

Setting up your Business in Nepal

Issues to consider



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Nepal is an independent and federal democratic republic country. It is in the process of establishing a state system but number and boundaries have not been finalised. It is a land-locked country in South Asia with a population of 26.4 million. The country has an area of 147,181 square kilometres, making it the world's 93rd largest by area. It is also the 41st most populous country. Nepal is an agriculture dominated country, however due to globalization and technological advancement potential business sectors in Nepal are rapidly rising. The key business sectors in Nepal are Agro-business, Hydropower, Tourism, Herbal, Sugar, Match, Flour, Carpets, Paper Garment and Textiles, Cigarette, Cement and Brick, Leather and leather goods, Soap, Health, Telecommunication and Mines.

Despite being a small country, Nepal is diverse in terms of topography. Mountains and rugged hills cover almost 77% of the total area. With the lowest part of Nepal as low as 61 meter to the highest mountain in the world, Mt. Everest as high as 8,848 meter and having eight out of fourteen 8000 meter mountains in the world, Nepal has potential to become one of the most important mountaineering tourist zones in the world.

Bordering China to the North and India to the South, East and West, most trade is done via two industrial giants. Due to the rapid industrialization of India and China, Nepal has potential to become one of the fastest growing nations in the world. The major industrial centres of Nepal are Biratnagar, Birgunj, Kathmandu, Bhairahawa, Janakpur, Hetauda, Nepalganj, Patan and Pokhara.

There are around 150 ethnic groups in Nepal as of 2011, these groups coexist in Nepal, each with their own complex customs. The major ethnic groups in Nepal are: Brahman, Chettry, Newar, Gurung, Sherpa, Magar, Tamang, Tharu, Rai, Limbu and Muslim.

The major minerals available in Nepal are Iron, Lead, Copper, Mica and Magnesite. Nepal has estimated water potential of 83000 MW, out of which 40,000 MW is technically and economically viable. However, Nepal to date has been able to develop only approximately 680 MW of power. As per an Economic Survey published by Ministry of Finance for FY 2015/16, the total exports were Rs. 74.2 billion while the total imports were Rs. 789.3 billion.

Being an economically developing country, Nepal has recently emerged as a key destination for foreign investors. Nepal strives to promote foreign investment in a focused, comprehensive and structured manner with a main focus to provide quality input and support services to its prospective foreign investors.

However, there are a number of issues which you must consider when you are looking to set up your business in Nepal.

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This document takes you through some of the common questions we come across and gives you practical information about the issues you need to consider.

What type of Business Structure should we use?

There are advantages and disadvantages to all of them, and there is no one correct answer, it's all dependent on your specific business circumstances and needs. A brief overview of the main structures is below:

Private Company

- Minimum 2 shareholders; Maximum 50 shareholders excluding persons who are in the employment of the company;
- 1 shareholder for One Person Company;
- Restrictions on transfer of shares; and
- Restrictions on invitation to the public to subscribe in its shares and debentures.
- A private company may be converted into a public company.

Public Limited Company

- May issue invitation to the members of the public to subscribe to the shares and debentures of the company through a prospectus which complies with the requirements of the Companies Act 2006 and the Securities Act 2006 as amended from time to time;
- Minimum 7 members, but there is no maximum limit;
- Minimum paid up capital of ten million Nepalese Rupees;
- Has at least 3 directors;
- Has at least one independent director.

Establishment of Branch or Liaison or Representative Office

To open or seek extension of a Branch or a Liaison Office of a foreign company, the company has to submit in prescribed form an application along with prescribed fees to Registrar Office of Nepal along with the following documents:

- Permission obtained from competent authority to carry on its business and transact in Nepal;
- Copies of the charter of the principal company;
- MOA and AOA of the Principal company and Nepalese translation;
- Certificate of Incorporation of Principal Company and Nepalese translation;
- Full Name, address of the registered office and principal office of business of the company;
- Date of incorporation of the company, description of the paid up capital and major objectives of the company;

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- Names and addresses of the Directors, manager, company secretaries or main officers of the Principal Company and description of their citizenship;
- Name of the person residing in Nepal authorized to receive any summons, notice, etc. issued in the name of the company;
- Full address of the principal place where the company carries on its transaction or business in Nepal and of the office of the company situated in that place;
- Details of the proposed investment and transaction to be carried on in Nepal;
- Proposed date of commencement of transactions in Nepal;
- A declaration by director or his representative, that the matters contained in the returns submitted by the company are correct and
- Power of Attorney.

Investment Procedures for Foreign Investors

Foreign Investors shall complete the following procedures for foreign investment:

- 1. Get approval from Department of Industries (DOI)**
 - a. Establish a new industry either with 100% foreign equity or in Joint Venture (JV) with Nepalese/foreign investors.
 - b. Engage in Technology Transfer in an existing industry
 - c. Make a loan investment, foreign or local, in an existing industry
 - d. Make an equity investment in an existing industry by Share Transfer

- 2. Incorporate the company at the Company Register's Office (CRO)**

After the approval of foreign investment from the DOI, the investors shall submit following documents to the CRO.

 - a. Copy of the permission for foreign investment issued by DOI
 - b. Copy of citizenship certificate of Nepalese promoter
 - c. Copy of passport of the foreign promoters
 - d. If the foreign party is a company, copy of minute of the board of directors
 - e. Two copies of company's proposed MoA&AoA in Nepalese language

- 3. Register the industry at Department of Industries (DOI)**

After completion of procedures 1 & 2, the industry is required to be registered with the DOI filling a prescribed form along with following documents:

 - a. A copy of the foreign investment approval letter issued by the Foreign Investment Section, DOI.
 - b. A copy of the Certificate of Incorporation, MoA&AoA of the company
 - c. Environmental Impact Assessment (EIA) Report or Initial Environmental Examination (IEE) Report

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4. Registration at Inland Revenue Office to get Permanent Account Number (PAN)

Then after, industry has to be registered with the District office of the Inland Revenue Department (IRD) or Inland Revenue Office (IRO) before its operation. Company has to apply with an application form along with the following documents.

- a. Copy of the certificate of incorporation
- b. Copy of the memorandum and articles of incorporation
- c. Copy of the citizenship certificate (or passport in case of foreign national) who signs the application
- d. Two passport size photo of the individual who signs the application
- e. Hand drawn sketch of the business location of the applicant
- f. Power of Attorney, if applicable

5. Others, if applicable (such as Trademarks/design/patents)

The industries using Trademark on their products can register their Trademarks with the DOI as per Patent, Design & Trademark Act, 1965. Company has to apply in a prescribed form duly signed by applicants along with two witnesses & following documents:

- a. Copies of the Industry Registration Certificate & Certificate of Incorporation
- b. Four copies of the word, label or both to be used in the form of trademark (i.e. representation sheet)
- c. The name of the product/services in which the Trademark is to be used
- d. The statement of claim regarding the originality of the trademark
- e. In case of registration of Trademark of foreign origin, a copy of home registration certification alongwith application form, deed of assignment & four copies of representation sheet should be included.

How much Corporation Tax will the business pay?

Current (Assessment year 2015-2016) Corporation Tax rates in Nepal are:

<u>Category</u> <u>Rates (%)</u>	<u>Tax</u>
Private/ Public Company (General)	25%
Bank, general insurance & petroleum production	30%
Tobacco Production or liquor related business	30%

Export Company, Special Industry, Infrastructural Business-Construction and operation of roads, tunnel, ropeway, sky bridge, power-house construction,



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generation and transmission	20%
Environmental Friendly Transportation- Operation of Trolley Bus or Tram	20%
Co-operative Society or Unions	20%
Built, Own, Operate and Transferred to GON	20%

What if we make cross-border transactions between group companies?

Nepal follows internationally recognized **Transfer Pricing** (TP) rules where cross-border trading and financial transactions between affiliated entities have to be conducted on an arm's length basis. Arm's length price means a price in a transaction, the conditions (e.g. price, margin or profit split) of which do not differ from the conditions that would have prevailed in a comparable uncontrolled transactions between independent entities carried out under comparable circumstances. Transfer pricing regulation was incorporated in the Income Tax Act, 2001. Section 33 of the Income Tax Act, 2001 contains the transfer pricing regulations.

Typical transactions between associated entities that are covered by TP provisions are:

- Purchase and sale of goods
- Property rental charges
- Interest free long dormant advances
- Use of trademarks without any royalty
- Provision of management services
- Provision of benefits of research and development without any reasonable consideration

The following method is to be applied for computation of "arm's length price"-

- a) Comparable uncontrolled price method
- b) Resale price method
- c) Cost plus method
- d) Profit split method
- e) Transaction net margin method
- f) Any other method

Tax Treaties:

- Nepal has Double Taxation Avoidance Agreements (DTAA) with 10 countries in the world. The countries are as follows:

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Asia-Pacific		Europe	Africa
India	Thailand	Norway	Mauritius
China	South Korea	Austria	
Sri Lanka	Qatar		
Pakistan			

- In case an international agreement includes a term that Nepal will exempt income tax on a payment or will charge a tax at a lower rate of tax on an income or on a payment, the terms of the agreement shall prevail over the provisions of the Income Tax Act, 2001 in this regard. But the exemption or concessionary rates shall not be applicable to the following entities:
 - 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 contracting state or Nepal
- If there is no agreement, 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 the country on that income. The maximum amount of tax credit allowed for the year shall not exceed the average rate of Nepal income tax or the person for the year applied to the person's assessable income from each foreign country.

What Employment Taxes and Social Security will need to be paid?

- Liability for Income Tax is governed by the residential status of the individual during the fiscal year. Individuals are considered to be residents if they meet either of the following criteria:
 - Person having normal place of abode in Nepal
 - Natural Person staying in any day in Nepal and his stay in last 365 days till that day is 183 days or more.
 - Individual is employed by Nepal, whether in Nepal or abroad.
- Entity which meets either of the following criteria shall be considered as resident for that fiscal year.
 - Entity is registered(or established or incorporated under any Nepal law) in Nepal
 - Entity those are registered elsewhere in the world, or in case of unregistered body of individuals, if their management is effective in territory of Nepal within that income year).

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It is advised that any new entrant to Nepal or person who spends time working in Nepal to seek professional advice to determine whether they are Nepalese tax resident or not.

Current Personal Income Tax rates in Nepal are:

Income slabs (NRs.)	Income Tax
0-350,000 (for Single Person) Or 0-400,000 (for Married Person)	1% SST
Next 100,000	15%
Up to 2,500,000	25%
More than 2,500,000	+ 40% on Highest Rate

NB: rates are for the tax year 17th July, 2016 to 16th July, 2017

- Social Security in Nepal is governed by Income Tax Act, 2001. The SST is mentioned in Schedule 1 of the Income Tax Act, 2058
- Every covered employer is required to contribute 20% (including 10% employee's share) of the employee's monthly pay as defined towards the Provident Fund.

VAT

Value Added Tax is tax on value addition (further cost plus profit over VAT paid on purchase) made by any person. For the purpose of foreign trade and public procurement, the term 'Value Add' shall be the addition on the price of goods within the country or said economic region.

In Nepal, VAT is regulated by the Value Added Tax Act, 1996; Value Added Tax Rules, 1997.

The basic rates under VAT are as follows:

- 13% as Single Rate- can reclaim input VAT
- 0% for export of goods and services- can reclaim input VAT
- VAT exemption for goods and services mentioned in Schedule 1 of the VAT Act)- cannot reclaim input VAT

Customs Duty:

Custom duty is levied by the Nepalese Government on import of goods into Nepal and is typically

payable by the importer of goods. It is also levied on export of certain goods. Custom duty rates depend on the classification under the Customs Tariff, which is aligned with the International Harmonized System of Nomenclature.

Excise Duty:

Excise Duty is applicable on the manufacture of goods within Nepal and is payable by the manufacturer. Excise duty is generally levied on an ad valorem basis, either expressed as a

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percentage of the transaction value or maximum retail price (for certain specified goods). Credit of Excise Duty paid is available in certain situations.

Can we provide Share option plans to our staff?

The Companies Act, 2006 has provisions regarding the employee share scheme to be provided in the public companies.

How else can we compensate our employees?

Nepal has a very comprehensive range of compensation and benefit options available for companies to offer their employees. In general, most elements of compensation are taxable in Nepal. However, certain benefits are likely to receive preferential tax treatment.

Provident Fund, Gratuity, Pensions, Accommodation facility, interest free/ low interest loans, reimbursement of medical expenses, leave/travel/education allowance, pensions etc. are now common benefits provided by many Nepalese businesses to their workforce.

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