FOREIGN EQUITY INVESTMENTS FOR NEPAL'S PROSPERITY

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Foreign equity investments in Nepal have been both in green field investing and brown. A green-field investment is where a parent company creates its subsidiary from the ground in a different country, whereas a brown-field investing is where an entity purchases existing facilities to begin new production in another country. Joint venture investments in banks would be an example of green-field investing and investments in hotels, hydropower, cement etc. would be examples of brown-field investing. In the past decade, the concept of Private Equity (PE) investing in Nepal would be considered a bit of both as it includes many approaches to investing.

Regulations on foreign equity investment, associated challenges, and avenues for improvement: The Nepal Rastra Bank (NRB) Foreign Direct Investment (FDI) and Loan Management Bylaw 2021 has introduced an automatic route that has helped onshore investment companies to receive blanket approval (Off Shore PE funds are not exempt from this). This means the companies do not have to wait for the approval from the central bank for each investment to be sanctioned once they receive permission from the Department of Industries (DoI) or the Investment Board of Nepal (IBN) or other government authorities. However, each investment still requires approval from the Department of Industry, making the process cumbersome. One of the ways to mitigate this challenge is by providing annual progress reports or information. The greatest lag for any investment seeking FDI approval in Nepal is the time taken by the authorities to approve the investment. There have been cases where the capital increment in FDI has taken over two years.

The recent regulation allowing FDI in an investment company has simplified PE/Venture Capital (VC) to start operations onshore. Earlier, Business Oxygen was the only company in this structure. A minimum of NPR 1 billion as corpus of the fund has to be declared to commence operations. Since this requires each investment to be approved by the Department of Industry (DoI) it is time consuming; otherwise, this is a start towards institutionalizing PE/VC investments in Nepal although much can be done in future to making it commensurate to international best practices.

Moreover, the Industry and Investment Promotion Board (IIPB) needs to approve investments above NPR 5 billion (USD 42 million). The Public Private Partnership (PPP) and Investment Bill 2019 requires investments over NPR 6 billion (USD 50.37 million) to be approved by the IBN. This creates further inconvenience to FDIs greater than NPR 6 billion (USD 50.37 million) as they need to be approved by two entities instead of just one. The IIPB could be replaced by the IBN to make this process simpler. This brings us to the major challenge, the governing system. It should be more result-oriented rather than the current process-driven system. Currently, approval is required for almost every process in investment, divestment, and return of sale proceeds, thus resulting in increased cost and time for decision making. Until the system is result-oriented, these anomalies will continue to deter FDI in the country. The other underlying problem here is that each bureaucrat has their own interpretation of the law that delays the entire process.

In addition, COVID-19 added a huge economic insecurity, where the PE's inability to provide risk capital comes at a time when businesses with high debts are left vulnerable due to COVID-19. A major way to promote PE transactions is to remove double taxation at exit. In the absence of a Double Taxation Avoidance Agreement (DTAA), both foreign investors of a local PE fund as well as offshore PE funds investing in Nepal have to pay tax at 25% on any gains from sale of investments in Nepal. Meanwhile domestic investors are subject to capital gains tax of only 5% (for sale of listed entities) and 10% (for sale of unlisted entities)[238]. Some

DTAA would require foreign investors to be taxed exclusively at the country of residence, while other DTAA would require foreign investors to be taxed at source but at preferential rates compared to local investors. This would encourage FDI in Nepal. More specifically, we need to amend Section 57 of the Income Tax Act if we are to do away with this constraint. Section 57 of the Income Tax Act states that if the ownership of any entity changes by 50% or more within a period of three years, then such an entity is considered to have disposed of its asset and liabilities. So, any gain on such transaction is subject to tax at the rate applicable on their business income. Private Equity funds would benefit greatly if portfolio companies receive specific waivers from Section 57 of Income Tax Act. This waiver can be similar to those provided to Banks and Financial Institutions (BFIs) to encourage mergers and acquisitions.

Furthermore, we need digitization of processes. Until now the need for digitization has only been realized but not implemented. As an FDI investor in PE, Business Oxygen has assisted Securities Exchange Board of Nepal (SEBON) in drafting the Specialized Investment Fund (SIF) regulation. The SIF has somewhat streamlined the approval process by allowing FDI in PE funds from bilateral and multilateral organisation and recognizing both investment committee and advisory committee as per international practice. However, SIF still needs to address the double taxation of PE funds and waiving of blacklisting provision for onshore PE funds.[239] We have realized and have continuously tried making SEBON aware of the balance required between the SIF regulation and the prevailing acts that will assist in addressing the problems that international PE faces in Nepal. Without this, SIF will be another layer of hassle on top of what we have to go through at the DoI. There are chances that SIF might work for local firms but for us, it needs to be revised before subscribing to it. The existing Company Act provides only two financial instrument options. Unless SIF regulation breaks its silence and talks about debentures, blacklisting provision for PE, mezzanine financing and the likes, it might be hard to subscribe to SIF.

Scope of PE in Nepal: There are various sectors that have the potential for PE investments. Due to COVID-19, in recent times, we have seen that information technology-related companies are doing well and so are companies related to renewable energy and health sectors. Agriculture also has enormous potential, but the government has placed it in the negative list for FDI and, as a result, we are barred from investing in it. In agriculture, FDI could help modernize the sector and facilitate technology transfer in areas of higher-yielding crops, genetically modified organisms, processing facilities, and cold storage. Foreign Direct Investments (FDIs) could help prevent the waste of surplus food and dairy products by using the surplus to produce different product variants as well as using cold storage facilities to keep produce fresh for longer periods of time. Ironically, Nepal imported NPR 321 billion (USD 2.78 billion) of agricultural goods in the last fiscal year.