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PREFACE

This handbook is primarily designed for general taxpayers to provide guidelines regarding income tax act and regulations. For them, it is important to know how to calculate the tax and how to deal with administrative issues, which are usually linked with the submission of the tax return and the payment of tax.

The first part is focused in the area of tax calculation. It extends to the explanations of what the taxable income is and which amounts to be included into the taxable income and which amounts are allowed to be deducted. Special cases in the area of international taxation and taxation of major entities are not dealt with in detail. Likewise, depreciation rules and methods are also not explained in length since these are special topics that would go beyond the general scope of this handbook.

The second part of the handbook deals with the subject of income tax administration. It explains detailed guidelines for the submission of the income tax return as well as rights and duties of the taxpayers regarding review, appeal, interests, and penalties.

It is an stupendous task to educate the taxpayers in an age of growing complexity of their business, where the taxation law tend to be as comprehensive and of international standard. It might happen that a taxpayer will not find an answer to his question or find some explanations too complicated. In such situation it might be helpful to directly refer to the text of the act or look into the income tax forms and the respective guidelines. This means, that this handbook needs to be used in the context of other documents dealing with the explanation and implementation of the income tax act. In order to make it easy to find the respective sections, which are explained in this handbook, in the income tax act itself they are referred to and quoted wherever possible, using *italic* letters. The handbook also follows the order of paragraphs and the structure of the income tax act.

Finally, this handbook might also be of interest for the income tax administrators in the Inland Revenue Department (referred to in the handbook as IRD) and the Inland Revenue Offices (referred to in this handbook as IRO).

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1. BASIC PRINCIPLES

1.1 Paramount Force

The new income tax act has consolidated all the income tax related provisions provided by other acts while minimizing the exemption level and thus widening the tax base. There are some new provisions in this income tax act in order to bring all incomes under the tax net. This law has provided some new concepts and new provisions which may take some time to adjust with the new legal environment.

The act contains two schedules, of which schedule 1 is related to *s 4* of the income tax act and encompasses details about the calculation of tax and the tax rates. Schedule 2 is related to *s 19* and contains directives for the calculation of depreciation. Furthermore, for better carrying into effect of the principles and purposes of the income tax act HMG/N is empowered to enact rules. The income tax act describes the tax matters where the authorization to make rules is given to HMG/N and where rules are prescribed. In addition to the rules, the IRD may issue Income Tax Manual and public circulars providing administrative details and homogeneity in the interpretation of tax law.

The income tax act and the rules come into existence in different ways. As any other law the income tax act has to pass the parliament. By contrast, the rules are based on and amended by decision of the cabinet.

1. In order to make the wording of the income tax act consistent and also user-friendly, *section 2* in the beginning of the income tax act comprehensively defines technical terms, which are frequently used in the subsequent sections of the act. If there is any ambiguity in the meaning of a word in a section or paragraph, the taxpayer or the tax administrator needs to look into this definition chapter in order to find the proper meaning of the word in the context of income taxation.

1.2 Taxation of Income

The income tax act imposes tax on income or wealth created by a person in the course of an earning activity. There are basically three sources that generate income: labor, capital, and labor plus capital. Correspondingly, the act imposes tax on income from employment - which is labor, income from investment - which is capital, and income from business - which is labor plus capital. Income created outside these sources is not taxable. A typical example for such type of income is winnings from gambling. They are not connected with an earning activity and therefore not taxable.
In the case of employment and investment of an individual, income is recognized for taxation purposes only at the time when it is paid for. But in the case of an entity, income is recognized in accrual basis. Payments can be made in cash or in kind. If the taxpayer receives a benefit not in the form of money but in the form of other benefits for example, free housing or facility of a car, for which he does not have to pay, this benefit has to be valued at and converted into money and is then taxable. The rules provide regulations on how to assign a certain amount of money to a specific benefit.
Income from employment is the remuneration. Income from a business and investment comprises profits and gains from conducting the business and the investment. While profits are directly connected to an earning activity in the sense that the taxpayer receives them once he has carried out the earning activity, gains are incorporated into the value of an asset. They result from the increase in the value of asset and are realized once the asset is disposed of in any manner. This is also the moment when they are recognized for tax purposes, i.e. when they are taxed.

For example: The taxpayer buys some shares of a company for 20 Lakhs in December of the year 2059 and sells those shares in February of the same year for 25 Lakhs. The

taxpayer has received gains amounting to 500,000 Rs. He has to pay taxes on them in the year 2059 when he obtained the money.

r: An individual bought a house in the year 2059 for 110 Lakhs and sold in the year 2060 for 120 Lakhs. The gains are 10 Lakhs to be taxed in the year of sale, that is the year 2060.

These gains are also a part of the income and therefore subject to income tax.

2. All actual costs to the extent incurred in the production of income from business or investment are deductible *(s 13)*. This means that the income from each business and investment needs to be calculated separately because the types of business and investment and the deductions connected with each type of business and investment may differ. No deductions are allowed from the income from employment.

1.3 Administration

Administratively the income tax act is based on a self-assessment system. That requires the taxpayer to calculate the tax by himself using the income tax forms prescribed by the tax administration. The tax authorities have basically to accept the taxpayer's declaration. Only if the tax administrators find reasons for a change of what the taxpayer has declared they should amend the taxpayer's statement.

Income tax rules are in place binding the tax authorities as well as the taxpayer and guide the taxpayer on how to handle specific tax matters. If the taxpayer wants to object to a decision of the tax administration the income tax act makes it mandatory for him to, first, file an objection with the Inland Revenue Department for review, second, appealing to the Revenue Tribunal, if he is not satisfied with the review decision.

2. TAXATION OF INCOME

2.1 Taxpayers (taxpaying subjects)

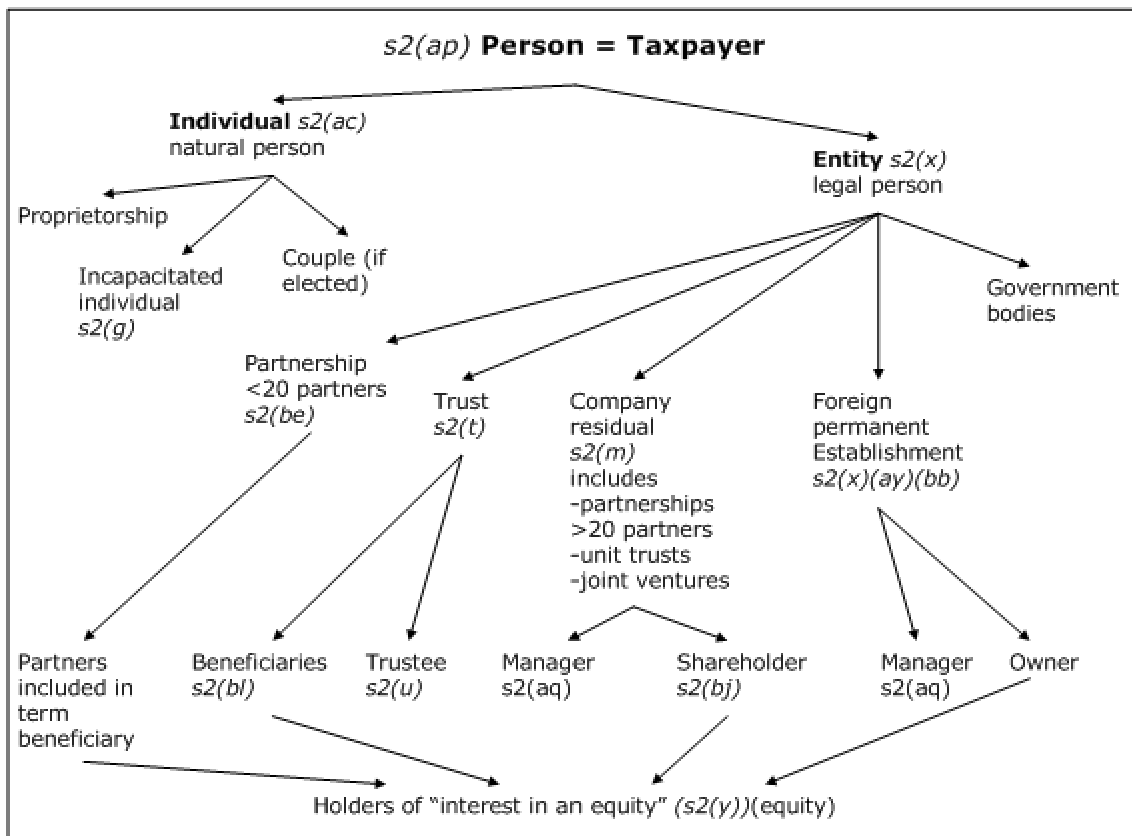
General Remarks

3. The taxpayers are the taxpaying subjects, on whom income tax is imposed and from whom income tax is realized. In the income tax act, they are described as

- persons, who have a taxable income for the year *(s 3(a))*.
- Permanent establishments of non-resident persons that are situated in Nepal and have repatriated income *(s 3(b))*.
- persons, who have received payments from which income tax has been finally withheld, i.e. who have received final withholding payments *(s 3(c))*.

The income tax act refers to taxpayers as persons as shown in the diagram below. As a rule of the thumb the income tax act distinguishes between individuals, partnerships, companies and trusts.

Figure 1



Individuals

12. A person can be a natural person. i.e. an individual *(s 2 (ac))*. The term individual also includes a proprietorship firm owned by an individual, whether or not the proprietorship firm is registered in concerned entity.

For example: If an individual owns a small shop he will be taxed as a proprietorship irrespective of the fact whether or not he has been registered with his small business in business registration office.

An individual and his spouse is taxed separately, but can also be taxed as couple, if both spouses elect to be treated this way *(s 50(1))*.

Entities/Legal Persons

13. A person can also be a legal person, which means an entity *(s 2 (x))*. Entities are private organizations like partnerships *(s 2 (be))*, trusts *(s 2 (t))*, companies *(s 2 (m))*, foreign permanent establishments *(s 2 (x)(ay)(bb)),* as well as public institutions, i.e. government bodies, such as village development committees, municipalities or district development committees.

14. A partnership is a group of persons carrying on a business jointly. A partnership has fewer than 20 partners. A partner is characterized through the fact that he has, like a beneficiary, an interest in the firm. For the term partnership it is not relevant whether or not the firm is registered in concerned authority. A partnership needs to be clearly distinguished from a proprietorship firm owned by an individual as described above. If a partnership firm has more than 20 partners it turns into a company *(s 2(m) (3)))*.

15. By contrast to a partnership, a company is, at its broadest, any unincorporated association and body of persons. It is a business enterprise established under the company laws for the time being in force. Because of the similarity to a company the following institutions are also treated as companies for tax purposes *(s 2 (m))*:

- Corporate bodies established under the laws presently in force;
- Any unincorporated association, committee, institution, society, or group of persons that is not a partnership or a proprietorship firm, or a trust
- A partnership firm with more than 20 partners, a retirement fund, a co-operative, a unit trust, or a joint venture
- Foreign company
- Any foreign institutions prescribed by the Director General of IRD

16. A trust is an arrangement where a trustee holds assets *(s 2(t)),* but does not include a partnership, a corporate body, or an entity referred in section 2 (m)(3). Trustee covers an individual or a corporate body holding assets in a fiduciary manner. Practical examples are:

- Executor or administrator of estate owned by a deceased person
- Liquidator, trustee or official receiver.
- Persons administering in a private or official capacity assets of an incapacitated individual.
- Any person who manages assets under a private foundation or other similar arrangement.

17. Compared to a trust or a partnership the company is the residual type of entity. Partnerships and trusts are generally excluded from the definition of the term company. However, to the extent possible, tax treatment should follow the substance of an activity and not the form in which it is conducted. This is the reason why partnerships consisting of more than 20 partners and unit trusts are treated as companies.

18. Permanent establishments are inferior organizational units of a company or an individual. They are places where an individual or an entity wholly or partially carries on a business *(s 2 (bb))*. Examples are given in the definition:

- an agent of a taxpayer but excluding a general agent of independent status
- a place where substantial equipment or machinery is used or installed
- one or more places where a person provides related services through the employee or in any other way for a period of more than 90 days within a 12 month period; the services can be of technical, professional or consulting nature; the way the services are delivered is irrelevant;

- a place where a person is engaged in a construction, assembly, or installation project for 90 days or more whereas the term engagement also includes supervisory activities.

19. As long as they are situated in Nepal permanent establishments are not independent persons subject to income tax but their income is covered and thus taxed on the level of the superior organizational unit, which might be an individual or an entity of the type described above.

The situation is different if the permanent establishment is situated in Nepal and the individual or entity, to which the permanent establishment belongs, is not located in Nepal. In this case the permanent establishment is treated as an independent taxpayer subject to income tax in Nepal.

2.2 Residents and non-residents

20. The income tax act distinguishes between resident *(s 2 (ao))* and non-resident *(s 2 (q))* persons. Income tax in an annual basis is normally imposed only on the income of residents. A non-resident with residential income is subject to income tax in final withholding basis.
An individual is residing in Nepal if

- The normal place of abode of the individual is in Nepal, or
- The individual is present in Nepal for 183 days or more in any period of 365 consecutive days.

21. The citizenship of the individual is not relevent for taxation purposes. Nepal's right to impose income tax on an individual is solely linked with the residence of the individual. A special rule applies to government officials. The income of employees or officials of His Majesty's Government of Nepal (HMG/N) is fully taxable in Nepal even if they are posted abroad.

22. Partnerships are always treated and taxed as resident persons. By contrast, a company resides in Nepal if it is incorporated under the laws of Nepal or has its effective management in Nepal. A trust is a resident person if it is established in Nepal, or has a resident person as a trustee, or is controlled by a resident person. Permanent establishments are places where a person carries on a business *(s 2 (bb))* and are subject to income tax if they belong to a non-resident person and are situated in Nepal.

23. The tax is imposed and calculated for an income year. The income year starts with the month of Shrawan and ends at the end of Ashad of the following calendar year *(s 2 (i))*.

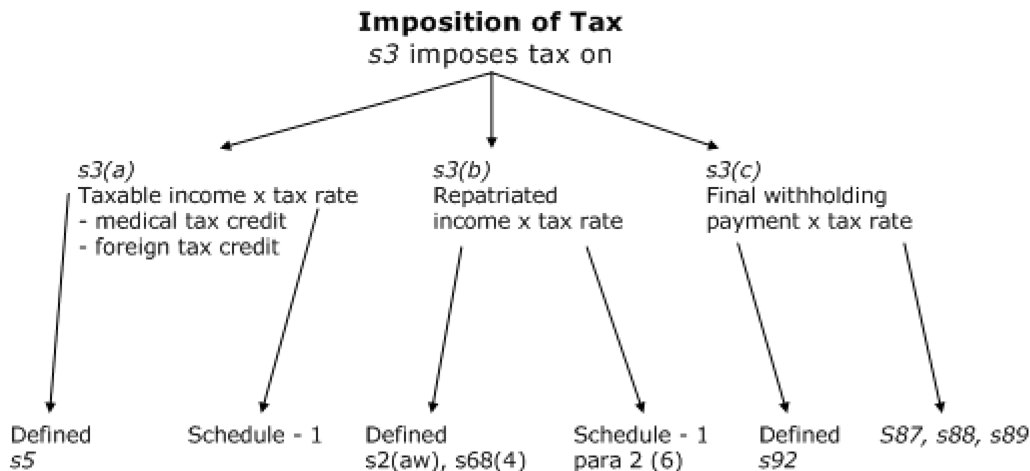
2.3 Income (taxable objects)

General Remarks

24. The objects of taxation, on which tax is imposed, are *(s 3)*

- the taxable income
- final withholding payments
- the repatriated income of a foreign permanent establishment.

Figure 2



The income tax payable is calculated by applying the relevant rates to the taxable income, final withholding payments or, in case of a foreign permanent establishment, the repatriated income.

25. Amounts, on which in practice income tax is most frequently imposed, are the taxable income and final withholding payments. Therefore, the following explanations will mainly focus on that. Repatriated income covers a special case where a foreign permanent establishment as described in section 18 and 19 of this handbook is located in Nepal but belongs to a foreign, non-resident parent individual or entity, and this foreign permanent establishment transfers income derived from earning activities in Nepal through bank or other means to the parent, i.e. it repatriates its income *(s 2 (aw))*. With the local income, the foreign permanent establishment of a non-resident parent person is treated and taxed like a local taxpayer, i.e. this income is taxed at regular rates. In other words foreign permanent establishment is taxed like a resident taxpayer and the repatriated income of this establishment is treated like dividend.
The income, which is sent back to the home country of the non-resident parent, to whom the permanent establishment belongs, is taxed with a special rate as mentioned in schedule 1.

26. Withholding payments are amounts from which tax is deducted at source. This means, the person who does a specific payment, i.e. the payer, has to withhold tax at the prescribed rate on behalf of the person who receives the payment, i.e. the payee. The payments that are treated as final withholding payments are mentioned in *s 92*. The rates, at which these payments are taxed, are stated in *s 87, 88 and 89*. The subject withholding is dealt with in the administration part of this handbook.

Income Heads

27. Income covers earnings from the sources employment, business and investment *(s 2 (h)).* The earnings consist of amounts, which the taxpayer receives or is entitled to receive. Amounts received are payments, which can be done in cash, i.e. the taxpayer

receives money, or in kind, i.e. the taxpayer gets any type of benefit that is not money. Income can be accounted for on a cash or accrual basis. The basis that the taxpayer is required to take depends on the type of income.

28. Taxable is the net-income, which are the gross earnings less deductions allowed under *chapter 5* of the income tax act. Deductions are permitted only to calculate the income from business or investment, and not permitted to calculate the income from employment. Deductible are expenses if they are incurred in the production of income from business or investment. It is the taxpayer's duty to calculate the income properly for each earning activity. The type of income a taxpayer can derive depends on whether the taxpayer is an individual or an entity. An individual can derive income from employment, business and/or investment. An entity cannot earn money from employment because it cannot become an employee. Therefore, it can derive income only from business or investment.

Assessable Income

29. The calculated income (gross income i.e. inclusions less deductions) from each income head is assessable in Nepal and, thus, becomes the assessable income. This is the case for income that a resident person in the above-explained sense has derived. Persons residing in Nepal are taxable with their global income irrespective of the location of its source *(s 6)*. This means, an individual residing in Nepal as well as a partnership, company, trust or foreign branch situated in Nepal is taxable with the total income that this taxpayer has earned irrespective of the country where the earning activity, say, business or investment, was carried out.

30. The income of a non-resident person is only assessable to the extent that it has a source in Nepal *(s 6)*. To provide for these situations of international taxation the income tax act contains detailed rules and descriptions about the circumstances under which income, losses, gains and payments have a source in Nepal *(s 67)*.
Income from an agriculture and cooperative business *(referred in s 11 (1) and (2))* and of an approved retirement fund *(s 64 (2))* is exempt from tax and does not belong to the assessable income.

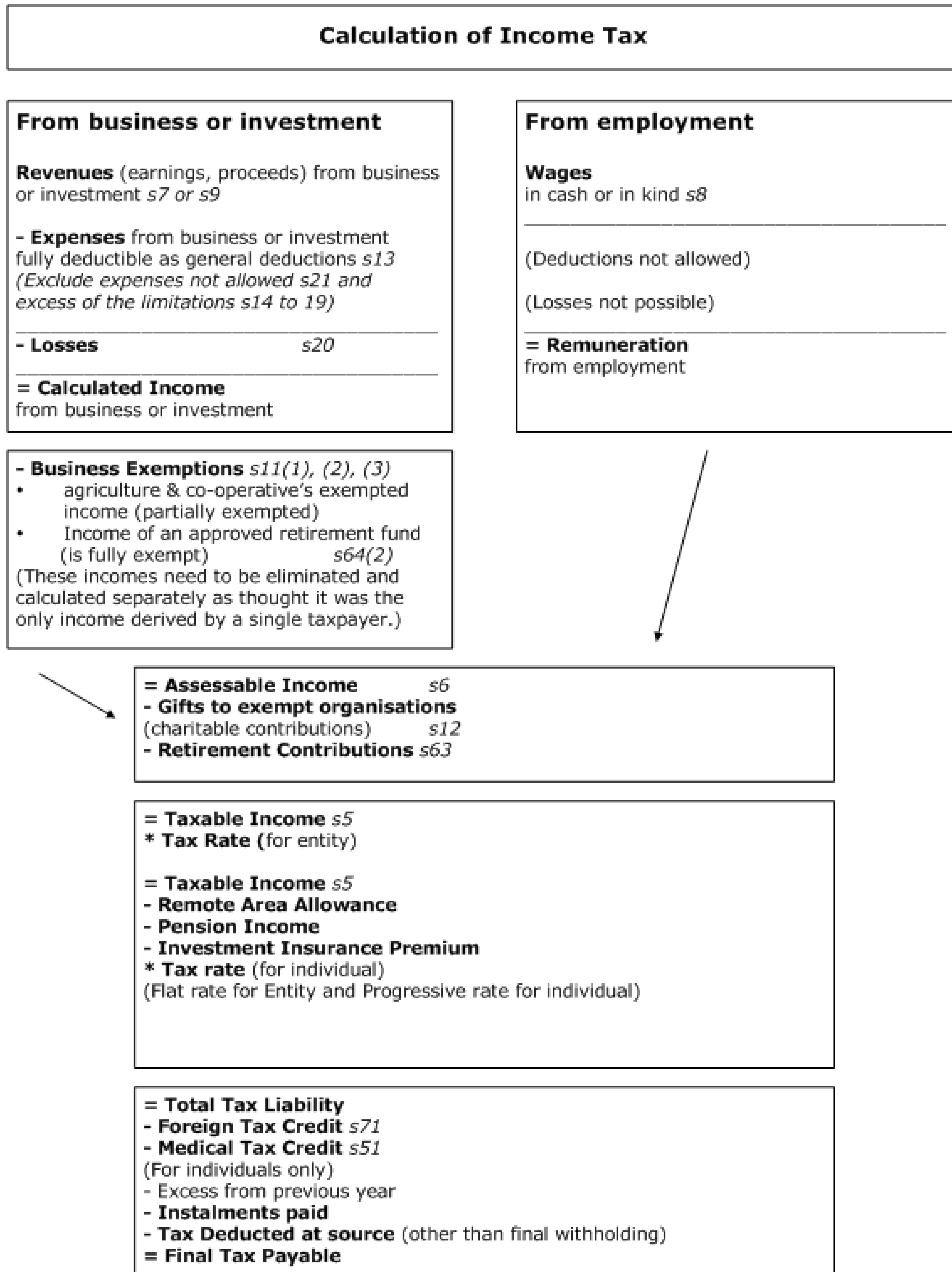
Taxable Income

31. The income, to which tax rates are applied, is the taxable income *(s 5)*. It is defined as the assessable income less reductions for gifts to exempt organizations *(s 12)* and retirement contributions *(s 63)*. This shows that it is calculated in a "slice-by-slice" manner. The taxpayer starts with the calculation of income from each employment, business, or investment for a particular income year. Deductions, if allowed and available, are taken separately in each of these calculations of income. This income, after any deduction, is filtered in a sense that resident income is divided from non-resident income. Then particular business exemptions and concessions are considered. If the taxpayer is an approved retirement fund the income is fully exempt from income tax. That results in the taxpayer's assessable income from each employment, business or investment for an income year.

32. The assessable incomes from the three income heads are aggregated for the income year. The aggregate is then reduced by gifts to exempt organizations and certain contributions to approved retirement funds, to arrive at the taxpayer's taxable income for the year. After the application of the respective tax rate the owed tax is shown. This amount is the total tax liability for the year but not payable. Because tax credits, installments paid and tax amounts deducted on behalf of the taxpayer have not yet been considered. After their reduction the final tax payable is shown.

33. Hence, the income is determined and the income tax is calculated as follows:

Figure 3



2.4 Tax Rates

34. Tax rates differ in structure and in terms of percentage depending on whether the taxpayer is an individual or an entity.

Individuals

35. The tax rates for single individuals and couples have a progressive three-tier structure. First, a basic exemption threshold remains tax-free, i.e. is taxed at the rate of 0 %, representing the taxpayers' basic living amounts. Second, after the exemption threshold a middle part of the taxable income is taxed at the rate of 15 %. Third, the part of the income exceeding a certain upper limit or ceiling of income is taxed at the highest rate of 25 %. The amounts of the basic exemption threshold, the middle part of the income and the upper limit vary depending on whether the taxpayer is taxed as a single individual or a couple. For couples the amounts are higher. The amounts also will be frequently reassessed, as may the percentage of tax imposed on the various parts of the income of an individual.

36. The taxable income of a single resident individual for an income-year is taxed at the following rates:

- taxable income not exceeding Rs 80,000 - nil;
- taxable income in excess of Rs 80,000 but not exceeding Rs 155,000 -

  15 percent of taxable income in excess of Rs 80,000; and
- taxable income in excess of Rs 155,000 - Rs 11,250 plus

  25 percent of taxable income in excess of Rs 155,000.

37. The taxable income of a resident married couple is clubbed together and taxed as follows:

- taxable income not exceeding Rs 100,000 - nil;
- taxable income in excess of Rs 100,000 but not exceeding Rs 175,000 -

  15 percent of taxable income in excess of Rs 100,000; and
- taxable income in excess of Rs 175,000 - Rs 11,250 plus

  25 percent of taxable income in excess of Rs 175,000.

38. This means:

- The first 80,000Rs. (single individual) or 100,000 Rs (couple) are tax-free. If the taxpayer's income is not higher than this basic exemption threshold, no tax needs to be paid. Through this rule taxation is removed from a basic living amount.
- The amounts between 80,000 Rs. (single individual) or 100,000 Rs (couple) and 155,000 Rs. (single individual) or 175,000 Rs. (couple) are taxed at the rate of 15 %. This tax rate refers to an amount of 75,000 Rs (155,000 minus 80,000 for single individuals or 175,000 minus 100,000 for couples respectively) and leads to a tax on this amount of 11,250 Rs (75,000 x 15 %).
- Amounts above 155,000 Rs. (single individual) or 175,000 Rs. (couple) are taxed at the rate of 25 %.

39. Resident individual taxpayers can calculate his tax payable by using the calculation schemes below:

Figure 4

Calculation Schemes

Tax calculation <u>individual</u>

Taxable Income (if your taxable income is **under 155,000 Rs** enter here)	Tax Rate	Tax
- 80,000 Rs	**0%**	**nil**
=.........................Rs	**x 15%**	=.....................Rs **Total Tax Payable**

Tax calculation <u>couple</u>

Taxable Income (if your taxable income is **under 175,000 Rs** enter here)	Tax Rate	Tax
=.........................Rs **- 100,000 Rs**	**0%**	**nil**
=.........................Rs	**x 15%**	=.....................Rs **Total Tax Payable**

Taxable Income (if your taxable income is **over 155,000 Rs** enter here)	Tax Rate	Tax
=.........................Rs **- 80,000 Rs**	**0%**	**nil**
=.........................Rs Subtotal		
- 75,000 Rs	**x 15%**	**= 11,250 Rs**
=.........................Rs	**x 25%**	=.....................Rs
add amounts in this column		=.....................Rs **Total Tax Payable**

Taxable Income (if your taxable income is **over 175,000 Rs** enter here)	Tax Rate	Tax
=.........................Rs **- 100,000 Rs**	**0%**	**nil**
=.........................Rs Subtotal		
- 75,000 Rs	**x 15%**	**= 11,250 Rs**
=.........................Rs	**x 25%**	=.....................Rs
add amounts in this column		=.....................Rs **Total Tax Payable**

The calculation schemes on the left apply to single individuals. The schemes on the right are designed to be used for couples. The schemes above cover an income, which is below 155.000 Rs. for single individuals or 175.000 Rs. for couples respectively. The schemes below are designed to calculate the tax on income above 155.000 Rs. for single individuals or 175.000 Rs. for couples respectively.

40. If a married resident couple want their income to be counted up, the resident individual and the resident spouse of the individual have the right to be treated for tax purposes couple*(s 50)*. In this case they have to submit a notice in writing to their responsible IRO mentioning that they opt to be treated as couple

The two parties of a married resident couple are normally taxed as two single individuals. The income of each party is allocated to the respective individual, i.e. husband and wife, and taxed in the hand of each spouse. To each spouse the tax rates and the calculation scheme for individuals apply. If a married resident couple have elected to be treated as a couple, tax rates and calculation schemes for couples apply. In general, the option is more favourable for couples of which only one spouse derives income, for example for couples where the husband is earning income and the wife is a housewife.

41. Individuals residing in remote parts of Nepal are granted a hardship allowance called <u>remote area allowance</u>. For these taxpayers the rules may increase the basic

exemption thresholds of Rs 80,000 and Rs 100,000, by an amount not exceeding Rs 30,000 per income year. The rules have prescribed the remote area allowance as follows.

- Class "KA" 6,000 Rs
- Class "KHA" 12,000 Rs
- Class "GA" 18,000 Rs
- Class "GHA" 24,000 Rs
- Class "NGA" 30,000 Rs

See Annex-1 of this handbook for the classification of geographical areas prescribed by HMG/N for the purpose of remote area allowance.

42. An individual taxpayer is entitled to reduce lower amount of Rs. 10,000 or 7% of the insured amount or the actual insurance premium he/she has paid for investment insurance policy.

43. A specific relief is provided for resident individual taxpayers running a small business *(s4 (4))*. They do not need to keep detailed documentation of their income and expenses through books of accounts and the like if they derive income exclusively from a domestic business, of which the income does not exceed 1.2 Lakh and the turnover is not greater than 12 Lakh. Turnover in this respect means the gross amount derived from the business. On these presumptive taxpayers tax is imposed as a fixed amount that depends on the area where the business is conducted. If the taxpayer wants to make use of this relief he has to elect in written that this provision shall apply to him for the income year.

44. The presumptive tax for individuals conducting small domestic businesses amounts to:

- Rs 2,000 in the Metropolitan or Sub-Metropolitan Cities
- Rs 1,500 in Municipalities and
- Rs 1,000 anywhere else in Nepal.

45. Gains from the disposal of non-business chargeable assets, i.e. obtained in the course of a private activity, are taxed at the rate of 10 percent. Gains derived in the course of business and investment are part of the business or investment income and taxed accordingly.

46. Non-resident individual are taxable with their income sourced in Nepal. The tax imposed on this income is 25 percent. But if the income is final withholding payment, the withholding rate applies.

47. Tax is imposed only 20% instead of 25% as a highest rate to the individual engaged in a special industry or export business.

Entities

48. Entities are taxed on a flat rate basis. The percentage of the flat rate depends on the nature of the entity or the kind of the entity's business respectively. The flat rates may change depending on the country's or the taxpayers' general economic situation or the budget needs of the country.

49. The taxable income of an entity is generally taxed at the rate of 25 percent unless prescribed otherwise.

50. The income of an approved retirement fund is exempt from tax *(s 64 (2))*.

51. Banks or financial institutions or general insurance business or entity dealing with petroleum business as per Nepal Petroleum Act, 2040 are taxed at the rate of 30 percent.

52. The taxable Income derived by an entity-

- wholly engaged in a special industrial (defined in the act) enterprise; or
- from operating-
  - any road, bridge, tunnel, rope-way, or flying bridge constructed by the entity; or
  - any trolley bus, or tram manufactured by the entity,

is taxed at the rate of 20 percent.

53. The taxable income of an entity wholly engaged in

- a business of building, operating and transfer (BOT) public infrastructure, or
- power generation, transmission, or distribution

is taxed at the rate of 20 percent.

54. The taxable income of an estate of a deceased resident individual or trust of an incapacitated resident individual is taxed as though the estate or trust was a resident individual.

55. The repatriated income of a foreign permanent establishment of a non-resident person situated in Nepal is taxed at the rate of 10 percent.

56. The taxable income of a non-resident person deriving income from providing shipping, air transport, or telecommunication services in Nepal is taxed at the rate of 5 percent.

2.5 Calculation of Income

57. The definition of income encompasses both revenues and gains. Revenues arise in the ordinary course of conducting a business or investment and are referred to by a variety of different names like sales, fees, interest, dividends, royalties, rent etc.
58. Gains are the increase in value of assets or decrease in value of liabilities and may, or may not, arise in the course of the ordinary activities of an enterprise, i.e. in the normal course of conducting a business or investment. Gains represent increases in economic benefits, i.e. wealth, and as such are not different in nature from revenue. Hence, they are not regarded as constituting a separate element in the framework of the taxation of income from business and investment but are considered as an ordinary part of the taxable income.
59. However, gains are dealt with separately in the context of taxation of employment. Income from employment is a return for the provision of labor of an individual to somebody else. This return does not necessarily include gains in the above-mentioned sense because there are no assets or liabilities involved in the earning activity provision of labor (employment), like they are with respect to the earning activity of conducting a business or investment. Therefore, there need to be special provisions for the taxation of gains in the case of income from employment. These provisions are not a part of income from business or investment and will be referred to later on as taxation of gains from non-business chargeable assets, which are basically private assets.
60. The calculation of income is aimed at finding the net income. That applies in principle to the income calculation for tax purposes as well as to the income calculation for commercial purposes. Consequently, amounts allowed to be deducted from the revenues while calculating the commercial profit, are in general also deductible from the taxable income. But it needs to be highlighted that this is a rule of thumb for the sake of simplicity that might cover many cases of income from business and investment. Legally, however, the commercial way of calculating the profit is different from how the income tax act prescribes the calculation of taxable income. Only where the income tax act refers explicitly to the commercial rules, these rules are, too, relevant for tax purposes. Otherwise the income tax act constitutes its own rules that need to be followed by the taxpayers independent of what is required according the commercial bookkeeping rules.
61. The taxpayer, whether an individual or an entity, needs to calculate his income separately for each of his activities that constitutes an employment, business, or investment. It is, therefore, necessary for the taxpayer to determine whether or not his activities are of these types. The definitions in the income tax act provide the relevant characterization.
62. Each of the following definitions of employment and business includes a past, present, or prospective employment (s 2 aj) or business (s 2 ar) respectively. This means that amounts derived and costs incurred with respect to a particular activity either before the activity is started or after it ceases are treated as resulting from the earning activity and are to be included in the calculation of income from the activity.

For example: where start-up costs are incurred before the business commences, they may be deductible during the tax year in which they are incurred, unless they give rise to a lasting asset. This may cause a loss in early years of a business that may be set against income from other businesses or be carried forward.

Or: an employee receives remuneration either before or after employment. The remuneration will be included in calculating income from the employment even for tax years before the employment activity commences or after it ceases.

63. In *s 7 (2), 8 (2)* and *9 (2)* the income tax act consists of lists of specific amounts to be included in the calculations of income from business, employment, or investment, respectively. Although the lists are quite comprehensive they are not exhaustive. Even amounts that are not mentioned in this list must be included in the calculation of income

if they are required to be included by the ordinary meaning of “remuneration” or “profit and gain”.

2.6 Income from Employment

General Remarks

64. Employment means a position of an individual in the employ of another person. It includes a past, present, or prospective employment *(s 2 aj)*. It is characterized as the provision of labor in return for any type of compensation and includes a position of an individual as a manager of an entity other than a partner of a partnership. It also comprises a public office held by an individual. Characteristic for an employment is a position of an individual where the individual is entitled to a periodic remuneration in respect of services performed.

Payments

Figure 5

s8 Income from Employment = s8(1) remuneration from employment (Inclusions)	
cash payments	• wages, salary, leave/overtime pay, fees, commissions, prizes • received personal allowances • reimbursed personal costs
in kind payments	• private use of motor vehicle or house • services for domestic assistance (servants) • meals, refreshments, entertainment • water, electricity, telephone and the like • discharged costs
payments with regard to the condition and duration of the employment and to retirement	• agreements to any employment condition • redundancy, loss or termination • retirement contributions • retirement payments

Income from employment is the remuneration from the employment of the individual for the income year. It consists of any type of payments made to the individual by the employer as a compensation for the provision of the individual's labor *(s 8)*. Payments include any financial gain, benefit, or satisfaction directly conferred on a person like *(s 2 (ag))*:

- the transfer by one person of money or an asset to another person or the transfer by another person of a liability to the one person, e.g. the employer hands over an asset to the employee or the employer takes over a liability of the employee,
- the creation by one person of an asset that on creation is owned by another person or the decrease by one person of a liability owed by another person,
- the provision by one person of services to another person, and
- the use, or availability for use, of an asset owned by one person to another person.

65. Payments can be made in cash, i.e. the taxpayer receives money, or in kind, i.e. the taxpayer receives a non-monetary benefit. Both kinds of payments need to be included in the income for an income year. Employees are required to account for tax purposes on a cash basis *(s 22 (2))*. Therefore, payments made to an employee are

recognized for tax purposes at the time of payment. Payments result from income from employment only if they are made by the employer, a third person under an arrangement with the employer, or an associate of the employer.

Inclusions

66. To be included in the calculation of income from employment are

- wages, salary, leave pay, overtime pay, fees, commissions, prizes, gifts, bonus, and other facilities;
- personal allowances, including any costs of living, subsistence, rent, entertainment, and transportation allowance;
- reimbursed costs.

These are typically payments that the employee receives in cash, means in the form of money, from the employer. Reimbursed costs are private costs of the employee that the employer pays back to the employee.

67. In kind payments to be included are

- the provisions of the private use, or availability for use, of a motor vehicle or house;
- the provisions of services for domestic assistance, typically servants;
- the provisions of meals, refreshment, entertainment;
- the provisions of water, electricity, telephone and the like;
- discharged costs.

In all of these cases the employer provides the employee with payments that under usual circumstances the employee has to bear by himself as costs of living. If borne by the employer they come along as a benefit compensating for the employee's labor. Since these benefits are not a transfer of money they need to be quantified or valued in terms of money to become taxable.

68. In most cases the income tax act prescribes the amounts to be taxed. If not explicitly prescribed the respective benefit is quantified by its value to a reasonable person in the position of the employee. That means that the employee has to assess the amount that he would have to spend if he would have to pay for the benefit by himself.

The following quantifications are prescribed in the income tax act and rules:

69. The use of a motor vehicle wholly or partly for the private purposes of the employee is quantified, where the person is an employee or a person who is not an employee but is remunerated by the payer on a monthly basis, at 0.5 percent of the salary of the person *(s 27 (b) (1)) and (rule 13).* Use of motor vehicle only to come office and back home has been treated as partial use.

For example: The taxpayer works as a chief executive officer in a major private limited company and gets salary amounting 1,500,000 Rs. per year. His company has provided him with a Toyota Corolla car that is also available for his private use. He has to incorporate an amount of 7500 Rs.(.5% of 1,500,000 Rs.) in his income from employment as an in kind payment in the form of the provision of the availability for use of the car. It does not play a role whether or not he really uses the car for private purposes. The mere availability for use is considered as an in kind payment and leads to the inclusion of the value for this payment in his taxable income.

70. The provision of a house to an employee or a person who is not an employee but is remunerated by the payer on a monthly basis is valued at 2 percent of the salary *(s 27 (b) (2)) and (rule 13).*

In both of these cases, salary includes annual increment but not other allowances and benefits.

71. The provision of

- services of a housekeeper, chauffeur, gardener, or other domestic assistant;

- any meal, refreshment, or entertainment; or

drinking water, electricity, telephone and the like utilities in respect of the payee's place of residence.

is taxed as the employee’s income with an amount that is equal to the amount of expenses incurred by the employer in making the provision as reduced by any contribution made by the employee towards the provision *(s 27 (c) (1)).*

For example: If the employer provides the employee with a chauffeur the employer might pay the driver’s salary. Or the employer pays the bills for the employee’s entertainments, or private phone calls. In all of these cases these expenses of the employer are amounts to be included into the employee’s taxable income as the value for the in kind payments that the employee receives as a compensation for his labor. The employee would have to spend the same amount by himself if he would not have received this benefit from the employer. If the employee paid a part of these amounts by himself this contribution, of course, must not be included in his income.

However, if the employer has provided meals or refreshments in the work premises to all his employees on similar terms no value for this benefit needs to be included in the employee’s income *(s 8 (3) (b))*.

72. If an employee has received a loan from the employer and is granted interest rates that are lower than the market rate, the amount by which the interests payable is lower than the interest at the market rate has to be included into the employee’s income as an in kind payment *(s 27 (d)).*

For example: The employee has been granted a home loan amounting to 100,000 Rs. with an annual interest rate of 10 %. That means the employee has to pay 10,000 Rs per year interests to his employer. If the market rate for home loan were 15%, the interest would have been 15,000 Rs per year. The difference of 5,000 Rs between the interests based on the agreed interest rate and the market interest rate needs to be included into the employee’s remuneration.

73. The employee’s remuneration also comprises costs from which the employer discharged the employee or which the employer reimbursed to the employee.

For example: The employer reimburses costs for a private travel that the employee did to meet his family. The reimbursement needs to be included in the employee’s taxable income.

However, if the discharged or reimbursed costs serve the proper business purposes of the employer, in other words if they are deductible business expenses for the employer, they must not be included into the employee’s remuneration.

For example: The employer invites his employee for a dinner on the occasion of a meeting with an employer’s business associate. In this case of a business dinner the total entertainment costs are deductible as business expenses for the employer. Even the costs for the entertainment of the employee are of a business nature and, therefore, not to be included into the employee’s remuneration.

Or: The employer reimburses costs for a business travel of his employee. These expenses are deductible for the employer and not to be included in the employee’s taxable income.

If the employee derives in addition to his remuneration income from business or investment and the discharged or reimbursed amounts were deductible from the employee’s income from business or investment these amounts are not to be included into the employee’s remuneration from employment *(s 8 (3) (c)).*

74. Income from employment encompasses furthermore payments with regard to the condition and duration of the employment and to retirement. These payments include

- payments for the individual’s agreement to any condition of the employment;
- payments for redundancy or loss or termination of the employment;
- retirement contributions, paid by the employer to a retirement fund in respect of the employee;

- retirement payments received by the employee from a retirement fund.

Retirement contributions are payment made to a retirement fund for the provision or future provision of retirement payments *(s 2 (f))*.

Retirement payments *(s 2 (e))* mean payments from a retirement fund to

- an individual in the event of the individual's retirement, or
- a dependant of an individual in the event of the individual's death.

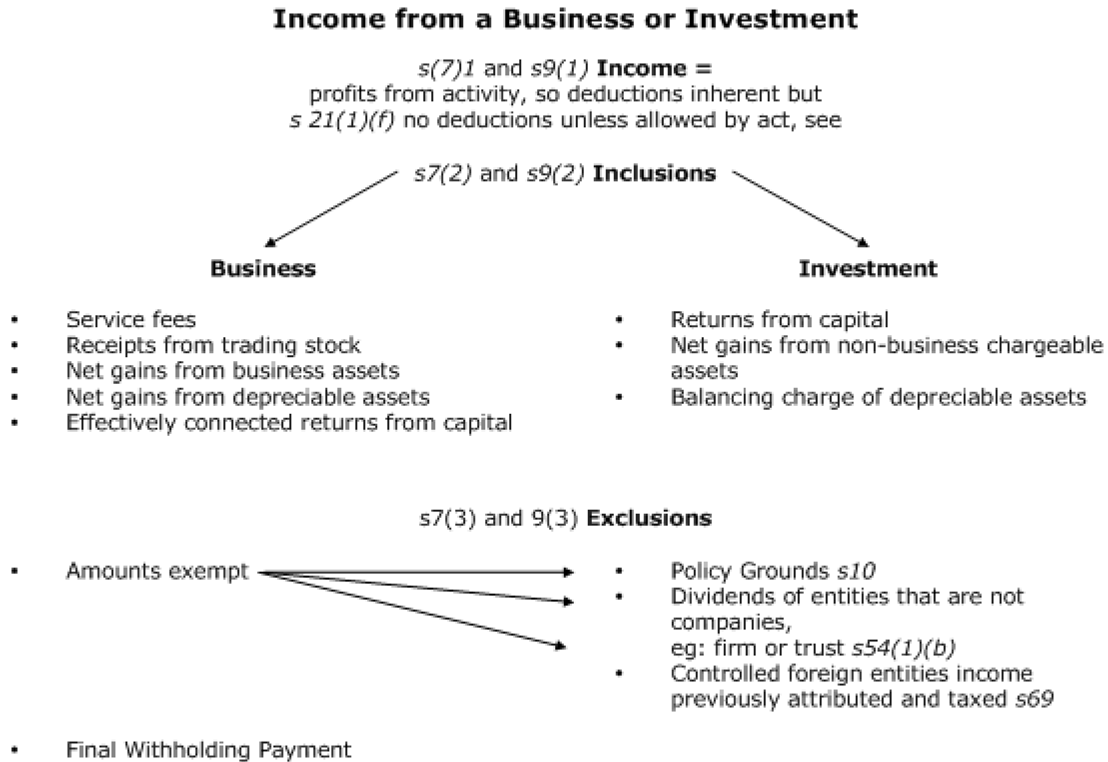
75. Excluded in calculating an individual's remuneration from an employment are

- exempt amounts and final withholding payments,
- meals or refreshments provided in premises by or on behalf of an employer to the employer's employees that are available to all the employees on similar terms *(s 8 (3) (b)),*
- any discharge or reimbursement of costs incurred by the individual if they serve the proper business purposes of the employer.

2.7 Income from Business

General Remarks

Figure 6



76. Business includes an industry, a trade, a profession, as well as arrangements and isolated transactions with a business character and includes a past, present or prospective business *(s 2 (ar))*. By contrast to employment, business is an earning activity typically consisting of not only the provision of labor but of the combined provision of labor and capital. If in a rare case a business activity may also be characterized as employment, primacy is given to the characterization as employment.

77. Because a taxpayer can conduct more than one business he must calculate the income separately for each business. Whether a particular business activity constitutes one or more than one business will depend on the facts of each case. The income from business comprises amounts that the taxpayer receives or is entitled to receive. These amounts can be accounted for on a cash or accrual basis. If the taxpayer is an individual he should account his income from employment and/or investment on a cash basis *(s 22 (2))*. In the case of business the individual has option to elect cash or accrual basis of accounting. A company shall always for tax purposes account on an accrual basis *(s 22 (3))*. The difference between both accounting methods is the time when a payment is considered for tax purposes.

78. Income from business and investment both deal with assets. The table below gives an overview about the types of assets and their treatment for income tax purposes when the asset is disposed of.

Figure 7

s2(bc) **Assets**					
Types	Trading Stock *s2(at)* If not ⇨	Depreciable Asset *s2(bk)* If not ⇨	Business Asset *s2(au)* If not ⇨	Non-business Chargeable Assets *s2(r)* If not ⇨	Other Assets
Treatment on Disposal	Receipt direct in Income *s7(2)(b)* Direct Deduction for Cost of Stock Disposal *s 15*	Deduction for Depreciation *s19 and Sch 2 para 2* and Balancing Allowance *Sch-2 para 4(2)(b)* Balancing Charge in Income *Sch-2 para 4(2)(a)* *s7(2)(d) and 9(2)(c)*	Net Gain in Income *s7(2)(c)*	Net Gain in Income *s9(2)(b)*	No Consequences

79. The meaning of the term asset covers tangible items like property and intangible economic benefits like know how, goodwill or a right to income or future income *(s 2 (bc))*. Assets that are intended to be sold in the ordinary course of a business belong to trading stock *(s 2 (at))*. The proceeds from trading stock are to be included in the business income, deductions are available for specific costs when the trading stock is disposed of.

80. Depreciable assets are used in the production of income from business or investment and likely to lose value especially because of wear and tear or the passing of time *(s (bk))*. For these types of assets a depreciation allowance may be deducted. The calculation of the depreciation allowance is explained in *schedule 2* of the income tax act.

81. An asset can be related to and used in a business activity as a business asset *(s 2 (au))*, or it might be used only in a private context. In the latter case the asset is privately hold and only relevant in the context of income taxation if it is chargeable. To be included in the income from business are the net gains from the disposal of business assets. For non-business, i.e. privately hold, assets that are chargeable under the income tax act the net gains must be included into the income from investment. Which assets are chargeable is explicitly described in *s 2 (r)* of the income tax act.

82. Irrelevant for the purpose of income taxation are solely private assets. These assets do not belong to a business and are not chargeable.

83. Income from business that is sourced in Nepal can be calculated by using the following calculation scheme whereas details of the scheme are explained below:

Figure 8

Calculation of Income from Business
sourced in Nepal

Inclusions	**= Revenues**	(earnings, proceeds)	
- General Deductions	**= Costs**	incurred in the production of income from business	*s13*

+ Deductions Limited

- Interest *s14*
  (Interest paid to the parent by an exempt controlled resident entity may be deducted up to the limit of Para 2: limit is interest income plus 50% of the taxable income calculated without including interest income and deducting interest expenses)
- For the costs of trading stock *s15*
  (deduction allowed for opening value + cost for the year - closing value)
- Repair and improvement costs *s16*
  (costs incurred with respect to an owned and used depreciable asset may be deducted up to the limit of para 2: limit is 7% of the depreciation basis of the pool, which the repaired or maintained asset or assets belong to)
- Pollution control costs *s17*
  (costs for a process or the acquisition of an asset that seeks to protect or to sustain the environment may be deducted up to the limit of para 2: they shall not exceed 50% of the adjustable taxable income whereas the adjustable taxable income is calculated without deducting the pollution control costs, gifts to an exempt organization and the research and development costs)
- Research and development costs *s18*
  (costs for research and development may be deducted up to the limit of para 2: they shall not exceed 50% of the adjustable taxable income whereas the adjustable taxable income is calculated without deducting the research and development costs, gifts to an exempt organization and pollution control costs)
- Depreciation allowance for depreciable assets *s19*

+ Deductions not allowed *s21*

- Domestic or personal expenses
- Income Tax, fines, penalties
- Expenses incurred in deriving exempt amounts under *s10*
- If the annual turnover of the taxpayer exceeds 2 mill Rs:
  cash expenses in excess of 50,000 Rs unless explicitly permitted *s21(2)*
- Distribution of profits
- Expenses of a capital nature (Not applicable for s14 to s19)
- Foreign income tax

- Losses *s20*

The following losses are deductible

- Losses from other business sourced in Nepal of the year of assessment
- Losses from other businesses sourced in Nepal of the preceding 4 years of assessment

= Income = profits and gains from business sourced in Nepal *s7*

Inclusions

84. The following amounts are to be included in calculating profits and gains from conducting a business *(s 7)*:

- service fees *(s 2 (bi))*, i.e. payments attributable to the rendering of services.
- amounts derived from the disposal of trading stock. That includes all sale proceeds from trading stock, which are, therefore, directly included in calculating income.
- net gains from the disposal of business assets or liabilities of the business. Net gain is to be calculated as per chapter 8.
- excess of realization over written down value in the disposal of all depreciable assets of a pool.
- gifts received in respect of the business. If gifts have a sole private motivation they are not subject to income tax.
- amounts derived as a consideration for accepting a restriction on the capacity to conduct the business.
- amounts derived from an investment, which are connected with the business.

Amounts, which are exempt, and final withholding payments, are excluded in calculating profits and gains from business.

85. Small individual resident taxpayers with exclusively income from Nepal source business not exceeding a threshold of 120,000 Rs. income and 1,200,000 Rs. turnover of the business may opt for a presumptive tax which varies depending on the area where the business is conducted. If such a taxpayer elects to be taxed on a presumptive basis he does not need to calculate his income in detail but is taxed with a fixed amount based upon his statement that his income and turnover is less than the threshold outlined in the act. It, again, needs to be highlighted that this relief is only available upon explicit election of the taxpayer.

86. There may be cases where amounts might fall under the heading investment although it is effectively connected with a business. Such amounts would be included in the calculation of income from the business and not income from the investment.

For example: Rents from a company that owns several flats and operates a rental business. In this case income from investment is derived but in the form of a business. The company has then derived income from business and not from investment because the income is effectively connected with a business.

2.8 Income from Investment

General Remarks

87. By contrast to employment and business, investment is typically an earning activity predominantly consisting of the provision of capital. Capital is provided by holding one or more assets of a similar nature *(s 2 (al))*. An asset is defined as a tangible or intangible asset such as currency, good will, know-how, property, an owner's interest in a foreign branch, a right to income or future income, and a part of an asset *(s 2 (bc))*.

88. This definition covers any assets unless they are held primarily for personal use by the person who owns them and are not used in the production of profits. The definition of investment excludes employment or business. If the issue arises as to whether certain activities of a person constitute one or more investments, there are two tests to check it. The first is whether the assets held are of a similar nature.

For example: A block of shares may constitute a single investment.

The second test is whether the assets are used in an integrated fashion, on similar terms, and subject to similar conditions, including as to location.

For example: A house that is held passively and rented out with associated furniture will constitute a single investment

Any liabilities incurred with respect to the asset or assets held are also part of the investment.

89. If an investment is jointly owned with other persons amounts to be included and deducted in the calculation of income from investment shall be apportioned among the joint owners in proportion to their respective investment *(s 30)*.

90. Income from investment that is sourced in Nepal can be calculated along the following basic scheme whereas details of the scheme are explained below:

Figure 9

Calculation of Income from Investment
sourced in Nepal

Inclusions	**= Revenues**	(earnings, proceeds)	
- General Deductions	**= Costs**	incurred in the production of income from investment	*s13*

+ Deductions Limited

- Interest — *s14*
  (interest paid to the parent by an exempt controlled resident entity may be deducted up to the limit of para 2: limit is interest income plus 50% of the taxable income calculated without including interest income and deducting interest expenses)
- Repair and improvement costs — *s16*
  (costs incurred with respect to an owned and used depreciable asset may be deducted up to the limit of para 2: limit is 7% of the depreciation basis of the pool, which the repaired or maintained asset or assets belong to)
- Depreciation allowance for depreciable assets — *s19*

+ Deductions not allowed — *s21*

- Domestic or personal expenses
- Income Tax, fines, penalties
- Expenses incurred in deriving exempt amounts — *s10*
- If the annual turnover of the taxpayer exceeds 2 mill Rs:
  cash expenses in excess of 50,000 Rs unless explicitly permitted — *s21(2)*
- Distribution of profits
- Expenses of a capital nature (not applicable for *s14 to s19*)
- Foreign income tax

- Losses — *s20*

The following losses are deductible

- Losses from other business sourced in Nepal of the year of assessment
- Losses from other businesses sourced in Nepal of the preceding 4 years of assessment
- Losses from other investments sourced in Nepal of the year of assessment

= Income = profits and gains from business sourced in Nepal — *s9*

Inclusions

91. While calculating profits and gains from investment the following amounts shall be included *(s 9)*:

- any dividend, interest, natural resource payment, rent, royalty;
- gains from investment insurance;
- gains from an unapproved retirement fund;
- interests or retirement payments made by an approved retirement fund;
- net gains from the disposal of non-business chargeable assets of the investment;
- excess of realization over written down value in the disposal of all depreciable assets of a pool.
- gifts received in respect of the investment;
- retirement contributions and retirement payments in respect of the investment.

Again, exempt amounts and final withholding payments are excluded from the calculation.

92. Amounts to be included as returns from capital are shown in the picture below.

Figure 10

Returns from Capital			
Type of Capital		**Return Type** for use of money	
Money			
Debt Claim	*s2(l)*	Interest	
Interest in an entity	*s2(y)*	Dividend	*s53(6)*
investment insurance		gain from investment insurance	*s62*
retirement fund		gain from retirement fund interest (not deductible for payer: *s21(1)(f), s61(2)(b)(i), s64(1)(b))*	*s65*
Tangible Asset		Rent	*s2(af)*
Intangible Asset		Natural Resource Payment	*s2(ad)*
		Royalty	*s2(ak)*

93. Dividends, interests, natural resource payments, rents, and royalties are the classic forms of return on capital. Dividends are essentially any return of a shareholder from an interest in a company. Interests are payments for the use of money. The term includes certain payments under debt obligations and other financial instruments as well as amounts payable under an annuity, an installment sale, or a finance lease. Natural resource payments are payments for the right to take natural resources like water or minerals *(s 2 (ad))*. The term also covers amounts as calculated by reference to the quantity or value of water, minerals or the like living or non-living resources taken from the land.

94. The terms rent and royalties excludes natural resource payments. Rent *(s 2 (af))* is defined in terms of a payment under a lease of a tangible asset, and royalty *(s 2 (ak))* in terms of a payment under a lease of an intangible asset with a list of specific inclusions.

Non-business chargeable assets

95. Income from investment includes also gains from the disposal of non-business chargeable assets *(s 2 (r))*. These are assets that do not belong to a business or an investment but are privately hold by an individual. If such assets are disposed of and, on the occasion of disposal, the individual owner obtains a gain, this gain is taxable as income from investment. Non-business chargeable assets are securities or an interest in an entity as well as land and buildings. This means, any income from the sale of private share or securities, land and buildings is in principle taxable. If a loss occurs it can be carried forward.

96. As an exception from this rule, gains from private property that does not exceed a certain value and belongs to the same owner for a long period of time are not taxed. Therefore, not taxable are gains from the disposal of

- a private residence of an individual that has been
  - (A) owned continuously for three years or more; and
  - (B) lived in by that individual continuously or intermittently for a total of three years or more;
- a private residence or a land of an individual that is disposed of for less than Rs. 10,000,000/-; or

- non-business assets of an individual that are disposed of by way of any type of transfer other than sales and purchase made within three generations. An interest of a beneficiary in a retirement fund is also not taxable asset.

2.9 Exemptions

General Remarks

97. The following amounts are exempt from tax on social grounds *(s 10)*

- allowances paid to widows, elder citizens, or disabled individuals
- amounts derived by way of gift, bequest, inheritance or scholarship, except as required to be included.

Exempt Amounts

98. The following amounts are exempt from tax:

(a) amounts derived by a person entitled to privileges under a bilateral or a multilateral treaty concluded between His Majesty's Government and a foreign country or an international organisation;

(b) amounts derived by an individual from employment in the public service of the government of a foreign country.

provided that,-

(1) the individual is a resident person solely by reason of performing the employment or is a non-resident person; and

(2) the amounts are payable from the public funds of the country;

(c) amounts derived from public fund of the foreign country by an individual who is not a citizen of Nepal as referred to in paragraph (b) or by a member of the immediate family of the individual.

(d) amounts derived by an individual who is not a citizen of Nepal from employment by His Majesty's Government on terms of a tax exemption;

(e) allowances paid by His Majesty's Government to widows, elder citizens, or disabled individuals;

(f) amounts derived by way of gift, bequest, inheritance, or scholarship, except as required to be included in calculating income under sections 7, 8, or 9, and

(g) amounts derived by an exempt organisation by way of-

(1) gift; or

(2) other contributions that directly relate to the organisation's function referred to in paragraph (s) (1) of the definition of <u>exempt organisation</u> in section 2, whether or not the contribution is made in return for consideration provided by the organisation.

(h) pension received by a Nepali citizen retired from the army or police service of a foreign country provided the amounts are payable from the public fund of that country.

Exempt Organizations

99. Donations and contributions derived by a tax-exempt organization (s 2(s)) are tax-free. An organization, which income is exempt from tax, is an entity that has the legal status and functions as

a. a religious, educational, or charitable organization of a public character;

b. an amateur sporting association that has been formed for the promotion of socials or sporting amenities;

c. a political party registered with the Election Commission;

d. a VDC, DDC, metropolitan city, or municipality *(s 2(s))*.

Both, the legal status and the function are required for the entity to become tax exempted. To be treated as a tax-exempt organization by the entity mentioned in clause "a" and "b" above, the entity must register in inland revenue office as tax exempted organization.

100. Since earning activities of exempt organizations are detrimental to their tax status the exemption does not extend to amounts derived in conducting a business. For example, a school that has been approved as an exempt organization by the IRO produces handicrafts and sells them to tourists, profit from that handicraft business will be taxable. This limitation is needed in order to ensure that exempt organizations do not compete in the markets where they have a tax advantage over other market participants. Furthermore, assets or amounts that the entity has derived must not provide a benefit to any person unless the benefit is connected with the entity's function or consists of payments for assets or services that the person has rendered to the entity.

101. Exempt organizations are mainly of a charitable character and depend on donations as a source of income to cover their costs and to fulfill their purpose. In order to give incentives to potential donors gifts are deductible from the donor's taxable income within given limits *(s 12)*. Refer to section 143 of this handbook for further details with regard to the treatment of gifts.

Agriculture business

102. Income derived by a landlord, holding the land within the ceiling prescribed in Land Act, 2021 from an agriculture business is exempt from income tax. But, 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 not tax exempt. Here, agriculture business means the business of producing crops from public or private land, or deriving crops from a tenant using land *(s 11)*.

Co-operatives

103. Tax exempt is income derived by cooperative societies, registered under Cooperative Act, 2048 (1991), from business mainly based on agriculture and forest products such as sericulture and silk production, horticulture and fruit processing, animal husbandry, diary industries, poultry farming, fishery, tea gardening and processing, coffee farming and processing, horticulture and herb processing, vegetable seeds farming, bee-keeping, honey production, rubber farming, floriculture and production and forestry related business such as lease-hold forestry, agro-forestry, cold storage established for the storage of vegetables and business of agricultural seeds, insecticide, fertilizer and agricultural tools (other than machine operated)as well as income derived by rural community based saving and credit cooperatives.

Entities other than company

104. Dividend distributed by the entities other than companies (s 2(m)) is exempted (s 54(1)(b)). But if any partnership firm having more than 20 partners distributes dividend to its partners is taxable.

105. Dividend is taxed at a single point. If tax deducted dividend will be distributed to the shareholders, it is exempted *(s 54(1)(3))*.

Approved retirement fund

106. Income of an approved retirement fund (s 2(bh)) is tax exempted (s 64(2)).

Controlled foreign entity

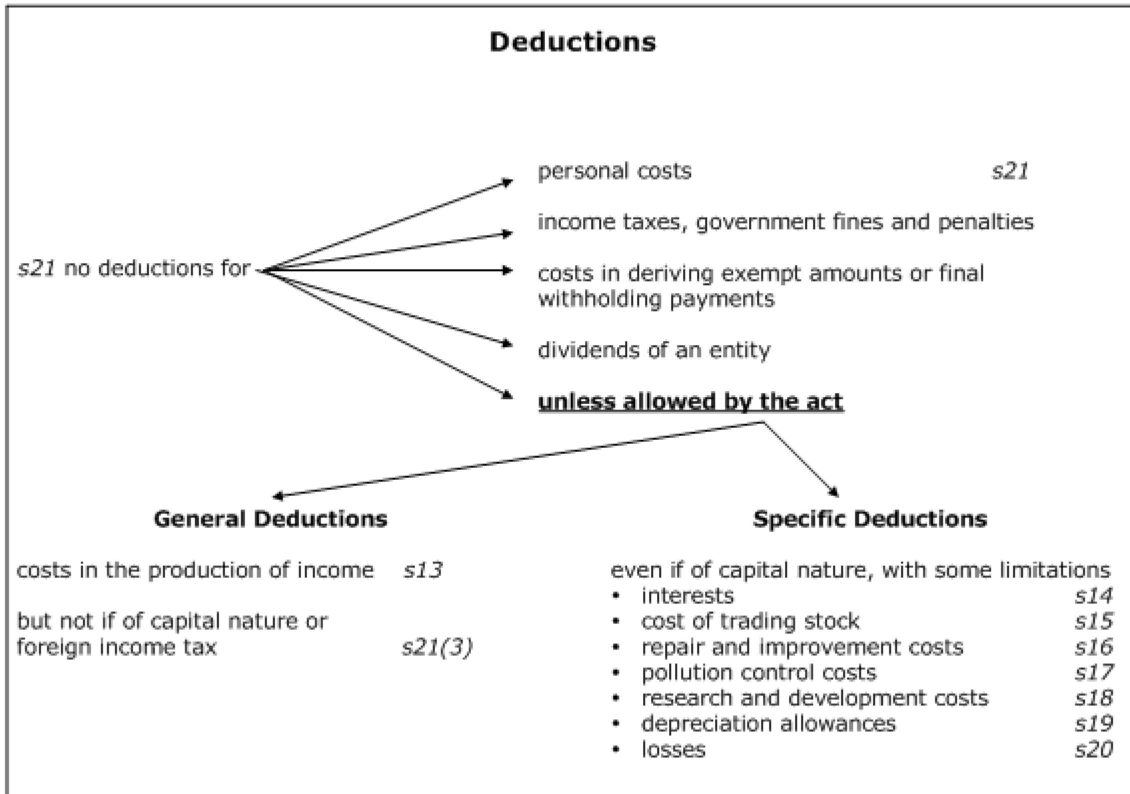
107. A controlled foreign entity should distribute dividends to its beneficiaries in accordance with the beneficiaries' rights. This dividend is taxable (as income of the

beneficiary). Other Dividends distributed by a controlled foreign entity are exempt from tax *(s 69(2)).*

2.10 Deductions

General Remarks

Figure 11



While calculating a person's income from any business or investment all actual costs to the extent incurred in production of income from the business or investment are allowed to be deducted *(s 13)* if these costs are not of a capital nature or consist of domestic income tax or restricted to be deductible by the act. This means as a rule of the thumb that all costs are deductible in calculating income from business or investment to the extent they are caused by the business or investment activity. In addition to this general regime special rules are provided for to deal with special types of deductions.

By contrast to deductions from business and investment income, no deductions are allowed in calculating the income from employment.

108. Costs are amounts of payments in cash or its equivalent or debts incurred to acquire services or assets. The term includes expenses, which are the costs of services and assets that have been consumed or have expired in the production of revenues. Expenses arise in the course of ordinary activities of an enterprise and, for example, include, costs of sale, wages and depreciation. They usually take the form or an outflow of depletion of assets such as cash and cash equivalents, inventory, property, plant and equipment.

109. If the taxpayer is calculating domestic source income only deductions are allowed for amounts that have a domestic source. This means that a taxpayer who derives income from a business sourced in Nepal may only deduct expenses sourced in Nepal, and not expenses that have a source outside Nepal (s 67).

Deductions limited

110. <u>Interests</u> are allowed to be deducted if incurred in the course of conducting a business or investment. This is the case if the borrowed funds, for which interests are paid, are used in that production or used to acquire an asset used in that production.

Important is the use to which the borrowed funds are put and not the purpose for which the funds were borrowed. This means that where the use of the funds changes so may the deductibility of interest incurred with respect to the funds.

111. The deductions are limited for resident entities owned or controlled to the extent of 25 % or more by organizations or persons, which are tax exempt, or non-resident persons, or associates of exempt organizations, or non-resident persons, if the interest is paid to that controlling entity. In these cases the deduction must not exceed the sum of all interests that are to be included in the entity's taxable income plus 50 % of the entity's taxable income whereas the taxable income is calculated without including any interest derived by the entity and not deducting interest expenses.

Any interest, for which a deduction is denied, may be carried forward and treated as incurred during the next income year *(s 14)*.

112. For the costs of trading stock (i.e. assets that are intended to be sold *(s 2 (at))*), disposed of during the income year an allowance is deductible. Other deduction except that allowance for the cost of trading stock is denied. Detailed rules are provided for on how to determine the deductible allowance *(s 15).* The sale proceeds from trading stock are directly included in calculating income. Allowed to be deducted are the costs of trading stock sold. The methods of costing follow the general accepted accounting principles in the form of the "prime cost" and "absorption cost" methods *(s 15 (5))*. Where trading stock is not readily identifiable the taxpayer may choose the first-in-first-out method or the average-cost method *(s 15 (6))*.

113. Costs for repair and improvement of owned and used depreciable assets are deductible in principle but to a limited extent. This avoids controversial interpretations and discussions between a repair and an improvement. The deduction available with respect to all assets in a particular pool of depreciable assets is limited to 7 % of the depreciation basis of the pool to which the repaired or improved asset belongs at the end of the income year in question. Any cost that is not deductible is added to the depreciation basis of the pool and will be depreciated in the following years *(s 16)*.

For example: If the taxpayer replaces the engine of a business car. i.e. the car is used for conducting a business and, thus, in the production of income from business, it might be disputable whether this measure constitutes a repair or improvement of the car. In any case, the replacement costs may be principally deducted. To calculate the limit of the deduction the taxpayer needs find out what class of depreciable assets the car belongs to – which is class C with a depreciation rate of 20 % (schedule 2 s 1(1) and s 3 (1)). Than the limit needs to be calculated by applying 7 % of the depreciation basis (written down value) of the pool of class C assets at the end of the income year. This amount is than compared with the costs. If 7% amount will be higher than the repair and improvement expenses, the total expense will be deducted. But if the repair and improvement cost will be higher than 7% of depreciation basis, only up to that amount the cost will be deducted and the balance amount will be added to the *depreciation basis in the end of that income year.*

Figure 12

Calculation of Repair and Improvement Limits		Example 1		Example 2	
Repair and Improvement Costs	________Rs		80,000 Rs		30,000 Rs
value of the pool to which the repaired or improved asset belongs at the end of the income year	________	1,000,000 Rs		1,000,000 Rs	
* 7% = limit for deduction	________ -________Rs	70,000	- 70,000 Rs	70,000	- 70,000 Rs
if 0 or negative fully deductible	= -________Rs				- 40,000 Rs
if positive to be added to the depreciation basis of the pool	= +_______Rs		+10,000 Rs	repair and improvement costs of 30,000 Rs fully deductible	

114. Pollution control costs means costs incurred by a person with respect to a process or an asset that seeks to control pollution or otherwise protect or sustain the environment. These costs are only deductible if incurred in conducting a business, not an investment. A cumulative deduction is granted with respect to all businesses conducted by the taxpayer and the deduction is limited to 50 % of the taxpayer's adjustable taxable income whereas the adjustable taxable income is calculated by not deducting gifts, research and development costs and pollution control cost *(s 17)*.

115. Research and development costs may be deducted separately if not directly connected with a depreciable asset. If these costs are incurred in the acquisition or improvement of an asset they are dealt with under the general provisions applicable to costs of that type. Again, the deduction is limited to 50 % of the adjustable taxable income of the taxpayer. For the purpose of determining the deduction the adjustable taxable income is calculated by not deducting gifts, pollution control costs and research and development cost *(s 18)*.

116. Depreciation allowances are granted for depreciable assets *(s 2 (bk))* to recognize the wasting character of such assets. The recognition of outgoings is provided without the requirement of a realization. The allowance is available for each income year at the end of which a depreciable asset is held.

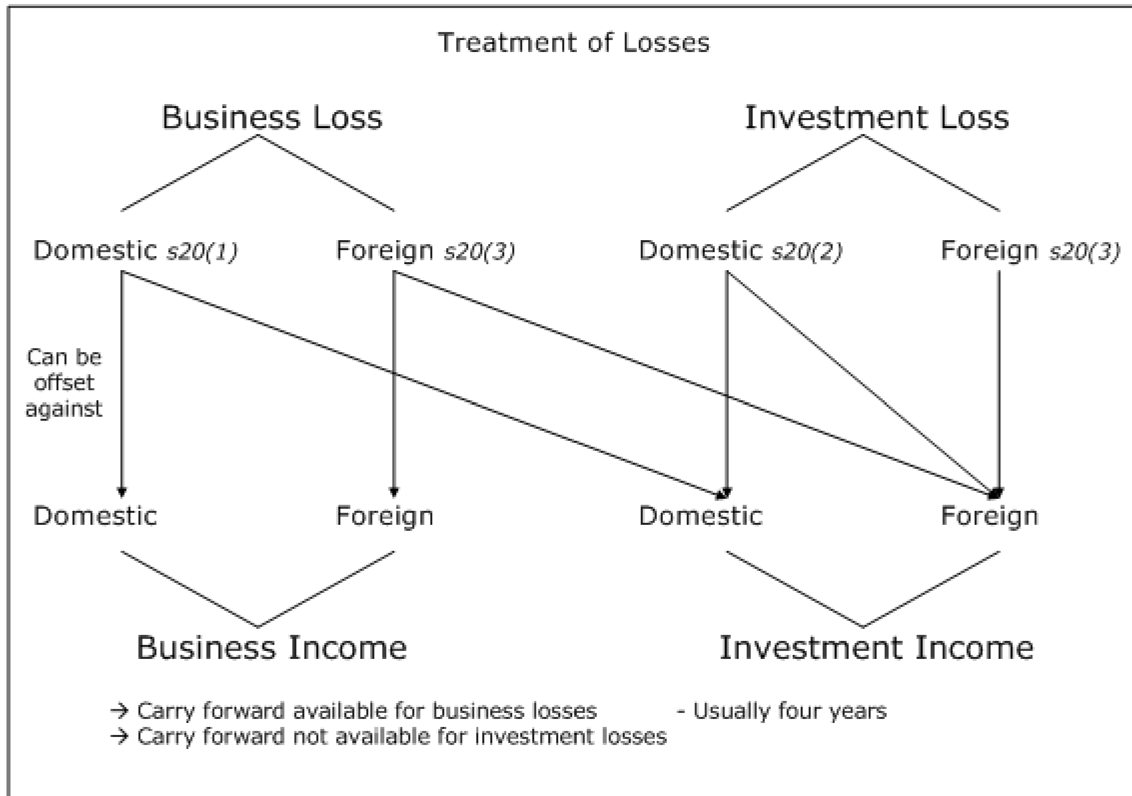
117. Depreciable assets are categorized in 5 classes. The classes are based upon the average useful life of the assets belonging to one class. In other words, each class represents assets that will waste at similar rates. The assets of each class are placed in a pool and a depreciation rate applies to each pool. Detailed rules are provided for on how to determine the applicable depreciation rate for each pool and how to calculate the costs for incoming and outgoing assets. These rules follow in principle the general accepted accounting principles *(s 19, schedule - 2)*.

2.11 Losses

General Remarks

118. Losses represent decreases in economic benefits and as such are not different in nature from other expenses. Losses may, or may not, arise in the course of the ordinary activities of the enterprise. Losses include, for example, those resulting from disasters such as fire and flood, as well as those arising on the disposal of non-current assets. Losses can also be unrealized if, for example, they arise from the effects of increases in the exchange rate for a foreign currency in respect of the borrowing of an enterprise in that currency.

Figure 13



119. Losses (*s 20)* are essentially fully deductible but are treated differently depending on whether they result from conducting a business or investment and whether they are of domestic or foreign nature. The general approach is that any loss from a business for an income year may reduce any other income from a different business or investment for the same income year but not income from an employment. Losses from investment may only be offset against income from investment. Further, foreign losses sourced in a particular country may only reduce foreign income sourced in the same country.

Deductibility of losses

120. Any excess business loss that exceeds the income from which it has been deducted and is thus unrelieved may be carried forward to reduce income from any business or investment of four future tax years. This means that a carry-forward is provided for business losses and that the carry forward is usually limited to 4 years. By contrast to business losses, unrelieved losses from investment must not be carried forward. However, if the taxpayer cannot use a loss from a business because of the 4 year limit or a loss from an investment because the taxpayer cannot use it in the year it was incurred it is turned into a capital loss and may be carried forward forever *(clarification s 36)*.

For example: If the taxpayer suffers a loss from investment and cannot use it in the year it is incurred, the taxpayer can carry that loss forward. If loss is incurred in business asset, this can be set-off from the gain on the disposal of business or/and non-business chargeable asset. But if loss is incurred in non-business chargeable asset in can only be set-off against the gain on the disposal of non-business chargeable asset.

121. Special provisions exist for electricity projects and BOT businesses, i.e. projects that build, operate and transfer public infrastructure. For them the time to carry forward losses is extended to 7 years *(s 20 (1)(b))*. Furthermore, banking and general insurance businesses are not only allowed to carry forward their losses but may also carry them back and deduct them from their business income for any of the 5 preceding tax years *(s 59 (2), 60 (3)*.

122. The table below shows which type of income and which income head may be reduced by what kind of losses.

Figure 14

Offset of Losses

(A) Domestic income from business

may be reduced by

- domestic losses from other business of the current income year, and *(s 20(1))*
- domestic business losses of the previous four years

(not: domestic losses from investments and foreign losses from business and investment)

(B) Domestic income from investment

may be reduced by

- domestic losses from other businesses *(s 20(1))*
  - of the current income year
  - of the previous four income years
- domestic losses from other investments of the current income year only *(s 20(2))*

(not: foreign losses from business or investment)

(C) Foreign income from business

may be reduced by

- foreign losses from other businesses *(s 20(3))*
  - of the current income year
  - of the previous four income years

(not: domestic losses from investments)

(D) Foreign income from investment

may be reduced by

- foreign losses from other businesses
  - of the current income year
  - of the previous four income years
- foreign losses from other investments

(not: foreign losses from business or investment of other countries)

123. If the taxpayer derives income from a domestic business or businesses he may reduce it by losses from his other domestic business or businesses *(s 20 (1).* He must not

deduct losses from domestic investments and losses from foreign business/es or investment/s.

124. If the taxpayer derives income from a domestic investment or domestic investments he may reduce it by losses from other domestic businesses *(s 20 (1)* and/or losses from other domestic investments *(s 20 (2))*. He must not deduct losses from foreign business or investment.

125. If the taxpayer derives income from a foreign business or businesses he may reduce it by losses from other foreign businesses of the same country *(s 20 (3))*. He also can deduct losses from other domestic businesses. But he can not deduct losses from investments either from domestic or from foreign investments.

126. If the taxpayer derives income from foreign investment or investments he may reduce it by losses from other foreign businesses and/or losses from other foreign investments of the same country. He also can deduct losses from other domestic businesses or domestic investment.

127. If the amount of a loss or losses is greater than the amount of income from which a loss or losses may be deducted a loss remains unrelieved or unused. These losses may be generally carried forward for 4 years if they are business losses. Losses from investments are only deductible in the income year when they occur. Losses that remain unrelieved even after they have been carried forward are allowed to be deducted from net gains from the disposal of assets. Any unrelieved business net loss of the current income year or of a previous income year may be offset against net gains from the disposal of business assets or non business chargeable assets depending on the taxpayer's choice *(s 36 (4))*. Any unrelieved net loss of the current income year or of previous income years from an investment is allowed to be offset against net gains from the disposal of non-business chargeable assets *(s 36 (2))*.

Order of offset of losses

128. If losses are allowed to be offset against income as described above the following order needs to be followed:

Figure 15

Order of offset of losses against income		Example 1	Example 2
Profits and Gains			
	(of the current income year, ie, the year for which a tax return is submitted, before deduction of losses)	year 2062 + 1,000,000 Rs	year 2063 + 1,000,000 Rs
- unrelieved loss	(of the 4th year prior to the current income year)	year 2058 - 1,000,000 Rs	year 2059 - 1,000,000 Rs
- unrelieved loss	(of the 3rd year prior to the current income year)	year 2059 - 600,000 Rs	year 2060 - 1,600,000 Rs
- unrelieved loss	(of the 2nd year prior to the current income year)	year 2060 - 200,000 Rs	year 2061 - 1,800,000 Rs
- unrelieved loss	(of the 1st year prior to the current income year)	year 2061 - 100,000 Rs	year 2062 - 1,900,000 Rs
- loss	(of the current income year from another business or investment)	year 2062 - 100,000 Rs	year 2063 - 100,000 Rs
= income	(of the current income year after deduction of losses)	positive income, ie, profit year 2062 = + 800,000 Rs	negative income, ie, loss year 2063 = - 1,000,000 Rs
			> in general to be carried forward for 4 years > exception for banks and general insurances: to be carried back for 5 years

129. The next picture shows the treatment of unused losses. They are carried forward for 4 years *(s 20)*. That means they will reduce the taxpayer's potential future income. Banking and general insurance businesses may carry back losses for five year before the carry forward applies, i.e. they may reduce their taxable income or incomes of previous years and deduct the loss from them before they carry forward the loss to future income years.

Special provisions exist on how to deal with losses incurred in the conduction of a long-term business contract *(s 20 (4), (5))*.

2.12 Deductions denied

130. No deductions are granted for

- personal costs
- domestic income tax, government fines and penalties
- costs in deriving exempt amounts or final withholding payment
- dividends distributed by an entity
- costs of a capital nature (not applicable for s. 14 to 19)
- cash payment (expenses) of more than 50,000 Rs. at one time. *(s 21)*

Personal costs (domestic expenses)

131. Expenses of a domestic or personal nature *(clarification (a) of s 21)* are costs incurred by individuals in respect of themselves, which means that the individuals spend money for their personal consumption to satisfy their personal needs. These expenses are not deductible from any of the income heads employment, investment or business. Such expenses include

- costs for the provision of shelter as well as meals, refreshment, entertainment, or other leisure activities.
- expenses incurred with respect to the individual commuting. If the commuting is related to the conducting of a business or investment the costs of commuting are deductible from the income from the respective business or investment with which the commuting is connected. But even if in such a case the commuting costs are deductible the deductibility does not include cost for commuting between the individual's home and a place at which the business or investment is conducted because this is in each case a private activity.
- expenses for the acquisition of private clothing for the individual owner. If the clothing is only suitable for to be worn at work the costs of the purchase of those clothes may be deducted.
- expenses for education and training of an individual owner. If the education is directly relevant to a business or investment conducted by the individual and the education and training does not lead to a general degree or diploma but has a link to the business or investment conducted the expenses for training or education are deductible.

132. If the taxpayer has borrowed money to bear expenses as mentioned above and needs to pay interests for that, these interests are related to a non-deductible expense and, therefore, also not deductible.

133. Expenses of a domestic or personal nature *(s 21)* also include costs incurred by another person in respect of an individual.

134. For expenses paid to an individual the following alternative conditions apply*(clarification (a) (2) of s 21)*:

(A) the payment is included in calculating the individual’s income. Whether or not the payment is included in calculating the individual’s income will depend on whether the payment is sufficiently connected with an earning activity of the individual that the payment has received. In other words, if the payment constitutes income from employment, business or investment for the individual the other person may deduct this payment from his taxable income.

For example: Assumed that an employer provides an employee with a payment in the form of a fringe benefit. If the fringe benefit is not included in calculating the

employee's income, like the provision of in-house meals and refreshments meals (s 8 (3)(c)(1)), generally no deduction will be allowed to the employer for costs incurred in making the payment, e.g. the employer must not deduct costs of the food and any help in serving the meals.

If the payment is included in calculating the employee's income then whether or not a deduction is granted for the costs incurred by the employer depends on whether the costs are deductible under another provision such as the general deduction rule of s 13, which means that they are deductible if incurred in the production of income from business or investment by the employer, e.g. if the employee works for the business of the employer.

(B) the individual makes a return payment of an equal market value to the person as consideration for the first-mentioned payment;

For example: A restaurant owner provides a meal at a restaurant to an individual and receives a payment in return for that. The restaurant owner may deduct his costs for providing the meal (and has to include the payment of the individual in his taxable income).

By contrast, if same restaurant owner provides a free meal to a relative he must not deduct the costs incurred for the provision of the gratis meal, because he does not receive any taxable payment from his relative in return for the provision of the meal.

(C) the payment consists of amounts which are so small and thus unreasonable or administratively impracticable to make accounting for them.

These are payments that satisfy the following conditions

(1) the payment is made for the tea, stationery, awards, emergency aid or payment for similar other provisions approved by the Department;

(2) the payment that is administratively impractical to keep account separately in the name of payee; and

(3) the payment does not exceed Rs. 500 at one time of payment.

Other deductions denied

135. Not deductible is the income tax to be paid under income tax act, 2058. Furthermore, if the taxpayer has been imposed with fines or penalties these expenses must not reduce the taxable income. This rule refers to the breach of any kind of law or bylaw in Nepal or in a foreign country. If the taxpayer has been fined by a public authority for whatever reason in whatever country he is not allowed to deduct these penalties from his taxable income.

136. Costs incurred in deriving exempt amounts are not deductible because the income to which they are related is not taxable. If only a part of the taxpayer's income is tax exempt then only the expenses related to the tax exempt part of the income are not deductible.

For example: If the taxpayer has derived agriculture income that is exempt from income tax he must not deduct any expenses paid in order to receive this exempt income.

137. No deductions are granted for expenses incurred in receiving final withholding payments, i.e. amounts from which income tax has been finally withheld.

138. If an entity distributes its profit this profit is the basis for the income tax and must not reduce the entity's taxable income. Hence no deductions are allowed for distributions of profits by entities *(s 21 (e))*. The requirements to be met by payments to qualify as distributions of profits are dealt with in *s 53 (3) and (4)*.

139. Deductions are denied for expenses of a capital nature. These are expenses incurred

- in respect of natural resource prospecting, exploration, and development, or
- in the acquisition of fixed asset, or
- on the disposal of a liability *(clarification (d) of s 21)*.

140. Foreign income tax must in principle not be deducted because foreign tax offsets are provided for in the form of foreign tax credits *(s 71)*. Another option is to relinquish the foreign tax credit. Instead of claiming a foreign tax credit the taxpayer may elect to claim a deduction for foreign income tax for which the tax credit is available *(s 71 (4))*. In this case a deduction is not denied and the taxpayer may reduce his taxable income by the foreign income tax.

Deductions denied for large taxpayers

141. Special rules exist for large taxpayers. These are individuals or legal persons with an annual turnover of 2 million Rs or more. For these taxpayers deductions are in principle not allowed for cash payments in excess of 50,000 Rs. at one time*(s 21 (2))*. For the purpose of this provision, a cash payment is defined as a payment made other than through a bank or financial institution by way of letter of credit, check, draft, money order, money transfer (hundi) or any other form *(clarification (b) of s 21)*.

142. Though there are some exceptions from this rule. Any cash payment is deductible if

it is made to HMG, a constitutional body, a corporation owned by HMG, or a bank or financial institution;

it is made to a farmer or a producer of primary agriculture products, also if the product is primarily processed by the farmer himself;

it is a retirement contribution or a retirement payment;

it is made in an area where no banking facilities are available within a radius of 10 kilometer;

it is and necessarily must be made in cash or on a day when banking services are closed;

it is made into a bank account of the recipient.

2.13 Gifts

143. Gifts are payments without consideration or with consideration only to the extent the market value of the payments exceed the market value of the consideration *(s 2 (j))*. As one can see from the tax calculation in section …. of this hand book. those gifts or donations have a character that is different from that of deductions. Gifts (or donations) reduce the assessable income and not the income from one of the three income heads business, investment, or employment.
This means that gifts have nothing to do with the production of income and may reduce the taxable income on policy grounds if made to an exempt organization as per section 99 of this hand book and if the gifts are within the limit *(s 12)*. Apart from these limitations, HMG/N may prescribe by notification in the Nepal Gazette special donations that are deductible whether partial or in full *(s 12 (3))*.
144. The reduction of the taxable income by gifts is limited to 100,000 Rs or 5 percent of the person's adjustable taxable income for the income year whereas adjustable taxable income is calculated without a deduction for gifts, pollution control and research and development costs *(s 12 (2))*. That leads to the following calculation scheme:

Figure 16

	Calculation of the limit for the deduction of gifts to exempt organisations	
	Inclusions	**Rs**_____________
(-)	**Deductions**	**Rs**_____________
	(other than pollution control costs and research and development expenses)	
=	**Assessable Income**	**Rs**_____________
(-)	**Retirement Contribution**	**Rs**_____________
	(in the case of the individual)	
=	**Adjustable Taxable Income**	**Rs**_____________
		x 5%
=	**Limit for Gift**	**= Rs**___________
	-> if below rs 100,000	
	amount allowed to be deducted for gifts	**= Rs**___________
	->if over Rs 100,000	
	amount allowed to be deducted for gifts	**= Rs 100,000**

2.14 Tax Accounting and Timing

Income year

145. Apart from rules on what to include into and what to deduct from the taxable income it is necessary to determine for which period of time the taxable income needs to be calculated and to which period of time the tax is related. Tax is imposed on and realized from every taxpayer for each income year *(s 3)* whereas the income year is the period from the start of Shrawan of the year to the end of Ashad of the following year *(s 2 (i))*. Therefore, this income year is also the time for which the taxable income needs to be calculated.

146. The income year for tax purposes covers basically the same period of time as the fiscal year for commercial purposes. The commercial fiscal year describes an annual accounting period. This is an interval of time at the end of which a statement of income (profit and loss account) and a statement of financial position (balance sheet) are prepared from the accounting data of a taxpayer. For the sake of simplification, these commercial documents can be taken as the basis for the calculation of the taxable income and, if so, need then to be adjusted for tax purposes. If the taxpayer does not prepare such commercial documents the taxable income needs to be calculated based on the amounts required to be included and allowed to be deducted under the rules of the income tax act for the tax year. The IRD has prescribed the tax payers, who should prepare a profit and loss account and balance sheet. Similarly, IRD has prescribed the contents of profit and loss account and balance sheet, which is as follows :-

श्री ५ को सरकार

अर्थ मन्त्रालय

आन्तरिक राजश्व विभागको सूचना

आयकर ऐन, २०५८ को दफा ८१ को उपदफा (१) तथा आयकर नियमावली, २०५९ को नियम ८ को उपनियम (२) को अधिकार प्रयोग गरि आयकर ऐन, २०५८ वमोजिम आफ्नो आयको विवरण पेश गर्नु पर्ने करदाताहरु मध्ये आयविवरण साथ लेखा परिक्षण गरिएका वासलात, नाफानोक्सानी हिसाव, उत्पादन हिसाव तथा अन्य कागजात पेश गर्नु पर्ने गरि तोकिएका करदाताहरुले देहाय वमोजिमको विवरण खुल्ने ढांचामा आयकर प्रयोजनकोलागी लेखांकन गर्नु पर्ने गरि यस विभागवाट तोकिएको व्योहोरा सबैको जानकारीकोलागी यो सूचना प्रकाशित गरिएकोछ ।

१. नगद कारोबारको यथार्थ चित्रण हुने गरी राखिएको बैंक वा नगद हिसाब ।

२. कमसेकम वर्षको एक पटक भौतिक जांच (Physical Verification) गरी सोजांचको आधारमा तयार गरेको अन्तिम मौज्दातको विवरण ।

३. करदाताले अपनाएको लेखा प्रणाली (Accounting System), लेखा सिद्धान्त (Accounting Principle) तथा प्रमुख लेखा नीतिहरू (Accounting Policies) उल्लेख गरी लेखासित सम्बन्धित सम्पूर्ण मूल तथा सहायक खाता वहिको सूची आय विवरण साथै पेश गर्नु पर्नेछ ।

४. प्रचलित नेपाल कानून बमोजिम कुनै फर्म, कम्पनी वा संस्थाले राख्न पर्ने गरी तोकिएको लेखाको ढांचा वा तरिकामा कुनै थप कुरा भएमा त्यस्तो थप कुराहरू समेत यसै सूचनाको अंग मानिनेछ ।

५. करदाताले वासलात, नाफा नोक्सान हिसाब एवं नाफा नोक्सान वांडफांड हिसाब तयार गर्नु पर्नेछ । यस्तो वासलात र नाफा नोक्सान हिसाबमा कारोवार गरेको आय बर्ष र अघिल्लो आय बर्षको अंकहरु उल्लेख गर्नुका साथै न्यूनतम देहायका कुराहरू खुलेको हुनु पर्नेछ ।

(क) वासलात

अ) पुंजी र दायित्व

(१) पूंजी (अधिकृत पुँजी,जारी पुँजी र चुक्ता पुँजी अलग अलग देखिने गरी)

(२) जगेडा कोष र अरू जगेडाहरू

(३) सुरक्षित ऋण

(४) असुरक्षित ऋण

(५) चालु दायित्व तथा अन्य दायित्वहरू

(६) संचित मुनाफा

(आ) सम्पत्ति तथा जायजेथा

(१) अचल सम्पत्ति :-

(क) जग्गा

(ख) भवन, स्ट्रक्चर र स्थायी प्रकृतिका यस्तै प्रकारका अन्य वनौटहरु

(ग) कम्प्यूटर तथा अन्य कार्यालय उपकरणहरु

(घ) फर्निचर तथा फिक्चर्स

(ङ) अटोमोबाइल्स, बस तथा मिनीबसहरु

(च) निर्माण तथा उत्खनन् सम्बन्धी उपकरणहरु, प्लाण्ट, मेशिन र अन्य मालसामानहरू

(छ) पेटेण्ट, ट्रेडमार्क, डिजाइन,ख्याती आदि

(ज) निर्माणाधिन सम्पत्ति

(२) लगानी

(३) चल सम्पत्ति :-

(क) स्टकमा रहेका मालसामानहरू, उत्पादन प्रकृयामा रहेका मालसामानहरू, कच्चा मालसामानहरूको मौज्दात

(ख) सेकयूरीटीहरू

(ग) पेश्की, सापटी तथा धरौटीहरू

(घ) विविध आसामी

(ङ) नगद तथा बैंक मैज्दात

(४) संचित नोक्सानी

(५) अपलेखन गर्न बांकी खर्चहरु

(ख) आय र व्यय देखिने गरी तयार गरेको नाफा नोक्सानी हिसाबः-

(१) बिक्री वा प्राप्त रकम

(२) बिक्री लागत

(क) सुरु मौज्दात

(ख) खरिद

(ग) अन्तिम मौज्दात

(३) अन्य आय

(४) व्यवसायीक खर्च (अनुसूची संलग्न गर्ने)

(५) प्रशासनिक खर्च (अनुसूची संलग्न गर्ने)

(६) वितरण खर्च (अनुसूची संलग्न गर्ने)

(७) संचालनवाट नाफा

(८) व्याज खर्च

(९) ह्रास कट्टी

(१०) अपलेखन गरिएका रकमहरु

(११) अन्य खर्चहरु

(१२) व्यवस्थाहरु (अनुसूची संलग्न गर्ने)

(१३) खुद मुनाफा/नोक्सानी

६. माथि दफा-दफामा उल्लेख भएका कुराहरूको अतिरिक्त उत्पादनशिल, खानीजन्य र प्रोसेसिँग प्रतिष्ठानहरूले देहायका विवरण समेत खुलाउने गरी लेखा राख्नु पर्नेछ ।

(क) कच्चा पदार्थ तथा सहायक कच्चा पदार्थको शु रू मौज्दात, खरिद, खपत तथा बाँकी मौज्दातको परिमाण र मूल्य देखिने गरी तयार गरिएको उत्पादन हिसाब ।

(ख) उत्पादित सामानहरू टुटफुट वा हानी नोक्सानी भएमा नोक्सानीको मूल्याङ्कन सहितको विवरण ।

(ग) उत्पादनको सिलसिलामा प्राप्त भएका सहायक उत्पादन (वाई प्रोडकटको) परिमाण ।

(घ) उत्पादित सामानको शुरू मौज्दात, उत्पादन, र बाँकी मौज्दात परिमाण ।

(ङ) उत्पादन क्षमता सम्बन्धी विवरणहरू :

(१) सम्बन्धित निकायबाट स्विकृत भएको उत्पादन क्षमता ।

(२) उद्योगमा जडान भएको उत्पादन क्षमता ।

(च) एक भन्दा बढी किसिम वा प्रक्रितिका सामानहरू उत्पादन गर्ने भएमा उपर्युक्त विवरणमा प्रत्येक किसिम वा प्रक्रितिका सामानहरू वेग्ला वेग्लै देखिने गरी खुलाउनु पर्नेछ ।

Methods of tax accounting

147. Tax accounting also deals with the question at what time amounts derived and costs incurred are recognized for taxation purposes, i.e. when these amounts are to be included in the calculation of the taxable income. This time is determined according to the generally accepted accounting principles if there are no special rules in the income tax act *(s 22 (1))*. Generally accepted accounting principles are commercial accounting principles

- prescribed in any law in force,
- adopted by the Nepal Institute of Chartered Accountants, or
- prescribed by the IRD based on any international standards and practice.

148. The income tax act prescribes the following methods of accounting for tax purposes:

(A) An individual has to account on a cash basis in calculating his income from employment and investment, i.e. the cash method is to be used by employees for their employment and investment income *(s 22 (2))*.

(B) A company has to account on an accrual basis *(s 22 (3))*.

(C) Any other taxpayer may choose between the cash or the accrual method for calculating his income from business or investment unless the IRD prescribes otherwise by notice in writing *(s 22 (4))*.

Taxpayers can apply in writing to the IRD for a change in his basis of accounting. The IRD may then in exceptional cases allow the change if it is necessary to clearly reflect the taxpayer’s income *(s 22)*.

Cash and accrual basis accounting

149. The cash accounting method applies to income from employment, business and investment. Under this method an amount is derived and therefore to be included into the taxable income when the taxpayer has received the underlying payment or when the underlying payment is made available to him so that he is able to receive it, i.e. in most of the cases when the taxpayer has received money *(s 23 (a))*. Under this method the taxpayer has incurred an expense and may deduct it when he has made a payment, i.e. generally when he has transferred money *(s 23 (b))*.

150. The accrual accounting method applies only to income from business and investment, not employment. By contrast to the cash method, under the accrual accounting method the taxpayer has derived an amount when he becomes entitled to a payment, i.e. in general when he has the right to claim money *(s 24 (1))*.

151. In the reverse situation of incurring an expense the income tax act distinguishes between two cases *(s 24 (2))*:

(A) The taxpayer makes the payment that constitutes an expense in return for another payment *(s 24 (2)(a))*.

The payment becomes an expense and therefore deductible at the time when the taxpayer is obliged to make a payment *(s 24 (2)(a)(1))*. However, the obligation is not itself sufficient that a cost is incurred. In addition to the obligation itself the value of the obligation must be able to be determined with reasonable accuracy *(s 24 (2)(a)(2))* and the other payment must be received *(s 24 (2)(a)(3))*. This means that where the underlying payment considered for deduction is made in return for another payment, the underlying payment constitutes only a deductible expense to the extent the return payment has been made.

For example: A person sells trading stock to another person in return for cash (note: according to the definition in s 2 (ag(1)) the term payment also includes the transfer by one person of an asset to another person, i.e. the sale of trading stock constitutes a payment). On the signing of the contract the purchaser will be entitled to the trading stock and obliged to make the payment and, reverse, the vendor is obliged to deliver the trading stock and entitled to receive the payment. However, the purchaser will not incur the cost of the cash payment under the accrual method until the trading stock is transferred to him. This means that the purchaser must not deduct the price for the trading stock as an expense before the trading stock has been delivered to him.

(B) In other cases the expense is treated as incurred when the payment is made (s 24 (2)(b)).

Adjustments

152. Where in the course of calculation the income from business or investment inaccuracies in quantifying amounts occur that directly result from use of the accrual method of tax accounting the taxpayer shall make appropriate adjustments at the time the payment is received or made *(s 24 (4))*. Example of this provision might be the exchange gain or loss.

153. Likewise, while calculating the income from employment, business, or investment other incorrectness might result from the recognition of amounts that, if looked at it after the recognition, i.e. in hindsight, should not have been recognized or have been reversed, especially in cases where payments have been refunded or recovered. Other examples are cases of disclaimer, write-off or forgiveness. In such situations the taxpayer shall, too, correct the calculation by making the suitable adjustments *(s 25 (1))*.

Write-offs of bad debts

154. A practically important adjustment is the write-off of a debt as bad. The taxpayer is permitted to do so after he has taken all reasonable steps to follow up the payment, and reasonably believes that the debt claim will not be satisfied *(s 25 (2)(b))*.

Special rules apply to bad debts of banks or financial institutions. These are determined in accordance to the standards as prescribed by law and, if such standards are not available, according to criteria established by the Nepal Rastra Bank *(s 25 (2)(a))*.
Example for the need for adjustments: An expected payment, i.e. a debt, has been correctly included in calculating the income on an accrual basis as an entitlement. This debt has been written-off and deducted from the income as bad because legal steps to receive the payment have been fruitless. If unexpectedly the payment is made in the future, i.e. the written off debt is recovered, the amount must be included in calculating the future income at the time of recovery.

2.15 Quantification, Allocation and Characterization of Amounts

Quantification

155. Payments in the sense of the definition in *s 2 (ag)*, whether in cash or in kind, are quantified based upon market values. The market value of an asset and a service denotes the normal buying and selling price for the asset or services in the ordinary course of a business amongst unrelated parties *(s 2 (ae))*. If money or an asset is transferred then the money or the market value of the asset is included in the calculation of income *(s 27 (a))*.

156. For in kind payments comprising the provision of certain facilities or services as described in *s 27 (b) to (d)*, like the use or the availability for use of a car or the provision of a house, the market value is standardized by characterizing the benefit for the recipient with fixed percentages. Other payments are quantified by valuing the benefit of the payment to a reasonable person in the position of the payee *(s 27 (e))*. This subject has already been dealt with in connection with the inclusion of in kind payments detail in section 65 to 68 of this handbook.

157. All amounts used in calculating the taxpayer's income are required to be quantified in Nepali Rupees. The amount quantified in a different currency must be converted into Nepali Rupees at the time the amount is recognized for tax purposes and at the standard exchange rate at that time *(s 28)*.

Allocation

158. In case a taxpayer indirectly benefits from a payment or directs who is to be the recipient of a payment and the payer intends to benefit this taxpayer the IRD has the right to reallocate the payment and treat the taxpayer as the recipient of the payment *(s 29)*. The decision of the IRD requires a notice in writing to the taxpayer.

159. This entitlement of the IRD might not only be used to prevent abuse, for example in cases of direct and indirect value shifting involving independent parties, but might also be exercised to treat a taxpayer as making a payment to ensure that the taxpayer receives the benefit of the payment.

For example: Retirement contributions made by an employer directly to a retirement fund on behalf of an employee may under this provision be treated as made by an employee to ensure that the employee can claim a reduction of the retirement contributions from the taxable income.

160. The IRD has also the power to re-allocate amounts to be included or deducted in calculating income from employment, investment or business, if taxpayers who are associates have made transfer pricing or other arrangements or entered into agreements that would not have been made or entered in between taxpayers that are unrelated. This means that the arrangements or agreements are not conducted at arm's length. In other words, the reason for the arrangements or agreements lies in the relationship of the taxpayers. The re-allocation is targeted at reflecting the taxable income or tax payable as it would have arisen for the associated taxpayers if they would have entered into arrangements or agreements like amongst unrelated parties *(s 33)*.

161. Where a taxpayer attempts to split income with another taxpayer and this income splitting is likely to cause a tax reduction, the IRD is given the right to adjust amounts to be included or deducted in calculating the income of each person. The duty of the IRD is to prevent any reduction in tax payable as a result of the splitting of income *(s 34 (1))*. The cases covered here have their cause in the different tax rates. Because different taxpayers are taxed at different rates, for example a parent company and its subsidiary, the taxpayer being taxed at a high rate might seek to have some of his income allocated to a taxpayer taxed at a low rate. If he, in order to do so, enters into an income splitting agreement the IRD has the power for adjustments.

Characterization of Amounts

162. Payments under an annuity, an installment sale, or a finance lease are re-characterized as interest and a repayment of capital under a debt claim *(s 32 (1))*. The idea behind this rule is that annuities, installment sales, and finance leases are economically equivalent. Therefore, it needs to be ensured that these substitutable forms of financing are treated similar.

163. All payments under an annuity, an installment sale, or a finance lease must be aggregated. The total is then to be divided into a capital portion and an interest portion. The capital portion is treated as a repayment of capital and the interest portion is dealt with as interest paid or to be paid *(s 32 (6))*. Each of these portions is calculated as described in detail in *s 32 (2)*. At the time of concluding an annuity, installment sale, or finance lease the taxpayer, who receives the payment, is required to determine the installments and segregate the installments into an interest and a capital portion *(s 32 (3))*.

164. If the taxpayer cannot provide such a list he must treat the interest and capital portion of the annuity, installment sale, or finance lease as a blended loan with the interest compounded six monthly.

165. A blended loan means a loan under which payments by the borrower represent in part a payment of interest and a part a repayment of capital and

- the interest part is calculated on capital outstanding at the time of each payment, and
- the rate of interest is uniform over the term of the loan.

166. Finance leases are treated as sales. A finance lease with respect to the leasing of an asset means a lease where

- the lease agreement at the end of the lease term
  - provides for the transfer of ownership, or
  - comprises the option for the lessee to purchase the asset for a fixed or presupposed price, or
- the lease term exceeds 75 % or the useful life of the asset, or
- the estimated market value at the end of the lease term is less than 20 % of the market value at the beginning of the lease, or
- the asset is custom made for the lessee and at the end of the lease will not be of practical use to anyone other than the lessee *(s 32 (5))*.

This definition provides a list of tests where a lease may be considered essentially equivalent to a sale and, therefore, justifies the treatment as a sale.

167. As a general anti-avoidance rule to correct and re-characterize arrangement targeted at minimizing the taxable income or payable tax the IRD is empowered to re-typify arrangements, of which one of the main purpose is to avoid or reduce the liability of tax. Other arrangements, which the IRD may correct, are those that do not have a substantial economic effect or appear in a legal form that does not reflect the economic substance of the arrangement *(s 35)*.

2.16 Calculation of net gains from Assets and Liabilities

168. The diagram below shows the general treatment of gains from assets and liabilities.

Figure 17

Net Gains from Assets and Liabilities			
		s36 Net Gains = Total Gains - Total Losses (incl. Carry forward)	
s37	Gain/Loss	Difference between outgoings and incomings	
s38	Outgoings	Like deferred deductions but no actual deductions	
s39	Incomings	Like inclusions but not	Exempt amounts Final withholding payments Actual inclusions
s40	Disposal	The timing for recognition of gains and losses	
		General Rule: when part with ownership	Transfer Destruction Death
		Disposal with retention of ownership	Excess income Bad debt Change in use of asset Change in ownership of entity Become non-resident

169. As explained before, income from business includes net gains from the disposal of business assets or liabilities and income from investment includes net gains from the disposal of non-business chargeable assets of an investment of a taxpayer. Business assets comprise assets to the extent to which they are used in a business *(s 2 au)*. Non-business chargeable assets mean securities or an interest in an entity as well as land and buildings *(s 2 r)* to the extent that they are not private residences of an individual owned and lived in continuously for 3 years or more, or they are not disposed of for more than 10 m Rs. Both definitions exclude depreciable assets or trading stock.

170. A gain or a loss is calculated with respect to an asset or liability. Asset is defined as a tangible or intangible asset and includes currency, goodwill, know-how, property, an owner's interest in a foreign branch, a right to income or future income, an a part of an asset *(s 2 (bc))*. Broadly spoken assets are defined as legal rights. By contrast, liabilities may be defined in terms of legal obligations. Rights and obligations are necessary to be grouped by the taxpayer so that assets and liabilities can be properly defined for income tax purposes.

171. A gain or a loss from an asset or liability is determined by comparing "incomings" for the asset or liability with "outgoings" for the asset or liability. "Incomings" are the amounts of money that the taxpayer receives when he gets rid of the asset or liability. In case of an asset, incomings are usually the amount of money that the taxpayer obtains in return for loosing the asset. In case of a liability, incomings are the amount of money that the taxpayer does not need to pay any more to fulfill the liability, which is usually the value of the liability at the time of disposal.

172. "Outgoings" are amounts that the taxpayer needs to spend at the time of acquiring the asset or incurring the liability as well as expenses with respect to the asset or liability during the time of owning the asset or owing the liability. A positive difference between "incomings" and outgoing is a gain, a negative difference between "incomings" and "outgoings" is a loss.

173. The calculation schemes below show the amounts to be included while calculating the "incomings" and "outgoings":

Figure 18

Calculation of Gains and Losses of an Asset

Incomings *s39*

(amounts

- derived in respect of owning the asset
- derived or to be derived in respect of disposal of the asset which is in most cases the sales price that the owner of the asset receives)

- Outgoings *s38*

(expenses incurred

- in acquiring the asset, which is in most cases the cost price of the costs of construction or production of the asset
- in owning the asset including expenses of altering, improving, repairing and maintaining the asset
- for the disposal of the asset
- as incidental expenses for the acquisition and disposal of the asset)

____

= Gain or *s37(1)*

Loss *s37(2)*

Figure 19

Calculation of Gains and Losses of a Liability

Incomings *s39*

(amounts

- derived in respect of incurring the liability
- derived or to be derived in respect of disposal of the liability)

- Outgoings *s38*

(expenses incurred

- in owing the liability
- expenses of altering, improving, and maintaining the liability
- for the disposal of the liability
- as incidental expenses for incurring and disposing of the liability)

____

= Gain or *s37*

Loss *s37*

Figure 20

Calculation of net gains
from the disposal of non-business chargeable assets of an investment *s36(2)*

Total of all gains
- from the disposal of non-business chargeable assets of an investment
- of the income year

- Total of all losses
- from the disposal of non-business chargeable assets of an investment
- of the income year

- Any unrelieved net loss
- out of any losses of business or investment
- for the income year

- Any unrelieved net loss
- out of the losses of
  - investment
  - any business or
  - other investment
- for a previous income year

Net Gain/Net loss

174. The tax is imposed on the net gains, which are the total gains minus the total losses including unrelieved losses for the actual income year and those from a previous income year which thus can be carried forward forever.

175. The time at which gains and losses are recognized for tax purposes is the time of the disposal of the asset or liability that results in a gain or loss. The taxpayer disposes of an asset when he parts with ownership of the asset *(s 40 (1))*, i.e. when he relinquishes the asset*.* This is, among other things, the case when the asset is distributed, leased to another person under a finance lease, transferred or destroyed. The taxpayer disposes of a liability when he parts with the obligation constituting the liability. This includes when the liability is satisfied, cancelled or released *(s 40 (2))*.

176. It is important to note that to part with ownership of an asset or with the obligation that constitutes a liability does not necessarily mean that the taxpayer need to give up the asset or liability in favor of another person. The term disposal covers, besides the transfer, also the destruction of the asset or liability and any other manner in which an asset may cease to exist. It, too, includes the situation that the taxpayer himself stops to exist. This applies to individuals and entities. It means in the case of individual that the individual dies and in case of an entity that the entity is dissolved.

177. In the following cases the assets involved are treated as disposed of even though they are retained and still owned by the taxpayer

- when a debt claim becomes a bad debt *(s 40 (3)(c), 41))*
- when the use of assets changes *(s 40 (3)(d), 41))*
- when a person becomes a non-resident *(s 40 (3)(f), 41)* or dies, *(s 40 (3)(a))*.
- the ownership of an entity changes *(s 40 (3)(e), 41))*; that results also in the disposal of a liability.

178. Special rules are provided for disposals by way of

- installment sales or finance leases *(s 42)*

- transfers of assets to spouses and former spouses *(s 43)*
- transfers on death *(s 44)*
- non-market transfers such as those between associates *(s 45)*
- involuntary disposals of assets or liabilities with replacement *(s 46)*
- disposals by merger *(s 47)* and by splitting *(s 48)*

These rules are designed to deal with particular cases in a predictable, uniform manner.

2.17 Special provisions for Individuals

Option for couples

179. In the case of a Married resident couples, each spouse is taxed separately. But married resident couples may elect to be treated as a couple for a particular income year *(s 50)*. In this case their income will be clubbed and added together. If the income of both spouses is added up the basic exemption threshold for couple applies. If the income of both spouses is calculated separately each spouse can claim the basic exemption threshold for individuals. Refer to section 37 for the tax rates applying to individuals. If a couple elects to be taxed as couple each spouse is jointly and severely liable together with the other spouse that the tax for the couple is paid *(s 50 (2))*.

Medical tax credit

180. Resident individuals may reduce their tax payable, not their taxable income, by claiming a medical tax credit as an offset. The medical tax credit is calculated as 15 % of the approved medical costs of the resident individual *(s 51 (1))*. The costs that are treated as approved are mentioned in the rules. The deduction of the medical tax credit is limited to an amount of 750 Rs. per income year. If the deductible medical credit exceed this limit, i.e. if the amount of 15 % of the taxpayer's medical costs is higher than 750 Rs., or the tax credit cannot be utilized because the taxpayer does not need to pay tax the sum of the excess can be carried forward to the next income year and added to the medical tax credit of the next income year *(s 51 (2))*.

181. The following expenses made by the taxpayer for his own medical treatment is treated as approved medical costs.

- insurance premiums paid for health insurance,
- costs incurred in filing prescriptions of diagnosis issued by recognised hospitals, nursing homes, health centres or medical practitioners, and
- payments for filing prescription bills including the purchase of medicine according to the prescriptions issued by recognised hospitals, nursing homes, health centres or pharmacists

182. Costs incurred for cosmetic surgery are not treated as approved medical costs. Also, if costs incurred in filing prescriptions of diagnosis, or payments for filing prescription bills including the purchase of medicine as described above are reimbursed by an insurance company under a health insurance scheme, they cannot be claimed as a medical tax credit because the taxpayer does not directly pay them.

183. The following scheme shows how to calculate the medical tax credit.

Figure 21

(1) Approved medical costs	Rs__________
15 % out of (1) = Medical tax credit	Rs__________
- Prescribed limit	Rs - 750
= Subtotal	Rs. = +/-
Deductible amount if the <u>subtotal</u> is <u>negative</u>: medical tax credit fully deductible because it is less than 750 Rs. and thus below the prescribed limit	Rs __________
Deductible amount if the <u>subtotal</u> is <u>positive</u>: medical tax credit deductible only up to the prescribed limit of 750 Rs. because it is greater than the prescribed limit of 750 Rs.	Rs 750
Remainder to be carried forward to the next income year and added to the medical tax credit of that income year	Rs__________

2.18 Special Provisions for Entities

General Remarks

184. Entities are taxpayers with legal structures that are more complex in comparison to individuals, particularly with respect to the relationship between the entity and its shareholders or partners respectively. This situation needs to be provided for by special tax rules.

185. An entity (as defined in *s 2 x*) is liable to tax separately from its beneficiary, who is a person having an interest in an entity *(s 2 y)*. This means, that the entity and its beneficiary are regarded for tax purposes as two different persons. Consequently, transactions between the entity and its beneficiary are possible. These transactions are recognized for tax purposes unless stated otherwise in the income tax act *(s 52 (6))*. The same applies to transactions between entities and its managers, whereas a manager in relation to an entity is defined as any person who participates in making senior management decisions on behalf of the entity *(s 2 aq)*.

Partnerships

186. Entities appear in business life mainly in the form of partnerships and companies. Both types of entities are taxed in a different way. Partnership means a firm that has fewer than 20 partners. The term does not include a proprietorship firm or a joint venture *(s 2 (be))*.

Companies

187. Company means an organization established under the company law. For tax purposes the term also covers organizations as explicitly mentioned in *s 2 m*. A company consists of shareholders. Companies are taxpaying subjects, which means that it is in general them to whom the income of the company is allocated. The company's income will only be allocated to shareholders if a company distributes a dividend.

188. The profit of a company, i.e. the company's income after the company has paid tax, can either be retained or distributed to its beneficiaries, i.e. shareholders. <u>Distributions of profit</u> are dividends *(s 2 (an))*. The term includes a payment of the company to any of its beneficiaries in any capacity or any capitalization of profits, by, for

example, way of issuing bonus interests or increasing the amount paid up on interests in the company *(s 53 (1))*. Capitalization of profits also includes collateral benefits. A collateral benefit, which can be characterized as a kind of hidden distribution of profit, is, for example, where a company provides the use of a house or of a car free of costs or below market value to the shareholder without showing in its books of accounts the real value of the payment made to the shareholder.

189. Not a distribution of profit and, therefore, not a dividend are repayments of the company's capital or payments to a beneficiary, which are included in calculating the beneficiaries' income.

For example, remuneration paid to a beneficiary, who is employed by the company, are not a distribution of profit of the entity (s 53 (2) (b)).

190. Hence, the income tax act distinguishes between distributions of profits and collateral benefits of a company, which are dividends *(s 53 (6))*, representing a return of interest of capital, and the repayment of capital, which is the return of the capital itself. The income tax act provides a profit-first-rule saying that a distribution is a return of capital to the extent that it is not a distribution of profits *(s 53 (5))*. Repayments of capital are free of tax. Dividends are subject to tax.

191. Dividends of a resident company to the company's shareholders are taxed in the form of a final withholding tax. Dividends of other resident entities such as partnership are exempt from tax *(s 54 (1))*. Dividends of a non-resident entity, which are distributed to a resident beneficiary, are taxed by inclusion in calculating the income of the beneficiary *(s 54 (2))*. Distribution of dividends, which are derived after deducting tax are exempted from tax *(s 54 (3))*.

192. If the distribution is made in the form of a collateral benefit it is also subject to a final withholding tax, but, in addition to that, the benefit needs to be included into the company's income *(s 56 (3))*.

193. Besides these general provisions the income tax act contains detailed regulations for special cases covering

- complete or partial liquidations of entities *(s 55)*,
- dealings between an entity and a beneficiary *(s 56)*,
- changes in control of an entity *(s 57)* and
- dividend stripping *(s 58)*.

194. These rules guide the taxpayers through difficult tax cases and clearly draw the line between arrangements, which are acceptable for the tax administration and those, which are regarded as inappropriate and unlawful for income tax purposes.

2.19 Special Provisions for Insurance and Banking Businesses

General Remarks

195. Since the business of insurances and banks is special compared to other businesses special provisions in the income tax act are required. Activities in conducting a banking business or a general or an investment insurance business are treated as separate businesses, which income or loss need to be calculated detached from any other activity *(s 59 (1), 60 (1), 61 (1))*.

Banks

196. Banks and financial institutions dealing with banking transactions has a option to deduct up to 5% of the total debt but not more than the limit prescribed by Nepal Rastra Bank to cover the risk. If these businesses do not enjoy this option, they can carry back loss for a period of five years. Because the yields of these types of businesses may vary widely between profits in one year and losses in another year banks are allowed to carry back losses for 5 years before the carry forward rule applies *(s 59 (2))*. Insurers are only granted this right of carry back if they conduct a general insurance business which is registered as per prevailing law of Nepal. Insurance business has no choice to deduct for risk bearing fund provision.

Insurances

197. An investment insurance is defined as covering the event of death, injury or incapacitation of the insured person or an associate, based on an agreement to be in effect for at least 5 years and terminable by the insurer only in special circumstances as well as a reinsurance *(s 2 (ag))*. Other types of insurances are referred to as general insurances *(s 2 (x))*.

198. The income from an insurance business is principally calculated like the income from any other business or investment. But, in addition to that, general insurance businesses as insurer are required to include premiums of the insured and compensations from third parties in the calculation of their income and they are allowed to deduct insurance payments made or premiums returned to the insured *(s 60)*. This is not the case for investment insurances *(s 61)*.

199. On the level of the insured taxpayer, proceeds from a general insurance are to be included in the income from employment, business or investment if the proceed compensates for income or an amount to be included in calculating the income or a loss *(s 62 (1), s 31)*.

200. Gains from investment insurance are taxed in the hand of the insured taxpayer in the form of a final withholding tax if the proceeds are paid by a resident insurer. In cases where a non-resident insurer pays the proceeds they are to be included in calculating the income of the insured taxpayer *(s 62 (2)*.

2.20 Special Provisions for Retirement Funds

201. A retirement fund is any entity established and maintained solely for the purposes of accepting and investing retirement fund contributions in order to provide retirement fund payments to individuals who are beneficiaries of the entity or a dependant of such an individual *(s 2 (d))*. The income tax act distinguishes between the treatment of approved and unapproved retirement funds. A retirement fund is approved if it has its residence in Nepal and has received approval from the IRD that it complies with the requirements prescribed in the rules *(s 2 (bh))*.

202. The income of a retirement fund is calculated without including retirement contributions, Retirement payments and interests of beneficiaries in a retirement fund. *(s 64 (1)).* The approved retirement fund's income is exempt from tax *(s 64 (2))*. By contrast, the income of an unapproved retirement fund is subject to full income tax.

2.21 Special Provisions for Retirement Contributions and Payments

203. Retirement contributions are payments of an individual made to a retirement fund for the provision or future provision of retirement payments *(s 2 (f))*. Individuals can deduct their retirement contributions made to an approved retirement fund from their taxable income up to a limit of 3,00,000 Rs. or one third of assessable income, which ever is lower for each income year *(s 63 (3))*. By way of contrast, contributions of an individual to an unapproved retirement fund are not deductible.

204. Retirement payments are payments from a retirement fund to an individual in the event of the individual's retirement or to a dependant of the individual in the event of the individual's death *(s 2 (e))*. Retirement payouts from an approved retirement fund to an individual taxpayer are to be included in calculating the income of the individual taxpayer and, in case of a lump sum payment, are treated as a gain from the disposal of a non-business chargeable asset of the individual subject to final withholding. *(s 65 (1)).* Gain is calculated by deducting 50% of lump sum payment or Rs. 5 Lakhs, which ever is higher from total lump sum retirement payment.

205. Payouts of an unapproved fund are up to the extent of the contributions exempt from tax because they are in this case a repayment of capital. The gains are taxed in the hands of the individual beneficiaries in the form of final withholding tax. If a non-resident fund pays out the proceeds they shall be included in the income of the individual beneficiary *(s 65 (2))*.

2.22 International Taxation

General Remarks

206. This chapter of the income tax act determines the basis, on which Nepal has the right to levy taxes, and deals with provisions for internationally operating businesses. All payments and gains, which are sourced within the country of Nepal, need to be considered for taxation purposes. Details of the circumstances under which this is the case are defined in *s 67* following international standards.

Foreign permanent establishments

207. Tax is imposed on the income of a foreign permanent establishment of a non-resident person situated in Nepal *(s 68)*. Permanent establishment means a place where a person wholly or partly carries on a business, also through an agent that does not have an independent status *(s 2 bb)*. For details refer to section 18 of this handbook. Such a permanent establishment can be attributable to an individual or an entity. It is a foreign permanent establishment if the individual or entity, to whom it is attributable, is not situated in the country of Nepal.

208. Foreign permanent establishment need to pay income tax on their repatriated income also. Repatriated income is the repatriatable income that the permanent establishment of non-resident sends through bank to a foreign country or an amount of payment made through any other means *(s 2 (aw))*. The repatriated income is equal to dividends distributed by the foreign permanent establishment *(s 68 (4))*.

Controlled foreign entities

209. A controlled foreign entity means an entity not residing in Nepal, in which a resident person holds an interest and controls or may benefit from 50 % or more of the rights to income, capital or voting power alone or with not more than 4 other resident *(clarification (b) of s 69).*

210. A controlled foreign entity is treated as distributing its attributable income, calculated as if the entity were a resident entity *(clarification (a) of s 69))*, as a dividend to its beneficiaries in accordance with the beneficiaries´ rights to that income, or, where those rights are not reasonably certain, in such manner as the IRD thinks appropriate *(s 69 (1))*.

Non-residents providing shipping, air transport or telecommunication services

211. Apart from any remaining taxable income non-resident persons (this comprises resident entities being a part of a group of associated entities situated outside Nepal) carrying on a business of charter or air transport operator are taxed on their amounts derived from carriage of passengers who embark as well as mail, livestock, or goods that are embarked on a flat rate *(s 70 (1)*. That also applies to non-resident persons who transmit messages by any technical means such as cable, radio, and satellite communication if the apparatus is established in Nepal *(s 70 (2))*.

Foreign tax credit

212. If an individual or entity residing in Nepal derives income from a foreign country the foreign income is taxed in Nepal under the concept of global taxation: the taxation of income is linked with the residence; each taxpayer residing in Nepal has to pay tax on his global income in Nepal. But foreign income is presumably also taxed in the foreign country so that there is a chance for double taxation. In order to avoid this and ensure that the income in Nepal is only taxed once, foreign tax paid in the foreign country can be offset against the Nepali income tax. The taxpayer can reduce his Nepali income tax by claiming a foreign tax credit (*s 71 (1))*.

213. A tax credit may be claimed for any foreign income tax paid with respect to foreign source income. The tax credit needs to be calculated separately for assessable foreign income sourced in each foreign country. However, to claim a foreign tax credit is not the only option for the taxpayer. The taxpayer can also elect to relinquish the foreign tax credit and deduct the foreign income tax from his taxable income in Nepal.

214. The tax credit is limited and shall not exceed the average rate of Nepali income tax applied to the assessable foreign income *(s 71 (2))*. The average tax rate of Nepali income tax is calculated as the percentage of Nepal income tax that the person has to pay with respect to the taxable income in Nepal whereas the taxable income is calculated before any foreign tax credit (clarification of (b) *s 71))*.

215. To the extent the tax credit is not granted as a result of the limitation it may be carried forward *(s 71 (3))*. This means, if the amount of paid foreign income tax is higher than the amount of average Nepali income tax applied to the foreign income the difference may be deducted from the income tax of the next income year.

216. The foreign tax credit can be determined using the scheme below.

Figure 22

(A)	(B)	(C)	(D)	(E)	(F)	(G)
Foreign income from country: ………….. (please name the country)	Average Nepali tax rate	Tax on foreign income multiply (A) with (B)	Tax paid in Foreign country: ………….. (please name the country)	Balance foreign tax credit subtract (D) from (C)	Deductible Foreign tax credit for the year if (E) is positive full amount of (D)	Foreign tax credit to be carried forward if (E) is negative (Negative amount only)
Rs.	%	Rs.	Rs.	Rs.	Rs.	Rs.

3. ADMINISTRATION

3.1 Tax Administration and official Documentation

Inland Revenue Department (IRD)

217. This part of the income tax act deals with administrative issues describing the power and legal obligations of the income tax administration as well as the rights that the taxpayers are granted and the duties that the taxpayers have to fulfill. Explicitly mentioned are the actions to which the tax authorities are empowered and the obligations that the taxpayers have to follow. As a principle, the income tax act directs that within HMG/N the IRD is responsible for the administration and implementation of the provisions of the income tax act *(s 72 (1))*. This means that no other part of HMG/N has the right to execute the regulations of the income tax act.

Figure 23

Execution of Administrative Power *s72*	
HMG (MoF)	General directives
Inland Revenue Department (IRD)	
Director General	Subject to direction from HMG/N • right to exercise and delegate any power granted to the department Exclusive power which cannot be delegated • issue public circulars • prescribe documents • stay or otherwise affect a reviewable or an objection decision • compound an offence
Deputy Director Generals Chief Tax Administrators Directors Chief Tax Officers Officers as the Chief of a Tax Office	Subject to direction from HMG/N and DG • right to exercise any power other than the exclusive power of DG • right to delegate the power granted to them
Other Officers	• may exercise delegated power other than the exclusive power of the DG • cannot authorize power under *s83* or issue a notice under *s83* or *s109* • cannot delegate their power

218. The scheme above shows how the administrative power is structured, i.e. which administrative level is granted to execute what kind of power.

The execution of power is given to three administrative tiers, which are

(A) subject to direction from HMG/N, the level of the Director General,

with the right to exercise and delegate any power granted to the Department.

The Director General reports directly to the Ministry of Finance, which has the right to give the general directives that the tax administration needs to follow.

(B) subject to direction from HMG/N and the Director General, the level of the Deputy Director Generals, Chief Tax Administrators, Directors and Chief Tax Officers, as well as Officers as the Chief of a tax office.

with the right to exercise and delegate any power granted to the Department, other than to issue public circulars, prescribe documents, stay or otherwise affect a reviewable or an objection decision or compound an offence.

This level reports to the Director General and the Ministry of Finance.

(C) such other officers as my be necessary for the administration of this Act

with the right to exercise any power that has been delegated to them other than the above described power of the superior level *(s 72 (4) and (5))*.

This level reports to the executive level below the level of the DG, DG and the MoF.

Any application to the IRD or the Director General that a taxpayer is authorized to make may be made through the concerned IRO.

219. HMG/N may conclude a treaty or any other agreement with a foreign government aimed at avoiding double taxation and the prevention of fiscal evasion. Such an agreement can also provide reciprocal administrative assistance in the enforcement of tax liabilities *(clarification of s 73)*. In this case, the Nepalese tax liabilities of a tax debtor who is a resident of Nepal can be enforced on request of HMG/N by the respective authorities in the foreign country and, vice versa, HMG/N may on request assist a foreign tax administration in collecting their income tax in Nepal in the same manner as it collects domestic income tax *(s 73 (2), (3))*.

Taxpayer's Rights

220. A taxpayer shall meet his tax duties *(s 74 (1))*. A taxpayer shall enjoy the following rights *(s 74 (2))*:

- respectful treatment;
- tax related information as per the prevailing laws;
- presentation of evidence in his own favor to proof his tax matters;
- consultation of a lawyer or auditor for his defense;
- secrecy of his tax matters.

Public Circulars

221. The IRD may issue public circulars. They serve the purpose to achieve consistency in the administration of the income tax act and to provide guidance to the taxpayers as well as to the tax authorities, and contain the IRD's interpretation of the Act *(s 75 (1))*. They are binding on the IRD until revoked but are not binding on the taxpayers *(s 75 (3))*. Public circulars shall be made available to the public at offices of the IRD and at locations determined by the IRD *(s 75 (2))*.

Personal Rulings

222. If the taxpayer wants to propose or enter into a specific tax agreement and seeks after a predictable and reliable decision with respect to this tax case he can apply in writing to the IRD for a personal ruling. A personal ruling is a decision of the IRD setting out the IRD's position with regard to the question whether or not the income tax act is applicable with respect to an arrangement that the taxpayer intends to make or has entered into *(s 76 (1))*. The position is binding for the IRD if the taxpayer has disclosed all information including all aspects of the arrangement, and if the arrangement comes into effect as described in the application for the personal ruling *(s 76 (3))*.

223. The IRD shall issue the personal ruling within 90 days after it has received the taxpayer's application. If the IRD does not comply with that the taxpayer is treated as having received a ruling in his disfavor. The taxpayer then may object against the decision, i.e. against the lack of making a decision within the given period of time, with the IRD, or appeal to the revenue tribunal.

224. A personal ruling may not be issued if the tax matter involved is presently being dealt with before a court, or has already been decided by a court *(s 76 (2))*. A decision of a court always overrules a decision or an opinion of the IRD.

Permanent Account Number (PAN)

225. The IRD may issue a unique number (PAN) and require the taxpayer to show it in any return, statement or other document used for the purposes of the income tax act *(s 78 (2))*. A PAN is a non-descriptive number with nine digits that gives access to information about the taxpayer. The information has been collected in the taxpayer's application when the PAN was issued. A PAN is mandatory for taxpayers who intend to derive assessable income or intend to make payments from which income tax is required to be withheld. These taxpayers need to apply to their concerned IRO for a PAN before they derive income or make payments.

226. Other taxpayers who are not required to hold a permanent account number may apply for it on a voluntary basis. In each case of application the taxpayer shall be registered and provided with a PAN certificate in the form prescribed by the IRD. HMG/N may prescribe situations in which the taxpayer is required to show or quote the PAN *(s 78 (3))*.

227. If the taxpayer has received a PAN and the information recorded when the PAN was issued changes the taxpayer has to notify the concerned IRO of the changes within 15 days after the changes happened. The responsible IRO will then modify the PAN certificate accordingly.

Service and Defects of Official Documents

228. An official document under the income tax act is considered sufficiently served to the taxpayer if it is *(s 79 (1))*

- sent to his electronic mail address or transmitted through fax to him,
- handed over to the individual or, in case of an entity, a manager of the entity, or
- left or sent by regular post to the usual or last known place of abode, business, office or other address.

229. A document issued by the IRD or an IRO is adequately authenticated if the name or title of an authorized IRD officer is signed, encrypted, computer encoded, stamped or written on the document *(s 79 (2))*.

230. An official document is not treated as defective if its substance and effect is in conformity with the income tax act, and if the addressee is designated in the document according to common understanding *(s 80 (1))*. The IRD has the right to rectify defective documents if no dispute about the interpretation of the income tax act, or about facts involving a particular person are concerned *(s 80 (2))*.

3.2 Record Keeping and Information Collection

Maintenance of documents

231. Every taxpayer shall maintain in Nepal and in Nepali or English language documents as prescribed in detail by the IRD *(s 81 (1))* which

- are necessary to explain information to be provided in a return,
- enable an accurate determination of the tax payable, and
- substantiate deductions and outgoings.

If the documents are not in Nepali or English language the taxpayer should provide at his expense a Nepali translation by a legally recognized translator *(s 81 (3))*.

232. Usually the documents must be retained for a period of 5 years after the end of the income year to which they are relevant *(s 81 (2))*. The IRD may make exceptions from this rule.

Collection of Information

233. For the purpose of implementation of the income tax act through, for example, audit every officer of the IRD has comprehensive rights to access to information such as full and free access to any premises, places, documents or other assets situated in Nepal. Tax authorities may make extracts or copies of documents, or may seize the documents that may be relevant to determine the tax liability of the taxpayer *(s 82 (1))*. To exercise these powers the respective tax officer needs a written authorization from the empowered officer and has to produce this as a proof on request of the person who is present when the tax officer enters the premises *(s 82 (2))*. The owner, manager, or any other person on the premises or place are obliged to assist the tax authorities on request by an officer of the IRD *(s 82 (3))*.

234. The IRD may also serve a notice on a taxpayer or a third party to obtain any information as described in the notice as well as summon the taxpayer or third party for the purpose of being examined on oath *(s 83)*.

Official Secrecy

235. The broad obligations of a taxpayer and a third party to reveal information require the protection that this information is kept confidential. Therefore, every tax officer or any other related person shall regard and deal with all documents and information coming into his possession or knowledge as secret and shall not disclose except in cases explicitly allowed in the income tax act *(s 84)*. The failure in doing so is punished as an offence *(s 126 (1)).*

3.3 Payment of Tax

236. The provisions about the payments of tax bring together all rules regarding the payment of taxes. "Tax" in this sense must be understood in the broad context *(s 2 (n))*, which includes not only the income tax as such in its forms as, for example, installments, assessments or final payments but also
costs of charge and auction;
amounts from which income tax is to be withheld;
income tax liabilities of a third party;
recovery tax;
amounts payable by way of interest and penalties;
amounts payable by way of compounding fines.

237. The place where the taxpayer has to make the payment is shown and prescribed in the respective notice if the IRO has served the taxpayer with such a notice. If the taxpayer has not received a notice from the tax authorities payments are to be made at any bank empowered to conduct government transactions, or at the concerned IRO.

238. Permitted methods of payments are, if the payment is made to the IRO, cash payments not exceeding the limit prescribed by the IRO, or payments by bank cheque or by bank draft. Payments to a bank are permitted to be made in cash or through bank cheque or through bank draft.

239. Income tax is payable at the following times:

(A) in case of tax payable by a withholding agent

within 15 days after the end of each month *(s 85 (2)(a), 90 (4))*.

(B) in case of tax payable by installments the tax is due to be paid in three parts

by the end of Poush 40 % of the estimated annual tax payable

by the end of Chaitra 70 % of the estimated annual tax payable

by the end of Ashad 100 % of the estimated annual tax payable *(s 85 (2)(b), 94 (1))*.

in cases of tax payable on *assessment (s 99)*

— if the taxpayer files or fails to file a return

on the date by which the return of income must be filed *(s 85 (2)(c)(1)),*

— if the IRD makes a jeopardy assessment *(s 100 (2), 102))*

on the date specified in the notice of assessment served on the taxpayer

(s 85 (2)(c)(2))

— if the IRD amends an assessment *(s 101, 102)*

on the date specified in the notice of the amendment served on the taxpayer *(s 85 (2)(c)(3),))*.

(C) in cases where the IRD

— requires a tax debtor to pay costs of charge and sale of an asset *(s 104 (8))*,

— claims tax from a third party owing money to the tax debtor *(s 109 (1)),* or

— requires an agent of a non-resident tax debtor to pay tax on behalf of the tax debtor *(s 110 (1))*

on the date set out in the respective notice *(s 85 (2) (d))*.

(D) in cases where officers of an entity are liable to pay tax because the entity fails to pay tax *(s 107 (2))*

at the same time as the tax is payable by the entity *(s 85 (2)(e))*.

(E) in cases where the IRD requires a receiver to pay tax debts *(s 108 (3), (4))*

7 days after the sale from which the receiver had to set aside the due amount of tax *(s 85 (2)(f))*.

(F) with respect to assessed interests and penalties *(s 122)*

on the date specified in the notice of assessment *(s 85 (2)(g))*.

3.4 Withholding

240. Where the income tax act requires tax to be withheld, a withholding agent (withholder), who makes a certain payment as described as withholding payment in the income tax act to another person, has to calculate the income tax for this specific payment, deduct it from the payment to the other person and transfer the income tax to the tax authorities. Both, the withholding agent, who needs to hold back the income tax *(s 2 (a))*, and the withholdee, who receives or is entitled to receive a payment, from which income tax is required to be withheld *(s 2 (o))*, can be individuals or entities.

241. Every withholding agent shall file with the IRD within 15 days after each month a statement specifying

- the payments made to the withholdee from which income tax is required to be withheld,
- name, address and, if the withholdee holds one, the withholdee's permanent account section (PAN), and
- the tax that has been withheld from each payment *(s 90 (1))*.

242. At the same time of filing the monthly withholding statement and calculating the tax to be withheld the withholding agent has to pay the withheld income tax *(s 90 (2))*. If the withholding agent fails to withhold and does not make the payment to the tax administration as required the withholdee and withholding agent both will jointly and severely liable for the payment of the amount that should have been withheld *(s 90 (5))*. The withholdee is in this case obliged to pay the tax within a period of 15 days after the expiry of the time limit that the withholding agent had to file a withholding statement and make the payment *(s 90 (4))*.

243. Every withholding agent shall prepare and serve on each withholdee a withholding certificate in the form as prescribed by the IRD *(s 91(1)(a))*. In the withholding certificate the amount of payments made and the tax withheld needs to be stated *(s 91 (1)(b))*. The withholding certificate shall be delivered within 15 days after the end of the month for which tax has been withheld *(s 91 (2))*.

244. The cases and the rates of tax to be withheld are specified in the diagram on the next page. From there one can see that no flat tax rate is mentioned for income tax that an employer is required to withhold on behalf of his employees. In these withholding cases a resident employer is required to withhold tax from a payment to his employee at the rate as specified in schedule 1 of the income tax act. This means, that the employer has to calculate the income for each employee as if he were the respective employee. The employer has to include in the income tax calculation of his employee all payments to the employee as described in the chapter income from employment in this handbook. Deductions from the income are not allowed because the income in question is income from employment. The applicable tax rate depends on the amounts of payments and whether tax is calculated for an individual or for a couple. The tax payable may be reduced by a medical tax credit that the respective employee is entitled to claim. After the employer has completed this tax calculation he has to withhold the calculated tax and pay it to the tax administration.

245. Where the payments to an employee can be fixed for an income year, the monthly amounts to be withheld may be determined by calculating the payable tax for the entire income year and dividing the amount by twelve. In this case the tax shall be withheld monthly.

246. The withholding tax can be of final or not final nature. If the withholding tax is of final nature *(refer to the cases in s 92)* no additional calculation or determination of

income tax with regard to the received payment needs to be done from the taxpayer, i.e. the withholdee, on whose behalf the income tax has been withheld.

247. If the withholding tax is not final the withholdee is entitled to a tax credit equal to the withheld tax *(s 93)*. This tax credit is claimed by the withholdee through filing annex-10 of income tax return. The taxable income then includes the payments that the withholdee has received from the withholding agent. The tax payable at the end will be reduced by the income tax that the withholding agent has withheld for this specific payment.

248. As one can see from the diagram below payments where the withholding tax is final are usually those made to a recipient, i.e. a withholdee, in a non-business context. This means that recipient receives the payment as a private person not conducting a business. In this case he is not necessarily required to file an income tax return. This justifies the income tax to be final. By contrast, a withholdee with a business activity usually has to file an income tax return and can in this context claim the tax withheld on his behalf as a tax credit. This is the reason why in such cases the withheld income tax does not need to be of final nature.

Figure 24

Withholding *s87-s89 and s92*

Legal Source	Withholding Agent	Withholding Payments	Withholding Rate	Final
s 87 (1)	employers	income from employment	normal rate for individuals	No
s 88 (1)	resident person	natural resource payments; royalties; service fees	15%	No
s 88(2), s 92(1) (a)	resident company	dividends	5%	Yes
s 88 (1), s 8 (4) (b)	resident persons, mainly banks or financial institutions	interest in general, but not if paid to a resident bank or other financial institution	15%	No
s 88 (3), s 92(1) (e)	resident persons, mainly banks or financial institutions	interest paid to an individual not related with business	6%	Yes
s 88 (1)	resident person	rent in general	15%	No
s 88 (4)(a), s 92 (1)(b)	resident persons	rent for the lease of land or a building and associated fittings and fixtures and the rent is received by an individual other than in relation with business	15%	Yes
s 88 (1), 92 (1)(g)	approved retirement funds, HMG/N	gain from lump sump retirement payments	6%	Yes
s 88 (2), s 92(1)(c) and (d)	unapproved retirement funds; investment insurances	gains from investment insurance and unapproved retirement interests	10%	Yes
s 89	resident persons	Insurance premium paid for general insurance, including contract payments exceeding 50.000 Rs. not covered above	1.5%	No
s 92 (1)(f)	any of the above mentioned withholding agents	any of the above mentioned cases, but payments are made to a non-resident person	any rate like above	Yes

3.5 Installments

249. Taxpayers who derive or expect to derive any assessable income from a business or investment shall pay tax for the year by three installments *(s 94 (1))*. Therefore, they are called installment payers. Taxpayers with income solely from employment are not obliged to pay tax in installments because their tax from employment income is collected by withholding. Similarly, presumptive taxpayers are also not obliged to pay tax in installments. Payment of tax by installments is fundamentally different from payment of tax by withholding. Withholding requires a person's tax to be paid by a third party, whereas under an installment system the person pays his or her own tax.

250. The installments have to be paid as follows

(A) 40 % of the tax as estimated for the current income year

less paid tax, i.e. less amounts that have already been paid

by the end of the month Poush

(B) 70 % of the tax as estimated for the current income year

less paid tax, i.e. less amounts that have already been paid

by the end of the month Chaitra

This means, if the taxpayer has already paid the first installment amounting to 40 % of the estimated annual income tax and has no other tax credits that he can additionally deduct from his second installment, the payment of the second installments amounts to (70 % minus 40 % equal to) 30 % of the estimated tax for the current income year.

(C) 100 % of the tax as estimated for the current income year

less paid tax, i.e. less amounts that have already been paid by the end of the month Ashad

This means, if the taxpayer has already paid the first installment amounting to 40 % and the second installment amounting to 30 % of the estimated annual income tax as calculated above and he has no credits to be deducted from his second installment the installment the installment remaining to be paid amounts to (100 % minus 40 % minus 30 % equal to) 30 %.

251. Where the amount of an installment calculated as above is less than 2000 Rs., the installment is not required to be paid *(s 94 (3))*. If at the end of the year a final tax liability remains to be paid, as, for example, a result of the income tax return filed at the end of the year the income tax paid by installments is credited against this liability.

252. The calculation for each installment starts with the annual tax that the taxpayer has based on an estimation determined as his tax debts for the whole income year ahead. The installments are adjusted during the year, e.g. for changes in circumstances, in an attempt to ensure that the amount of tax paid by installments by the end of the year is reasonably sufficient to meet the taxpayer's full tax liability for the year. Therefore, the taxpayer may deduct from each installment paid tax, which means payments prior to the date for the payment of the respective installment. These payments are

- excess payment of previous year.
- tax paid during the running income year by prior installments.

- tax withheld (paid to the IRO) from payments that are not final withholding payments and are included in the estimated income.
- tax this is treated as withheld and paid to the IRO from payments that are not final withholding payments and are included in the estimated income.
- a medical tax credit that may be claimed for approved medical costs that the taxpayer has paid prior to the due date for payment of the installment.

253. Every installment payer has to submit for the income year ahead an estimate of his tax payable. For that the estimated tax returns are to be utilized. The submission is due to be made by the date for payment of the first installment, i.e. it shall be filed together with the first installment *(s 95 (1))*. Since the first estimate has to be submitted after the income year is half over the estimate should include the actual taxpayer's facts of the first half of the income year so that there is some thorough basis for the estimation of the possible profit of the second half of the income year. In this estimate the following amounts are to be specified

- the assessable income to be derived for the income year from employment, business, and investment *(s 95 (1)(a))*,
- the source of this income *(s 95 (1)(a))*,
- the taxable income to be derived for the income year *(s 95(1)(b))*, and
- the tax to become payable calculated without reduction for any medical tax credit *(s 95(1)(b))*

Foreign permanent establishments of non-resident persons situated in Nepal need to refer to their repatriated income and the tax on that income *(s 95 (1)(c))*.

254. Such an installment payer's estimate shall remain in force unless it is revised.*(s 95 (4))*. This can result in the consequence that all installments are based on an estimate that has not been corrected during the year although the circumstances of the estimate have changed over the time. For example, the taxpayer estimated a profit as the basis for his calculation of income tax that proved to be too low as he could see some months later. If the taxpayer would in such case not adjust his estimation of income and tax he would have to pay a final tax liability considerably exceeding the amounts of his installments paid would arise. This could result in a heavy interest. In order to avoid such a situation a taxpayer is well advised to scrutinize on the due dates for the payments of his second and third installment whether his first estimate is still valid or needs to be adjusted by, for example, taking into account an economic development that turned out to be more positive than originally anticipated.

255. The tax administration is provided with the power to exempt a person or class of persons from providing an estimate, e.g. small taxpayers. The tax administration is also given the power to override an actual estimate of a taxpayer. This means that in cases where

- an installment payer fails to file an estimate, or
- the tax authorities are not satisfied with the estimate or the revised estimate *(s 95 (7))*

the IRD may make its own estimate which may be based on tax payable for the previous income year *(s 95 (7))*. The taxpayer then shall be served with a notice mentioning the reasons for the difference *(s 95 (8))*.

3.6 Returns of Income

256. In addition to the estimate (during) an income year every taxpayer has to file a return of income not later than 3 months after the end of each income year *(s 96 (1))*. By contrast to the estimate, this final return is based on the tax facts of the previous year so that possible misjudgments or wrong estimates are then corrected. Therefore, the taxpayer has, first, to submit an estimate for the year ahead. Second, as explained above he should scrutinize and adjust this estimate on the occasion of the payments of the second and third installment. Third, at the end of the income year he has to file a tax return based upon the facts of the previous year. That leads to an adjustment of the estimates and to a final tax liability. For the income tax return the respective forms provided by the tax authorities are to be utilized. The income tax return needs to be signed by the taxpayer or the manager. Furthermore, to be included is a statement that the return is complete, true and accurate *(s 96 (2)(b))*.

257. Upon the taxpayer's written request the tax authorities may extend the date by which a return is to be filed *(s 98)*.
258. Unless explicitly requested by the tax authorities, no returns are required from taxpayers who

- have no tax payable for the year *(s 97 (a))*.
- derive solely final withholding payments, i.e. income from which income tax is finally withheld *(s 97 (b))*.
- are resident individuals
    - with income exclusively from employment having a source in Nepal,
    - having only one resident employer at a time during the year, and
    - who do not claim a deduction of their taxable income by gifts to exempt organizations or a reduction of their tax payable by a medical tax credit, other than paid by the employer *(s 97 (c), 4 (3)).*

259. Income tax return forms and the instruction manual to fill the forms could be obtained from the concern IROs. These documents are also available in the IRO website **www.ird.gov.np**, from where any one can download it.

3.7 Assessments

260. Income tax payable by withholding and installment is only a preliminary tax liability (unless the withholding is final). At the end of the year an overall appraisal of the taxpayer's income tax liability for the income year with appropriate accounting for any tax paid by withholding or installment is made. This requires a filing of a return of income with the tax administration and the assessment of that return. However, this is a deemed assessment that is only relevant for the purpose of triggering the availability of administrative review. This means, the income tax act generally adopts a self-assessment system. The deeming provision is offset by the power of the tax administration to amend assessments. Where the tax administration makes use of this powers to amend an assessment, the taxpayer in question must be served with a notice of assessment.

261. The types of assessment provided for in the income tax act are shown in the diagram below.

Figure 25

Assessment	
General Rule s99	• Filing of returns is treated as assessment with regard to the tax calculated by the taxpayer • In case of non-filing an assessment is treated as made with regard to - tax withheld - instalments paid • Notice of assessment not required
Amended Assessment s101	• Possible at any time within 4 years unless suspicion of fraud on basis of best judgement • Notice of assessment required
Jeopardy Assessment s100	• In the following cases - bankruptcy, winding-up, liquidiation - indefinite absence from Nepal - ceasing activities in Nepal - if considered appropriate by the Department • Notice of assessment required (if assessment made by an IRO)

262. Where an income tax return is filed an assessment of the tax payable and still to be paid is treated as made based upon the amounts shown in the return *(s 99 (1))*, i.e. based on the taxpayer's statement. Where a taxpayer fails to file a return an assessment is treated as made stating that the amount of tax payable is equal to the sum of any tax withheld from payments derived by the taxpayer and any the tax paid by the taxpayer by installment. In this case no tax is payable on the assessment *(s 99 (2))*.

263. In cases of <u>tax jeopardy</u>, i.e. in circumstances where there is concern for securing that the payment of tax will be made, such as if the taxpayer
becomes bankrupt, is wound up, or goes into liquidation
is about to leave Nepal
is otherwise about to cease its activities in Nepal

the tax authorities may require the taxpayer to file an early return of income prior to the regular date of filing a return (*s 96 (5))* or, instead, may make an assessment according to the tax administration's best judgment for any time of the year *(s 100)*. The time at which tax must be paid under a jeopardy assessment is at the discretion of the tax administration. If the jeopardy assessment refers to a part of an income year the taxpayer is still required to file a return of income for the year *(s 100 (3)(b))*. If the jeopardy assessment is made for a full income year the assessed person shall not file a return of income *(s 100 (3)(a))*.

264. The tax administration has the broad power to amend assessments. This power extends to self-assessments, jeopardy assessments, as well as assessments amended under a previous use of the power of amendment, i.e. it allows also re-amendments. The tax administration may amend an assessment in a manner that is consistent with the intention of the income tax act and using its best judgment *(s 101 (1))*. The power to make an amended assessment is restricted to a time period of 4 years *(s 101 (3))*. The time restriction is not relevant if the reason for the amendment is fraud. In this case the assessment is required to be made within a period of 1 year after the information that the return has been filled out or the assessment has been made be fraud was noticed*(s 101 (4))*. The amendment is excluded with respect to issues that have been decided by order of the Revenue Tribunal or a court of competent jurisdiction In cases where an assessment has been amended or reduced following a decision of a court the tax administration is not allowed to make another amendment to that extent.*(s 101 (5))*.

265. Where the tax administration makes a jeopardy or amended assessment it shall serve a written notice on the taxpayer that includes *(s 102)*

- the tax payable or still to be paid,
- the period of time to which the assessment relates,
- the calculation of tax payable or still to be paid,
- the date at which the tax must be paid, and
- the time, place, and manner of objecting to the assessment

3.8 Collection of Tax, Remission and Refund

266. This chapter contains detailed provisions with regard to securities for withholding tax, charges over assets, auctions of charged assets, departure prohibition order, liabilities of officers of entities, recovery procedures, remissions, and refunds.

267. Tax required to be withheld by a withholding agent is not subject to an attachment in respect of a debt or liability of the agent and has priority with respect to other debts or liabilities of the withholding agent including in the events of liquidation or bankruptcy. The withholding tax does not form a part of the estate in liquidation or bankruptcy and the tax administration has a first claim over the tax before any distribution in liquidation or bankruptcy is made *(s 103 (2))*.

268. The tax administration may in favor of HMG/N cause a charge over the assets of a tax debtor and notify a tax debtor of its intention to sell charged assets held by the debtor. The respective procedures are described in detail following international practices *(s 104, 105)*.

269. Where a taxpayer fails to pay tax on or before the date when the tax is payable the tax administration may serve a departure prohibition order on the Immigration Office to prevent the taxpayer from leaving Nepal for 72 hours *(s 106)*.

270. The income tax act holds officers, i.e. a manager of the entity or a person purporting to act in that capacity, responsible for the fulfillment of the entity's tax duties *(s 107 (1))*. Where an entity commits an offence every such officer of the entity is treated as also committing the same offence. An officer who has not exercised the appropriate care *(s 107 (3))* is in principle jointly and severally liable with the entity for any tax, which the entity failed to pay *(s 107)*. This also refers to officers who were in power 6 months prior to the date when this failure took place.

271. For the purpose of recovery of income tax a receiver, i.e. a person who is appointed to act on behalf of a taxpayer (such as a liquidator or trustee in bankruptcy, a mortgagee in possession, an executor of a deceased individual's estate or a representative of a incapacitated person *(clarification of s 108*), has to notify the IRD within 15 days of being appointed or of taking possession of an asset. If the IRD holds him responsible for any tax of a tax debtor he is required to sell sufficient of the assets under his possession to set aside the due tax amount which he then is liable to pay (*s 108 (3)*).

272. Income tax may also be recovered from third parties owing money to the tax debtor. Upon written notice of the IRD, any person who owes money to or holds money for a tax debtor is obliged to pay the owed and held amounts of money to the tax administration on account and to the extent of the tax that is payable by the debtor *(s 109)*. The IRD may also recover tax arrears from an agent of a non-resident tax debtor *(s 110)*.

273. Tax may be remitted by HMG/N if the IRD certifies that it cannot be effectively collected *(s 112)*. Tax that has been paid in excess of the liability is credited against any tax payable, and the remainder shall be refunded *(s 113 (1)*). Refunds may be applied for and granted only within 2 years after the payment of the excess, or after the event occurred that led to the payment of the excess, or after a litigation was settled (*s 113 (4)*). In case of a refund interest at the standard interest rate need to be paid *(s 113 (6))*.

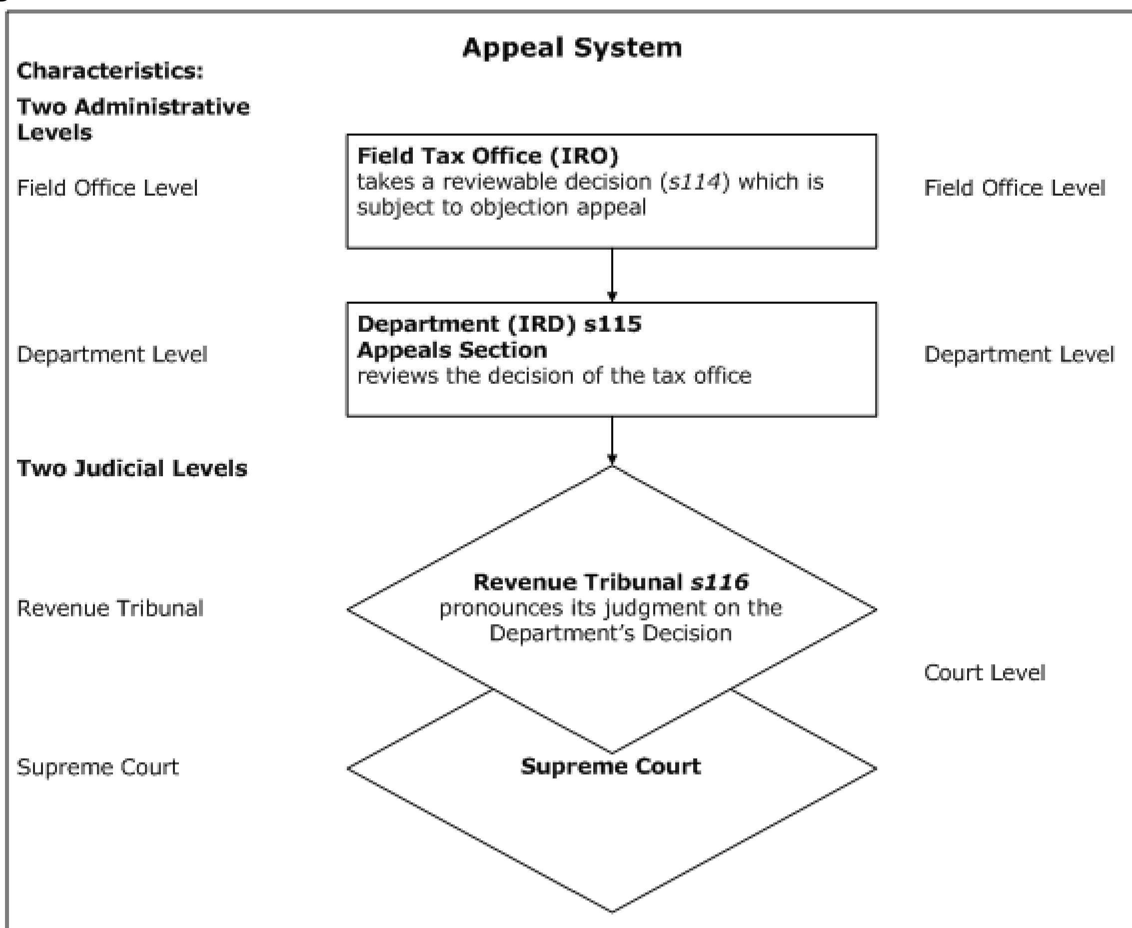
3.9 Reviewable Decisions

274. The income tax lists the reviewable decisions exclusively as follows *(s 114)*:

- personal rulings (Decision made by the officer, other than Director General);
- IRO decision to make an amended estimate of tax payable;
- IRO decision regarding requirements to file an income return;
- IRO decision regarding extensions of time to file an income return;
- amended or jeopardy assessments of income tax;
- assessments of interest and charge;
- IRO decision regarding the recovery expenses,
- notifications of amounts to be set aside by a receiver;
- payment orders to third parties owing money to the tax debtor;
- orders to third parties to pay tax on behalf of a non-resident person;
- decisions about refund applications;
- decisions on applications for time extension to file an objection.

275. The scheme below shows the appeal system under the income tax act.

Figure 26



276. A taxpayer who is aggrieved by a reviewable decision of an IRO may file an objection with the IRD within 30 days after the decision has been made *(s 115 (1))*. The objection must be in writing and specify in detail the grounds upon which it is made *(s 115 (2))*. The IRD may extend this time limit for another 30 days *(s 115 (3))*. For that the taxpayer needs to apply not later than 7 days after expiry of the first 30 days limit

277. If the IRD fails to serve a taxpayer with a notice of an objection decision within 90 days after the objection has been filed the taxpayer may elect to treat the IRD as having refused his objection and then appeal directly to the Revenue Tribunal. In this case the taxpayer must file a respective notice with the IRD *(s 115 (8))*.

278. If the taxpayer is burdened by the IRD's decision about his objection he may appeal to the Revenue Tribunal *(s 116 (1))*. In this case he needs to, within 5 days of doing so, inform the IRD through a copy of the notice of appeal *(s 116 (2))*.

279. It is mandatory to deposit 50% of the disputed amount before filing application for administrative review.

3.10 Charges and Interests

280. Charges are imposed on the taxpayer as explained in the table below. The left column describes the failure that the taxpayer is responsible for. The right column shows the charge that he is obliged to pay as a penalty for this failure.

Figure 27

Failure	Charges
• No maintenance of documentation • No filing of statements or returns (*s117*)	0.1% pa of all amounts to be included or 1,000rs per year, whichever is the higher
No filing of a statement as a withholding agent (*s117(3)*)	1.5% pa of the tax to be withheld
False or misleading statement or omission from a correct statement (*s120*) • without reasonable excuse • knowingly or recklessly	 50% of the underpayment 100% of the underpayment
Aiding or abetting (incl. Counselling or inducing) an offence (*s121*)	100% of the underpayment

281. For certain failures the taxpayer is punished with the payment of interests as illustrated below.

Figure 28

Failure	Interest
Understating estimated tax payable by installments *(s 118)*	Standard interest rate (15 % p.a.) of the understated tax per annum.
No tax paid on the due date *(s 119)*	Standard interest rate (15 % p.a.) of the outstanding tax per annum.

282. Interests and charges are imposed where and because the taxpayer has violated his civil duties under the income tax act. The imposition of interests serve the purpose to skim off economic advantages resulting from the violation of the duties, whereas the misbehavior itself will be reprimanded through charges.

283. Interests at the standard interest rate apply if an installment payers estimate of tax payable is less than 80 % of the correct amount *(s 118)* and where a taxpayer fails to pay tax *(s 119)*.

284. charges for making false of misleading statements are imposed which amount equal to 50 % or 100 % of the underpayment of tax where the statement or omission is made without reasonable excuse or knowingly or recklessly, respectively *(s 120)*. In case a taxpayer knowingly or recklessly aids, abets, counsels or induces another person to commit an offence charge applies equal to 100 % of the underpayment of tax, which may have resulted from the offence *(s 121)*.

285. Interests and charges need to be assessed by the IRD which shall serve a written notice on the taxpayer *(s 122)*.

Offences

286. Offences are dealt with in the income tax act in a sense of criminal offences of taxpayers as well as tax administrators. They lead to punishment in the form of fines and imprisonment on conviction.

Figure 29

Offence	Punishment		
	Fine	**Imprisonment**	**Both**
General Rule:			
Failure to comply with the Income Tax Act (*s128*)	Between Rs 5,000 and Rs 30,000		No
Special Provisions re: Tax Compliance			
Failure to pay tax (*s123*)	Between Rs 5,000 and Rs 30,000	Up to 3 months	Yes
Making false or misleading statements (*s124*)	Between Rs 40,000 and Rs 160,000	Between 6 months and 2 years	Yes
Impeding the tax administration (*s125*)	Between Rs 5,000 and Rs 20,000	Between 1 month and 3 months	Yes

287. The income tax act covers the following cases:

Figure 30

Offence	Punishment		
Special Provisions re:Personal Conduct	**Fine**	**Imprisonment**	**Both**
Unauthorized persons collecting or attempting to collect tax (*s126(1)*)	Between Rs 80,000 and Rs 240,000	Between 1 year and 3 years	Yes
Breaching the rule of Official Secrecy (*s126(2))*)	Up to Rs 80,000	Up to 1 year	Yes
Aiding and abetting	Half the penalty imposed on the main offender		Yes

288. Where any person, except in cases of offences by authorized or unauthorized persons and breaching the rule of secrecy, admits an offence in writing the IRD may compound the offence and order the person to pay a sum of money as specified by the IRD but not exceeding the fines prescribed for the offence. The order is final and not subject to any appeal *(s 129)*.

289. District court is empowered to make decision on fine and imprisonment for the offences.

3.11 Transitional

290. The income tax act closes with a chapter mentioning the repealed legislation and fundamental transitional measures which may be supplemented by the Rules *(s 143)*.

291. The income tax act contains two schedules dealing with tax rates *(schedule - 1)* and details on how to calculate depreciations *(schedule - 2)*.

ANNEX-1

Classification of geographical areas prescribed by HMG/N for the purpose of remote area allowance:

1. Areas falling in Category-"A"

(a) Manang District

(b) Kalikot District

(c) Mugu District

(d) Dolpa District

(e) Humla District

(f) Bajura District

2. Areas falling in Category-"B"

(a) Dhunsa , Olangchung Gola and its Village Development Committees of Taplejung District

(b) The following Village Development Committees of Sankhuwa Shabha District:

1. Chepuwa
2. Hedangna
3. Kimathanka
4. Yaksila
5. Valung
6. Simajor

(c) The following Village Development Committees of Solukhumbu District:

1. Khumjung
2. Namche
3. Chaurikharka

(d) Gogar Village Development Committee of Dolakha District.

(e) Timur Village Development Committee of Rasuwa District:

(f) The following Village Development Committees of Gorkha District:

1. Sirdibas
2. Prok
3. Loha
4. Keroja
5. Chhekampar
6. Manbu

(g) The following Village Development Committees of Baglung District:

1. Bodang
2. Nisi
3. Hukam
4. Ranma
5. Maikot
6. Takbachhi

(h) Mustang District

(i) Jumla District

(j) Bajhang District

(k) Area of Khaptad Jadibuti Udyan of Doti District above the altitude of 900 feet.

(l) Darchula District

3. Areas falling in Category-"C"

(a) Rukum District

(b) Jajarkot District

(c) Dailekh District

(d) Achham District

4. Areas falling in Category-"D"

(a) Village District Committees of Taplejung District other than those falling in category-"B"

(e) Bhojpur District

(b) Terhathum District

(c) Village District Committees of Sankhuwa Shabha District other than those falling in category-"B"

(d) Khotang District

(e) Okhaldhunga District

(f) Village District Committees of Solukhumbu District other than those falling in category-"B"

(g) The following Village Development Committees of Dhading District:

1. Budathum
2. Lapa
3. Phulkharka
4. Rigaun
5. Salyankot
6. Salyantar

(h) The following Village Development Committees of Sindhupalchok District:

1. Baramcho
2. Baruwa
3. Mautada
4. Biratf Golade
5. Gunsa
6. Guwa
7. Kiul
8. Listikot
9. Mahangkal
10. Pang Tang
11. Phulping Katti
12. Dhagpalkot
13. Timulthagal Tinas Dhyagal

(i) The following Village Development Committees of Lamjung District:

1. Bahundada Mahendrodaya
2. Shree Kali Katadhi
3. Thuli Besi Patangi
4. Thakan Phalikadevi

(j) Myagdi District

(k) Rolpa District

(l) Salyan District

(m) Pyuthan District

(n) Village District Committees of Doti District other than those falling in category-"B"

(o) Dadeldhura District

(p) Baitadi District

5. Areas falling in Category-"E"

(a) Panchthar District

(b) Dhankuta District

(c) Ramechhap District

(d) Dolakha District

(e) Village District Committees of Rasuwa District other than those falling in category-"B"

(f) Village District Committees of Dhankuta District other than those falling in category-"D"

(g) Village District Committees of Dhading District other than those falling in category-"D"

(h) Village District Committees of Lamjung District other than those falling in category-"D"

(i) Village District Committees of Gorkha District other than those falling in category-"B"

(j) Gulmi District

(k) Arghakhanchi District

(l) Parbat District

(m) Village District Committees of Baglung District other than those falling in category-"B"