

Highlights of the Procedures on Imposing Direct and Indirect Taxes on Digital Services by Non-Residents

The Finance Act 2079 (2022 AD) introduced Digital Service Tax (DST) through section 20 on digital services provided by non-residents to consumers in Nepal and certain amendments in the Value Added Tax Act 2052 (1996) were made to register the non-residents providing digital services with the Inland Revenue Department (IRD) and issue TAX invoices to the consumers including collecting the VAT.



The IRD has issued separate procedures on the Digital Service Tax and VAT on Digital Services to provide clarity by defining digital services, providing the registration process, applicability of the tax, basis of computation of tax, filing of returns, and deregistration. The highlights of both the procedures issued by IRD are given below:

A. Procedures related to Direct Tax on Digital Service

Inland Revenue Department has issued the procedures for simplification and effective implementation of Digital Service Tax (DST) introduced by the Finance Act, 2079. Digital Service Tax shall be applicable from 1 Shrawan 2079 (17 July 2022).

1. What is Digital Service?

“**Digital Service**” means the following goods and services for which there is essential need of the information technology for rendering service to **consumers** (see definition below) and which are automated through the internet with minimal human intervention:

- a) Advertising services.
- b) Movies, television, music, over the top (OTT) and other similar subscription based services,
- c) Data collection services,
- d) Cloud services,
- e) Gaming services,
- f) Mobile Application related Services,
- g) Online Marketplace Services and the services and goods provided through it,
- h) Supply of and updating of software,
- i) Sales of data collected from residents of Nepal
- j) Download services including data and pictures,
- k) Education, consultancy, skill development and training services,
- l) E-book, E-library and E-newspaper service
- m) Services of similar nature other than clauses (a) to (l).

2. Who are the consumers?

"Consumers" are persons having a normal place of residence in Nepal availing facility/consumption of digital service in the form of goods and services but shall not include any person procuring goods or services through separate arrangements for business use or purpose.

3. When is the tax on services triggered?

Digital/electronic service provided by nonresidents to the consumers in Nepal triggers when any of the following conditions are met:

- If the service is received within Nepal;
- If the invoice is issued to an address in Nepal;
- If the payment is made through a bank account in Nepal or institutions licensed to operate payment instruments;
- If the payment is made through credit card, debit card, or other payment modes issued from banks in Nepal or other licensed institutions for payments;
- If the service is received through an internet protocol address within Nepal; and
- If service is received through a SIM card having a telecommunication code of Nepal or through a landline.

4. At what rate is DST levied?

- Digital service tax will be levied at the rate of two percent (2%) on the transaction value (**excluding the indirect taxes attracted in Nepal**) of the digital service provided to the consumers of Nepal by non-resident persons.
- Annual transactions up to **NPR 2 million** shall not be taxed, however, if the amount exceeds **NPR 2 million**, the entire transaction amount shall be taxed.
- Since the nature of DST is direct, it should not be added to the invoice amount and recovered from the consumer.
- **Income Tax as per Income Tax Act, 2058 shall not be applicable** on the transaction on which DST is provided. However, if service is provided to a person other than a consumer as per the Act, tax as per Income Tax Act, 2058 shall be applicable.

5. Who administers the DST?

- The administration of DST shall be done by the Large Taxpayer Office.

6. Who needs to register for DST?

- A non-resident person who provides digital services in Nepal for more than **NPR 2 million** in the last twelve months shall be required to register for Digital Service Tax.

"Nonresident person" means a person outside Nepal who does not have a permanent business address, business representative, or legally recognized representative in Nepal.

PKF Nepal Comments

Considering that the digital service tax is a new concept in Nepal and was introduced on 29 May 2022, the period for computation of the threshold of NPR 2 million shall be from that date and not of a period prior to the date of introduction of the tax.

7. Is PAN registration necessary?

- Person liable to pay DST shall compulsorily register in Nepal and obtain PAN. Non-registration will not provide an exemption from the responsibility to pay DST.
- Registration for PAN shall be done **within 30 days** from which transaction amount exceeds the threshold of NPR 2 million. Voluntary registration for PAN is permitted.

PKF Nepal Comments

Transaction amount includes only sales to consumers (as defined) and shall exclude sales to person availing digital service for business use.

- Entities that have already registered for VAT need not obtain a separate PAN.
- Application for PAN shall be made online in the standard format as per Annexure 1 of DST related Procedures 2022. The following documents are to be uploaded along with the application:
 - a) Notarized copy of the registration certificate of the company in the country of domicile in the English language.
 - b) Notarized copy of the registration certificate with tax authorities in the country of domicile in the English language.
 - c) Power of Attorney provided to authorized person in English & Notarized copy of the passport of such person in the English language.
 - d) Photo of the authorized person.
 - e) Specimen signature of the authorized person.
 - f) Power of Attorney, if any given to a Nepali citizen as the authorized person to pay taxes and Notarized copies of the citizenship or passport.
- PAN Certificate shall be issued electronically as per the format prescribed in Annexure 2 within seven days of application from the non-resident. In case of the inability to register, the IRO shall notify the non-resident with reasons within 15 days of receipt of the application.

8. How is the accounting done and returns submitted?

- The transactions shall be recorded in Nepalese currency.
- The accounting shall be done on accrual basis.
- The return shall be submitted online within 3 months from the end of each income year. [For FY 2022-23, deadline would be within mid October 2023.]
- The format of return shall be as specified in Annexure - 3.
- A fine shall be imposed @ 0.1% per annum on the amount of annual transaction if the returns are not filed timely.

9. How is the DST deposited with the IRO?

- Payment shall be made electronically in the defined revenue head within 3 months from the end of each income year. [For FY 2022-23, the deadline would be within mid-October 2023.]
- Interest at the rate of **15% per annum** shall be levied on non-payment of tax within the stipulated time period.

10. How do the tax officers inspect the transactions and conduct assessments?

- When information or evidence is received that the transaction amount has been lowered or concealed in order to reduce tax liability, the tax officer shall give notice of preliminary tax assessment to the taxpayer.
- The notice shall be deemed to be provided if it is sent to the email address provided at the time of registration or to an authorized representative appointed by the non-resident.
- 15 days period shall be provided to give clarification along with evidence.

- Based on the evidence submitted by the taxpayer, the tax officer can give notice of the final tax assessment.
- Where it is found that transaction amount is concealed or inadequately reported a fine of 50% of tax on such concealed or unreported amount.

11. How is PAN registration cancelled?

- Application as per the format in Annexure - 4 shall be submitted to the tax office for cancellation of registration.
- The tax office shall inform the authorized person about the cancellation or reason for the non-cancellation of registration **within 3 months** of receipt of the application.

B. Procedures related to Value Added Tax on Digital Service

1. What is Digital Service?

For VAT purposes, “Digital Service” means the goods and services (as listed above on page 1 except a few) for which there is an essential need for the information technology for rendering service to customers (as defined) and which are automated through the internet with minimal human intervention:

The list of services falling under digital service are same as mentioned above under Section A - Procedures related to direct tax on digital service except the following which are excluded:

- a) Sales of data collected from residents of Nepal
- b) Education Service
- c) E-book, E-library and E-newspaper service

2. What is the basis and VAT rate on Digital Services?

- VAT shall be levied on the digital service transaction by a registered non-resident person at the rate of 13% with reference to section 7 of the VAT Act, 2052 (1996).
- The registered non-resident person shall collect VAT only from the consumers that fall under definition of consumer as per clause 2 (kha) of the procedures. Person other than consumer importing service shall be liable to collect and deposit VAT as per section 8(2) of the VAT Act, 2052 under reserve charge mechanism of VAT and non-resident should not collect VAT from such person.

3. When to register in VAT Digital Service Transactions?

- Non-resident persons transacting on digital services for an amount exceeding **NPR 2 million** within the past 12 months shall be registered as per section 10(kha)(1) of the VAT Act, 2052 and levy VAT from the date of registration. Voluntary registration is also permitted.
- Once the non-resident is registered, it shall recover VAT irrespective of the annual transaction amount in the future.
- Such person shall apply for registration within 30 days from the date of existence of the above condition before the tax office in the format prescribed in Annexure - 1 in case s/he is not registered in Digital Service Tax and as per Annexure - 1ka in case s/he registered as Digital Service Tax.
- Documents required to be uploaded along with the application shall be the same as those required for PAN registration in case of registration for Digital Service Taxpayer.
- Registration certificate shall be provided electronically within 7 days of the application in the format given in Annexure – 2.

PKF Nepal Comments

Considering that the digital service tax is a new concept in Nepal and was introduced on 29 May 2022, the period for computation of the threshold of NPR 2 million shall be from that date and not of a period prior to the date of introduction of the tax.

4. *Is a fine payable for failure to register?*

- A fine shall be levied as per section 29 subsection 1(ka) i.e. NPR 20,000 each time for failure to register.

5. *When do invoices have to be raised?*

- A registered non-resident person shall issue tax invoices electronically. Approval of the IRD is not required for such electronic billing.
- The invoice shall be issued at the earlier of service rendered or consideration received.

6. *How are the foreign currency transactions accounted for?*

- All accounting of the transactions has to be done in Nepalese Rupees.
- Accounting for consideration received in foreign currency by a non-resident registered person shall be done by converting such foreign currency amount into Nepalese currency by applying the conversion rate published by NRB at the date of such transaction (*apply the selling rate ruling on the date*).

7. *When should the VAT returns be submitted?*

- Non-resident persons shall submit a tax return to the IRD electronically as per section 18 of the Act within 25 days of the next month from the end of the tax period in the format prescribed in Annexure - 3.
- In the case of non-submission of return within the prescribed tax period, a fine shall be levied as per section 29 subsection 1(ja) of the Act i.e. 0.05% of the taxable amount or NPR 1000 per tax period whichever is higher.

8. *In which revenue code to deposit the VAT collected?*

- Registered person shall make an online payment of the determined tax under the **revenue code 33316**.

9. *Are interest and additional fees charged on delay in depositing VAT?*

- Yes, interest at the rate of 15% p.a. and an additional fee of 10% p.a. shall be recovered on failure to make payment of VAT within the prescribed time limit.

10. *How do the tax officers inspect the transactions and conduct assessments?*

- Tax officers can assess tax as per Section 20 of the VAT Act in case doubt arises that less tax liability has been determined by the taxpayers.
- If it is found that the transaction amount has been lowered or concealed in order to reduce tax liability, the punishment shall be as per Section 29 of the VAT Act.
- In case the person is not satisfied with the tax assessment of the tax officer, an appeal for administrative review can be made as per Section 31A of the VAT Act.
- If the person is not satisfied with the decision of the Direct General as well, an appeal can be made to the Revenue Tribunal.

11. *How is VAT registration cancelled?*

- If any registered person ceases to conduct a transaction attracting VAT or wishes to cancel the registration, the process as per Section 11 of the VAT Act shall be followed for cancellation of registration.
- Application as per the format in Annexure 4 shall be submitted to the IRD for cancellation of registration and all due taxes must have been paid prior to deregistration.
- The IRD shall inform the authorized person about cancellation or reason for non-cancellation of registration **within 3 months** of receipt of the application.



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right size
right solutions

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