International Taxation Journey in Nepal: Still a long way to go in

> The international taxation generally refers to tax on cross boarders transactions which expands its horizon depends on the country's foreign trade and investment volumes. The incidence of international taxations are directly proportionate to the foreign trade and investments i.e. more foreign trade and investments bring incidences of international taxation more.

The birth of taxation in Nepal is dates back to ancients times in some forms but the concrete idea of formalized income tax in Nepal was came in early 1950 only and the changes has come in different times with much awaited high level reforms only after five decades in 2002 with Income Tax Act, 2002.

The birth of international taxation in Nepal is dated back to through the enactment of Income Tax Act, 1962 with the provision of bilateral tax treaties. But the country signed first Double Tax Avoidance Agreement with India only in 1987. The provision of giving deduction of foreign tax was already there through the Income Tax Act, 1974 but the provision of foreign tax credit has been introduced through various bilateral tax treaties i.e. DTAA (Double Tax Avoidance Agreement) with various countries thereafter.

The areas of international taxation has been touched directly through various Sections of Income Tax Act, 2002 and these Sections are 2,3,6,33,67 to 71, 73 and indirectly through other ancillary Sections.

These Sections have touched the provision to levy tax in case of non-residents, transfer pricing arrangement, GAAR (General Anti Avoidance Rule), sources of income/losses/gains and payments, foreign permanent establishment, controlled foreign entities, tax on non-resident on providing water or air transport or telecommunications services, foreign tax credits and international agreements. But question arises whether these

CA. Kaushlendra Jha
CA. Jha is a Member of ICAN
He can be reached at
kaushlendra@jkkfoundation.org

concepts and provisions cover the international taxation aspects comprehensively? Obviously this aspect needs to re-look from governing authority seeing high rise case of base erosion and profit shifting in many developing and least developed countries including Nepal.

The tax policy plays a key role is domestic economy but not less in the context of international business now which has given rise to the concept of international taxation. Presently, the country's tax policy uses it as tools to foreign trade policy of the country protecting the domestic against external players as well. Hence the importance of international taxation has become substantial in today's world of global business.

The international taxation generally refers to tax on cross boarders transactions which expands its horizon depends on the country's foreign trade and investment volumes. The incidence of international taxations are directly proportionate to the foreign trade and investments i.e. more foreign trade and investments bring incidences of international taxation more.

The levy of taxation are of two basis, one is territorial (Source) system of taxation and worldwide (or Residence) system. Under source system, all income earned are taxed in the country where its source lies irrespective of residential status whereas income under residence system are taxed in the country of residence where the income earned irrespective of its source. Some of the countries use mix of both system of taxation but if all the countries in the world uses the same system of taxations, there would not have any issues like double taxations and any international taxations issues. The system of taxations could even be the same because of its linkages directly with its foreign trade and investment policy which definitely cannot be the same at global level.

Despite of covering international taxation provision in the Income Tax Act, 2002, Rules and Manual, the government has to check with the availability of enough tools to achieve the goals of international taxation which is avoidance of double taxation and double non-taxation. Some of these are the comprehensive concept of international taxation are State verses Other Contracting States, Source Country verses residence Country, Taxable Subject verses Taxable Object, Capital Importing Country verses Capital Exporting Country, Juridical Double Taxation verses Economic Double Taxation, Active Income verses Passive Income, Tie-Breaker Rules for Residential Status, Permanent Establishment, Force of Attraction Rules, Associated Enterprises Transactions, Beneficial Ownership, Make Available Clause, Tax Relief / Credits, Most Favored Nation Clause, Treaty Shopping, Thin Capitalization, GAAR, APA (Advance Pricing Agreement), BEPS (Base Erosion and Profit Shifting).

Avoidance of Double Taxation:

The history of DTAA (Double Taxation Avoidance Agreement) is dates back to January 18, 1987 when the country was signed its first tax treaty with India. The second tax treaty was signed with Norway 18, 1996. Similarly the country signed bilateral tax treaty with other eight countries till date which are Thailand, Sri Lanka, Mauritius, Austria, China, Qatar, Korea and Pakistan in different times as per need and demand from other side of the contracting states.

The further tax treaties are in pipeline with Bangladesh, Malaysia since long time and with United Kingdom recently. Including these, the country shall have DTAA with thirteen countries in the span of three decades.

Globally, there are about 3000 bilateral tax treaties which are in force whereas neighboring country India has already signed such treaties with 88 countries and 85 in implementation till 2015 and China has concluded tax treaties with 101 countries and many of them are recent.

The fast pace of development to rationalise international taxation through bilateral tax treaty is one of the indicator of noneconomic development and cross boarder investment in the country which we can also evident from other development in both neighboring country.

The Double Taxation Avoidance Agreement is the bilateral tax treaty/agreement/convention to avoid double taxation or double exemption from tax of the same income in both countries. The Fiscal Committee of OECD (Organisation for Economic Cooperation and Development) in model double taxation convention on income and capital 1977, defines double taxation as "the imposition of comparable taxes in two or more states on the same tax payer in respect of the same subject matter and for identical period'.

The main objectives of tax treaty are to boost up economic growth by mitigating double taxation and other barrier to cross border trade and investment and other important objective is to improve tax administration in two contracting states in reducing opportunities for international tax evasion.

The above both objectives are equally important in for developing and least developed countries for which economic development in high priority. Many least developed countries especially on the verge of graduating in developing countries have opened its arms in global economy for trade and investments. The need to have tax treaty mainly depends on the having cross boarder economic transaction with other states in trade and investments felt at large is inevitable.

Our country has done DTAA with above ten countries not based on having its own need assessment rather invitation/calls from the contracting states. But none of DTAA has been further reviewed other than the DTAA with India which has been revised in 2011.

The number of countries having cross boarder investment pledge in Nepal through FDI are about 80 countries but the actual materialization or actual funding ranging from fractional amount to maximum percentage are approximately fifty percent i.e. 35-40 countries.

Seeing the cross broader investment commitment and transactions, the country is still not ready with tool to rationalize the international taxation matter of DTAA. The recent big transactions in telecom has hit drastically to the matter of international taxation which exposes weaknesses in Nepalese tax regime.

Absence of well-established international taxation mechanism through which the practice and procedures can be started. The country lacks requisite experience, exposure and enough negotiation capacity to initiate DTAA with maximum number of countries through with cross boarders investment have been committed or materialized till date.

The world has been changing at fast pace seeing the shifting of regulation of international taxation which was based on bilateral treaties are now shifting to multilaterisation. The bilateral treaty is the matter of regulation of international taxation only state by state way which is now becoming complicated seeing number of subsidiary/investment vehicle set up by one controlling Multinational Companies in many countries or states.

Shift from bilateral to multilateral agreements can also be noticed in the Rules on tax information exchange between two states or tax jurisdictions as per Article 26 and 27 OECD Model Convention. These Rules are becoming obsolete due to recent developments, such as the endorsement of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and the proposals for the adaptation of a (stronger) EU Savings Tax Directive.

The right mechanism to initiate having DTAA with at least top investing countries with establishment of strong mechanism with enough resources, capacity building program of resources, building of negotiation capacity of officials responsible for, inclusion of tax consultant from private sectors in the negotiation process, can only be saved the flipside of foreign investment.

I believe the authority has not enough resources to cover all these above concepts like converges in Act , Rules, Manual, Circulars, Specific Guidelines, trained income tax officials which definitely needs high attention of the government to come in pace with global business development and to develop sound taxation system for an economic growth vehicles of the country.

Reference:

https://www.oecd.org
https://ird.gov.np/
Income Tax Act, ,2058 and Rules, 2059
Income Tax Directory, 2068 amended;
thehimalayantimes.com/category/perspectives
-same Author
Various online publications.