Rework (hr) cost	*4,80,000*
(1,200×Rs.440)	*16,000*
Customer support (800×Rs.20)	*36,000*
Load	*3,60,000*
(200×Rs.180)	
Repair	*6,00,000*
(800×Rs.45)	
Additional contribution	*14,92,000*
(100 copies × Rs.6,000)	*10,00,000*
Saving in Costs	*4,92,000*
[Extra cost (Rs.50 X 20,000)]	
Net Benefit	

Decision: It is better to introduce new lens. The additional cost of lens on addition copier has been already analyzed in arriving at figure of contribution Rs 6,000. Hence, there is no need to consider again.

Advanced Taxation

Revision Test Paper

Income Tax 2058

Question No. 1

What are the provisions set by the act to address the principle of taxation in respect of entities?

Answer to Question No. 1

The principles of taxation in respect of entitles provides a basis of levying tax from them. Since entities are the legal personalities distinct from its beneficiaries, such principles are necessary to address some technical issues in taxing them. IT Act 2058 has made specific provision under Sec 52 for the "Principles of Taxation in Respect of Entities" as under:

(1) An entity shall be liable to tax separately from its beneficiaries.

(2) Distributions of entities shall be as defined in section 53 and beneficiaries of the entities shall be taxed in respect of such distribution in accordance with section 54.

(3) Amounts derived and expenses incurred by an entity, whether or not derived or incurred on behalf of another person, shall be treated as derived or incurred by the entity.

(4) Assets owned and liabilities owed by an entity shall be treated as owned or owed by the entity and not any other person.

(5) Foreign income tax paid with respect to the income of an entity, whether paid by a manager, beneficiary, or the entity, shall be treated as paid by the entity.

(6) Subject to Chapter 7 and section 45, transactions between an entity and its managers and beneficiaries shall be recognised.

Question No. 2

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What do you understand by Involuntary Disposal of Asset or Liability with Replacement?

Answer to Question No. 2

Where a person involuntarily disposes an asset in any of the manners like leased to another person under a finance lease, cancelled, redeemed, destroyed, lost, expired, or surrendered and that the person acquires ownership of a replacement asset of the same type then it is known as Involuntary Disposal of Asset or Liability with Replacement. Under such circumstances the transaction attracts some gain or loss on disposal of assets.

Under IT Act 2058, such provision is governed as under:
(1) Where a person involuntarily disposes of an asset in any of the manners described in section 40(1), the person acquires ownership of a replacement asset of the same type within one year of the disposal, and the person elects in writing for this subsection to apply-
(a) the person shall be treated as deriving in respect of the disposal an amount equal to the sum of the following-
(1) the net outgoings for the asset immediately before disposal; plus
(2) the amount, if any, by which amounts derived in respect of the disposal exceed expenses incurred in acquiring the replacement asset; and
(b) the person shall be treated as incurring in acquiring the replacement asset expenses in an amount equal to the sum of the following-
(1) the net outgoings for the asset disposed of immediately before disposal; plus
(2) the amount, if any, by which costs incurred in acquiring the replacement asset exceed the amounts derived in respect of
the disposal.
(2) Where a person involuntarily disposes of a liability in any of the manners described in section 40(2), the person incurs a replacement liability of the same type within one year of the disposal, and the person elects for this subsection to apply-
(a) the person shall be treated as incurring expenses for the disposal in an amount equal to the difference remained after subtracting the amount of subparagraph (2) from subparagraph (1) of the following-
(1) the net incomings for the liability immediately before disposal; less
(2) the amount, if any, by which the costs incurred for the disposal exceed the amounts derived in respect of incurring the replacement liability; and
(b) the person shall be treated as deriving in respect of incurring the replacement liability an amount equal to the sum of the following-
(1) the net incomings for the liability disposed of immediately before disposal; plus
(2) the amount, if any, by which the amounts derived in respect of incurring the replacement liability exceed the expenses incurred for the disposal.
(3) The circumstances shall be as prescribed in which the replacement of one security in an entity with another security in an entity as a result of conversion of the security or reconstruction of the entity constitutes an involuntary disposal.

Question No. 3

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Jai Hanuman Ltd. (special industry) furnished its income statement for the income year 2071-72 as under:

Particulars	Schedule	In Rs. million
Sales		100
Less:		
Change in stock	1	(80)
Other direct expenses	2	(7.5)
Operating profit		12.5
Add:		
Other Income	3	5.15
Less:		
Other non-operating expenses	4	(12.03)
Profit/loss before taxes		5.62

Schedule 1 : Change in stock

Particulars	In Rs. m
Opening stock	15
Purchase	75
Less: Closing stock	(10)
Total	80

Schedule 2 : Other direct expenses

Particulars	In Rs. m
Freight inward	4
Direct wages	2
Manufacturing expenses	1.5
Total	7.5

Schedule 3 : Other Income

Particulars	In Rs. m
gain on sale of business assets	0.06
prize from display competition	0.25
bad debt recovered	2.8
interest received	1.5
rent income (net of TDS)	0.54
Total	5.15

Schedule 4 : Other non-operating expenses

Particulars	In Rs. m
administrative expenses	2.6
interest expenses	5
repair & improvement	0.41
depreciation	2.12
miscellaneous expenses	0.05
audit fee	0.1
pollution control cost	0.5
research & development	0.75
donation	0.50
Total	12.03

Additional Information

Schedule 1: Change in stock:

i. Closing Stock valuation as per Income Tax Act Rs 9.5m.

ii. Purchase included the following

- Payment of VAT on purchase of raw material of Rs 0.13 million was booked as expenditure. (Note: The Company is a VAT registered person).
- Rs 1 million paid in cash to farmer who supplied raw agricultural products to the company in previous year.
- Purchase of Rs 1million during the year but the payment was made through depositing cash into supplier's bank account.

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- Raw materials of Rs 2.5million that was received on 2072/3/31 at factory. However, the tax invoice that was submitted later on contained the date of 2072/4/1.

Schedule 2 : Other direct expenses

Direct wages included:

- Rs 0.15m on the omission of recording of wages of Ashad of previous year.
- Rs 0.1m worth of gratuity payment to two employees during the year by debiting provision for gratuity which was disallowed during previous years when it was booked as expenditure in the financial accounts.

Manufacturing expenses included:

- Consumption of store was booked on current market price of the year end as per the replacement cost policy of the company i.e of Rs 1m actual cost was booked for Rs 0.75m.
- Salary of Rs 1m of General Manager(GM), Indian Citizen who was newly appointed in the company on 2071/11/1, previously he was in India, without deducting with-holding tax.

Schedule 3 : Other Income

- Out of Bad Debt recovered 60% was not allowed as deduction in previous years.

Schedule 4 : Other non-operating expenses

- Administrative expenses included expenses of Rs 0.2m for staff tea & refreshment through various vouchers less than Rs 450 each, which had no supporting i.e, PAN bill and Rs 0.3m was deposited to an approved retirement fund.
- 2/3rd Research & Development cost was only related to business.
- Repair & Improvement expenses were in excess of Rs 0.2m than allowable limit as per act.
- Donation to Lumbini Development Trust with IRD's pre- approval.
- Rs 5m was given to one of the Board of Director of the company for the entire fiscal year without charging interest. The company arranged the fund for such advance from bank loan which costs 10 % p.a to the company.
- Depreciation was as allowed by the act. However, it did not include allowable additional depreciation that is allowable to special industries..

Other Information

- Estimated Tax Return was not submitted;
- Advance tax of Rs 0.3m was paid on 31/3/2072.
- Income Tax Return was filed on 20th Magh,2072.

Required

- Calculate Taxable income and Income Tax to be paid.

Answer to Question No. 3

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Impact of Additional Information to calculate Taxable Income of the Company

Schedule 1: Change in stock:

- Closing Stock valuation as per Income Tax Act Rs 9.5m.

  Impact: Rs 0.5m is to be deducted from closing stock.

- Purchase includes the following
  - VAT of Rs 0.13m of material purchase posted as purchase.

    Impact: Disallow Rs 0.13 m as it is not expenses, it can be claimed as input tax credit.
  - Rs 1m paid in cash to farmer who supplied raw agricultural products to the company in previous year.

    Impact : Disallowed expenses since it is not related to purchase/ expenses of this year (section 13) i.e, payment is shown as purchase.
  - Purchase of Rs 1m during the year but the payment is made through depositing cash into supplier's bank account.

    Impact: cash deposit into supplier bank is allowed
  - Materials received on 2072/3/31 at factory, whereas the tax invoice of supplier contains transaction date of 2072/4/1.

    Impact: Allowed. If we go by the spirit of the act, the expenditure pertains to the income year 2071/72, thus should be allowed on the basis of receipt of goods during the year.

Schedule 2 : Other direct expenses

- **Dir**ect wages includes Rs 0.15m the omission of recording of wages of ashad of previous year. Rs 0.1m gratuity paid to two employees by debiting provision for gratuity a/c during the year which was disallowed in previous years when it was recorded as provision for gratuity.

  Impact: Rs.0.15m will be disallowed as it is not related to expenses of this year.

  additional Rs.0.1m is allowed for expenses (not included in wages of P/L)

- Manufacturing expenses includes the following:
  - Consumption of store is booked on current market price of year end as per the replacement cost policy of the company i.e of Rs 1m, actual cost is Rs 0.75m.

    Impact: Rs 0.25m shall be disallowed.(Refer section 15)
  - Salary of Rs 1m of General Manager(GM), Indian Citizen who is newly appointed in the company on 2071/11/1, previously he was in India, without deducting with-holding tax.

    Impact : No impact but with- holding tax to be deducted @ 25% as non resident.

Schedule 3 : Other Income

- Out of Bad Debt recovered 60% was not allowed as deduction in previous years.

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Impact: only 40 % shall be included in taxable income.

Schedule 4 : Other non-operating expenses

- Administrative expenses includes the expenses of Rs 0.2m for staff tea & refreshment through various vouchers less than Rs 450 each, which has no supporting i.e, PAN bill and Rs 0.3m deposited to an approved retirement fund.
  Impact: No impact (Refer Rule 6, section 21(2))
- Pollution control cost is the cost of equipment installation to control pollution.
  Impact: up to 50% of Adjusted Taxable Income is allowable.
- 2/3rd Research & Development cost is only related to business.
  Impact: 1/3rd Rs 250000 is not allowed as expenses (Sec 13)
- Repair & Improvement expenses was excess by Rs 0.2m than allowable maximum limit.
  Impact: Disallow Rs. 0.2m from total repairs expenditure.
- Donation to Lumbini Development Trust with IRD's pre- approval.
  Impact: Rs 1m or 10% of assessable income or actual whichever is lower is allowable (section 12 (ka))
- Rs 5m has been given to one of the Board of Director of the company for the entire fiscal year without charging interest. The company arranged the fund for such advance from bank loan which costs 10 % p.a to the company.
  Impact: Fund Rs5m is used in other than business, hence its interest cost is disallowed i.e Rs.0.5m.
- Depreciation does not include allowable additional depreciation.
  Impact: Company may deduct additional 1/3 rd depreciation (Schedule 2)

<u>Other Information</u>

- Estimated Tax Return has not been submitted , advanced tax of Rs 3 lacs has been paid on 31/3/2070.
  Impact: Rs 2,000 penalty for non-filing of ETR. Besides, Interest to be calculated for short deposit of installment tax as per section 118, 119.
- Income Tax Return is filed on 20th Magh,2072.
  Impact: Penalty of 0.1% p.a for 4 months on amount arrived by including all amount to be included in income.

Question No. 4

Mr. Dhanjeet Shah has income from many different sources during the income year 2071/72. As such, he was a bit confused in working out his taxable income and seeks your consultancy to work out the same from the following information:

<u>Source 1: Salary income from Vabisya Nirman Engineering Consultancy Pvt. Ltd.</u>

- Basic Salary - Rs 40,000 per month

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- Children Allowance - Rs 2,000 per month
- Dearness Allowance - Rs 2,000 per month
- Driver's Salary for car facility born by office - Rs 8,000 per month
- Petrol Expenses for car facility born by office - Rs 10,000 per month
- Repair Expenses for car facility born by office - Rs 25,000
- Staff Bonus - Rs 60,000
- Reimbursement of house rent from office - Rs 300,000
- He received loan @ 5% p.a. – loan amount Rs 1,000,000 for personal use from office, current market rate of interest is 10%.
- Leave Encashment of Rs 50,000 was received.
- Office deducted 10% of basic salary & deposited 20% of basic including his deduction at an Approved Retirement Fund.
- He himself deposited Rs 20,000 per month at CIT as retirement contribution.
- Company provided one month basic salary as festival bonus.
- The bank provided him with a car for his personal & official use.

Source 2: Salary income from Engineering campus

- He received Rs 200,000 from engineering campus as remuneration income.

Income from shops

- Sales Rs. 2,000,000 and Expenditure Rs. 2,5000,000 at New Road Shop
- Sales Rs. 2,500,000 and Expenditure Rs. 2,2000,000 at Baneshwor shop.

Income from other sources

- Earned Rs 10 Lacs from sale of a house for Rs 50 lacs, which was purchased 2 years before.
- Gain of Rs 10 Lacs from sale of gold & silver jewelries purchased in his marriage.

Details about expenditure

- Investment Insurance Premium paid of Rs 23,000 to non-resident insurance company.
- Donation to political party registered at Election Commission Rs 50,000 and Rs 25,000 to a social club not registered in PAN.
- Medical expenses of Rs 10,000 were incurred for himself at Bir Hospital.
- Interest of Rs 50,000 was paid to the office for his personal loan taken.
- Paid salary of Rs 150,000 p.a. to the house maids.

Answer to Question No. 4

Answer

Calculation of Taxable Income of Mr. Dhanjeet Shah for I/Y 2071/72

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Particulars	Working Note	(Rs)
Basic Salary (40000 x 12)		480,000
Dashain Allowance		40,000
Children Allowance (2000 x 12)		24,000
Dearness Allowance (2000 x 12)		24,000
Staff Bonus		60,000
Vehicle facility	W.N. 1	2,400
Driver's Salary	W.N. 2	-
Repair Expenses	W.N. 2	-
Petrol Expenses	W.N. 2	-
Reimbursement of House Rent	W.N. 3	300,000
Deemed Interest Income	W.N. 4	50,000
Leave Encashment		50,000
Employee's Contribution foe ARF (10%)		48,000
Salary from Engineering Campus		200,000
Income from Remuneration (A)		**1,278,400**
Income from Business (Computer Shop)	W.N. 6	(200,000)
Income from Business (B)		**(200,000)**
Income from Investment		
Income from Sale of House	W.N. 7	1,000,000
Income from Sale of gold & silver jewelries	W.N. 8	-
Income from Investment (C)		**1,000,000**
Total Assessable Income (D=A+B+C)		**2,078,400**
Deductions		
Contribution to Approved Retirement Fund (E)		300,000
i) Actual Payment		
:- Deposited by Employer 96,000		
:- Deposited by Dhanjeet 240,000		
:- Total Deposit 336,000 or		
ii) Maximum of Rs 300,000 or		
iii) 1/3 of Assessable Income 2,078,400 i.e. 692,800 whichever is lower		
Adjusted Taxable Income (D - E)		**1,778,400**
Less: Donation Expenses		50,000
i) Maximum of Rs 100,000 or		
ii) Actual to tax exempt entity i.e. 50,000 or		
iii) 5% of Adjusted Taxable Income i.e. Rs 103,920, whichever is lower		
Less: Investment Insurance Premium	W.N. 9	20,000
Taxable Income		**1,708,400**

Calculation of Income Tax

Particulars	Amount (Rs)	Tax Rate	Tax
First	250,000	-	-
Next (Income from NBCA)	1,000,000	5%	50,000
Next	100,000	15%	15,000

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Next	358,400	25%	89,600
Total	**1,708,400**		**154,600**

Tax Liability

Income Tax Computed Less: Medical Tax Credit (WN. 10)	154,600 750
Tax Payable	**153,850**

Working Notes

W.N.1

Vehicle Facility

As per Rule 13 (1) (Ka), 0.5% of Basic (Regular) Salary shall be included in income of employee.

Hence, 480,000 x 0.5% = Rs.2,400

W.N. 2

As per circulation of IRD, where vehicle facility is provided by employer then prerequisites of driver's salary, petrol & related expenses shall not be included in income of employee.

W.N. 3

As per Section 8(Ga), reimbursement of home rent is to be included in income from employment.

W.N.4

Deemed Interest Income

As per Section 27 (1) (Gha), income where the interest paid by the payee during the year under the loan is lower than the interest to be paid as per the current market interest rate, to the extent it is lower shall be deemed income.

Hence, margin of interest i.e. (10-5%) 5% on Rs 1,000,000 i.e. Rs 50,000 is included in income of employee.

W.N.6

Income from Business

Loss of business can be set off in income of spouse’s business.

W.N.7

Here, house sold within 10 years & having value more than 30 lacs is Non Business Chargeable Assets (NBCA) & income from NBCA is Investment income, hence included in income. Income from such NBCA is taxed @ 5%.

W.N.8

Income from sale of goods & silver jewelry are personal belongings not NBCA, hence not taxable.

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W.N.9

As per Section (1) of Schedule 1 of Income Tax Act, any resident person paying investment insurance premium, he may deduct up to Rs 20000 as expenses.

Though payment is to Non-resident Insurance Company. It is allowed as expenses.

W.N. 10

Approved medical expenses of Rs 750 can be set off from tax payable (Rule 17) and balance shall be carried forward.

Question NO. 5

Discuss the applicability of withholding tax in the following case:

a. "A telecommunication company Resident in Nepal is providing international communication services to local customers by using facilities of optical fiber and satellite service providers situated outside Nepal. The Company pays fixed charge plus fee based on transmission of information/data periodically against these services."

Answer:

As per sec.67(5) (jha) of the Act, payments received by a person who conducts a business of transmitting messages by cable , radio, optical fiber, or satellite communications in respect of the transmission of messages by apparatus established in Nepal , whether or not such messages originate in Nepal is deemed to have source in Nepal. Since in the question the optical and satellite service provider are situated outside Nepal and naturally the equipment are also supposed to be placed outside Nepal, their income has no source in Nepal and is not liable to tax in Nepal. If the equipments are situated in Nepal, then the provider of service shall be liable to tax deduction at source of 5% as per Schedule 1-clause 2(7)

b. For the income year 2064/65, Niagara Limited, a music company operating in Nepal, declared dividend at the rate of 25% of paid up capital. Mr. Justin Bieber, a Canadian singer, was the owner of 10 % of the paid up capital of the company came to Nepal on 2070.4.25 and collected the dividend pertaining to that income year and flew back to his country within a month of arrival. The company paid Rs. 50 million to Mr. John as dividend and deducted withholding tax at the rate 5 % of the payment.

However, upon full audit of the bank on 2072.5.22, the tax officer argued that the bank should have deducted withholding tax at the rate 10% of the payment.

Answer:

The argument of the tax officer was correct. Because, during income year 2064/65, the tax rate for the payment of dividend having source in Nepal by a resident person to non-resident person was 10% of the payment (As per Sec. 88 (2) (Ka) of Income Tax Act 2058). Therefore, Niagara Limited should have deducted tax at source at the rate of 10% of the dividend amount. Thus, the TDS amount comes to Rs. 5 million (10% of Rs. 50 million).

Note:

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The said provision of levying 10% withholding tax on payment dividend having source in Nepal by resident person to non-resident person was repealed from 2065.6.3.

Question No. 6

a. Government of Nepal has issued five year-special bond against the duty draw back payable to an exporter. The exporter sold it before the date of maturity at 90% of the face value. The loss amount has been charged to profit and loss account. Will such loss be allowed as expenses for the purpose of determining taxable income of the exporter? Will your answer be differing if such bond is sold to associate person?

Answer to Question No. 6 'a'

First of all we should identify whether the loss incurred on sale of government bonds is capital loss or revenue loss. Under the duty draw back scheme, the exporter gets refund of the duties paid against the goods exported out of the country. The government had paid such bond in lieu of cash. Besides this the intention of the exporter is not make investment in "bond" but to realize cash against the duty. Accordingly the bond should be treated as marketable securities or short-term investment. Hence, such loss should be treated as revenue loss and thereby allowed u/s 13 of the Act.

The answer will be differing, if the bonds are sold to the associated person. In such case the selling price of the bond should be verified with the market rate (armed length principal) because there could be the transfer of profit to associated person.

b. The Company has made the revaluation of the depreciable assets by Rs. 10 million and same amount is credited to concern reserve account, and then distributed to the shareholder. What are the provisions laid down in Income Tax Act 2058 and what would be the tax implication in the hands of company as well as to the shareholders?

Answer to Question No. 6 'b'

Sub Section 3 of Section 56 of the Act clearly states that, where an entity distributes dividend to the beneficiary that is not a distribution of profit, the amount of the dividend shall be included in calculating the income of the entity.

The reserve created by revaluating the depreciable assets to the extent it is distributed shall be included in the income of the entity. Besides, the withholding tax at the rate 5% is required to be deducted while making payment to the shareholders. This withholding tax will be treated as final withholding at the hand of the shareholders.

Question No. 7

Mr. Raj Shrestha is a graduate on banking business from University of Idaho, USA.

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Upon completion of his studies, he returned to Nepal and made investment as a promoter in one of the reputed commercial bank named "Shuva Laxmi Bank". He also served as a director and chairman of the executive committee of the same bank for a period of 4 years. During his tenure, the bank was able to secure huge market share and a significant public trust and confidence. The performance of the bank was also beyond set target and it was able to secure a significant volume of profit after tax.

Upon completion of the tenure from directorship of the bank, the bank honored him with an honorarium of Rs. 25 Lakhs. Besides, he was gifted an I-pad that he was using while on duty for the bank.

Required:
From the above information, discuss the possible consequences of tax liabilities for the company and Mr. Shrestha.

Answer to Question No. 7

i. The payment is made at the time of retirement from the directorship. As such, it may be considered as a retirement payment. Under sec. 2(e) a retirement payment is any payment made to an individual on retirement. It does not state a relationship of employer / employee should be there. If it is treated as retirement payment then it will be treated as income from investment and will become taxable as income from non-business chargeable asset, namely, the holding of shares in the company and being a director as a result of that, thus having beneficiary interest in the company and will be liable to tax at 10% in accordance with clause 1(4) of Schedule I of the act.

ii. Again, under Section 31, if the payment is treated as a compensation for loss of office of director, then, it shall be treated as income from investment. It is because he is not an employee of the bank to treat the payment as income from employment.

iii. Gift of I-Pad shall be treated as investment income and taxed accordingly at fair market price.

iv. Besides above, the payment is in recognition of improving the earnings of the company, this is allowable under sec.13 as expense of the company. But as per the directions of the department and of Nepal Rastra bank, any residual remuneration to directors will have to be paid from the after tax profit only and so the company cannot claim it as an expense for the purpose of income tax. Since the amount is paid out of after tax profit, it may be treated as dividend and distribution of profit under sec.53, in which case 5% tax should be deducted by the company as final withholding payment since it will be distribution of dividend,

<u>International Taxation</u>

Question No. 8

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What do you understand by the term double taxation avoidance agreements?

Answer to Question No. 8

A double tax avoidance agreement (DTAA) is an agreement entered into between two countries in order to avoid taxing the same income twice i.e., one in income country & other in residence country. Generally, the two legal criteria for tax liability under any tax law are "residence" and "source".

Basic rule of taxation

- Residence Rule "Worldwide Taxation"
- Source Rule "Source Taxation"

On account of this, when a resident of a country derives income from a source in another country, he is likely to get taxed in both the countries namely, the "source country" as well as in the "country of residence". The country in which he resides (Home Country) exercise the right to tax the income on the basis of residence rules. The country in which the situs of transaction exists (source country) also exercise such rights on the basis of source rules. This gives rise to double taxation of the same income in the hands of the same person by two different countries. Hence, to avoid the double taxation there is DTAA. DTAA avoids the double taxation by means of exemption method or the credit method or deduction method.

Question No. 9

What is the principal aim of DTAAs? What are the commonly used models of DTAA?

Answer to Question No. 9

DTAAs aim at eliminating or reducing the tax burden of a resident of a Contracting State engaged in transactions with a resident of another Contracting State. The intention behind a DTAA is to aid in enhancing trade. As the tax element is an important consideration for a businessman, he would always weigh his return on investments post tax. In order to attract more trade, which generates more employment, which in turn raises the disposable income and increases the purchasing power, giving a general boost to the economy; countries are willing to forsake a certain percentage of collection in revenues.

As the problems faced by most countries would be largely similar, a need was felt to standardize the DTAA. As early as in the 1920s, the International Chamber of Commerce sought the help of the League of Nations to overcome the problem of double taxation. The need to standardize DTAAs was felt to reconcile the laws and needs of different countries while preserving their individuality. A standardised DTAA would also help the persons dealing in trade with different countries at the same time.

Model forms of the Convention were first prepared by the Fiscal Committee of the League of Nations in 1927. Later the Committees conducted meetings in Mexico during 1943 and in London in 1946 to discuss the drafts and proposed minor variations. The Model Conventions were published in 1946 by the Fiscal Committee of the United Nations (UN) Social and Economic Council. These drafts were the starting point by

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Organisation for Economic Co-operation and Development (OECD) for its draft model DTAA.

There are four different models of DTAA in existence:

1 OECD Model Tax Convention: The draft model DTAA was first published by the OECD in 1963 and updated periodically. The OECD model is generally regarded as favouring developed countries as it gives priority of taxation to the residence state over that of the state of source. OECD Model is the base on which other Models are built. It has also been used as a Model for negotiating Treaties between OECD Members and non-member countries.

2 U. N. Model: Since the OECD Model was regarded as furthering the interests of the developed countries, therefore, the developing countries prepared their own model in 1979, which is known as the 1979 UN model. This was developed / modified further in 1980 and 2001 incorporating the changes gained out of the experience. As the OECD model was the source, both the drafts are largely similar.

3 U.S. Model: U.S. Model serves as a model to negotiate Treaty with USA. It is also based on OECD Model. It adapts to the conditions peculiar to the US. The U.S. Model was first published in 1976 and revised in 1977, 1981 and 1996. USA has also published Technical Explanation to explain / clarify the provisions in the Articles of the U.S. Model.

4 Andean Model: This Model is adopted by the Member states of Andean Group namely, Chile, Equadot, Columbia, Peru and Venezuela. The Model primarily follows the source rule of taxation and accordingly, royalty, interest, dividend and income from mineral natural resources are taxed in the source country. These DTAA Models have led to the development of international tax law besides harmonization of DTAAs at the time of negotiation of the DTAA and also at the time of interpretation of DTAAs in the event of a dispute.

Question No. 10.

What are the methods of elimination of double taxation?

Answer to Question No. 10:

The methods/ means of avoidance of double taxation are:

<u>Exemption Method</u>

The Treaty may provide for exemption from the liability in one jurisdiction i.e. the country in question will refrain from taxing the particular income and allow the other jurisdiction to impose tax.

<u>Tax Credit Method</u>

Treaty may not provide for exemption from tax liability which implies that both countries shall be entitled to levy tax. However, income tax paid by the person in the foreign

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income is allowed as tax credit to the extent of effective tax payable in the country of residence and only the balance, if any, shall be collected.

<u>Deduction Method</u>
Income Tax paid by the person in the foreign income is allowed as deductible expenses.

Question No. 11.
Mr. Narayan Bhusal is a professor of Tribhuvan University and was a resident of Nepal. On Ashwin 1, 2071, he went to China under an assignment for carrying out specific research work in Harbin University. For his outstanding work, the University paid remuneration of Chinese Yuan. 100,000 for the period Ashwin 1, 2071 to Ashadh 31, 2072. Discuss the tax liability of Mr. Bhusal.

Answer to Question No. 11:
According to Article 20 of the agreement between Nepal and China for avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income, a professor or teacher who is or was a resident of one of the contracting states immediately before visiting the other contracting state for the purpose of teaching or engaging in research, or both, at a university, college, school or other approved institution in that other contracting state shall be exempt from tax in that other state on any remuneration for such teaching or research for period not exceeding two years from the date of his arrival in that other state. This provision applies to Mr. Bhusal because he was resident in Nepal during FY 2070/071 and his stay in China has not exceeded two years. Therefore, remuneration of Chinese Yuan 100,000 received by Mr. Bhusal during income year 2071/72 is exempt from tax in China. However, the income is taxable in Nepal, as he has been in Nepal for a continuous period of 182 days before departure to China.

Value Added Tax 2052

Question No. 12
Explain the cases where an unregistered person needs to collect VAT on transactions similar to as registered person.

Answer to Question No. 12
In the case of reverse charging method VAT is collected even from non-registered person.

- Service receiver from foreigners- According to Sec. 8(2), any person (registered or not) in Nepal receiving service from person outside Nepal need to pay VAT on the amount paid for service provider attending in Inland Revenue Office. If the person is registered person, it can set off such payment as other purchases.
- Housing Developers- According to Sec. 8(3), any person (registered or not) in Nepal engaged in constructing commercial buildings, apartments, shopping malls or similar having value more than Rs. 5 million need to pay VAT on the construction cost, if not paid to a registered person.

Question No. 13

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XYZ Ltd. exported goods worth Rs. 15,000,000 that contained the taxable and non-taxable goods at a ration 8:7. The company also had sales in the domestic market worth Rs. 31,625,000 that contained taxable sales of Rs. 29,625,000 and the rest is non-taxable sales. Besides, the domestic taxable sales included Rs.14,125,000 sold through abbreviated tax invoice.

The company paid VAT on purchase of taxable Goods Rs. 30,00,000 and on taxable service Rs. 200,000. The opening input credit of VAT carried forward is Rs. 300,000.

From the above information, calculate the following:

i) Statement of taxable and non-taxable sales; and
ii) Statement of VAT receivable or payable at the end.

Answer

i. Statement Showing Taxable and Non Taxable Sales

Particulars	Sales (NRs)				
	Taxable			Non Taxable	Total
	0 %	13%	Total		
Export Sales (8:7)	8,000,000		8,000,000	7,000,000	15,000,000
Domestic Sales					
i. Tax Invoice		15,500,000	15,500,000		15,500,000
ii. Abbreviated Invoice *		12,500,000	12,500,000		12,500,000
iii. Non Taxable				2,000,000	2,000,000
Total	**8,000,000**	**28,000,000**	**3,60,00,000**	**9,000,000**	**45,000,000**
		% of total sales	80%	20%	100%

* Excluding tax

ii. Statement of VAT A/C

Particulars	**Taxable Value**	**VAT (NRs.)**	
		Debit	**Credit**
Opening Balance		300,000	
On Purchase of Taxable Goods		3,000,000	
On Purchase of Services		200,000	
Tax Collected on Sales from Tax Invoice	15,500,000		2,015,000
Tax Collected on Sales from Abbreviate Invoice	12,500,000		1,625,000
Tax Input on service disallowed ***(W.N.)***			40,000
VAT Payable to Inland Revenue Department		**180,000**	
Total		**3,680,000**	**3,680,000**

Working Note:

Rule 40 (4) of the VAT Rule 2053 states that in case a taxpayer carrying out the transactions of both taxable and tax exempt goods or services fails to establish the direct relationship of the purchased or imported goods with the taxable goods or services, such taxpayer may deduct the amount of tax paid on his purchases or imports by calculating the proportion of taxable transaction value out of his total sale value.

Hence, remaining within the provision stated above, the Vat paid on purchase of service is disallowed to the extent 20% on the proportionate basis of taxable and non-taxable value transaction. As such tax input disallowed = 20% of Rs. 200,000 = Rs. 40,000.

Excise Act 2058

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Question No. 14

XYZ ltd. is a producer of sophisticated electronic devices that attract excise duty. The information of the company regarding its imports and other cost of production is detailed hereunder:

Particulars	Rs.
Cost of imported materials (excluding customs)	10,000
Transportation cost up to Nepal customs point	400
Transportation cost from customs point to factory	100
Cost of local materials (including VAT)	22,000
Wages	2,000
Factory Overheads	3,000
Office Overheads	4,100
Distribution cost	3,000

The rate of customs and excise duty is 15% and the profit margin is 25% on cost before overheads and distribution cost.

Required: Calculate Customs Duty, Excise and VAT from the above transactions.

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Answer:

Particulars	Rs.	VAT (Rs.)
Cost of imported raw materials	10,000	
Transportation up to Nepal customs point	400	
Cost of imported raw materials (before custom duty)	10,400	
Customs duty	**1,560**	
Cost of imported raw materials (after custom duty)	11,960	1,554
Transportation cost from customs point to factory	100	
Cost of local materials	20,000	2,600
Wages	2,000	
Cost before overheads	34,060	
Factory overheads	3,000	
Office overheads	4,000	
Cost of production	41,060	
Excise duty	**6,159**	
Distribution cost	3,000	
Total	50,219	**4,154**
Profit	8,515	
Sales price	58,734	
VAT to be collected @ 13%	**7,635**	

Question No. 15

The Nirman Bricks Industries is registered under the Excise Act and incurred heavy loss since F/Y 2066/067 due to various reasons. The owner of Nirman Bricks Industries wanted to suspend the license for two years from F/Y 2070/071 to 2071/72. As you are a tax expert, the firm wants your expert opinion whether the suspension for two years is possible or not? Your views are to be based on the legal provision of Excise Act, 2058.

Answer to Q. No. 15

As per the decision of Inland revenue Department dated 2068.04.17, in the case where an application is made to the excise officer for the suspension of license for limited period giving valid reason, the excise officer may grant the permission for suspension of license if the following conditions are satisfied:

i) The firm has paid full amount of Tax and other applicable fee till the date of suspension.

ii) Separate record has to be maintained.

iii) The declaration of closing stock of all brands and quantity is to be provided.

iv) The time limit of suspension is to be fixed.

v) At least two times inspection has to be done in those industries.

vi) The notice of suspension is to be circulated to local authority and firm registered office.

vii) In case the firm desired to re-operate the business, an application is to be made to excise officer and necessary examination is to be done by excise officer before granting the operating license.

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Customs Act 2064

Question No. 16

i. DRP system

The full form of DRP is duty refundable procedure. DRP is an export promoting tool used by India. Under this procedure, India refunds Nepal the excise duty paid by Nepalese importer. Indian Government has settled some procedure regarding refunding the excise duty. This procedure is known as DRP system. This provision is mentioned in protocol 3 of Nepal India Trade Treaty. But the refund-payment will not be excess than the excise charged by Nepal Government on similar type of goods. Similarly while charging the custom on such excise paid Indian goods, the custom duty should be charged after deducting the excise duty.

ii.CTD form

CTD is known as custom transit declaration. An importer is liable to submit such form in custom point. Mainly this form is used when the importer of Nepal imports the goods from third country via India. This is the form for certification by importer regarding the goods that have to be imported. This form contains name and address of importer's agent, name and address of importer, address for delivery, ship's name, route of transit, Country of consignment or country of origin and serial number, import license number, endorsement of customs and Indian border custom, Quantity of goods, descriptions of packages and value of goods.

iii. Bill of Lading and Airway Bill:

Bill of lading is transportation related document that is used by exporter or importer. This is related to ship transport or ship freight. Transport Company issues it. This form contains importer/exporter's name, address, quantity of goods, container number, name of the goods, date, freight amount etc.

Airway Bill is related to air transport. Concern Airlines issues it. It contains importer/exporter's name, address, quantity of goods, container number, name of the goods, date, freight amount etc.

iv. **Indent:**

It is a document showing the particulars of the consignment for which the buyer has placed an order with the supplier. It normally gives particulars about:

i) Full description of the goods

ii) Unit price

iii) Mode of payment

iv) Quantity required

v) Delivery instructions

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