TAXATION SYSTEM IN NEPAL

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13.1 Tax Law

Terminologies

Accounting Profit: It is net profit or loss for a period before deducting tax expense.

Taxable Profit (tax loss): It is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

Tax Expense (tax income): It is the aggregate amount included in the determination of net profit or loss for the period in respect of current tax and deferred tax.

Current Tax: It is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

Deferred Tax Liabilities: They are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

Deferred Tax Assets: They are the amounts of income taxes recoverable in future periods in respect of:

a. Deductible temporary differences.
b. The carry forward of unused tax losses; and
c. The carry forward of unused tax credits.

Tax Base

The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

13.2 Depreciation Rate

Depreciation:

- Depreciation of depreciable assets owned and used by taxpayer during the year in the production of the taxpayer's income (business or investment) is deductible from taxable income.
- Depreciation can be charged only in Diminishing Balance Method value of pool of assets basis.
- One third additional rate of depreciation can be charged for manufacturing industry, export business and public infrastructure entities.

Reasons of Depreciation

- To replace old assets.
- To find net profit or loss.
- To find net taxable income.
- To find actual costing price of any product.
- To keep capital safe.

Table13.1: Classification and Rates of Depreciable Assets.

Class	Assets	Rates/Year
A	Building structure & similar work of permanent nature.	5%
B	Computer data handling equipment, fixture, office furniture and office equipment.	25%
C	Automobiles, minibus & buses and other transportation assets.	20%
D	Construction and earth moving equipment and depreciable assets not included in other class.	15%
E	Intangible assets others than class D.	$\frac{\text{Cost Price} - \text{Salvage value}}{\text{Useful life}}$

Table 13.2: Classification of House.

Classification	House
A	Raw bricks with mud mortar or made of wood.
B	Fine bricks/stone with mud mortar.
C	Fine bricks/ stones with cement mortar.
D	RCC frame structure.

Depreciation of houses can be subtracted. But its rate and years for respected houses are limited by the act, which is as under:

House Class	Average/ sq ft	Depreciation Rate (%)/Year	Useful Life (Year)
A	450	3	25
B	525	2	30
C	575	1	70
D	635	0.75	100

Loss Recovery

- Business loss can be carried forward up to 7 succeeding years from any source of income.
- Investment losses can be forwarded up to 7 succeeding years from any investment income.
- Infrastructure development project and petroleum business can forward losses up to 12 succeeding years.
- In case of long term contract, loss can be carried back as per the notice of the Internal Revenue Department.

13.3 Recaptured Depreciation

- When depreciable asset in business is sold in an amount which is greater than the estimated book value but less than original cost, it is known as recaptured depreciation.
- It is also known as ordinary gain.
  Recaptured depreciation= Selling price - Book value
  Book value= Cost price- Depreciation
  Total gain= Capital gain + Recaptured Depreciation

13.4 Taxes

- Entity having annual turnover up to Rs 50 Lacs and annual income up to Rs. 2 Lacs:
  - In the Metropolitan or Sub Metropolitan Cities Rs. 5,000.
  - In the Municipalities Rs. 2,500.
  - In the rest of Nepal Rs. 1,500.

- Entity having turnover of Rs.50 Lacs or more is required to get registered with Value Added Tax Office and 13% VAT shall be applicable to it.

Normal Gain

- It is the profit earned in the ordinary course of business.
- The excess of revenue receipts over expenditure is called normal gain.
- It may be also called net profit.
- The gains or profit are taxable income as per tax act.

Capital Gain

- The profit earned or gained by a company by selling its fixed capital assets or in connection with raising capital for the firm is known as capital gain.
- Acquisition costs and related expenses are deductible when calculating taxable capital gains.
- Capital gains realized from selling real property that are used in business are considered ordinary income and taxed at the standard income tax rate.
- The capital gain/loss is expressed as:

  Capital gain/loss = Selling price – original cost.

Personal Tax

- Personal tax is direct tax and is generally imposed by the central authority and is collected through the local authority.
- It is charged on income and property.

Income Tax

- Nepalese income tax system generally follows the prevailing international practices.
- Resident taxpayers (Individual or entities) are taxed on worldwide income while non-resident taxpayers are taxed only on their income earned in Nepal.

Table 13.3: Tax Rates for Individual & Family Annual Basic Exemption Amount.

Status	Income Limit	Tax Rate
Individual	Up to 2,50,000	1%
	Next Rs 1,00,000	15%
	Next 3,50,001-2,500,000	25%
	Balance exceeding 25,00,000	35%
Couple	Up to Rs 3,00,000	1%
	Next Rs 1,00,000	15%
	Next 4,00,001-25,00,000	25%
	Balance exceeding 25,00,000	35%

Additional Deduction Remarks

a. **Person Working at Remote Areas**
Additional deduction from taxable amount up to Rs 50,000. (A-50,000, B-40,000, C-30,000, D-20,000, E-10,000) Where, A, B, C, D are categories of remote areas.

b. **Natural Person with Pension Income Included in the Taxable Income**
Additional deduction from taxable amount equal to 25% of amount prescribed under first tax band.

c. **Incapacitated Natural Person**
Additional deduction from taxable amount equal to 50% of amount prescribed under first tax band

d. **Life Insurance Premium**
A natural person who has procured life insurance and paid premium amount thereon shall be entitled to a reduction of actual annual insurance premium or Rs 20,000 whichever is less from taxable income.

e. **Medical Insurance**
A natural person insured in resident insurer for health insurance shall be entitled to a reduction of actual premium paid or Rs 20,000 whichever is less.

f. **Contribution to Retirement Fund**
1/3 of taxable income or NRs 300,000 which-ever is lower.

Rates

House and land is taxed according to the kind of local body i.e., VDCs or Municipalities.

In case of VDCs: Rs. 5 to Rs. 100 on the basis of number of storey, structures, area and location of house.

Urban House and Land Tax

The urban house and land tax is levied on the value of the property. Depreciation is taken into account, at rates ranging from 0.05% to 1.50% per year, depending on the type of construction of the house.

Urban House and Land Tax

Tax Base (Rs)	Tax Rate/Year (Rs)
Up to 1 million	Nil
1 million to 2 million	300
2 million to 3 million	0.05%
3 million to 5 million	0.25%
5 million to 10 million	0.50%
Over 10 million	1.50%

Corporate Tax

Income and capital gains by corporations are taxed at a flat rate of 25%. Income-generating expenses and operating expenses are deductible when computing for the taxable income.

Nepal Corporate Tax Rates

The standard rate of corporate tax in Nepal is 25%. However, different entities are taxed at different rates as:

SN	Particulars	Tax Rate
1.	Bank, Finance Company, General Insurance Company, Petroleum Entities.	30%
2.	Cigarette, Tobacco, Beer and Alcohol Company.	30%
3.	Special Industries & IT Industries.	20%
4.	Entities engaged in construction & operation of Road, Bridge, Tunnel, Ropeway, Trolley Bus and Tram.	20%
5.	Co-operative Institution registered under Co-operative Act, 2048 (other than co-operatives dealing in except dealers in Exempted Transaction).	20%
6.	Entity wholly engaged in the (BOOT) projects conducted so as to build public infrastructure, own, operate and transfer it to the Nepal Government & in power generation, transmission, or distribution.	20%
7.	Non-resident person Providing Shipping, Air Transport or Telecommunications Services in Nepal.	5%
8.	Private Limited Co., Limited Co., Partnership Firm not specifically mentioned above.	25%
9.	Airline Services having office in and business in Nepal but not operating flights to and within Nepal.	2%
10.	All Export Entities.	20%
11.	Repatriation of income of a Foreign Permanent Establishment of a Non-Resident situated in Nepal.	5%

Concession and Facilities for Industrial Sector According to Income Tax Act 2002:

- All business related expenses are deductible from taxable income including expenses occurred to reduce pollution and minimizes the adverse environment effects and research and development expenditure.
- Information technology industries or Manufacturing industry providing employment to 300 or more Nepali citizens during the whole year gets additional facilities of income tax rebate at the rate of 10% on the applicable tax and industry provides employment 1,200 or more citizens during the whole year gets rebate at the rate of 20% on prevailing rate.
- Industries established in certain underdeveloped, remote and semi-developed areas are given rebates on income tax. The rebate may range from 50 to 25% of the applicable tax depending on the level of development of the district.
- Information technology industries or industries which providing employment to more than 100 Nepali citizens including 33 percent women, dalit and disable person during the whole year gets income rebate of 20%.
- Ten years income tax holiday for Industries established in certain underdeveloped areas. (22 districts).
- 5 years tax holiday for Industries established in Special Economic Zone (SEZ) or Export Processing Zone (EPZ) and 50% income rebate on the applicable tax rate after 5 years.
- 10 years income tax holiday industries established in hilly region and prescribed special economic zone of mountain region and 50% income tax rebate on the applicable tax rate after 10 years.

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- Fifty percent income tax rebate in income of Foreign investor generated from industry established in special economic zone providing services such as foreign technology, management fee and royalty.
- 40% income tax rebate for the Enterprises, which construct and operate road, bridge, tunnel, ropeway, flying bridge, trolley bus, tram.
- 25% income tax rebate for commodity export industry on prevailing tax rate.
- 50% income rebates on income from export of Intellectual property, sale and transfer.
- 7 years tax holiday and 50% tax rebate for 3 years after 7 years from the operation date for industry involved in investigation of petroleum product and natural gas.
- Any hydropower industry start construction before 2071 Bhadra 7 (B.S) and starts commercial transaction before chaitra 2075 will get 10 years tax holiday and 50% income tax rebate for 5 year after 10 years from the date of starting commercial transaction.

VAT

The Value Added Tax (VAT), a tax on value added portion of price of the taxable goods and services. Entity having turnover of Rs.5 million or more is required to get registered with Value Added Tax Office and 13% VAT shall be applicable to it. **The objectives of VAT in Nepal are as follows:**

- To increase revenue by broadening the tax base.
- To make the tax system efficient.
- To establish a fair and transparent tax system.
- To enhance sustainability in domestic sources for revenue mobilization.
- To promote volume of export trade, etc.

Value Added Tax (VAT):

1. A firm whose annual turnover of goods and services is less than Rs.50 million needs not be registered with the VAT office and collect VAT on sales. But they can register voluntarily.
2. VAT is charged at a single rate of 13%. In certain cases, the rate may be zero and certain goods and services are free from VAT.
3. Value Added Tax is collected at every (manufacturing, distribution, wholesale and retail) stage of selling goods and services.

4. Exports of taxable goods are zero rated.
5. A firm registered with the VAT Office may claim credit on tax paid on inputs /purchases.
6. VAT paid on inputs can be adjusted while collecting the VAT on finished products.
7. Industries that exported more than 80% of total sales in past twelve months and which have a minimum of twenty percent of value addition can import raw materials providing bank guarantee on account of the payable VAT.
8. Certain products such as primary food stuffs, primary agricultural products, and industrial machineries are exempted from VAT.
9. **VAT exempted goods and services are as follows:**
   - Basic agricultural products.
   - Goods of basic needs.
   - Live animals, animal products, animals feed and feed supplements.
   - Agricultural inputs.
   - Education services.
   - Transport service.
   - Health Services.
   - Raw materials for pharmaceutical industries.
   - Books, Newspapers and Publications.
   - Industrial machinery.
   - Cultural and Artistic goods and Services.
   - Specified personel & Professional Services.
   - Others goods and services such as postal service, financial & insurance service, buying and selling of real estate.
10. **Zero rated goods and services are:**
    - Goods exported or services provided abroad.
    - Goods and services imported by accredited diplomats.

Advance Income Tax
Income Tax for fiscal year should be paid in 3 installments as follows:

Installment	Time Period	Amount
First	Up to mid January (Poush end)	40%
Second	UP to Mid April (Chaitra end)	70%
Third	Up to April (Ashad end)	100%

VAT Calculation

- It is based on indirect tax.
- It is charged on goods or service according to their value added.
  VAT = VAT form sales – VAT paid on purchase.

Example 13.1

Calculate the VAT for the information given below.
Cost of raw material = Rs 500
Cost of finished product = Rs 600
Selling price of wholesaler= Rs 750
Selling price of retailer= Rs 900

Production/ Distribution	Sale Price without VAT (1)	Value Added	13% VAT Collected from Sales (2)	Sales Price with VAT 1+2	Tax Gained on Purchase (3)	Actual Tax Paid to Government 2-3
Purchased by producer	500	500	65	565	-	65
Producer to wholesaler	600	100	78	678	65	13
Wholesaler to retailer	750	150	97.5	847.5	78	19.5
Retailer to consumer	900	150	117	1017	97.5	19.5
					Total VAT Paid=	117

Questions

1. Define direct and indirect tax. Explain briefly effectiveness of VAT implementation in Nepal.
2. What is value added tax? Explain reasons for calculating depreciation.
3. Discuss in detail the taxation system in Nepal in reference to Nepalese law and policies.
4. Write short notes
   a. VAT in Nepal.
   b. Taxation System in Nepal.
   c. Direct and Indirect Tax.
   d. Personal and corporate tax.