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## **Doing Business in Nepal**

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# Doing business in Nepal

**MSI's guide on Doing Business in Nepal provides current information about the financial, regulatory and legal considerations that could affect business dealings within Nepal. For further assistance please contact our MSI member firm in Nepal.**



## Country overview

### The Country

Nepal is a land locked country in south Asia between India and China. Nepal is divided in three physical divisions, i.e. mountain, hill and plains. The mountains, also called Himalayan range, are situated in northern parts bordering on China. Nepal contains the highest elevations in the world including 8,848 metres height Mount Everest. The hill region is composed of mountains and varies from 800 to 4,000 metres in altitude with progression from subtropical climates to alpine climates. The southern lowland plains or Madhesh bordering on India are part of the northern rim of the Indo-Gangetic plains.

### Population

Nepal has a total population of 26.5 million inhabitants with population growth rate of 1.35% per annum (June 2011).

### Government

Nepal is a secular federal republic with a parliamentary system of government.

The centre is represented by federal parliament whereas provinces have separate provincial parliaments. The federal government is run by council of ministers headed by Prime minister elected by federal parliament. The federal and provincial parliaments are divided in upper and lower houses. There is a multiparty system and members of parliament are elected through a mix of direct election and proportional representation. Nepal is headed by a president elected by members of parliaments. However, the President has no political power; the Government is responsible.

As said, the head of state does not bear political responsibility and can therefore not be held politically accountable by the parliament.

Nepal has 7 provinces, each with its own governments. The provincial governments are run by council of ministers headed by Chief Minister elected by provincial parliament.

The provinces are further divided in local authorities governed by elected representatives.

### Languages

The official language is Nepali. However, English is spoken widely. Each region has its own language that is used by the majority of residents there. Most belong to the Indo-Aryan and Sino-Tibetan language families. Maithili is the second largest language in Nepal after Nepali.

### Currency

The national currency is the Nepalese Rupee (NPR).

### Economic summary

Nepal has faced major setbacks in recent decades, but the country has made steady progress.

GDP: **\$24.47 billion**

Income per capita: **\$728.40**

GDP expected to grow by 5.9% in 2018 and 5.5% in 2019

Inflation rates forecasted at 4.2% in 2018 and 6% in 2019

Per capita GDP growth is expected at 3.5% in 2018 and 4.1% in 2019

Inflation: **4.7%. Expected to trend around 6.30% in the long run.**

### Main sectors of the economy

Nepal's economy encompasses agriculture, handicrafts and cottage industries, manufacturing industries, and dynamic services sector.

The main sectors in the Nepalese economy comprises of the Services sector (52%), Agriculture Sector (27%), Industry sector (13%) and the Manufacturing Sector (5%).

## Foreign Investment Policy

### Foreign Investment Policy

Nepal accepts Foreign Direct Investment of US\$ 50,000 or more in small, medium and large scale industries except in few industries reserved for only Nepalese or the Government of Nepal. FDI is not allowed in cottage industries. However, there is no restriction on transfer of technology in cottage industry. The industry can be setup in or without joint venture with Nepalese.

The benefits provided to foreign investors include repatriation of profits and investments and visa to investors and family.

### Foreign Investment Climate

With election and formation of all levels of governments, political instability and industrial peace has improved. There is a long term commitment towards conducive investment climate for foreign investors. Further, Nepal has taken initiatives to improve access to the different regions. Other initiatives of the Government include reform of business-related policies and procedures and development of industrial and commercial infrastructures. These developments and initiatives have created more confidence among

investors. As a result actual foreign investment has more than doubled in 2017/18 compared to 2016/17.

### Types of Investment

Investment may be in form of equity or debt form. There is no limit of debt investment. Minimum equity investment is NPR 5 million. Equity investment may be either jointly with Nepalese individual/entity or through 100% equity investment by foreign individual or entity. The project may be financed fully through equity investment or through a mix of domestic debt, foreign debt domestic equity and foreign equity.

### Form of Investment

Foreign investors may invest either in the form of convertible foreign currency through proper banking channel or in the form of plant machinery and equipment required for the industry. However, Indian nationals may invest in Indian Currency as well through proper banking channels.

### Sectors of Investment

Industry and banking sectors in Nepal are open to foreign investments. While, 100% investment is allowed in industries it cannot be more than 40% of equity in the banking sector. Further, foreign investment is not allowed for trading activities including import and export.

Foreign Direct Investments and technology transfers may be made in existing and new industries.

### Potential areas of Investment

There are a number of investment ideas that can generate significant returns over the years. The opportunities can be vast considering Nepal's strategic location between two largely populated countries, India and China, and increased growth of the middle class population in Nepal. Some of the areas identified as potential areas are:

- Outsourcing of Information Technology (IT) and IT-enabled services; research and labour intensive products
- Hydropower
- Tourism

- Agriculture – traditional and modern organic farming
- Infrastructure
- Manufacturing
- Mining
- Communication
- Health and
- Education

## Setting up a business

The first step in setting up a business is obtaining approval of foreign investment. Anyone desiring to operate in Nepal is required to apply to the Department of Industry (DOI) along with prescribed information and documents. After obtaining approval, the foreign investor may incorporate a company with or without joint venture of a Nepalese entrepreneur. The industry is also required to be registered in Department of Industry and Internal Revenue Department. As all repatriation need approval of Nepal Rastra Bank (Central Bank of Nepal), it is essential to register the industry in NRB along with a certificate of money brought in, a certified list of shareholders and other prescribed documents.

### Legal types of business entities

1. Sole proprietorship
2. Partnership
3. Private Limited Liability Company
4. Public Limited Liability Company

In international business, the Private Limited Liability Company is most commonly used. The Private Limited Company is incorporated by one or more (not exceeding 50) promoters. The private limited company, if incorporated in a joint venture with a Nepalese, may have restrictions in transferring shares. The private limited company can be subsidiary of another company.

### Process of how to set up a business

Foreign investors desiring to invest in equity in a new industry is required to submit an application in prescribed form along with a project report, a joint venture agreement and other relevant documents such as identification/registration, credibility certificate from bank, legal documents, resolution to invest in Nepal, Resolution

of authorization, letter of authority etc. If the industry is listed as requiring IEE/EIA Report as per Environment Protection Regulation, 1997, such report is also needed to be enclosed for approval of License and Technology & Environment Section of DOI.

After obtaining approval for investment from DOI, the company is required to be incorporated in the Office of the Company Registrar. The application for registering the Company needs to be made along with Memorandum of Association, Articles of Association, Approval letter of the DOI, Resolution to incorporate Company, authorization letter etc.

After incorporation of Company, the industry needs to be registered with the DOI. For this purpose, an application in prescribed form is to be submitted along with required documents.

In certain industries an additional approval or license is needed. For example medical equipment for a diagnostic centre needs to be approved by the Ministry of Health before ordering. Thus, the company may need additional approvals and licenses before commencing and/or during operation.

### Financial year of taxes and financial accounts

The financial year for taxes and financial statements ends on 15 July of each year. The Annual General Meeting of the company must be held within six months from the end of financial year.

### Accounting and auditing

Financial reports are required to be prepared in accordance with Nepal Financial Reporting Standards (NFRS). The NFRS is similar to IFRS.

Every business, irrespective of the legal form, nature of its business or turnover, must have its annual accounts audited each financial year. The audit can be conducted only by an individual or firm having certificate of practice from The Institute of Chartered Accountants of Nepal.

In addition to the audit of financial statements, income tax returns are also required to be certified by an individual or a firm having a certificate of practice from The Institute of Chartered Accountants of Nepal.

### **Economic and fiscal incentives**

The Government of Nepal offers a number of incentive schemes in various sectors to support companies in their business operations. Some of these incentives provided are summarized below:

- Refund of VAT and custom duty to industries manufacturing and exporting manufactured goods.
- Concessions in income tax and tax holiday to specified industries based on nature of business, location and employment.
- Additional depreciation at 1/3 of prescribed depreciation rates to prescribed industries.
- Full allowance of pollution control and research and development expenses.

### **Incentives to foreign investors**

The incentives provided to foreign investors include repatriation of interest, dividend, principal of loan, sale of shares and salary of expatriates. In addition to the above economic benefits, foreign investors and their family members are entitled to a business/resident visa.

## **Taxation**

The tax system in any given country is invariably an extremely important criterion when it comes to companies finding a country of incorporation. The view taken by the Government of Nepal is that the tax system may under no circumstances form an impediment for companies wishing to incorporate in the Nepal.

In that framework, it is possible to obtain advance certainty regarding the fiscal qualification of international corporate structures in the form of so-called Advance Tax Rulings. In addition, Nepal has also signed tax treaties with many other countries to prevent the occurrence of double taxation.

At the same time, its vast network of tax treaties offers instruments for international tax planning.

The tax system in Nepal can be divided into taxes based on profit and gains, and value added taxes.

### **VAT**

The general VAT rate is 13%. On export the rate is 0%.

### **Income tax**

The tax base for income tax purposes is divided into the following:

1. Income from employment
2. Income from business and profession
3. Income from investments.

Income from business is computed after deducting expenditure incurred for earning the income. Income from investments includes dividend, interest, payment for natural resources, rent, royalty, life insurance business etc.

### **Income tax Rate**

Income from employment is taxed at progressive rates:

- Income from normal business is taxed at 25%
- Dividend whether paid to domestic or foreign persons @5%
- Royalty paid to foreign persons @15%
- Rental income @10%
- Other investment incomes are taxed @25%
- Some specified business such tobacco products, liquor, life insurance are taxed @30%
- Capital gains are taxed @10%

### **Losses**

Losses from business and investments may be carried forward for seven years.

### **Registration procedures**

Private persons and companies are registered with the tax authorities and are given a Permanent Account Number. Communication with the tax authorities by way of tax returns is done in an electronic way.

## **HR/ Labour Law**

### **Employment law**

An employment agreement may be agreed for an indefinite or fixed period of time. Employees with an indefinite period agreement are considered permanent employees unless terminated within 6 months.

### **Social security**

It is obligatory to contribute in social security funds towards provident fund and retirement benefits @10% and 8.33% respectively. Employers need to insure workers for illness and accidents. These insurance policies can be taken out from a number of insurance companies operating in Nepal.

### **Bonus**

It is mandatory to set aside 10% of profit for bonus. The amount to set aside is distributed to employees as per guidelines. 70% of the remaining amount goes to national welfare fund and the balance 30% goes to welfare funds of the entity.

### **Visa and work permits**

All non-Nepalese, except Indian nationals, require valid visas to stay inside Nepal. People from outside Nepal must apply for a work permit for taking employment in Nepal.

### **Employment Conditions**

Rights and duties of employers and employees, health, safety, welfare, working hours, leave etc. are dealt with by the Nepal Labour Act, 2017.

### **Establishment and operation of Industry**

Procedures regarding establishment, closures, permissions etc. are dealt with by the Nepal Industrial Enterprises Act, 1981.

### **Industrial Relations**

Legal provisions regarding registration, operation of Trade Union and other necessary provisions including labour rights are dealt with by the Nepal Trade Union Act, 1992. Entities with 10 or more employees are required to form industrial relations and collective bargaining Committees.

## Contact us

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The information provided in this guide cannot be exhaustive and we recommend anyone considering doing business in Nepal should seek professional advice from our member firms before making any business or investment decision.

### Contact our member firm in Nepal to discuss your requirements:

#### Accounting member

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