

# Transfer Pricing Directives, 2081 (2024)

## Highlights



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**Transfer Pricing (TP) refers to the value of transactions between related parties, often influenced by a group's interests rather than market forces. Companies may manipulate prices to shift profits to lower-tax jurisdictions, reducing taxes in higher-tax countries. To address this, a TP directive has been issued to ensure that transactions between related multinational companies are conducted at arm's length price, ensuring fair taxation for each country involved. Highlights of the directives are summarized below:**

#### **1. To whom is the directive applicable?**

The directive is applicable to controlled transactions for the supply of goods or services between associated persons and having cross-border transactions, where at least one person is chargeable to tax in Nepal. This directive is effective from FY 2081/82 (2024-25).

#### **2. Who are Associated Persons?**

Associated Persons refers to an individual and a relative or partner of the individual, or, a foreign permanent establishment and its owner, or, an entity and a person who, either alone or together with an associate or associates controls or may benefit from 50 percent or more of the rights to income, capital, or voting power of the entity, as the case requires, either directly or through one or more interposed entities.

#### **3. Why is comparability analysis done?**

Comparability analysis is done to determine the comparable uncontrolled transactions. Only when all aspects such as the nature of the transaction, performance of the business, external economic environment, and terms of contracts are analyzed, a suitable comparable transaction can be selected for determining arm's length price. The following steps should be applied in comparability analysis:

- a) Analysis of economically significant characteristics of business and transaction
- b) Examination of comparability of factor of controlled transaction
- c) Selection of tested party
- d) Identification and selection of comparable
- e) Appropriate adjustment to comparable
- f) Selection of appropriate arm's length method

#### **4. What are the methods for Arm's Length Price (ALP) determination?**

Comparable independent transactions are selected through a comparability analysis, and then the arm's length price is determined by comparing the controlled transactions with independent ones using the following methods:

- a) **Comparable uncontrolled price method (CUP):** compares the price charged for

property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.

- b) **Resale price method:** focuses on the price at which goods purchased by the enterprise from an associated enterprise are resold or are provided to an unrelated enterprise. The mechanism of the resale price method reduces the price of a product that the related sales company charges to an unrelated customer (i.e. the resale price) by an arm's length gross margin.
- c) **Cost plus method:** identifies the costs incurred by the supplier of property or services in a controlled transaction for property transferred or services provided to an associated enterprise. An appropriate mark-up, determined by reference to the mark-up earned by suppliers in comparable uncontrolled transactions, is then added to these costs, to make an appropriate transfer price in light of the functions performed and the market conditions.
- d) **Transactional net margin method:** It is usually applied with respect to functions rather than discrete controlled transactions. It examines a net profit indicator, i.e., a ratio of net profit relative to an appropriate base (e.g. costs, sales, assets), that an assessee realizes from a controlled transaction with the net profit earned in comparable uncontrolled transactions.
- e) **Transactional profit split method:** This is a method where the entire transaction executed by multiple associated enterprises is considered as a single commercial event. Respective costs incurred by each of the parties to the transaction are identified together with their relative contribution. The ultimate profit earned by the group of associated enterprises is split after providing for costs incurred in the ratio of their contribution to the transaction.

#### **5. How to select the appropriate method?**

The selection of the most appropriate method among the five methods depends upon:

- a) The nature and class of the international transaction:
- b) The class or classes of AEs entering into the transaction and the functions performed by them considering assets employed or to be

employed and risks assumed by such enterprises;

- c) The availability, coverage and reliability of data necessary for the application of the method;
- d) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
- e) The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
- f) The nature, extent and reliability of assumptions required to be made in the application of a method.

## 6. *What are the steps for TP assessment?*

### **Step 1: Identification of associate relationship**

To identify whether the parties involved in the particular transaction fall under the definition of associated persons as defined in the directive.

### **Step 2: Identification of Intra-Group Cross-Border Transactions**

For the application of the directive, at least one party to the transaction shall be non-resident of Nepal. Thus, transactions, where the non-resident parties are involved, shall be identified for implementation of TP procedures.

### **Step 3: Function, Assets and Risk (FAR) Analysis**

It is the most important step in TP assessment as it helps to identify the comparable transaction by assessing the functions executed, assets involved and risk assumed for completion of the transaction.

### **Step 4: Identification of Comparable Transactions**

Based on the FAR analysis comparable transactions in an Uncontrolled environment shall be identified for determining the Arm's Length Price.

### **Step 5: Selection of the Most appropriate method**

Based on the availability of the comparable, the most appropriate method among the five methods mentioned in the directive shall be selected.

### **Step 6: Comparability Adjustments**

There may be some contractual differences between the comparable and the assessee thus such differences shall be adjusted to make comparison more precise.

### **Step 7: Determination of Arm's Length Price (ALP)**

ALP is determined by the application of the most suitable method. In case where seven or more comparables are available, range concept is used and in case of lesser comparable arithmetic mean is used to determine ALP.

### **Step 8: Transfer Pricing Adjustment**

After determination of ALP, if it is outside the permissible range of 5% such difference shall be adjusted with the actual price.

## 7. *What documentations to be maintained?*

Taxpayer shall document the controlled cross border transactions with associated entities as per prescribed format however, it shall not be compulsory for taxpayer transacting less than NPR 100 million in such transaction.

Taxpayers are required to keep sufficient records for a period of five years as per section 81 of the Income Tax Act as prescribed from the end of the year to which income from the business relates to enable the IRD to ascertain income or loss from the business.

- a) Basic information of taxpayer and period covered
- b) List of associated enterprises with whom the Taxpayer has entered into international transactions
- c) Document relating arm's length price determination

Every person who has entered into an international transaction during a previous year shall obtain certification from an auditor and furnish such report along with the Income Tax Return.

In case of cross-border transaction between related persons exceeding NPR 500 million, verification shall be done by an auditor separate from the auditor who conducts the financial/tax audit. Such an auditor should have audit experience of at least five years.

## 8. *Are any fines, interest and penalties levied?*

If the taxpayer fails to keep required documents or file statements, a fee is charged under Section 117. If tax installments are not paid on time, interest is charged under Section 118. Late

payment of tax incurs interest under Section 119, and if less tax amount is found to be paid, a fee is charged under Section 120.

**9. *Is advance pricing arrangement available?***

In order to gain certainty prior to entering into an international transaction with an associated entities, the taxpayers have an option of applying for an Advance Pricing Agreement (APA) and obtaining results before the transaction is actually undertaken. The tax payer may request in writing for Advance pricing Arrangement to Department pursuant to rule 15 of the Income Tax Rule 2059.

**10. *What remedies are available for dispute resolution?***

In case where the taxpayer is not satisfied with the assessment of the assessing officer, the taxpayer may file an application to IRD for administrative review as per section 114 and 115 of the Income Tax Act 2058 by depositing the one-fourth of the disputed amount.

The Department may accept or reject, fully or partially, the matters mentioned in the application by giving the written notice to the applicant. In case the department fails to give the applicant a notice of decision within sixty days of the date on which the application was made, the taxpayer may make an appeal to the Revenue tribunal pursuant to section 116 of the Income Tax Act.

Any taxpayer who is not satisfied with any decision made by the Administrative Review may make an appeal to Revenue Tribunal. The taxpayer needs to provide application along with depositing 50% of the disputed amount.



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right size  
right solutions

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