NITI PARTNERS & ASSOCIATES

A NITI PARTNERS HANDBOOK

Permanent Establishment in Nepal

A handbook for foreign enterprises, contractors and tax counsel

Income Tax Act, 2002 | Permanent Establishment Directive (2021) | DTAAs

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HANDBOOK

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FRONT MATTER

Introduction

A foreign company can become liable to Nepalese income tax without registering anything in Nepal. Nepal taxes income that has a Nepalese source, which section 67 of the Income Tax Act, 2002 (the Income Tax Act) defines by reference to the payment or the work, so an activity carried on abroad can still produce taxable income. Where the company also carries on business through a place, a person or a project in Nepal, that presence is a permanent establishment (PE), taxed on its profits as a resident company, and registration does not itself create a PE.

This handbook explains when a PE arises under the Income Tax Act and the Income Tax Rules, 2002 (the Income Tax Rules), as interpreted by the Permanent Establishment Directive, 2021 (the Directive). The Inland Revenue Department (IRD) issued the Directive on 19 January 2021 to clarify how the Income Tax Act applies to permanent establishments. The handbook then covers the effect of Nepal's double taxation avoidance agreements (DTAAs), tax registration and compliance, and the attribution and taxation of the profits of a PE. The scope is limited to income tax. Value added tax, customs, immigration, employment and foreign investment approvals are mentioned only where they affect a PE consequence.

A PE is a tax concept. Being a PE, or registering as one for tax, does not itself entitle a foreign company to carry on business in Nepal, which also requires the commercial presence and registration that other Nepalese law demands. In the Directive the IRD has provided worked illustrations to make the rules easier to understand and apply. Each shows how the IRD applies a rule to a particular set of facts, so it should be read within those facts and reviewed carefully against the arrangement under consideration. Amounts are stated in Nepalese rupees (NPR) in international notation, dates follow the Gregorian calendar, and each PE is identified by a Permanent Account Number (PAN) once registered. The handbook states the law and the Directive as issued, and later amendments should be checked before reliance.

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OVERVIEW

The Handbook at a Glance

The handbook follows a PE from identification to closure. The five stages below correspond to its chapters, and the four figures are the numbers that recur through the analysis.

The life of a PE

Stages and the chapter in which each is addressed

1 **Identify** — Chapters 3 to 8

2 **Register** — Chapter 9

3 **Compute** — Chapter 10

4 **Remit** — Chapter 10

5 **Close** — Chapter 9

Key figures

Figures stated in the text and the chapter in which each is addressed

90 days
Threshold for a construction PE and for a service PE within any twelve months
Chapter 6

183 days
DTAA period for a site PE or service PE under several DTAAs
Chapter 8

25%
Corporate rate used in the examples of the Permanent Establishment Directive
Chapter 10

5%
Tax on income remitted abroad, payable by the PE
Chapter 10

Chapter guide

CHAPTER	SUBJECT	QUESTION ANSWERED
1	Legal and regulatory framework	Which instruments govern a PE and which prevails
2	Key definitions	What makes an arrangement a PE
3	Eligibility and threshold tests	Whether a company can have a PE at all
4	Fixed-place PEs	When premises, staff or storage in Nepal create a PE
5	Agency PEs	When a person acting for the company in Nepal creates a PE
6	Construction sites and service teams	How the 90-day tests operate
7	Other situations and special cases	How licences, subsidiaries and multiple activities are treated
8	Double taxation agreements	How a DTAA changes periods, income and rates
9	Tax registration, returns and closure	What must be registered for tax, filed, kept and closed
10	Taxation of the PE	How profit is computed and taxed, and what is due on remittance
11	Exposure management and compliance	Where exposure arises and how it is addressed

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CHAPTER 1

1 Legal and Regulatory Framework

A foreign company's Nepalese tax position is governed by three sources that rank differently, namely the Income Tax Act, the Directive and any applicable DTAA. This chapter sets out which prevails, which office administers it and how the income year runs.

> **INCOME TAX ACT, SECTION 2, DEFINITION OF PERMANENT ESTABLISHMENT (IN TRANSLATION)**
>
> "Permanent establishment" means a place where a person carries on business wholly or partly, and includes:
>
> (1) a place where a person carries on business wholly or partly through an agent, other than an ordinary agent acting independently in the ordinary course of business;
>
> (2) a place where a person's principal equipment or machinery is located, used or installed;
>
> (3) one or more places in a country where a person provides technical, professional or consultancy services, through employees or otherwise, for more than ninety days in any twelve-month period, whether at one time or in instalments; and
>
> (4) a place where a person is engaged in a construction, installation or assembly project for ninety days or more, together with the place where supervisory activity for that project is carried out.

1.1 Why a PE matters

Nepal taxes a non-resident on income that has its source in Nepal, and section 67 of the Income Tax Act decides what has that source. Under section 67(6) and (7), payments for services performed in Nepal or paid by the Government of Nepal, dividends and interest paid by a resident, rent and royalty for property in Nepal and general insurance of risks in Nepal have a Nepalese source wherever the company is based, and income not treated as Nepalese-source under section 67 is foreign-source. A supply made wholly from abroad does not by itself create a PE (Directive, para 1.1), but its income may still have a Nepalese source under section 67. A company that is itself present in Nepal, through an office, factory, construction site, service team or agent, earns income sourced in Nepal, and the PE identifies that presence and limits Nepalese tax to the profits of the Nepalese business, so the foreign company is not assessed on its worldwide accounts (Directive, paras 1.1 and 3.1).

Under section 2 of the Income Tax Act the PE of a non-resident is treated as an entity and a resident person (Directive, para 2.2). It therefore files its own returns, pays tax at the resident company rate and is taxed on the profit of its Nepalese business. Registration does not create a PE, and a person who ought to have registered is not relieved of liability by failing to (Directive, para 10.2(6)), so a company that has begun work without registering may already be liable.

1.2 Governing instruments

Exhibit 1 identifies what each principal instrument contributes.

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Exhibit 1 Instruments governing the permanent establishment

INSTRUMENT	WHAT IT GOVERNS
Income Tax Act and Income Tax Rules	Source of income (section 67), definitions (section 2), taxation of the PE and of income remitted abroad (section 68), controlled foreign entities (section 69), the interest limit (section 14), related-party adjustment (sections 33 and 56), disposals (sections 37 to 39), suspension of registration (section 78A and rule 23A of the Income Tax Rules) and records (section 81).
Directive	The IRD's interpretation of the PE provisions, with worked examples.
DTAAs	Article 5 (permanent establishment), Article 7 (business profits) and the articles on dividends, interest and royalty. The Directive refers to eleven bilateral agreements and one multilateral agreement (para 9.4(1)). The agreement with Mauritius has been terminated.
Companies Act, 2006	Registration of a branch of a foreign company (section 154), which is separate from registration of a PE for tax and is not a substitute for it.

1.3 Order of authority

Where the Income Tax Act or the Income Tax Rules contain a provision, that provision applies. Where they are unclear, the Directive explains how they are understood (Directive, para 1.2), and it is applied after those instruments and the Income Tax Directive, 2009 (para 1.1). A DTAA prevails over domestic law where the two differ, but only for a resident of the other state (para 9.4(1)).

A DTAA prevails over domestic law for a resident of the other state, and the Directive, which is the IRD's interpretation of the Income Tax Act, cannot enlarge it. A return position should cite the section of the Income Tax Act as well as the paragraph of the Directive, and a DTAA position should identify the article and the basis of residence in the other state.

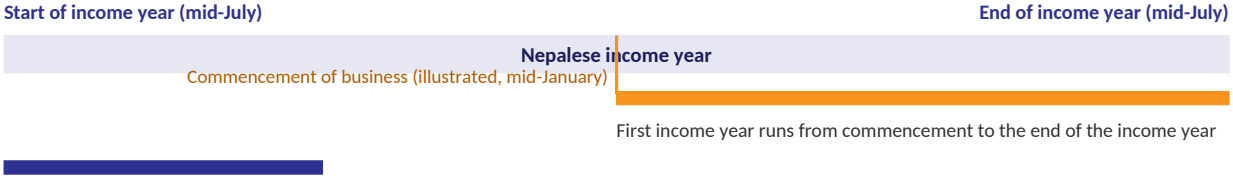
1.4 Administration

The IRD administers income tax. Registrations, returns and applications under the Directive go to the Chief Tax Officer (Pramukh Kar Adhikrit) of the competent tax office, which may be the Large Taxpayer Office, the Medium Taxpayer Office or an Inland Revenue Office. An application lodged with an office that lacks jurisdiction delays the issue of a PAN, so the competent office should be confirmed with the IRD before filing.

1.5 The income year

The Nepalese income year runs from approximately mid-July to mid-July. A PE's first income year runs from the day business commences to the end of that income year, and its last from the start of the income year to the date the business ends (Directive, para 4.2(10)). Both are part-years, and a project that crosses two income years is divided at the end of the income year (Exhibit 2).

Exhibit 2 The Nepalese income year and the part-years of a PE



Source Directive, para 4.2(10). Dates are approximate.

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CHAPTER 2

2 Key Definitions

The Income Tax Act recognises four different ways in which a foreign company can have a PE in Nepal. Only the first involves premises, and the others arise through a person, a team or a project. This chapter sets out the four routes, the elements all of them require and the defined terms used throughout.

2.1 Four routes to a PE

A permanent establishment is the presence in Nepal through which a foreign company carries on its business. It matters because the profits of that presence are taxed in Nepal as if earned by a resident company, with the registration, return and record-keeping obligations that follow (Chapter 1). The Income Tax Act identifies four situations in which a company is treated as having such a presence (section 2, as quoted in paragraph 2.2 of the Directive).

The first is a fixed place of business, where the company itself operates from premises or equipment in Nepal. The second is a dependent agent, a person who carries on the company's business for it other than as an independent agent acting in the ordinary course of its own business. The third is a service team, employees or others who provide technical, professional or consultancy services in Nepal. The fourth is a construction, installation or assembly site, a project together with the place where it is supervised.

The routes divide in a practical way. A fixed place and a dependent agent arise from a place or a person and carry no time test, so the PE exists from the day the business is carried on. A service team and a construction site arise from a team or a project and depend on duration, so the question is when the 90-day threshold is passed. A DTAA may set a longer period for these two routes (Chapter 8). Exhibit 3 sets the routes side by side.

Exhibit 3 The four routes to a permanent establishment

PE ROUTE	WHAT TRIGGERS IT	APPLICABLE TIME TEST	WHERE EXPLAINED
Fixed place of business	A place of business in Nepal from which the company carries on business, including premises, and equipment or machinery that it uses or installs	None. The PE exists from the day business is carried on	Chapter 4
Dependent agent	A person in Nepal who carries on the company's business other than as an independent agent acting in the ordinary course of its own business	None	Chapter 5
Service team	Employees or others who provide technical, professional or consultancy services in Nepal	More than 90 days in any twelve-month period. A DTAA may set a longer period	Chapter 6
Construction, installation or assembly site	A construction, installation or assembly project in Nepal and the supervision of that project	90 days or more. A DTAA may set a longer period	Chapter 6

Source Income Tax Act, section 2, as quoted in Directive, para 2.2.

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2.2 Elements

Whichever route applies, four elements must be present (Directive, para 2.2). The owner must be a non-resident entity, which excludes individuals and resident companies. The entity must carry on a business, which excludes investment, employment and mere supply. The Nepalese activity may be the whole or only part of that business, so a small project of a large foreign group can create a PE. The activity must also take place in Nepal.

2.3 Defined terms

Several terms carry specific consequences. An entity includes the PE of a body organised in another country, and a resident person includes the foreign PE in Nepal of a non-resident person (Income Tax Act, section 2). A non-resident person is any person other than a resident person. Because the PE is both an entity and a resident person, it is a taxpayer separate from its head office, with its own books, its own return and its own treatment of dealings with the head office. Income remitted abroad is the amount that a foreign PE pays or sends abroad out of its income, whether through banking channels or otherwise, and it is the base on which the remittance tax in Chapter 10 is charged. Royalty is a payment under a lease of intangible property or for the use of a copyright, patent, design, secret formula, trademark, know-how or similar right.

2.4 Business, investment and employment

Business must be distinguished from two things that resemble it. Employment involves the supply of labour. Investment involves holding an asset without taking an active part in earning the income. Business, which means any industry, trade, profession or similar commercial transaction, involves active engagement in earning the income. The Directive illustrates the distinction with rent. A person who holds property and collects rent has an investment, whereas a person who actively manages the property and its rental income carries on business (Directive, para 2.2). A passive holding of securities, a loan or immovable property does not itself create a PE (para 3.4(1)). Funds, lessors and lenders that also manage an asset through personnel in Nepal should therefore assess how the activity is characterised, because management and employment are the facts on which the characterisation turns.

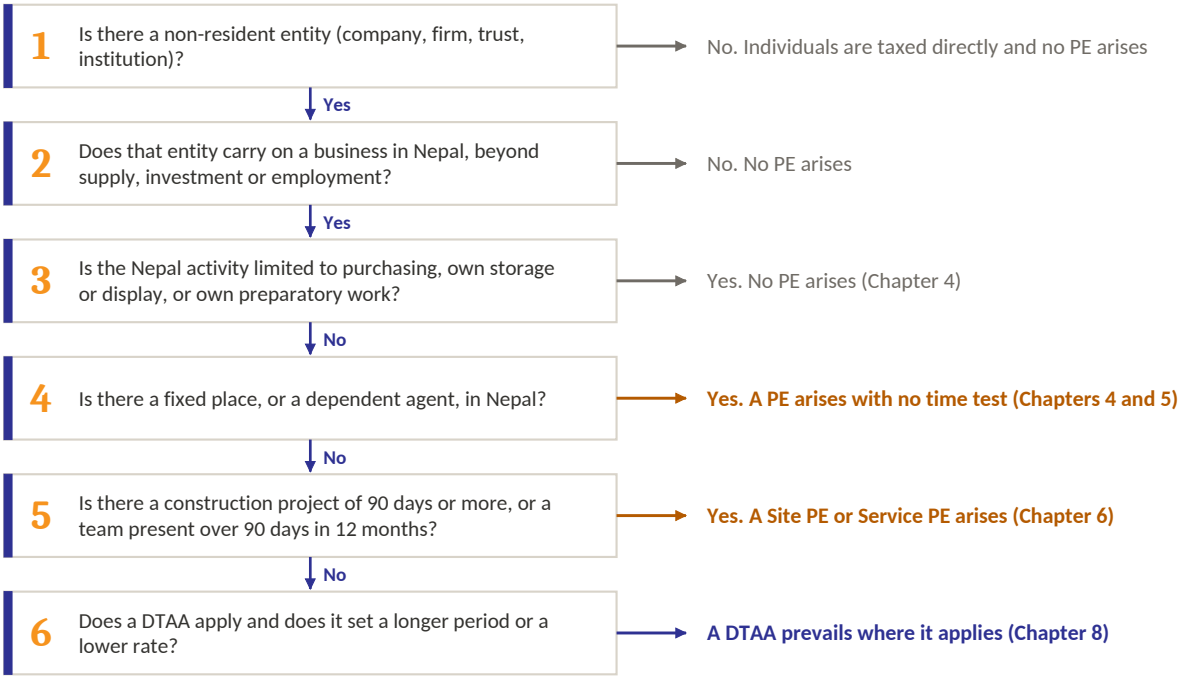
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CHAPTER 3

3 Eligibility and Threshold Tests

Before the form of a foreign company's presence in Nepal is analysed, two prior questions must be answered. The first is whether the company is an entity capable of having a PE, and the second is whether what it does in Nepal is business as the Income Tax Act uses that term. Many arrangements fall away at this stage because supply, investment and employment do not create a PE, and Exhibit 4 sets out the sequence of questions.

Exhibit 4 Sequence of questions for determining whether a PE exists



Source Niti Partners & Associates, based on the Directive, Chapters 3 to 9.

3.1 The owner

A PE is an entity, so an individual or sole proprietor cannot have one, and the Nepalese-source income of an individual is taxed directly on that individual (Directive, paras 3.1 and 8.3(1)). The owner may be any company, partnership, limited partnership, government body, university, unit trust, family group or other corporate body registered abroad. A body of individuals that is not registered abroad but is managed in Nepal is treated as a company-like entity under the Income Tax Act and is not the PE of any other person (para 3.1). A group that operates through partnerships or informal consortia should therefore establish the character of the owner before analysing the activity.

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3.2 Business and continuity

Business takes three forms, being industry (the conversion of goods), trade (the sale of goods) and profession (the rendering of services). Preparatory work and mere supply are not business, and business requires continuity, which means it must be ongoing or habitual (Directive, para 3.2). A single installation of imported machinery at the buyer's premises, a single training session on its use and an occasional repair of a customer's goods lack continuity. Installation that is a main element of the supply, and repair provided as and when required, are business. For a supplier of equipment this means that commissioning, training and warranty work should be described accurately in the supply contract, priced separately where that reflects the facts, and recorded visit by visit with dates and personnel.

3.3 Purchase, conversion and sale

The Directive tests purchase, conversion and sale separately (para 3.3), and the result in each case depends on where the activity takes place. The Directive illustrates that purchasing alone is not business with an example of a United Kingdom community interest company that bought raw material in Nepal and processed and sold it in the United Kingdom. It finds no PE (example 3.3.1). It illustrates conversion with a United States company that operated a factory in Nepal and bought its inputs locally, and the factory is a PE (example 3.3.2). It illustrates sale with an Indian company that sold in Nepal goods made or bought either in Nepal or abroad, and finds that the company was carrying on business in Nepal (example 3.3.3).

The remaining Directive illustrations distinguish a sale made in Nepal from a sale made from abroad. A Sri Lankan company that sold to a Nepalese importer taking delivery from abroad did not conduct business in Nepal (example 3.3.4). A French company that stored goods in Nepal and delivered to a Nepalese importer from that store made a sale in Nepal, as would a sale of goods bought in Nepal and supplied there, because a Nepal-to-Nepal supply is neither an import nor an export (example 3.3.5). Together they establish that the location of the activity decides the result. An exporter that considers holding stock in Nepal should recognise that the store is both a place of sale and a fixed place, and should register before the stock arrives.

3.4 Investment, employment and special businesses

Interest, returns on securities or immovable property and gains on their disposal do not create a PE, and the employment or business of a foreign individual creates no PE in that individual's name (Directive, paras 3.4(1) and (2)). Three further categories are also excluded because they are taxed on another basis. These are the income of international aircraft operations (sections 67 and 70 of the Income Tax Act and DTAA Article 8), business conducted through communication equipment installed in Nepal, including roaming over the equipment of a Nepalese operator, and royalty income (para 3.4(3)). Where the PE itself earns any of these items, they form part of its business income.

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CHAPTER 4

4 Fixed-Place Permanent Establishments

The fixed-place PE is the category most readily established, because Nepalese law applies no minimum period of presence. A foreign company can therefore have a PE from the day it occupies a place or begins storing goods, and this chapter sets out what counts as a place, who may work there and which activities remain outside the rule.

4.1 Requirements

A fixed-place PE requires a place of business of a non-resident entity in Nepal and business carried on from that place (Directive, para 4.1). A place is any premises, facility, installation or equipment, whether owned, rented or otherwise at the entity's disposal, used exclusively or shared, and staffed or automatic. It must have the permanence appropriate to the business. Offices, branches, factories, workshops, warehouses, plantations, farms, mines and wells qualify, as do an employee's home used as an office and co-working space at the entity's disposal (paras 4.1 and 4.2(1)). A moving business such as a truck fleet or a mobile sales outlet qualifies without a fixed site (para 4.2(3)), and the legality of possession is irrelevant (para 4.2(2)).

Because no period of presence is counted, a short-term project office, site store or rented desk can be a PE from its first day. Registration, books and returns are then due from commencement, including a return for the short first period, and registration should precede occupation of the place. The PE begins when business commences after preparatory work and ends when business at the place ceases, a temporary closure being treated as continuing business (Directive, para 4.2(10)). Registration may be made on proof of presence for preparatory work, on business registration before commencement where no preparatory work is needed, or on the business registration certificate (para 10.1).

4.2 Personnel and subcontractors

Work performed by employees, by former employees now employed by a related company, by temporary local staff or by subcontractors is attributed to the non-resident entity whose business is conducted, and a subcontractor may also have a PE of its own (Directive, para 4.2(1)). The Directive illustrates that attribution with an example of a Chinese company that registered a branch to build a road and assigned the work to a Nepalese subcontractor. It concludes that the branch is a PE, because the construction is the Chinese company's business, whoever performs it (example 4.2.1). It makes the same point with a Russian software company that established a production and repair unit in Nepal with the assistance of a Nepalese individual, characterising that assistance as managerial activity and treating the unit as a PE (example 4.2.3). Neither subcontracting nor local assistance therefore removes an activity from the non-resident's business.

Two further illustrations in the Directive show that the test looks to the business and not to the premises. A Russian company that traded from rented premises, from a public place or without any lease carried on business in Nepal (example 4.2.2), and a Japanese company that carried goods by truck in Nepal and stored them only at customers' premises has a PE through its moving business (example 4.2.4). Together the four illustrations show that the contractual form, the identity of the worker and the existence of a fixed site do not decide the question, and each conclusion rests on its stated facts. A group that uses secondees or

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subcontractors should align payroll, invoicing and withholding with the entity whose business is conducted.

4.3 Storage, display and processing

Storing or displaying an entity's own goods does not create a PE, whereas storing the goods of others does, because that activity is itself business carried on from the place (Directive, para 4.2(4)). Goods held for processing by another entity are treated as storage or display for the owner (para 4.2(5)). The Directive illustrates the distinction with a Swiss company that displayed goods in the exhibition room of a Nepalese company and stored them in the Nepalese warehouse of a German company. It finds that the Swiss company, which had no sales agreement or selling programme, has no PE, while the German company has one because it stores the Swiss goods as well as its own (example 4.2.5). It illustrates the processing rule with an Austrian limited partnership that bought raw material and had it processed at the Nepalese factory of an Austrian partnership. The limited partnership has no PE and the partnership operating the factory has one (example 4.2.6). The test therefore applies separately to each party, and an entity that offers storage or processing to others should register.

Exhibit 5 Storage and display in Nepal

Own goods, third party's premises

Storage or display of the entity's own goods only.

NO PE

Own goods, own warehouse

Storage of its own goods only. Sales from the store are a separate question.

NO PE

Third party's goods, own warehouse

Storing the goods of others is itself business carried on from the place.

PE

Own goods stored for processing by another entity

Treated as storage or display. The processor with a factory in Nepal has its own PE.

NO PE FOR THE OWNER

Source Directive, para 4.2(4) and (5), examples 4.2.5 and 4.2.6.

4.4 Preparatory and auxiliary activities

Four activities do not create a PE when carried out for the entity's own business only. They are purchasing for own account (para 4.2(6)), advertising own products including through a liaison office (para 4.2(7)), collecting information for own use (para 4.2(8)) and other preparatory activity unrelated to a Nepalese business, such as training own staff (para 4.2(9)). The same activities create a PE when they are performed for others or when the office sells. The Directive illustrates purchasing with an Italian company whose Kathmandu office bought Nepalese goods for its branch in Tibet and finds no PE (example 4.2.7).

The remaining Directive illustrations show that identical activity produces different results according to whom it serves. In the illustration of a Serbian state company that advertised only its own products through a liaison office that did not sell, there is no PE, although advertising for a related company or others would have created one (example 4.2.8). In the illustration of a Polish software company that collected advertisements of Nepalese companies and displayed them to potential customers, advertising was its business and a PE arose (example 4.2.9). In the illustration of a Polish limited partnership that conducted consumer research for its own future business there is no PE, although research serving other businesses would have created one (example 4.2.10). In the illustration of a Malaysian company that trained its own staff in Nepal for work in Tibet there is no PE, although training the staff of other entities would be business (example 4.2.11). A liaison office should therefore have its permitted functions recorded in its constitutive documents and should not sell or act for related companies.

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4.5 Size, duration and the people who work at the place

Once business is carried on from a place, the Directive treats the physical features of that place as largely irrelevant. The place may be large or small and the presence long or short, and a place held under a lease, under a legal right or through unlawful occupation is treated alike (Directive, para 4.2(2)). Because no period of presence is counted for a fixed place (paras 2.2 and 10.3(1)), none of these features can show that a place falls short. The Directive's first illustration is a branch that an American sports company opened on Durbar Marg in Kathmandu to sell its goods. A branch of a non-resident is taxed as a PE, and where the place is the dominant fact the days for which the structure was effective in Nepal need not be counted (example 2.2.2).

The people at the place need not be employees of the non-resident itself. The Directive treats a place as a permanent office where staff of the entity, of a related entity or of an unrelated foreign or domestic entity work together (Directive, para 4.1). A parent directs the staff of its related entities, so an employee moved to another group entity becomes in law a former employee while doing the same work, which remains the work of the entity whose business it is (Directive, para 4.2(1), items 1.1 and 1.2).

Human presence is not required either. Where the nature of the business allows it, the operation of automated equipment without any person present is itself business, and because the equipment is in Nepal a PE arises (Directive, para 4.2(1), item 1.4). In our view an officer applying the Directive is likely to look at the location of the equipment and not at the location of any staff. Exhibit 5A sets out the tests in the order in which they are usually taken.

Exhibit 5A Tests to apply to a fixed place

TEST	WHAT MUST BE SHOWN	DIRECTIVE REFERENCE	WHERE THE TEST IS NOT MET
Owner	A non-resident entity and not an individual	Paras 3.1 and 8.3(1)	No PE arises in the owner's name
Business	Industry, trade or profession carried on with some continuity	Paras 3.2 and 3.3	Preparatory work, mere supply and purchasing alone are not business
Place	A place in Nepal, being premises, a facility, an installation or equipment, owned, rented or otherwise at the entity's disposal, exclusive or shared, staffed or automatic, with permanence suited to the business	Paras 4.1 and 4.2(3)	No fixed-place PE arises, although a moving business needs no fixed site
Link	The business is carried on from that place	Para 4.1	A place used only for the entity's own storage, display, purchasing, advertising, information gathering or other preparatory work is outside the rule (paras 4.2(4) to (9))

Source Directive, paras 3.1, 3.2, 4.1 and 4.2.

4.6 How the Directive's examples fit together

The Directive's examples on fixed places answer four separate questions. Examples 4.2.1 and 4.2.3 ask who performs the work. Examples 4.2.2 and 4.2.4 and example 2.2.2 ask what kind of place suffices, and find that rented premises, a public place, a vehicle or a bare branch will do. Examples 4.2.5 and 4.2.6 ask whose goods are kept at the place, and answer for both the owner of the goods and the owner of the place, which produces no PE for the first and a PE for the second. Examples 4.2.7 to 4.2.11 ask whether the activity serves the entity alone.

The last group has one decisive fact in common, which is who benefits. Advertising for a related entity or for other companies, research whose results serve other businesses and training open to the staff of other

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entities each convert an own-use activity into business (examples 4.2.8, 4.2.10 and 4.2.11), whereas goods bought in Nepal may be sent to the head office or to associates in the home country or a third country without creating a PE (example 4.2.7 and the Directive's figure 14). In our view an officer applying the Directive is likely to examine the use made of the place and not its label.

4.7 Fixed places under the DTAAs

Every bilateral DTAA listed in the Directive treats as a PE a fixed place of business in Nepal from which an enterprise of the other state carries on business, which is the rule in section 2 of the Income Tax Act (Directive, para 9.4(6)). The DTAAs also list particular places, and insurance business where premium is collected, excluding reinsurance premium, with the variations in Exhibit 5B (para 9.4(7)). The variations narrow the warehouse, sales outlet and farm or plantation for some partners and widen the extraction reference for others.

Exhibit 5B Fixed places listed in the DTAAs

LISTED PLACE	COMMON POSITION IN THE DTAAS	VARIATION STATED IN THE DIRECTIVE
Place of management, branch, office, factory, workshop	Listed	None stated
Mine, oil or gas well, quarry or other place of extraction of natural resources	Listed	Pakistan and Qatar add exploitation, and Qatar adds exploration
Warehouse	Listed	For China, India and Thailand the warehouse must be in relation to a person providing storage facilities for others
Sales outlet	Not listed	Listed only in the DTAAs with India, Pakistan and Qatar
Farm or plantation	Listed	Not listed in the DTAA with Norway

Source Directive, para 9.4(6) and (7). The DTAA with Mauritius is omitted.

4.8 Start and end of the PE and what follows from them

Two dates matter for a fixed-place PE, being the day on which business is first carried on after any preparatory work and the day on which business at the place closes, and a temporary closure is treated as continuing business (Directive, para 4.2(10)). Those dates fix the first and last income years. A PAN is needed before business begins, is cancelled when the business closes, ends or is completed (paras 10.1 and 10.2(4)), and may be suspended on application within thirty days (para 10.4).

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CHAPTER 5

5 Agency Permanent Establishments

A foreign company may be taxed in Nepal through a person who acts for it there, even where it has no premises. This chapter sets out how the Income Tax Act distinguishes the dependent agent, which creates a PE, from the independent agent and the ordinary importer, which do not.

5.1 The dependent agent

The Income Tax Act treats a place of business carried on through an agent as a PE, unless the agent is an ordinary agent acting independently in the ordinary course of its own business (Directive, para 5.1). The Directive illustrates the rule with a Myanmar company that appointed a Nepalese company to sell its goods to buyers throughout Nepal. It finds that the Myanmar company has a PE through that company, because the agent conducts the principal's business in Nepal (example 5.1.1). A dependent agent implements decisions that the principal takes, and a person who conducts the principal's main business in Nepal is a dependent agent. Agents, intermediaries and brokers acting for commission on another's goods are included, whatever their nationality or residence (paras 5.2(1) and (2)).

A dependent agent arises in any of the four situations shown in Exhibit 6 (para 5.2(2)). Because conduct prevails over documentation, the description of the arrangement is immaterial. Whether the contract refers to an agent, intermediary, broker or support provider, and whether remuneration is a fee, commission or bonus, does not determine the outcome.

Exhibit 6 Dependent agent and independent agent compared

A dependent agent arises where the person

ANY ONE OF FOUR SITUATIONS

1. Acts under a contract conferring actual authority to conduct the business of the principal or a related entity
2. Holds express authority to conclude business contracts in Nepal
3. In practice concludes such contracts without contractual authority
4. Habitually takes in complete purchase orders for the principal or a related entity

versus →

An independent agent

THREE CHARACTERISTICS

1. Acts in the ordinary course of its own business
2. Does not work wholly or mainly for the principal
3. Is not under the principal's common control

The Directive does not state whether the three are cumulative.

Source Directive, para 5.2(2) and (3).

The Directive illustrates the dependent agent with a Pakistani company that engaged a Nepalese firm to identify buyers, conclude sales and recommend supply, where the firm's main business was supporting the company's Nepalese trade. It finds that the firm is a dependent agent and its activity a PE of the company (example 5.2.1). It illustrates the contrary with a United States supplier that sold to a Nepalese importer, which set its own prices and bore its own risk with no restriction on ownership, price or customers. It finds the importer independent and no PE for the supplier, and adds that had the supplier fixed the resale price and borne the profit or loss, the importer would have been a dependent agent (example 2.2.1). The two illustrations show that control of price, allocation of risk and the share of the person's activity devoted to the

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principal decide the matter.

5.2 The independent agent

The characteristics of an independent agent are shown in Exhibit 6 (Directive, para 5.2(3)). The Directive does not state whether they are cumulative, so an agent that works mainly for one principal or is under its common control should not assume that it is independent. No PE arises where the acts are performed outside Nepal or where the agent only assists the purchase of goods in Nepal (para 5.2(4)). The Directive illustrates the purchasing exception with a Laotian company that engaged a Nepalese company to assist the purchase of goods in Nepal for export, with no sale or conversion in Nepal, and finds no PE (example 5.2.2).

5.3 Distributors and importers

A distributor that buys from the foreign supplier and resells on its own account is an importer and not an agent where it imports into its own ownership, the price is at arm's length (the price independent parties would agree in comparable circumstances), the exporter retains no control after export, the importer markets without the exporter's help and payment is made on the export documents (Directive, para 5.3(1)). Any one of the opposite features indicates agency, namely a price off market or a fee fixed by commission, contract or practice, continuing control or marketing help by the exporter, or a continuing link beyond a warranty such as quantity or trade discounts or replacement of expired goods (para 5.3(2)), as Exhibit 7 shows.

Exhibit 7 Independent import compared with agency

Independent import		Agency PE
Imports into its own ownership		Price off market, or fee at a fixed rate
Arm's length price	*Any one feature* →	Exporter keeps economic or legal control
Exporter has no control after export		Exporter helps market or finds customers
Importer does its own marketing		Exporter's sale or use still affects the importer
Pays on the export documents		Price risk stays with the exporter

Source Directive, para 5.3(1) and (2).

Legal title does not settle the question. An importer may hold title and bear no price risk where the principal sets the resale price and the importer's margin, and beneficial ownership then remains with the exporter, so that the importer is an agent (para 5.3(3)). The Directive illustrates the point with a Nepalese importer that resold goods of a Dutch company at prices fixed by the Dutch company, and bought them at prices that fixed its own margin. It finds an agency PE although the importer's name appeared on the import (example 5.3.1). Each distribution agreement should be assessed against every feature in Exhibit 7, because any one is sufficient.

5.4 Subsidiaries and trademarks

A subsidiary is a resident company and is not a PE of its parent by reason of the shareholding (Directive, para 8.3(3)). Where the subsidiary directly assists the parent's sales, and the parent would have an agency PE had another Nepalese firm performed the work, the parent has a PE. The Directive illustrates the subsidiary rule with an Israeli parent whose Nepalese subsidiary identified and negotiated with buyers who then contracted directly with the parent. It finds that the parent has an agency PE through that work (example 5.2.3). Transactions between parent and subsidiary do not of themselves create a PE, and a price that departs from the market price raises a question of transfer pricing and not of a PE. Registration in Nepal of a trademark already registered abroad does not itself create an agency PE (para 5.3(4)). The agent and the PE are separate taxpayers (paras 2.2 and 11.1).

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5.5 The four ways in which a dependent agent arises

Section 5.1 lists four situations in which a person becomes a dependent agent. The Directive names each of them, and the names show where on a scale from contract to conduct each situation sits (Directive, para 5.2(2)). Exhibit 7A sets them out.

Exhibit 7A The four ways of becoming a dependent agent

WAY	DIRECTIVE LABEL	WHAT THE PERSON DOES	POSITION OF THE WRITTEN AGREEMENT
First	Actual authority	Carries on the business of the principal or of a related entity	The agreement confers authority to carry on that business
Second	Explicit actual authority	Concludes business contracts in Nepal for the principal or a related entity	The agreement does not confer all such authority but gives authority to conclude contracts in Nepal
Third	Apparent authority	In practice concludes such contracts	The agreement gives no authority to conclude contracts
Fourth	Collection of purchase orders	Habitually takes in complete purchase orders for the principal or a related entity	There is no agreement, or the agreement gives no authority over the business

Source Directive, para 5.2(2) and figure 19.

The first two ways depend on what the agreement says, so a principal controls them by the terms it grants. The last two operate in spite of the agreement, because the person in practice concludes contracts without authority or habitually takes in complete purchase orders although there may be no agreement. In our view a clause that forbids an agent to conclude contracts therefore protects the principal only to the extent that the agent's conduct follows it.

5.6 Importers and distributors, documents and substance

The Directive tests an import arrangement by what happens and not by what the documents say. Its figure 22 contrasts the documentary evidence, being the import document and the sales invoices, with the real facts, which are pricing, expiry, obsolescence and any commercial or economic assurance given by the exporter (para 5.3(2) and figure 22). The same treatment applies where the agent sells goods imported from the principal, goods supplied from the principal's own warehouse in Nepal, or goods bought in Nepal for the principal, so the place from which the goods are supplied does not change the result (para 5.3(3)).

Examples 2.2.1 and 5.3.1 begin from the same arrangement, a Nepalese importer that buys and imports in its own name, and differ in one respect. In example 2.2.1 the importer set its own prices, bore its own risk and was free of restriction on ownership, price and prospective customers. In example 5.3.1 the Netherlands company fixed the prices at which the importer both sold and bought, and so its profit ratio, whether by agreement or by practice alone. In our view the pair shows the question that an officer applying the Directive is likely to ask first, which is who earns the profit or bears the loss on resale.

5.7 Subsidiaries, separate returns and the principal's other sales

Example 5.2.3 gives three outcomes for a subsidiary, set out in Exhibit 7B. In our view the common feature of the first, shown in the Directive's figure 21, and of example 5.2.1 is that the person in Nepal finds and deals with buyers on the principal's behalf, which is why the subsidiary's separate legal personality does not help the parent.

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Exhibit 7B Subsidiary work and the parent's agency PE

CONDITION	RESULT FOR THE PARENT	DIRECTIVE REFERENCE
The parent would have an agency PE had it used another Nepalese firm or person for the same work	The subsidiary's work creates a PE of the parent	Example 5.2.3
The parent would not have an agency PE had it used another Nepalese firm or person for the same work	The subsidiary's work does not create a PE of the parent	Example 5.2.3
The transactions are only between the subsidiary and the parent	No PE arises on that basis alone, and a price off the market price raises transfer pricing and not a PE	Example 5.2.3

Source Directive, example 5.2.3 and figure 21.

A dependent agent files two statements of income, one for the transactions of the PE and one for its own business, including its commission (example 2.2.1 and para 11.1), so in our view the agency agreement should state the agent's remuneration separately from the sums it handles for the principal. Registration rests on the agency agreement made before the agent starts business, or on the agent's declaration where there is no direct agreement but the agent in practice represents the non-resident (para 10.1), and a non-resident has one PAN even where it has several PEs (para 10.2(2)).

For a principal resident in Pakistan, Qatar, Sri Lanka or Thailand, the DTAA rule on force of attraction also adds its Nepalese sales of similar goods to the income of the PE, as a Qatari company's government supply contract was added to the sales made through its Nepalese agent (Chapter 8, Directive para 11.11 and example 11.11.1). In our view an agent that creates a PE therefore exposes such a principal's direct sales to tax as well as the agent's.

5.8 Drafting distribution and representation agreements

The Directive does not prescribe contract terms, but each test that it applies corresponds to a clause that a distribution or representation agreement usually contains. Exhibit 7C pairs the clauses with the tests, and the drafting consequences are our view.

Exhibit 7C Clauses of a distribution or representation agreement and the tests they engage

CLAUSE	TEST ENGAGED	DRAFTING CONSEQUENCE
Resale price and margin	Para 5.3(2) and example 5.3.1	Leave resale price and margin to the distributor, because an exporter-fixed price or margin is a ground for agency
Title and risk	Para 5.3(2) and (3)	Avoid exporter responsibility for unsold or expired goods, and avoid discounts that pass the loss to the exporter after payment
Marketing and customers	Paras 5.3(1) and (2)	Leave marketing to the distributor, and avoid exporter identification of customers or joint search for customers
Authority, orders and control	Para 5.2(2) and (3)	Confer no authority to conclude contracts, avoid the distributor receiving complete purchase orders for the exporter, allow it to serve other principals, avoid common control, and ensure that practice follows the clauses
Remuneration and payment	Paras 5.3(1) and (2)	Avoid fixed or minimum commission linked to resale, and require payment of the exporter's invoice on the export documents whatever the distributor's own sales

Source Directive, paras 5.2 and 5.3. The drafting consequences are our view.

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CHAPTER 6

6 Construction Sites and Service Teams

Two categories of PE depend on duration, the construction site and the service team. They are the rules most likely to affect contractors and consultants that maintain no office in Nepal. The chapter explains the activities covered, how days are counted, when contracts are treated as one project and how subcontracting affects the count.

6.1 The construction PE

A construction PE requires a project of 90 days or more, involvement in construction, installation, assembly or their supervision, and activity in Nepal (Directive, para 6.1). Construction covers buildings, roads, bridges, tunnels, dams, canals, renovation, pipelines, excavation and dredging. Ordinary repair and redecoration are services. Installation covers fitting equipment connected with construction, and assembly covers joining equipment into a technical whole. Technical supervision, including site planning, falls within the construction PE although it is a service.

6.2 Separate sites and aggregation

Each site is a separate PE, and its period is not added to that of a fixed place (para 6.2). Works are nevertheless aggregated into one site in five situations. These are works under one construction contract, separate contracts that are directly or substantially related, independent contracts concerning one place and using the same supply or service, one work with partial handover provisions, and independent contracts related in substance (para 6.3). Exhibit 8 sets out the five situations.

Exhibit 8 Aggregation of works

Works at several places under one construction contract	→	**One site. Period and income are aggregated.**
Separate contracts that are directly or in substance related	→	**One site.**
Independent contracts for work at one place using the same supply or service	→	**One site.**
One work with partial handover provisions	→	**One site. Time runs for the whole work.**
Independent contracts related in substance	→	**One site.**

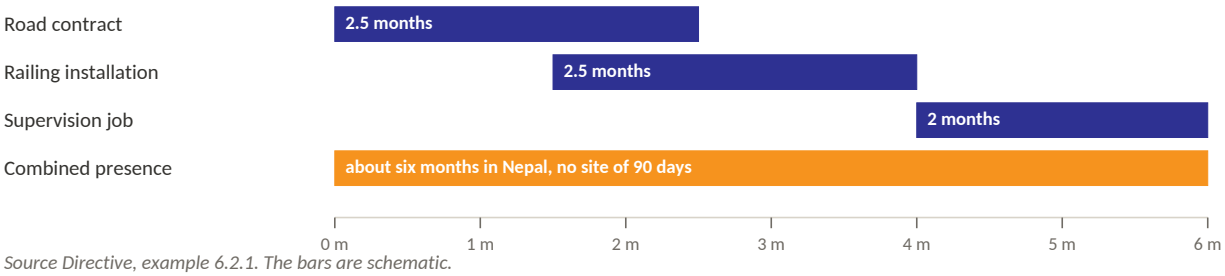
Source Directive, para 6.3(1) to (5).

The Directive illustrates the five rules in turn. Telecommunication towers at seventeen locations in twelve districts under one contract are one work (example 6.3.1), two tunnel contracts under which experience on the first benefits the second are aggregated (example 6.3.2), structural and sanitary supervision contracts for one building are aggregated (example 6.3.3), fifteen prefabricated houses handed over monthly under one contract are one work of fifteen months (example 6.3.4), and three hundred houses on one land pooling scheme, each owner contracting separately, are one construction (example 6.3.5).

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The Directive illustrates the opposite result with a New Zealand contractor that held three unrelated contracts in three places of two and a half months, two and a half months and two months. It was present in Nepal for about six months, yet no site reached 90 days and no PE arose (example 6.2.1). Neither continuous presence nor the number of contracts is therefore the test. The question is whether the engagements form one project in substance, and an arrangement that divides work among contracts or group companies to remain below 90 days should be expected to be examined on that basis.

Exhibit 9 Example 6.2.1, three unrelated engagements



Source Directive, example 6.2.1. The bars are schematic.

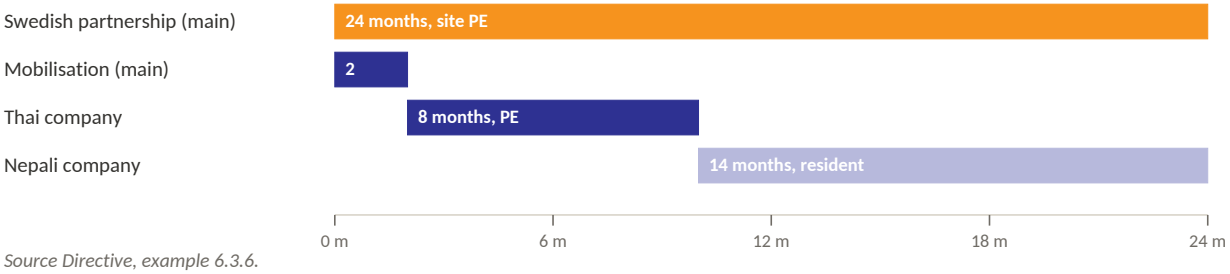
6.3 Counting the period

The period starts when the site is handed over and preparatory work begins, and ends on take-over. The defect liability period is excluded. Suspension is excluded unless the stoppage is temporary or forms part of a technical work schedule. Manufacturing outside Nepal for supply to the site counts towards the period (Directive, para 6.4). The Directive illustrates the counting of off-site manufacture with a Lebanese company that contracted to design, manufacture and install electrical equipment for a hydropower project, and spent 25 days on site visits and design, 275 days manufacturing in Lebanon and 60 days installing and testing. It counts the whole 360 days (example 6.3.8).

6.4 Subcontracting

The period of a subcontractor also counts in the main contractor's period, whether the subcontractor is resident or not, and a non-resident subcontractor may have a PE of its own (Directive, paras 6.4 and 8.2). The Directive illustrates the effect of subcontracting with a Swedish partnership that took a two-year road contract, performed two months of mobilisation, and subcontracted eight months to a Thai company and fourteen months to a Nepalese company. It finds that the partnership has a PE for the whole period. The Thai company exceeded the 90 days under domestic law and the 183 days under the DTAA between Nepal and Thailand and has its own PE. The Nepalese company is resident (example 6.3.6). A second illustration of an Indonesian company holding a supervision contract that subcontracted eight months to a Mongolian company, fourteen months to a Nepalese company and two months to a Hungarian company finds that the Indonesian and Mongolian companies have PEs, while the Hungarian company has none because two months is below 90 days. It also confirms that supervision of construction is a construction PE and not a service PE (example 6.3.7).

Exhibit 10 Example 6.3.6, a subcontract chain on a two-year contract



Source Directive, example 6.3.6.

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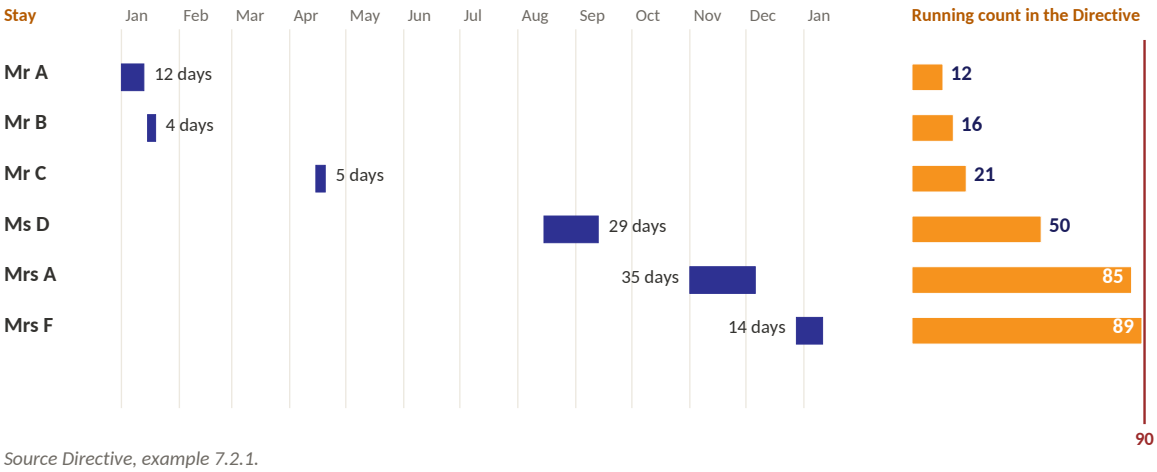
The main contractor's period therefore runs for the whole project and each subcontractor is tested against its own period, so a main contractor cannot avoid a PE by passing work down a chain. Each party should obtain the project-day records of the others and allocate registration accordingly.

6.5 The service PE

A service PE arises where technical, professional or consultancy services are provided in Nepal, through employees or otherwise, for more than 90 days in any twelve-month period, whether at one time or in instalments (Directive, para 7.1). For each day of presence the preceding twelve months are examined, and counting runs from the day the service provider enters Nepal until completion. Days are solar days and not person-days, so a day on which several people are present counts once. Once a PE exists for a service, later income years need not be counted again. Time worked by a subcontractor counts as the main provider's time. Separate services are separate PEs, and works at several places under one service contract are one service (para 7.2).

The Directive illustrates the service rule with a United States sports company that sent two employees to Nepal for research, working 35 days from 1 January, 30 days in July and 60 days in December. It finds a service PE because the total of 125 days falls within twelve months (example 2.2.4). Another traces a running count for a Belgian research team that arrived and left in stages. Mr A stayed 12 days, Mr B 4 days, Mr C 5 days, Ms D 29 days, Mrs A 35 days and Mrs F 14 days, and the illustration records running counts of 12, 16, 21, 50, 85 and 89 (example 7.2.1).

Exhibit 11 Example 7.2.1, the Belgian research team across a year



Source Directive, example 7.2.1.

The count of 89 after the stay of Mrs F reflects the twelve-month window. A simple total of days stayed is 99, and ten of the days of the first stay fall outside a window ending on 10 January. The illustration then records a further ten-day stay by Mr A with the count unchanged at 89. On the window described, that stay brings the total within the window to 93 days, which exceeds 90, and this later figure should be read with caution. The Directive does not set out how the window moves, so the method of counting should be confirmed with the IRD before a threshold is approached. A service provider should keep one consolidated travel register for the whole team.

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6.6 The construction PE, further points from the Directive

This section and the next return to the construction PE discussed in sections 6.1 to 6.4 and add the Directive's remaining material on it. The Directive's first illustration of the rule shows how the threshold is tested. A Singapore construction company was given 100 days to dry the slurry in the tunnel of the Melamchi project, and its five employees completed the work in 95 days, so the Directive finds a PE because the company was engaged in Nepal for more than 90 days (example 2.2.3). The threshold is therefore tested against the days of engagement in Nepal and not against the days contracted.

The aggregation examples carry reasons that the summary in section 6.2 omits. The Directive aggregates the two tunnel contracts in example 6.3.2 because knowledge gained in the Nepalese geography on the work done first improves the second, and it says that this is so although the costs were recorded in separate site ledgers. It aggregates the two supervision contracts in example 6.3.3 because supervision of the two kinds is interrelated in nature, and the three hundred contracts in example 6.3.5 because the houses are built at one place. Example 6.2.1 is the counterpart. Its three engagements were of different kinds, being a road construction, the installation of railing at a fish pond and the supervision of a tower construction, and on the dates stated the second began before the first ended and the third before the second ended, so that the contractor was in Nepal continuously for about six months (example 6.2.1 and the Directive's figure 24). The Directive nevertheless finds no PE because no site reached 90 days. In our view the examples together show that the test is a link of substance, such as one contract, one place, the same supply or service, or knowledge passing from one project to the next, and that continuous presence at unrelated sites does not supply it.

Exhibit 11A sets out the periods in the Directive's construction examples so that they can be compared.

Exhibit 11A Periods counted in the Directive's construction examples

EXAMPLE	PERIODS IN THE EXAMPLE	WHAT THE DIRECTIVE COUNTS	RESULT STATED
2.2.3	Contract of 100 days, work completed in 95 days	95 days of engagement in Nepal	PE arises
6.2.1	Three sites of two and a half months, two and a half months and two months	Each site separately	No PE arises
6.3.4	Fifteen houses handed over monthly	Fifteen months as one construction	One construction
6.3.6	Two years, with 2 months by the main contractor and 8 and 14 months by subcontractors	Two years for the main contractor and each subcontractor's own period	PE for the main contractor and the Thai subcontractor, none for the Nepalese subcontractor
6.3.8	25 days of site visits and design, 275 days of manufacture in Lebanon and 60 days of installation and testing	360 days, including manufacture outside Nepal	Construction period of 360 days
8.5.1	Two construction contracts of two and a half months and four months	Each site separately	PE for the four-month site only

Source Directive, examples 2.2.3, 6.2.1, 6.3.4, 6.3.6, 6.3.8 and 8.5.1.

The reasoning in example 6.3.8 explains why manufacture outside Nepal counts. The contract combined supply with installation, and the equipment was made only after construction in Nepal had begun and to the specification in the contract, so the Directive treats the manufacture as part of the Nepalese construction.

Where a construction period falls in two income years, the Directive divides it at the end of the income year, and its figure shows a project running from about mid-May to about early August, with the part to mid-July in the first income year and the remainder in the second (para 6.4 and figure 27). For a contract that is initially for fewer than 90 days, registration follows once an extension takes the period beyond 90 days (para 10.1).

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6.7 What a contractor should draft, record and monitor

The Directive does not prescribe records for a contractor, but its tests depend on facts that are easiest to establish from contemporaneous records. Exhibit 11B sets out what, in our view, a contractor should keep and the part of the Directive that makes it relevant.

Exhibit 11B Matters for a contractor to record

MATTER	DIRECTIVE BASIS	WHAT TO RECORD
Handover, commencement and taking over	Para 6.4	The date on which the site is handed over and preparatory work starts, the date of taking over, and the start and end of the defect liability period, which is excluded
Suspension	Para 6.4	The reason for each stoppage and whether it was temporary or part of a technical work schedule, because only a suspension outside those cases is excluded
Manufacture outside Nepal	Para 6.4 and example 6.3.8	The days of manufacture for the project, the date construction began and the contract specification to which the goods were made
Related contracts	Para 6.3 and examples 6.3.1 to 6.3.5	The links between contracts, being the same contract, the same place, the same supply or service, partial handover and knowledge passing between projects
Subcontracts	Paras 6.4 and 8.2 and examples 6.3.6 and 6.3.7	The period worked by each subcontractor and whether it is resident
Income year and registration	Paras 6.4 and 10.1	The part of the project in each income year, the date of the signed contract or the owner's request letter, and the date of any extension beyond 90 days

Source Directive, paras 6.3, 6.4, 8.2 and 10.1. The records listed are our view.

The Directive records that contracts define the construction period in various ways and that different parts of one contract may carry different periods to suit the parties (para 6.4), so the contract should state the commencement and taking-over dates by reference to events and the contractor should keep its own record of them. The Directive also treats partial taking-over provisions and separate site ledgers as irrelevant to the number of constructions (examples 6.3.2 and 6.3.4), and in our view a contractor therefore cannot rely on the accounting or handover structure of a contract to keep related works apart.

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CHAPTER 7

7 Other Situations and Special Cases

Several situations fall outside the four principal routes or modify their application, including licences, subsidiaries, branches, partnerships, joint ventures and entities with more than one activity in Nepal. Exhibit 12 summarises the position and the points that depend on facts are then explained.

Exhibit 12 Special situations

SITUATION	RESULT	BASIS
Individual or sole proprietor	No PE	A PE is an entity (para 8.3(1)).
One employee of a non-resident entity	May be a PE	One employee's work can create a PE if the other tests are met (para 8.3(2)).
Subsidiary in Nepal	No PE by itself	A PE of the parent arises only if the subsidiary performs work that would create one (para 8.3(3)).
Branch office and liaison office	Branch is a PE, liaison office is not	A liaison office must do no business (para 8.3(4)).
Partnership firm	PE	A partnership is an entity in Nepal even if transparent at home (para 8.3(5)).
Joint venture	Resident company	A partner is a PE only on its own presence (para 8.4).

Source Directive, paras 8.1 to 8.5

The Directive illustrates the difference between a licence to use an asset and a licence to conduct a business with two examples. A Philippine company that licensed its technology to two Nepalese companies for five years each, one for a lump sum and one for two percent of sales, had no PE, because a sale or royalty is a receipt and not the conduct of business in Nepal (example 8.1.1). An Australian company that held a licence to conduct a telecommunications business in Nepal has a PE whether it conducts the business itself or through others, because the activity takes place in Nepal (example 8.1.2).

An entity with several activities in Nepal is tested separately for each (para 8.5). The Directive illustrates multiple presences with an Iranian company that opened a factory, an office advertising only its own goods, and took construction contracts of two and a half months and four months. It finds two PEs, being the factory and the four-month site. The advertising office falls within the rule for own-use activity and the shorter site is below 90 days. The analysis changes if the construction relates to the factory, because the periods would then be aggregated (example 8.5.1). The tax attributes of one PE cannot be set against those of another (para 10.2(3)).

Exhibit 13 Example 8.5.1, four presences and two PEs

Factory	Advertising office	Construction site 1	Construction site 2
A fixed place of business in Nepal.	Advertises the entity's own goods only.	Two and a half months, under 90 days.	Four months, 90 days or more.
PE	NO PE	NO PE	PE

Source Directive, para 8.5 and example 8.5.1.

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CHAPTER 8

8 Double Taxation Agreements

A DTAA overrides domestic law for a resident of the other state and in most cases lengthens the periods that apply, so a company resident in a DTAA state should read the DTAA before the Income Tax Act. This chapter explains its effect on the periods, on the income attributed to a PE and on the rates of tax at source.

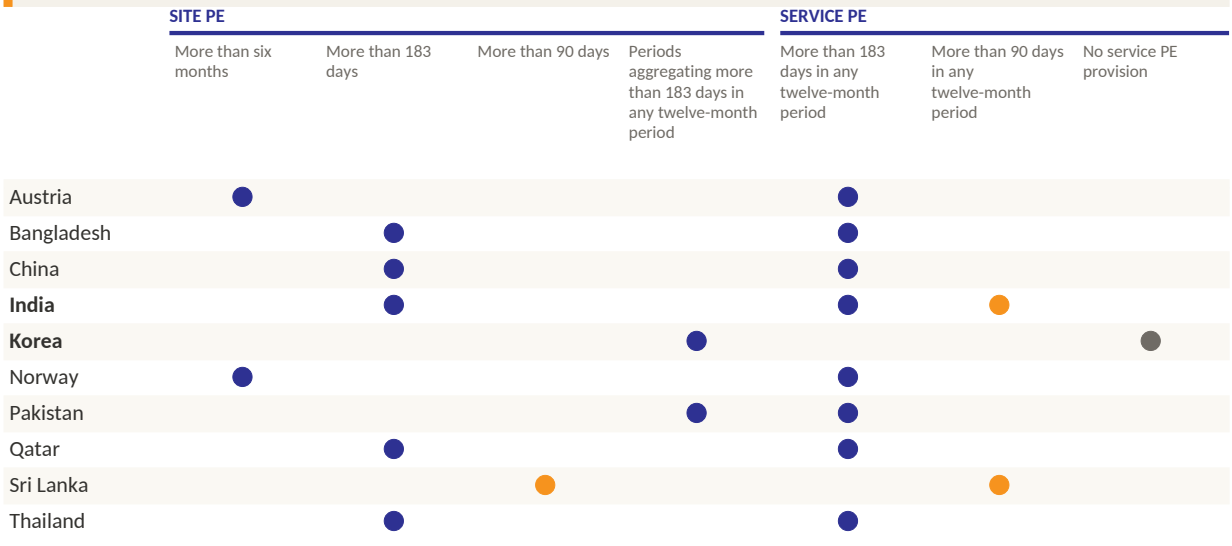
Where the Income Tax Act and a DTAA differ, the DTAA applies to a resident of the other state (Directive, para 9.4(1)). The Directive refers to eleven bilateral DTAAs and one multilateral agreement. The DTAA with Mauritius has been terminated and is not discussed, and the ten in force are with India, Norway, Thailand, Sri Lanka, Austria, Pakistan, China, Korea, Qatar and Bangladesh. The status of each DTAA, including entry into force and any termination, should be confirmed against the published texts before reliance, and the entries in this chapter follow the Directive. A claim to DTAA relief requires evidence of residence in the other state and of beneficial entitlement.

8.1 Periods under the DTAAs

The domestic period of 90 days is generally shorter than the period in a DTAA (Directive, para 9.4(7)). Exhibit 14 shows each DTAA period by partner against the domestic period.

Exhibit 14 Site and service PE periods under Nepal's DTAAs

Income Tax Act. Construction site, 90 days or more. Services, more than 90 days in any 12 months.



India appears under both service periods in the Directive. The applicable article governs. Orange dots mark periods of 90 days. The Korea DTAA has no service PE provision.

Source Directive, para 9.4(7).

A contractor resident in Bangladesh, China, India, Qatar or Thailand may remain outside the site PE for a project of up to 183 days, although domestic law would apply at 90 days, whereas a Sri Lankan contractor obtains no extension for a site. A Korean consultancy appears to fall outside the service PE rule because the

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Korea DTAA contains no service PE provision. The India DTAA appears under both service periods, so its article should be read before a position is taken. These conclusions depend on treaty residence and entitlement, and presence should be tracked against both the domestic and the DTAA period until the position is settled with the IRD.

8.2 Fixed places, income articles and force of attraction

The DTAAs list a place of management, branch, office, factory, workshop, mine, oil or gas well, quarry or other place of extraction, warehouse, sales outlet, farm or plantation, and insurance business where premium is collected, other than reinsurance (Directive, para 9.4(6)). A sales outlet is listed only in the DTAAs with India, Pakistan and Qatar. The warehouse reference is limited in the China, India and Thailand DTAAs to a person providing storage for others, and a farm or plantation is listed in all DTAAs except Norway. Income from immovable property, independent agents, international air transport, interest, dividends, royalty, capital gains and directors' fees does not create a PE unless earned as part of the PE's own business (para 9.4(9)). Under the Pakistan DTAA technical service fees are taxed as royalty, so the service PE rule does not reach technical services performed without presence in Nepal (para 9.4(8)).

Under the DTAAs with Pakistan, Qatar, Sri Lanka and Thailand, a PE's income includes sales in Nepal of goods of the same or similar kind as those sold through the PE, even where the PE did not make them (para 11.11). The Directive illustrates the force of attraction rule with a Qatari company that sold goods worth NPR 70 million through a Nepalese agent and obtained a government supply contract of NPR 40 million. Under Article 7(1) of the DTAA between Nepal and Qatar it treats the company as having sales through its PE of NPR 110 million (example 11.11.1). The rule therefore reaches sales that bypass the PE, and an enterprise resident in one of these states that has a PE should track all of its Nepalese sales of similar goods.

8.3 Rates of tax at source

The DTAAs limit the tax that Nepal charges on dividends, interest and royalty paid to a resident of the other state (Directive, para 9.5), but not the tax on the business profits of a PE, which Article 7 governs. Exhibit 15 reproduces the rates.

Exhibit 15 Rates of tax at source under Nepal's DTAAs

DTAA PARTNER	DIVIDEND	INTEREST	ROYALTY
India	5%, 10%	10%	Up to 15%
Norway	5%, 10%, 15%	10%, 15%	Up to 15%
Thailand	Not above 15%	10%, 15%	Up to 15%
Sri Lanka	Not above 15%	10%, 15%	Up to 15%
Austria	5%, 10%, 15%	10%, 15%	Up to 15%
Pakistan	10%, 15%	10%, 15%	Up to 15%
China	Not above 10%	10%	Up to 15%
Korea	5%, 10%, 15%	10%	Up to 15%
Qatar	Not above 10%	10%	Up to 15%
Bangladesh	10%, 15%	10%, 15%	Up to 15%

Source Directive, para 9.5. The DTAA with Mauritius is omitted. Several rates depend on shareholding or recipient, and a lower domestic rate on dividends prevails (5 percent for a dividend paid by a resident entity).

Relief from double taxation is given by the ordinary credit method, which limits the credit to the tax of the other state on the same income (para 9.5(7)). Interest paid to the government or central bank of a DTAA partner is not taxed at source (para 9.5(3)).

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CHAPTER 9

9 Tax Registration, Returns and Closure

A PE must be registered for tax before it commences business, and the evidence required depends on the type of PE. Registration is followed by separate returns, records kept in Nepal and, at the end of the project, suspension of the registration. This chapter sets out each of these tax requirements under the Income Tax Act, the Income Tax Rules and the Directive. It does not describe the corporate, commercial or other registrations a foreign company may need in order to operate in Nepal.

9.1 Registration

A PE may be registered for tax whether or not it is registered as a branch under section 154 of the Companies Act, 2006, and a registered branch is treated as a PE. A non-resident entity must obtain a PAN before it commences business in Nepal (Directive, para 10.1). Registration as a PE for tax does not itself entitle the company to carry on business in Nepal, which also requires the commercial presence and registration that other Nepalese law demands. Exhibit 16 shows the evidence on which a PAN is issued for each type of PE.

Exhibit 16 Basis of registration by type of PE

Fixed place NO TIME TEST	On proof of presence for preparatory work, on business registration before commencement or on the business registration certificate.
Agency NO TIME TEST	On the agency agreement before the agent commences, or on the agent's declaration where there is no direct agreement.
Construction site 90 DAYS OR MORE	On the contract or the project owner's request letter after signing, or when an extension takes a short contract past 90 days.
Service OVER 90 DAYS IN 12 MONTHS	On the service contract or the client's request letter, or once presence reaches 90 days or more in the past 12 months.

Source Directive, para 10.1.

The Directive does not prescribe a processing time, fee or list of forms for the registration of a PE. The competent office, the required documents and the processing time should therefore be confirmed with the IRD during planning, and the application should be filed on the evidence shown in Exhibit 16 before mobilisation.

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9.2 Rules applying to the PAN

A subcontractor is registered as an ordinary taxpayer, and the IRD checks the main contractor, its relationship with the subcontractor and the status of the main contractor's PE (Directive, para 10.2(1)). A non-resident entity holds one PAN even where it has several PEs, and each PE is treated as a separate person for computing income, so the tax attributes of one business cannot be set against another (paras 10.2(2) and (3)). A PAN is cancelled when the business is closed, ended or completed. A holder that takes a further work may apply to use the same PAN and must then file a return for each work separately (para 10.2(4)). Separate ledgers and bank accounts should be maintained for each work.

9.3 Counting presence

Presence is counted for the construction PE, construction supervision and the service PE, and not for the fixed-place PE or the agency PE. A new business is treated as being in Nepal from the start, and installation of equipment by a foreign seller that is not a separate business is not treated as business, even if occasional (Directive, para 10.3). A fixed-place or agency PE must therefore be registered from its first day. A construction or service PE is registered once the period is passed or the contract shows that it will be, and registration at signature is appropriate where the contract term plainly exceeds the threshold.

9.4 Certificate of tax paid

A PE that wishes to claim credit in its home country may apply to the competent office for certification of tax paid or relieved in Nepal, and the IRD issues the certificate (Directive, para 10.2(5)). The certificate refers to the corporate rate of 25 percent, to relief under section 11 of the Income Tax Act and to income tax paid excluding fees and interest but including tax on income remitted abroad. It should be requested for each income year after the return and payment.

9.5 Suspension and closure

Section 78A of the Income Tax Act permits suspension of registration in the circumstances it states. Under rule 23A of the Income Tax Rules the application must be made within thirty days of the circumstance arising, with a return and payment of tax to that date. The IRD must notify the applicant within thirty days of the application whether the PAN is suspended (Directive, para 10.4). A temporary closure is treated as continuing business (para 4.2(10)), so a PE that intends to close should apply within the period.

9.6 Returns and records

A PE files its return under section 96 of the Income Tax Act, for each work separately where it holds more than one, and keeps its accounts in Nepal in accordance with section 81 (Directive, para 11.4). Documents that are not in Nepalese or English may be required to be translated by a recognised translator at the taxpayer's cost, and electronic invoicing and record-keeping may be approved by the IRD. Return due dates, advance tax and audit requirements are those prescribed by the Income Tax Act and are not restated in the Directive. Because section 81 requires documents to be kept in Nepal, contracts, invoices, payroll and expense records that support deductions should be held in a Nepalese file.

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CHAPTER 10

10 Taxation of the Permanent Establishment

The tax cost of a PE has three components, being its taxable profit, the corporate tax on that profit and the tax on income remitted abroad. This chapter takes them in turn.

> **INCOME TAX ACT, SECTION 68 (IN TRANSLATION)**
> The foreign permanent establishment of a non-resident person is responsible for the tax on its income, and the income of the person who owns it is separated from that income under section 69. Tax on income remitted abroad is imposed on the permanent establishment, and income remitted abroad in an income year equals the dividend the permanent establishment distributes in that year.

10.1 Independent entity and computation of profit

A foreign PE is treated as an entity separate from its parent (Directive, paras 11.1 and 11.3). Its assets and liabilities are its own, and contracts, purchases, sales, loans and bank documents in the foreign company's name are treated as the PE's. The Directive illustrates that treatment with a Canadian corporation that had a PE through construction contracts (example 11.3.1). Funds contributed by the head office are the PE's capital, and a loan from the head office or a related party is treated as capital to the extent that the head office's own capital ratio is lower and otherwise as debt, with interest subject to section 14(2). Expenses incurred wholly for the PE are its own, and indirect head office expenses are allocated only as section 33 permits. Dealings with the head office and related persons must be at arm's length, and tax at source applies to them as to dealings with others (para 11.1).

10.2 Dealings with the head office

Deductions follow sections 13 to 21 of the Income Tax Act, but certain dealings with the head office or related persons are not recognised (Directive, para 11.8). Interest on funds provided by the head office is not deductible, except a proportionate share of interest on the head office's borrowings from others to the extent the PE uses them, or interest on a loan taken for the PE. Royalty for the head office's own brand is not deductible, except the proportionate amount the head office pays to others for a trademark the PE uses. A management fee charged by the head office is not deductible, although a proportionate share of its actual management and administrative expense is.

Goods sent from the head office to a branch in Nepal are treated as purchased by the branch at market price, so the import cost is deducted as the cost of stock under section 15, as the Directive illustrates with a Jordanian company (example 11.5.1). It illustrates transfer pricing with a Romanian company's branch that imported at the price charged to the Nepalese customer and not at the factory price, so that it showed no profit. Transfer pricing under sections 56 and 33 applies and the adjusted amount is the branch's deductible expense (example 11.7.1, a number the Directive also gives to the Algerian illustration below). A PE should replace charged fees with an allocation of actual head office cost on a stated key, retain third-party invoices and price stock transfers at market value.

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The Directive illustrates the three rules with the sales branch of an Algerian company (example 11.7.1), which Exhibit 17 sets out.

Exhibit 17 Deductions for the Nepalese branch of an Algerian company

ITEM	FACTS	DEDUCTIBLE	NOT DEDUCTIBLE
Interest	NPR 30 million head office loan at 7 percent. Funded by NPR 10 million from an Algerian bank at 6 percent for the branch, NPR 10 million from an African bank at 6 percent drawn for the company's businesses and used by the branch, and NPR 10 million of own funds.	NPR 600,000 on each of the first two NPR 10 million amounts, a total of NPR 1.2 million.	The 7 percent charged by the head office, NPR 2.1 million.
Logo royalty	Head office charges NPR 10 million for its own logo. The charge includes NPR 3 million that it paid to a Spanish company for that company's logo on one product.	NPR 3 million.	NPR 10 million for the head office's own logo.
Management fee	Head office charges NPR 20 million. Total management cost is NPR 500 million and the branch's sales are 2 percent of total sales.	NPR 10 million, being 2 percent of NPR 500 million.	The NPR 20 million fee.

Source Directive, example 11.7.1 (Algeria).

10.3 Rate of tax

The PE is taxed as a resident entity at the rate in Schedule 1 of the Income Tax Act for the nature of its business, and it receives the concessions in section 11 (Directive, para 11.10(1)). The examples apply 25 percent as the corporate rate and 30 percent to general insurance. Donations to approved bodies are deductible up to the lower of NPR 100,000 and 5 percent of adjusted taxable income, and contributions to the Prime Minister Disaster Relief Fund and the reconstruction fund are deductible under sections 12 and 12B (para 11.9). The Directive illustrates the exemption with an Iraqi company that opened a household goods factory in 2020 with capital investment of NPR 2 billion and employment for 600 Nepalese citizens. It finds that the company qualified as a special industry with investment above NPR 1 billion and received a five-year exemption from income tax under section 11 (example 11.10.1). Rates and concessions are those under the Income Tax Act as amended and the examples reflect the rates at the date of issue, so the applicable rate should be confirmed against current legislation when a return is prepared.

10.4 Tax on income remitted abroad

A PE cannot distribute dividends because it is not a company registered in Nepal. Its after-tax profit is sent to the head office or related persons and is taxed as income remitted abroad. The remitted amount is treated as a dividend under sections 53 to 55 (Directive, paras 11.2 and 11.3). Unrealised profit sent abroad under section 56(3) is included in the PE's income (para 11.10(2)). The rate is 5 percent under Schedule 1, paragraph 2(6), and the controlling head office is not taxed again. Exhibit 18 reproduces the Directive's three computations.

Exhibit 18 Tax on income remitted abroad

EXAMPLE	TAXABLE INCOME	CORPORATE TAX	AFTER TAX	REMITTED ABROAD	TAX AT 5%
Italian road builder (11.2.2)	NPR 10 million	NPR 2.5 million at 25%	NPR 7.5 million	NPR 7.5 million	NPR 375,000
Indian general insurer (11.2.3)	NPR 10 million	NPR 3 million at 30%	NPR 7 million	NPR 5 million	NPR 250,000
Singapore group (11.10.4)	Profit after tax NPR 6.5 million	Already paid	NPR 6.5 million	NPR 6 million	NPR 300,000

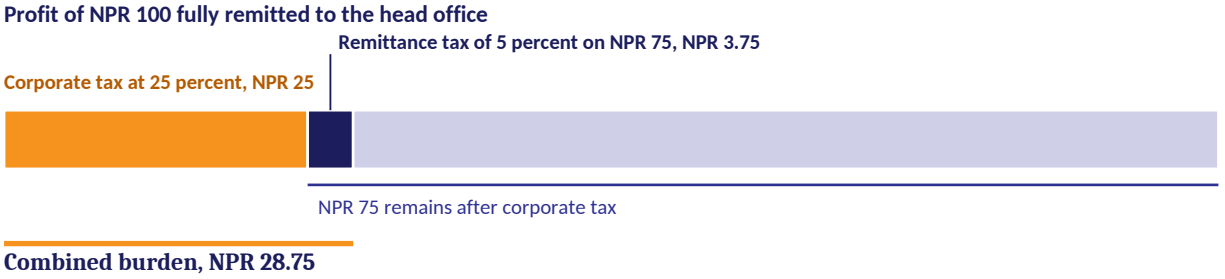
Source Directive, examples 11.2.2, 11.2.3 and 11.10.4. Tax in the Italian example is 5 percent of the amount remitted.

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The Directive illustrates how the remitted amount is measured, where the PE trades with its head office and related companies, with a Singapore group. The opening payable to the group was NPR 4 million and the closing payable NPR 4.5 million, an increase of NPR 500,000. Profit for the year was NPR 6.5 million. The remitted profit is the profit less the increase in the amount owed to the group, being NPR 6 million, and tax at 5 percent is NPR 300,000 (example 11.10.4).

A profitable PE that sends all of its post-tax earnings abroad bears two layers of Nepalese tax. On profit of NPR 100, corporate tax at 25 percent leaves NPR 75. The remittance tax of 5 percent on that amount is NPR 3.75, and the combined burden is NPR 28.75. A PE that retains its profit in Nepal postpones the second layer until funds leave the country. A PE with a section 11 exemption pays no corporate tax, but the exemption does not extend to the remittance and the 5 percent charge falls due when the profit is sent out (examples 11.10.1 and 11.10.2). The remittance tax should be modelled separately, and an income tax exemption should not be assumed to carry through to the head office.

Exhibit 19 Combined Nepalese tax on profit that is fully remitted



10.5 Related-party dealings and interest limitation

A transfer of assets or liabilities between the PE and its owner is recorded at cost where section 45(6) applies and otherwise at market value (sections 56(1) and (2), Directive, para 11.5). Section 33 and the associated enterprises article of a DTAA permit the IRD to adjust income, deductions and expenses to arm's length amounts (para 11.7). Section 14(2) of the Income Tax Act separately restricts interest deductions of an entity with 25 percent or more non-resident ownership or control on payments to controlling or associated persons. The Directive does not address whether section 14(2) applies to a PE in addition to its own rule on interest paid to the head office, so the interaction should be confirmed before interest on head office funding is deducted.

10.6 Disposal and force of attraction

A gain on the disposal of a PE is calculated under section 37 as the excess of receipts over outgoings for the asset or liability at the time of disposal. The Directive illustrates the disposal rule with a Danish company that sold a half-finished construction contract and all related assets and liabilities to a Bulgarian company. It finds that the payment is a receipt of the PE under section 39, the tax base of the PE's assets is an outgoing under section 38, and the gain is a Nepalese-source gain taxed under section 9 (example 11.6.1; Directive, para 11.6). Sales attracted to a PE under a DTAA, discussed in Chapter 8, increase both the corporate tax and the amount available for remittance (para 11.11).

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CHAPTER 11

11 Exposure Management and Compliance

The preceding chapters identify the facts on which each PE test turns. The arrangements that most often create exposure, and the measures that address them, are collected below, followed by a checklist for the pre-engagement and compliance stages.

11.1 Exposure and mitigation

PE exposure arises from the facts on which the Directive bases each test. Exhibit 20 collects the principal arrangements, the exposure each creates and the documentation or structural measure that addresses it.

Exhibit 20 Exposure and mitigation

ARRANGEMENT	EXPOSURE	DOCUMENTATION AND MITIGATION	CHAPTER
Branch, project office or rented space in Nepal	PE from the first day with no time test.	Register before occupation and keep Nepalese books from the date of occupation.	4, 9
Distributor subject to supplier price, margin or customer control	Agency PE of the supplier.	Remove the controls or register the PE.	5
Liaison office doing more than own advertising or research	PE from the date the activity changes.	Record permitted functions and review activity at fixed intervals.	4
Contracts divided by owner, phase or place	Aggregation into one site.	Review linking factors before mobilisation.	6
Subcontract chain	Main contractor and subcontractors tested separately.	Obtain subcontractor day records and allocate registration.	6
Visiting team across several visits	Rolling twelve-month count of solar days.	Keep one consolidated travel register.	6
Reliance on a longer DTAA period	Relief depends on residence and entitlement.	Obtain a certificate of residence and confirm DTAA status.	8
Head office charges for interest, brand and management	Disallowed as charged.	Allocate actual third-party cost.	10
Remittance to head office or related persons	Tax at 5 percent on income remitted abroad.	Compute on each transfer and reconcile intercompany payables.	10
Several PEs under one PAN	Separate returns and no set-off.	Keep separate ledgers and returns.	9
Stock held in Nepal for sale to Nepalese customers	A sale in Nepal and a fixed place.	Register before the stock arrives.	3, 4
Subsidiary performing sales work for the parent	Agency PE of the parent.	Assess the work against the agency tests and price intercompany dealings at arm's length.	5

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ARRANGEMENT	EXPOSURE	DOCUMENTATION AND MITIGATION	CHAPTER
Licence to conduct business in Nepal exercised through others	PE of the licence holder.	Assess the PE position before operating arrangements are concluded.	7
Completion of the project	PAN remains active until suspended.	Apply within thirty days and file a closing return.	9

11.2 Compliance checklist

Before commencing activity in Nepal

- Establish whether the owner is an entity and identify each Nepalese activity as purchase, conversion, sale or service.
- Identify any fixed place, including employee homes, shared offices and storage used for the goods of others.
- Assess each distributor, importer or representative against the agency tests in Chapter 5.
- Map each project against the 90-day construction and service tests and the aggregation rules, and obtain the DTAA text if the owner is resident in a DTAA state.
- Plan registration so that the PAN precedes commencement of business, and confirm the competent tax office.
- Model corporate tax, the 5 percent remittance tax and the non-deductible head office charges.

After registration

- Maintain separate books and a separate return for each PE or work, and keep records in Nepal for five years.
- Price all dealings with the head office and related persons at arm’s length and maintain a transfer pricing file.
- Pay tax on income remitted abroad on each remittance.
- Apply for the certificate of tax paid where home-country credit is required.
- Apply for suspension within thirty days when the relevant circumstances arise.
- Assess any licence to conduct business in Nepal for a PE before operating arrangements are concluded.

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PUBLICATION DETAILS

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Tax advice for foreign companies, contractors and tax counsel in Nepal

Niti Partners & Associates is a Nepal-based law firm. Its tax advisory work for foreign companies, contractors and tax counsel covers the Nepalese income tax treatment of a presence in Nepal, from the first question of whether a permanent establishment exists to the closure of its registration. Punya Prasad Khanal, a seasoned tax litigator, contributes to the firm's work on assessment and dispute.

PRESENCE AND STRUCTURE

Assessing whether a presence in Nepal is a permanent establishment

Double taxation avoidance agreement analysis and certificates of residence

Reviewing contracts and distribution arrangements for tax exposure

REGISTRATION AND COMPLIANCE

PE and PAN registration

Returns, books and records

Closure and suspension of registration

COMPUTATION AND REMITTANCE

Head office dealings, transfer pricing and deductions

Tax on profit sent abroad

Assessment and dispute

KNOWLEDGE PARTNERS

The firm's published insights appear in The Legal 500, International Comparative Legal Guides (ICLG) and Mondaq.

RELATED PUBLICATIONS

Project Finance 2026, Foreign Lending in Nepal 2026, International Arbitration ICLG Guide 2026 and the Foreign Guarantee Handbook 2026.

CONTACT

Foreign enterprises seeking local advice from a law firm in Nepal on permanent establishment matters may contact Niti Partners & Associates.

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