

## Transfer Pricing in Nepal: Need to have Comprehensive Guidelines and Practice

*To implement Transfer Pricing concept, the Tax Authority has to take appropriate step for coming up with comprehensive manual or guidelines and have to work on war stage without any delay.*



**CA. Kaushalendra Jha**  
CA. Jha is a member of ICAN  
He can be reached at  
kaushalendra@jkkfoundation.org

### Background

Transfer pricing is a mechanism adopted in relation to transactions between two related entities, so as to minimize the overall tax liability of the group of companies of which the two entities are members. Despite of having existing provisions of the Income Tax Act to some extent but there is no practice to cover the arm length principle that neutralizes the adverse effect of transfer pricing. It is therefore, proposed to incorporate in our tax statute a comprehensive guidelines and practices to enforce the arm's length principle.

In 2004, Nepal has become the member of world trade organization which has brought major significance and changes in business in the country and

global market, although the concept of Transfer Pricing has been introduced in/with Income tax reforms and Act, 2002. But the drastic changes with inflow of Foreign Direct Investment and entry of foreign company in Nepal and some Nepalese companies also made an investment outside Nepal only after 2004. Nowadays over 60 countries have adopted transfer pricing rules and over 60% of the international trade is carried out within Multinational entities.

There are about 400 to 500 foreign companies associated with Nepali Business environment out of which about 282 to 285 are Indian companies. Since there are good numbers of business transactions of foreign companies in Nepal and lots of foreign direct investments are awaiting of government stability

and conducive environment, Transfer Pricing concept is very necessary to have fair taxation practice in Nepal.

Earlier Seminar organized on "International Taxation & Transfer Pricing" was also conducted by SAFA International for implementation of Transfer Pricing in Nepal which I believe must have sensitized the issues. However there is still some confusion and unawareness regarding importance of implementation of Transfer Pricing provisions in Nepal are witnessed.

### Importance of TP

Globalization and economic growth have driven the level of inter-company transactions to new heights. It is estimated that more than 2/3 of all business, in particular; developing countries are observing immense growth in intra-group transactions due to the fact that their economies are still in the process of opening up and attract large amounts of FDI transactions worldwide take place within groups. Therefore, TP is not only of importance to business but also for tax administrations, which have to implement or adapt their national TP legislation and practices accordingly. International consistency in TP is beneficial to create a basic structure of taxable persons and events, which ensures proper application of the arm's length principle. Further Transfer pricing helps to identify practical issues in business restructuring and manage risk of double taxation.

### Global Scenario

Transfer pricing is one of the most important issues in international taxation. It is a major tool for corporate tax avoidance which is also referred as base erosion and profit shifting. The OECD (Organization for Economic Co-operation and Development) has adopted (subject to specific country reservations) fairly comprehensive guidelines. These guidelines have been adopted with little modification by many countries. There are around 70 countries have already been adopting transfer pricing rules and these rules are mostly based on arm's length principles in most of the countries. The OECD has published guidelines based on arm's length principles which being followed in part and whole most of the OECD's member countries and non-member countries too. Despite of following up OECD guidelines but BEPS (Base Erosion and Profit Shifting) Action 13 "Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting" only 31 countries sign tax co-operation agreement to enable automatic sharing of country-by-country information till 27/01/2016.

The BEPS Action 13 report (Transfer Pricing Documentation and Country-by-Country Reporting) provides a template for multinational enterprises (MNEs) to report annually and for each tax jurisdiction in which they do business the information set out therein. This report is called the Country-by-Country (CbC) Report.

To facilitate the implementation of the CbC Reporting standard, the BEPS Action 13 report includes a CbC Reporting Implementation Package which consists of (i) model legislation which could be used by countries to require the ultimate parent entity of an MNE group to file the CbC Report in its jurisdiction of residence including backup filing requirements and (ii) three model Competent Authority Agreements that could be used to facilitate implementation of the exchange of CbC Reports, respectively based on the:

1. Multilateral Convention on Administrative Assistance in Tax Matters;
2. Bilateral tax conventions; and
3. Tax Information Exchange Agreements (TIEAs).

### Provision of Transfer Pricing in Income Tax Act, 2058

As per Section 33, in any arrangement between persons who are associates person, the department may, by notice in writing, distribute, apportion, or allocate amounts to be included or deducted in calculating income between the persons as is necessary to reflect the taxable income or tax payable that would have arisen for them if the arrangement had been conducted at arm's length price.

In making any adjustment under Sub-Section the Department may re-characterize the source and type of any income, loss, amount, or payment; or Allocate costs, including head office expenses, incurred by one person in conducting a business that benefit an associate or associates in conducting a business to the associates based on the comparative uncovery 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 may act on as permanent Establishment and Subsidiary.

### Provision on Tax Treaty

Contracting States may conduct the transfer pricing audit and the State in which profit was shifted has to recalculate the taxable income

### Challenges of Transfer Pricing practice for Regulatory Authority.

Not Sufficient number of qualified officers and auditors who lacks accounting techniques or expertise; lack knowledge within the private sectors, lack of provision of advance price agreement, limited number of tax treaties between trading countries, lack of available sufficient data and information to calculate arms length price.

To mitigate these challenges, the department may have to come up with comprehensive guidelines on transfer pricing with capacity building program of the tax officers and tax professionals, establishment of data bank in existing transfer pricing materials and potential transfer pricing materials depending on the trading partners and investing countries and finally raising an awareness among stakeholders.

### The Way Forward

#### Need To Have Comprehensive Manual/Guidelines

Seeing the business transaction with cross borders transactions among associates enterprise by foreign company in Nepal, the tax authority has very limited tax provision and practice to identify the issue of transfer pricing cases in the country. **Absence of catch in transfer** pricing shall increase the possibility of transfer pricing to shift profits in the contracting states where tax rates are lower.

To implement Transfer Pricing concept, the Tax Authority has to take appropriate step for coming up with comprehensive manual or guidelines and have to work on war stage without any delay. A compressive manual is required for implementation of Transfer Pricing specially containing:-

- Proper study of Nepali Business Market.
- Proper study regarding need of Transfer Pricing concept.
- Study of foreign investors in Nepal.
- Study on top 10 foreign companies for case studies with available data.
- Study of top 10 trading partners of the country.
- How to integrate transfer pricing into business and tax strategies
- How to perform the required transfer pricing analyses

- Selection and implement appropriate transfer pricing policies
- Study to know which evidence needs to be gathered.
- Study to identify and manage transfer pricing risk.
- Brief study of international market implementing Transfer Pricing.
- Proper Guidelines and policy regarding Transfer Pricing required.
- Study regarding difficulties and challenges emerging from implementation Transfer Pricing.

Adopting OECD guidelines and complying BEPS 13 action is far away in the context of Nepal hence the primary and immediate need of the authorities are to touch upon above issues and comprehending it will be the right way in the matter.

### Reference:

<https://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/country-by-country-reporting.htm>

Income Tax Act, 2058 and Rules 2059

Income tax Directory 2068 amended;

Various online publications.

*Notice to the Students*  
(Regarding Dec 2016, Examination)

Students are hereby notified to consider, for their exams, the amendments in the Standards, Acts, Rules, Directives, Circulars and any other Notifications that are in force up till 3 months prior to the date of the final examinations.

More specifically the following amendments should be considered by the students.

Topic	Coverage
Accounting Standards	Nepal Financial Reporting Standards and Nepal Accounting Standards.
Nepal Standard on Auditing	Nepal Standards on Auditing, July 2015 version.
Code of Ethics	ICAN Code of Ethics 2015 edition
Income Tax Act 2058, Rules 2059 Custom Act 2064 & Rules 2064 Value Added Tax Act 2052 & Rules 2053 Excise Act 2058 & Rules 2059	Amendments made by Finance Bill 2073.
Corporate Laws	Amendments in all the related laws

**Note:**  
Students of CAP I and CAP II shall study from the above topics only to the extent mentioned (limited) in the syllabus.