal place to Nepal customs office
FOB at named board	Purchase price (includes loading till ship)	Transportation, and other cost from said terminal place to Nepal customs office
CFR at destination port (say Haldiya)	Purchase price (includes transportation cost upto destination port, say Haldia)	Insurance, if any from port of shipment and transportation from port of destination and other costs to Nepal customs office
CIF at destination port (say Haldiya)	Purchase price (includes transportation and insurance cost up to destination port, say Haldia)	Insurance and transportation from port of destination and other costs to Nepal customs office

In case the deal has made under Sea or Inland Waterway transportation (FAS, FOB, CFR, CIF terms), Nepal transport to be converted into DAT for Customs purpose.

Consider the place of transfer of risk, when risk and rewards transferred to the buyer, the goods is asset of buyer and revenue for seller, for the purpose of NAS 18 (NFRS 15 now), Income Tax also.

Direct expenses or other expense, as the context required above, in this regard shall be:

- Port clearance expenses and duties, commission of the clearing agent;
- Transportation cost up to customs office.
- Insurance premium incurred on transit insurance on the consignment.
- Any other expenses like loading unloading expenses, etc.

Transaction Price in case of Goods imported from Khasa area of China:

In this case also the expenses incurred up to Khasa and after Khasa up to the customs office at Tatopani shall be included in the transaction price.

The direct expenses may be:

- Transportation cost up to customs office.
- Insurance premium incurred on transit insurance on the consignment.
- Any other expenses like loading unloading expenses, etc.

In case the supplier from China raises the invoice for Khasa or Tatopani, the direct expenses up to Khasa or Tatopani shall not be considered for calculation of transaction value because it is already included in the invoice price.

Transaction Price in case of Goods imported from Any countries through aircrafts:

Incase goods are transported using aircrafts; the consignee has to produce airway invoice in support of the transportation and other expenses.

But sometimes the airway invoice does not contain the information regarding transport and other charges, in that case according to the Act, the estimated cost for transport etc shall be determined on the basis of such expenses being incurred when the goods are delivered through ship or other means of transport from the country up to the customs office.

If there is a reasonable ground to believe that the value declared by the importer is doubtful, the Customs Officer may ask the importer to produce additional documents or evidence in writing to prove that such value is the actual transaction value. It shall be the responsibility of such importer to provide documents so asked. If the customs value of any goods cannot be determined on the basis of the transaction value declared by the importer or the bills, invoices and documents submitted by the importer, the Customs Officer shall give a notice, accompanied by the reason for the same, to the concerned importer.

Price of Identical goods based valuation

If the customs value cannot be determined on the basis of the transaction value, the customs duty of such goods shall be determined on the other priority valuation modules. For the next step as basis of the transaction value of identical goods ("identical goods" means goods which are the same in all respects, including physical characteristics, quality and reputation) already imported into Nepal prior to the import of such goods.

Price of similar goods based valuation

If the customs value cannot be determined on the basis of the transaction value of identical goods even so far, the customs duty of such goods shall be determined on the basis of the transaction value of similar goods ("similar goods" means goods which, although not alike in all respects, have like characteristics and like component materials which enable them to perform the same functions and to be commercially interchangeable) already imported into Nepal prior to the import of such goods.

Price based on deductive value

If the customs value cannot be determined on the basis of the transaction value of similar goods and such goods have already been imported into Nepal and sold at market to a person who is not related to the importer, the customs value of such goods shall be determined on the basis of deductive value method, by deducting the tax, duty levied in Nepal on the selling price of each unit of the maximum unit so sold, and other related costs and profits.

Price based on computed value

If the customs value cannot be determined pursuant to this act, the customs value shall be determined on the basis of computed value method, also calculating the costs incurred in the

production or manufacturing of such goods and profits made or likely to be made by the seller while selling such goods to the importer.

Residual Valuation

If the customs value cannot be determined even on the basis of Computed Value, the Customs Officer shall so determine the customs value of such goods on a reasonable basis as not to be contrary to the provisions of sub-sections (2)- Valuation on the basis of transaction value, sub-section (8)- Valuation on the basis of identical goods, sub-section (9)- Valuation on the basis of Similar goods, Sub-section (10)- Deductive Value Method, Sub-section (11)- Computed Value Method of Sec. 13.

Exceptions and complications on above valuation modules

If the importer makes a request for the determination of customs value by adopting the procedures set forth in sub- section (11) (to apply Computed Value Method) of Sec. 13 prior to adopting the procedures set forth in sub- section (10) (before the application of Deductive Value Method) of Sec. 13, the Customs Officer may determine the customs value in accordance with the provisions of sub-section (11) of Sec. 13, i.e. applying Computed Value Method.

Notwithstanding anything contained elsewhere in this Section 13, if the owner of the goods imported under notice related to goods that pessanger can bring or take for personal purpose or the goods received as a gift or specimen and imported from a foreign country or relief materials makes an application for the valuation of such goods, showing the reason for failure to indicate the transaction value thereof and if the Customs Officer considers the matter to be appropriate or submitted without indication of value, he or she may determine a reasonable customs value of such goods. *Remedies in case the transaction value declared by Importer differs from Transaction Value determined by customs Officer*

As per Sec. 13 (15), if the value declared by an importer is less than the customs value determined by the Customs Officer pursuant to that Section, the Customs Officer may do the following in relation to such goods:

- Clearing such goods by collecting fifty percent additional customs duty on such difference value, or
- Purchase, or cause to purchase, such goods in a manner such that the amount to be paid is arrived by adding five percent amount to the value so declared to the importer.

Valuation on Foreign currencies (Sec. 13(16))

While determining the customs value of goods in accordance with the provisions of Section 13 of the Act, the customs value shall normally be determined in a foreign currency.

The conversion of such currency into Nepalese rupees shall be made according to the selling rate of foreign currency which is prescribed by the Nepal Rastra Bank and prevailing on the day in which the declaration form is registered in customs office or received in customs office in electronic medium through the computer system of such goods.

In the case of such foreign currency, the exchange rate of which is not prescribed by the Nepal Rastra Bank, such foreign currency shall be converted into American dollars, and the selling rate of American dollars shall be taken as the basis.

Provided that in converting the customs value of the goods of which duty is paid subsequent to the importation thereof under the diplomatic facility, duty facility or full or partial exemption of duty, such conversion shall be made according to the selling rate of foreign currency which is prescribed by the Nepal Rastra Bank and prevailing on the day of payment of the remaining duty.

Notwithstanding anything contained in Section-13, the director general may instruct for revaluation of goods wherever he deems necessary on determining the value of goods based on the valid reason that the custom officer has not complied the process or technique mentioned in the section or the value determined is doubtful within ninety days of clearance of such goods.

On receipt of above instruction, the custom officer shall perform evaluation revaluation of goods after necessary examination and inform to director general within thirty days.

If the custom officer deems that any goods are imported with excessive billing, such officer may send for necessary investigation and action to the concerned authority in writing as per prevailing Federal laws.

Provisional Valuation

As per Sec. 14, custom officer has power to determine customs value provisionally in the following cases:

- the importer makes an application, along with a reasonable reason, that he or she is not able to forthwith provide necessary documents and other related information as required for the valuation of goods,
- the customs value has to be or can be determined only after carrying out the laboratory test or other examination of goods or there appears a need to make further inquiry into the documents and information provided by the importer.
- Where, after the determination of provisional customs value, the importer wishes to clear the goods by furnishing a deposit of the duty chargeable on such goods, the Customs Officer shall make clearance of such goods.
- In such provisional valuation, Customs Officer shall determine the customs value of the goods under the provisions of Section 13 no later than thirty days after the date of determination of the provisional value.
- And if the customs value determined replacing the provisional valuation, is more than the provisional customs value determined, the Customs Office shall recover from such importer the duty chargeable on such excess value, and if it is less than that, the duty collected in excess shall be refunded to the importer.

Valuation for accompanied goods with passengers

The value of the goods imported under baggage of the passengers as accompanied (with self) or unaccompanied (before or after self) goods shall be levied in lump sum at the rate of 40% for customs duty, excise duty and value added tax.

- In the items like ***ornaments of silver, cigarette, liquor, vehicle weapons, or other items which are allowed to import under license- usual rate, not lump sum.***
- Duty shall be levied as below on gold carried by traveler returning from abroad:
  - - NRs. 9,500 per 10 grams for first 50 Gram
  - - For more than 50 grams, NRs. 10,500 for each 10 grams.
  - - If gold is imported more than 100 gram, gold more than 100 gram will be seized.
- Duty shall be levied as below on gold carried by traveler returning from abroad:
  - NRs. 10,500 per 10 grams for first 50 Gram
  - For more than 50 grams, NRs. 12,000 for each 10 grams up to 100 grams.

Valuation for exportation

Determination of export value is important but less critical than importation. According to Sec. 16, determination of customs value of goods to be exported shall be as follows:

- The invoice value declared by an exporter shall be the customs value of the goods to be exported. But, Government of Nepal may, if considers necessary, determine separate customs value of any goods of specific nature to be exported, by notification in the Nepal Gazette. Where separate customs value is so determined, the customs value of such goods shall be the invoice value declared by the exporter or the customs value so determined by the Government of Nepal, whichever is higher.
- The customs value referred to above shall be the free on board, FOB ("free on board (FOB) value" means a value which includes the factory price of the goods to be exported and costs incurred in movement of such goods up to the concerned Customs Office of Nepal) value.

Customs Base= ex-factory price + transportation cost up-to Customs Area + other cost up-to Customs Area

- The value of goods to be determined pursuant to Sec. 16, shall be determined in foreign currency. Such foreign currency shall be converted into the Nepalese rupees according to the buying rate of foreign currency which is prescribed by the Nepal Rastra Bank and prevailing on the day of clearance of such goods.

Valuation of Specific duty items

Items on which the duty is levied based on quantities are not required to make valuation at all. The duty is levied on the duty rate in the line-items. For that purpose, determination of HS Code line is important.

- **Procedure of Custom Clearance & Payment**
- **Submission of Declaration Form (Pragyapan Patra)**

Import or export is to be reported in Customs Office by way of declaration form as prescribed in the regulation under power of Sec. 27.

Submission of Other Supporting

According to Sec. 18, any person who exports or imports any goods shall fill up the declaration form (the details may be send through electronic medium also), accompanied by the documents, and submit it to the Customs Officer of the concerned area. It shall not be necessary to fill up the declaration form in the case of those goods which have been exempted from customs duty by the Government of Nepal by notification in the Nepal Gazette, out of the goods contained in the luggage and baggage of passengers going out from Nepal and coming into Nepal from foreign countries.

Additional Time to Submit other Supporting

In the event of occurrence of a circumstance beyond control or any other reasonable reason, in case the concerned person is not able to submit any document along with the declaration form; such person may make an application, showing such circumstance or reason, to the Customs Officer for permission to submit such document later. Upon examination of the application, in case such circumstance or reason appears to be reasonable, the concerned Customs Officer may prescribe the period within which such document has to be submitted. Customs Officer may prescribe any terms or ask for a reasonable deposit for security.

- **Examination of declaration form:**

  According to Sec. 19, the declaration form filed by the importer/exporter or their agents shall be examined by concerned Customs Officer as to whether the goods declared in the declaration form are exportable or importable under law. While carrying out such examination, the Customs Officer may, as required, carry out or cause to be carried out physical inspection of the concerned goods.

  If, in carrying out examination procedure, such goods are found to be non-exportable or non-importable or restricted ones, the matter shall be referred to the concerned body or authority for investigation or action under the prevailing laws.

- **Examination of goods:**

  According to Sec. 20, after examining the submitted form the officer shall examine the concerned goods in whole or in on a sample basis "selective method" *("selective method" means a system so determined by the Department that any goods can be cleared, with or without examining such goods, or by examining documents only, taking into account the risks of revenue, trade, goods or other activities).* In case, goods are found to be exportable or importable, the Customs Officer shall examine such goods in accordance with the provisions contained in Chapter-7. However, if it is not required to examine such goods in accordance with the selective method, the Custom Officer may examine the related documents only.

- **Determination of duty and clearance of goods**

  After the examination of goods or documents, the Customs Officer shall determine the customs value of the goods to be imported and of the goods to be exported as per Sec. 21. Based on those values the Customs Officer shall determine the duty chargeable on the goods. According to Sec. 23, except where exemption from or facility granting waiver of the duty

is provided under the prevailing laws, the Customs Officer shall make clearance of goods only upon collecting the duty determined pursuant to Section 22. Exception to determination of duty, according to Sec. 24, if any importer wishes to pay the duty chargeable on any goods to be imported by the importer prior to the arrival of such goods at the concerned Customs Office, the importer may, for that purpose, make an application, accompanied by the declaration form filled up and such documents relating to such goods as referred to in Section 18, to the Customs Officer.

If the rate of duty determined or the exchange rate of convertible foreign currency prevailing on the day of payment of duty differs from that prevailing on the day of clearance of goods, the rate prevailing on the day of clearance of goods shall be applied. The Office shall complete necessary procedures and make clearance of such goods with priority.

- **Physically export or import of goods**

  The exporter or importer of any goods to be exported or imported or his or her customs agent may export or import such goods only after the declaration form or a receipt of payment of the duty has been received, and after the Customs Officer has given permission to clear the goods upon making, or causing to be made, examination thereof, as per Sec. 25.

  If any person exports software through electronic means, such software shall be deemed to have been exported only after certification by the Nepal Rastra Bank, on the basis of, inter alia, the agreement relating to export, invoice and the evidence of payment made by the concerned importer.

- **Post clearance audit**

  Customs Department is empowered, under Sec. 34, to order for post clearance audit of the goods, the delivery of which has already been taken by the importer after payment of the customs duty. Customs Department or Customs Officer may select certain importer, certain goods or any specified goods for which certain information is received for post clearance audit.

  In case it is found that, as a result of the post clearance audit, the value of the goods declared is less than the assessed value and thereby it is determined that the revenue is collected less than the actual, fine for the customs duty chargeable on the difference shall be charged. And the customs officer may impose any other penalty on the importer as per Customs Act.

  The post clearance audit shall be conducted, normally, within 4 years from date of the customs clearance of the goods.

  It is discussed in detailed in Chapter 4.4.

CHAPTER 4

Customs Officers and Their Rights, Duties and Powers

Section 3 has provided power to Nepal Government to establish main customs offices and sub-customs offices anywhere within the territory of Nepal.

The Customs Department established by Nepal Government is working as regulating authority for customs duty. Every main customs office is headed by a chief of customs office and other customs officers are recruited there for customs collection.

The duties and powers of the employees of customs office are described hereunder.

- **Power to open and examine consignment or packet:**

  Examination:

  Customs Officer has power to open and examine consignment or packet as per Sec. 28. For this, a customs officer may:

  - Open and examine, or give order to any of his or her sub-ordinate employees to open and examine each and every consignment or packet of any goods whatsoever to be exported or imported or open and examine them randomly and casually or open and examine only a certain percentage of the same. In case of examination of live animals, perishable goods and such other goods as the Customs Officer considers necessary shall be made first.
  - Set down the method of such examination and a clear description of the items so examined in the declaration form.
  - Give order to any of his or her sub-ordinates to examine such consignment or packet if it has not been examined or to re-examine the same if it has already been examined, if there is a suspicion about any consignment or packet examined or not examined or any information is received about the same.
  - Examine or cause to be examined the goods in presence of exporter/importer who give information having wishes to get the goods examined in his or her presence.
  - Examine or cause examination only upon collection of the duty chargeable on the basis of declaration.
  - Re-examine, or cause to be re-examined, such goods wholly or partly, prior to taking delivery of the goods once cleared from the customs area or after taking them outside the customs area; and shall provide information of the reason for such re-examination to the concerned importer.

  Deemed examination:

  According to Sec. 29, while examining any consignment or packet, the goods held in the consignment or packet are found to be conforming to the submitted bills, invoices, other

documents or details, the goods in the other consignments or packets which have not been examined shall also be deemed to have been examined.

For example, there are 7 containers of goods as per packing list of importation including, inter alia, other importation documents; then the officer examined one container at full-length with verification of packing list. If officer found the quantity of goods (including said specification and quality) verified with packing list, then the remaining container may be cleared without examination at full.

Special test of **goods**:

According to Sec. 30, for the health or environmental prospective, if it is required to special test, the officer may get such goods tested by the concerned body or laboratory. For this purpose:

- The officer may take a specimen of such goods from the consignment or packet and send it to the concerned body or laboratory.
- The concerned authority or laboratory shall promptly test the goods sent for test and send results thereof to the Customs Office promptly.
- If, in carrying out test, the goods appear to cause adverse effects or damage to the environment or health, the Customs Officer shall order the concerned importer to return such goods back to the concerned exporter of the foreign country and recover the foreign currency paid to vendor, in such manner as prescribed.
- If the concerned importer does not send back such goods pursuant to the order issued, the Customs Officer may seize such goods and destroy or decompose such goods and shall recover from the concerned importer the expenses incurred or likely to be incurred in such destroy or decomposition.

- **Power to visit and examine goods in the concerned place:**

According to Sec. 31, any exporter may submit an application to the Customs Officer to visit the production site or godown of any goods to be exported by the exporter and examine such goods. Similarly, importer may submit an application, accompanied by the prescribed documents and the declaration form filled up, to the Customs Officer for the examination of the goods imported by the importer outside the customs area. If, upon inquiry into the application received, it appears reasonable to make such examination, the Customs Officer may, by obtaining prior approval of the Director General, visit the site outside the customs area on his or her own and examine the goods or send any of his or her sub-ordinate employee for such examination, by collecting the fees as prescribed.

Additionally, prior to making examination beyond customs area, the Customs Officer shall take a deposit of an amount to be set by adding fifty per cent duty to the duty chargeable on the goods according to the customs value declared by the importer. The Customs Office shall refund the excess amount to the importer if such deposit is more than the customs duty chargeable on such goods and recover from the importer the shortfall amount if such deposit is less than such customs duty.

- **Power to seal the means of transport**

  According to Sec. 32, After the clearance of goods by the Customs Office, such goods may be kept in the closed container for transporting them, and the Customs Office may seal such container.

  More-ever, according to Sec. 33, nobody other than the authority authorized to make investigation under the prevailing laws on revenue leakage shall, without prior approval of the Ministry of Finance or the Director General, open, inspect and examine any goods cleared by the Customs Office and any means transporting such goods such sealed means of transport or container whatsoever.

- **Power to make post clearance audit**

  As per the power vested with the officer under Sec. 34, in order to ascertain whether the goods cleared by the Customs Office are the same as declared by an importer/exporter or confirm to the declaration made by the importer/exporter or not, the Director General or Customs Officer may audit, inter alia, the importer's/exporter's books relating to the purchase, import or sale of goods, records, books of accounts or similar other documents, bank records, computer system and all records related to his or her business.

  Based on such audit, if it is found that the goods imported by the importer are different than those declared by the importer or are inconsistent with the declaration made by the importer or the transaction value or the quantity of the goods has been declared less and by virtue thereof lesser duty has been recovered, the Customs Officer shall immediately recover from the importer the duty chargeable on such less value or quantity at the time of import and take action against such importer for the declaration of less transaction value or quantity, pursuant to this Act. If, upon audit made pursuant to sub-section (1), it appears that less duty has been recovered by the reason of difference in sub-heading of commodity classification or due to exemption of applicable duty, the concerned Customs Office shall recover such shortfall amount of duty and fine equivalent to that of shortfall amount from the importer.

  Period: Post clearance audit may be made until four years after the date of clearance of goods.

  Procedures: For this officer has power for summoning of the concerned person, taking his or her deposition, examination of evidence, requiring the submission of documents and the trial of case. If such documents, as required by the officer has not produced before the officer, the assessment shall be done based on the evidences availed for it.

  Opportunity of hearing: In case any variation found, the officer shall allow a period of 15 days time for clarify the case or make the evidences the person had. In case, any new evidences availed after assessment but before lapse of 4 years period, officer may reassess the assessment made earlier (reassessment of reassessment).

  Period of payment of duty: The amount established from reassessment shall be deposited within 35 days from date of reassessment. An interest of 15% is levied thereafter. If the amounts of duty and interest have not paid on time, other methods of collection may be initiated.

- **Power to goods to be produced before Officer**

  According to Sec. 35, if any employee of the Customs Office or authority deputed by the Director General finds that any person has exported or imported any goods through any route other than the route prescribed or smuggled the goods or is going to make such export or import, such employee or authority shall capture such goods and the person and motor vehicle carrying such goods and produce them before the Customs Officer. The Customs Officer shall institute action against and in relation to the goods, person and motor vehicle so produced on the offense of export smuggling or import smuggling.

  According to Sec. 37, where any employee other than the Customs Officer or the employee designated for that purpose intends to make search, the concerned person may make a demand that he or she be produced before the Customs Officer prior to making such search. In such cases, the employee of the concerned Customs Office shall produce him or her before the Customs Officer promptly. Then, officer may search such person or cause any of his or her subordinate employees to make such search, and where the Customs Officer does not see such ground, he or she shall release such person immediately.

- **Power to make search on suspicion or ground**

  According to Sec. 36, if there is a reasonable ground or reason to believe that or there is a suspicion that any person has brought any goods subject to customs duty without paying such duty or smuggled and imported such goods or is going to smuggle and export such goods or has exported or imported or is going to export or import any restricted goods, any employee of the Customs Office may, at any time, stop such person or any motor vehicle and search such person or motor vehicle.

  According to Sec. 39, where there is a reasonable ground to believe or doubt that any person has hidden or kept any goods brought into by evading the customs duty or by way of import smuggling in any house, building, godown or other place, the Director General or the concerned Customs Officer may make decision, accompanied by the reason, and search such house, building, godown or place or give order to make such search.

  - The employee who gets order shall, prior to searching such house, building, godown or place, give a notice, accompanied by the reason for making such search, to the owner of that house, building, godown or place or the person who are residing in such house, building, godown or place for the time being. If such owner or person refuses to acknowledge such notice, a copy of the notice shall be affixed to such house, building, godown or place in a manner conspicuous to all; and after the notice is so affixed, the concerned owner or person shall be deemed to have duly received the notice of search.
  - After the notice has been given to the concerned owner or person, such owner or person shall allow the employee deputed to make search to search such house, building, godown or place.
  - If any person makes any obstruction or objection to making search, the employee deputed to make search shall give a notice and opportunity to the persons who are staying in the house, building, godown or place to be searched to leave such house, building, godown or place. If such persons do not leave in spite of such notice and opportunity, such

employee may search the house, building, godown or place required to be searched at any time between sunrise and sunset by opening or breaking the external or internal door, window or locker thereof also by using necessary force with the assistance of the security body.

- In making search pursuant to this Section, the employee deputed to make search shall, to the extent of availability, make search in witness of the ward chairperson or ward member of the concerned Rural Municipality or Urban Municipality or an employee of any office or house owner or his or her agent or any person having attained the age of sixteen years. If no such person is found to witness the search or such person refuses to witness the same, the person making search shall execute a memo of remarks to that effect and sign it.
- If, on making search pursuant to this Section, any goods brought by evading the customs or by way of import smuggling are seized, the employee making such search shall take such goods in his or her custody, prepare an inventory indicating the details of such goods and deliver a copy of the inventory to the concerned person of the house, building, godown or place searched immediately. If the concerned person refuses to receive such copy or if it is not possible to deliver it to such person, that copy shall be posted by executing a recognizance deed in witness of two witnesses. If the copy of inventory is so posted, it shall be deemed to have been delivered to the concerned person.
- Such employee shall produce the goods and inventory as referred to the concerned Customs Officer; and upon such production, the Customs Officer shall take action under this Act

  Where, upon making a search pursuant to Section 36 or 39, any goods which are subject to the customs duty or which have to be exported or imported by making declaration pursuant to this Act are seized, the Customs Officer shall give order to the person searched to submit the declaration form of such goods and evidence of payment of duty if such goods are those which are subject to customs duty. In the event of failure to submit such declaration or evidence, such person shall be deemed to have committed export smuggling or import smuggling as per Sec. 38.

- **Power to arrest and release on bail or detain**

  According to Sec. 40, where, upon making a search pursuant to Section 36 or 39, any person is found to have committed any offence, the employee making such search may arrest, or cause to be arrested, such person. If there is a reasonable ground or reason to believe or doubt that any person is going to commit or has committed export smuggling or import smuggling or any act contrary to this Act, the concerned Customs Officer or any other employee of the Customs Office authorized by him or her may arrest, or cause to be arrested, such person in any motor vehicle or place.

  - Person arrested shall be produced before the Officer looking the case within twenty four hours excluding the time required for journey.
  - The Officer looking the case shall immediately take legal action against the person produced. Such person shall not be held in detention for more than twenty four hours without taking such action.

- If any person produced is found to be an offender based on the evidence available for the time being, the Customs Officer may release such person on bail which includes the amount for imprisonment and fine that can be imposed on such person pursuant to this Act and the amount equal to the amount in controversy where such amount is also to be recovered on the condition that such person shall make presence at the prescribed place and time.
- Any person who fails to furnish the bail demanded shall be held in detention until such bail is furnished to the Customs Office. But, if there is a ground that such person may destroy evidence if he or she is released on bail, the Customs Officer may forward action by holding such person in detention, by assigning the reason for the same. Obviously, such person shall not be held in detention for a term that exceeds the maximum term of punishment that can be imposed on such person pursuant to the act.
- According to Sec. 42, If any person who commits any act that is considered an offence under this Act cannot be arrested at the time of commission of the offence or such person, despite being arrested, absconds, the Customs Officer or the employee authorized by him or her or the employee deputed for that purpose may arrest such person at any time. Action shall be taken against such person as if he or she were arrested at the time of commission of the offense.

- **Power to use maximum force:**

  According to Sec.43, if any person attempts to export or import any goods through any route other than prescribed, the Customs Officer or the employee of the Customs Office authorized by him or her or the competent government employee may stop such person. If, while trying to stop such person, such person manhandles or uses force, the Customs Officer or such employee shall request and convince such person not to do so.

  Despite the request and effort of convincing him/her, if the person does manhandling or uses force, the Customs Officer or such employee may arrest him or her. While trying to make arrest, that person uses force or tries to escape or go away and cannot be arrested for the time being, the employee deputed for security on the spot may, by order of such Customs Officer or competent authority for his or her security and for the observance of duties, first make an aerial firing and then open fire in such a manner as to cause a minimum of loss provided the situation cannot be controlled despite such firing or the person using force has also a weapon.

  An employee of the Customs Office may order any person who makes movement by a motor vehicle through the route prescribed under Section 3 to stop, or cause to be stopped, such motor vehicle, as well. If such person does not carry out such order but manhandles or uses force and attempts to take away or takes away such motor vehicle without getting it examined, the employee deputed for the security of customs may, by order of the Customs Officer, open fire at the tyre of such motor vehicle in such a manner as to cause a minimum of loss. If it is necessary to open fire, the Customs Officer or the authorized person shall give by faster means the information of that matter to the Director General or the Concerned Chief District Officer.

CHAPTER 5

Bonded Warehouse, Facilities to it and Other Specific Conditions for Import and Export

Those business houses that have taken permission from Customs Departments for bonded warehouse are called "bonded warehouse". These are the big export houses producing goods or purchases goods for export. According to Sec. 2(n) "Bonded warehouse" means a warehouse licensed by the Department to import and hold, against the bank guarantee facility, such raw materials or subsidiary manufacture goods to be exported to foreign countries or to be sold domestically at convertible foreign currencies or such goods as to be sold at a duty free shop.

According to Sec. 10, the Government of Nepal may, if it considers appropriate to accord the bonded warehouse facility to any person desirous of availing of the bonded warehouse facility, so accord the facility and that the bonded warehouse is operated subject to the terms as prescribed in Chapter III of Customs Regulation, 2064. Followings are the conditions and facilities regarding bonded warehouse:

- **Licensing**

  According to Rule 9 Following Industry or person intending to avail of the facilities of bonded warehouse should apply at the Department for the license.

  - Industry exporting garment to foreign country, and other industries exporting at least fifty percent of its production to India,
  - Industry exporting its product to third country,
  - Person who is importing goods to sale through the government licensed duty free shop

  For licensing of warehouse as above, industry applying should submit certificate stating that the industry qualifies as above. In case the industry which is not operating for more than a year, intends to get license for the bonded warehouse should not need to submit certificate if it submits conditional contract paper with the export plan and conformity of its export to third country or exports to India of its production at least fifty percent.

  Upon verification of the application and found to be justified to issue the license, the Department may issue licensee to the industry by charging Rs.6 thousand as a license fee. The licensee can get the license renewed from the Department by paying renewal fee of Rs. 3 thousand before the next fiscal year starts, if licensee intends to renew the license for the next fiscal year.

- **Facilities for Licensed bonded warehouse**

  According to Rule 10, license holder may import necessary raw materials and the auxiliary raw materials (including the packaging materials not produced in Nepal) with the furnishing of the bank guarantee equivalent to the chargeable Customs duty for the purpose of producing goods for export or sale in Nepal in convertible foreign currency.

Amount of Bank Guarantee

For this, Bank Guarantee should be furnished to the amount equivalent to ***the total of chargeable Customs duty in addition to 15 percent on such Customs duty.***

Period of Bank Guarantee & Time Extension

Time period of the bank guarantee should be from six months to twelve months. In case of six months bank guarantee, if the extension is required beyond 6 months, it can be extended from 6 months to 12 months.

Bonded Warehouse Facility for Packing Materials not produced in Nepal

In case of packing materials not produced in Nepal, the Department will provide bonded warehouse facilities on the recommendation of the Department of Industry stating that the packing materials are not produced in Nepal and bonded warehouse facility be extended.

Import of Goods by Bonded Warehouse operating Duty Free Shop

- The owner, who received the license of bonded ware house to operate the duty free shop, should furnish the bank guarantee equivalent to the chargeable Customs duty for the import of goods to be sold from the duty free shop.
- In order to import such goods, the Department should approve the list of goods and their quantity.
- The goods imported, the liquor and cigarette should be sold to the person and organization specified to receive diplomatic and Customs duty privilege on the recommendation of Ministry of Foreign Affairs, Government of Nepal.

Import of Goods under Buyback Agreement

- Industry licensed to operate bonded warehouse as per agreement with the foreign buyer to buy its product under buyback agreement and with the recommendation of Department of Commerce can import raw materials and auxiliary raw materials under bank guarantee equivalent to Customs duty without opening of Letter of Credit.
- The product under this agreement should be made of the raw materials and auxiliary raw materials of no value sent by the foreign buyer charging only the cost of production incurred during production process and the profit.
- The products shall be exported to same buyer or in case of export to other buyer, the recommendation of Ministry of Commerce is compulsory.
- Such importer should submit the recommendation letter of the Department of Commerce specifying the necessary procedures and the terms and condition for the import without letter of credit agreement with the foreign buyer, and invoice of value for the Customs purpose only with the declaration form.

In order to furnish the bank guarantee, the bank guarantee should be issued only by the Bank and the financial institution permitted to do so under the prevailing rule.

- **Terms and conditions with bonded warehouse facility**

Export through Banking Channel only

According to Rule 12, the industry with bonded warehouse facility should export the goods through Letter of Credit or banking documents.

Time Period for Export

The industry with bonded warehouse facility should export the finished products within ***eleven months*** from the date of import of raw materials or auxiliary raw materials (including packing materials not produced in Nepal).

Extension of Time Period

This period may be extended, if the person applies for the time extension at the Department with the reasons for not being able to export or sale the product within the allowed time period, the chief of customs office may extend the time period by six months if the reasons are found to be justified (Rule 13).

Minimum Value Addition on Goods

On the export of the finished product made of imported raw materials or auxiliary raw materials (including packing materials not produced in Nepal) by the industry with bonded warehouse facility as per rule 10, the value addition on export should be ten percent over the value as determined by the Customs office Customs. In such case, the rate of value addition is calculated in the following manner:

- FOB price of export minus value determined by the Customs at the time of import of materials as per rule 10 used in the finished product. The residual amount is divided by value determined by the Customs at the time.
- Of import of materials used in the finished product, the amount so derived from division is multiplied by hundred, which is the rate of value added in this case.

The selling price of the product should not be lower than the following amount:

Particulars	Quantity	Rate	Amount
A	**B**	**C**	**D**
Different Raw materials consumed	Required as per input norms	Calculated as per value determined for customs purpose	C X D
Different auxiliary raw materials consumed	Required as per input norms	Calculated as per value determined for customs purpose	C X D

Different packing materials consumed	Required as per input norms	Calculated as per value determined for customs purpose	C X D
Total value			**Xxx**
10% value addition		**Xxx**	
Minimum price for the export	**xxx**		

The person getting the license of bonded ware house, should sale the goods from the duty free shop in one year from the date of import as imported for the sale in duty free shop.

Special Extension in the case of Textile Industry

The textile industry importing yarn should sale its textile made from such yarn to the export-oriented garment industry within eleven months from the date of import of yarn. This period may be extended, if the person applies for the time extension at the Department with the reasons for not being able to export or sale the product within the allowed time period, the Department may extend the time period by Six months if the reasons are found to be justified as per Rule 13.

- **Release of Bank Guarantee or deposit**

According to Rule 14, the industry with the bonded warehouse facility should apply for the release of the bank guarantee in the concerned Customs office as per the time period of Rule 12 or extended time period of Rule 13 with the attachment of the following documents:

- Document relating to import of goods as per sub rule (10);
- Document relating to the export of finished product;
- Certificate of foreign exchange earning issued by the concerned bank;
- Certificate of consumption ratio of use of raw materials and the auxiliary raw materials from the concerned agency.

The person with the bonded warehouse facility to sale the goods from the Duty Free Shop, should apply for the release of the bank guarantee or cash deport in the bank guarantee or cash guarantee deposited Customs office with the documents relating to the sales from the Duty Free Shop.

The Airline companies should apply for the release of the bank guarantee or the cash deposit as per sub-rule (1) of Rule 11 in the bank guarantee or cash guarantee deposited Customs office with the documents relating to the use of the goods at the international flight.

The Textile Industry should apply for the release of Bank Guarantee at the Customs office where the bank guarantee is deposited as per sub rule (2) of Rule 11 along with the following documents:

- Certificate of sales of textile to the garment industry made from the yarn within eleven months from the date of import of yarn with minimum ten percent value addition ;

- Sales agreement between the textile purchasing garment industry and the yarn importing textile industry;
- Yarn consumption ratio certified by concerned agency;
- Bank guarantee paper issued on the recommendation of the textile purchasing garment industry equivalent to the chargeable Customs duty on the import of yarn.

Yarn importing industry after the sale of textile to the garment industry, may chose not to release the bank guarantee until the garment industry exported the garment. In such a situation, the textile industry should apply for the release of the bank guarantee within twenty two months from the date of import of yarn with the attachment of the following documents:

- Documents as mentioned in sub rule(4)
- Documents certifying the export of garment with the minimum ten percent value addition by the garment industry
- Documents relating to the ratio of consumption certified by the concerned agency
- Foreign exchange earning certificate.

Export oriented industry which purchased textile from the industry importing yarn by furnishing bank guarantee, should submit application with the following documents for the purpose of release of the bank guarantee:

- Documents relating to export of garments manufactured from textile purchased from the yarn importing industry with the minimum ten percent value addition within eleven months from the date of purchase;
- Certificate of foreign exchange earning authenticated by the concerned bank; and Certificate of ratio of consumption.

In order to release the bank guarantee furnished, should submit application with the following documents:

- Documents relating to the export of garments manufactured with the minimum ten percent value addition as prescribed by the Department of Commerce within the time limit or within the extended time period;
- Certificate of foreign exchange earning equivalent to the amount of value addition authenticated by the concerned bank; and Certificate of ratio of consumption of raw materials and the auxiliary raw materials.

The exporter who has exported the products within the time limit and has fulfilled all requirements except the certificate of foreign exchange earnings may submit application with adequate reasons for this and the Department may extend time period maximum of three months to submit the certificate.

Release Procedure

Upon the scrutiny of the application received and it is found that the applicant has fulfilled all the terms and condition mentioned above, the Customs office should release the bank guarantee and the deposit within one month.

As per Rule 15, the bank guarantee or the deposit equivalent to the Customs duty shall be partially released to the extent of the use of the materials in case of the following:

- Partial use of materials imported under the bonded warehouse facility in the manufacturing of the product which is exported ;
- Partial sale of the goods from the Duty Free Shop within the time limit ;
- Yarn imported is partially used in the manufacturing of textile by the export oriented garment industry;
- Locally purchased of such textile is partially used by the export oriented garment industry for the manufacturing of the garment and export of such garment.

Recovering Customs duty from the bank guarantee and the deposit

According to Rule 16, in case of not complying with the terms and conditions by the importer and such importer not submitting application, chargeable Customs duty and fifteen percent addition on such customs duty will be recovered from the furnished bank guarantee and chargeable Customs duty will be transferred to the revenue account from the deposited amount if such amount was deposited.

In case of partial use of materials, chargeable customs duty to be recovered from the bank guarantee on the materials not used will be equivalent to the sum of the customs duty chargeable on the day of import and fifteen percent additions on such customs duty.

For above purpose, even bank issued its guarantee for a specified period even, according to Rule 17, on the request of the customs office, the bank guarantee issuing Bank or financial institution should pay the amount equivalent to the bank guarantee amount to the requesting customs office in whose favor the bank guarantee is issued within fifteen days of the date of request.

On contrary to payment of (matured) guarantee by the Bank or Financial Institution to the customs office, the bank guarantee subsequently issued by the Bank or Financial Institution should not be accepted. The Bank or Financial Institution which issued the bank guarantee in favor of the customs office, is not immune from the liability of payment equivalent to the amount mentioned in the bank guarantee, unless the bank or the financial institution receive letter notifying the release of the concerned bank guarantee by the customs office.

CHAPTER 6

Customs Tariff, Concessions, Rebates and Customs Duty Privilege provided on Import

Students are not required to keep in memory the prevailing customs tariff for each and every item. That is why, the full text of the customs tariff is not given in this study material. The list of concessionary customs duty chargeable on certain goods is also not re-produced in this study material. However, certain important customs privileges, concessions, discounts, etc provided by this Act and by Finance Act, 2075 are re-produced herein.
Each finance Act provides the tariff which has amended by that finance Act/Ordinance only, the detail list of tariff is availed in printed form in Department of Customs or downloaded from www.customs.gov.np/en/normal.html at free of cost.
However, there have been many occasions when customs tariffs have been asked in Final Examinations. But these are rather a tricky part than regular practice of the Institute. Students are advised to go through the rates so that they will not miss any questions in Final Examination.

- **Schedule 1: Import duty**

  Schedule 1 of Finance Act, 2075 (and each Finance Acts or Finance Ordinances) is a list of tariff chargeable on import of different goods. This schedule also includes certain specific provisions regarding import of goods under specific conditions. This list also includes concessionary rates applicable on import of certain goods for specific purpose. The list as provided by each Finance Act shall be treated as final for that finance year.

- **Import from India: (Schedule 1 Section 3)**

  In case of goods produced in India and imported from India through Letter of Credit, a concession of 5% on the prescribed rate if the customs duty on the goods is 30% maximum and 3% in case the tariff is more than 30% shall be provided in ad-valorem basis. In case the tariff is fixed on the basis of quantity of the goods, such concessions are not provided.

  In case of goods imported from India under Duty Refund Procedure (DRP), the excise duty paid in India shall be reduced from custom tariff as computed above. Indian excise duty is not adjusted in the transportation cost, transit insurance cost or deviations in the value of goods, if any.

  Example:

  One Indian Party has raised an invoice for a supply of items as follows:

Price of items 2 pcs @ IRs. 300,000	600,000
Excise duty @ 16%	96,000
Surcharge on excise duty 2%	1,920
Delivery charges up to Raxaul	20,000
Total	717,920

  Suppose the customs duty in Nepal is 12% on that item. Calculate the amount of customs duty payable supposing all the formalities for DRP are complied with.

Solution:

Value of the items for customs purpose:

600,000 X 1.6015 =	960,900
Customs duty 12% of the value 115,308	
Less: Excise duty of India	
96,000 X 1.60 = 153,600 but subject to Nepal custom	115,308
Customs on the items	0
Customs on other expenses	21,900 X 1.6015
= 35,105 @ 12%	4,213

Thus, total customs duty payable shall be Rs. 4,213 only.

- Import from China through Tibet: (Schedule 1 Section 4)

  In case of goods produced in China and imported through the route of Tibet under letter of credit arrangement, a concession of 5% on the prescribed rate if the customs duty on the goods is 30% maximum and 3% in case the tariff is more than 30% shall be provided on ad-valorem basis. In case the tariff is fixed on the basis of quantity of the goods or the payment is not made through letter of credit method, such concessions are not provided.

- **Import from SAARC countries (Schedule 1 Section 6):**

  Goods produced in SAARC country and imported, invoiced and shipped from the same country under L/C shall be granted a rebate at a specified rate on specified goods under SAPTA agreement. This reduced rate has given in the side of each item of tariff rates in the finance acts.

  Imports from SAARC countries has another tariff system too; which has reduction based on January 1, 2006 rates. In case the yearly tariff is lower than these rates, yearly rates are applied:

Rates on January 1, 2006	SAARC Rate
5%	5%
10%	6%
15%	7.25%
25%	9.50%
35%	11.25%
40%	11.25%
80%	11.25%

- **Rebate on vehicles and other items imported with customs duty privilege (Schedule 1 Section 13(1))**

  Vehicle and equipment imported under diplomatic facilities or duty facilities or imported by project or project contractor or consultant under a condition of return back of such assets under full or partial duty facilities or bank guarantee facility or deposit facility or imported by any other association under full or partial duty facility, or vehicle imported on full or partial duty facility on personal purpose, gifted or sold or retain by the importer, for finding the

customs value, the customs officer shall deduct 10% on the value fixed at the time of import on WDV method for a maximum period of five years.

Customs value (after depreciation) is calculated in foreign currency (based on the time of import). Such foreign currency shall be converted into Nepalese currency as per current rate.

Depreciation will be calculated from the date of manufacturing less the period spend in foreign country.

If the vehicle or equipment are imported more than 5 years back, 60% tax rebate will be provided on the total duty to be levied.

Example:

A car manufactured in 2013 was imported in Nepal in 2016 by a project under customs duty privilege paying 1% customs duty for recording purpose. The value determined at the time of import was FCY 15,000 and rate of exchange was Rs. 72 for FCY1.

On July 14, 2021 the project has allowed the general manager in Nepal to get the ownership of the car in his own name free of cost. But the GM has to pay customs duty in case payable. The exchange rate on that day was Rs. 66 for FCY 1.

Calculate the transaction value of the car for customs duty purpose.

Solution:

Particulars	**FCY**
Value of the car at the time of import	15,000
Depreciation allowed: Before import the car was in foreign for 3 years. The maximum period for depreciation allowed is 5 years minus 3 years = 2 years only. Depreciation for 1st year of import @ 10%	1,500
Depreciated balance for 2nd year	13,500
Depreciation for 2nd year	1,350
Value for customs duty	12,150
Value for customs duty in Nepali currency 12,150 X 66	Rs. 801,900

- **Temporary import of vehicles:**

  Any vehicle imported by a tourist under Carnet Facility for own use within Nepal, the maximum period of use shall be 6 months (continuous or periodic) within one year shall not be levied the duties. If any tourist kept such vehicle more than 6 months in Nepal, except upon authenticated by the Nepal Police for repairs in workshop or kept in Police Custody due to accident, shall be seized. Such vehicle cannot be donate, sale or otherwise transfer within Nepal.

In case of temporary importation of vehicles other than carnet arrangement above, the duty shall be levied as follows:

- If the vehicle returns from nearest Nepalese Market within same day of importation, No duty.
- If the vehicle is car, jeep, van, bus, tourist bus, minibus, Rs. 400 per day, motorbike, scooter Rs. 100 per day, Three Wheelers Rs. 300 per day. Maximum stay of such vehicle is 30 days in a year. In stay more than this period of 30 days, either the vehicle can be seized or duty is levied at Rs. 2000 per day (Motorbike Rs. 1000 per day)
- Tractor Rs. 300 per day, tractor with trailer, 600 per day. Maximum stay of such vehicle is 30 days. In case, goods imported from such tractor returns empty within forty eight hours, no duty is levied.
- In case of LP gas bullet, no duty is levied up to seventy two hour for unloading within customs area.
- In case of passenger bus or minibus enters into Nepal under bilateral agreement with the neighbour countries, the duty shall be levied as per agreement for that purpose.
- In case of trailer took the goods or container and entered into Nepal for the purpose of unloading such goods, no duty is levied for 72 hours. In case of, the unloading place is out of customs area, 48 hours is allowed for unloading and one day duty is levied for this purpose at the rate of Rs. 2000 per day. Of course, in case of strike or banda etc. customs officer may extend this period by 3 days in above.
- For drinking water and irrigation purpose, imported equipment installed with boring machine import temporarily charges duty Rs. 1000 per day.
- In case of import of Excavator, Dozer, Loader, Roller, Leveller, Crane and similar heavy equipment import temporarily, NRs. 1,000 per day shall be levied for a maximum period of one year.
- Combined harvester with oiler or straw collector used on agriculture function can import temporarily by paying duties NRs. 1,500 per day for maximum period of three months.
- Foreign tourist enters Nepal without paying duties under this provision and if he presents at customs office and applied for paying of duties, customs officer charges fine Rs. 25000 as penalty in addition of duties under the act subject to:
- The vehicle enters Nepal maximum seven days back.
- No any entity seize and submit it to custom office as petition.

- **Other Rebates**

  Schedule 1 of each finance act(s) allowed numerous rebates and exemptions. The details have not reproduced here.

- **Schedule 2: Export duty**

  Schedule 2 of each Finance Act (s)/ Ordinance(s), gives a list of tariff chargeable on export of different goods. It is specified that the list is exclusive list for charging export duty. It means export duty shall not be charged on the goods exported which are not covered by this list.

The transaction value for export is determined on the basis of FOB the customs office. It means all the direct expenses incurred to bring the goods up to the customs office shall be included in the invoice price for charging export duty.

The rate of foreign exchange shall be as determined by NRB for the day of export for conversion and determining the transaction value in case the invoice value is in foreign currency.

CHAPTER 7

Fines, Penalties, Rewards, Departmental Review and Appeals

Any person involved in any activities which are against the provisions of this Act, rules and directions framed under Customs Act, 2064 shall be punished under the same act. The punishment may be financial fines, seizure of the goods, and/or imprisonment for a certain term. Various sections of the Act have provisions regarding seizure of the goods under certain conditions. In addition to that Sec. 57 of the Act provides the provisions of fines and penalties chargeable for infringement of various sections and rules.

Fines and penalties according to Sec. 57 for the person:

1. If any person commits or attempts to commit export smuggling or import smuggling of any goods or exports or imports or attempts to export or import any goods through any route other than the route so prescribed under Sec. 3 that such goods are to be exported or imported only through that route, the Customs Officer may forfeit such goods and impose a fine equal to the amount in controversy of such goods or imprisonment as follows or both punishments:

   (1Ka) If the offence is up to one million, the Custom Officer shall forfeit such goods and shall punish equal to the amount of value of such goods.

   (1Kha) Where the motor vehicle used to transport the goods to be forfeited pursuant to sub-section (1) has been used with the consent or knowledge of the owner of that motor vehicle, the Customs Officer shall forfeit such motor vehicle and punish the owner with fine up to one lakh rupees. Where the driver of such motor vehicle has knowingly used it to transport such goods without consent or knowledge of the owner of that motor vehicle, the Customs Officer may punish such driver with a fine of up to fifty thousand rupees.

2. If the amount of offence under section 57(1Ka) is one million to ten million, the custom officer shall forfeit such goods and shall punish equal to the amount of value of such goods and imprisonment as follows.

Subsection	Amount of Offence	Imprisonment
(1Ga)	1 million to 2.5 million	1 Month
	2.5 million to 5 million	1-3 Months
	5 million to 10 million	3 Months to 1 Year
(1Gha)	10 million to 30 million	1 to 3 Years
	Greater than 30 million	3 to 5 Years

3. The Customs Officer of the District Court may punish any person who aids and abets the commission of offense referred to in sub-section (1) as if such person were the offender.

4. If any person hides or knowingly keeps any goods exported or imported by way of export or import smuggling, the Customs Officer may forfeit such goods and punish such person with a fine of up to ten thousand rupees.

5. If any exporter, importer or customs agent make declaration with less quantity despite that the name, nature, physical features, characteristics, measurement, size and quality of goods are accurate, the Customs Officer may clear such goods by imposing a fine of cent percent of the value of those goods which have been less quantity on the owner of such goods and collecting the chargeable duty.

6. If any exporter, importer or customs agent makes declaration falsifying the country of origin despite that the name, nature, physical features, characteristics, measurement, size, quality and quantity of goods are accurate, the Customs Officer may clear such goods by imposing a fine that is twenty-five percent of the custom duty chargeable on such goods on the owner of such goods and collecting the chargeable duty.

7. If any exporter or customs agent declares the quantity that exceeds the actual quantity of the goods to be exported, the Customs Officer may clear the goods by imposing a fine that is two hundred percent of the value of goods so declared as excess and mentioning that fact in the declaration form.

8. If any exporter or customs agent make declaration falsifying all or any details out of the name, nature, physical features, characteristics, measurement, size and quality of goods, the Customs Officer may forfeit such goods and impose a fine that is equal to the amount in controversy on the owner of such goods.

9. If any importer or customs agent makes declaration falsifying the goods or the materials of which the goods are made or falsifying all or any details out of the nature, physical features, characteristics, measurement, size and quality of goods or does not make declaration of any goods, the Customs Officer may forfeit such goods by imposing a fine that is equal to the value of such goods on the owner of such goods or clear such goods by imposing a fine that is equal to two hundred percent of the value of such goods and collecting the chargeable duty.

10. If any person causes or attempts to cause a loss of revenue or duty by submitting a forged, fake or false document to the Customs Office, the Customs Officer may punish such person with a fine that is two hundred percent of the amount of duty or revenue the loss of which has been so caused or attempted to be caused or with imprisonment for a term from six months to one year or with both punishments; and the matter shall be forwarded to the concerned body or authority to take action under the prevailing laws in relation to the commission of forgery of governmental documents.

11. If the owner of any goods or his or her agent opens in any manner any customs godown or goods stored in that godown with intention to steal goods or cause loss of or damage to such goods, the Customs Officer may punish such owner or agent with a fine not exceeding five thousand rupees.

12. If any person removes or takes goods stored in a customs godwon from such godown without approval of the Customs Office, the Customs Officer may punish such person with a fine that

is equal to the amount in controversy and with imprisonment for a term not exceeding six months or with both punishments.

13. If any person knowingly writes, signs or uses the specific matter of the declaration form or document utilized in the performance of the functions of the Customs Office or forges or alters or destroys any document signed, stamped or sealed with initial, signed by or any sign or symbol affixed therein by the Customs Officer in the course of the performance of the functions of the Customs Office, the Customs Officer may punish such person with a fine not exceeding five thousand rupees and with imprisonment for a term not exceeding one year or with both punishments, and the matter shall be forwarded to the concerned body or authority to take action under the prevailing laws in relation to the commission of forgery of governmental documents.

14. If the person or employee who has the custody of the goods stored in the customs godown recklessly loses or knowingly damages such goods, the Customs Officer may punish such person or employee with a fine not exceeding five thousand rupees, by recovering from such person or employee the value of such goods and the chargeable duty.

15. If any unauthorized employee removes or gives order to remove any goods stored in the customs godown, the Customs Officer may punish such employee with a fine not exceeding five thousand rupees or with imprisonment for a term not exceeding two years or with both punishments.

15-A.If the importer could not make available the statement, tax return, invoice and other documents required for the purpose of audit under section 34 within the stipulated time, the Director General or the Custom Officer may charge fine of Rupees 10,000 for each time.

16. If it appears, from the review carried out pursuant to Sec. 70, that there is a difference in the customs duty by the reason of submission by the owner of goods of fake bills, invoices or documents, the Customs Officer may punish such owner with a fine that is two hundred percent of the value of the goods cleared from the Customs Office or with imprisonment for a term not exceeding one year or with both punishments.

17. If any person commits any act contrary to this Act or the Rules framed under this Act, except that set forth in this Section, the Customs Officer may punish such person with a fine not exceeding five thousand rupees.

18. Notwithstanding anything mentioned in section 57, the goods cleared under section 20(2) (a), (b) or (c), if it is found that goods are in different than declaration in name, nature, physical specialty, qualitative characteristic, measurement and quality during rechecking by authorized officer, the 300% of value of goods on addition to the fine will be charged and goods shall be released or additional 200% of value of goods will be charged and goods shall be confiscated.

19. The importer punished under section 57(18) may not be allowed to perform the task of import and export and cease the transaction by the department.

20. If any person has imported goods by taking full or partial customs duty exemption or under facility of any prevailing laws and has sold or used for the purpose other than specified, or if it is found that any person has imported goods under exemption or facility wherein exemption

facility is not available, Custom officer may charge 100% fine on Custom value.

Section 57Ka: The case mentioned in section 57 (1Ka), (1Kha) and (1Ga) shall be initated and sorted out by Custom officer and case mentioned in section 57 (1Gha) by District Court.

Section 60Ka: The case mentioned under section 57 (1Ga) and 57 (1Gha), the plaintiff shall be Government of Nepal.

- **Punishment for obstruction and agents**

According to Sec. 58, if any person deliberately obstructs or hinders the Customs Officer or any employee of the Customs Office in the exercise of the powers conferred by this Act and the Rules framed under this Act, the Customs Officer shall punish such person with a fine not exceeding five thousand rupees or with imprisonment for a term not exceeding one year or with both punishments, if such person is a governmental employee, and with a fine not exceeding one thousand rupees or with imprisonment for a term not exceeding six months or with both punishments if such person is not a governmental employee.

According to Sec. 59, Customs Officer may punish a customs agent who commits any act as referred to in sub-sections (5), (6), (7), (8) and (9) of Section 57 with a fine from twenty-five thousand rupees to fifty thousand rupees or with imprisonment for a term from one month to six months or with both punishments. The owner of goods shall not be deemed to have been released from punishment or fine imposable on him or her pursuant to this Section by the reason only that the customs agent has been subject to punishment.

- **Punishment to be imposable under other laws**

According to Sec. 60, where any offense or act under this Act is punishable under the prevailing laws, this Act shall not be deemed to bar the taking of action and imposing of punishment also under such laws.

Section 60 (Kha): The Director General or Chief Custom Officer may assign any officers of customs as investigation officer to act in the offences mentioned in this act. Based on immediate evidences, the assigned investigation officer may charge him the punishment upto the amount mentioned in this act, may imprison if the amount of the value of goods to be recovered, may demand the cash guarantee equivalent to the value of goods, from the person convicted if deems necessary.

If the cash guarantee is not submitted the investigation officer may imprison such person with the permission of officer looking after the case.

The investigation officer shall complete the investigation within 25 days from start of such action and if the cases are related to section 57 (1Ga) and 57 (1Gha) he shall file to officer looking after the case after obtaining suggestion from government lawyer.

- **Goods subject to seizure**

The Customs Officer or the authorized employee of the Customs Office or the employee authorized by the Government of Nepal may, if he or she sees or finds any goods liable to be forfeited pursuant to this Act, seize such goods at any place and time as per Sec. 44. According to Sec. 45, proof of seizure to be provided indicating the reason for so seizing the goods and

an inventory setting out the details of goods so seized to the owner of such goods within a maximum of three days after the seizure of such goods.

After seizing the goods, according to Sec. 46, the same shall promptly hand over the goods seized by that employee or body pursuant to Section 44 and a copy of the inventory.

After the goods have been handed over, the Customs Officer shall inquire into whether such goods are liable to be seized under this Act. If, upon such inquiry, it appears either that such goods have been seized for no reason or that it is not necessary to seize such goods, the Customs Officer shall immediately return such goods to the owner thereof. If, upon making inquiry, it appears that the goods are liable to be seized, the Customs Officer shall take action as referred to in this Act in relation to such goods.

In case, ownership of goods seized deemed to be belonged to Government of Nepal as per Sec. 47.

According to Sec. 50, except where the Government of Nepal has itself used any goods which have been forfeited pursuant to this Act, the concerned Customs Officer may auction such goods.

- **Review and Appeal**

There are two mechanisms for review and appeal against the decision of customs authority: Valuation Review Committee, Appeal to Revenue Tribunal. Decision of Valuation Review Committee is also appealable in the tribunal by both of aggrieved party (any person or customs officer).

- **Valuation by Valuation Review Committee (Sec. 61):**

Person who is not satisfied with any decision or order made by the Customs Officer regarding valuation under Sec. 13 may, for the review of such decision or order, file an application, no later than thirty days after the date of such decision or order.

For this purpose, the Government of Nepal shall form the following valuation review committee (each member has 3 years general tenure):

At least Gazetted First Class officer of the Civil Service who has knowledge and experience in the field of revenue administration	Chairperson
One person who is incumbent in the office of at least Gazetted Second Class and has gained at least three years of experience in the Gazetted post on customs administration or who has retired from the office of that Class and has gained the said experience	Member
One person who is incumbent in the office of at least Gazetted Second Class and has gained at least three years of experience in the Gazetted post on international trade	Member

The valuation review committee shall, while making review pursuant to this Section, inquire into whether the customs valuation determined by the Customs Officer is accurate or not and may approve or void the valuation determined by the Customs Officer or make valuation of such goods pursuant to this Act. The valuation review committee shall also assign clear reasons and bases while so approving, voiding valuation or making valuation.

- A person who is not satisfied with any decision or order for Custom Valuation made by the Customs Officer may, for the review of such decision or order, file an application, as prescribed, to the valuation review committee no later than thirty days after the date of such decision or order.
- The term of the chairperson and members of the valuation review committee shall be of three years.
- The Valuation Review Committee shall, while making review, inquire into whether the customs valuation determined by the Customs Officer is accurate or not and may approve or void the valuation determined by the Customs Officer or make valuation of such goods or order Customs Officer for revaluation. The Valuation Review Committee shall also assign clear reasons and bases while so approving, voiding valuation or making valuation or ordering for revaluation.
- A person who files an application for valuation review, prior to making such application, furnish with the Customs Officer a deposit of the duty chargeable according to the valuation determined by the Customs Officer.
- Valuation Review Committee should take final decision within ninety days from the date of registration of the application.
- Function, duty and authority of Valuation Review Committee shall be as follows:

  a. To examine into the evidence presented by the applicant,

  b. To approve the decision of the customs officer or revoke the decision and take decision on behalf of the customs officer,

  c. To ask to the applicant for submitting additional documents or evidence,

  d. To collect necessary information for valuation of the goods.

- **Appeal**

According to Sec. 62, any person who is not satisfied with the customs duty determined by the Customs Officer or other employee under this Act or with any order or punishment or decision issued or made by the Customs Officer, except any decision or order referred to in Sec. 13, or with any decision made by the valuation review committee formed pursuant to Sec. 61 may make an appeal to the Revenue Tribunal within thirty five days after the date of the determination of such customs duty or the imposition of punishment or the making of decision after making payment of or furnishing a deposit of the duty and amount of fine and penalty chargeable. However, if such person is in imprison and cannot deposit the required amount, he can make appeal without depositing the amount.

Person who files an appeal may make such appeal, shall give a copy of such appeal to the concerned Customs Office or Custom clearance audit office no later than seven days after the filing of such appeal.

In the next side, if in the event of not being satisfied with any decision made by the valuation review committee formed pursuant to Sec. 61, the Customs Officer may file an appeal to the Revenue Tribunal no later than thirty five days after the making of such decision.

CHAPTER 8

Miscellaneous Provisions

Customs Agent

Agent may be appointed (Sec. 52)

If any exporter or importer wishes to get the goods to be exported or imported cleared not by himself or herself but through a customs agent or to do any act related with the Customs Office not by himself or herself but through a customs agent, such exporter or importer may appoint his or her customs agent.

Agent to be deemed owner of goods (Sec. 53)

If the owner of any goods appoints any person as his or her customs agent to get such goods cleared from the Customs Office or to do any other act, such customs agent shall, for that purpose, be deemed to be the owner of such goods.

Duties of Custom Agent (Sec. 53Ka)

For the purpose of clearing the goods from the customs office or to perform other tasks related to Customs Office, the custom agent have following duties:

a. To comply with all laws related to Custom.

b. To provide necessary support to custom office for simplifying the process of clearing goods.

c. To provide necessary support to custom office in collection of duty.

d. Not to do any activities with effects the work of custom office.

e. To handover the notice to respective importer or exporter if issued by custom officer asking importer or exporter to be present

Agents to indemnify the owner in case of loss (sec. 54)

If any customs agent does any act contrary to the Act or the Rules, thereby causing any loss and damage to the owner of goods, such agent shall pay an amount equal to that loss to the owner of such goods.

License to be obtained for Agency Function (Sec. 51)

A person who wishes to act as the customs agent or representative of any importer or exporter to clear goods to be imported or exported from the Customs Office or to do any act related with the Customs Office shall obtain the license of customs agent from the Department or Customs Office.

License may be suspended or Cancelled (Sec. 55)

- The Customs Officer may suspend any customs agent on whom a fine is imposed or who does any act contrary to this Act or the Rules framed under this Act or fails to fulfill his or her duty for a period from one month to six months.
- If any customs agent does the act as above for the third time or gets license by submitting fake academic qualification certificate or other fake document, the Customs Officer may cancel his or her license. Such customs agent shall not be entitled to obtain the license of customs agent again.
- Prior to suspending or canceling the license, the concerned Officer shall give an opportunity to such customs agent to defend him or herself.
- If case has been filed in court in accusation of criminal offence or accusation of corruption as per the prevailing law against the customs agent, he/she shall, ipso facto, be suspended from the date of filing the case.
- If any customs agent is proved offender from the court in any criminal offence, his/her license shall, ipso facto, be cancelled. Such customs agent shall not be entitled to obtain the license of customs agent again.

Application may be filed against suspension or Cancellation decision (Sec. 56)

Where the Customs Officer makes decision to suspend or cancel the license of a customs agent or to impose a fine on him or her pursuant to Section 55, the customs agent who is not satisfied with that decision may file an application to the Director General within thirty five days after the date of such decision. The Director General shall make decision on such application normally within thirty days and such decision shall be final.

- Ministerial Inspection:

  According to Sec. 67, Ministry of Finance shall, in relation to the activities carried out by the Director General, and the Department shall, in relation to the activities carried out by the Customs Officer, make inspection once a year. In carrying out inspection, the Ministry of Finance and the Department shall inspect, inter alia, whether the duty of goods exported or imported has been recovered actually, whether post clearance audit has been made pursuant to Sec. 34, whether or not declaration review has been made pursuant to Sec. 70, whether the goods required to be auctioned have been auctioned in time and whether the revenue omitted to be collected has been recovered as promptly as possible and give a report of such inspection to the Council of Ministers and the Ministry of Finance, respectively.

  On receipt of a report, the Council of Ministers and the Ministry of Finance shall give necessary direction to the Ministry of Finance and the Department, respectively.

- **Goods violation of intellectual property rights**

  If a person exporting or importing any goods in violation of intellectual property rights such as patent, design, trademark, and copy right acquired by any one pursuant to the prevailing laws, the concerned person may submit an application, accompanied by evidence, to the concerned Customs Officer for withholding such export or import according to Sec. 68. In

such a case, Customs Officer shall withhold such goods in the Customs Office and make a request to the concerned body or authority for necessary action in that respect. Such body or authority shall take action in that respect and settle the matter in accordance with the prevailing laws and give information thereof to the Customs Office. If, upon taking action in accordance with the prevailing laws, the body or authority, holds that such goods are liable to be forfeited, the Customs Officer shall hand over such goods to such body or authority.

- **Compensation for goods withheld in Customs godown**

  If the goods kept in customs godown are stolen, lost or otherwise destroyed, damaged or get damaged, except for a wear and tear due to a natural calamity or accident or wear and tear likely to arise normally in the course of holding or lifting goods, the owner of such goods shall be entitled to recover, compensation for such goods from the Customs Office or the body operating the godown as covered in Sec. 69. However, such owner shall not be entitled to make a claim for compensation unless and until his or her title to such goods is established.

- **Demurrage**

  According to Sec. 72, if the owner of goods stored in a customs godown operated by the Customs Office does not get clearance and get delivery of such goods within the following time limit, demurrage shall be charged as follows as per Rule 50:

  - No demurrage shall be charged for seven days from the date on which goods are stored in the customs office operated warehouse.
  - In case goods are not cleared within seven days, the demurrage shall be charged from the eighth day at a rate of:
    - Tribhuwan International Airport Customs Office : Per day per KG charge 60 paisa up to 30 days, Per day per KG charge Re. 1.00 from more than 30 days up to 60 days, Per day per KG charge Rs.1.40 from more than 60 days
    - Other customs offices: Per day per KG charge 40 paisa up to 30 days, Per day per KG charge 60 paisa from more than 30 days up to 60 days, Per day per KG charge 80 paisa for more than 60 days.
    - The demurrage shall not be more than the customs value of goods.

    In case of those goods which could not be cleared by the Customs Officer because of confusion about the valuation, classification of goods or for other reason, such demurrage is not charge.

Remission of Demurrage Charge (Rule 51)

If the owner of the goods has reasonable ground for the remission of the demurrage, the owner may apply for the remission with the evidence and documents to proof the claim to the chief of the customs office.

In case of remission of the demurrage; following officers can grant remission to the following amount:

- Up to Rs. 25000/ if non-gazetted staff is the chief of the customs office;
- Up to Rs. 1,00,000/ if third class gazetted officer is the chief of the customs office ;
- Up to Rs 3,00,000/ if First or Second class gazetted officer is the chief of the customs office .

  If the chief of the customs office is satisfied that the remission should be granted over and above the amount within his authority, the chief should write to the Director General with his recommendation along with the relevant documents.

  Upon the enquiry into the recommendation, if the Director General is satisfied that either partially or in full remission should be granted, he should approve and instruct the chief of the customs office. After the approval from the Director General, the chief of the customs office should grant the amount of remission.

- **Duty Privileges in case of Import, Export or Transfer through different Tax Jurisdiction**
- **Duty Privilege in case of transport of goods of Nepalese origin via foreign route (Rule 4)**

Pragyapan Patra to be filled and Application to be filed

The owner of goods who is willing to transport goods from one place of Nepal to another via foreign route shall submit Pragyapan Patra to concerned customs office from where the goods is dispatched to foreign country after filling it. The matters relating to the Custom Office from where the goods are transported into Nepal shall be clearly specified in the Pragyapan Patra.

No Permission if Route in Nepal can be availed

In case the customs officer feels it reasonable to transport goods via Nepalese territory as to the cheaper and easier means of transportation facility in Nepal, the officer may reject the application of such transport via foreign route.

Permission to be granted for transportation

- In case the custom officer reasonably believes that goods shall be transported via foreign route due to the unavailability of cheaper, easier means of transportation and other facility of transportation, the customer officer shall permit such transportation complying all the following conditions:
- The goods may be released after Keeping the Record of Custom duty or taking the deposit equivalent to applicable custom duty,
- The container shall be sealed,

The custom officer shall specify the date of transportation from where goods are dispatched to the destination in Nepal in Pragyapan Patra and release the goods providing a copy of Pragyapan patra to the owner of goods, and

Transport of Restricted Goods

In case any good is restricted for export purpose, the person shall transport such goods as per the agreed work procedure specified in agreement with such foreign country, if any.

Procedure for entry of Goods into Nepal and Release of such goods

In case the receiving custom office receives the Pragyapan Patra issued and certified by the Custom Office from where goods are dispatched and if the matters are correct as per the record, the receiving shall permit the goods to be transported into the state of Nepal mentioning the same matter in the Pragyapan Patra.

The receiving custom office shall notify the dispatching custom office within 3 days about the entry of such goods along with a copy of Pragyapan Patra.

In case of failure to produce the Pragyapan Patra issued by dispatching custom office, the goods shall be released only after obtaining the applicable custom duty as deposit.

Refund of Deposit or Scrapping off of Record

The dispatching custom office shall refund the deposit or scrap off the record, as the case may be, after obtaining the information of entry of goods into Nepal and if the custom officer deems that appropriate.

Custom duty to be collected in case of Partial entry of Goods

In case the person takes the goods partially into Nepal once dispatched under this facility, the custom officer shall collect custom duty on the remaining goods not entered into Nepal treating it as export. In case the goods were dispatched by recording it, the export duty shall be recovered within seven days.

- Duty Privilege in case of transport of goods of foreign origin via Nepalese territory to the same country (Rule 5)

Application to be filed

The person will to transport goods of foreign origin from one place of a foreign country to other place of the same country via Nepalese territory shall file an application at Customs Department specifying the following details:

- Reason for using the Nepalese Territory
- Custom office from where goods are entered into Nepal (imported into Nepal), and
- Custom office from where goods will exit from Nepal (exported from Nepal)

Department may permit such transportation

The department, after obtaining such application, if deems it appropriate to permit such transportation of goods of foreign origin from one place of a foreign country to other place of the same country via Nepalese territory shall give permission for such transportation.

If required, the department may seek recommendation of concerned embassy of such foreign country in Nepal or of any other diplomatic mission.

Formalities to be fulfilled

The person willing such transportation shall fill Pragyapan Patra and submit it to concerned Custom Office. The matters as to the exporting custom point of Nepal shall also be specified in the same Pragyapan Patra.

Custom Office to permit after receiving Pragyapan Patra

The custom office shall permit the transportation of goods via Nepal as per the permission of department after receiving the Pragyapan Patra. While providing such permission the following formalities shall be fulfilled:

- The container carrying the goods shall be sealed,
- The owner of the goods shall be provided with the deadline to cross the Nepalese territory a ***Maximum of Seven days Period***
- The matters related to transportation deadline shall be mentioned in the Pragyapan Patra and the a copy of Pragyapan Patra shall be provided to the owner of goods

Duty of Custom Office from where goods will be exported

When the custom office from where the goods are to be re-exported receives the Pragyapan Patra, goods as per Pragyapan Patra and transport documents, if it finds everything intact it shall release the goods mentioning the same fact in the Pragyapan Patra. A copy of such pragyapan Patra shall be sent to the custom office from where the goods were imported into Nepal within 3 days.

Refund of Deposit or Scrapping off of Record

The importing custom office shall refund the deposit, if any once it receives the information as to the re-export of goods. Only partial amount shall be refunded, if the re-export is done partially. In case of partial re-export of goods that were allowed to be imported under record, the import duty shall be collected from such person.

Transport of Goods on which restriction on Import into Nepal is imposed

Such transportation shall be regulated by treaty or agreement between Nepal and the other country.

- **Duty Privilege in case of transport of goods of foreign origin Via Nepalese territory to other foreign country (Rule 6)**

Customs office may be designated

The department may prescribe the custom offices from where the goods of foreign origin of a country are transported to another country via Nepalese territory.

Application to be filed

The people willing to transport goods of foreign origin of a country to another country via Nepalese territory shall fill up Pragyapan Patra and four copies of from prescribed by Department and submit it to department along with the goods.

Department may permit

After obtaining such four copies of forms, pragyapan patra and goods, the department may permit the transportation if the goods are not restrictive in nature. The following formalities to be fulfilled while permitting such transportation:

- The container containing the goods shall be sealed,
- The forms shall be certified and a copy of form shall be handed over the owner of goods, a copy shall be kept for the record of department and two copies of the form shall be sent to the importing custom office.
- Maximum of Fifteen days period shall be granted to complete the route within Nepalese territory.

Duty of Custom Office from where the goods are imported into Nepal

In case the goods are received in importing custom office, the custom office shall certified the form so received & permit the import of goods within territory of Nepal. A copy of such form shall be sent to the custom office from where the goods shall be re-exported.

Deadline of transportation may be extended

Department may extend the 15 days time limit if it receives application of the goods owner specifying the reason of failure to complete the procedure in 15 days, if it deems appropriate.

Effect if the goods are consumed in Nepal

In case the goods are not re-exported and consumed within Nepal, the duty applicable in such goods shall be recovered from the owner of such goods along with additional fees equivalent to 100% of duty.

Use of Sealed Container

For the transportation of goods from a country to another via Nepal, sealed container shall be used.

- **Goods to be transported from Nepal to foreign country for repair (Rule 7)**

Repair of Aircraft, Helicopter or their parts

- Pragyapan patra shall be filled with complete details as to number, size, and specification of goods when goods are exported outside Nepal for repair and imported into Nepal after repair.
- ***Customs officer may allow passage for such goods, after receiving guaranty of airlines operator without any cash deposit for airplane, helicopter and engines thereof, and after receiving deposits equivalent to 0.5 percent of the value of goods for spare parts of airplane and helicopter.***

- The goods shall be returned to Nepal within three months of export for repair. The tax office shall collect applicable custom on the parts replaced and service fee incurred in foreign country and deduct the duty from deposit and refund the balance.
- In case the goods cannot be returned within three months of original export, the owner shall file an application along with the evidence of shortage of time limit. On receiving such application, the tax officer may extend such time limit by additional three months. In case of shortage of time limit even after addition of three months period, the tax officer shall write to Director General along with the reasons and if Director General approves so, the time limit may be extended as per the approval of Director General.
- In case the goods cannot be returned within the specified time limit, the deposit shall be confiscated and on returning the goods, import duty shall be levied on such items as equivalent to fresh import.

Repair of other goods

- Pragyapan patra shall be filled with complete details as to number, size, and specification of goods when goods are exported outside Nepal for repair and imported into Nepal after repair.
- Custom officer may permit the export (dispatch from Nepal) once pragyapan patra is received obtaining 5% of Price of goods
- The goods shall be returned to Nepal within three months of export for repair. The tax office shall collect applicable custom on the parts replaced and service fee incurred in foreign country and deduct the duty from deposit and refund the balance.
- In case the goods cannot be returned within three months of original export, the owner shall file an application along with the evidence of shortage of time limit. On receiving such application, the tax officer may extend such time limit by additional three months. In case of shortage of time limit even after addition of three months period, the tax officer shall write to Director General along with the reasons and if Director General approves so, the time limit may be extended as per the approval of Director General.
- In case the goods cannot be returned within the specified time limit, the deposit shall be confiscated and on returning the goods, import duty shall be levied on such items as equivalent to fresh import.

Procedure for import of goods for repair and export (return) after repair

- The owner shall fill up pragyapan patra while taking the goods into Nepal and while returning it back from Nepal along with the details as to number, size and specification of goods and submit such pragyapan patra to custom officer.
- The goods can be released and entry approval may be granted after obtaining deposit ***equivalent to custom duty applicable on such goods*** with conditions that the goods shall be ***returned within six months of entry into Nepal.***
- The deposit shall be refunded if the goods are returned within six months period and documents as to the certificate of payment of repair expenses in Nepal.
- In case the specification of goods imported into Nepal and exported (return of goods) out of Nepal does not match or the certificate of payment of repair expenses cannot be

produced, the goods and the deposit placed at the time of import (entry) into Nepal shall be confiscated.

Procedure for import of aircraft engine in replacement of engines on repair

The persons involved in operation of air services can import engines after producing bank guarantee of an amount equivalent to the import duty applicable on such goods if all the following conditions are satisfied:

- The existing engine is to be sent for repair.
- Such import is for temporary use only and till the period when the engines sent on repair are not returned to Nepal.
- The import of such engines shall be on rent, i.e. engines shall not be purchased.

The engines, if returned after the use on such periods, the guarantee shall be released. In case the engines are not returned, import duty is collected assuming the import of engine.

Special relief in case of export of goods by Diplomatic Mission

In case any diplomatic missions export goods for repair purpose and import the same goods after repair, the goods may be released by maintaining records without any deposit on recommendation of Ministry of Foreign Affairs of Nepal.

- **Procedures to re-import or re-export goods once imported or exported (Rule 8)**
- **Export of Imported Good**s

Custom officer may permit export without any custom duty

Custom Officer may permit the export of imported goods within 90 days of import of such goods or arrival of goods at custom premise in case all the following conditions are satisfied without obtaining any export duty:

- The objective of the import of goods cannot be fulfilled by such import or the goods are proved to be sub-standard quality as per the laboratory report, and
- The imported will import similar goods in place of the goods returned back or the foreign currency, if paid while importing such goods, will be refunded from the foreign party

Time limit to Import similar fresh goods or refund of foreign currency and effect of failure by importer

- The similar fresh goods shall be imported or the paid foreign currency shall be refunded within six months of re-export of imported goods.
- In case of failure to do so, the custom officer shall write to concerned department for legal actions as per prevailing law.

Procedure in case fresh similar goods are imported before returning the goods

- In case similar type of fresh goods have already been obtained in place of the goods to be returned, the custom officer shall release the goods obtaining applicable duty after the application of the owner and confirmation of documents.

- No custom duty shall be levied on exporting the goods within 90 days of import or arrival of goods at custom premise in place of which fresh goods have already arrived. In case the custom duty is already levied, such custom duty on returned goods shall be refunded.
- In case of failure to return goods within 90 days, the custom duty paid on such goods that is to be returned shall not be refunded.

Customs points for Re-export

- The same custom point as that of import of goods shall be utilized for re-exporting purpose.
- In case the same custom frontier cannot be used, the importer shall file an application along with the reasons therefor, at the customs department. The department may permit the use of another frontier in case the reasons appears genuine and department deems it appropriate.
- **Import of goods for sale, distribution or demonstration in Trade fair, Haat Bazzar**

Procedure

The importer of exporter willing to participate and sell, distribute or demonstrate goods in haat bazzar, trade fair or exhibition shall fill up Pragyapan patra along with the disclosure of the purpose of such import or export and produce the goods custom officer.

Deposit to be obtained

The import or export of goods shall be permitted obtaining deposit equivalent to the applicable custom duty on it.

Procedure of Release of Deposit

- The importer or exporter, as the case may be, shall produce the goods to customs office for re-export (in the case of import for such exhibition) or re-import (in the case goods were initially exported for exhibition) within SEVEN days (excluding the time to reach the custom frontier) in case of Haat Bazzar and within Thirty days (excluding the time limit to reach custom frontier) in case of exhibition or trade fair.
- The custom office shall release such amount of deposit deducting the duty applicable on goods that cannot be re-imported or re-exported, as the case may be.

Customs points for Re-export/re-import

- The same custom point as that of import of goods shall be utilized for re-exporting purpose.
- In case the same custom frontier cannot be used, the importer shall file an application along with the reasons therefor, at the customs department. The department may permit the use of another frontier in case the reasons appears genuine and department deems it appropriate.

- **Import of Container**

Import of Container that is vital to consumption of goods

The custom officer may permit the import of container obtaining bank guarantee of amount equivalent to the custom duty applicable on such import if all the following conditions are satisfied:

- The container shall be supplied with the goods, usable regularly and cannot be emptied unless the goods are consumed completely.
- The import shall attach the condition of exporting the same container after the use of goods.
- The time limit to export the same container shall be specified in Pragyapan Patra.
- In case the container cannot be returned within the deadline specified in Pragyapan Patra, the applicable duty on import of such container shall be recovered from bank guarantee.
- The bank guarantee facility cannot be granted for import of container in case the goods can be consumed taking the goods out from the container.

Export of Container for self purpose to fill goods for import purpose

- A person willing to import container for self purpose to fill the goods for import (the container that shall be supplied with goods, usable regularly and cannot be emptied unless the goods are consumed completely) shall file an application to custom officer specifying the reasons therefore.
- The custom officer may permit the export of container obtaining the ***deposit equivalent*** to ***5% of price of empty container*** or ***bank guarantee*** with ***six months validity*** and the guarantee amount of which is **equivalent to 5**% ***of price of empty container***. The container shall be ***re-imported within three months*** of export filling the imported goods in the container.
- A maximum of one month period can be extended to re-import the container in case the importer files an application at Custom office along with the reasons therefore for time extension and if the custom officer deems it appropriate.
- In case the container is re-imported within the original deadline (3 months) in case of no extension or within the extended deadline (4 months- 3 months plus one month), the custom officer shall refund the deposit or release the bank guarantee, as the case may be.

In case of failure to re-import within the specified deadline, the custom officer shall deposit the deposit amount in the revenue account or shall recover the amount from invoking bank guarantee, as the case may be. The deposit shall be deposited in the revenue account or the guarantee shall be invoked to recover the duty even if the container is re-imported after the expiry of deadline.

Customs points for Re-export/re-import

- The same custom point as that of import of goods shall be utilized for re-exporting purpose.

- In case the same custom frontier cannot be used, the importer shall file an application along with the reasons therefor, at the customs department. The department may permit the use of another frontier in case the reasons appears genuine and department deems it appropriate.

- **Export of imported Chassis of Bus or Truck to prepare body**

Application to be filed for export of Chassis

In case the importer of chassis of bus or truck requires exporting the chassis within three months of import to make the body of such bus or truck, it shall fill up Pragyapan Patra and make an application at custom officer.

Permission to be granted

On receipt of application along with pragyapan patra, the custom officer may grant permission to re-export such chassis attaching the following conditions:

- The importer exporting the chassis shall provide bank guarantee or cash deposit of amount equivalent to 5% of price of the chassis.
- The exported chassis shall be re-imported after making the body within 6 months of such export.

Release of Bank Guarantee

In case the importer exporting such chassis re-imports the bus or truck within Six months, the custom office shall release bank guarantee or cash deposit, as the case may be, after recovering the applicable custom duty on the expenditure incurred for making the body of such truck or bus.

Effect of failure to re-import or failure to re-import within deadline

- In case of failure to re-import within the specified deadline, the custom officer shall deposit the Cash deposit in the revenue account or shall recover the amount from invoking bank guarantee, as the case may be.
- The deposit shall be deposited in the revenue account or the guarantee shall be invoked to recover the duty even if the bus or truck is re-imported after the expiry of deadline. The bus or truck may be released on re-import after deadline after confiscating the cash deposit or recovering the amount from invoking guarantee and collecting the applicable custom duty on additional cost of making body of the bus or truck.

Customs points for Re-export/re-import

- The same custom point as that of import of goods shall be utilized for re-exporting purpose.
- In case the same custom frontier cannot be used, the importer shall file an application along with the reasons therefor, at the customs department. The department may permit the use of another frontier in case the reasons appears genuine and department deems it appropriate.

- **Special Relief for GON, Public Corporation fully or partially owned by GON or Diplomatic Missions**

  The custom officer may permit the export/import (return of goods due to sub-standard quality with conditions of receiving similar fresh goods or refund of FCY already paid; import of container, export of chassis or import/export to participate in fair or exhibition) of goods maintaining the records of such import or export in case such action of re-import/re-export is conducted by Government of Nepal, public corporation wholly or partially owned by GON or on recommendation of diplomatic missions.

  Applicable duties shall be collected in case the exported goods are not re-imported into Nepal and consumed in foreign country and imported goods are not re-exported out of Nepal and consumed in Nepal from such importer or exporter, as the case may be.

- **Harmonized System**

  Goods imported or exported are valued as per Harmonized System basis. According to Sec. 89, if, in determining the customs duty, there is a doubt as to in which heading or sub-heading of the harmonized system do any goods fall, the Customs Officer shall classify such goods in the heading or sub-heading as prescribed by the Director General.

  If, prior to the exportation or importation of any goods, any exporter or importer submits an application to the prescribed committee also comprising an expert in the field concerned for the specification of the heading or sub-heading of commodity classification of such goods, the committee may, also examining a sample of such goods, prescribe the heading or sub-heading of such goods.

  The Director General and the committee shall, in prescribing a heading or sub-heading, respectively, so prescribe based on the authentic text of the harmonized system of the 'World Customs Organization'.

  For the purposes of prescribing the heading or sub-heading of any goods, advice of the concerned expert or national or international body may be sought.

  Definition and Nepalese Use

  The Harmonized System or HS is a goods nomenclature that is developed and maintained by the World Customs Organization (WCO), and is governed by an international convention. Nepal is a member of WCO. It comprises about 5,000 commodity groups; each identified by a six digit code, arranged in a legal and logical structure and is supported by well-defined rules to achieve uniform classification. The HS System is governed by "The International Convention on the Harmonized Commodity Description and Coding System". The official interpretation of the HS is given in the Explanatory Notes published by the WCO. The system is used by more than 200 countries and economies as a basis for their Customs tariffs and for the collection of international trade statistics. Over 98% of the merchandise in international trade is classified in terms of the HS. Over 190 countries and economies use the HS as a basis for their customs tariffs. Apart from Customs, and Excise and VAT laws and regulations also commonly refer to tariff headings to determine the tax treatment of specific categories

of goods. Normally, HS code are applicable for international trade; but, when customs tariff headings are used without further qualifications for domestic tax purposes such as sales or consumption taxes, its rules of application and interpretation serve well for such national purposes too. Nepal revenue authorities use it for the national purpose too; as excise and VAT has adopted HS code.

A customs tariff schedule based on HS is comprises two elements: a nomenclature and its tariff rates. Both elements are automatically linked to determine tariff rates for different categories of goods, be well defined nomenclature.

The HS provides a logical structure in which over 1,200 headings are grouped in 96 Chapters, almost all Chapters are divided into sub-Chapters. The Chapters are arranged in 21 Sections. Each heading is identified by a four-digit code, the first two digits indicating the Chapter wherein the heading appears, the latter two indicating the position of the heading in the Chapter. In addition, most of the headings are subdivided into 1-dash subheadings which, where necessary, are further subdivided into 2-dash subheadings, identified by a 6- digit HS code. Nepalese HS Code is with 8-digits further expansion of WCO codes of 6-digits by numerical codes.

Example of HS Code

Chapter 17 Sugars and sugar confectionery

Heading 17.01 Cane or beet sugar and chemically pure sucrose, in solid form.

Subheading 1701.11 -Raw sugar not containing added flavouring or colouring matter:
--Cane sugar:

Subheading Item details 1701.11.90 ---Sakhhar (Gud)

Hence, the full description of subheading 1701.11.90 is “Sakhhar (Gud); Raw sugar not containing added flavouring or colouring matter: --Cane sugar:; Cane or beet sugar and chemically pure sucrose, in solid form; Sugars and sugar confectionery”. As per chapter details, for the purposes of Sub-headings 1701.11, "raw sugar " means sugar whose content of sucrose by weight, in the dry state, corresponds to a polarimeter reading of less than 990.

This code is usable for following tax laws (Rate has given for 2077/78):

Customs- for the purpose of import -15% from SAARC and other country

Excise- Rs. 72 per quintal

VAT-13% of sales price

Interpretation of HS Code

WCO HS is set up as a “closed system”. WCO HS code classifies all traded goods, whether or not existing at the time the HS was established, but domestic law may fix tariff for the items trading within state.

General Rules for the interpretation (GRI)

These are the main tool for the daily application of the HS, and form an integral part of the HS Convention. Following are 6 GRIs as per WCO interpretations:

GRI 1. The titles of Sections, Chapters and sub-Chapters are provided for ease of reference only; for legal purposes, classification shall be determined according to the terms of the headings and any relative Section or Chapter Notes and, provided such headings or Notes do not otherwise require, according to the following provisions :

GRI 2. (a) Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also be taken to include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this Rule), presented unassembled or disassembled.

(b) Any reference in a heading to a material or substance shall be taken to include a reference to mixtures or combinations of that material or substance with other materials or substances. Any reference to goods of a given material or substance shall be taken to include a reference to goods consisting wholly or partly of such material or substance. The classification of goods consisting of more than one material or substance shall be according to the principles of Rule 3.

GRI 3. When by application of Rule 2 (b) or for any other reason, goods are, prima facie, classifiable under two or more headings, classification shall be effected as follows :

(a) The heading which provides the most specific description shall be preferred to headings providing a more general description. However, when two or more headings each refer to part only of the materials or substances contained in mixed or composite goods or to part only of the items in a set put up for retail sale, those headings are to be regarded as equally specific in relation to those goods, even if one of them gives a more complete or precise description of the goods.

(b) Mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, which cannot be classified by reference to 3 (a), shall be classified as if they consisted of the material or component which gives them their essential character, insofar as this criterion is applicable.

(c) When goods cannot be classified by reference to 3 (a) or 3 (b), they shall be classified under the heading which occurs last in numerical order among those which equally merit consideration.

GRI 4. Goods which cannot be classified in accordance with the above Rules shall be classified under the heading appropriate to the goods to which they are most akin.

GRI 5. In addition to the foregoing provisions, the following Rules shall apply in respect of the goods referred to therein :

(a) Camera cases, musical instrument cases, gun cases, drawing instrument cases, necklace cases and similar containers, specially shaped or fitted to contain a specific article or set of articles, suitable for long-term use and presented with the articles for which they are intended, shall be classified with such articles when of a kind normally sold therewith. This Rule does not, however, apply to containers which give the whole its essential character;

(b) Subject to the provisions of Rule 5 (a) above, packing materials and packing containers presented with the goods therein shall be classified with the goods if they are of a kind normally used for packing such goods. However, this provision is not binding when such packing materials or packing containers are clearly suitable for repetitive use.

GRI 6. For legal purposes, the classification of goods in the subheadings of a heading shall be determined according to the terms of those subheadings and any related Subheading Notes and, mutatis mutandis, to the above Rules, on the understanding that only subheadings at the same level are comparable. For the purposes of this Rule the relative Section and Chapter Notes also apply, unless the context otherwise requires.

Updates

The HS Committee that is set up under the HS Convention convenes regularly to update the Explanatory Notes to the HS, to issue Classification Opinions and Rulings on specific goods. Although these notes, opinions and rulings are not legally binding, they provide useful and authoritative guidance for the application of the HS. HS Code updates are legally binding when the domestic law adopts these, WCO, recently revised some of its codes effective from January 1, 2012, which has yet to be incorporated into Nepalese legal system (normally new amendments to be adopted by state parties within 2.5 years).

Section 89Kha (6)

Administration of export or import identification number under this section shall be done by prescribed entity published in Nepal Gazette by Nepal Government and until the publication of such notice custom department shall perform administrative work related to such identification number.

Section 89Gha

i. Notwithstanding anything contained in applicable laws, custom officer if after using its authorized password takes print out of documents related to clearance from the records maintained at computer system shall be deemed equivalent to as if it is signed even if it is not signed by the employee.

ii. By using authorized password provided by the Custom Department if takes print out of documents from the records done through electronic medium related to declaration of goods, communication of information or clearance maintained at computer system shall be deemed equivalent to as if it is signed even if it is not signed by the related person.