

Legal Update

New Legislation on Industrial Enterprises – Brief Highlights

January 31, 2017

Industrial Enterprises Act 2016 (2073 BS) (the "Act") has been introduced with effect from November 22, 2016 repealing the Industrial Enterprises Act 1992 (2049 BS) (the "Previous Act"). However, certain provisions of the Act would be issued in the form of Regulation, which has not been formulated as of this date.

The Department of Industries (the "DOI") continues to operate as primary implementing agency under the Act. The key provisions of the Act are set out below:

Industry Registration

The Act makes it mandatory for all the business activities falling under the definition of "industry" to be registered as an industry.

Various registration requirements have frequently been cited as areas requiring reforms but the Act has missed this opportunity to re-evaluate the requirement of business registration. Further the Act does not have any new provisions which will assist reduction in cost of registration or doing business in Nepal.

Classification of Industry

- The Act has given continuity to the general classification of industries on the basis of-(a) size of fixed asset investment, and (b) nature/sector of business. However, on the basis of size of fixed assets investment, the Act has newly added "micro industries" within the classification. Further, "Industries based on Information, Transmission and Communication Technology" has been added as a new classification on the basis of sector of business. The Act lists the industries falling within each classification and grants authority to the Industry and Investment Promotion Board to recommend to the Government of Nepal to alter the classification of industries.
- The primary purpose of such classification appears to be the provision of fiscal and non-fiscal incentives on the basis of classification. However, such an approach is likely to create problem especially when a business in question does not fall under the category of "industries". For example, previously the Government of Nepal has classified "investment business" as one of the categories of the industries and this category permitted foreign investment in Nepal. However, as the Act has not included such industry within the list, the DOI might take the view that foreign investment is not allowed in investment business; unless the same is notified by the Government of Nepal through Nepal Gazette

Approval and Compliance Requirement

- Multiple approval requirements have been imposed under the Act. For example, approval requirements are applicable for-(a) extension of the time period for bringing the industry into operation, (b) transfer of location of

the industry, (c) liquidation of industry. Further, approval from Industry and Investment Promotion Board is also required for the registration of industry in which foreign investment approval has been granted by such Board. These approval requirements appear to be applicable to all kinds of industries irrespective of investment or sector of operation such as micro industries.

- The Act has also provided for ongoing reporting and filing requirements. For example, each industry is required to notify certain details to the authorities upon bringing industry into operation and within 6 months from the date of expiry of the fiscal year. A notification is also required to be given to the authorities when the industries stop their operation. These requirements are sure to add cost of registration of business and satisfying ongoing compliance.

Environmental Compliances

- Pursuant to the Act, industries should commence activity related to establishment and operation of industries only after completion of applicable environment studies. This provision provides for much needed clarity as there were certain practical difficulties where environmental clearance required prior to registration of the industry.

Corporate Social Responsibility

- The Act makes it mandatory to allocate at least 1% of the annual profit (there is no clarity on whether it is to be calculated on pre-tax profit or post tax profit) to be utilized towards corporate social responsibility (the "CSR Requirement").
- The CSR Requirement is applicable to all (i) medium industries; i.e. industries having investment in fixed assets exceeding NPR 100,000,000 but less than NPR 250,000,000; and large industries; having investment in fixed assets exceeding of NPR 250,000,000) and (ii) cottage industries and small industries having annual turnover more than NPR 150,000,000.
- The fund created for CSR is to be utilized on the basis of annual plans and programs but in the sectors that are prescribed under the Act, however, such sectors are yet to be specified by the Act. The progress report of the utilization of the fund collected for CSR is required to be submitted to the relevant government authorities registered within three months from expiry of the financial year.

No Work No Pay and Restriction on Strikes

- The Act has addressed the long standing demand of the industries seeking "No Work No Pay" provision and will most likely be helpful in addressing illegal strikes. The Act further restricts employees to carry out any strike which may affect the operation of an industry and its production.
- The Labor laws provides right to strike without limitation (after completing notification and voting procedures) and is yet to be seen if the provision will assist in enhancing work environment, specially in manufacturing sectors.

Contract Manufacturing

- The Act clarifies that that the goods can be produced on the basis of the contract manufacturing arrangement entered between the producers of the goods. The concept also extends to supply of services.
- This provision provides much needed regulatory clarity as the contract for manufacturing was undertaken on the

basis of approval from the DOI on a case to case basis. The Act does not mandate prior approval of the DOI to enter into a contract manufacturing arrangement.

- The Act also prescribes the provision where the contract manufactures can be provided exemption and benefit for providing of goods or services as per prescribed criteria to the export industries or export processing units. The Government is yet to issue notification related to such benefits and exemptions.

Incentives and Facilities to Industries

- The Act has provided various fiscal incentives to industries, most of which were repealed after the introduction of the Income Tax Act 2002 (the "Income Tax Act"). The Income Tax Act was introduced with the concept that all tax related incentives will be covered by the Income Tax Act and Finance Act which is enacted every year. Generally, matters related to income tax, value added tax (VAT) and custom duty are governed by Fiscal Act.
- In marked departure with this principle, the Act has introduced additional fiscal incentives. The manufacturing and export oriented industries enjoy most of the fiscal incentives. For example, the manufacturing industries (which excludes tobacco, alcoholic beverages, etc.) are entitled to 20% discount on the applicable tax rate (currently 20%) making the effective tax rate 16%. The export income from export of goods are entitled to 25% discount making the effective tax rate from export income 15%. The exhaustive description of benefits is provided in Annex-I.
- The Act provides statutory protection of changes in law in relation to benefits and exemption provided under the Act and other applicable laws. The stabilization provision states that no provisions shall be made to limit the benefits and exemptions prescribed under the Act and other applicable laws. This provision is introduced against the background that, stabilization provision was set-up mostly for infrastructure projects under the applicable laws but now all industries registered under the Act will be eligible to enjoy the benefits.

Offences and Sanctions

- The Act has defined various non-compliances as offences and has also imposed sanctions. Offences that include; (a) operation of industry without registration, (b) failure to meet the reporting/filing requirement as set out under the Act, (c) misuse of facilities and incentives as made available under the Act, (d) non-fulfillment of the CSR Requirement, etc.
- The sanctions under the Act include, (a) closure of industry, and (b) fine on the basis of types of industry. For example, a large scale industry is liable to fine ranging from NPR 100,000 to NPR 300,000 for operating without registration. Similarly, an industry is liable to fine amounting to 0.75% of the annual transactions for non-compliance with CSR requirement.
- The sanctions are levied either on, (a) industry, or (b) responsible officer of the industry. The time limitation for filling an appeal against the imposition of sanctions is thirty-five (35) days. Such appeal can be filed at the concerned High Court.

Annex I Fiscal Concessions for Different Industries

A. Income Tax Concessions

Industry	Concessions
Manufacturing Industries	20% exemption on the rate of tax imposed on the income earned from such industries.
Industries investing in construction of roads, bridge, tunnel, Ropeway, Railway, Tram, Trolleybus, Airport, Industrial Structure and Infrastructural Complex and bringing such constructions into operation	40% exemption on the rate of tax imposed on the income earned from operation of such infrastructures.
Manufacturing industries except those producing fruits based cider, brandy or wine established in Under Developed, Undeveloped and Less Developed Region	90%, 80% and 70% exemption on rate of the income tax for up to 10 years from the date of commencement of commercial production or transaction
Manufacturing industries producing fruit based cider, brandy or wine established in any Under Developed Region	40% exemption on the income tax for up to 10 years from the date of commencement of business
Manufacturing Industries set up with the investment of at least 1 billion rupees and providing direct employment to more than 500 individuals throughout the year	100% income tax exemption for first five years from the date of commencement of business. 50% exemption on the income tax for next 3 years. Industries already in operation are entitled to the above stated exemption in case such industries enhance their installed capacity by at least 25%, increase investment to 1 billion and provide direct employment to 500 individuals throughout the year.
Individuals or entities obtaining approval to commercially generate transmit or distribute Hydroelectricity by mid-April 2024 A.D. (Chaitra 2080 B.S.)	100% income tax exemption for first 10 years 50% income tax exemption for next 5 years. Such exemption is entitled to Solar, Wind and Bio Mass energy as well. In case of industries that have already begun commercial production at the time of commencement of this Act, the exemptions applicable at the time of receiving approval would be applicable.

Industries conducting research and excavation of natural gas and fuel commercially, if commence the commercial transaction by mid April 2019 A.D. (Chaitra 2075 B.S.)	100% Income tax exemption for first 7 years from the date of commencement of transaction; 50% exemption on the income tax for next 3 years.
Industries relating to Tourism Sector established with the investment of above 2 billion rupees	100% Income tax exemption for the first 5 years from the date of commencement of commercial transaction 50% exemption on rate of Income Tax for next 3 years Such Industries already in operation are entitled to the above stated exemption in case such industries enhance their installed capacity by 25%, increase investment to 2 billion.
Tourism Industry including hotel, resort etc. established outside the metropolitan or sub-metropolitan area with the investment of more than 50 million	100% Income tax exemption for the first 5 years from the date of commencement of commercial transaction 50% exemption on rate of Income Tax for next 3 years
Industries related to software development, data processing, cyber café and digital mapping established inside technology park, bio-tech park and information technology park specified by Nepal Government by publishing notice in Nepal Gazette.	50% exemption on tax imposed on income of such industries
Manufacturing Industries and Information and Communication Technology Industries employing 300 or more Nepalese throughout the years	15% exemption on tax imposed on income of such industries on that year (Additional 15% exemption on income tax on that year in case the industry has 50% of its employees from among Women, Scheduled Caste and Disabled person)
Manufacturing Industries and Information and Communication Technology Industries employing 1200 or more Nepalese throughout the year	25% exemption on tax imposed on income of such industries on that year (Additional 15% exemption on income tax on that year in case the industry has 50% of its employees from among Women, Scheduled Caste and Disabled person)
Manufacturing Industries exporting goods or commodities produced	25% exemption on the rate of tax imposed on the income earned.

All industries

Expenses made by industries for long term welfare and benefit of employees or workers such as housing, life insurance, health facility, education and training, child care, sports etc. can be deducted for purpose of income tax.

Expenses made for equipment & technology used to reduce or control the pollution or re-processing or reuse of wastages can be deducted up to 50% of the adjusted taxable income of the same fiscal year.

In case the expenses cannot be deducted in full the remaining amount is allowed to capitalize the depreciation on which may be claimed in the subsequent fiscal year.

Expenses incurred for the machine or equipment used for reducing power consumption can be deducted for the purpose income tax.

The costs incurred for increasing entrepreneurship, research and development and creation of new technology for enhancing the productivity of the industry can be deducted while calculating taxable income for an income year from business provided that such deduction does not exceed 50% of the adjusted taxable income from all business of the industry.

In case the expenses cannot be deducted in full the remaining amount is allowed to capitalize the depreciation on which may be claimed in the subsequent fiscal year.

Costs incurred in market promotion, survey and advertisement relating to the business can be deducted for the purpose of income tax.

Costs incurred for the security of the physical assets as prescribed and actual premium paid for insurance can be deducted for the purpose of income tax.

Costs incurred for the protection of industrial property in Nepal which is registered in Nepal can be deducted for the purpose of income tax.

All industries	<p>25% exemption on the rate of income tax on royalty received from export of Intellectual Property created and registered in Nepal.</p> <p>50% exemption on the rate of income tax on income earned from transfer or sale of intellectual property created by the industry.</p> <p>Government of Nepal may reimburse the registration fee paid to register the intellectual property in foreign country for its protection in the manner as prescribed by Nepal Government.</p> <p>Gifts or donations given to tax exempted organization can be deducted up to Rs. 100,000 or 5% of adjusted taxable income of the industry, whichever is less</p> <p>The Government of Nepal may also provide other exemptions by publishing a notice in Nepal Gazette.</p>
Industries established inside Industrial Estate	Local Taxes including Unified Property Tax is not levied

Note:

- i. Industries based on tobacco, liquor and kachha or kattha are not entitled to any of the exemptions or facilities listed above. However, such industries may deduct actual expenses incurred in business promotion activities including long-term welfare and benefit of employees or workers, in reducing or controlling pollution, re-processing of waste materials, in technologies and devices used reducing environment effects, in machine or equipment used for reducing power consumption, research and development expenses.
- ii. In case an industry qualifies for more than one exemption in respect to similar income from among those listed above, the industry is only entitled to one exemption. Such industry is entitled to select the applicable exemption.

B. VAT Exemptions

Industry	Benefits
All Industries	VAT imposed on production is reimbursed if such goods are exported, based on the quantity of export.

C. Customs duty Exemption

Industry	Benefits
Industries not having Bonded Warehouse or Passbook facility	The Government of Nepal may refund the amount of Duty Draw Back in export of goods after determining the aggregate of costs incurred in import (Samadar) as prescribed in Nepal Gazette.
Industries not having Bonded Warehouse approval exporting goods through existing Banking Channel or Letter of Credit or selling such goods in domestic market in convertible currency	<p>Raw materials or auxiliary raw materials as well as packaging materials that are not produced in Nepal can be imported by furnishing the required guarantees under prescribed conditions and procedures.</p> <p>However, in case of packaging materials not produced in Nepal, a recommendation is required from IRD to enjoy stated benefit.</p> <p>The Custom Duty levied in the import of such raw materials, auxiliary raw materials and packaging materials required for production shall be one level below the existing Custom Duty rate in import of finished goods using such materials.</p>
Laboratories for Quality Assurance	Custom Duty is levied in the minimum rate for the import of machinery and scientific devices that are being imported to ensure quality as well as such machinery and equipment imported by industries for research and development.
All Industries	Custom duty is levied in the minimum rate on import of machinery, transformers, generators having a capacity of 10 Kilowatt and other industrial devices imported by an industry for commercial purpose.

D. Other Exemptions and facilities for Micro Industries

- Notwithstanding anything mentioned in existing acts, no fees or charges is levied on registration of micro industry pursuant to this Act.
- Micro Industries already under operation at the time of commencement of this Act are entitled to 100% income tax exemption for at least 5 years from the date of commencement of this Act.
- Micro Industries registered and operating pursuant to this Act are entitled to 100% income tax exemption for at least 5 years from the date of commencement of commercial transaction.

E. Additional benefits for Female Entrepreneurs:

- Industries registered under the ownership of Female Entrepreneurs only are entitled to following additional benefits and concessions:
- 35% exemption in existing Industry Registration Fees
- 20% exemption in existing rate of registration of Industrial property used inside the industries
- Female entrepreneur shall be prioritized while allocating the areas inside Industrial Estate
- In case such industries require loan for exporting produced goods, export loan will be provided to the industry depending upon the financial status of the transaction of the industry.

F. Other Exemptions and facilities

- Industries based on forest products can be given possessory right pursuant to existing laws over forest in any region through lease or other promissory guarantee under prescribed conditions.
- No fees or royalty pursuant to the existing laws shall be applicable in electricity produced by industry for its own consumption.
Such industry willing to sell surplus electricity to any other industry, may sell so pursuant to existing laws in the rate agreed upon by both parties.
- Government of Nepal may provide additional exemptions and facilities to export based industries and prescribed industries established inside Special Economic Zone or inside Government or Private Industrial Estate by publishing notice in Nepal Gazette.
- Government of Nepal may provide additional exemptions and facilities by publishing a notice in Nepal Gazette to National Priority Industries or industry making optimum use of domestic raw materials, labor or skill or industries established by inventing new technology or goods inside Nepal upon recommendation of Industries and Investment Promotion Board.
- Government of Nepal may provide exemptions in Demand Charge added in Electricity cost under prescribed conditions and procedures.
- Government of Nepal may provide aid assistance as seed capital to cooperatives, micro industry, small and cottage industries to establish industries inside Under Developed Region under prescribed conditions.
- Industries operating under Foreign Investment may be given approval to import goods produced by the head office located in foreign countries for production, market development and promotion of new goods for a prescribed period under prescribed terms and conditions.

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