

**CASE BRIEF**

# **Withholding tax applies on Cross-Border Digital Service Payments in Nepal**

**Standard Chartered Bank Nepal Ltd.  
v. Inland Revenue Department, Lazimpat**

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Understanding the Standard Chartered Bank Nepal Ltd. Tax Case: Implications for Cross-Border Digital Services and Withholding Tax in Nepal.

## Context

This case brief examines the legal question arising under the Income Tax Act, 2058 (2002) (the “Act”): Whether service payments made by a resident entity to a foreign company for services rendered online, without physical presence in Nepal, are subject to withholding tax in Nepal. The Supreme Court of Nepal has adjudicated on this issue in Standard Chartered Bank Nepal Ltd. v. Inland Revenue Department, Lazimpat. The case provides authoritative interpretation on the meaning of “income sourced in Nepal” under Section 67 of the Act and the applicability of withholding tax under Section 88 of the Act.

### **Whether a service fee paid to a foreign company for remote services is taxable in Nepal?**

Yes, the Supreme Court held that payments made to a foreign company for services utilized in Nepal are considered Nepal-sourced income under Section 67(6)(j) of the Income Tax Act and are therefore subject to a 15% withholding tax under Section 88(1), regardless of the physical location of the service provider.

### **Whether the foreign service provider was physically present in Nepal or registered under VAT?**

No. The service provider, Scope International Pvt. Ltd., an Indian company, provided back-office support services (such as reconciliation, system support, KYC/AML, etc.) to Standard Chartered Bank Nepal via the internet. The company was not registered in Nepal, was not subject to VAT registration, and did not maintain a permanent establishment in Nepal.

### **Whether the service activities took place in Nepal?**

Yes. Although performed remotely, the Court ruled that services were used by Standard Chartered Bank Nepal within Nepal, enabling its core banking functions. The Court emphasized that income source is determined by the location of benefit and use, not the provider’s location.

### **Whether the source of payment for such service is regarded as being in Nepal?**

Yes, Section 67(6)(j) of the Act stipulates that service fees are considered to have a source in Nepal if the activity associated with the payment occurs in Nepal. The Court reaffirmed this by interpreting the services’ use in Nepal as the basis for deeming the income Nepal-sourced.

## Whether the Double Taxation Avoidance Agreement (DTAA) between Nepal and India prevents Nepal from taxing such income?

No. The Court clarified that under the DTAA, income that is taxable in Nepal may be granted credit in India. The withholding tax does not violate the treaty, and Nepal is within its rights to tax income derived from activities benefiting Nepalese operations.

## Whether services performed abroad are exempt from Nepalese tax?

Not necessarily. The Court held that what matters is not where the service is performed, but where it is utilized. Even if the service is rendered outside Nepal, it is taxable in Nepal if it contributes to business functions within Nepal.

## Implications of the Judgement

The ruling sets a precedent for digital cross-border transactions. It confirms that any foreign entity providing remote services which are used within Nepal may be subject to tax withholding obligations, even without physical or legal presence in Nepal. The judgment clarifies that the determining factor for the source of income under Section 67 is the place where the service is utilized or the benefit is received, not the place of service provider or payment. This interpretation will guide future tax rulings on cross-border digital or intangible services.

## Analysis

The Court's decision underscores the significance of determining the source of payment based on the location where the underlying activity has taken place. In the present case, despite the foreign service provider rendering its services remotely from India via the internet, the Court focused on the taxpayer's business operations in Nepal and the benefits derived therefrom. The Court adopted a similar approach in *Probiotic Industries v. Large Taxpayer's Office* (NKP 2068 Decision No. 8544), where it ruled that a company established in Nepal must withhold tax on payments made to an agent appointed for the sale and distribution of its products in Nepal, as such payments were deemed to have a Nepalese source. These decisions reflect the Court's inclination to interpret tax laws in a manner that ensures the Government of Nepal does not experience revenue loss, even in the absence of explicit statutory provisions.

In determining the taxability of cross-border transactions, the relevant factors include: (i) the country where the payer is located, (ii) the country where the payee is situated, (iii) the country where the payment is made, and (iv) the country where the activity related to the transaction occurs. In the case of service transactions, Section 67 of the Income Tax Act stipulates that taxability is determined by the location where the service is performed. Accordingly, in the present case, the transaction should be taxable in India, as the services were provided there.

This interpretation aligns with the Income Tax Directives, 2066, which provide an illustrative example concerning Section 67(6) of the Act. In that example, a Dutch company, IMGD, conducted training in Nepal for Nepali tax officials under a program sponsored by the Danish Government. Although the service fees were remitted to IMGD in the Netherlands, the transaction was deemed to have a Nepalese source because the training took place in Nepal. Applying the same reasoning, the services rendered in India in the present case should be considered sourced in India, thereby rendering them non-taxable in Nepal.

Furthermore, this interpretation is supported by the Commentary on the Commonwealth Symmetrical of Income Tax prepared by the International Monetary Fund, which serves as a persuasive authority for interpreting Nepal's Income Tax Act. Specifically, paragraph 144 of the commentary states that "the source of a payment for services, including remuneration of an employee, typically follows the place of performance of the services." Additionally, Article 15 of the Model Tax Convention on Income and Capital prepared by the Organization for Economic Cooperation and Development (OECD) provides that employment income is taxable only in the jurisdiction where the related activity occurs. By analogy, this principle should extend to service agreements, reinforcing the argument that the services performed in India should be taxable there.

Additionally, various judicial precedents in India support the position that service fees paid to foreign entities for services rendered outside India are not taxable in India. A leading case on this issue is CIT v. Toshoku Ltd., wherein the Supreme Court of India held that an Indian tobacco manufacturing company, having appointed an agent in Japan to facilitate sales, paid a commission for such sales. Since the commission was earned for activities conducted outside India, it could not be considered as income sourced in India, and no tax liability arose in India.

Thus, applying the principles established in international tax law, domestic precedents, and authoritative commentaries, it is arguable that the payments made in the present case should not be subject to withholding tax in Nepal.

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