Revenue Mobilization Measures and Current Tax Issues: Nepalese Experience

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Outline

- Introduction
- Revenue Composition
- Recent Trend
- Revenue Organization
- Revenue Policy
- Tax Policy
  - Instruments, Reform Dimension,
  - Strategies and Achievements
- Case Study
- Challenges
Introduction

- **Nepal in Brief**
- Geographic area 147,181 square km
- Country of Mt. Everest
- Birth place of Lord Buddha
- Situated between India and China
- Population 26.6 million (BS, 2011)
- Economic size (GDP at current Price) Nrs.1346.81 billion (MOF,2009) US$1 = Nrs. 80
- Economic Policy : Liberal & open market economy
Nepal in the Map of Asia
# Revenue GDP Ratio

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<tbody>
<tr>
<td>Revenue annual growth(%)</td>
<td>21.3</td>
<td>22.7</td>
<td>33.3</td>
<td>25.4</td>
<td>14.7</td>
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<td>Revenue/GDP (%)</td>
<td>12.1</td>
<td>13.2</td>
<td>14.5</td>
<td>15.4</td>
<td>15.0</td>
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<td>Tax Revenue /GDP (%)</td>
<td>9.8</td>
<td>10.4</td>
<td>11.8</td>
<td>13.3</td>
<td>12.8</td>
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<tr>
<td>Non Tax Revenue /GDP (%)</td>
<td>2.3</td>
<td>2.8</td>
<td>2.7</td>
<td>2.0</td>
<td>2.2</td>
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Source: Annual Progress Report, 2011, Revenue Division MOF
Revenue Trends

Trend Analysis of Revenue, Tax Revenue as % of GDP

As % of GDP

Revenue as % of GDP

Tax Revenue as % of GDP

Years:
- 1990/91
- 1991/92
- 1992/93
- 1993/94
- 1994/95
- 1995/96
- 1996/97
- 1997/98
- 1998/99
- 1999/00
- 2000/01
- 2001/02
- 2002/03
- 2003/04
- 2004/05
- 2005/06
- 2006/07
- 2007/08
- 2008/09
- 2009/10

GDP

0.0 2.0 4.0 6.0 8.0 10.0 12.0 14.0 16.0

0.0 2.0 4.0 6.0 8.0 10.0 12.0 14.0 16.0
Structure of Government Revenue

- Income Tax: 21%
- VAT: 31%
- Excise: 0%
- Education Service fee: 18%
- Customs duties: 14%
- Non tax revenue: 2%
- Registration fee: 1%
- Vehicles tax: 1%

Source: Annual Report 2012 IRD Nepal
Composition of Tax Revenue

Source: Annual Progress Report 2011, Revenue division, MoF, Nepal
Revenue Trends

Trend Analysis of Revenue

- Customs as % of Tax Revenue
- VAT as % of Tax Revenue
- Income Tax as % of Tax Revenue
- Excise Duty as % of Tax Revenue
Organization Structure of Revenue Administration

- Finance Ministry
  - Office of the Financial comptroller General
  - Revenue Division

- Department of Customs
  - Field Offices
    - Chief Tax Officer
      - Audit and Investigation
      - Tax Officer
      - Assistant
    - Chief Tax administrator/ Officer

- Inland Revenue Department
  - 23 Inland Revenue offices including Large Taxpayer office
  - Inland Revenue Office
    - Chief Tax Officer
      - Collection
      - Tax Officer
      - Assistants
    - Tax Payer Service
      - Tax Officer
      - Assistant

- Department of Revenue Investigation
  - Field Offices
    - Chief Tax Officer
      - Tax Officer
      - Assistant

- Revenue Administration Training Center

- Anti Money Laundering Department
Revenue Policy

- **Objective**
  - To build sustainable, private sector friendly, transparent and self-reliant economy through maximum utilization of domestic resources, and developing the equitable tax system.

- **Policies:**
  - Mobilization of revenue through administrative reform and administrative capacity building without increasing revenue rates.
Revenue Policy

- Broadening revenue bases by bringing in new and unidentified areas into the tax net.
- Identification of new areas of non-tax revenue, revision of existing rates.
- Effective control in revenue leakage through addressing the different areas like leakages, foreign exchange misuse and money laundering.
Revenue Policy

- Tax incentives to both domestic and foreign investors in order to promote investment in hydropower and infrastructure development sector.

- To protect and promote production oriented, import substituting and export oriented industries for further industrialization of national economy.

- Develop transparent as well as professional revenue administration.
Taxation Policies

- Instrument of Revenue Mobilization
- Revenue related Acts and Regulations
  - IT, VAT, Excise, Customs, Revenue Leakage Control, Liquor Control etc.
- Revenue related manuals
  - VAT, IT, Excise, Audit and Investigation etc.
- Financial Act : Yearly basis
Taxation Policies

Legal Provisions

IT Act

Nepalese taxation is best on global and source principle together with Progressive Tax.

Tax rates:

- 1% social security tax for salary holders.
- 10% for rent
- 15%, 25% and 40% for natural person.
- 15% to the taxable income from exports
- 20% for special Industries.
- 25% for normal business.
- 30% for financial institutions.
Taxation Policies

Legal Provisions

- **VAT Act**
  - Single standard rate 13%
  - zero rate for export
  - More than 65% is collected from imports
  - Provision of exemption (basic goods and services i.e Education, Health, Agriculture, Transportation, Postal Services etc.)
  - Registration threshold: annual turn over Nrs. 2 million
Taxation Policies

Legal Provisions

Excise Act
- Both Ad-valorem and Specific rates exist
- Levies on Imports and domestic goods
- More than 65 percent of excise revenue collected from domestic sources
- Few goods and service under the net of excise duty
- Mainly health hazardous and environmentally harmful items are taxed: e.g., Liquors, Cigarette, Tobacco, Plastic goods
Taxation Policies

- **Dimensions of Tax Policy Reform**
  - Expansion of tax base by bringing new areas into tax net.
  - Promotion of voluntary compliance and tax morale.
  - Making investment friendly climate for economic growth.
  - Assurance of compliance through effective investigation mechanism.
- Administrative reform and capacity building.
- Simple, transparent and efficient service delivery mechanism.
- Overall fiscal stability and growth.
Taxation Policies

- **Major Achievements of Tax Reform**
- Separate Revenue service within civil service.
- Officer oriented functional organization
- International standard tax laws with reduced discretionary power of tax officers.
- Fully IT based administration.
- Adoption of e-governance (online registration, e-filing, e-payment, e-return, ABBS, etc.)
- More than 90% VAT and 60% IT returns through online system
Taxation Policies

- Major Achievements of Tax Reform
- Call centre for grievance handling.
- Online tax clearance certificate.
- Performance based incentive system.
- Focus on tax payers education.
- Audit selection based on risk engine.
- Simple working procedure
- Capable Human Resource Development
- Establishment of LTO for special treatment of large taxpayers.

Contd...
Steps Adopted for Audit and Investigation

- A prior information is given to the taxpayer.
- Notice about the evidence, documents and goods taken as testimony.
- Examination of relevant information and documents.
- Written and oral clarification of the taxpayer.
- Primary report
Taxation Policies (Implementation) Contd...

- Steps Adopted for Audit and Investigation

- Final report comprising the findings charges, additional tax liabilities, fines and penalties.

- Preliminary Assessment order – providing 15 days for clarification.

- Final Assessment order

- Administrative review and appeal in concerned authority (DG/R.T.) revenue tribunal.
Taxation Policies  (Implementation)

- **Tax Fraud style**
- **Income Tax**: Use of fictitious documents of purchase, sales and expenditure declared in accounts. Fabrication in accounting: date, voucher, entry, narration and disclosure.
- **Customs**: value, classification, quality, quantity and misuse of customs documents.
- **VAT**: Fake purchase/sales bills, under valuation, low ex-factory price and absence of billing habit at wholesales and retail stages.
- **Excise Duties**: Illegal distillation, stock maintenance and non declaration of sales.
- **Tax Refund**: claim through fake invoices and fictitious documents of export and payments.
Case: Investigation of Fake VAT Bills

Inland Revenue Department detected suspicious purchase invoices while investigating against refund claims in early 2010.

In Nov 2010, IRD detained four persons selling fake invoices.

IRD scaled up investigation against 200 bogus firms that sold fake bills to real taxpayers for tax credit in VAT and over claiming expenses in income tax.

IRD started investigation against 38 business firms since Dec. 2010. More than 300 firms were found supplying fake bills and nearly 500 suspicious business firms were found using such bills. Altogether 518 business firms were brought under investigation.

Investigation has been completed of 468 cases till Jan. 2012 and tax revenue worth Rs. 4.5 billion has been assessed against them.
Problem in Implementation

- Inadequate co-operation among different agencies such as revenue offices, banks, insurance companies, immigration offices, securities and local government units etc.
- Inadequate indicators to identify potential revenue leakage.
- Less effectiveness of short term inspections of accounts as sudden visits, stock verification and post clearance audit.
- Absence of social awareness programmes to boost up tax morale and fight against unlawful earning.
- To keep uniformity in interpretation of tax laws among tax officials, business community and legal authorities
Recent Measures Taken To Combat Tax Fraud

- Development of risk engine in pro tax database.
- Cross verification of third party report through mismatch data and refund records.
- Massive collection of documents/papers and payment reports from major government organisations and private institutions.
- Verifications of TDS reports and cash payment records.
- Sudden inspection in internal movement of goods and services by Revenue Investigation Offices.
- Formation of a joint co-ordination committee comprising all Director Generals of revenue related departments to advance inter-departmental co-ordination.
Challenges

- Assurance of revenue policy stability.
- Lack of political commitment
- Poor compliance, tax evasion and fraud
- Tracing out the transaction of informal economy into national account.
- Proprietorship firms and family run businesses.
- Cash based transactions rather than Banking channel.
- Prevalence of corruption and mal-practice.
- Mixed transaction of taxable and exempted items.
- Exemptions and tax incentives
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