CHAPTER 7

Legal Structuring

A breakdown of the legal implications of investing in big infrastructure in Nepal, from preferred entity domiciles to fund structuring. Findings based on pragmatic assessment of available options for Nepal.

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CHAPTER 7

Legal Structuring

This chapter is an excerpt from the publication: Lessons on how to promote and execute equity capital in the renewable energy sector of Nepal (Dolma Foundation, 2019).

The full publication can be accessed at: www.dolmaenergy.com/publication

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Dolma Foundation is a non-profit organisation, promoting prosperity by investing in education and sustainable business in Nepal that are risky for the private sector.

This report series was produced and authored by Matthew Ribeiro-Norley and Vishal Bista. The team is grateful for collaboration and data within Dolma and from various agencies in Nepal. The cut-off date for data in this report was January 2019.

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DISCLAIMER

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EXECUTIVE SUMMARY

CHAPTER 1: ENERGY MARKET ANALYSIS

Chapter 1 sets the tone for the series in highlighting that commercial institutional investors are the only sector with the capacity to finance this gap.

Nepal currently sits on a USD 17.8 bn infrastructure gap (excluding transmission and distribution) which needs to be addressed.

A prime solar belt region with 300 days of sunshine, and holding an economically feasible potential of ~43,000 MW of hydropower, Nepal boasts impressive renewable energy potential.

Despite this, Nepal's total installed capacity (March 2018) stands at 1,017 MW – 968 MW from hydro resources and 49 MW from thermal alternatives. Solar capacity is limited to 1.2 MW.

Electricity imports remain high in the dry season (Oct-Mar) for both peak load and base load energy, and as of March 2019 stood at 650 MW.

The Nepalese Rupee has remained pegged to the Indian rupee since 1993, primarily in the interest of price stability.

Based on Dolma's findings, the Project Internal Rate of Return for hydropower projects in Nepal range from 15-20%.

The main barriers to entry in Nepal include political stability, policy stability, currency, weak governance, climate change and bureaucracy.

Barriers to exit include the process of repatriating funds (whereby multiple authorities are required to sign-off after taxes are paid); as well as the lock-in period of up to three years after IPO on the Nepal Stock Exchange.

While there is a clear opportunity to export electricity to India in future, a clear framework agreed by both parties has not yet been enforced.

CHAPTER 2: CLIMATE CHANGE

Chapter 2 reflects on the environmental and social implications of a changing climate. Known for its pristine glaciers and abundant flora, the Himalayan region has witnessed an alarming number of climate-related tragedies in the last two decades. Between 2000 and 2015, ICIMOD estimates that 45,534 people died due to flooding, 10,893 to extreme heat, and 191 by drought, in Himalayan countries alone.

Higher temperatures have resulted in glaciers receding at alarming rates, adding volume to Glacial Lakes which pose a threat to those living downstream in the event of a burst. Moreover, unpredictable river flow can be a threat to farmers.

This chapter also puts into perspective that while CO_2 rates remain high, the most immediate threat to the region – as identified in a series of recent reports from the Intergovernmental Panel on Climate Change (IPCC) and International Centre for Integrated Mountain Development (ICIMOD) – are short-lived climate pollutants, such as black carbon.

Despite its shorter life-span (approximately 50 years), black carbon is a warming agent with 1,500 times the warming effect of CO_2. According to research, fossil fuel sourced black carbon appears to have twice the particle-specific warming potential of biomass sourced black carbon.

Based on conversations Dolma has had with regional climate scientists, prioritising the mitigation of short term climate pollutants is paramount to reversing Himalayan glacial melt – of which one third is expected to disappear by 2100 in a business-as-usual environment.

CHAPTER 3: TRANSMISSION AND DISTRIBUTION

Chapter 3 traces Nepal's energy infrastructure development and progress. Unlike energy generation, Nepal's transmission network grew at an annual rate of 8% from 2008 to 2012.

Electricity markets in Nepal are gradually un-bundling. Until 1990 all production, transmission and distribution were vertically controlled by the Nepal Electricity Authority.

Since 1990, Independent Power Producers have added ~500 MW to the grid.

Despite plans to un-bundle the NEA's transmission and distribution business following The Hydropower Development Policy 1992, it was only with assistance from the Asian Development Bank in 2015 that the National Transmission Grid Company was set up.

As this publication went to print, the newly-found distribution company had still not made any significant progress.

There are some USD 817 mn allocated to the enhancement of Nepal's transmission and distribution, mainly led by key donors such as ADB, Government of Norway, MCC and JICA.

A further USD 471.5 mn is being spent on policy and institutional reforms led mainly by the World Bank, ADB, and Canadian Government.

CHAPTER 4: REGULATORY ADVOCACY

Chapter 4 puts forward a number of recommendations to government that would facilitate the enabling environment for international investors.

Nepal has over the last five years (2013-2018) amended and introduced several regulations to facilitate public-private partnership and encourage further private sector investment.

Despite the government's best intentions to prioritise infrastructure, some have labelled the planning "erratic": since 2001 there have been five strategic documents on energy capacity targets, one every three years on average.

The most recent government plan, from 2016, calls for the construction of 10,000 MW by 2030.

The World Bank and others have argued that to attract and retain investment to the tune of tens of billions of dollars, an enabling environment is required.

"Quick-Win" regulatory reforms that would have a disproportionately positive impact on the infrastructure investment environment in Nepal:

Automatic route for foreign investment
Foreign currency power purchase agreements
Return on equity (ROE) clarifications
Alternative and auxiliary energy tariffs (new technologies such as batteries)

Long-term reform opportunities beyond the scope of this project:

Sovereign credit rating
Cost-plus approach
Competitive bidding
Protection for seasonality
Benefit sharing
Cooperation with regional partners

CHAPTER 5: INSTITUTIONAL INVESTOR INVESTMENT LANDSCAPE

Chapter 5 identifies three key catalysts for driving institutional investors into frontier markets like Nepal: low global interest rates; the commercial viability of renewable technologies; and heightened public, shareholder and regulatory opinion in relation to carbon emissions.

The need to attract large amounts of FDI to finance Nepal's power needs is well documented, both the Investment Board of Nepal and National Planning Commission agree that to meet just domestic demand, approximately USD 18 bn is required in capital investment (both debt and equity), or USD 1.5 bn annually.

The Dolma team interviewed some of the world's largest institutional investors, testing the risk and return mandate for Nepal against their current and emerging risk strategies. Interviewees included funds with assets under management from USD 1 bn to 6 tn.

These were our findings:

Some investors suggested that the required return on equity for construction risk could be up to 20%, provided a Nepal project vehicle can demonstrate equivalency to investment grade status after successfully mitigating risks.

Among institutional investors there is a clear negative bias against credit and currency risk, suggesting that FX risk, real or perceived, prevents perhaps trillions of dollars from flowing to the poorest economies.

Dolma's findings also suggested that a country's credit rating is fundamental to getting an investment proposal through the first step of the investment procedure. In some cases, the lack of a sovereign credit rating and international sovereign bonds for Nepal has been too large a barrier to overcome in our discussions with some investors who are often restricted to considering countries that are at least investment grade (BBB-).

Some solutions to perceived risks included adopting Political Risk Insurance (PRI); Currency Hedging Mechanisms; and Bank Guarantees, amongst others.

Investors interviewed fell into two groups –leaders and followers – the former willing to take higher risk in search of greater yield and the latter less so; 2) there is no clear connection between Assets Under Management (AUM) and risk profile when it comes to investing in frontier markets like Nepal.

CHAPTER 6: COMPLEMENTARY INVESTORS

Chapter 6 discusses complementary investors (or blended concessional finance) which provide a new wind of opportunity for institutional investors – previously unable to invest in frontier market because of perceived risk. Blended capital works to de-risk perceived obstacles.

Investment instruments typically involve the deployment of grants, concessional lending, guarantees, and equity. These are deployed using adaptable programme, policy and sector investment loans, debt swaps, PPPs, advanced market commitments, and first loss reserve tranches.

Green bonds have recently also proven to be a potential solution by providing debt financing to eligible climate change projects. As of 2018, green bond issuance reached some USD 250 bn.

Complementary investors have played a key role in attracting investment to Nepal's renewable sector – these include Development Finance Institutions such as FMO, OEEB, DGGF and FINNFUND, as well as Multilateral platforms like IFC and ADB.

As stated in chapter 5, Dolma finds that at least two blended finance instruments are required for institutional investors to consider a renewable energy project in Nepal: political risk insurance and a currency hedge.

Dolma's research finds that countries successful in solving these risks for investors were able to make bold moves within their own domestic economies.

Nepal could follow the path of successful governments in doing so by creating its own government backed instruments and enacting reform.

CHAPTER 7: LEGAL STRUCTURING

Chapter 7 explains the legal structuring backdrop which is an essential component for foreign investors considering large infrastructure in Nepal.

To invest in Nepal through the FDI route, it is important to analyse and decide upon which country to invest from. To date there are 15 jurisdictions which hold a Dual Taxation Agreement (DTA) with Nepal which mitigates the risk of paying double taxation.

Dolma finds that Mauritius is generally viewed as the "gateway" to Nepal because both countries hold a DTA – Mauritius is also known as a transparent jurisdiction that ranks well according to the financial services index. It also has experience fund management and administrative services which manage approximately USD 670 bn in assets.

Despite Mauritius' favourable positioning, the choice of domicile is based on the circumstances and preferences of individual investors.

Dolma views the UK as one of many strong locations to set up a fund manager, and has based the examples in chapter 7 on an English limited partnership or UK company as the fund vehicle.

CHAPTER 8: FINANCIAL STRUCTURING

Chapter 8 explores key regulated and non-regulated institutions that could act as potential sources of financing for energy projects in-country.

Nepal is yet to formulate specific regulatory provisions for private equity funds that invest in private companies.

There are a number of private equity players investing in renewable energy in Nepal, which include IFC, Dolma Impact Fund I and Equicap.

Dolma found that key exit issues for international investors include, but are not limited to the following:
Valuation at exit
Taxation in change of ownership
Repatriation issues

Dolma found that there could be some challenges for investors keen to invest through a project finance model, particularly for debt financing:

A limited tenor and floating interest rates on long term loans.
Generally, a limited capacity for banks to lend.
A limited scope for corporate bonds, which is still a nascent market.

The chapter also explores key financial issues for investors and how to integrate these solutions at the fund level: these include suggestions for currency risk, political risk, and debt risk.

CHAPTER 9: PROJECT DESIGN AND ENGINEERING

Chapter 9 focuses on the practical realities of executing renewables projects in Nepal, acknowledging that besides hydropower – Nepal's most mature energy asset class – other newer technologies such as solar and batteries could play a significant role in servicing growing supply, and providing auxiliary services.

Despite Nepal's installed generation capacity standing at 1,100 MW, there are some 7,000 MW in licenses that have been issued by the government to IPPs. The vast majority of these are for hydro-run-of-river (RoR) projects.

Dolma has identified a priority pipeline of hydro and solar projects that are optimal from a project execution perspective.

The chapter also includes a summary of leading battery technologies and which would be most suited in Nepal's context.

While there are no Nepali contractors that offer Engineer Procurement Construction (EPC) contracts this chapter analyses local firms that have a track record for hydro and solar projects in-country.

As financiers are increasingly aligning their investment mandates to the UN's Sustainable Development Goals, the chapter also outlines high level strategies for climate adaptation and resilience.

ABBREBIATIONS

TABLES

FIGURES

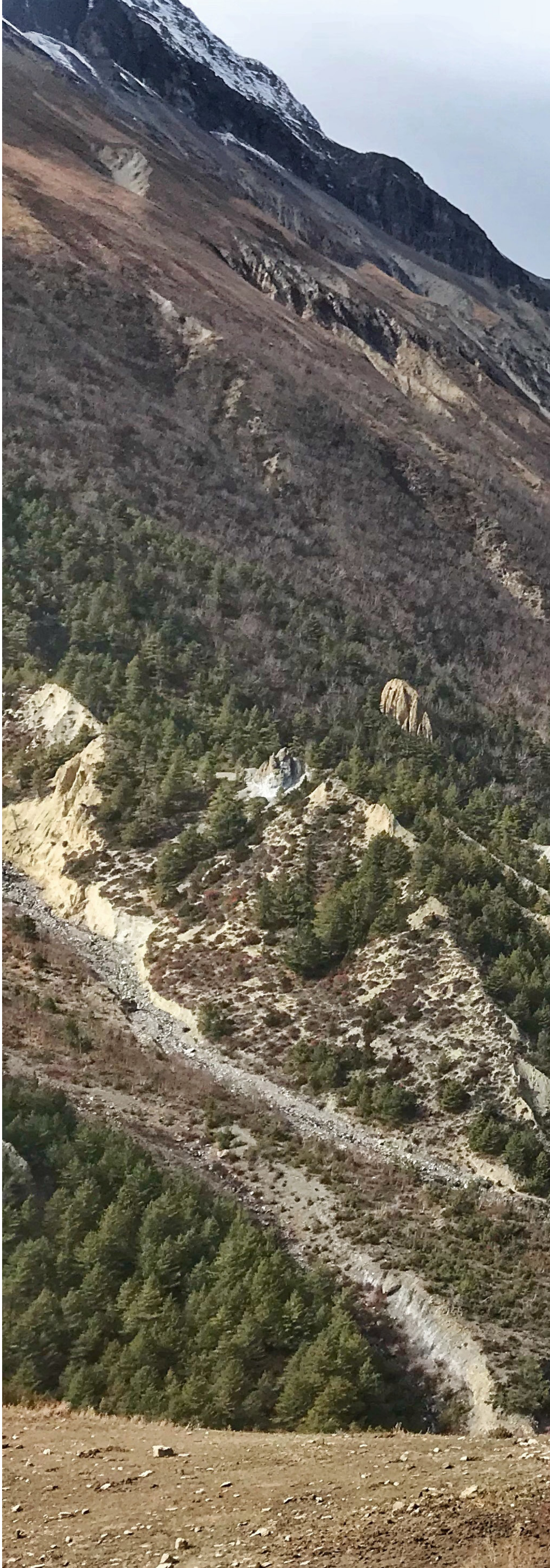
ABBREVIATIONS

BIMSTEC	BAY OF BENGAL INITIATIVE FOR MULTI-SECTORAL TECHNICAL AND ECO NOMIC COOPERATION
BIPPA	BILATERAL INVESTMENT PROMOTION AND PROTECTION AGREEMENT
DEVCO	DEVELOPMENT COMPANY
DTA	DOUBLE TAXATION AGREEMENTS
DTAA	DOUBLE TAXATION AVOIDANCE AGREEMENT
DTT	DOUBLE TAXATION TREATY
FDI	FOREIGN DIRECT INVESTMENTS
FSC	FINANCIAL SERVICES COMMISSION
FSI	FINANCIAL SECRECY INDEX
GATS	GENERAL AGREEMENT ON TRADE IN SERVICES
GBL	GLOBAL BUSINESS LICENCE
HOLDCO	HOLDING COMPANY
ICSID	INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
ILO	INTERNATIONAL LABOUR ORGANIZATION
ITA	INCOME TAX ACT
LLP	LIMITED LIABILITY PARTNERSHIP
LP	LIMITED PARTNER
MIGA	MULTILATERAL INVESTMENT GUARANTEE AGENCY
SAFTA	SOUTH ASIAN FREE TRADE ACCORD
SPV	SPECIAL PURPOSE VEHICLE
TRIMS	THE AGREEMENT ON TRADE-RELATED INVESTMENT MEASURES
TRIPS	THE AGREEMENT ON TRADE-RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS
UN	UNITED NATIONS
YIELDCO	YIELD COMPANY

1.1 INTRODUCTION

Investing in a Least Developed Country such as Nepal means dealing with a myriad of risks, including political, credit, currency, and environmental/social risks. Investors risk their money on a project, build it, and aim to make commensurate returns based on the risk taken. A strong legal entity structure in Nepal and outside to managethe flow of funds is essential to limit unnecessary liabilities and uncertainties, ensure maximum protection under international treaties, and avoid double or even triple taxation on returns (which could render the project economically unfeasible). All this must be achieved without hurting the interests of the host country.

Deliverable 1: Market Analysis andDeliverable 8: Financial Structuringexamined Nepal's tax law for investors and the benefits available to an investor in the energy sector. This report exploresNepal's international trade, investment, and tax treaties. These treaties could help investorsselect aninternational jurisdiction if their own country does not have such treaties with Nepal or if they are investing pooled funds with other investors and a mutually acceptable jurisdiction is required (see Section 1.3). Section 1.4 outlines the steps to structure entities in both Nepal and international jurisdictions.



1.2 ANALYSIS OF BILATERAL AND MULTILATERAL TRADE, INVESTMENT AND TAX TREATIES WITH NEPAL

BILATERAL TRADE TREATIES

Nepal has bilateral trade treaties with 15 countries. The first was signed with the US in 1947.

Nepal has bilateral trade treaties with India, Pakistan, Sri Lanka, and Bangladesh from South Asia; China, Mongolia, and Korea from the rest of Asia; the Soviet Union, Poland, Romania, Bulgaria, and Czechoslovakia from Europe; Egypt from Africa; and the US from North America.

Table 1 summarizes imports and exports of Nepal in 2015 from and to these countries. It shows that signing a trade treaty is not necessarily a sign of increased trade between the two countries.

TABLE 1: NEPAL'S TRADE (IN 2015) WITH COUNTRIES WITH WHICH IT HAS TRADE TREATIES

S.N.	Country	Export (USD)	% Value	Import (USD)	% Value
1	India	418,516,909	56.5	6,561,869,841	65.2
2	U.S.	82,796,702	11.2	81,988,461	0.8
3	China	22,418,351	3	1,271,409,408	12.6
4	Bangladesh	9,838,683	1.3	38,945,875	0.4
5	Russia	1,766,658	0.2	11,473,450	0.1
6	Korea	1,555,240	0.2	93,170,293	0.9
7	Pakistan	921,416	0.1	11,863,699	0.1
8	Czech Republic	915,055	0.1	11,503,055	0.1
W	Poland	224,593	<0.1	4,154,667	<0.1
10	Egypt	204,625	<0.1	26,000,302	0.3
11	Slovakia	180,777	<0.1	276,382	<0.1
12	Romania	125,816	<0.1	977,417	<0.1
13	Sri Lanka	98,597	<0.1	2,049,213	<0.1
14	Bulgaria	23,229	<0.1	759,642	<0.1

Source: Export-Import Data Bank, Trade and Export Promotion Centre, Government of Nepal (2018)

INVESTMENT TREATIES

Nepal has a Bilateral Investment Promotion and Protection Agreement (BIPPA) with six countries. The first was signed with France in 1983. India, the largest trade partner of Nepal, was the last country to sign a BIPPA with Nepal.

TABLE 2: BILATERAL INVESTMENT TREATIES

Country	Signed Date
France	May 2, 1983
Germany	October 10, 1986
United Kingdom	March 2, 1993
Mauritius	August 3, 1999
Finland	February 3, 2009
India	October 21, 2011

Investment treaties between countries aim to smoothen the transaction costs associated with investments being made across both jurisdictions . Treaties generally cover the following points:

i) Promotion and protection of investments
ii) Treatment of companies of the other country as if they were companies of the host country
iii) Compensation for losses in case of war,

armed conflict, revolution, etc. (compensation payments may be transferred freely)

iv) Prohibition on nationalising or expropriating foreign companies by the host country

v) Compensation of property if the host country seizes a company owned by the other country

vi) Unrestricted repatriation of investment and returns

TABLE 3: OTHER TREATIES WITH INVESTMENT PROVISIONS

No.	Short title	Parties	Date of signature	Date of entry into force
1	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) Framework Agreement	Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka, Thailand	08/02/2004	30/06/2004
2	South Asian Free Trade Accord (SAFTA)	Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal Pakistan, Sri Lanka	06/01/2004	01/01/2006
3	EC–Nepal Cooperation Agreement	European Union	20/11/1995	01/06/1996

Besides bilateral treaties and multilateral treaties, Nepal has signed an open-ended category of investment-related instruments (IRIs). These encompass various binding and non-binding instruments and include, for example, model agreements and draft instruments, multilateral conventions on dispute settlement and arbitration rules, and documents adopted by international organisations. For a list of these instruments, please refer toAnnex 1.

TAX TREATIES OF NEPAL

Nepal has entered into Double Taxation Treaties with 10 countries: India, Norway, China, Pakistan, Sri Lanka, Austria, Thailand, Mauritius, Qatar, and the Republic of South Korea.

Section 73(1) of the Income Tax Act 2002 provides that where Nepal has entered into a DTAAtreaty with another country, in the event that an income of a person or company is taxable in Nepal and the same income is also taxable in the other county, beneficial tax provisions (exemption or lower rate of tax) under the DTAAare applicable, subject to the fulfilment of certain conditions as may be provided in the relevant DTAA.

Nepal's DTAAs generally cover the treatment of dividends, royalties, interest, and capital gains.

DIVIDEND

Nepal's income tax act taxes distribution of profits whether it is made as dividends (payments in cash) or as bonus shares (profits capitalized as share capital). Both dividends and bonus shares are taxable at 5% andtax is the final withholding tax.

ROYALTIES

Under the act,a royalty is defined as any payment made under a lease of an intangible assetand includes any payment made for the following purposes:

i) The use of, or the right to use, a copyright, patent, design, model, plan, secret formula or process, or trademark

ii) The supply of know-how

iii) The use of, or right to use, a film, video tape, sound recording, or any other such medium and the supply of information concerning industrial, commercial, or scientific experience

iv) The supply of assistance ancillary to a matter referred to in (i), (ii), or (iii)

v) A total or partial forbearance with respect to a matter referred to in (i), (ii), (iii), or (iv)

A withholding tax of 15% is applicable on any royalty payments from Nepal.

INTEREST

As per Nepal's income tax act,interest refers to the following payments or gains:

i) A payment made or incurred under a debt obligation that is not a repayment of capital
ii) Any gain realized by way of a discount, premium, swap payment, or similar payment under a debt obligation
iii) The portion which is treated as interest in the payments made to a person under an annuity or by a person acquiring an asset under an instalment sale or the use of an asset under a finance lease under Section 32 of the Income Tax Act

A withholding tax of 15% is applicable on any interest payments from Nepal.

CAPITAL GAINS

Theseare not defined under Nepal's tax act. However, net gains from the disposal of business assets or business liabilities of an entity are taxable. Capital gains from disposing of an interest in a resident entity will be withheld at a 10% rate if paid to a resident natural person and at a 15% rate if paid to others.

CURRENT TRADING SCENARIO

Nepal is currently a net importer. As of 2015, Nepal had a negative trade balance of USD 5.7 bn in net imports. Until recently, Nepal was a net importer, but the imbalance between import and export was minimal; in 2006, imports began shooting up rapidly.

In 2017, Nepal exported USD 740 million worth of goods. Textiles, foodstuffs, vegetable products, and metals were its major exports, contributing 39%, 17%, 12%, and 9.8% respectively to total exports. India is Nepal's biggest export destination, receiving over 60% of total exports. The US is the second biggest export destination,making up nearly 10% of total exports. All other destinations combined receive no more than 10% of total exports.

Nepal imported USD 6.61 BNworth of goods comprising mainly of petroleum products, machines and equipment, metals, vehicles, and chemical products. As with exports, India is Nepal's major import partner, with just under 60% of imports coming from India. Imports from China make up around 14% of total imports. Imports from all other countries make up not more than 5% of total imports.

FIGURE 1: COUNTRIES WITH BILATERAL TRADE TREATIES WITH NEPAL

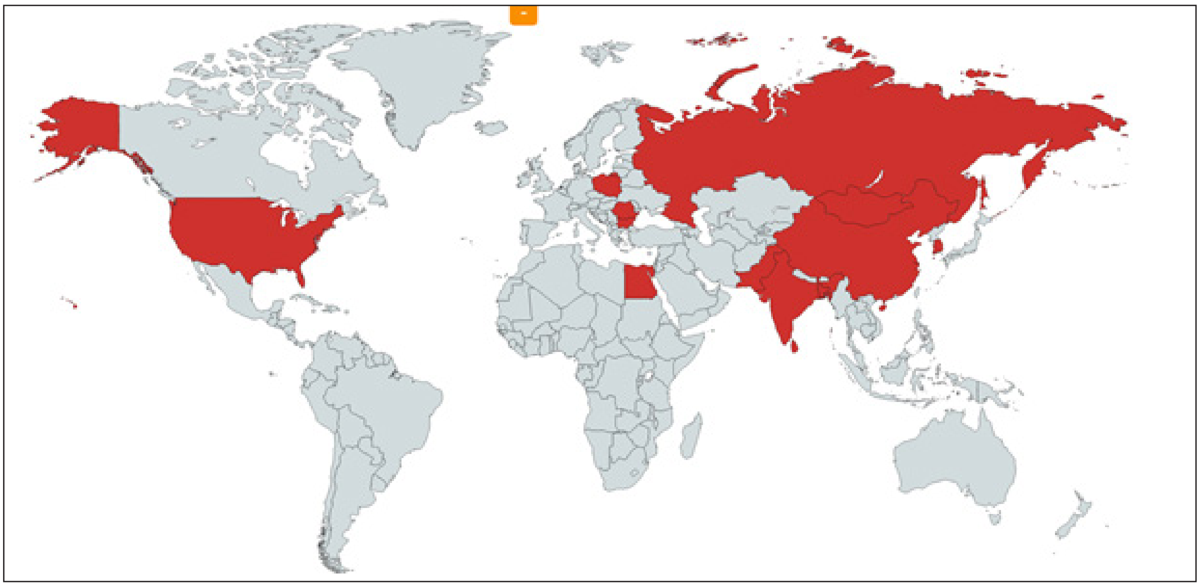


FIGURE 2: NEPAL'S TRADE BALANCE 3

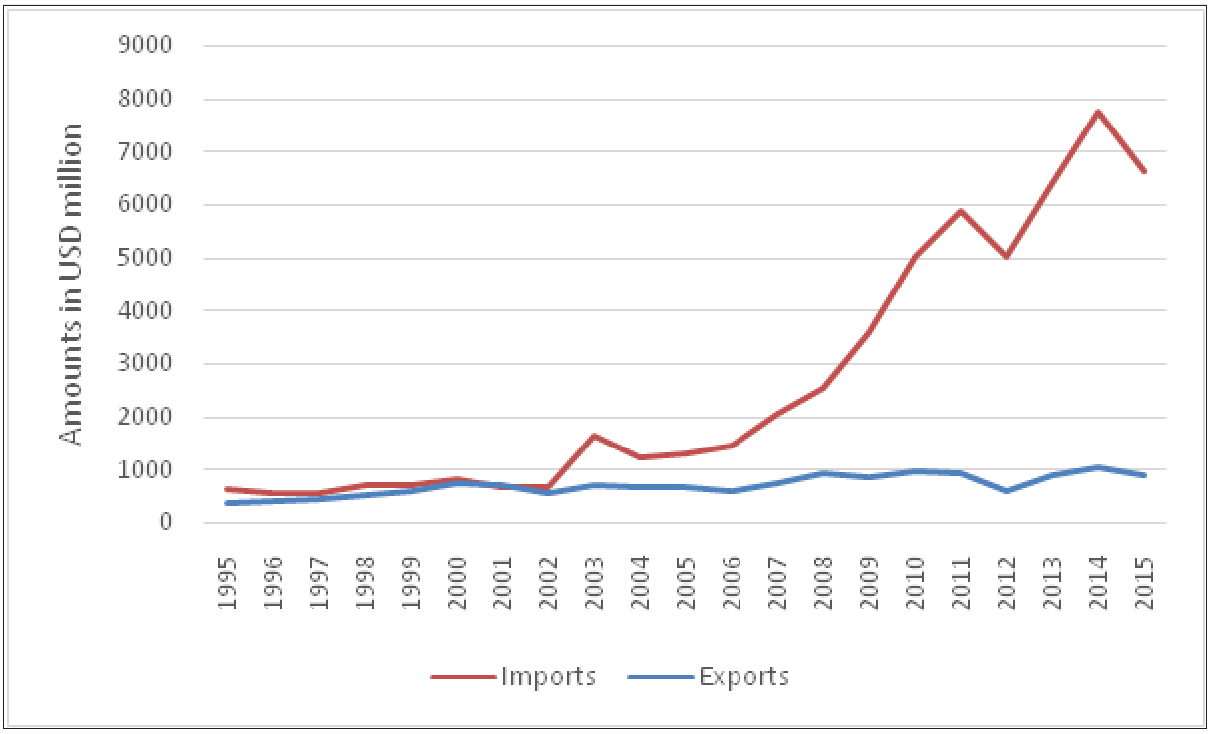


FIGURE 3: TOP COUNTRIES WHERE NEPAL EXPORTS TO

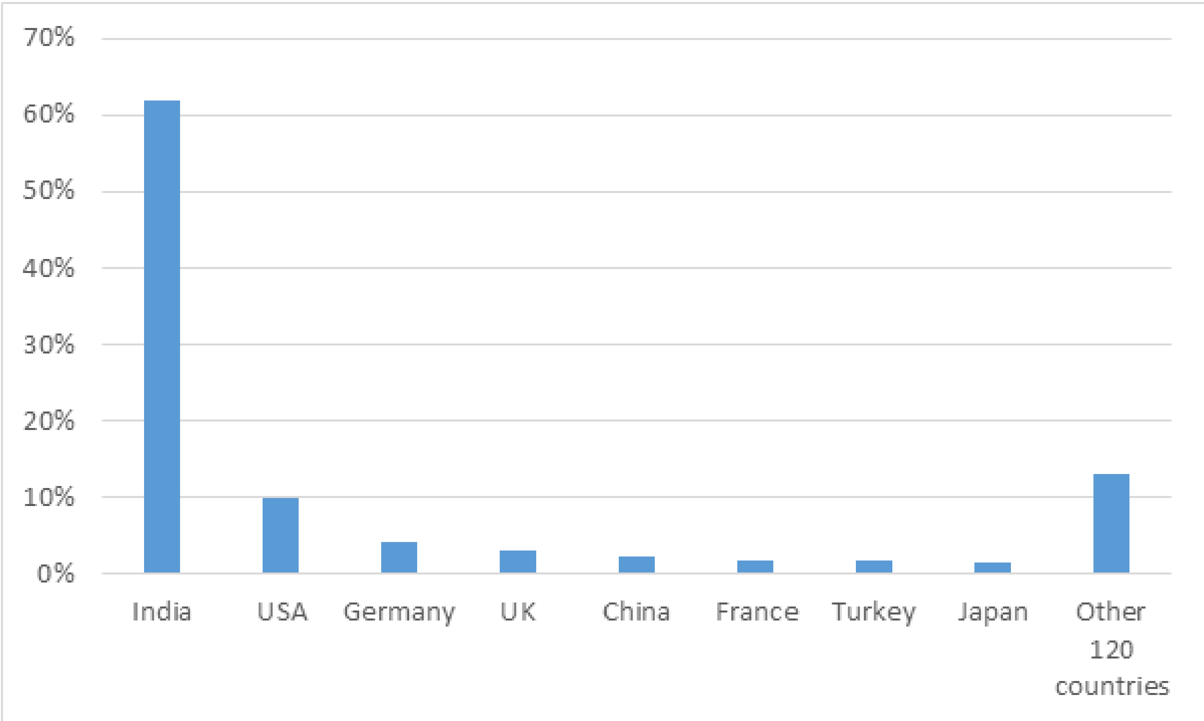
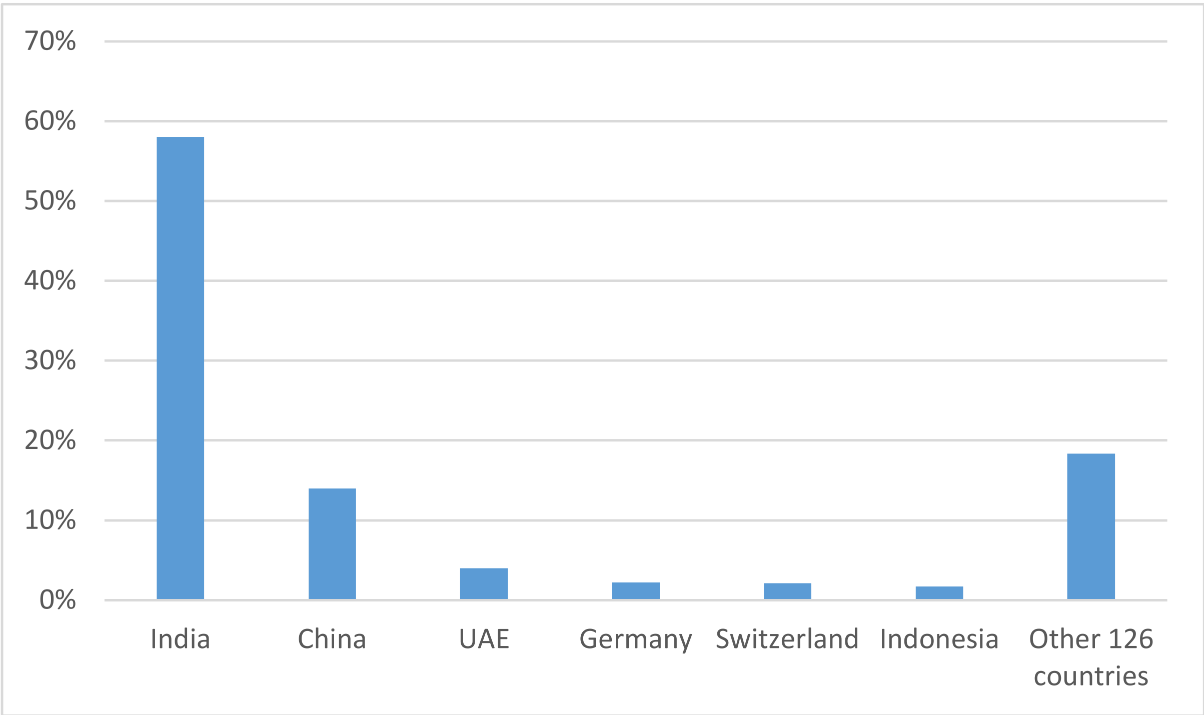


FIGURE 4: TOP COUNTRIES WHERE NEPAL IMPORTS FROM



1.3 POTENTIAL DOMICILES AND LEGAL STRUCTURES

Companies and individuals that wish to establish an offshore vehicle, either individually or jointly (referred to in this report as a “fund”), to invest in Nepal (including in renewable energy) need to plan the vehicle structure. This section sets out, in high-level terms, two example structure options.

Disclaimer: This is in no way intended as advice for specific situations. Each investor or group of investors has unique mandates and tax considerations. Independent professional advice should be sought in each case. The examples below are based on Dolma’s research and should not be taken as anything other than examples.

POTENTIAL DOMICILES

OFFSHORE VS ONSHORE

For discussion on offshore vs onshore, refer to Deliverable 8: Financial Structuring.

OFF-SHORE LOCATION CHOICES

If investors opt for an offshore location, it should be credible and efficient in terms of transparency, governance, and taxand be on the “white list”, as classified by the OECD on AML practices.Offshore locations may be analysed based on the following criteria.

DOUBLE TAXATION AGREEMENT (DTA) WITH NEPAL

As discussed above, Nepal has double taxation treaties with 10 countries. Hence, the report will analyse the suitability of these 10 countries for foreign investors.

TAX, AML AND INTERNATIONAL COMPLIANCE

The OECD has formulated “white”, “grey”, and “black” lists for international financial centres. The whitelist contains countries that have implemented international tax standards – i.e. they are not consideredas tax havens. The grey list includes countries which are improving on tax, AML, and other international compliance standards. The blacklist includes countries that arenon-cooperating on the aforementioned standards.Among countries that have signed a DTA with Nepal,no country is on the OECD blacklist.

Similarly, the Global Forum on Transparency and Exchange of Information for Tax Purposes conducts peer reviews on the ability of its member jurisdictions to co-operate with tax administrations in accordance with international standards based on the following criteria:

- Availability of information
    - Legal and beneficial ownership and identity information
    - Accounting records
    - Bank information
- Access to information
    - Competent authority’s ability to obtain and provide information
    - Notification requirements, rights, and safeguards
- Exchanging information
    - Exchange of information mechanisms
    - Exchange of information mechanisms with all relevant partners

- o Confidentiality
- o Rights and safeguards of taxpayers and third parties
- o Requesting and providing information in an effective manner

The Global Forum examined the legal and regulatory framework in phase 1 and looked into the implementation of this framework in practice in phase 2. Based on these reviews, each jurisdiction is rated compliant, largely compliant, provisionally largely compliant, partially compliant, provisionally partially compliant,or non-compliant.

TABLE 4: GLOBAL FORUM RATING OF JURISDICTIONS WITH A DTA WITH NEPAL

Jurisdictions	Rating
India	Largely compliant
Norway	Compliant
China	Compliant
Sri Lanka	Not rated
Pakistan	Largely compliant
South Korea	Compliant
Mauritius	Compliant
Austria	Largely compliant
Thailand	Not rated
Qatar	Largely compliant

Likewise, the Financial Secrecy Index of the Tax Justice Network ranks jurisdictions according to their secrecy and the scale of their offshore financial activities. It is a politically neutral ranking and a tool for understanding global financial secrecy, tax havens or secrecy jurisdictions, and illicit financial flows or capital flight. Table 5 shows the 2018 rankings of the 10 jurisdictions. The higher the FSI value, the higher the secrecy of the jurisdiction.

TABLE 5: FINANCIAL SECRECY INDEX (FSI)

Jurisdictions	Ranking	FSI
India	32	316.62
Norway	45	242.84
China	28	372.57
Sri Lanka	Not ranked	Not rated
Pakistan	Not ranked	Not rated
South Korea	33	314.05
Mauritius	49	223.47
Austria	35	310.41
Thailand	15	550.59
Qatar	Not ranked	Not rated

Among the 10 countries, Mauritius comes out best, Thailand is considered the most secretive, while three countries – Sri Lanka, Pakistan, and Qatar –are unrated.

TRACK RECORD OF DOMICILE IN MANAGING FOREIGN CAPITAL

It is important to understand the reputation of territories in terms of compliance, efficiency, and availability of fund management services. Furthermore, the cost of operating the fund, its management, and ease of operations are key factors that need to be considered in order to selectan appropriate domicile. The availability of fund management and administration professionals, the efficiency of the system (both of the private sector and regulators), and the trend being followed in developing or frontier markets are important to domicile selection.

EASE OF DOING BUSINESS

The World Bank ranks countries around the world on their “ease of doing business”. Economies are ranked from 1 to 190 on 10 different topics and overall ranking is based on aggregate rank across these topics. A high ranking for ease of doing business means the regulatory environment is more conducive to starting and operating a local firm.

TABLE 6: THE WORLD BANK'S EASE OF DOING BUSINESS FOR SELECTED COUNTRIES

	Korea, Republic of	Norway	Austria	Mauritius	Thailand	China	Qatar	India	Sri Lanka	Pakistan
Ease of Doing Business Rank	4	8	22	25	26	78	83	100	111	147
Starting a Business	9	19	118	40	36	93	89	156	77	142
Dealing with Construction Permits	28	21	42	9	43	172	19	181	76	141
Getting Electricity	2	23	22	51	13	98	65	29	93	167
Registering Property	39	14	31	35	68	41	26	154	157	170
Getting Credit	55	77	77	55	42	68	133	29	122	105
Protecting Minority Investors	20	10	29	33	16	119	177	4	43	20
Paying Taxes	24	28	39	10	67	130	1	119	158	172
Trading across Borders	33	22	1	70	57	97	90	146	86	171
Enforcing Contracts	1	8	9	27	34	5	123	164	165	156
Resolving Insolvency	5	6	23	36	26	56	116	103	88	82

Korea tops this listwhile South Asian countries are towardsthe bottom. The highlights items in green in each row represent the best-ranked country in each category among the 10 countries.

TAX TREATIES OF THE JURISDICTION WITH OTHER COUNTRIES

It is not only important for the jurisdiction country to have a tax treaty with Nepal, but also for it to have tax treaties with other countries. This suggests that the domicile has more experience in managing and enforcing such treaties. Individual investors may also want to evaluate whether their home country has a treaty with the host country and any implications of this on the legal structuring decisions.

TABLE 7: NUMBER OF TAX TREATIES OF SELECTED JURISDICTION

Jurisdictions	Number of countries with which it has tax treaties
India	96
Norway	50
China	102
Sri Lanka	44
Pakistan	65
South Korea	91
Mauritius	44
Austria	95
Thailand	61
Qatar	68

China has tax treaties with the greatest number of countries (102)and Mauritius and Sri Lanka with the least (44 each).

EXAMPLES OF POTENTIAL LEGAL STRUCTURE

In preparing this section, an international tax consultant analysedhow potential structures could be set up. However, the structures outlined below are broad structures and further detailed technical analysis will be needed on behalf of all parties before a precise structure can be outlined.

Mauritius is generally viewed as the "gateway" to Nepal because of the double tax treaty between the two countries. However, as we saw above, Mauritius offers much more than just tax treaties. It is a compliant country according to the Global Forum on Transparency and Exchange of Information for Tax Purposes, which means that it is a fairly transparent jurisdiction. It also ranks well on the financial services index. Moreover, the country has good fund management and administration services and has USD 659 bn in assets under management through companies with a Global Business License.

However, the choice of domicile is based on the investor's preference. Based on the criteria above, investors can choose another jurisdiction oropt to invest directly in an onshore company in Nepal or through a holding company in another jurisdiction, such as the UK.

The UK is known as a global financial and services hub with presence of top financial, legal and engineering firms and therefore one of the preferred domiciles for a holding company. From a fundraising perspective, London has an established debt and bond market. Between January and September 2018, investors raised over USD 14.9 bn at the London Stock Exchange (LSE). The LSE is one of the major stock exchanges and has a market capitalisation of USD 4.15 tn, accounting for USD 2.15 tnin debt securities. The UK should also be attractive to prospective investors who choose to invest in countries other than Mauritius.

The example provided here uses an English limited partnership or a UK company as the fund vehicle. This example also includes the option of a separate management company or fund manager as may be the case with private equity funds or a separate renewable energy management company. Here, an English limited liability partnership acts as the Fund Manager. Investors may want an Investment Adviser on the ground in Nepal that provides investment advisory services to the fund manager – meaning that the fund manager would only provide fund management services and research and analysis would be done by the investment adviser.

The UK and the global tax landscape are witnessing rapid and dramatic changes; so while the two examples here factor in the uncertain global tax landscape, significant flexibility has been built in so that any future adverse changes can be successfully navigated.

EXAMPLE STRUCTURE1: ENGLISH LIMITED PARTNERSHIP FUND VEHICLE

Structure 1 proposes the use of an English limited partnership as the fund vehicle with an English limited liability partnership (LLP) Fund Manager (who may be advised by a Nepali Advisor).

An English limited partnership is a common fund vehicle which provides flexibility for fund investors while limiting the liability of a limited partner (LP) to that individual partner's contribution to the partnership. An English limited partnership is treated as "tax transparent" for UK tax purposes, meaning that the fund itself would generally not be subject to UK tax on its income, profits, and gains.

STRUCTURE 2: UK COMPANY FUND VEHICLE

Structure 2 proposes using a UK company, managed by an English limited liability partnership Fund Manager (which may be advised by a Nepali company Investment Advisor), as the Fund vehicle.

The UK is an attractive holding company jurisdiction and a UK holding company provides a suitable Fund vehicle alternative to an English limited partnership, which is more typical. The UK has a good treaty network, EU directive benefits, and a beneficial domestic holding company tax regime.

COMPARISON OF STRUCTURES AND TAX IMPLICATIONS

The two structures are similar. Structure 1 envisions the fund as a UK limited partnership entityand Structure 2 envisions it as a company. A UK limited partnership has more flexibility, no tax at the fund level, and dividends are not taxable at the fund level. A holding company would not have those privilegesbut would be subject to a standard reporting standards which might be attractive to investors.

STEPWISE DESCRIPTION OF STRUCTURING THE FUND

This section details the steps to structure the fund, assuming that:

- Each company in the structure will be managed and controlled and resident for tax purposes solely in its jurisdiction of incorporation.
- This structure proposes using an English limited partnership or an English company as the Fund vehicle with an English limited liability partnership or English company as the Fund Manager,whichwill provide fund management and investment advisory services;if desirable an Investment Adviser who would provide investment advisory services to the Fund Manager may be located on the ground in Nepal.
- All services will be provided, and all transactions will be entered, on arm's length terms.

STEP 1: FORMATION OF THE FUND MANAGER

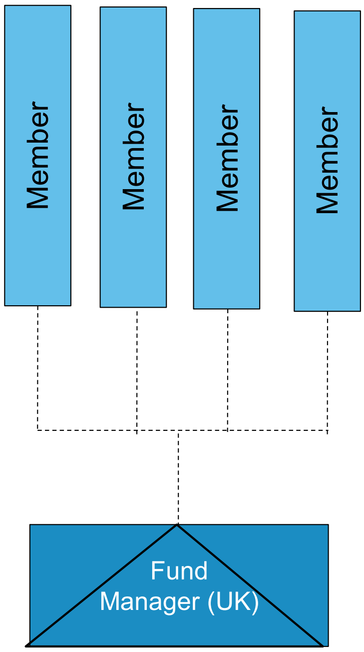


Figure 1: Formation of the Fund Manager

STEPS

The Fund Manager is established. Members identify a suitable existing Fund Manager in the UK or the Fund Manager is established as an English limited liability partnership ("LLP") or an English company.

KEY TAX CONSEQUENCES

UNITED KINGDOM

No adverse tax consequences are anticipated in the UKbecause of the implementation of this step. The Fund Manager, if established as an English LLP, will be "tax transparent" for UK tax purposes, meaning that the Fund Manager will generally not be liable to UK tax on its income, profits, and gains. If it is established as an English company, it will be subject to United Kingdom corporation tax, the rate of which is currently 20%, and will fall to 19% for the financial years starting 1 April 2017, 2018, and 2019, and to 17% for the financial year starting 1 April 2020.

MAURITIUS

No adverse tax consequences are anticipated in Mauritius because of the implementation of this step.

NEPAL

No adverse tax consequences are anticipated in Nepal because of the implementation of this step.

STEP 2: FORMATION OF THE ADVISOR

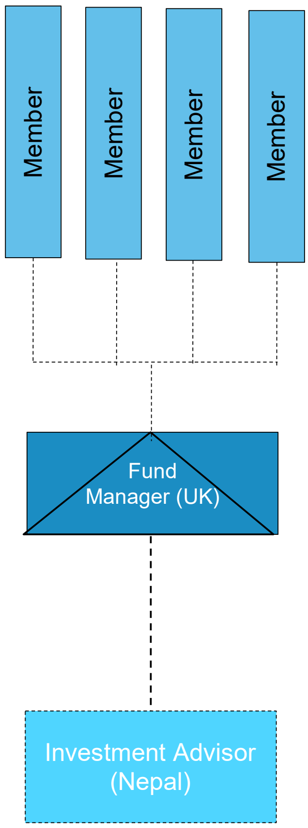


Figure 1: Formation of Investment Advisor

STEPS

If a separate Investment Adviser is required on the ground in Nepal, the Fund Manager can use services of an existing Investment Adviser in Nepal or can incorporate a company in Nepal as the Investment Adviser.

NOTE: If an Investment Adviser in Nepal is not required, then the Fund Manager will provide both fund management and investment advisory services to the Fund.

KEY TAX CONSEQUENCES

UNITED KINGDOM

No adverse tax consequences are anticipated in the United Kingdom because of the implementation of this step.

MAURITIUS

No adverse tax consequences are anticipated in Mauritius because of the implementation of this step.

NEPAL

No adverse tax consequences are anticipated in Nepal because of the implementation of this step.

STEP 3: FORMATION OF THE FUND

STEPS

- The Fund is established. It can be established as an English limited partnership ("LP") or an English company.
- Agreements are entered into between the Fund Manager and the Fund (the "Fund Management Agreement") and between the Investment Adviser and the Fund Manager (the "Investment Advisory Agreement").

KEY TAX CONSEQUENCES

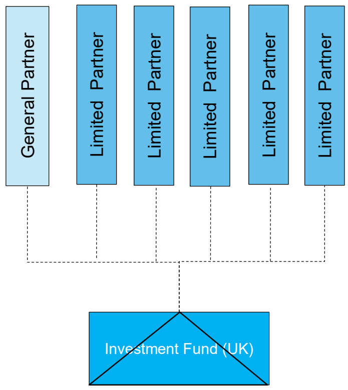


Figure 1: Formation of the Fund

UNITED KINGDOM

No adverse tax consequences are anticipated in the UK because of the implementation of this step. The Fund Manager, if established as an English LLP, will be "tax transparent" for UK tax purposes, meaning that the Fund Manager will generally not be liable to UK tax on its income, profits, and gains. If it is established as an English company, it will be subject to United Kingdom corporation tax, the rate of which is currently 20%, and will fall to 19% for the financial years starting 1 April 2017, 2018, and 2019, and to 17% for the financial year starting 1 April 2020.

MAURITIUS

No adverse tax consequences are anticipated in Mauritius because of the implementation of this step.

NEPAL

No adverse tax consequences are anticipated in Nepal because of the implementation of this step.

FIGURE 5: ENGLISH LIMITED PARTNERSHIP FUND VEHICLE STRUCTURE

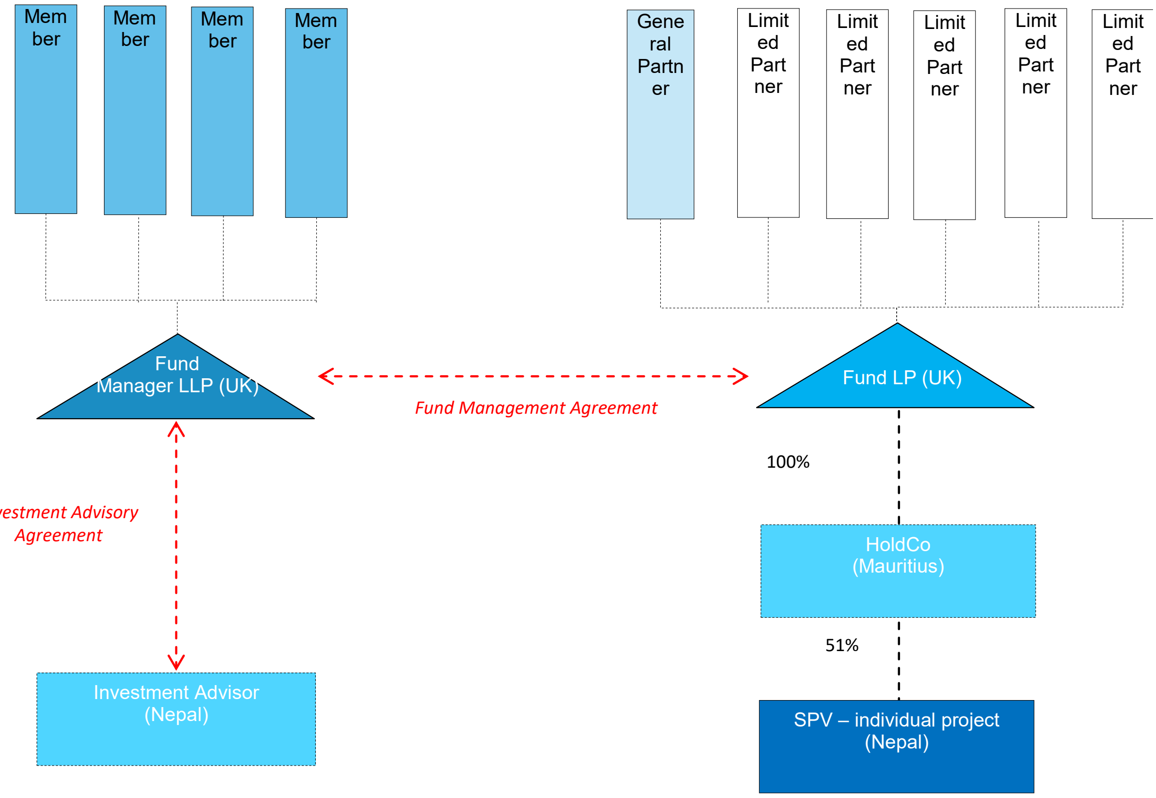
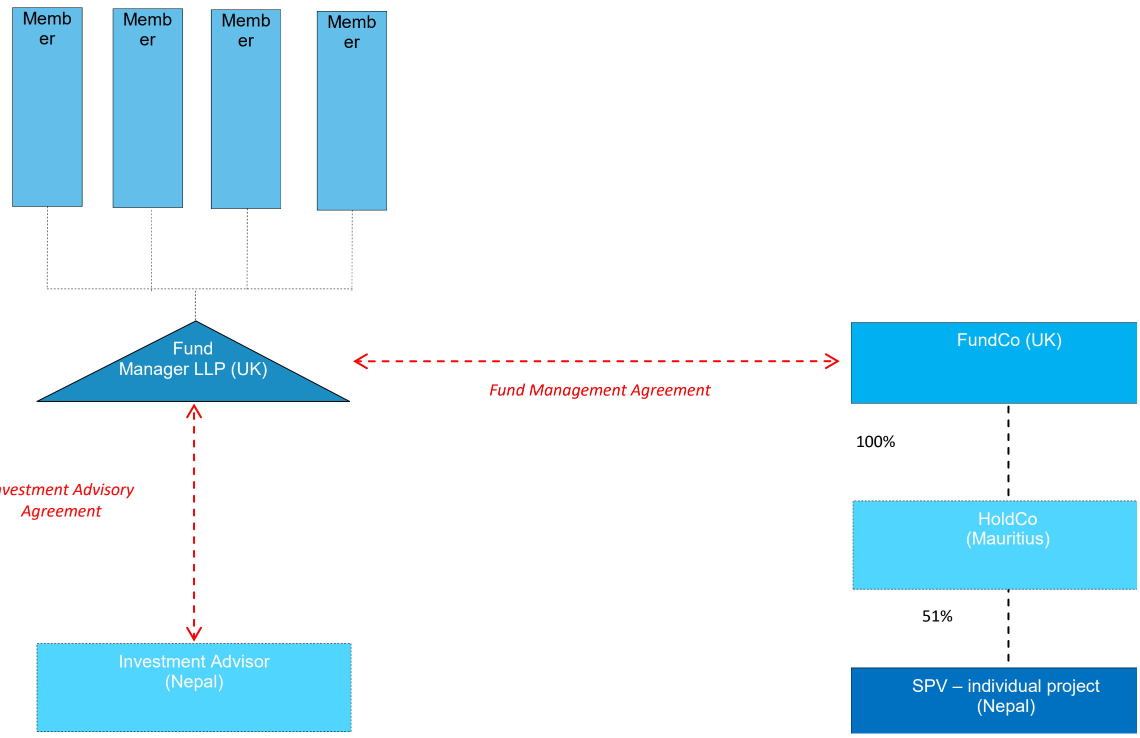


FIGURE 6: UK COMPANY FUND VEHICLE STRUCTURE



STEP 4: FUND INCORPORATES HOLDCO

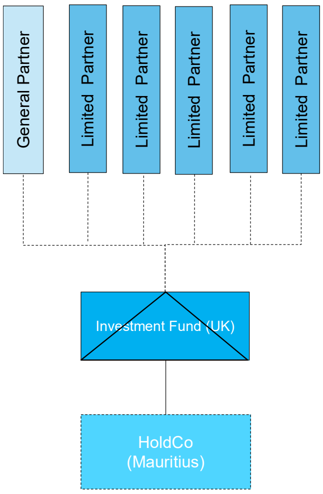


Figure 1: Fund Incorporates Holdco

STEPS

1. The Fund incorporates a company in Mauritius to act broadly as the holding company of the Fund's investments in Nepali assets ("HoldCo").
2. HoldCo applies to the Mauritius Financial Services Commission (the "FSC") for a Category 1 Global Business Licence ("GBL-1").

KEY TAX CONSEQUENCES

UNITED KINGDOM

No adverse tax consequences are anticipated in the United Kingdom because of the implementation of this step.

MAURITIUS

No adverse tax consequences are anticipated in Mauritius because of the implementation of this step.

NEPAL

No adverse tax consequences are anticipated in Nepal because of the implementation of this step.

STEP 5: HOLDCO INCORPORATES DEVCO AND YIELDCO AND ACQUIRES SHARES IN SPV

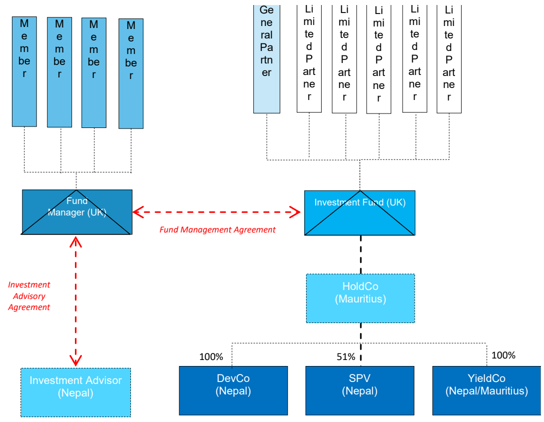


Figure 1: Holdco Incorporates Devcoand Yieldcoand Acquires Shares in SPV

STEPS

- HoldCo incorporates DevCo in Nepal.
- HoldCo incorporates YieldCo in Mauritius/ Nepal (see note below) to hold the renewable energy asset in the long-term.
- HoldCo acquires shares in a Nepali company ("SPV"), thereby entitling it to 51% of SPV. Local investors hold the remaining 49%.
- SPV acquires the rights to the renewable energy project and DevCo enters into construction contracts, procurement contracts etc. to construct and develop the asset.

KEY TAX CONSEQUENCES

UNITED KINGDOM

No adverse tax consequences are anticipated in the United Kingdom because of the implementation of this step.

MAURITIUS

No adverse tax consequences are anticipated in Mauritius because of the implementation of this step.

NEPAL

No adverse tax consequences are anticipated in Nepal because of the implementation of this step.

STEP 6: YIELDCO ISSUES GREEN BONDS

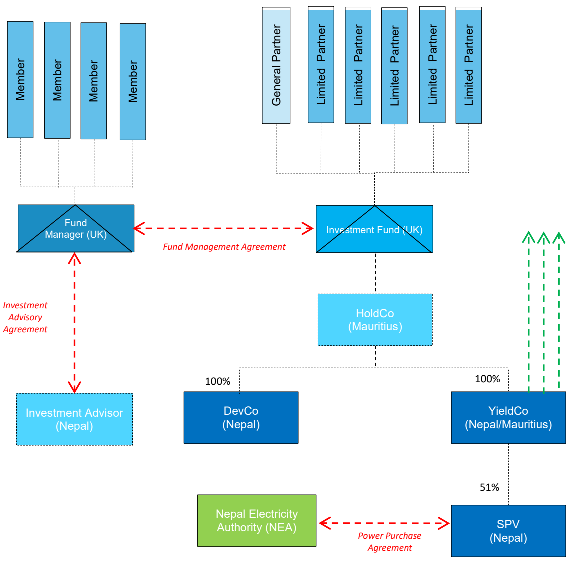


Figure 1: Yieldco Issues Green Bonds

STEPS

1. YieldCo issues green bonds to long-term investors such as pension funds, asset managers, and insurers.
2. YieldCo uses the proceeds to acquire the 51% shareholding in SPV from HoldCo. As a result, YieldCo holds the renewable energy asset.

KEY TAX CONSEQUENCES

UNITED KINGDOM

No adverse tax consequences are anticipated in the United Kingdom because of the implementation of this step.

MAURITIUS

No adverse tax consequences are anticipated in Mauritius because of the implementation of this step.

NEPAL

No adverse tax consequences are anticipated in Nepal because of the implementation of this step.

IMPLICATIONS OF NCELL CAPITAL GAINS CASE

Teliasonera divested holdings in Ncell by selling its 60.4% of Reynold holdings (an offshore entity in Nepal) to Axiata. Nepali tax authorities raised capital gains tax obligations on TeliaSonera. However, TeliaSonera refused to accept the tax obligationsby pointing to Nepal's double taxation agreement with Norway, in which Nepal has waived its right to tax gains from sale of shares owned by a Norwegian entity.

The Ncell caseset a precedent that offshore transactions of Nepali underlying assetsmay be taxable in Nepal. Investors should factor this into their legal structuring. A direct divestment of their interest in a Nepali entity would be far less complicated in terms of tax matters compared to the divestment of their shares in the offshore entity.

TABLE 8:INVESTMENT-RELATED INSTRUMENTS

No.	Short title	Date of signing	Level	Type
1	Fifth Protocol to GATS			
1997	Multilateral	Intergovernmental agree-ments		
2	Fourth Protocol to GATS	1997	Multilateral	Intergovernmental agree-ments
3	TRIPS			
1994	Multilateral	Intergovernmental agree-ments		
4	TRIMS			
1994	Multilateral	Intergovernmental agree-ments		
5	GATS	1994	Multilateral	Intergovernmental agree-ments
6	MIGA Convention			
1985	Multilateral	Intergovernmental agree-ments		
7	ICSID Convention			
1965	Multilateral	Intergovernmental agree-ments		
8	New York Convention	1958	Multilateral	Intergovernmental agree-ments
9	UN Code of Conduct on Transnational Corpora-tions	1983	Multilateral	Draft instruments
10	UN Guiding Principles on Business and Human Rights	2011	Multilateral	Guidelines, principles, resolutions and similar
11	ILO Tripartite Declaration on Multinational Enter-prises	2006	Multilateral	Guidelines, principles, resolutions and similar
12	Doha Declaration	2001	Multilateral	Guidelines, principles, resolutions and similar
13	ILO Tripartite Declaration on Multinational Enter-prises	2000	Multilateral	Guidelines, principles, resolutions and similar
14	Singapore Ministerial Declaration	1996	Multilateral	Guidelines, principles, resolutions and similar
15	World Bank Investment Guidelines	1992	Multilateral	Guidelines, principles, resolutions and similar
16	ILO Tripartite Declaration on Multinational Enter-prises	1977	Multilateral	Guidelines, principles, resolutions and similar
17	New International Economic Order UN Resolution			
1974	Multilateral	Guidelines, principles, resolutions and similar		
18	Charter of Economic Rights and Duties of States	1974	Multilateral	Guidelines, principles, resolutions and similar
19	Permanent Sovereignty UN Resolution	1962	Multilateral	Guidelines, principles, resolutions and similar

ANNEXURE 1: INVESTMENT-RELATED INSTRUMENTS

Dividends

<table>
<tr><td colspan="11">Taxable also in Nepal if companies from another country directly holds</td></tr>
<tr><td></td><td>Mauritius</td><td>China</td><td>India</td><td>Sri Lanka</td><td>Pakistan</td><td>Korea</td><td>Thailand</td><td>Austria</td><td>Norway</td><td>Qatar</td></tr>
<tr><td>At least 25% of capital/ shares of Nepali entity</td><td rowspan="2">5%</td><td rowspan="4">10% of gross divi-dends</td><td rowspan="3">5%</td><td rowspan="4">15% of gross divi-dends</td><td rowspan="3">10%</td><td>5%</td><td rowspan="2">15%</td><td>5%</td><td>5%</td><td rowspan="4">10% of gross dividends</td></tr>
<tr><td>At least 15% of capital/ shares of Nepali entity</td><td rowspan="2">10%</td><td rowspan="2">10%</td><td rowspan="2">10%</td></tr>
<tr><td>At least 10% of capital/ shares of Nepal entity</td><td>10%</td><td rowspan="2">Taxable in Nepal</td></tr>
<tr><td>Other case</td><td>15%</td><td>10%</td><td>15%</td><td>15%</td><td>15%</td><td>15%</td></tr>
</table>

Royalties

Rate of tax in Nepal as a percentage of gross amount of royalties

	Mauritius	China	India	Sri Lanka	Pakistan	Korea	Thailand	Austria	Norway	Qatar
Tax rate	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%

Interest

Maximum rate of taxation as a percentage of interest amount

	Mauritius	China	India	Sri Lanka	Pakistan	Korea	Thai-land	Austria	Norway	Qatar
Entity is a financial institution (including insurance)	NA	NA	NA	NA	NA	NA	15% of gross amount	NA	NA	NA
Entity is a banking business	NA	NA	NA	10%	NA	NA	NA	10%	10%	NA
Entity in other country is an investment company receiving income from financial investments (in the form of debentures or otherwise)	10%	NA	NA	NA	10%	NA	NA	NA	NA	NA
Any other case	15%	10% of gross amount	10% of gross amount	15% of gross amount	15%	10% of gross amount	10%	15% of gross amount	15% of gross amount	10% of gross amount

Capital Gains

		Mauritius	China	India	SriLanka	Pakistan	Korea	Thailand	Austria	Nor-way	Qatar
A) Are capital gains from the alienation of shares/capital stock of the Nepali entity held by the other entity taxable											
i)	In Nepal only	NA	No	No	No	No	No	NA	NA	No	Yes
ii)	In Nepal but										
	the property of such Nepali entity consists mainly of immovable property	NA	Yes	Yes	NA	Yes	Yes	NA	NA	NA	NA
	Such shares repre-sent 25% or more of the shareholding/ voting rights of the Nepalientity	NA	Yes	NA	Yes	Yes	NA	NA	NA	NA	NA
iii)	Taxable in another country only	NA	Yes	Yes	Yes	Yes	Yes	NA	Yes	Yes	No

B) Are capital gains of an entity based in another country from the alienation of movable property situated in Nepal											
i)	Taxable in Nepal	NA	NA	NA	NA	NA	NA	Yes	NA	NA	NA
II)	Taxable in another country only	Yes	NA	NA	NA	NA	NA	NA	NA	NA	NA

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