Crowe

Crowe Transfer Pricing Wednesday

Transfer Pricing in Nepal

20 September 2023

Briefing on the Transfer Pricing (“TP”) Regulations

From an overall historical perspective, TP regulations in terms of dealing with transactions in accordance with the arm’s length principle were introduced when the New Income Tax Act, 2058 (2002) (“the Act”) was adopted by the Government of Nepal effective 1st April 2002. Nepal became a member of the World Trade Organization (WTO) in 2004 and thereafter, there have been drastic changes with the inflow of Foreign Direct Investment and entry of foreign company in Nepal.

Transfer pricing refers to the setting of prices for transactions between **“associated persons”**, involving the transfer of assets or services. Associated persons typically represent the integral components of a multinational group such as companies under the same management. These transactions are also referred to as controlled transactions, as distinct from uncontrolled transactions between companies that are not associated and can be assumed to operate independently (on an arm’s length basis) in setting terms for such transactions.

Section 33 of the Act contains provisions related to transfer pricing and other arrangements between associated persons. According to the Act, in any arrangement between associated persons, Inland Revenue Department (IRD) may, by notification in writing, distribute, apportion or allocate the amounts to be included or deducted in the income between the persons as to reflect their taxable income or tax liability when the arrangements are operated by them according to general market practices (at arm’s length). The IRD may, in the process of the notification:

1. Re characterize the source and type of any income, loss and amount of payment; or
2. Allocate costs, including the head office expenses, incurred by one person in conducting a business that benefits an associate or associates in conducting their businesses based on the comparative turnover of the businesses.

‘Associated persons’ means two or more persons or group of such persons where one may reasonably be expected to act in accordance with the intentions of the other associated persons.

As per the Rule 15 of Income Tax Rules, 2002, where one or more persons make an application in writing for the clarification in respect of distribution, apportionment or allocation of the amounts to be included or deducted according to general market practices (at arm’s length) where transfer pricing between associates is necessary, IRD may issue a written notification as follows:

1. The term of the written notice shall not exceed five years at a time; and
2. The written notice may be renewed every, five years.

The written notice is a compulsion to both the taxpayer and the tax authority. However, it may be made inoperative if the IRD agrees with the written notice for the same by the taxpayer.

The provision in the Act does not go further in suggesting how the arm’s length principle may be met in specific cases. This is complex and has not been appropriately dealt with by separate regulations or practice notes.

Documentation Requirements

Although there is no filing requirement or requirement to prepare a detailed Transfer Pricing Study Report in Nepal, companies involved in controlled transactions are advisable to maintain adequate documents to justify the arm’s length nature of the transactions with the associated person(s) making reference to the OECD principle. In the context of business transactions involving cross-border dealings among associated enterprises by foreign companies in Nepal, the tax authority has limited tax provisions and practices to identify transfer pricing issues within the country.

© 2023 Crowe Nepal

Country-by-Country Reporting (CbCR) Requirements

There is no such requirement in Nepal. However, multinational companies are advised to follow the OECD guidelines in this respect.

Disclosure in Annual Tax Filing

There is no such disclosure requirement in the prevailing tax laws in Nepal.

Controlled Foreign Company - CFC Reporting Requirements

There is no CFC reporting requirement in Nepal.

Thin Capitalization

Thin capitalization in taxation refers to a situation where an entity has relatively low capital but relies heavily on loan funds. In such cases, non-resident owners can derive higher returns through interest payments, which are subject to lower tax rates due to final withholding tax behavior, and the liquidation risk is shouldered by parties other than the owner.

If interest is paid by Exempt Controlled Entity* to its non-resident owner, such interest is not fully allowed to be deducted from the taxabe income. Interest expenses to the extent of 50% of the adjusted taxable income (ATI) without considering any interest elements shall only be allowed to be deducted in an income year, remaining interest, if any, shall be allowed to be carried forward to the next year.

**Exempted Controlled Entity – refers to a resident entity in a business or investment controlled 25% or more by any or all of the following in any day of an income year:*

- *Exempted Entity or its associates*
- *Persons having tax concession u/s 11 or its associates*
- *Non-resident or its associates*

Latest Updates in Tax Laws

There have been no changes or amendments to the transfer pricing regime in Nepal in recent years since its imposition in 2002.

Contacts Crowe Nepal

Pramod Kumar Swarnkar
Partner
Cell: +977 98510 47470
pramod.swarnkar@crowe.com.np

© 2023 Crowe Nepal